THE TAX CONSIDERATIONS FOR ACCOUNTING FOR LEASES – ASC 842

STRATEGIC TAX TEAMS PREPARE FOR THE IMPACT OF THE NEW LEASE STANDARDS

by Andy Miller

While accounting departments are focusing on complying with the new lease standards (ASC 842/IFRS 16), tax departments also need to focus on the impacts of moving leases with terms greater than 12 months onto the balance sheet.

Income Tax

Although the accounting for leases is changing for financial reporting purposes, there are no changes to how leases are treated for income tax purposes. New assets and liabilities will be added to the balance sheet, for which there is no tax basis. Accordingly, deferred income taxes must be recorded for these new temporary differences.

Of course, deferred taxes will need to be recognized when the new lease standard is adopted, but they will also need to be managed as the related assets and liabilities change. Operating lease payments will continue to be tax deductible under current rules for income tax purposes, but the amortization of the right to use asset and the related interest expense associated with the lease obligation is not deductible. These temporary differences are all reflected in the balance sheet accounts that will drive the deferred tax accounting. It will be important to establish a process (information system) that tracks this accounting so it can easily be identified and tracked into annual income tax filings as well as deferred tax balances.

Property Tax

Ad valorem or property taxes are typically addressed in a lease agreement; either the lessor pays the property tax (and it is embedded in the rental payment) or the lessee is responsible for the payment (for example in a net lease arrangement). In either case there should be processes already established within a business organization to ensure that the property tax obligations are properly paid.

The new lease accounting standard will require companies to record assets for operating leased assets that previously were not recorded on the balance sheet. Of course, these new assets should not be subject to property tax since that tax will have been paid either by the lessor or by the lessee through other processes. It will be important that the property records segregate these new right-to-use assets from other assets subject to property tax.

Other Issues

As companies consider the adoption of this new accounting standard, they are likely doing comprehensive review of all leases as well as other procurement arrangements that may have "embedded leases." Although the tax rules around leases have not changed, there are lease arrangements that may be considered a purchase of the asset for income tax purposes (a capital lease for tax purposes). The review of existing lease and procurement arrangements may identify contracts that, perhaps, might be classified as capital leases for tax purposes that previously were treated as operating leases. The alternative scenario may also happen where a lease was treated as a capital lease that should have been an operating lease for tax purposes.

In either of these situations the prior accounting for income tax purposes was in error and may need to be changed. Although each situation needs to be evaluated on its individual facts and circumstances, these changes will likely require the company to request a change in method of accounting from the IRS.

With proper planning and the right tools, companies can use this change as a catalyst for improvement. PowerPlan's Income Tax Suite includes features that allow forecasting of all tax depreciation, gain/loss and deferred taxes. For more information on how PowerPlan can support lease and tax compliance, planning and forecasting, visit our website at www.powerplan.com.

About the author

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Andy is a 1978 graduate of the University of Missouri - Columbia, receiving a BSBA in Accounting. He is a certified public accountant (CPA) licensed in the state of Missouri, and he is a member of the Missouri Society of CPAs and the American Institute of CPAs.