Question A10

How do you determine whether real estate sales are in the scope of Topic 606 or Subtopic 610-20?

Interpretive response: Determining which guidance applies depends on whether the buyer is a customer. If the buyer is a customer, the seller accounts for the sale under Topic 606 and recognizes revenue and cost of sales. The Master Glossary to the Codification defines a customer as "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration." [Master Glossary, 360-10-40-3A]

A real estate developer predominantly in the business of selling retail land or residential units would be an example of an entity that likely is selling real estate as an output of its ordinary activities.

In contrast, a real estate investment trust (REIT) that primarily leases real estate generally would not sell real estate as an output of its ordinary activities. While some REITs often sell properties as part of their overall investment strategy, they identify the output of their normal activities as the service they provide to their tenants. This conclusion is consistent with how a REIT's operations are characterized for US federal income tax purposes.

While a REIT's income generally is tax-free (assuming it meets qualification criteria), gains on dispositions of property held primarily for sale to customers in the ordinary course of business are considered "prohibited transactions" and are subject to 100% tax. To preserve the maximum tax advantage to the REIT and its investors, a REIT generally does not sell property to customers in its ordinary course of business.

Accounting for sales to customers – Topic 606

A seller accounts for customer sales under Topic 606 and recognizes revenue and cost of sales in its income statement. The seller follows this accounting regardless of whether it sells its direct interest in the real estate or its controlling ownership interest in an entity that holds the real estate.

When a contract exists and the seller transfers control of the property, the seller derecognizes the real estate and recognizes the transaction price as revenue.

If a contract does not exist, the seller recognizes the cash received as a deposit liability, continues to report the real estate in its financial statements, depreciates it (if not held for sale), and evaluates it for impairment as necessary. [360-10-35, 360-10-40-3C, 45-9 – 45-10]

This reporting continues until a contract does exist and control of the property transfers, or until the seller meets one of these conditions:

a. the seller has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the promised consideration has been received and is nonrefundable;
b. the contract has been terminated and the consideration received is nonrefundable; or
c. the seller has transferred control of the goods or services to which the consideration that has been received relates, has stopped transferring

goods and 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 buyer is nonrefundable. [606-10-25-7 – 25-8]

Accounting for sales to noncustomers – Subtopic 610-20

If the seller determines that the buyer is not a customer, it generally accounts for the sale under Subtopic 610-20 because a real estate asset is a nonfinancial asset and typically is not a business.[1] The seller recognizes a gain or loss in the income statement for noncustomer sales.

If the seller is transferring a group of assets or a controlling financial interest in a subsidiary, other considerations apply. If substantially all of the fair value of the assets of the group or subsidiary is concentrated in nonfinancial assets (e.g. real estate and intangibles) and the group or subsidiary is not a business, the seller applies Subtopic 610-20 to the sale of each distinct asset within the group or subsidiary. This includes assets in the group or subsidiary that would be financial assets if they were sold separately. These financial assets within the group or subsidiary are referred to as 'in-substance nonfinancial assets'. See Question A20. [610-20-15-4, 360-10-40-3A]

To address real estate sales to noncustomers, Subtopic 610-20 incorporates Topic 606's principles that address sales to customers. Specifically, a seller of a nonfinancial (or an in-substance nonfinancial) asset to a noncustomer applies Topic 606's guidance to determine:

a. whether a contract exists; [610-20-25-5, 606-10-25-1 – 25-8]
b. how to separate and measure one or more parts of a contract that are within the scope of other Topics; [610-20-15-9, 606-10-15-4]
c. the number of distinct assets in the disposal group; [610-20-25-6, 606-10-25-19 – 25-22]
d. the transaction price, including estimating variable consideration, constraining that consideration, and evaluating whether there is a significant financing component, noncash consideration and consideration payable to the customer; [610-20-32-3, 606-10-32-2 – 32-27, 32-42 – 32-45]
e. how to allocate the consideration in the contract to distinct assets in the disposal group; and [610-20-32-6, 606-10-32-28 – 32-41]
f. when an entity satisfies a performance obligation by transferring control of an asset. [610-20-25-6, 606-10-25-30]

Under Subtopic 610-20, when a contract exists and the seller has transferred control of the property (which includes concluding that it no longer has a controlling financial interest under Topic 810 (consolidation) if the asset is owned by a separate legal entity – see Question F90), the seller derecognizes the real estate and recognizes a gain or loss equal to the difference between the amount of consideration transferred and the carrying amount of the asset. The amount of consideration that is included in the calculation of the gain or loss includes both the transaction price determined under Topic 606 and the carrying amount of liabilities assumed or relieved by the buyer. [610-20-32-2]

If the seller is transferring a group of assets or a controlling financial interest in a subsidiary, the sale of each distinct asset within the group or subsidiary is

---

[1] For more information on the definition of a business, see KPMG Handbook, Business combinations.

accounted for as a separate unit of account under Subtopic 610-20 as previously discussed. The seller may need to allocate the consideration to each distinct asset – e.g. if the seller does not transfer control of all of the distinct assets at the same time. [610-20-25-6, 32-2]

Similar to Topic 606, if a contract does not exist, the seller recognizes the cash received as a deposit liability, continues to report the real estate in its financial statements, depreciates it (if not held for sale), and evaluates it for impairment as necessary. [360-10-35, 360-10-40-3C, 45-9 – 45-10]

This reporting continues until a contract does exist and control of the property transfers, or until the seller meets one of the conditions in paragraph 606-10-25-7. At that time, the property and related deposit liability are derecognized and the gain or loss is recognized. [606-10-25-1 – 25-8]

Question A20

What else is in the scope of Subtopic 610-20?

Interpretive response: As discussed in Question A10, the guidance on derecognition of nonfinancial assets to noncustomers in Subtopic 610-20 applies to sales to noncustomers of nonfinancial assets and in-substance nonfinancial assets. It also applies to other transfers of these assets including sales of ownership interests in certain subsidiaries that are not businesses (see discussion on partial sales below) and other changes in circumstances that result in loss of control over the nonfinancial (or in-substance nonfinancial) assets – e.g. because of the expiration or termination of a contractual agreement, a dilution event, a government action or default of a subsidiary's nonrecourse debt (see Question F50). An entity also could lose control over nonfinancial assets and in-substance nonfinancial assets by contributing those assets to a joint venture or another noncontrolled investee (see discussion on partial sales below). [610-20-05-2]

What is a 'nonfinancial asset'?

Nonfinancial assets include land, buildings, intangible assets and materials and supplies. A nonfinancial asset does not meet the definition of either a business or a financial asset (e.g. cash, receivables, equity method investment). Nonfinancial assets may be either recognized or unrecognized (e.g. a zero carrying amount). [610-20-15-2]

Nonfinancial assets may also include properties with real estate components, like land plus property improvements and integral equipment – i.e. those properties that have been identified as in-substance real estate historically. However, just because a property was in-substance real estate under legacy US GAAP does not mean that a sale of that property is in the scope of Subtopic 610-20. The current guidance requires an entity to apply Topic 810 to sales of all businesses, regardless of whether they were in-substance real estate under legacy US GAAP. The FASB retained the legacy guidance on identifying in-substance real estate only to identify the scope of
(a) sale-leaseback transactions that remain subject to the guidance in

Subtopic 360-20 until the new leases standard is adopted[2] and (b) the non-revenue-related guidance specific to timeshare transactions within the scope of Topic 978 (time-sharing activities). The definition is no longer relevant for identifying what guidance to apply to derecognition transactions other than sale-leasebacks. [610-20-15-4, 360-20-15-2, 978-10-15-7 – 15-12]

What is an 'in-substance nonfinancial asset'?

As previously mentioned, in-substance nonfinancial assets are financial assets that are being sold either as part of a group or within a subsidiary that is not a business and for which substantially all of the fair value of the assets of that group or subsidiary is concentrated in nonfinancial assets – e.g. real estate and intangibles. When determining the fair value of the assets of the group or subsidiary, a seller should include recognized and unrecognized assets, but exclude cash and cash equivalents. The seller should also exclude liabilities that are assumed or relieved by the buyer. [610-20-15-7]

The FASB decided to use the term **substantially all** because it is commonly used throughout US GAAP. However, it did not specify a quantitative threshold for what substantially all means when applying the scope of Subtopic 610-20. In other US GAAP, substantially all generally is interpreted to mean approximately 90% or greater; however, for evaluating the scope of Subtopic 610-20, we believe that substantially all is not necessarily meant to be a bright-line quantitative threshold. When there is uncertainty about whether the 'substantially all' threshold is met (e.g. because the ratio is close to the quantitative threshold or the valuation of assets is based on unobservable (Level 3) fair value measurement inputs subject to significant measurement uncertainty), we believe qualitative factors may also be considered. The purpose of a qualitative assessment is to evaluate whether the substance of the transaction is a transfer of nonfinancial assets. We believe relevant factors to consider include but are not limited to whether the financial assets in the transaction:

- are simply a product of the property's operations – e.g. rent receivables. If so, it may be appropriate to conclude that substantially all of the fair value of the assets is concentrated in nonfinancial assets even if their fair value is at or slightly below 90% of the fair value of the set.
- lack commercial substance. If so, a quantitative assessment that includes those assets would not be appropriate. For example, if the seller arbitrarily included financial assets in the transaction that otherwise would not have been part of the set to avoid applying Subtopic 610-20, those financial assets would be excluded from the quantitative analysis. These situations can be highly judgmental and based on facts and circumstances.

When substantially all of the fair value of the group's or subsidiary's assets is concentrated in nonfinancial assets and the group or subsidiary is not a business, a seller applies Subtopic 610-20 to the sale of each distinct asset

[2] Sale-leaseback transactions remain subject to Subtopic 360-20 only until a company adopts ASU 2016-02, Leases (Topic 842). Topic 842 supersedes Subtopic 360-20 and provides a single accounting model for sale-leaseback transactions that applies regardless of the nature of the asset transferred.

within the group or subsidiary. This includes assets in the group or subsidiary that would be financial assets if they were sold separately. [610-20-15-5]

In some cases, substantially all of the fair value of a group's assets is not concentrated in nonfinancial assets, but the group includes a subsidiary in which substantially all of the fair value of the subsidiary's assets is concentrated in nonfinancial assets. For example, Entity A has two consolidated subsidiaries (Sub A and Sub B) and has entered into a contract with Entity D to transfer 100% of the ownership in these two subsidiaries that are not businesses. Sub A's only asset is a parcel of land (i.e. a nonfinancial asset). Sub B's only asset is an equity method investment (i.e. a financial asset). The fair values of Sub A and Sub B are equal and therefore half of the total value of the assets being sold relates to a nonfinancial asset and the other half relates to a financial asset (and therefore, the equity method investment held by Sub B is not an in-substance nonfinancial asset). In that case, the seller applies Subtopic 610-20 to the sale of the distinct asset within Sub A and applies the relevant US GAAP to the sale of Sub B. See Case C of Example 1 in paragraphs 610-20-55-9 – 55-10. Also, see the flowchart below that describes the scope of Subtopic 610-20. [610-20-15-6]

Section 17.2.40 of KPMG Handbook, Revenue recognition, provides additional discussion, questions, and examples about how to identify in-substance nonfinancial assets.

What about partial sales?

Partial sales of real estate can occur in several ways.

Transaction 1. A seller and a third-party investor form a venture. The seller contributes real estate to the newly formed venture and the third-party investor contributes cash, property or services. The seller retains a controlling financial interest in the venture post-sale and no interest in the third party.

Transaction 2. Assume the same facts as Transaction 1 except the seller retains only a noncontrolling interest in the venture post-sale. The venture may be a joint venture.

Transaction 3. A seller contributes real estate to a newly formed, wholly owned venture. Sometime later, it sells a partial ownership interest in the venture to a third-party investor for cash, property or services. The consideration may come directly from the investor to the seller or may be contributed by the investor to the venture. The seller retains a controlling financial interest in the venture post-sale and no interest in the third party.

Transaction 4. Assume the same facts as Transaction 3 except the seller retains only a noncontrolling interest in the venture post-sale. The venture may be a joint venture.

Transaction 5. A seller transfers real estate to an existing equity method investee in exchange for cash or noncash consideration.

All of these transactions are in the scope of Subtopic 610-20 but the seller has different considerations relative to derecognition and measurement depending on whether it retains a controlling or noncontrolling interest. See Question F90. [610-20-15-3, 323-10-35-7(c), 970-323-30-3]

What isn't in scope?

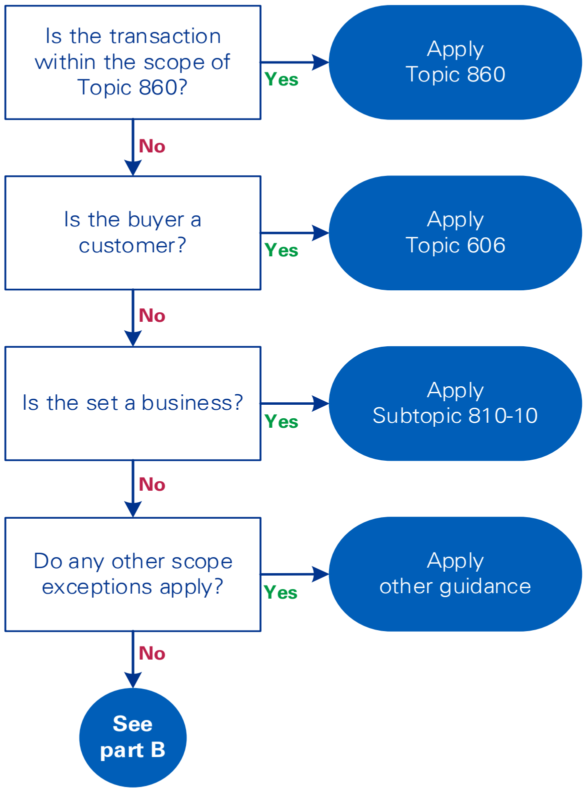
As previously mentioned, if an asset or a group of assets meets the definition of a business, the seller applies Topic 810 to the derecognition transaction. Subtopic 610-20 also does not apply to:

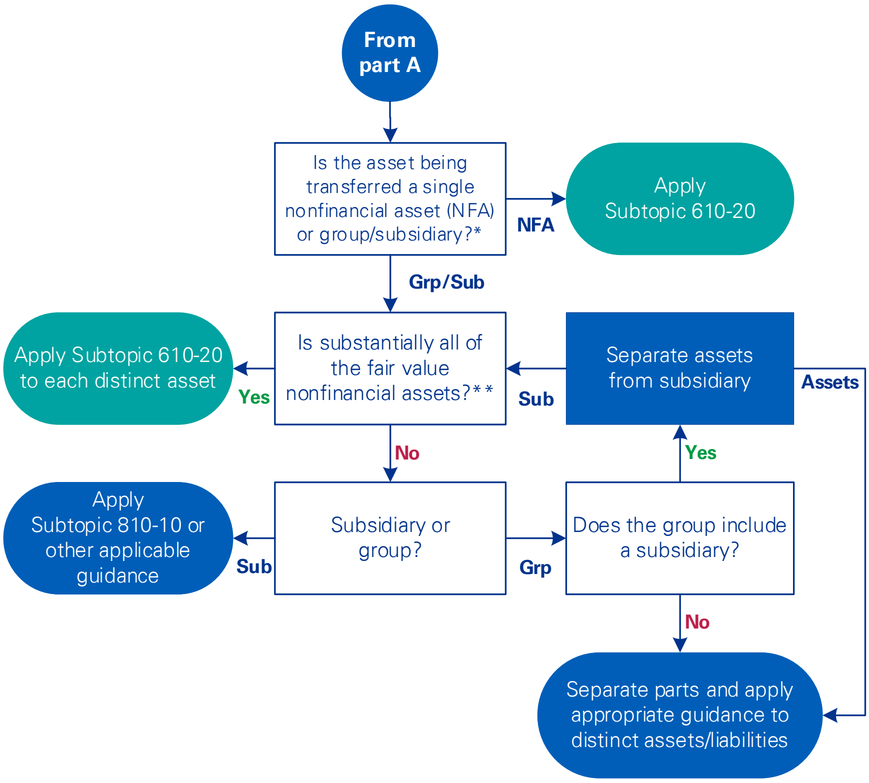
- sales to customers;
- services provided to noncustomers (see Question 17.2.60 of KPMG Handbook, Revenue recognition);
- sales of nonprofit activities;
- transfers of financial assets, including transfers of investments – e.g. those accounted for under the equity method, see Question A25;
- transfers of subsidiaries in which substantially all of the fair value of the assets is *not* concentrated in nonfinancial assets;
- exchanges of nonfinancial assets for a controlling financial interest in a business (business combinations);
- exchanges between entities in the same line of business to facilitate sales to customers;
- nonreciprocal transfers;
- sale-leaseback transactions (see discussion that follows);
- lease contracts;
- contributions made that are within the scope of Subtopic 720-25 (other expenses – contributions made) or Subtopic 958-605 (not-for-profit entities – revenue recognition);
- transfers of investments in ventures accounted for using proportionate consolidation as described in paragraph 810-10-45-14;
- transfers between entities under common control;
- conveyances of oil and gas mineral rights; and
- exchanges of airline take-off and landing slots. [610-20-15-4]

How does a seller determine what guidance applies when transferring a nonfinancial asset?

The following decision tree summarizes the sequence of analysis required to evaluate which guidance applies for a transaction that entirely, or partially, involves a nonfinancial asset.

This decision tree may be more useful in more complicated transactions (mix of financial and nonfinancial assets).


Is the transaction within the scope of Topic 860?
Yes
Apply Topic 860
No
Is the buyer a customer?
Yes
Apply Topic 606
No
Is the set a business?
Yes
Apply Subtopic 810-10
No
Do any other scope exceptions apply?
Yes
Apply other guidance
No
See part B



* If the transfer includes other contractual arrangements that are not the assets of the seller that will be derecognized (e.g. guarantees), those contracts are separated and accounted for under the applicable guidance. See Section 17.2.60 of KPMG Handbook, Revenue recognition, for additional guidance.

** See Section 17.2.40 of KPMG Handbook, Revenue recognition, for additional guidance.

What guidance applies to a real estate sale-leaseback if Subtopic 610-20 does not?

Seller/lessee applying Topic 840

Subtopic 610-20 does not apply to real estate sale-leaseback transactions; those transactions remain in the scope of Subtopics 840-40 and 360-20 until the new leases guidance (Topic 842) is applied. Therefore, sale-leaseback accounting is not changed when a company adopts Subtopic 610-20 until it adopts Topic 842.

For example, assume a calendar year-end private company adopts Subtopic 610-20 on January 1, 2020 and adopts Topic 842 on January 1, 2022. In its 2021 and 2020 financial statements, the company continues to apply Subtopics 840-40 and 360-20 to any real estate sale-leasebacks for which it is the seller-lessee. The company's adoption of Subtopic 610-20 on January 1, 2020 does not change how it accounts for these transactions as compared with transactions entered into before that date.

Subtopic 840-40 does not require a seller-lessee entering into sale-leaseback transactions for assets other than real estate or integral equipment to evaluate the pre-Subtopic 610-20 other income guidance in US GAAP. Therefore, the accounting for sale-leaseback transactions of those assets is unaffected by the adoption of Subtopic 610-20.

Seller/lessee applying Topic 842

Topic 842 supersedes all of Topic 840, including Subtopic 840-40, and also supersedes the sale-leaseback provisions in Subtopic 360-20 that continued to apply even after a company's adoption of Topic 606/Subtopic 610-20. Therefore, on adopting Topic 842 a seller-lessee will no longer apply Subtopics 840-40 and 360-20 to its sale-leaseback transactions. Topic 842 provides a single accounting model for sale-leaseback transactions that applies regardless of the type of asset transferred.[3]

The seller-lessee **and the buyer-lessor** in a sale-leaseback transaction consider the guidance in Topic 606 (and the other specific sale/purchase requirements in Subtopic 842-40) to assess whether a sale/purchase of the asset has occurred. The company then applies the lease guidance in Topic 842 when accounting for the leaseback (or the failed sale-leaseback guidance in Subtopic 842-40 if a sale/purchase has not occurred).

Question A21

Does Subtopic 610-20 apply to the transfer of an option to purchase real estate?

Background: A transferor applies Subtopic 610-20 when it derecognizes nonfinancial assets. Nonfinancial assets include intangible assets, land, buildings, or materials and supplies. [610-20-15-2]

A transferor applies Topic 860 (transfers and servicing) when it derecognizes financial assets and analogizes to Topic 860 when it derecognizes derivative assets that are not financial assets – e.g. derivatives that require physical delivery of a nonfinancial asset that is readily convertible to cash (and therefore meets the net settlement criterion). [860-10-15-3 – 15-5, 815-10-40-1 – 40-3, 15-119 – 15-139]

The Master Glossary to the Codification defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following: [Master Glossary]

- receive cash or another financial instrument from a second entity; or
- exchange other financial instruments on potentially favorable terms with the second entity.

Topic 815 (derivatives and hedging) defines a derivative instrument as a financial instrument or other contract with all three of the following characteristics. [815-10-15-83]

- It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both.
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

[3] For more information on sale-leaseback transactions, see KPMG Handbook, Leases.

— Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

However, Topic 815 excludes from its scope a contract that meets the definition of a derivative if it is: [815-10-15-59]

— not exchange-traded;
— the underlying on which the settlement is based is the price or value of a nonfinancial asset of one of the parties to the contract; and
— the nonfinancial asset is not readily convertible to cash.

Interpretive response: Generally, yes. A transferor applies Subtopic 610-20 when derecognizing an option to purchase real estate unless the option is a financial asset or a derivative within the scope of Topic 815.

We believe a real estate option is rarely a financial asset, because it generally does not give the holder the right to receive cash or a financial instrument.

We also believe a real estate option is rarely a derivative within the scope of Topic 815, because generally:

— it does not meet the definition of a derivative because it requires physical delivery of real estate; or
— it meets the exclusion from derivative accounting for contracts that meet the definition of a derivative but are not traded on an exchange.

If a transferor transfers (sells or assigns) an option to purchase real estate or other asset to a buyer and then leases that asset back from the buyer, the transfer and leaseback may be considered to be a sale-leaseback transaction that should be accounted for based on the guidance in Subtopic 842-40. Refer to the sale-leaseback discussion in Question A20 and Chapter 9 of KPMG Handbook, Leases, including Question 9.1.15 on determining when the transfer of an option and leaseback of the asset subject to the option is within the scope of 842-40.

Question A25

What guidance should a seller apply when it sells a noncontrolling interest in an entity that is not a subsidiary (e.g. equity method investee)?

Interpretive response: As discussed in Question A20, Subtopic 610-20 does not apply to transfers of financial assets, including transfers of investments – e.g. those accounted for under the equity method. The scope of Topic 860 applies to the sale of those investments regardless of whether (a) the buyer is a customer or a noncustomer, and (b) the underlying assets are predominantly real estate or other nonfinancial assets. [610-20-15-4(e)]

However, if an entity sells its 100% ownership in a subsidiary that is not a business to a noncustomer and the fair value of the assets within that subsidiary is concentrated in nonfinancial assets, then the seller applies Subtopic 610-20 to the sale of each of the assets within the subsidiary. This includes any financial assets (like equity method investments) because those financial assets are in-substance nonfinancial assets. See Question A20. [610-20-15-7]

Question A26

Are sales of undivided interests to noncustomers in the scope of Subtopic 610-20? What if the buyer is a customer?

Interpretive response: It depends. While Subtopic 610-20 does not address whether transfers of undivided interests are within its scope, we believe sellers should apply it to transfers when the undivided interest being sold is accounted for as a nonfinancial asset. Likewise, we believe sellers should apply Subtopic 610-20 to transfers of undivided interests in nonfinancial assets that were wholly owned before the sale.

Some entities account for undivided interests in legal entities under the equity method, but use gross financial statement presentation, often referred to as proportionate consolidation. Subtopic 610-20 excludes sales of both equity method investments and undivided interests in ventures when proportionate consolidation is used. These investors should apply Topic 860 to derecognition events. See Question A25. [610-20-15-4]

Undivided interests in unincorporated legal entities

Subtopic 323-30 generally requires an investor with an interest in a partnership or unincorporated joint venture (also referred to as **undivided interests in ventures**) to account for it under the equity method if the investor has significant influence over the investee. The SEC staff's position is that these investors should apply the equity method unless their interests are so minor that they have virtually no influence. General partners are presumed to have interests that are more than minor. In practice, limited partners generally are presumed to have interests that are more than minor when their equity interests are more than 3 to 5%. [323-30-15-2 – 15-3, 25-1, 323-30-S99-1, 970-323-25-2, 25-6]

There are narrow exceptions to the guidance in Subtopic 323-30. Subtopics 910-810, 930-810 and 932-810 each provide an exception for interests in investees in the construction or extractive industries when the investor also is in those industries. For those investments, the investor applies the recognition and measurement guidance for equity method investments as described in Topic 323 (equity method and joint ventures). However, the investor is permitted to apply gross, or proportionate, presentation in the financial statements versus the one-line presentation required by Topic 323. [910-810-45-1, 930-810-45-1, 932-810-45-1, 810-10-45-14]

As discussed above, Subtopic 610-20 excludes sales of equity method investments and investments in ventures accounted for using proportionate consolidation. We believe that investors with undivided interests in ventures, including those investors that present the assets and liabilities underlying the venture on a gross basis, should apply Topic 860 for derecognition. While some investors have the option for gross presentation versus one-line **presentation**, all must apply the recognition and measurement guidance for equity method investments.