Sale-leaseback accounting

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A sale-leaseback transaction is one in which the owner of a property sells it to a third party and then leases it back from the buyer. The situation can also arise when the lessee has all of the construction period risks for a property that it will lease from a third party when the property is complete. Evidence of construction risk retention can include such factors as guaranteeing the construction debt or funding cost overruns. The accounting from the perspectives of the lease participants follows.

Sale-Leaseback Treatment by Lessee

If a sale-leaseback transaction qualifies as a capital lease, the lessee classifies the lease as a capital lease. Otherwise, it is classified as an operating lease. The lessee should defer its recognition of a profit or loss on the sale portion of the transaction, except when one of the following conditions is present:

- *Rights relinquished*. The seller leases back only a minor portion of the property sold, in which case the sale and the lease elements are to be accounted for separately.
- *Partial rights retention*. The seller leases back less than the entire amount of the property sold, but more than a minor amount, and realizes a profit greater than either the present value of the minimum lease payments (if classified as an operating lease) or the recorded amount of the leased asset (if classified as a capital lease).

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- *Fair value less than cost*. If the fair value of the property on the transaction date is less than its undepreciated cost, recognize a loss at once.

For the purposes of these exceptions, "minor" is when the present value of a rental is not more than 10% of the fair value of the asset sold.

If the recognition of profit on the sale part of the transaction is allowed, measure it by subtracting either the present value of minimum lease payments or the recorded amount of the asset from the sale price. Do not include executory costs in the derivation of profit.

If the recognition of profit on the sale part of the transaction is to be deferred, use the following rules to amortize the profit over time:

- *Land only*. If the leased property is strictly land, recognize the profit over the lease term on a straight-line basis.
- *Other (capital lease)*. If the leased property encompasses additional types of property and qualifies as a capital lease, recognize the profit in proportion to the depreciation of the underlying leased asset.
- *Other (operating lease)*. If the leased property encompasses additional types of property and qualifies as an operating lease, recognize the profit in proportion to the rent charged to expense over the term of the lease.

If the lessee has instead retained all of the benefits and risks of ownership of the property it has ostensibly sold, the transaction is to be considered a financing. In this case, the lessee cannot recognize a profit on sale of the property if the lease transaction qualifies as a capital lease. If the arrangement involves real estate, evidence of retaining an ownership interest includes the lessee having the option or obligation to repurchase the property, the lessee guaranteeing the lessor's return on investment, or the lessee sharing in any subsequent appreciation of the property.

If the fair value of the asset sold by the lessee is greater than its carrying amount, the difference is treated as a rent prepayment. This means the lessee should defer recognition of the indicated loss and instead recognize it over the lease term as rent expense.

Sale-Leaseback Treatment by Lessor

If a sale-leaseback transaction meets the criteria for a capital lease, the lessor should record the property sale as a purchase and an associated direct financing lease. Otherwise, the lessor still records the property sale as a purchase, but accounts for the associated lease as an operating lease.

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