

## **Treatment of mobile phone licences in the national accounts**

### **PREAMBLE TO THE REPORT OF THE ISWGNA**

**21 December 2001**

1. Following the mandate received from the United Nations Statistical Commission in March 2001, the ISGWNA organised a meeting in April 5, 2001, in Washington, on the recording of mobile phone licences in the national accounts according to the 1993 SNA. This meeting came after extensive rounds of discussions, within Eurostat's (June 2000 NAWP, July 2000 CMFB) and the OECD's (September 2000 meeting of national accounts experts) constituencies, and within the ISWGNA itself (June 2000). As recommended by ISGWNA rules, a panel of experts was also consulted back-to-back with the April 2001 meeting in Washington. This panel included representatives (or comments received) from the United Kingdom, the United States, Spain, France, Australia, Italy, the Netherlands, and all members of the ISWGNA.
2. In this meeting, the ISWGNA came to conclusions that were summarised in a provisional report that has been circulated among members of the United Nations' Statistical Commission (UNSC) during the summer of 2001 with comments due before the 29 November 2001.
3. From the 24 members of the UNSC, the UN Statistical Division received eight responses. Of these eight responses, four stated explicitly their agreement with the ISWGNA proposal, one agreed with the main consequence of the proposal (treat up-front licence payments as sale of an asset) while disagreeing with part of the implementation method

(create two distinct assets), one can be interpreted as an abstention, one states that it is premature to take a decision, and one is against the proposal on the basis of a wide set of arguments, one of them being that the ISWGNA proposal is in contradiction with the current SNA.

4. The ISWGNA has carefully analysed and discussed the comments. One of the points discussed during the review is that the recommended method of implementation of the decision (creation of a non-produced licence asset) may be questionable when transposed to certain other cases, in particular produced assets. Alternative implementation treatments have to be analysed in the context of its proposal of more broad-based work on the treatment of all non-produced assets. In this context, the ISWGNA does not exclude that future clarifications should be made to the SNA.

5. The ISWGNA does not agree with two main arguments developed by some countries. First, it is not premature to formulate recommendations on this issue. The 2001 UNSC meeting adopted a two-handed approach: (a) a mandate to ISWGNA to produce a recommendation for the treatment of mobile phone licences within a short time frame so that countries are able to treat this item in an internationally consistent way; (b) a mandate to investigate more broadly the issue of intangible assets in the national accounts. The attached report fulfils the first mandate. By its very nature, the second mandate takes time for research and consultation. To wait with (a) until there is complete international consensus on (b) would do a disservice to national accountants who have to deal with mobile phone licences in their accounts now and here.

6. Second, the recommendations by the ISWGNA do not contradict the 1993 SNA. The fact that some of the recommendations are not explicitly covered in the 1993 SNA does not imply that there is a case of inconsistency. On the contrary, a core role of the ISWGNA is to analyse these “new” cases, to propose an economically sound treatment respecting international comparability, and consistency with the SNA.

7. The ISWGNA considers that the set of six criteria proposed in the report is sufficiently clear to lead to international comparability in the treatment of effective mobile phone agreements in the short term. It should be stressed again that the ISWGNA has not decided that all mobile phone agreements are to be treated as the sale of an asset. There are conditions explicitly mentioned in each of the six criteria, which allow for adaptation to country-specific economic conditions. A new annex has been attached to the report describing such cases. When the set of criteria is completely or closely met, the ISWGNA recommends strongly an interpretation as the sale of an asset. If not, a treatment as rent can be envisaged, or even mixed treatments, for example when up-front payments come with other payments which are not known at the moment of the first payment. If the set of criteria is used consistently, differences in its implementation would truly reflect differences in economic situations.

8. At the time of drafting the present report, it is hoped that, after the members of the Commission review the outcome of the recent ISWGNA deliberations, they will agree to adopting a consensual approach on this interpretation of the 1993 SNA so that the world community can move forward on this issue in anticipation of a comprehensive review of all intangible assets takes place.

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#### **The issue: sale of an asset or agreement on rent?**

1. In essence, two options of treating the payments for the mobile phone licences have been the subject of debate: (a) treatment of the transaction as rent for the use of an asset or (b) treatment as the purchase of an asset by the corporate sector from general government. The main implication of treating the payments as rent is that they become a component of income and consequently affect income and saving balancing items whereas the treatment as sale of an asset affects only the capital account. Net lending/borrowing items for government and the corporate sector are also affected differently under the two options, via accruals in the rent option and a one-off capital payment in the sales option.

#### **Conclusion 1: the spectrum is a tangible, non-produced asset**

2. The 1993 SNA defines an asset as “an entity over which ownership rights are enforced [...] and [...] from which economic benefits may be derived by their owners by holding them, or using them, over a period of time.” (1993 SNA, paragraph 10.2). There is a broad consensus that the spectrum satisfies this definition of an asset. It is normally owned by government, which can derive economic benefit from it.

3. Further, the spectrum meets the criteria for a tangible non-produced asset (“[...] occurs in nature” (1993 SNA, paragraph 13.53)). The characterisation as a tangible, non-produced asset puts the spectrum on a par with land or subsoil assets. The spectrum is recognised as an asset at the time its economic value is established.

## **Conclusion 2: the licence is an intangible, non-produced asset**

4. A licence authorises the licensee to the use of a certain part of the spectrum. In most circumstances, this constitutes a property right for the licensee, created by government by virtue of its regulatory powers. The ISWGNA considers that the mobile phone licence constitutes a separate asset from the spectrum itself: the rights conveyed by the licence fit the definition of an asset as stated in paragraph 4 above. Further, the licence is an intangible non-produced asset because it meets the definition in the 1993 SNA (Annex to Chapter 13, AN.22): there, intangible, non-produced assets are described as “constructs of society”, “[...] evidenced by legal or accounting actions”, that “[...] entitle their owners to engage in certain specific activities and to exclude other institutional units from doing so [...]”.

5. At its meeting in March 2001, the United Nations Statistical Commission (UNSC) encouraged the ISWGNA “...to review the treatment of intangible assets”. As part of such a review, the ISWGNA felt it might be considered appropriate to specifically identify licences as a special category within intangible non-produced assets along with similar assets that arise from governments exercising their regulatory powers (e.g. fishing rights, taxi licences in some countries, emission-trading permits). Another issue to be explored (see paragraph 18) is under which circumstances an underlying asset and a licence for its use should be part of the same asset category. In this context, produced and non-produced assets and licences should be examined together.

## **Conclusion 3: typically, licence payments are neither taxes nor purchases of the spectrum itself**

6. In several countries, the government receives payments for the mobile phone licences from the corporate sector. Such payments for licences do not, in general, constitute taxes: taxes are compulsory, unrequited payments and although some types of licence payments are recognised as taxes in the 1993 SNA, the payments for mobile phone licences are neither compulsory nor unrequited.

7. Also, unless licences are granted for an unlimited amount of time, the ownership over the spectrum remains with the government so that the sale of the licence cannot normally be considered the sale of the spectrum itself.

## **Conclusion 4: land, subsoil assets and the spectrum are similar types of assets and so are leases and licences based on the use of these assets**

8. As the spectrum is classified as a tangible, non-produced asset, payments for its use should be treated in parallel to payments for the use of other tangible, non-produced assets in particular land. One notes that the 1993 SNA does not stipulate that *all* land leases be treated as rent: some land leases are current in nature while others are capital. Current leases of land give rise to property income in the form of rent as mentioned in paragraphs 7.88, 7.128-131 and 10.129 of the 1993 SNA. Capital leases are independent assets for the leaseholder and are mentioned in paragraph 13.62 of the 1993 SNA.

9. The 1993 SNA provides very limited discussion of the borderline between transactions of a different economic nature, such as 99-year leases with up-front payments and leases for shorter periods of time with periodic payments. From an economic point of view, the latter case would lend itself to a treatment as rent, whereas the former would best be characterised as the sale of an asset. The criterion in distinguishing between such cases would seem to be the extent to which effective ownership over the asset or parts of it is transferred from the legal owner to the purchaser of the lease. This is in line with the SNA’s definition of economic assets (paragraph 10.2) that requires the presence of enforceable ownership rights. It is also consistent with the basis on which financial leases are distinguished from operational

leases (*all the risks and rewards of ownership are, de facto, transferred*, paragraph 6.118). Thus, when a land lease involves transmitting ownership over the right to use the land from the landowner to the licensee, such a transaction should qualify as the sale of an asset. If rights to use land were only partly transferred, payments under a lease would qualify as rent. The same rationale is also applied to the discussion of mobile phone licences in the following paragraphs.

10. In their comments to the above argumentation, some countries allow for only two possible treatments of the payments from the licensee to the government: sale of the spectrum itself and rent. The possibility of the licence constituting an intangible asset is acknowledged in the comments of the two countries but this case is relegated to the situation where an agreement on rents is transferable, as described in paragraph 10.129 of the 1993 SNA. While the ISWGNA does not challenge the relevance of such cases, it is of the opinion that nothing in 10.129 indicates that this is the *only* conceivable way by which a licence agreement can constitute an intangible asset. If the first option is rejected when a licence is not granted indefinitely, this leaves only the treatment as rent. The ISWGNA felt that, given that other options are equally compatible with the 1993 SNA, treatment as rent is unsatisfactory when the economic conditions of the allocation of mobile phone licences do not point in this direction. Therefore, the ISWGNA considered both possibilities (rent and sale of an asset) as theoretically correct and offers a set of criteria to discriminate between the two cases.

**Conclusion 5: there is no single, universal and clear-cut criterion to distinguish between rent and asset sale – a range of criteria needs considering**

11. Despite a number of indications in the 1993 SNA, there is no single, easy-to-use criterion that permits in all cases classifying transactions as either sale of an asset or rent. Conceptually, the issue can be narrowed down to answering the question whether or not ownership over an asset has in effect been transferred to the licensee. Though useful, this conceptual criterion does not yet give rise to an operational one and a number of aspects have to be examined.

12. Decisions are straightforward for polar cases such as licences granted indefinitely (this amounts to the sale of the spectrum and clearly constitutes a transaction in assets) or licences granted for less than one year (this excludes generation and sale of an asset in accordance with the SNA's "one-year rule"; the SNA mentions a year as a minimum holding period for produced assets and the ISWGNA feels it is reasonable to assume that one year should be the lower holding time in defining all non-financial assets). Many intermediate situations exist, however, that cannot easily be classified as either sale of an asset or rent simply by considering the length of the time period involved. Whether or not ownership rights are effectively transferred from the government to the licensee (sale of an asset) or not (rent) can only be determined by regarding a range of different criteria. One notes that, taken individually, none of these criteria may be sufficient to unambiguously characterise a transaction. Hence, the approach chosen here is one of obtaining an overall picture and then passing a judgement whether *on the whole*, the set of indicators points to a treatment as sale of an asset or a treatment as rent.

**Conclusion 6: most cases examined point to licence payments as purchase of an asset, not rent**

13. The following paragraphs consider several indicators.

- **Costs and benefits assumed by licensee:** the more of the risks and benefits associated with the right to use an asset are incurred by the licensee, the more likely the qualification of a transaction as the sale of an asset as opposed to rent. Thus, *pre-agreement on the value of payments* – by lump sum or by instalments – effectively transfers all economic risks and benefits to the licensee and so point to the sale of an asset. If, on the other hand, the value of

payment is made contingent on the results from using the licence, risks and benefits are only partially transferred to the licensee and the situation is more readily characterised as payment of rent. In the case of mobile phone licences, the total amount payable has often been pre-agreed. An additional indication for the degree to which commercial risks have been passed to the licensee is to examine the hypothetical case where a licence-taker goes bankrupt. If, in such a case, the licencer reimburses none of the up-front payment made by the licensee, this would constitute a strong case against a characterisation of the transaction as rent, as apparently the licensee has incurred all the commercial risks involved.

- **Up-front payment or instalment:** as with other indicators, the mode of payment is in itself not conclusive for a characterisation as asset or rent payment. Generally, the means of paying for a licence is a financial issue and *as such* not a relevant factor in determining whether or not it is an asset. However, business practice shows that up-front payments of rent for long periods (15-25 years in the case of mobile phone licences) are highly unusual and this favours an interpretation as sale of an asset.
- **Length of the licence:** licences granted for long periods suggest a treatment as the sale of an asset, for shorter periods a treatment as payments for rent. The ISWGNA felt that the time frame involved in mobile phone licensing (15-25 years) was rather unusual as a period for which to conclude a fixed payment of rent and therefore a further indication favouring an interpretation as sale of an asset.
- **Actual or de-facto transferability:** the possibility to sell the licence is a strong indication of ownership and if transferability exists, this is considered a strong condition to characterise the licensing act as the sale of an intangible asset. In practice, mobile phone licences are often transferable either directly (by the business selling the licence to another business) or indirectly (through the business being acquired through a take-over).
- **Cancellation possibility:** the stronger the restrictions on the issuer's capacity to cancel the licence at his/her discretion, the stronger the case for treatment as a sale of an asset. Conversely, when licences can easily be cancelled at the discretion of the issuer, ownership over benefits and risks has not been fully transferred to the licensee and the transaction qualifies more readily as rent.
- **Conception in the business world and international accounting standards:** businesses, in accordance with international accounting standards, often treat a licence to use the spectrum as an asset. Again, in itself this does not lead to treatment as an asset in the national accounts, and there are other areas where companies choose to present figures in their accounts in ways that are not consistent with the national accounts. But the treatment of the acquisition of mobile phone licences as capital investment in company accounts provides an added incentive to treat them in a similar way in the national accounts.

#### **Conclusion 7: value of licence and value of spectrum move symmetrically**

14. Under the treatment as an asset, the *value of the licence* is established at the time of its sale, for example by way of auction. Over time, with the expiry date moving closer, the value of the licence declines. The means of writing off the cost of a licence over the course of its life was discussed at some length by the ISGWNA. In contrast to the recording of consumption of fixed capital for produced assets, in the 1993 SNA, amortisation of non-produced assets is not recorded in the current accounts but in the other changes in asset account. As a licence is amortised, the value of the spectrum to the government progressively increases because the right to use it can potentially be sold again, assuming no technical change that would make its future use obsolete. The 1993 SNA recognises such reappearance of economic value and records it in the other changes in assets account. Not showing the write-off of the value in the current accounts is consistent with the treatment of other intangible non-produced assets, such as copyrights and so no change to the 1993 SNA is necessary if a decision is made to follow this route.

15. The ISWGNA considered two alternatives to record the annual write-downs in the accounts, namely, (a) in a way similar to the consumption of fixed capital, and (b) as other changes in assets. The meeting concluded that neither would be satisfactory for both the owner of the spectrum and the owner of the licence:

- If the write-off is not charged to the production account, the cost of the purchase is not recorded as a cost to the businesses concerned and so their net operating surplus could be considered as overstated over a period of time.
- If the write-off is charged to somewhere in the current account of the licence holder, then an offsetting amount has to be shown as a current receipt to the spectrum owner corresponding to the regain in value of the spectrum; otherwise “amortization” would increase although the total value of assets used in production had not changed. This adjustment would increase government saving and net lending or borrowing unless some further adjustment item is introduced into the capital account.

16. Therefore the ISWGNA recommended continuing the 1993 SNA treatment of restricting the write-off to the other changes in assets account. This allows the increase in the value of government assets to be recorded as the expiry date of the licences approaches, consistent with a potential further “sale” of the right to use the spectrum for another period. Further, this procedure ensures a neutral effect on the overall economy for variables such as consumption of fixed capital, saving etc.

17. The *value of the spectrum* corresponds to the discounted stream of future revenues that the government can achieve from selling rights to use the spectrum. However, before the first payment for mobile phone licences occurs, it is difficult to place a reasonable value upon the spectrum. Once payments for the rights to use the spectrum are observed (e.g. by way of an auction), an initial value can be established for the spectrum. At that moment, any value over and above the licence consists only of the discounted value of licence payments following the expiry of the current licence. As the years go by, the licence declines in value while the value of the government's spectrum asset increases by the same amount. After the licence expires the spectrum returns to full value and government can re-offer use of the spectrum for another generation of licences. The new full value of the spectrum is not necessarily identical to the original full value of the spectrum: inflation or changes in the expected revenues from licence sales may account for such differences.

**Conclusion 8: further elaboration will be useful for the future**

18. The ISWGNA found that there was the need for more broad-based work on the treatment of all intangible assets, in line with the request by the UNSC. For instance, an alternative treatment should be further investigated whereby the spectrum is ‘sold’ for a finite amount of time. The lessee would thus buy some share of time use of the spectrum rather than creating a new intangible asset (the right to use the spectrum), the spectrum itself would be sold, keeping the economy-wide composition of tangible and intangible assets intact. Another variant is to assume that the spectrum has a finite life itself that corresponds to the length of the licence. A more general way of capturing the cases of infinite licences and this proposal is to say that sale of the spectrum applies when the life-span of the licence and of the spectrum coincide. The ISWGNA confirms that the treatment as a temporary sale of the underlying asset has no differential effects on income, savings and net lending/borrowing from the treatment as sale of an intangible non-produced asset.

19. Full investigation should be made on the consequence of the introduction of the above set of criteria on the SNA. In addition, work should be conducted to elaborate a broader set of criteria to aid making decisions between the treatment of payments for leases or licences as rent or as sale of an intangible asset. These criteria should be applicable to a broad range of transactions, and not limited to the question of mobile phone licences.

20. As proposed by the ISWGNA, the Canberra Group on Capital Stock will be reconvened under the leadership of the OECD and the Australian Bureau of Statistics to discuss this issue as a priority item. It is expected that the task force will be able to deliver a first progress report in the autumn of 2002.

### **Summary**

21. Taking into account the discussions at various international meetings and taking into account the comments made by several countries in response to a draft conclusion, the ISWGNA came to the following conclusions regarding the treatment of the government receipts for mobile licences:

- Payment for a mobile phone licence constitutes the sale of an asset, not payment for rent when the licensee acquires effective ownership rights over the use of the spectrum. To decide whether ownership is effectively transferred or not, the ISWGNA has set up six criteria.
- When sale of an asset applies, and when the life span of the licence is different from the life span of the spectrum, ISWGNA recommends treatment of the payments for a licence as the sale of an intangible non-produced asset. When sale of an asset applies and when the life span of the licence and of the spectrum coincide, ISWGNA recommends the treatment of the payment for a licence as the sale of the spectrum itself. The latter situation applies always when licences are granted indefinitely.
- Under treatment of the licence agreement as the sale of an intangible non-produced asset, its value is established at the time of its sale. It declines with the expiration of the period of validity to fall to a value of zero at the point of the expiry of the licence. Symmetrically, the value of the spectrum falls when the licence acquires a value and is progressively re-established as the licence expires. This is consistent with a potential further sale of the right to use the spectrum for another period. This procedure also ensures a neutral effect on the overall economy for variables such as consumption of fixed capital, saving etc.
- ISWGNA considers that the treatment of mobile phone licences as proposed here is consistent with the 1993 SNA. However, this opinion should not pre-empt the outcome of a more broad-based discussion on the treatment of intangibles in the national accounts, as requested by the UN Statistical Commission.

## Annex

### Circumstances under which mobile phone licences should be treated as rent

This Annex seeks to illustrate in which cases mobile phone licences granted by government to enterprises should be treated as giving rise to payments of rent rather than payments for the acquisition of an asset.

As the Report indicates in paragraphs 11 and 12, the *1993 SNA* does not provide a single, universal and clear-cut criterion that permits distinguishing between the two options in all cases. However, the basic principle is that under a rent contract the lessor allows, against compensation and for a limited period, another unit to use a nonproduced nonfinancial asset while retaining effective ownership rights. A lease contract that transfers effective ownership rights over the asset, on the other hand, is a transaction in assets and should be recorded in the accumulation accounts.

Because the terms and conditions of lease arrangements vary widely, in practice it is often difficult to establish whether or not they effectively transfer ownership rights to the lessee. The correct classification in the accounts should therefore be based on a case-by-case study, taking a range of circumstances into account that may be indicators of the economic nature of the lease. Although none of the following provisions is in itself sufficient to support classifying payments made by the lessee as rent, a combination of them would indicate such recording:

- The contract is of **short-term duration**, or renegotiable at short-term intervals. Such contracts do not provide the lessee with a benefit when market prices for the leased asset go up in the way that a fixed, long-term contract would. Such benefits are holding gains that typically accrue to owners of assets.
- The contract is **non-transferable**. Non-transferability is a strong but not a sufficient criterion for the treatment of licence payments as rent, because, although it precludes the lessee from cashing in on holding gains, it does not preclude the lessee from reaping comparable economic benefits (e.g., using the licence in their business).
- The contract contains **detailed stipulations** on how the lessee should make use of the asset. Such stipulations are often seen in cases of rent of land, in which the owner wishes to retain a control over the usage of the land. In the case of licences, examples of such stipulations would be that the contract states what regions or types of customers should be served, or that it sets limits on the prices that the lessee may charge.
- The contract includes conditions that give the lessor the **unilateral right to terminate** the lease without compensation, for instance for under-use of the underlying asset by the lessee.
- The contract requires **payments over the duration of the contract, rather than a large up-front payment**. Although this condition is essentially financial in character and thus cannot be decisive on the type of the lease, it may indicate a degree of control for the lessor to direct the use of the spectrum. The case for a treatment as rent is further supported if the payments are related to the revenues the lessee derives from the licence.