

**TREATMENT OF MOBILE PHONE LICENCES IN THE NATIONAL ACCOUNTS
REPORT OF THE ISWGNA**

18-APRIL 2001

A. Background

1. This objective of this note is to explain, in some detail, the decision of the Inter-secretariat Working Party on National Accounts (ISWGNA) concerning the treatment of the receipts from the sales of mobile phone licences in national accounts. This note is a revised version of the report drafted by the ISWGNA following a special meeting in Washington, D.C. in June 2000 and discussed at the Eurostat National Accounts Working Party meeting in June 2000 and at the OECD National Accounts Experts meeting in September 2000. The initial report formed also the basis for Eurostat's decision¹ regarding the treatment of mobile phone licences.
2. The revised report presented here reflects additional deliberations of the ISWGNA with experts from OECD Member countries that took place on April 5, 2001 in Washington D.C. and some of the points made in a recent paper by Dippelsman and Maehle (2001)². These discussions were fruitful in further focussing the issue, and in defining the work ahead. Overall, however, the ISWGNA concluded that nothing had emerged since last June's meeting which would lead to it needing to change the conclusions made at that meeting.

B. The issue: sale of an asset or agreement on rent?

3. 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 other changes in volume of assets account. Net lending/borrowing items for government and the corporate sector are also affected differently under the two options.

C. Conclusion 1: the spectrum is a tangible, non-produced asset

4. 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." (SNA 93, 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 benefit from it by selling the right to use it.
5. Further, the spectrum meets the criteria for a tangible non-produced asset ("[...] occurs in nature" (SNA 93, paragraph 13.53)). The characterisation as a tangible, non-produced asset puts the

1. Eurostat Decision on the Allocation of Mobile Phone Licenses (UTMTS); *Eurostat News Release* July 14, 2000.

2. Dippelsman, Robert J. and Nils Ø Maehle (2001); "Treatment of Mobile Phone Licences in the National Accounts"; *IMF Working Paper*, February.

spectrum on a par with land or subsoil assets. The spectrum is recognised as an asset at the time its economic value is established.

D. Conclusion 2: the licence is an intangible, non-produced asset

6. A licence authorises the licensee to the exclusive use of a certain part of the spectrum. 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 license is an intangible non-produced asset because it meets the definition in the SNA 93 (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 [...]”.
7. 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 such licences as a special category within intangible non-produced assets along with other similar assets, which arise from governments exercising their regulatory powers (e.g. fishing rights, taxi licences in some countries, emission-trading permits).

E. Conclusion 3: licence payments are neither taxes nor purchases of the spectrum itself

8. In several countries, the government sells the mobile phone licences to 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 SNA 93, the payments for mobile phone licences are neither compulsory nor unrequited. 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 be considered the sale of the spectrum itself.

F. 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

9. 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 SNA 93 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 SNA 93. Capital leases are independent assets for the leaseholder and are mentioned in paragraphs 10.129-130 and 13.62 of the SNA 93.
10. Both types of leases have in common the permission to use land owned by another entity but the SNA 93 provides very limited discussion of the borderline between putting the land at the disposal of another unit and transferring ownership over the right to use land. From the examples given in the SNA, it is clear that transferable leases are assets while short-term leases are usually current transactions, giving rise to a treatment as rent payments. But many intermediate cases

remain and more general principles have to be evoked. In particular, the SNA's definition of economic assets (paragraph 10.2) requires the presence of enforceable ownership rights. Thus, when a lease involves transmitting ownership over the right to use the land from the landowner to the licensee, such a transaction qualifies as the sale of an asset. If rights to use land are only partly or not all 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.

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

11. Despite a number of indications in the SNA 93, 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 (the licence) 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 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 an asset or a treatment as rent.

H. Conclusion 6: most criteria examined point to licence payments as purchase of an asset, not rent

13. The following paragraphs consider several indicators. On balance, they point to a treatment of the sale of mobile phone licences as the sale of an asset rather than as a rental agreement.
 - ***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 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 licenses, the total amount payable has typically 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 license-taker goes bankrupt. If, in such a case, the licensor 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 licenses) 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 sufficient 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. This situation hardly applies to mobile phone licences.
- ***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 which are not consistent with the national accounts. But the treatment of the acquisition of mobile phone licenses as capital investment in company accounts provides an added incentive to treat them in a similar way in the national accounts.

I. 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 intangible 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 actually 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-offs 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 current account, the cost of the purchase is not recorded as a cost to the businesses concerned and so their net operating surplus is overstated over a period of time.
 - If the write-off is charged to the current account of the licence holder, then an offsetting amount has to be shown as a current receipt to the spectrum owner. This increases government saving and will affect 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 rights to use the spectrum are sold (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.

J. Conclusion 7: further elaboration of criteria will be useful for the future

18. Despite a strong case for the treatment of the sale of a mobile phone licence as the sale of an asset, the ISWGNA found that there was a need for more broad-based work on the treatment of all intangible assets, in line with the request by the UNSC. Such work could, for example, elaborate a 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 be limited to the question of mobile phone licences.

K. Summary

19. Taking into account the discussions at its special meeting in June 2000, at the Eurostat National Accounts Working Party, at the OECD National Accounts Experts meeting and at the September 2000 and April 2001 meetings of the ISWGNA, the ISWGNA came to the following conclusions regarding the treatment of the government receipts for mobile licences:

- The spectrum and the licence constitute two distinct non-produced assets – a tangible non-produced asset (the spectrum) and an intangible non-produced asset (the licence).
- The sale of a mobile phone licence constitutes the sale of an asset, not payment for rent when the licensee acquires ownership rights over the use of the spectrum. Examination of current practices of sales of phone licences in OECD countries against several indicators all point to the acquisition of full ownership rights over the use of the spectrum by the licence holder. (It should be noted that the sale of the right to use the spectrum for an unlimited time (as is the case in the United States) constitutes the sale of the spectrum itself rather than the sale of an intangible non-produced asset (i.e., the license).)
- The value of the intangible asset 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 value of the licence falls. 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.
- The treatment of mobile phone licenses proposed here is consistent with the treatment of intangible non-produced assets as laid out in the 1993 SNA and the ISWGNA considers that at present there is no need for modification of the SNA.