



## **Accounting & assurance update for private companies**

December 11, 2017

# AcSB activities

# ASPE work plan

## Active projects

2017		
Major improvements	Q3	Q4
• Agriculture		
• Consultation on priorities for Part II		
• Retractable or mandatorily redeemable shares issued in a tax planning arrangement	Exposure Draft	
Narrow-scope amendments		
• Financial Instruments		Exposure Draft

Status based on AcSB workplan as at December 1, 2017

<http://www.frascanada.ca/standards-for-private-enterprises/projects/active/item56206.aspx>

# Exposure draft

## Retractable or mandatorily redeemable shares issued in a tax planning arrangement

### Current exemption from liability classification:

- Preferred shares (redeemable at the option of the holder) issued in a tax planning arrangement under Sections 51, 85, 85.1, 86, 87 or 88 of the Income Tax Act are presented in **Equity**
- Measured at par, stated or assigned value
- When redemption is demanded, the shares are reclassified as liabilities and measured at the redemption amount
- (S. 3856.23)

## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)


#### **Why doesn't the current exemption work?**

- Section 3856.23 was being applied to transactions beyond those originally intended
- Some tax planning arrangements did not qualify as they were executed outside of the specified sections of the Income Tax Act
- Confusion on how to apply "when redemption is demanded"

# Exposure draft (cont'd)

## Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

### Shares in scope of proposed model ...



Retractable or  
mandatorily  
redeemable  
shares issued in a  
tax planning  
arrangement

These shares generally have the following attributes:

- Holder has the right to require redemption on demand at a redemption price = FMV of common shares exchanged
- Shares have, at least, voting rights on any matter involving a modification to the attributes attached to them
- No restrictions on their transfer
- Priority on distribution and liquidation over any other class of shares AND
- Shares are issued as part of a tax planning arrangement

# Exposure draft (cont'd)

## Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

### The proposed model...

Classify retractable or mandatorily redeemable shares issued in a tax planning arrangement as EQUITY only when the following conditions are met:

No change in control of the enterprise

- Recipient of shares must control enterprise before and after the transaction
- Control = power to direct strategic operating, investing and financing policies
- Substantive rights

+

No consideration other than shares exchanged

- Only consideration exchanged is 1 class of shares for another class of shares of issuing enterprise
- Asset rollover transactions will not meet this condition

+

No redemption schedule

- No implicit or explicit arrangement giving holder right to redeem in fixed/determinable period

## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

#### **If the shares meet all 3 conditions:**

- Classify shares as **Equity**
- Measure shares at par, stated or assigned value
- Re-assess if there is a subsequent event/transaction affecting conditions
- If conditions are no longer met, reclassify to liabilities

#### **If the shares do not meet all 3 conditions:**

- Classify shares as a **Financial Liability**
- Measure shares at the redemption amount (i.e., amount due on demand)
- Record "offsetting" charge to a separate component of equity
- Classify shares as a current liability (as they are redeemable on demand)
- Do not reclassify from liability to equity, even if conditions change.



## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement (cont'd)

**In which types of tax planning arrangements are mandatorily redeemable or retractable shares, expected to qualify for equity classification?**



Estate freeze transactions that meet all 3 conditions



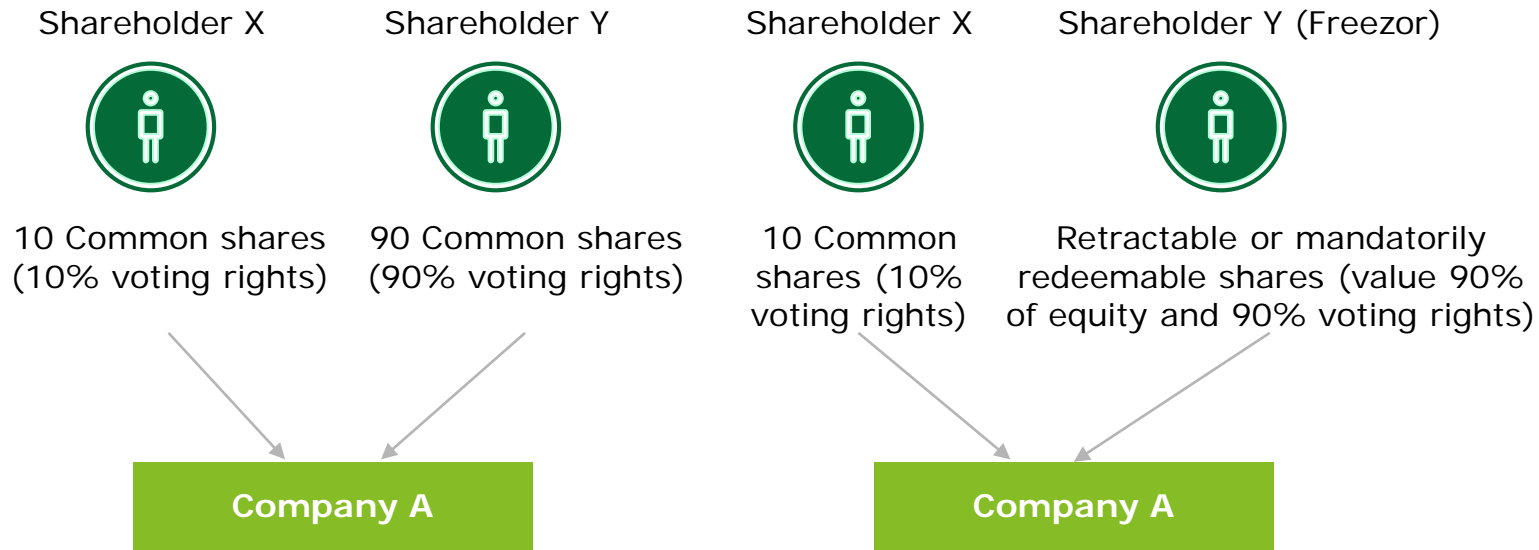
Tax planning arrangements that do not meet 1 or more conditions



Asset rollover transactions

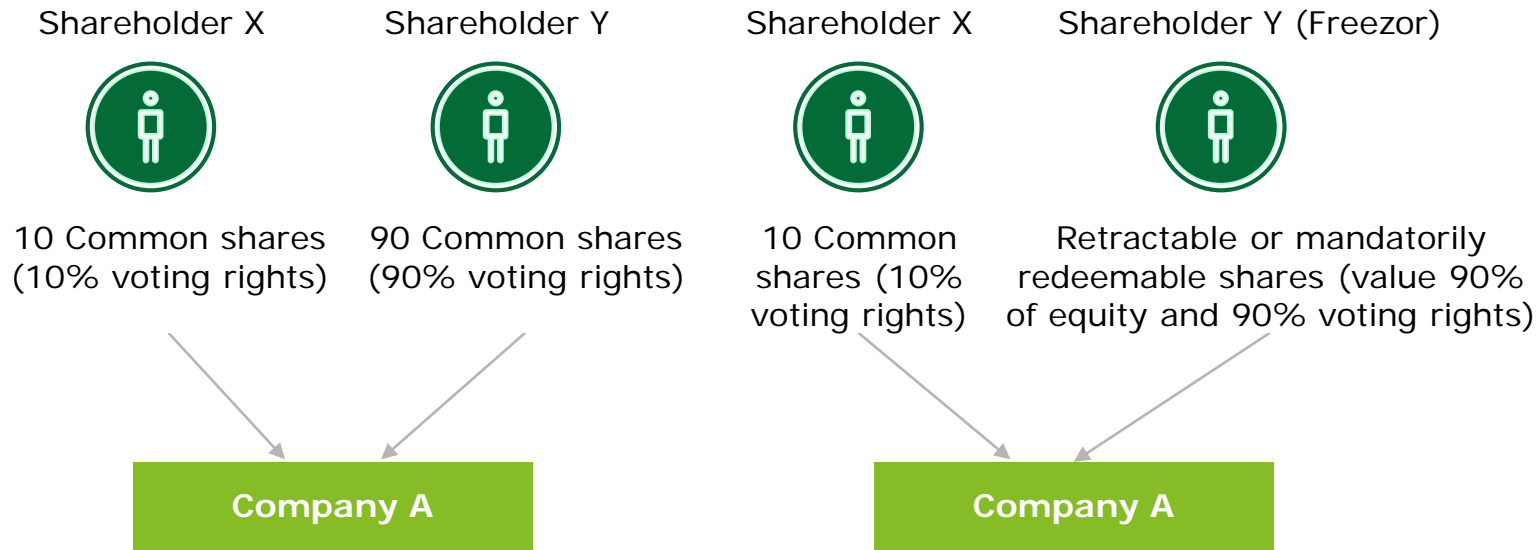
## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement - Example 1 – Estate Freeze



## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement - Example 1 – Estate Freeze (cont'd)

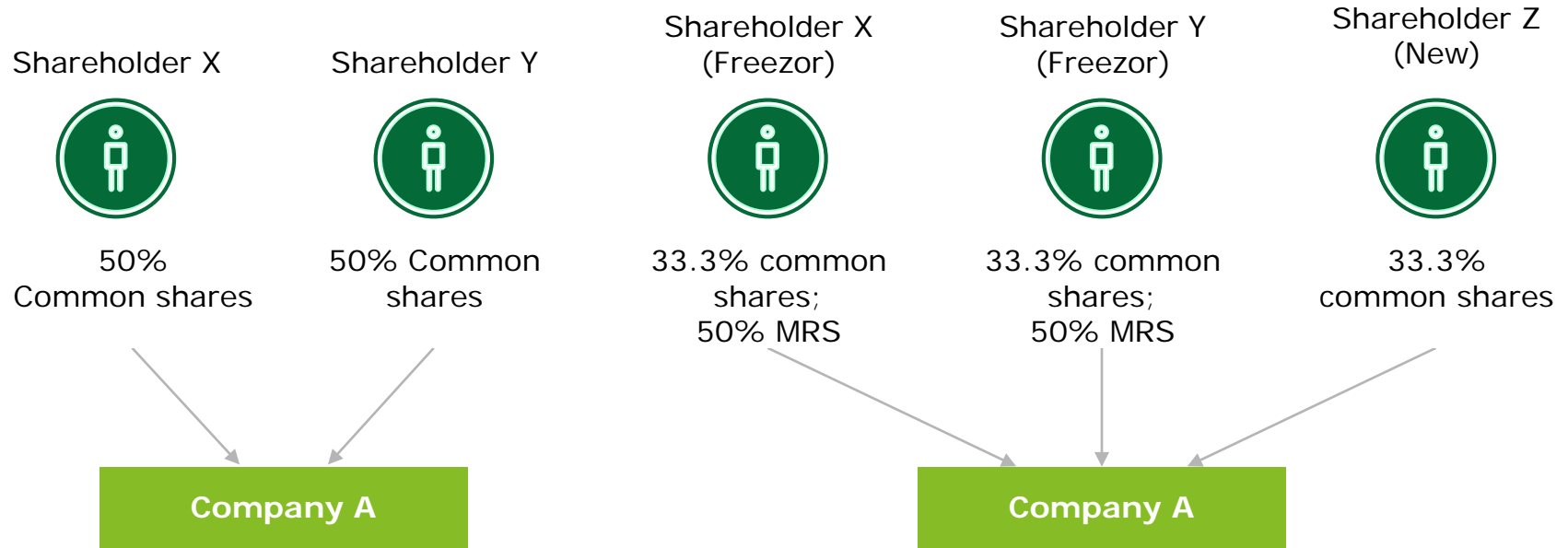


- ✓ Retain control?
- ✓ Only shares?
- ✓ No redemption schedule?

#### Equity Classification

## Exposure draft (cont'd)

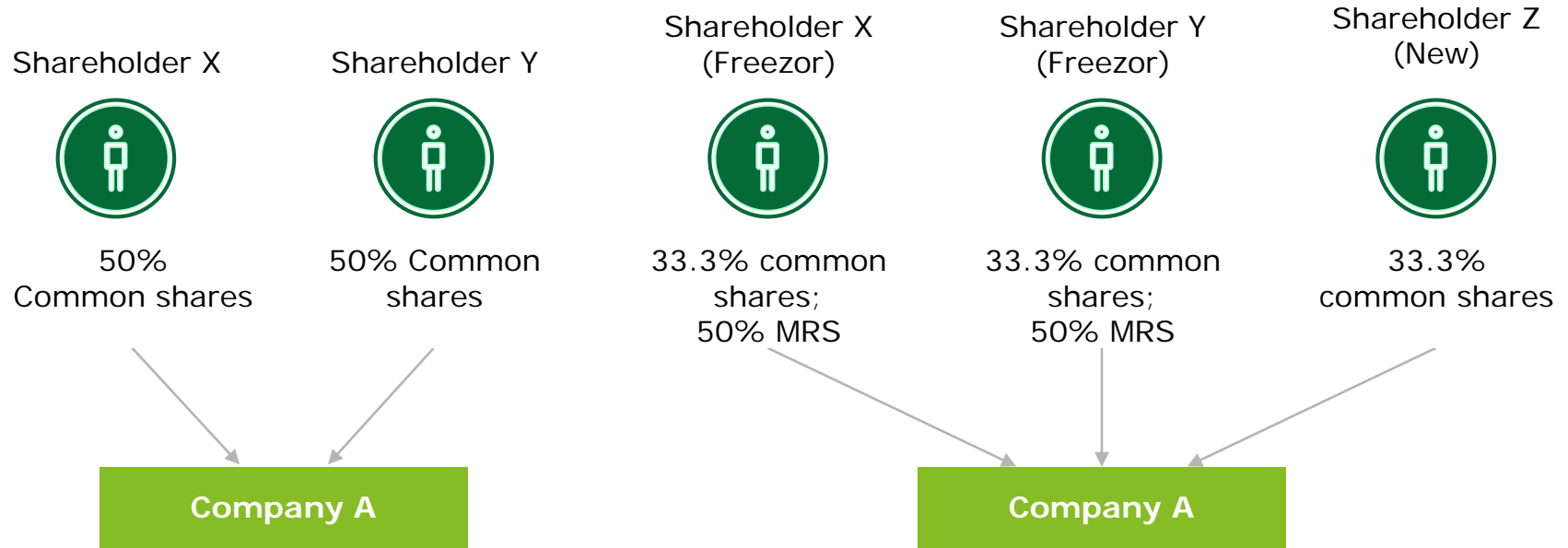
### Retractable or mandatorily redeemable shares issued in a tax planning arrangement - Example 2 – Estate Freeze



Common shares represent equal voting interest; all decisions on the strategic operating, investing and financing policies require the consensus of all shareholders. MRS: mandatorily redeemable shares.

## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement - Example 2 – Estate Freeze (cont'd)



Common shares represent equal voting interest; all decisions on the strategic operating, investing and financing policies require the consensus of all shareholders. MRS: mandatorily redeemable shares.

- ☒ Retain control?
- ☒ Only shares?
- ☒ No redemption schedule?

**Financial Liability  
Classification**  
(Due to joint control)

# Exposure draft (cont'd)

## Retractable or mandatorily redeemable shares issued in a tax planning arrangement

### Effective date and transition



Effective for fiscal years beginning on or after January 1, 2020, applicable retrospectively.

- Assess whether conditions for equity classification are met ***on the date amendments are applied for the first time*** (i.e., not original date of transaction)
- Transitional relief is available
  - Not required to assess shares redeemed before the effective date
  - Option to not restate comparatives

## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement – Example

#### Transition

- A shareholder transferred land to its wholly-owned company in an asset rollover transaction in 2012. Received preferred shares in the company (redeemable at any time at the option of the holder):
  - Par value \$100
  - Redemption amount \$1000
  - In 2012, the shares were classified as equity (Section 3856.23)
- Under the proposals in the ED, the shares would be classified as a liability.

## Exposure draft (cont'd)

### Retractable or mandatorily redeemable shares issued in a tax planning arrangement – Example (cont'd)

#### Transition

Before ED				After ED	
Liabilities:				Liabilities:	
Accounts payable	50			Accounts payable	50
				Tax planning shares	1,000*
Equity:				Equity:	
Tax planning shares	100			Effect of classifying tax planning shares as liabilities	(900)
Common shares	400			Common shares	400
Retained earnings	885			Retained earnings	885

\* At the redemption amount. Future income tax effects ignored.



# Exposure draft (cont'd)

## Retractable or mandatorily redeemable shares issued in a tax planning arrangement

### Key considerations:

- Do you have outstanding retractable or mandatorily redeemable shares issued in a tax planning arrangement?
- Would they meet the 3 conditions for equity classification?
- If not, how would your financial statements be impacted (e.g., key performance measures, bank covenants)?



Comments on the Exposure Draft are due to the AcSB by January 15, 2018... if you will be impacted, you are encouraged to have your voice heard!!

# Exposure draft (cont'd)

## Accounting for related party financial instruments and significant risk disclosures

### Background:

Post-implementation review for Section 3856 *Financial Instruments* identified issues in the following areas:

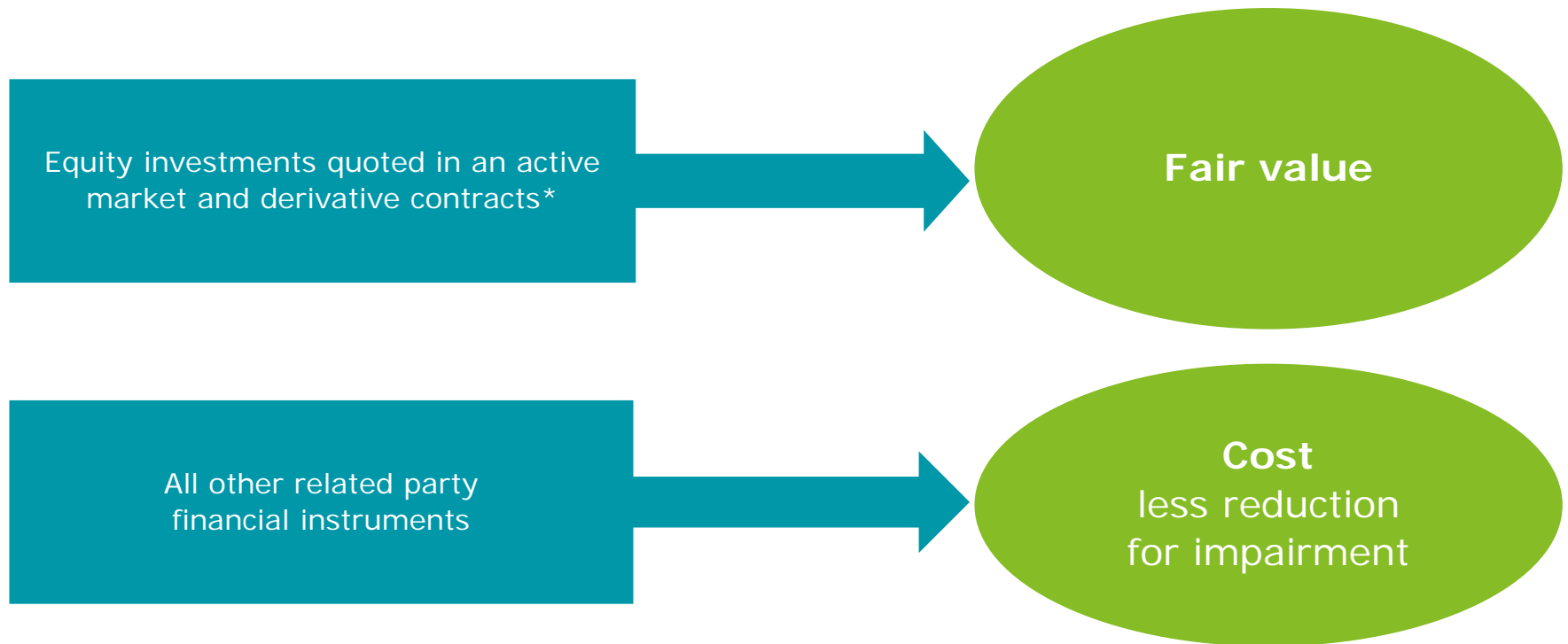
- Lack of clarity on the measurement of related party financial instruments, including the interaction with Section 3840 *Related Party Transactions*
- Clarification of risk disclosures within Section 3856

Other areas identified in the post-implementation review remain as topics for future projects, dependent upon the AcSB's relative priorities for Part II projects.

## Exposure draft (cont'd)

### Accounting for related party financial instruments and significant risk disclosures (cont'd)

Proposed measurement model for related party financial instruments:

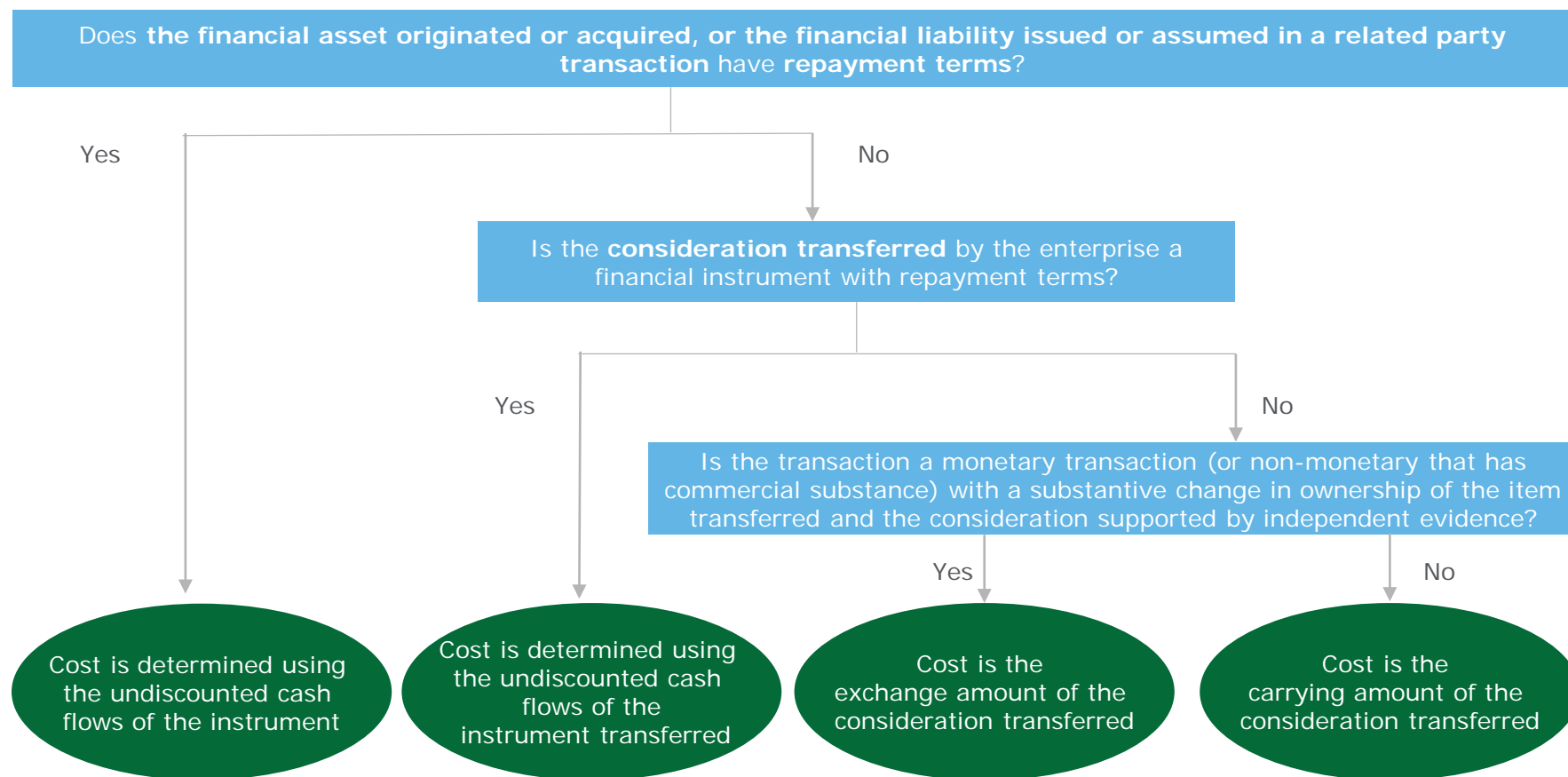


\* excluding derivatives in qualifying hedging relationships

# Exposure draft (cont'd)

## Accounting for related party financial instruments and significant risk disclosures (cont'd)

How is the “cost” of the financial instrument determined?



The undiscounted cash flows exclude interest and dividend payments

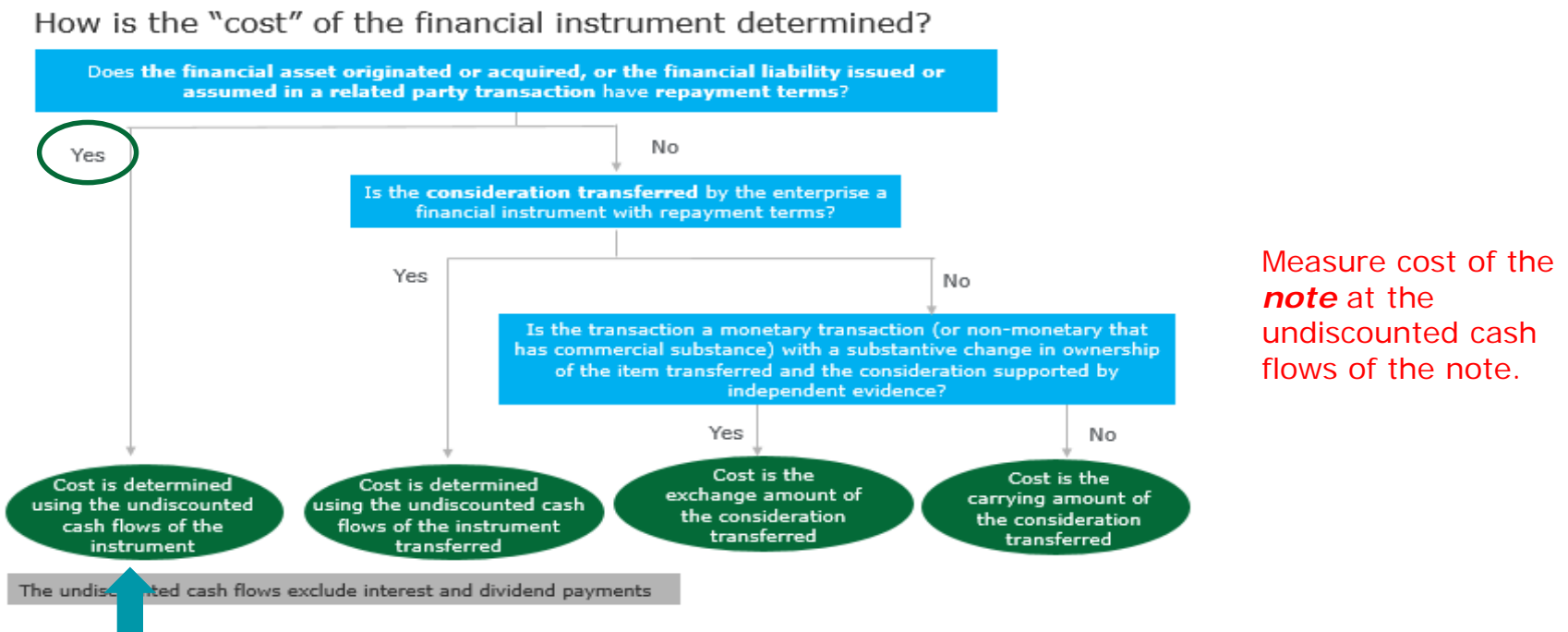
# Exposure draft (cont'd)

## Accounting for related party financial instruments and significant risk disclosures (cont'd)

### Example 1: Related party loan

- Parent company advances \$100K cash to its subsidiary, and receives as consideration a note receivable.
- Note has face amount = \$100K. No maturity date. No specified terms of repayment.

Note: *Debt with no stated repayment terms is deemed payable on demand (Section 3856.A12)*

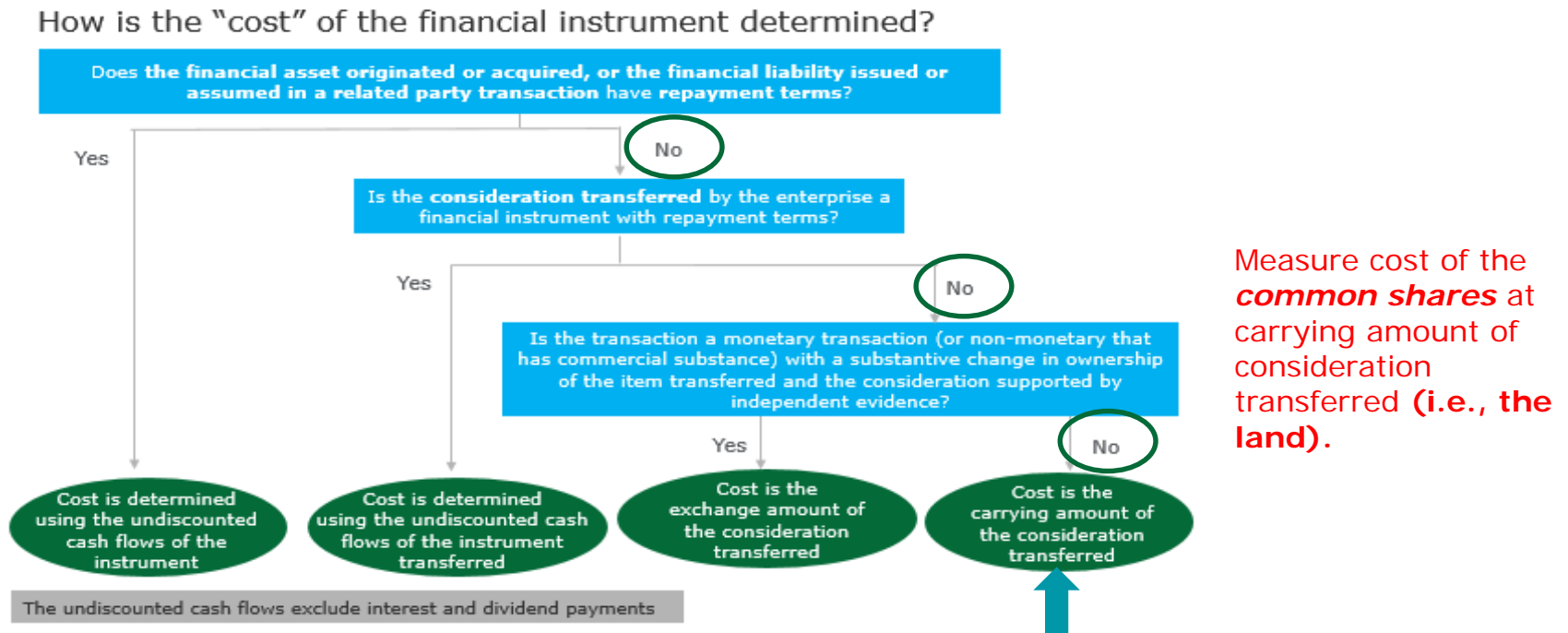


# Exposure draft (cont'd)

## Accounting for related party financial instruments and significant risk disclosures (cont'd)

### Example 2: Transfer of land

- Parent company transfers land to its wholly owned subsidiary and receives as consideration common shares in the subsidiary.
- Carrying amount of the land=\$90K.



## Exposure draft (cont'd)

### Accounting for related party financial instruments and significant risk disclosures (cont'd)

#### Example 2: Transfer of land

Parent (seller)		Sub (buyer)	
Dr. Investment in subsidiary	90K	Dr. Land	90K
Cr. Land	90K	Cr. Common shares	\$90K

ED does not impact how non-financial instrument consideration is measured.

# Exposure draft (cont'd)

## Accounting for related party financial instruments and significant risk disclosures

### Other key highlights

- ***Related party compound financial instrument*** – Permitted to initially measure the equity component as zero.
- ***Related party financial assets*** – Assess, and recognize in net income, any impairment of a RP financial asset, before forgiveness of such asset is recognized.
- ***All modifications of related party debt*** are treated as extinguishments of the original financial liability and the recognition of a new financial liability.
- ***Disclosure of significant risks arising from derivatives*** is permitted to be included with risks arising from other financial instruments.

Proposals are effective for fiscal years beginning on or after January 1, 2020, applicable retrospectively, with simplified transitional provisions.



# Exposure draft (cont'd)

## Accounting for related party financial instruments and Significant risk disclosures

### Key considerations:

- Do you enter into significant related party transactions?
- Does the consideration exchanged include financial instruments (e.g., shares, notes, warrants, etc.)?
- Will these amendments simplify the accounting for related party transactions (i.e., limited circumstances when fair value measurements will required)



Comments on the Exposure Draft are due to the AcSB by January 29, 2018... if you will be impacted, you are encouraged to have your voice heard!!



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