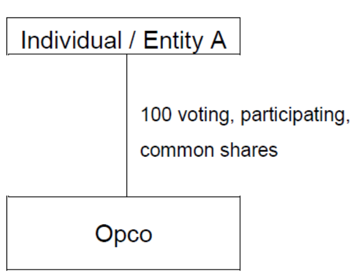
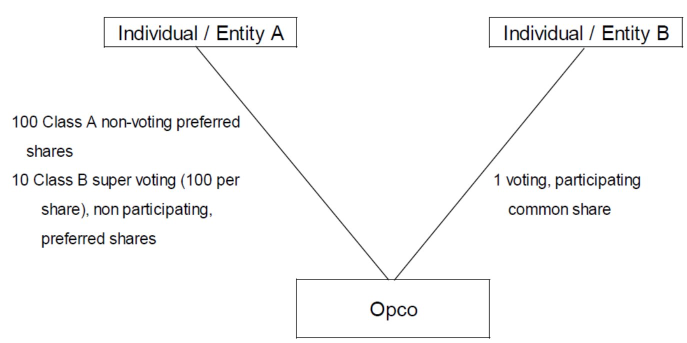
In Brief podcast

Topic:	Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement – Addressing Implementation Questions Podcast #2
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	We're into the second of our series of podcasts on the amendments for redeemables. If you haven't listened to the first podcast on some of the judgements that apply to the control condition, we encourage you to check out that podcast. Now, in this podcast, we'll focus on the second condition to assess whether redeemables issued in a tax planning arrangement can be classified as equity. The second condition for equity classification of redeemables in paragraph 23(b) of Section 3856 is that either no consideration is received by the enterprise issuing the redeemables, or only shares of the enterprise issuing the redeemables are exchanged in the transaction. Now, if we simplify this, any time there is cash or other assets involved or if liabilities are assumed in the tax planning arrangement, it's implied that something of substance has changed for the enterprise issuing the redeemables. Therefore, redeemables in those circumstances are classified as a liability. Armand, what has the Board been hearing about this condition?
Armand	We've received a number of questions on whether the inclusion of a small amount of cash to make a tax plan effective still meets this condition or not. Let's talk through an example where you have a vanilla estate freeze and work through where judgement might be applied for this condition. **Before:**  **After:** 

	In this scenario, in Step 1: 100 voting, participating, common shares are exchanged for 100 Class A non-voting preferred shares by Entity A – this being your freeze step. Then, in Step 2: Entity A subscribes for 10 Class B super voting shares for $10 and Entity B subscribes for 1 participating common share for $1. In this scenario, which we've stated is a vanilla estate freeze, the steps collectively form the tax planning arrangement. Entity A retains control with the super voting shares – that's fairly straight forward. But, to legally affect this estate freeze, Entity A and Entity B both have to purchase the voting shares for cash. The question that arises is, does the nominal amount paid for those shares put you offside on the no consideration condition? Let's take a step back here and consider the purpose of the condition. Our users told us that when cash or assets are included in a transaction or liabilities are assumed something is changing. Paying a nominal consideration (say, $1 or $10) to purchase the super voting shares is non-substantive to the transaction, and is simply required to legally affect the transaction. Therefore, in this scenario, we believe that the condition is met. If we were dealing with tens of thousands of dollars of consideration for the voting shares or including some other assets in the transaction. Judgmentally, there is a substantive change as a result of the transaction and has an effect on the issuer. In that case, this condition is not met and you have to classify your redeemables as a liability.
Mohamed	That's interesting Armand. So, one of the things we've heard though is that the cash, so in this case the $10 from Entity A and the $1 from Entity B, is not specially for the redeemables, but rather for the new common shares. Now, since the cash is not for the redeemables, then this condition is met. Is that interpretation reasonable?
Armand	That's a really interesting question. From the Board's perspective, it's not so much about the consideration being for the redeemables specifically. Rather it's about the consideration being part of the transaction itself. When more than a very minimal amount of cash for legal purposes is involved or if other assets are involved in a tax planning arrangement, something of substance is changing for the issuer of the redeemables. If that happens, the shares should be classified as a liability. If you were to interpret the consideration being for the redeemables specifically, there are asset rollover structures, that occur where the assets are not directly exchanged for the redeemables. In those cases, the interpretation as you described would result in redeemables qualifying for equity classification, which is counter to the notion that nothing of substance has changed. So again, it's about the consideration in the transaction as a whole and not just for the redeemables.
Mohamed	That brings us to the end of our second 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.