AcSB Accounting Standards Board

In Brief Podcast

Topic:	Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement – Addressing Implementation Questions Podcast #1
Presenters:	Armand Capisciolto, FCPA, FCA, CPA (MI) (AcSB Vice-chair) and Mohamed Hassanali, CPA CA (AcSB staff)

Script

Speaker	
Voiceover	You're listening to an In Brief podcast. In this episode, Mohamed Hassanali, Principal with the Accounting Standards Board, speaks with Armand Capisciolto, Vice Chair of the Accounting Standards Board, about questions received on the amendments to section 3856, financial instruments, relating to retractable or mandatorily redeemable shares issued in a tax planning arrangement. Be sure to check out the visual examples found in the full script.
Mohamed	Hello everyone. This podcast is the first in a series, which focusses on specific questions that we've received over the last few months about how to apply the amendments for retractable or mandatorily redeemable shares issued in a tax planning arrangement. As a reminder, the amendments were issued in December 2018 and are effective for periods beginning on or after January 1, 2020. When the amendments were issued, we also did a full hour webinar which is available on both the CPA Canada and FRASCanada websites. If you haven't already, we encourage you to first watch the webinar, for a more detailed overview of the amendments before listening to these podcasts that address more specific interpretation questions we've received. So, let's get right into it! There are 3 conditions that must be met for retractable or mandatorily redeemable shares issued in a tax planning arrangement, and we'll call them redeemables from here on out, to be classified as equity. First up is the control condition. Armand, can you remind us again what this condition is about and the questions the Board has been getting?
Armand	Absolutely! But before we get into the control condition itself, I wanted to point out that the Board has provided an exception to liability classification for redeemables based on the 3 conditions. In setting these 3 conditions, the Board attempted to create a principled exception to the definition of a liability, but at the end of a day, any exception to the definition of a liability is a rule. As a result, the Board expects that a relatively narrow set of circumstances should qualify for equity classification. Let's keep that in mind as we consider the questions that have been received. Now, onto the first of those conditions around retention of control. The control condition in section 3856, paragraph .23(a) reads "control of the enterprise issuing the redeemables is retained by the shareholder receiving the shares in the arrangement. Simply put if Company A issues redeemable shares to Company B in a tax planning arrangement, Company B needs to have control of Company A before and after for the redeemables to qualify as equity. So how do you apply the Control condition? Two questions we've received are: • First, does control of the enterprise that issued the redeemables have to be held directly or can control be indirect? • Secondly, does the enterprise that controls the issuer of the shares have to be the same enterprise that holds the redeemable shares? Now, I think you have some examples for me to work through?

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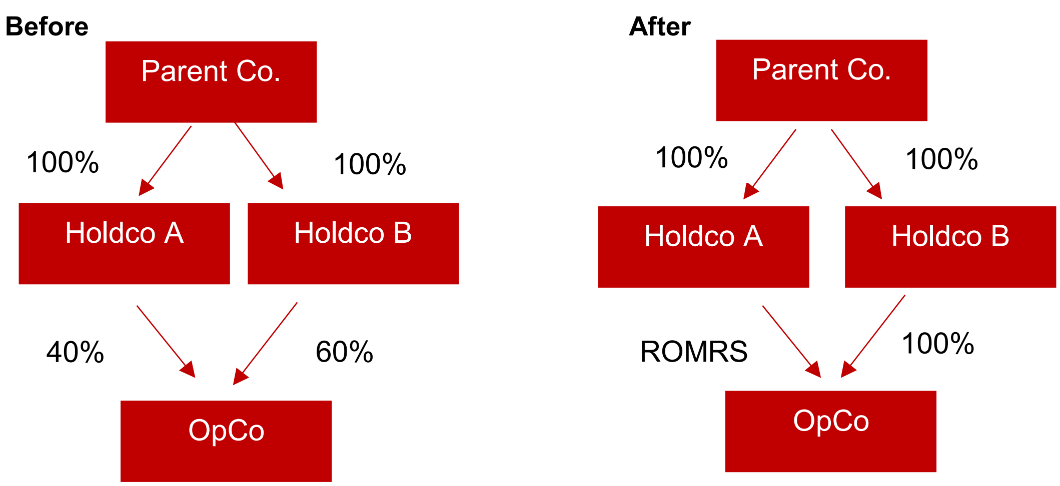
<tr><td>Mohamed</td><td>Yes, I do!...

a. Let's start with this one:
• Parent Co. owns 100% of two Holdco's, A & B.
• Holdco A has 40% interest in OpCo and Holdco B has 60% interest in OpCo
• Holdco A engages in an estate freeze transaction and exchanges its 40% common share interest in OpCo for redeemables
• Now let's assume that new voting shares for the 40% interest are issued to Holdco B which, now has 100% of the votes in OpCo
• The question arises, do the redeemables issued by the OpCo to Holdco A meet the control condition for equity classification?

Armand, what factors would you consider to assess the control condition in this scenario?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<tr><td>Armand</td><td>Great question! Here are some things that immediately jump out in the scenario:
• If we look at the transaction from the perspective of Holdco A, it only has 40% ownership of OpCo. Therefore, it does not control OpCo before or after the transaction
• However, if we looked at it from the perspective of Parent Co., nothing of substance has changed because Parent Co. still indirectly controls 100% of both Holdco's and by extension OpCo.
  ○ I want to point out here that if you refer to Section 1591, (Subsidiaries) for guidance on control, you'd look through Holdco A to Parent Co. and determine that control of OpCo is indirectly held by Parent Co. There is nothing wrong with considering indirect control when making the assessment.
• Now, is that rationale enough to say that control is retained, and the condition is met? It could be, as nothing of substance has changed from the ultimate Parent Co's perspective… but wait…
• The second half of the condition says control "is retained by the shareholder receiving the shares." So, you ask yourself…who is receiving these shares, Holdco A (which has the minority interest in OpCo) or the Parent Co.?

Considering all these data points, it's important to use some judgement here to look at where the weight of evidence lies. There is a strong case to be made that nothing of substance has changed particularly from the perspective of Parent Co. It could be said the Parent Co. indirectly holds the redeemables. At the same time, there is a strong case to be made that the shares</td></tr>
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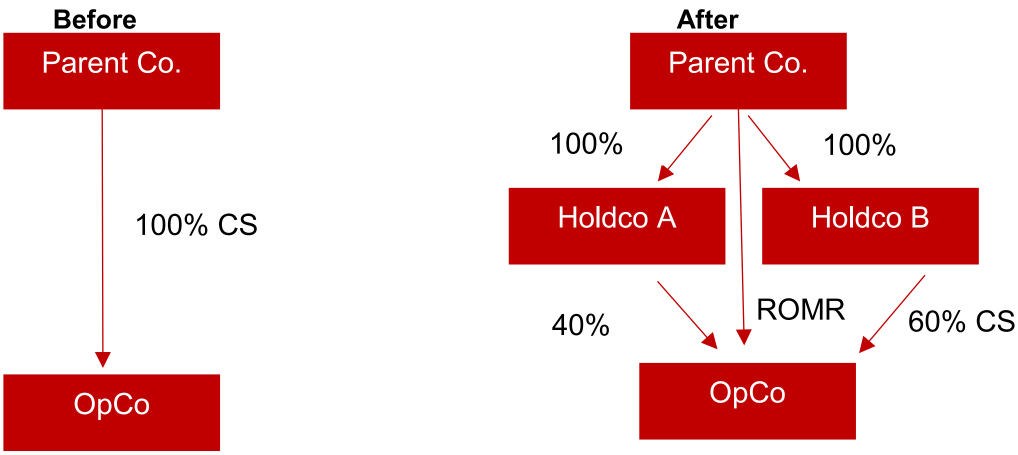
<tr><td></td><td>aren’t held by the Parent Co., which has control of OpCo. You have to make that judgement call given the facts and circumstances.</td></tr>
<tr><td>Mohamed</td><td>That’s a lot to consider there Armand. But how about a slight variant to the scenario you just highlighted. Here’s one that could occur on transition:



Very similar set of circumstances as before but initially, Parent Co. held all the voting shares in OpCo and there were no holding companies
Now, after a few tax planning arrangements Parent Co. now holds redeemables in OpCo. but its ownership interest in OpCo. is held through HoldCos A & B
Are these redeemable shares equity or liability in the OpCo?</td></tr>
<tr><td>Armand</td><td>From a control perspective, control of OpCo is indirectly held by Parent Co., which, as we said before, is appropriate to consider in the context of Section 1591.

The shares are held by Parent Co., which is the entity that controls OpCo before and after the tax planning arrangement.

Therefore, the weight of evidence suggests that control is retained and, therefore, the redeemables are classified as equity.

Overall, when looking at the control condition, judgement needs to be applied and it’s important to consider all the facts and circumstances of the tax planning arrangement before reaching a conclusion on whether the control condition is met or not.</td></tr>
<tr><td>Mohamed</td><td>That brings us to the end of our first podcast. Thank you for listening. Be sure to check out the other podcasts in the series on the other conditions for equity classification of redeemable shares.</td></tr>
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