



The Association of  
Accountants and  
Financial Professionals  
in Business

September 12, 2018

Ms. Susan M. Cospers, Technical Director  
Financial Accounting Standards Board  
401 Merritt 7, P.O. Box 5116  
Norwalk, CT 06856-5116

Re: **File Reference No. 2018-260**, Proposed Accounting Standards Update, *Leases (Topic 842) – Narrow-Scope Improvements for Lessors*

Dear Ms. Cospers:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board's (Board) Exposure Draft of the Proposed Accounting Standards Update (ASU), *Leases (Topic 842) – Narrow-Scope Improvements for Lessors*.

The Institute of Management Accountants (IMA) is a global association representing over 100,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The Committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC comments on proposed standards of the Financial Accounting Standards Board (FASB), the International Accounting Standards Board (IASB), and the US Securities and Exchange Commission (SEC). The FRC proactively brings relevant issues to the attention of these organizations and suggests solutions on behalf of IMA's members and the profession at large. Additional information on the FRC can be found at [www.imanet.org](http://www.imanet.org) (About IMA, Advocacy, Financial Reporting Committee).

We agree with the Board's decision to permit lessors to make an accounting policy election, consistent with the election permitted in Topic 606 *Revenue from Contracts with Customers*, to not evaluate whether sales and other similar taxes collected from lessees are costs of the lessor or the lessee. However, we have concerns about the Board's conclusions on accounting for payments made by lessees for property taxes and insurance. We have the following suggestions for improving the final ASU.

#### *Sales and Other Similar Taxes*

As noted above, we agree with the Board's decision to provide an accounting policy election to lessors that is aligned with the election provided in Topic 606. We believe the accounting policy election will simplify the adoption of Topic 842 by lessors. However, we have the following concerns about the proposed election.

- Proposed paragraph 39A of ASC 842-10-15 indicates that the scope of the election excludes taxes assessed on a lessor's total gross receipts. The purpose of the accounting policy election is



to allow a lessor to avoid having to determine whether it is obligated to pay the tax to the taxing authority. If the lessor charges the lessee an increased fee to compensate for the gross receipts tax, it seems appropriate to account for the reimbursement and the tax payment in a manner consistent with the treatment of sales and use tax payments. Further, excluding reimbursements of gross receipts taxes from the scope of the election seems inconsistent with the stated principle underlying the election: that it applies to “all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the lessor from a lessee”. It seems to us that the gross receipts tax is imposed on and concurrent with a specific revenue-producing transaction, so if the lessor collects the tax from the lessee, the reimbursement would qualify for the election.

- We recommend that the Board clarify what it means by taxes “on the lessor as the owner of the asset.” Presumably that is a reference to property taxes (addressed in the next section of our letter), but are there other taxes the Board believes would be covered by this exclusion from the accounting policy election?
- We encourage the Board to clarify the meaning of a tax “imposed on and concurrent with a specific lease revenue-producing transaction” as it relates to use taxes, which are based on the periodic payments made by the lessee. Is the “revenue-producing transaction” in an arrangement classified as an operating lease the delivery of the leased asset to the lessee or the recognition of revenue over the term of the lease? We believe the Board intended the latter, but the reference to “revenue-producing transaction” could be read to apply only to taxes due on delivery of the leased asset to the lessee and not those collected subsequently.

### Property Taxes Paid by the Lessee

We believe that the Board should provide a broader exception for property taxes paid directly by the lessee to the taxing authority – namely, an accounting policy election similar to the one for sales and other similar taxes. We are aware of a number of arrangements where the lessor acquired the property from the lessee in a sale-leaseback transaction. Based on the terms of the lease, the seller-lessee retained the obligation to make property tax payments directly to the taxing authority. The buyer-lessor would only be notified by the taxing authority if the seller-lessee failed to make a payment. All other communications by the taxing authority, including tax assessments, go directly to the seller-lessee. The buyer-lessor only has a reason to determine the amount of the property taxes paid by the seller-lessee in the event of a default by the seller-lessee and at the end of the lease term. In many cases, it may be difficult for the buyer-lessor to determine the amount of the property taxes (for example, if property tax records are not available on-line and require an in-person visit to the assessor’s office).

In the situations described above, there may be significant costs to the lessor to gather the information. Further, we are concerned the “readily determinable” criterion will lead to diversity in practice as well as debate as to whether the difficulties described above would allow a lessor to conclude that the amount paid by the lessee is not readily determinable. In addition, we understand that for equipment there is ambiguity as to who is legally responsible for the tax and that legal responsibility can vary by jurisdiction. We also have significant doubts as to whether the benefits of gathering the data exceed the costs. We note that in the amendments to Topic 606 to permit an election for sales taxes, users preferred net treatment. Finally, the amounts involved are usually not significant in comparison to actual rents; the proposed accounting would only result in grossing up revenue and expenses by the same amount, and



would have no impact on the lessor's cash flows. For all these reasons, we recommend permitting an accounting policy election for property taxes.

If the Board does not believe providing a broader exception for property taxes paid directly by the lessee to the taxing authority is appropriate, we encourage the Board to provide an exception to lessors for leases classified as either direct financing leases or as sales-type leases. In such leases, the lessor has transferred control over the leased asset. Given the transfer of control, we believe such costs would more appropriately be considered lessee costs than lessor costs. Further, requiring a lessor to recognize payments made by the lessee as part of lease income would distort interest income on finance leases, particularly when comparing companies with financing leases to companies with loans. The economics of the two arrangements are similar, but the accounting would be different if the lessor was required to include payments made by the lessee for property and other similar taxes, and the different accounting would cause comparability to suffer.

#### Insurance Purchased by the Lessee

We do not believe that insurance covering the leased asset purchased by the lessee and naming the lessor as the loss payee should be subject to the "readily determinable" condition in proposed paragraph 40A of ASC 842-10-15. The basis for the Board's conclusion that insurance is a lessor cost is discussed in paragraphs BC157 and BC158 of ASU 2016-02, which state, in part:

... in some leases, it is common practice for one party to the contract to pay certain costs directly to a third party, although the counterparty to the contract is principally liable to make those payments (for example, a lessee may make property tax payments to the taxing authority although the lessor is principally liable for those payments).

... The Board decided that activities (or costs of the lessor) that do not transfer a good or service to the lessee are not components in a contract. For example, an entity would not account for a portion of the consideration in the contract that is attributable to paying the lessor's property taxes (or its hazard insurance) as a component if the lessor is the primary obligor for those taxes (or insurance) and the amounts paid are not for a service (for example, maintenance or operations services) provided by the lessor to the lessee. [Emphasis added]

While in some circumstances the lessor may have arranged for insurance for the leased asset, in many cases (particularly in equipment leases), the lessee arranges for insurance directly and is principally liable to make premium payments. The lessor is not a party to the contract. Requiring the lessor to conclude that the amounts paid by the lessee are not "readily determinable" in a case where the lessor is not a principal to the transaction seems contrary to the view in paragraph BC158 that the lessor should only include amounts paid for insurance as part of the consideration in the contract when the lessor is the primary obligor for that insurance. Consistent with the discussion in paragraph BC158, we believe it would be more appropriate to require the lessor to determine whether it is the principal in the insurance arrangement. If it is not, the arrangement would have no accounting consequence to the lessor. While the Board concluded that paying for insurance does not transfer a separate service to the lessee, in cases where the lessee has purchased the insurance directly from the insurer, the arrangement does transfer a separate service to the lessee. We believe focusing on whether the lessor is the principal to the insurance



arrangement would be simpler than requiring the lessor to incur the cost necessary to support that the amounts paid by the lessee to the insurer are not “readily determinable” and would be more consistent with the discussion in the Basis for Conclusions to ASU 2016-02.

#### Transition for Lessor Costs Paid Directly by Lessees

The proposed ASU asks whether the guidance in proposed paragraph 40A of ASC 842-10-15 should be applied to new lease contracts only or to existing and new lease contracts. While the Board did not address how a lessor should determine lease income on existing leases subsequent to the effective date of Topic 842, it did provide guidance on how a lessee should measure the right of use asset and lease liability for existing leases, directing lessees to use minimum rental payments, which under Topic 840 exclude executory costs (meaning taxes and insurance). Because a lessee is able to use payments that exclude taxes and insurance in determining the amount of the right of use asset and lease liability for existing leases, we believe the same treatment should apply to a lessor’s determination of the amount of the payment to include as lease income. It would be helpful if the Board made that clear in the transition guidance.

#### Implementation Guidance and Illustrations

If the Board does not agree with our proposed recommendations for property taxes and insurance, we recommend including additional examples illustrating the following.

- Lessee obligated to insure leased equipment, with the lessor named as the loss payee.
- Lessee obligated to pay property taxes on an asset it sold to, and leased back from, the lessor and the lease is classified as an operating lease by the lessee but a direct financing lease by the lessor and therefore is not treated as a loan and a borrowing.

We believe those examples should illustrate the subsequent accounting by the lessor in each situation.

#### Other Matters

In ASU 2016-12, the Board modified paragraph 7 of ASC 606-10-25 to add another condition that would allow a seller to recognize revenue for amounts collected on an arrangement where the seller was unable to conclude that collectibility of the entire arrangement consideration was probable. That paragraph, as amended, states, in part:

When a contract with a customer does not meet the criteria in paragraph 606-10-25-1 and an entity receives consideration from the customer, the entity shall recognize the consideration received as revenue only when one or more of the following events have occurred: ...

- c. The entity has transferred control of the goods or services to which the consideration that has been received relates, the entity has stopped transferring goods or services to the customer (if applicable) and has no obligation under the contract to transfer additional goods or services, and the consideration received from the customer is nonrefundable.



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Topic 842 includes the conditions in paragraphs 7(a) and 7(b) of ASC 606-10-25, but was not amended to include the third condition added to Topic 606. That condition would apply to an arrangement that qualifies as a sales-type lease when the lessor delivered the asset to the lessee at the commencement of the lease and has stopped transferring goods or services to the lessee. Because the same circumstance exists in leasing that led the Board to decide to amend Topic 606, it would seem that the same guidance should apply to the lessor and the lessor should be able to recognize payments made by the lessee as rental revenue. However, under Topic 842 as it currently stands, a lessor is prohibited from doing so. We believe that difference between Topic 606 and Topic 842 should be eliminated.

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We would be pleased to discuss our comments with the FASB or its staff at your convenience.

Sincerely,

A handwritten signature in blue ink, appearing to read "N. Schroeder", is written over a light blue rectangular background.

Nancy J. Schroeder, CPA  
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Institute of Management Accountants  
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