
IASB[®] meeting

Date	November 2022
Project	Business Combinations under Common Control
Topic	Structuring opportunities
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Introduction and purpose

1. This paper analyses feedback on how the IASB's preliminary views set out in the Discussion Paper *Business Combinations under Common Control* (Discussion Paper) could result in *structuring opportunities*. Structuring opportunities—sometimes called opportunities for accounting arbitrage—are opportunities to choose between different structures with substantially the same economic substance, in order to achieve a desired accounting outcome (for example, increasing the reported value of assets to obtain future tax benefits). This paper only considers structuring opportunities as part of reaching overall decisions on selecting the measurement method to apply to a business combination under common control (BCUCC). Deciding which measurement method to apply will involve considering all factors collectively including, for example, the cost-benefit trade-off (Agenda Paper 23F).
2. As noted in paragraph 15 of Agenda Paper 23A, this paper is a supporting paper included for reference—it does not contain questions for the International Accounting Standards Board (IASB). IASB members can raise any particular questions or comments on our analysis in this paper when discussing Agenda Papers 23B and 23C or when answering question (c) on page 8 of Agenda Paper 23A.

Structure of this paper

3. The paper is structured as follows:
 - (a) background (paragraphs 4–6);
 - (b) which measurement method to apply (paragraphs 7–19);
 - (c) how each measurement method applies (paragraphs 20–32);
 - (d) staff initial views (paragraphs 33–34); and
 - (e) Appendix A—Illustrative scenarios.

Background

4. As Agenda Paper 23B explains, the IASB's preliminary views about selecting the measurement method were:
 - (a) neither the acquisition method nor a book-value method should apply to all business combinations under common control (BCUCCs);
 - (b) in principle, the acquisition method should apply if a BCUCC affects non-controlling shareholders of the receiving entity (NCS), subject to the cost-benefit trade-off and other practical considerations; and
 - (c) a book-value method should apply to all other BCUCCs, including all combinations between wholly-owned entities.
5. In reaching its preliminary views the IASB considered, amongst other things, structuring opportunities. Structuring opportunities could reduce the relevance and comparability of information about a BCUCC and may result in not faithfully representing the substance of a BCUCC. Feedback suggested some structuring opportunities could arise because of the preliminary views on:
 - (a) which measurement method to apply; and
 - (b) how each measurement method applies.
6. This paper focuses on structuring opportunities that could arise because of the preliminary views on selecting the measurement method. We also analysed feedback on structuring opportunities in how each measurement method applies because some respondents said these structuring opportunities influence their view on selecting the measurement method.

Which measurement method to apply

7. Feedback suggested that the preliminary views on which measurement method to apply could result in some structuring opportunities that would allow an entity to apply either the acquisition method or a book-value method. Our analysis includes considerations for:
 - (a) applying more than one method to BCUCCs (paragraphs 8–11); and
 - (b) selecting the measurement method by considering the effect on NCS (paragraphs 12–19).

Applying more than one method to BCUCCs

Observations/conclusions in the Discussion Paper

8. Paragraph 2.9(d) of the Discussion Paper notes some stakeholders' views that if the acquisition method applies to some BCUCCs and a book-value method applies to other BCUCCs, there may be some structuring opportunities—entities could structure a BCUCC so a particular measurement method applies.

Feedback

9. Respondents provided limited feedback on structuring opportunities that could arise from the preliminary view to apply more than one method to BCUCCs. One respondent said different legal structures with similar economic substance could be accounted for differently if two different measurement methods apply to BCUCCs.

Analysis

10. We agree that applying more than one method to BCUCCs could provide some structuring opportunities to qualify for a particular measurement method—the specific structuring opportunities would depend on where the IASB draws the line between applying the two methods. In forming our initial views on the principle of which method to apply to BCUCCs and any related exceptions (see Agenda Papers 23B and 23C respectively), we considered how the IASB could minimise such opportunities.
11. However, we think there may be some structuring opportunities to qualify for a particular measurement method unless the acquisition method applies to all BCUCCs. If a book-value method applies to all BCUCCs, some structuring opportunities might arise which allow an entity to structure a transaction to be under common control (so a book-value method would apply) or not under common control (so the acquisition method in IFRS 3 *Business Combinations* would apply)—for example, see Illustrative scenario III in paragraphs A6–A8.

Selecting the measurement method by considering the effect on NCS

12. This section analyses structuring opportunities to qualify for a particular measurement method that could arise when applying the IASB's preliminary views on selecting the measurement method, specifically:
 - (a) in principle, applying the acquisition method if a BCUCC affects NCS, subject to the cost-benefit trade-off and other practical considerations; and
 - (b) applying a book-value method to all other BCUCCs, including combinations between wholly-owned entities.
13. Agenda Paper 23C considers whether, as a result of the cost-benefit trade-off and other practical considerations, in some circumstances an entity should be permitted or required to apply a different method. This includes considering whether such exceptions or exemptions would reduce the structuring opportunities relating to the principle in paragraph 12.

Observations/conclusions in the Discussion Paper

14. Some stakeholders consulted in developing the Discussion Paper suggested that the acquisition method should be applied only if NCS hold a 'substantive' ownership interest in the receiving entity

because, amongst other reasons, applying the acquisition method to BCUCCs if the NCS do not hold a 'substantive' ownership interest could result in some structuring opportunities (see paragraphs 2.36–2.37 of the Discussion Paper).

15. As paragraph 2.38 of the Discussion Paper notes, the IASB considered whether to require applying a book-value method if NCS' ownership interest is below a quantitative threshold. The IASB rejected such an approach because a quantitative threshold would be arbitrary and would lack a conceptual basis. In addition, it could give rise to further concerns about structuring opportunities. Instead, the IASB considered qualitative factors in developing its preliminary views, including the optional exemption and related-party exception (explained further in Agenda Paper 23C).

Feedback

16. Some respondents said the IASB's preliminary views on which measurement method to apply could create some opportunities to structure transactions to qualify for a particular measurement method, for example:
- (a) a BCUCC could be structured with insignificant NCS to qualify for the acquisition method (Illustrative scenario I in paragraphs A2–A3); and
 - (a) a BCUCC could be structured with temporary / transitory NCS to qualify for the acquisition method (Illustrative scenario II in paragraphs A4–A5); and
 - (b) a business combination covered by IFRS 3 (IFRS 3 BC) could be followed by a BCUCC to qualify for a book-value method (Illustrative scenario III in paragraphs A6–A8).

Analysis

17. We agree that selecting the measurement method by considering the effect on NCS could create some opportunities to structure transactions to qualify for the acquisition method. As paragraph 15 explains, the IASB rejected a quantitative threshold to identify BCUCCs with insignificant NCS and instead considered qualitative factors—Agenda Paper 23C considers alternative approaches to identify BCUCCs with insignificant NCS, including whether such approaches would reduce structuring opportunities.
18. We also agree there could be some opportunities to structure transactions to qualify for a book-value method. However, in our initial view a book-value method would only apply to BCUCCs which do not affect NCS (Agenda Paper 23B) or to which an exception applies (Agenda Paper 23C).
19. In forming our initial views on the principle of which method to apply to BCUCCs and any related exceptions (see Agenda Papers 23B and 23C respectively), we considered how the IASB could minimise structuring opportunities to qualify for a particular measurement method. We also note that common control may be transitory in some of the structuring opportunities suggested by respondents

and the IASB has not yet deliberated transitory control—we will consider the risk of structuring opportunities when analysing transitory control.¹

How each measurement method applies

20. When applying a particular measurement method, there may be some opportunities to structure a BCUCC to result in different accounting outcomes. As mentioned in paragraph 6, although this feedback relates to applying the measurement methods, we analysed this feedback in this agenda paper because some respondents said these structuring opportunities influence their view on selecting the measurement method. Our analysis includes considerations when:

- (a) applying the acquisition method (paragraphs 21–26); and
- (b) applying a book-value method (paragraphs 27–32).

Applying the acquisition method

Observations/conclusions in the Discussion Paper

21. Paragraph 2.26 of the Discussion Paper explains that when applying the acquisition method to a BCUCC that does not affect NCS identifying the acquirer ‘would usually have a fundamental and pervasive effect on what information is provided’. The acquirer’s assets and liabilities continue to be measured at their existing book values, whereas the assets and liabilities of the acquiree are measured at fair value.

Feedback

22. Some users (who agreed with preliminary view that a book-value method should apply to a BCUCC by a wholly-owned receiving entity in preparation for an IPO) said if the acquisition method were applied in that scenario wholly-owned receiving entities could undertake a BCUCC to ‘step up’ asset values from their existing carrying amounts to fair value.²
23. A few respondents (who said a book-value method should apply to all BCUCCs) said if the acquisition method is applied to any BCUCCs the controlling party can decide which of the combining entities is the acquirer and which is the acquiree, giving rise to some structuring opportunities.

Analysis

24. We agree that applying the acquisition method to all BCUCCs could create some structuring opportunities:

¹ The IASB’s preliminary view in the Discussion Paper was that the preliminary views would apply to BCUCCs which are preceded by an acquisition from an external party. [Agenda Paper 23A](#) of the IASB’s December 2021 meeting explains respondents’ feedback.

² Almost all users we conducted outreach with were asked about specific scenarios rather than the underlying principles—see [Agenda Paper 23D](#) of the IASB’s December 2021 meeting for the scenarios and more details.

- (a) deciding whether to undertake a BCUCC—if a BCUCC is not required before an IPO (for example, because both businesses are already owned by a holding company which will be listed), the assets would remain at book value but if the controlling party decides to undertake a BCUCC (for example, to merge the two businesses) then the assets of the acquiree would ‘step up’ to be measured at fair value; and
 - (b) structuring a BCUCC to determine which business would be identified as the acquirer (illustrated in paragraphs A9–A10).
25. Applying the IASB’s preliminary views on selecting the measurement method, the acquisition method would be applied only to BCUCCs that affect NCS. If a BCUCC affects NCS, the transaction will affect the ultimate ownership interests of NCS and the controlling party. In addition, many jurisdictions have laws to protect the NCS’ interests (see Appendix A of Agenda Paper 23D) which may restrict structuring opportunities which would adversely affect the NCS’ interests. In contrast, BCUCCs between wholly-owned entities could be structured to achieve a particular accounting outcome without affecting ultimate ownership interests, so these structuring opportunities would be particularly relevant if the acquisition method were applied to BCUCCs between wholly-owned entities.³
26. In forming our initial views on the principle of which method to apply to BCUCCs and any related exceptions (see Agenda Papers 23B and 23C respectively), we considered the potential structuring opportunities when applying the acquisition method. When the IASB deliberates how to apply acquisition method, to the extent relevant, we will analyse these potential structuring opportunities and whether they could be mitigated.

Applying a book-value method

Observations/conclusions in the Discussion Paper

27. Paragraphs 2.25–2.26 of the Discussion Paper observe that applying a book-value method to a BCUCC undertaken in preparation for an IPO would provide information that does not depend on whether a BCUCC is needed or how any combination is legally structured. Applying the acquisition method in preparation for an IPO would usually have a fundamental and pervasive effect on what information is provided to potential public shareholders.

Feedback

28. Almost all users agreed a book-value method should apply to a BCUCC by a wholly-owned receiving entity in preparation for an IPO—that is, the outcome of applying the IASB’s preliminary views. Their reasons included:

³ We also think the practical challenge of identifying the acquirer may be more difficult in a BCUCC that does not affect NCS than in a BCUCC that affects NCS, as explained in paragraph 22 of Agenda Paper 23H.

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- (a) a book-value method would provide consistent book-value information for the combined group regardless of the BCUCC structure (some); and
 - (b) as a potential investor in an initial public offering, they assess the value of the entire group and are not interested in a BCUCC that happened before they invested (a few).
29. Some other respondents agreed a book-value method would provide similar information regardless of the structure.⁴

Analysis

30. Although a book-value method would provide similar information regardless of the structure in many cases, we think applying a book-value method could give rise to some structuring opportunities.
31. The specific structuring opportunities will depend on the IASB's future decisions about how to apply a book-value method. A potential structuring opportunity to decide which entity is transferred is illustrated in paragraphs A11–A12.
32. In forming our initial views on the principle of which method to apply to BCUCCs and any related exceptions (see Agenda Papers 23B and 23C respectively), we considered the potential structuring opportunities when applying a book-value method. When the IASB deliberates how to apply a book-value method, to the extent relevant, we will analyse these potential structuring opportunities and whether they could be mitigated.

Staff initial views

33. In our initial view:
- (a) some structuring opportunities to qualify for a particular measurement method (that is, the acquisition method or a book-value method) will exist unless the acquisition method applies to all BCUCCs, as well as to all IFRS 3 BCs;
 - (b) the IASB's preliminary views on which measurement method to apply could create some opportunities to structure transactions to qualify for a particular measurement method (for example, a BCUCC could be structured with insignificant NCS to qualify for the acquisition method), although exceptions could be designed to minimise such structuring opportunities (see Agenda Paper 23C);
 - (c) how the acquisition method is applied to BCUCCs could create some structuring opportunities, particularly if the acquisition method were applied to BCUCCs between wholly-owned entities; and

⁴ One respondent said that if a book-value method is required for any BCUCCs, some structuring opportunities will exist by structuring a transaction as an asset acquisition (which does not have to be recognised at book value) rather than a BCUCC. We think the economic substance of an asset acquisition differs from a business combination, so this is not a structuring opportunity.

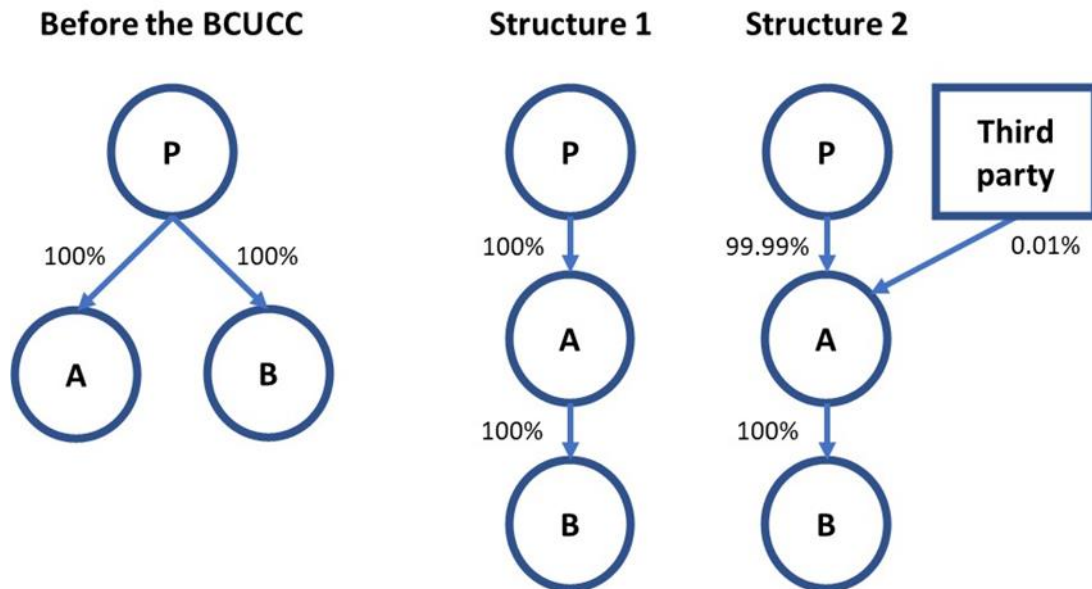
- (d) how a book-value method is applied to BCUCCs could also create some structuring opportunities.
34. We consider these structuring opportunities when reaching our staff initial views in Agenda Papers 23B and 23C to the extent relevant. When the IASB deliberates how to apply each of the measurement methods, we will analyse potential structuring opportunities relating to how each measurement method applies and whether they could be mitigated.

Appendix A—Illustrative scenarios

- A1. This appendix illustrates the following structuring opportunities:
- (a) structuring opportunities to qualify for the acquisition method (paragraphs A2–A5);
 - (b) structuring opportunity to qualify for a book-value method (paragraphs A6–A8);
 - (c) structuring opportunity applying the acquisition method (paragraphs A9–A10); and
 - (d) structuring opportunity applying a book-value method (paragraphs A11–A12).

Structuring opportunities to qualify for the acquisition method

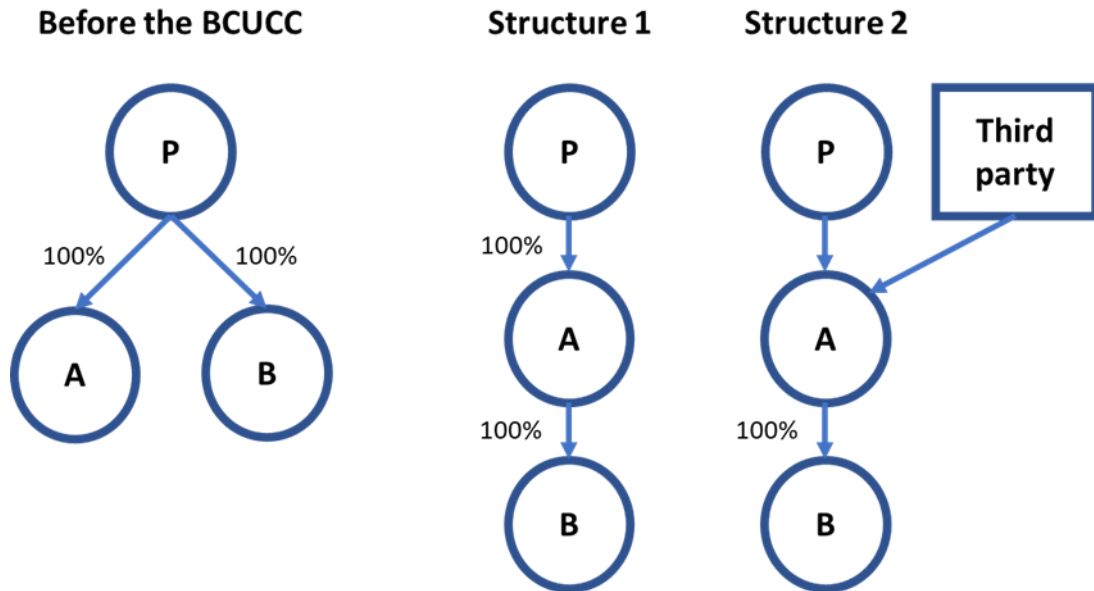
Illustrative scenario I—Insignificant NCS



- A2. Structure 1 shows a BCUCC between wholly-owned entities. Applying the IASB’s preliminary views on selecting the measurement method, Entity A would apply a book-value method to account for the BCUCC.
- A3. In Structure 2, before the BCUCC a 0.01% equity interest in Entity A is transferred to a third party (NCS). The 0.01% equity interest held by NCS does not substantially change the economic substance of the BCUCC. Applying the IASB’s preliminary views on selecting the measurement method, it is possible the acquisition method would apply.⁵

⁵ The IASB’s preliminary views included exceptions (for example, the optional exemption), so in some cases a book-value method would apply. Agenda Paper 23G analyses whether exceptions could reduce structuring opportunities, including a possible exception for insignificant NCS.

Illustrative scenario II—Temporary / transitory NCS

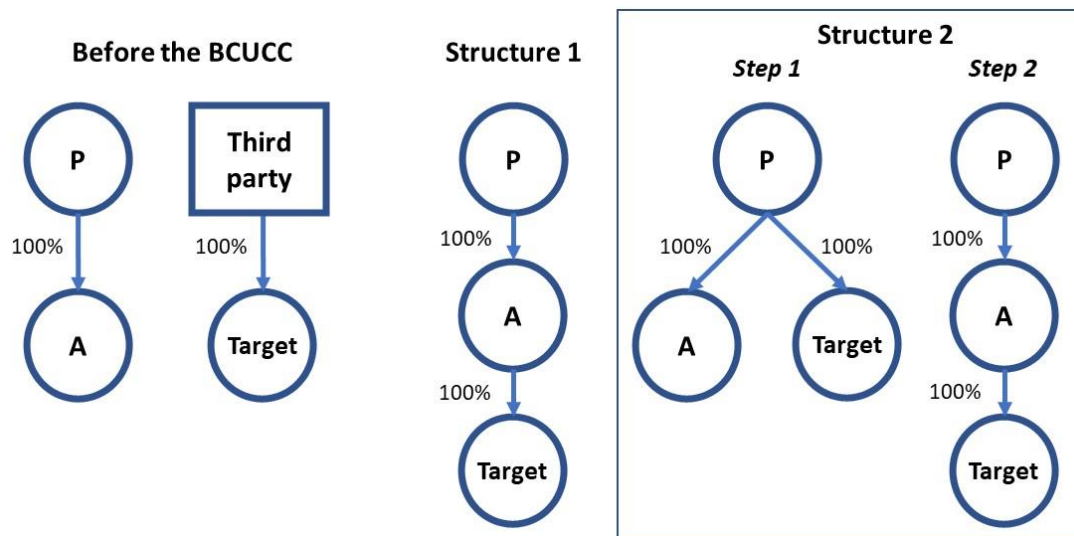


- A4. The structure before the BCUCC and Structure 1 are the same as described in Illustrative scenario I.
- A5. In Structure 2, an equity interest in Entity A is transferred to a third party before the BCUCC and will be transferred back to the controlling party after the BCUCC. In this scenario, we assume the interest temporarily held by a third party would be considered ‘shares’ and therefore the BCUCC would affect NCS.⁶ Therefore, applying the IASB’s preliminary views on selecting the measurement method, it is possible the acquisition method would apply.

⁶ Respondents requested clarification on particular terms and aspects of the IASB’s preliminary views, including the meaning of ‘shares’ and ‘affects’ NCS. As paragraph 28 of Agenda Paper 23A explains, we will analyse such clarifications in more detail if they are relevant after the IASB makes tentative decisions on selecting the measurement method.

Structuring opportunity to qualify for a book-value method

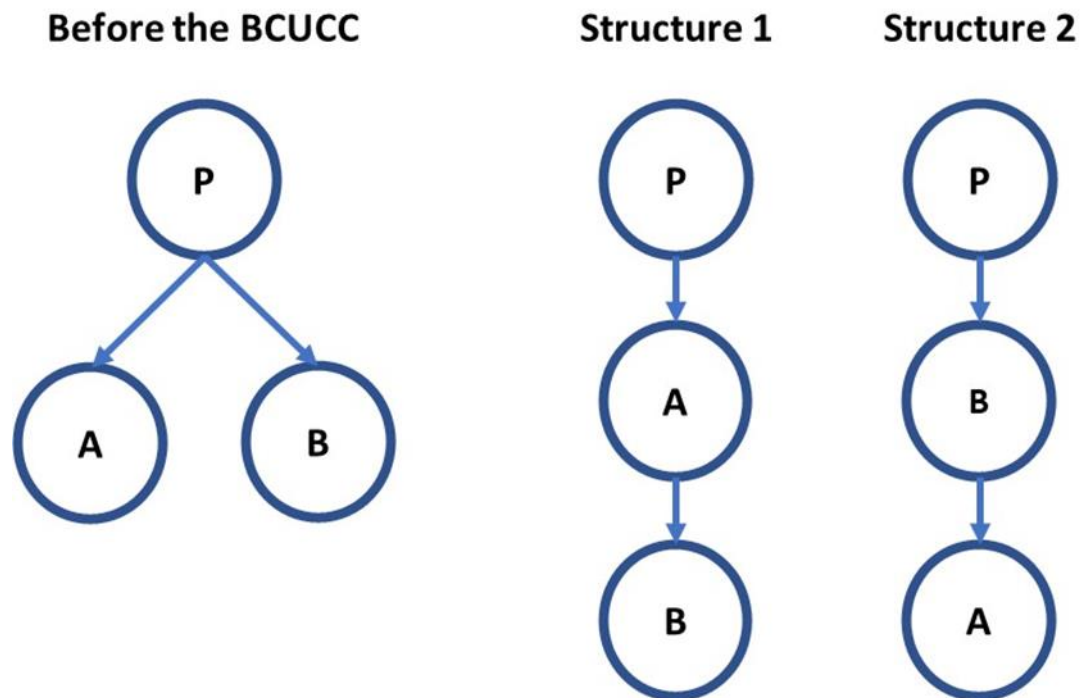
Illustrative scenario III—An IFRS 3 BC followed by a BCUCC



- A6. Structure 1 shows a business combination with A acquiring Target from a third party. Entity A would account for this acquisition as an IFRS 3 BC so IFRS 3's acquisition method would apply.
- A7. Structure 2 shows two steps to achieve the same final ownership structure but a different accounting outcome:
- in step 1, P acquires Target;
 - in step 2, Target is transferred to A—from A's perspective, this is a BCUCC and NCS are not affected (because A does not have NCS) so A would apply a book-value method.
- A8. As paragraph 19 notes, the IASB has not yet deliberated transitory control and will consider the risk of structuring opportunities when deliberating transitory control.

Structuring opportunity applying the acquisition method

Illustrative scenario IV—Deciding which entity is the acquirer

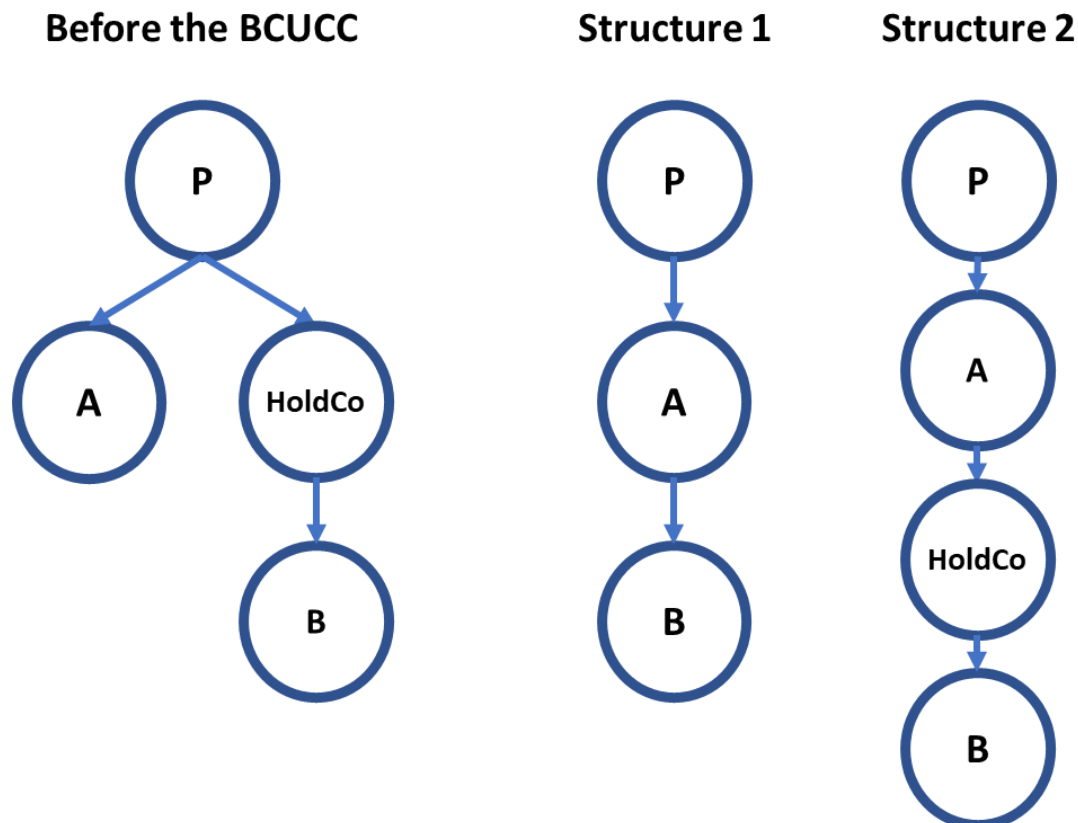


- A9. Structure 1 shows a BCUCC with Entity A acquiring Entity B and Structure 2 shows a BCUCC with Entity B acquiring Entity A. In this scenario we assume:
- the acquisition method would apply to both structures (for example, applying the IASB's preliminary views both structures are BCUCCs that affect NCS); and⁷
 - neither structure is a reverse acquisition applying IFRS 3's guidance on identifying the acquirer.
- A10. Structure 1 would result in Entity A applying the acquisition method to its acquisition of Entity B—Entity A's assets would remain at book value and Entity B's assets (including previously unrecognised identifiable assets) would be recognised at fair value. Structure 2 would result in Entity B applying the acquisition method to its acquisition of Entity A—Entity B's assets would remain at book value and Entity A's assets (including previously unrecognised identifiable assets) would be recognised at fair value.

⁷ Paragraph 25 notes that we think these structuring opportunities would be particularly relevant if the acquisition method applied to BCUCCs between wholly-owned entities. If a BCUCC affects NCS, the transaction will affect the ultimate ownership interests of NCS and the controlling party, which would restrict structuring opportunities.

Structuring opportunity applying a book-value method

Illustrative scenario V—Deciding which entity is transferred



- A11. B has net assets with a carrying amount of CU80 in its financial statements. When P originally acquired B, a few years ago, B was acquired by HoldCo, a holding company. In HoldCo's consolidated financial statements, the net assets of B have a carrying amount of CU100.
- A12. In Structure 1, B is transferred to A directly—applying the IASB's preliminary views A would recognise the transferred business's assets at CU80. In Structure 2, HoldCo (including its subsidiary B) is transferred to A—depending on the IASB's future decisions, A might be required to recognise B's net assets at HoldCo's carrying amounts of CU100.⁸

⁸ The IASB has not yet deliberated which book values the receiving entity should use to measure the assets and liabilities received when applying a book-value method. The IASB's preliminary view in the Discussion Paper was to use the transferred company's book values but the Discussion Paper only considered simple situations where the transferred company was a single company.