

# ACCOUNTING AND TAX IMPLICATIONS IN ACQUISITION OF A SUBSIDIARY THAT IS NOT A BUSINESS COMBINATION

## Implicações Contábeis e Fiscais em Aquisição de Controlada que não Constitui Combinação de Negócios

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ments on net assets acquired and goodwill. The paper is relevant given the recurrent tax assessments of companies that realize the goodwill tax deduction after incorporation, merger, or spin-off of the acquiree, according to Law 12,973. The matter addressed in the paper, not yet discussed in the literature, materializes an additional tax risk to the companies, which the paper seeks to clarify. The article contributes to companies presenting a model to mitigate the tax risks on the operation. It also presents contributions to the regulators, providing inputs for a future review of the legal provisions. **Keywords:** business combination, goodwill tax deduction, Law 12,973, investments in subsidiaries, consolidated financial statements.

### RESUMO

Este artigo discorre sobre as implicações contábeis e fiscais de operação de aquisição de controle sobre outras entidades tratada como aquisição de ativos, em vez de combinação de negócios, por força do CPC 15. A legislação vigente disciplina o tratamento fiscal apenas quando a operação é uma combinação de negócios, originando mais ou menos-valia e ágio. O artigo é relevante dadas as recorrentes autuações fiscais de empresas que tomam dedutibilidade do ágio originado em combinações de negócios após incorporação, fusão ou cisão da adquirida, conforme permitido pela Lei nº 12.973. A matéria aqui abordada, ainda não debatida na literatura, origina um risco tributário adicional às empresas, o qual o trabalho busca clarificar. O artigo contribui com empresas ao apresentar um modelo para mitigar os riscos tributários inerentes à operação. Também apresenta contribuições aos reguladores contábeis e tributários, fornecendo insumos para uma futura revisão dos dispositivos legais.

**Palavras-chave:** combinação de negócios, aproveitamento tributário do ágio, Lei nº 12.973, investimentos em controladas, demonstrações contábeis consolidadas.

### ABSTRACT

This article discusses the accounting and tax implications in operation of acquisition of control over other entities treated as acquisition of assets, instead of business combination, according to CPC 15. Current legislation clarifies tax treatment only when the operation is a business combination, resulting in fair value adjust-

### 1. INTRODUCTION

Brazil began the process of convergence to international accounting standards in 2008 through Law No. 11,638 (KLANN; BEUREN, 2015). Such standards are notably related to the consolidated financial statements (SARQUIS; SANTOS, 2021; VIEIRA, 2018). However, since taxation in the country occurs by legal entity, "there are many gaps in tax legislation and the pressing need to develop accounting guidelines aimed at accommodating peculiarities observed in Individual Financial Statements" (VIEIRA, 2018, p. 616, translated from Portuguese). This thought is corroborated by Sarquis and Santos (2021, p. 391, Translated from Portuguese), according to whom "there are some difficulties in implementing certain accounting treatments provided for in IFRS [international accounting standards] in our individual financial statements, which may require specific adaptations".

CPC 15 (COMITÊ DE PRONUNCIAMENTOS CONTÁBEIS [CPC], 2011), a rule that deals with business combinations, is clearly concerned with the consolidated financial statements of parent companies and subsidiaries. This standard determines that a transaction that results in the acquisition of control of another entity must be treated as a business combination only if it meets the definition of business set forth in its wording. Otherwise, it must be accounted for as an acquisition of assets. Rashty (2022) points out that while the business combination is recognized based on the fair value model, the acquisition of assets is accounted for based on the cost model. However, the tax legislation provided in its wording only how transactions that are classified as business combinations should be treated, not disciplining the treatment of transactions computed as acquisition of assets.

Thus, the present work aims to fill this gap, discussing the conflicts between tax legislation and the

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accounting rules for the acquisition of control operations that are treated as acquisition of assets, rather than business combination. The tax risks arising from these operations are pointed out in the face of the current tax legislation and how these risks can be mitigated. To this end, an accounting model is proposed to accommodate the tax requirements in the individual financial statements, without prejudice to the consolidated financial statements, in which the economic essence of the transaction prevails over its legal form, a principle defended by Iudicibus (2007) and Mello and Salotti (2013).

The work is structured in the form of an essay, which "transcends the critical review of the results of other people's works, but serves for the essayist to expose critical and reflective issues" (SOARES; PICOLLI; CASAGRANDE, 2018, p. 335, translated from Portuguese), being "a means of analysis and elucubrations in relation to the object, regardless of its nature or characteristic" (MENEGHETTI, 2011, p. 323, translated from Portuguese). It is intended to contribute to the literature on the dissonances between accounting for corporate purposes and accounting for tax purposes, specifically with regard to the deductibility of goodwill, a matter that has generated recurrent assessments due to adverse understandings of the tax authorities regarding the merits of the deductions made by companies (ZUGMAN, 2016; OLIVON, 2022).

## 2. CONTROL OBTAINED: BUSINESS COMBINATION OR ASSET ACQUISITION?

On December 12, 2017, the *International Accounting Board* (IASB) finalized an *amendment* to IFRS 3 amending the definition of business combination, effective January 1, 2020 (DELOITTE, 2018). The CPC mirrored this change in CPC 15 through the report of the public hearing for the review of technical pronouncements No. 14 (CPC, 2019), dated November 1, 2019, with effect also from January 1, 2020. This revision narrowed the definition of business combination (GRANT THORNTON, 2019). Consequently, an increase in transactions accounted for as asset acquisitions rather than business combinations is expected (PRICEWATERHOUSECOOPERS [PWC], 2019).

According to CPC 15 (CPC, 2011, p. 23, translated from Portuguese, emphasis added), "Business combination is an operation or other event in which **an acquirer obtains control of**

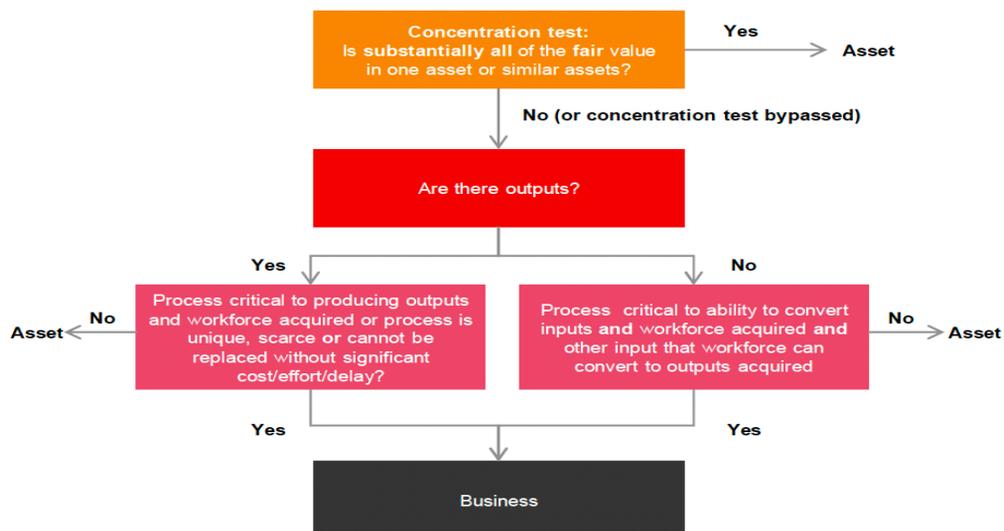
**one or more businesses**, regardless of the legal form of the transaction". Item 3 of the same standard determines that the entity must assess whether the control obtained constitutes a business, and "if the acquired assets **do not constitute a business**, the entity must account for the operation or event as an **acquisition of assets**" (CPC, 2011, p. 3, translated from Portuguese, emphasis added).

CPC 15 (CPC, 2011, p. 23, translated from Portuguese) defines "business" as "an integrated set of activities and assets capable of being conducted and managed with the objective of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities". Items B5 to B12D of CPC 15 (CPC, 2011), as amended in this revision, provide guidance for companies to determine whether a transaction that results in obtaining control over another company meets the definition of a business. This standard addresses the concepts of inputs, processes and outputs to qualify the acquired company as a business.

Although businesses usually present outputs, this attribute is not mandatory, and it is crucial that the company has "at least the input and the substantive process that together contribute significantly to the ability to generate output" (CPC, 2011, p. 29, translated from Portuguese). According to item B7 of CPC 15 (CPC, 2011), Inputs refer to economic resources that contribute to generating outputs; processes refer to systems, standards, protocols, conventions, or rules that, when applied to inputs, generate or have the capacity to generate outputs; and outputs are the result of inputs and processes applied to them, which culminate in the supply of goods or services to customers, investment income or other incomes of ordinary activities.

Given the complexity of qualitatively assessing whether the transaction meets the parameters of the business combination, CPC 15 (CPC, 2011) provides, in its items B7A and B7B, an optional quantitative test called "concentration test". This test "is met if, substantively, the entire fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets" (CPC, 2011, p. 27, translated from Portuguese). In this case, the conclusion will be that the transaction does not constitute a business and any qualitative assessment of inputs, processes and outputs will not be necessary. Figure 1 presents a flowchart to classify the operation:

Figure 1 - Flowchart for classifying the operation as a business combination or asset acquisition.



Source: PWC (2019, p. 1).

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In practical terms, the non-identification of a business implies that the acquirer will compute the transaction at the cost, accounting the book value of assets acquired and the liabilities assumed, with no goodwill or capital gain (CPC, 2011). If the transaction is classified as a business combination, it must be accounted for by the acquisition method. Such a method requires the revaluation of the assets and liabilities of the acquired company at fair value, the recognition of the consideration transferred in exchange for control also at fair value, including any contingent considerations, in addition to additional procedures that may result, in the end, in goodwill for expectation of future profitability or in capital gain (CPC, 2011). The operationalization of the acquisition method is known as "purchase price allocation" (PPA).

A search in the "ProQuest" database using the term "aquisição de ativos", with the "relatório" filter as the document type, did not return financial statements of Brazilian publicly traded companies that have disclosed acquisition of control operations as acquisition of assets. However, research with the term "asset acquisition" on the same basis returned financial statements of foreign companies that recorded operations as acquisition of assets instead of business combination. The Australian company Northern Star Resources Limited (2021) is an example. The company disclosed in its explanatory note No. 13 of the financial statements for the year 2021 an acquisition of a 100% interest in another company that did not qualify as a business combination, in which an asset

Named "exploration and evaluation asset" was the main asset acquired. Another example is Exact Sciences Corporation (2022), which disclosed in explanatory note No. 19 of the financial statements for the year 2021 one operation in 2021 and two operations in 2020 treated as acquisition of assets, whose amount paid was substantially concentrated in a technology intangible (in line with the elucidative example presented in chapter 4 of this work).

### 3. RECOGNITION OF AN OPERATION THAT CONSTITUTES A BUSINESS TRANSACTION

It should be assumed that  $\alpha$  acquired 100% equity interest in  $\beta$  for R\$ 100,000, with its own resources kept in cash and equivalents. In addition to the investment in  $\beta$ , the balances of other  $\alpha$  activities, including cash and cash equivalents, total R\$700,000 and its liabilities amount to R\$300,000.

If the acquirer ( $\alpha$ ) concludes that the transaction constitutes a business, it must account for it by the acquisition method, i.e., allocate the purchase price (PPA) of the acquired company ( $\beta$ ). Assume that the assets, liabilities and shareholders' equity of  $\beta$  on the date of acquisition were R\$ 16,000, R\$ 5,000 and R\$ 11,000, respectively. The  $\beta$  technology (software), not computed in its financial statements, was calculated at R\$ 80,000, at fair value, by an independent expert hired by  $\alpha$ . The local rate of taxes on profit is 34%. Table 1 illustrates the allocation of the purchase price of the operation:

**Table 1** – Allocation of the purchase price of the transaction

[a]	$\beta$ 's equity at book value		11,000
[b]	Fair value adjustment on assets of $\beta$ (software)	80,000	
[c]	Deferred tax liability (34% of 80,000)	(27,200)	
[b] – [c] = [d]	Net fair value adjustment on $\beta$		52,800
[a] + [d] = [e]	Net assets acquired from $\beta$		<b>63,800</b>
[f]	Value paid by $\alpha$ in the acquisition of $\beta$		100,000
[f] – [e] = [g]	Goodwill		<b>36,200</b>

Source: Prepared by the authors.

CPC 18 (CPC, 2012a) determines that investments in subsidiaries are, for the purposes of individual financial statements, initially recognized at cost and, subsequently, adjusted for reflex effects to movements in the shareholders' equity of the acquired company, a method called "equity pick-up". On the other hand, CPC 36 (CPC, 2012b) requires the presentation of consolidated financial statements of parent companies and subsidiaries, and in these statements the investment recorded in the individual statements is eliminated in consideration of the subsidiary's shareholders' equity, as disciplined in item B86(c) of said standard, and goodwill is reclassified to intangible assets (Gelbcke *et al.*, 2021; CPC, 2014).

According to CPC 36 (CPC, 2012b, p. 3, Translated from Portuguese, emphasis added):

5. The investor, **regardless of the nature of its involvement with the (investee) entity**, must determine whether it is a controlling shareholder by evaluating whether it controls the investee.

6. An investor controls an investment when they are exposed to, or have rights to, an investment regarding variable returns

arising from their involvement with the investee, they have the ability to affect those returns through their power over the investee.

The text of item 5 determines that the control must be verified regardless of the investor's involvement with the investee. This leads to the interpretation that control should be evaluated both whether the transaction qualifies as a business combination and as an acquisition of assets. Item 6, on the other hand, defines the criteria for qualifying an investee as controlled, and the existence of power over it is crucial. A company that acquires equity interest in another may exercise control over the acquired company, regardless of whether the transaction is classified as a business combination or asset acquisition.

Based on the foregoing considerations, Tables 2 and 3 illustrate the accounting treatment of the acquisition of  $\beta$   $\alpha$  if the transaction is classified as a business combination, both from the perspective of individual  $\alpha$  financial statements and consolidated financial statements of  $\alpha$  and  $\beta$ :

**Table 2** – Accounting for the transaction, if classified as a business combination

View	Account	Debit	Credit
Individual financial statements	Investment in $\beta$ – Book value	11,000	
	Investment in $\beta$ – Fair value adjustment	52,800	
	Investment in $\beta$ – Goodwill	36,200	
	Cash and cash equivalents		100,000
		<b>100,000</b>	<b>100,000</b>
Consolidated financial statements	Miscellaneous assets	16,000	
	Intangible – Software	80,000	
	Intangible – Goodwill	36,200	
	Miscellaneous liabilities		5,000
	Deferred tax liability		27,200
	Cash and cash equivalents		100,000
		<b>132,200</b>	<b>132,200</b>

Source: Prepared by the authors.

**Table 3** – Balance sheet after the transaction, if classified as a business combination

	$\alpha$	$\beta$	$\beta$ ' PPA <sup>1</sup>	Consolidation adjustments	Consolidated
Miscellaneous assets	700,000	16,000	–	–	716,000
Investments in subsidiaries	100,000	–	–	(100,000)	–
<i>Book value</i>	<i>11,000</i>	–	–	<i>(11,000)</i>	–
<i>Fair value adjustment</i>	<i>52,800</i>	–	–	<i>(52,800)</i>	–
<i>Goodwill</i>	<i>36,200</i>	–	–	<i>(36,200)</i>	–
Intangible – Software	–	–	80,000	–	80,000
Intangible – Goodwill	–	–	–	36,200	36,200
<b>Total assets</b>	<b>800,000</b>	<b>16,000</b>	<b>80,000</b>	<b>(63,800)</b>	<b>832,200</b>
Miscellaneous liabilities	300,000	5,000	–	–	305,000
Deferred tax liability	–	–	27,200	–	27,200
Equity	500,000	11,000	52,800	(63,800)	500,000
<b>Total liabilities + equity</b>	<b>800,000</b>	<b>16,000</b>	<b>80,000</b>	<b>(63,800)</b>	<b>832,200</b>

Note: <sup>1</sup> purchase price allocation.

Source: Prepared by the authors.

As can be seen, the transaction is accounted for as a controlled investment in the individual financial statements of  $\alpha$  at the acquisition cost of R\$ 100,000, in accordance with CPC 18 (CPC, 2012a). The splitting of the investment into sub-accounts is to comply with tax legislation, as discussed later in chapter 5. For the purposes of consolidated financial statements, the acquirer must  $\alpha$  follow the prerogatives of CPC 15 (CPC, 2011), accounting for the transaction by the acquisition method, whose effects are made possible by the consolidation procedure governed by CPC 36 (CPC, 2012b), consisting of the combination of the balance sheets of  $\alpha$  and  $\beta$ , including the extra-accounting balance sheet originated from the PPA, and in the pertinent deletions.

#### 4. RECOGNITION OF THE TRANSACTION AS AN ACQUISITION OF ASSETS

It should now be considered that  $\alpha$  acquired the entire capital of  $\beta$  exclusively by virtue of the technology (software) designed by it, which is still in the embryonic stage and will have its development continued for  $\alpha$  after the acquisition for large-scale offer to its customers, when completed. The acquirer has  $\alpha$  carried out the concentration test, which indicated that the acquired assets are substantially concentrated

in the intangible technology asset (software), in addition to the pre-existing assets and passives of  $\beta$ , acquired and assumed by  $\alpha$  upon obtaining control.

In the individual financial statements, the operation is normally accounted for as an investment in a subsidiary. But

in the consolidation process, given by CPC 36 (CPC, 2012b),  $\alpha$  will account for the specific assets acquired and the liabilities assumed in  $\beta$ , as provided for in CPC 15 (CPC, 2011) for operations treated as acquisition of assets. Tables 4 and 5 illustrate the applicable accounting effects:

**Table 4 – Accounting for the operation, if classified as acquisition of assets**

Vision	Account	Debit	Credit
Individual financial statements	Investment in $\beta$	100,000	
	Cash and cash equivalents		100,000
		100,000	100,000
Consolidated financial statements	Miscellaneous assets	16,000	
	Software	89,000	
	Miscellaneous liabilities		5,000
	Cash and cash equivalents		100,000
		105,000	105,000

Source: Prepared by the authors.

**Table 5 – Balance sheet after the transaction, if classified as an asset acquisition.**

	$\alpha$	$\beta$	Consolidation adjustments	Consolidated
Miscellaneous assets	700,000	16,000	–	716,000
Investments in subsidiaries	100,000	–	(100,000)	–
Intangible – Software	–	–	89,000	89,000
<b>Total assets</b>	<b>800,000</b>	<b>16,000</b>	<b>(11,000)</b>	<b>805,000</b>
Miscellaneous liabilities	300,000	5,000	–	305,000
Equity	500,000	11,000	(11,000)	500,000
<b>Total liabilities + equity</b>	<b>800,000</b>	<b>16,000</b>	<b>(11,000)</b>	<b>805,000</b>

Source: Prepared by the authors.

It can be seen that if the transaction is classified as an acquisition of assets, instead of a business combination, there is no *a priori* segregation of the investment in the subaccounts of net equity, capital gains or losses and goodwill in the individual financial statements, given that the calculation of these last two values occurs only when the acquisition method inherent to the business combination is applied. For the purposes of consolidated financial statements, the specific assets acquired and the liabilities assumed are accounted for, i.e., R\$ 16,000 of assets already existing in  $\beta$  acquired by  $\alpha$ , R\$ 5,000 of  $\beta$  liabilities assumed by  $\alpha$  and the technology acquired of R\$ 89,000 (R\$ 100,000 paid minus R\$ 11,000 of net value of assets (R\$ 16,000) and liabilities (R\$ 5,000) preexisting in  $\beta$ ). No goodwill or capital gain is recognized.

### 5. Table 5 – Balance sheet after the transaction, if classified as an asset acquisition.

Article 22 of Law No. 12,973 (BRASIL, 2014, translated from Portuguese, emphasis added) defines the treatment for the tax use of goodwill:

Article 22. The legal entity that absorbs assets from another, by virtue of **incorporation, merger or spin-off**, in which it held

equity interest acquired with goodwill resulting from the **acquisition of a social interest between non-dependent parties**, calculated in accordance with the provisions of item III of the caput of article 20 of Decree-Law No. 1,598, of December 26, 1977, may **be excluded for the purposes of calculating the actual profit** of the calculation periods subsequent the balance of said goodwill existing in the accounting on the date of acquisition of the equity interest, at the **rate of 1/60** (one sixtieth), at most, for each month of the calculation period.

It is necessary that the operation has taken place between non-dependent parties. The tax use is conditioned to the event of incorporation, merger or spin-off of the acquired by the acquirer. The exclusion of goodwill in the calculation of taxes on profit must occur in the 60 months following this event, or in a period longer, but not less than 60 months due to the limit of 1/60 (one sixtieth) stipulated by the tax legislation.

Article 20 of Decree-Law No. 1,598 (BRASIL, 1977, translated from Portuguese, emphasis added) establishes some criteria for the use of goodwill to be operationalized:

Article 20. The taxpayer who **evaluates the investment by the value of shareholders' equity** must, at the time of the acquisition of the interest, **split the acquisition cost into:**

I - net asset value at the time of acquisition, determined in accordance with the provisions of article 21; and

II - surplus or deficit, which corresponds to the difference between the fair value of the investee's net assets, in proportion to the percentage of the acquired stake, and the value referred to in item I of the main clause; and

III - goodwill, which corresponds to the difference between the acquisition cost of the investment and the sum of the values referred to in items I and II of the main clause.

§ 1º The amounts referred to in items I to III of the main clause will be recorded in separate sub-accounts.

§ 3º The value referred to in item II of the heading must be based on a report prepared by an independent expert, which must be filed with the Brazilian Federal Revenue Service or whose summary must be registered in the Registry of Deeds and Documents, by the last business day of the 13th (thirteenth) month following the acquisition of the shareholding.

The main criterion is the preparation of an appraisal report of the net assets acquired at fair value by an independent expert and, consequently, the accounting of the investment in different sub-accounts – net equity value, capital gains and goodwill. Therefore, the scenario in which obtaining control over another company is a business combination is considered, since it is on this occasion that the figure of capital gain or loss and goodwill arises. Thus, it is noted that the tax legislation was inspired by the wording of CPC 15 (CPC, 2011) regarding operations that constitute a business. However, the scenario of treating the transaction as an acquisition of assets, rather than a business combination, was not addressed by the tax legislation.

In the case of transactions classified as acquisition of assets, the practical problem arises that there is not, *a priori*, the preparation of the PPA report by an independent expert and the registration of the transaction in different investment subaccounts (value of net equity, capital gain or loss and goodwill), *sine qua non* conditions for the acquirer to be entitled to the tax use of goodwill after incorporation, merger or spin-off of the acquired company.

It should be noted that international accounting standards are based on the idea of economic group, therefore turn to consolidated financial statements (SARQUIS; SANTOS, 2021; VIEIRA, 2018). This may explain the fact that the tax authorities consider the possibility of an acquisition of equity interest between unrelated parties only when it is configured as a business combination, considering that the prerogatives related to capital gains and goodwill derive from the general rule stipulated by CPC 15 (CPC, 2011), rule clearly aimed at the consolidated financial statements of parent and subsidiary.

Zugman (2016) and Olivon (2022) ratify the growing tax assessments on the tax use of goodwill originated in business combinations. Consequently, there is a great risk of disallowance on the part of the tax authorities of any tax use of goodwill by a company that classifies the acquisition of equity interest as acquisition of assets, considering that, as the example discussed in chapter 4, the accounting record of the operation would not give rise to the allocation of the purchase price and, consequently, the investment would not be accounted for in subaccounts of the value of equity, capital gains or losses and goodwill, unlike the example discussed in Chapter 3, in which the transaction constitutes a business combination.

If the acquirer were to compute the transaction as an acquisition of assets directly in its individual financial statements to deduct from taxable income the depreciation or amortization of the acquired assets, there would be inconsistencies both from an accounting and tax perspective. From an accounting point of view, because there are two rules that govern the treatment of the transaction, namely, CPC 18 (CPC, 2012a), which requires the registration of the transaction as an investment in subsidiaries in individual accounting statements, and CPC 15 (CPC, 2011), which requires the registration of the transaction as a business combination or acquisition of assets. This is due to the consolidated financial statements. From a tax perspective, the treatment of the transaction as acquisition of assets is not regulated by the applicable legislation, which entails the risk of disallowance by the tax authorities of any deduction of depreciation or amortization of the assets acquired by obtaining control of the acquired company.

In addition, a strong argument for the disallowance may be that the company has used the accounting standard to simplify and accelerate the process of tax deductibility of the acquisition, since it is not necessary to prepare a report and the incorporation, merger or spin-off. It should be emphasized that taxation in Brazil is carried out by a legal entity, that is, based on the individual financial statements, a one-of-a-kind thing in relation to what is observed internationally (MARTINS, 2021), and it is up to the companies to prepare the individual financial statements from the view of an economic group (consolidated financial statements) recommended by international standards to comply with tax legislation (VIEIRA, 2018).

## 6. PROPOSAL OF A MODEL TO MEET ACCOUNTING AND TAX REQUIREMENTS

As previously discussed, in order to be entitled to the tax benefit of goodwill recommended by Law No. 12,973 (BRASIL, 2014), first, the company must contract the preparation of the purchase price allocation report by an independent expert to comply with paragraph 3 of article 20 of Decree-Law No. 1,598 (BRASIL, 1977), even if for accounting purposes the transaction is not recorded as a business combination. In possession of the values determined in the report, the acquisition cost of the investment would be broken down in the acquirer's individual balance sheet in the subaccounts of net equity, capital gain or loss and goodwill, in compliance with the provisions of items I, II and III of article 20 of Decree-Law No. 1,598 (BRASIL, 1977). In the consolidated balance sheet, the report would not have any effect since the transaction does not constitute a business combination from an accounting point of view, in accordance with CPC 15 (CPC, 2011), so that the company would proceed with the registration of the transaction as an acquisition of assets, with the pertinent adjustments on the individual balance sheet. Applying this rationale to the example presented in chapter 4, we would have the accounting effects presented in Tables 6 and 7:

**Table 6 – Accounting for the transaction, if classified as an acquisition of assets – suggestion**

Visão	Account	Debit	Credit
Individual financial statements	Investment in $\beta$ – Book value	11,000	
	Investment in $\beta$ – Fair value adjustment	52,800	
	Investment in $\beta$ – Goodwill	36,200	
	Cash and cash equivalents		100,000
		<b>100,000</b>	<b>100,000</b>
Financial statements consolidated	Miscellaneous assets	16,000	
	Software	89,000	
	Miscellaneous liabilities		5,000
	Cash and cash equivalents		100,000
		<b>105,000</b>	<b>105,000</b>

Source: Prepared by the authors.

**Table 7 – Balance sheet after the transaction, if classified as an asset acquisition – suggestion**

	$\alpha$	$\beta$	Consolidation adjustments	Consolidated
Miscellaneous assets	700,000	16,000	–	716,000
Investments in subsidiaries	100,000	–	(100,000)	–
<i>Book Value</i>	<i>11,000</i>	–	<i>(11,000)</i>	–
<i>Fair value adjustment</i>	<i>52,800</i>	–	<i>(52,800)</i>	–
<i>Goodwill</i>	<i>36,200</i>	–	<i>(36,200)</i>	–
Intangible – Software	–	–	89,000	89,000
<b>Total assets</b>	<b>800,000</b>	<b>16,000</b>	<b>(11,000)</b>	<b>805,000</b>
Miscellaneous liabilities	300,000	5,000	–	305,000
Equity	500,000	11,000	(11,000)	500,000
<b>Total liabilities + equity</b>	<b>800,000</b>	<b>16,000</b>	<b>(11,000)</b>	<b>805,000</b>

Source: Prepared by the authors.

It should be noted that such a solution does not eliminate the existing conflict between tax and accounting legislation, since the capital gain or loss and goodwill calculated in the report would not appear in the consolidated financial statements due to the non-characterization of the business, in accordance with CPC 15 (CPC, 2011). However, the suggested solution brings the transaction into compliance with the requirements of the tax legislation with a view to not invalidating the tax use of the underlying "tax goodwill", reducing, if not the risk of tax assessment, the legitimacy of any challenge by the tax authorities for non-compliance with the above requirements for such use.

## 7. EMERGENCE OF DIFFERENCES BETWEEN INDIVIDUAL AND CONSOLIDATED FINANCIAL STATEMENTS

According to Martins (2021), there is an "obsession" for individual financial statements prepared by Brazilian companies to present the same net result and net equity as consolidated financial statements. Gelbcke *et al.* (2021) point out the strict relationship between individual and consolidated accounting statements. Equity is nothing more than a "consolidation of a

line only", because the parent company brings to its balance sheet, in the "investment in subsidiaries" account, its share of the acquired company's net assets, and to its statement of income for the year, in the "equity pick-up gain or loss" line, its share of the acquired company's income (Gelbcke *et al.*, 2021). Martins (2021) points out that individual financial statements are extremely important in Latin countries, especially in Brazil, which culminated in the issuance of Technical Interpretation No. 09 (ICPC 09) by the CPC to elucidate accounting statements in individual and consolidated financial statements by Brazilian companies. This rule discusses the rationale of simplified consolidation by the equity method and the rationale of equality of equity and net income between the individual and consolidated financial statements:

11. In this sense, it should be remembered, first, that equity corresponds to a simplified form of consolidation; Through it, the value not of each asset and each liability of the invested entity is consolidated in the investor's assets, but only its net assets (net equity), constituting the book value

of the investment and determined by the investor's effective participation in the investee's net equity; and it is consolidated in the investor's result not each income and each expense of the investee, but only the part of the net income belonging to the investor in a single line. It is also recognized in the investor's investment on a consolidated basis (and not in each of its assets and liabilities) the investor's share in each comprehensive result recorded by the investee. Thus, equity and consolidation of financial statements are different views of the consolidation process of two or more entities, but with practically equal effects on the final value of the investor's shareholders' equity and net income. Therefore, they are based on the same objective of consolidation, but showing their effects one in a simplified way, the other in an integral way (CPC, 2014, p. 6, Translated from Portuguese).

However, treating a takeover transaction as an asset acquisition, rather than a business combination, would result in a difference in the individual versus consolidated equity and income values from the moment the acquired assets begin to be depreciated or amortized, affecting the consolidated financial statements, while in the individual financial statements the equity method is applied to adjust the investment balance to reflect the equity movements of the subsidiary. For practical purposes, let's consider that the intangible asset "software" of R\$ 89,000, discussed in chapters 4 and 6, has a useful life of 120 months. After one month, the acquired company ( $\beta$ ) reported revenues of R\$ 1,200 and expenses of R\$ 950, all on credit and resulting from transactions with third parties, resulting in a net profit of R\$ 250. The parent company  $\alpha$  did not carry out any operations. Based on this data,  $\alpha$  will record in its individual financial statements the equity method accounting of 100% of the profit earned by  $\beta$  of R\$ 250. Regarding the consolidated financial statements, the amortization of the intangible asset will be recorded in the amount of R\$ 742 (R\$ 89,000  $\div$  120 months). Tables 8 and 9 present these effects:

**Table 8 – Accounting after 1 month**

Vision	Account	Debit	Credit
Individual financial statements	Investment in $\beta$ – Book value	250	
	Equity pick-up revenue		250
		<b>250</b>	<b>250</b>
Consolidated financial statements	Amortization expense	742	
	(-) Accumulated software amortization		742
		<b>742</b>	<b>742</b>

**Source:** Prepared by the authors.

**Table 9 – Balance sheet and income statement after 1 month**

Balance sheet				
	$\alpha$	$\beta$	Consolidation adjustments	Consolidated
Miscellaneous assets	700,000	17,200	–	717,200
Investments in subsidiaries	100,250	–	(100,250)	–
<i>Book value</i>	11,250	–	(11,250)	–
<i>Fair value adjustment</i>	52,800	–	(52,800)	–
<i>Goodwill</i>	36,200	–	(36,200)	–
Intangible – Software	–	–	89,000	89,000
(-) Accumulated software amortization	–	–	(742)	(742)
<b>Total assets</b>	<b>800,250</b>	<b>17,200</b>	<b>(11,992)</b>	<b>805,458</b>
Miscellaneous liabilities	300,000	5,950	–	305,950
Equity	500,250	11,250	(11,992)	499,508
<b>Total liabilities + equity</b>	<b>800,250</b>	<b>17,200</b>	<b>(11,992)</b>	<b>805,458</b>

Income statement for the year				
	$\alpha$	$\beta$	Consolidation adjustments	Consolidated
Miscellaneous revenues	–	1,200	–	1,200
Miscellaneous expenses	–	(950)	–	(950)
Equity pick-up revenue	250	–	(250)	–
Amortization expense	–	–	(742)	(742)
<b>Net income</b>	<b>250</b>	<b>250</b>	<b>(992)</b>	<b>(492)</b>

Source: Prepared by the authors.

It is noted that  $\alpha$ 's individual net worth increased by R\$ 500,000 (Tables 5 and 7) at initial recognition to R\$ 500,250 (Table 9) after 1 month, due to the equity on the result of  $\beta$ , computed as an increase in the Miscellaneous income investment in return for revenue. For the purposes of consolidated financial statements, the investment balance (-R\$ 100,250) is eliminated and the acquired asset (+R\$ 89,000) and its amortization (-R\$ 742) are computed, resulting in a net adjustment of -R\$ 11,992 in assets. The counterpart of this adjustment is broken down in shareholders' equity in two amounts: elimination of  $\beta$  shareholders' equity (-R\$11,250) and reduction of consolidated shareholders' equity by amortization expense (-R\$742), totaling an adjustment of -R\$11,992. As a result, there is a difference of exactly R\$ 742 between individual (R\$ 500,250) and consolidated (R\$ 499,508) shareholders' equity. This same difference also occurs between the individual result (R\$ 250 of profit, resulting from the result of equity on  $\beta$  computed by  $\alpha$ ) and consolidated (R\$ 492 of loss, originating from R\$ 1,200 of revenues and R\$ 950 of  $\beta$  expenses consolidated by  $\alpha$ , and of the expense of R\$ 742 related to the amortization of the *software* acquired).

A solution for the individual shareholders' equity and net income to be equivalent to the consolidated ones would be to incorporate the amortization of the acquired assets (in the example, the software) into the calculation of the equity. This occurs in a manner analogous to the treatment in a business combination, in which equity is calculated based on the variations in capital gain or loss resulting from the remeasurement of the assets and liabilities of the acquired company at fair value, as provided for in items 18 to 34 of ICPC 09 (CPC, 2014). Thus, equity would be an expense in the amount of R\$ 492 (R\$ 250 of profit of  $\beta$  minus R\$ 742 of amortization of the software acquired). However, this is only a conjecture based on the premise of equality of equity and net income in the individual and consolidated financial statements, given that such treatment, when the transaction is classified as an acquisition of assets, and not as a business combination, is not currently regulated, either in ICPC 09 (CPC, 2014) or in other accounting standards. Tables 10 and 11 illustrate the above:

**Table 10** – Accounting after 1 month assuming equality of equity and profit in the financial statements individual and consolidated

Vision	Account	Debit	Credit
Individual financial statements	Equity pick-up expense	492	
	Investment in $\beta$ – Book value		492
		<b>492</b>	<b>492</b>
Consolidated financial statements	Amortization expense	742	
	(-) Accumulated software amortization		742
		<b>742</b>	<b>742</b>

Source: Prepared by the authors.

**Table 11** – Balance sheet and income statement after 1 month assuming equality of equity and income in the individual and consolidated financial statements

Balance sheet				
	$\alpha$	$\beta$	Consolidation adjustments	Consolidated
Miscellaneous assets	700,000	17,200	–	717,200
Investments in subsidiaries	99,508	–	(99,508)	–
<i>Book value</i>	10,508	–	(10,508)	–
<i>Fair value adjustment</i>	52,800	–	(52,800)	–
<i>Goodwill</i>	36,200	–	(36,200)	–
Intangible – Software	–	–	89,000	89,000
(-) Accumulated software amortization	–	–	(742)	(742)
<b>Total assets</b>	<b>799,508</b>	<b>17,200</b>	<b>(11,250)</b>	<b>805,458</b>

Miscellaneous liabilities	300,000	5,950	–	305,950
Equity	499,508	11,250	(11,250)	499,508
<b>Total liabilities + equity</b>	<b>799,508</b>	<b>17,200</b>	<b>(11,250)</b>	<b>805,458</b>

Statement of income for the fiscal year				
	α	β	Consolidation adjustments	Consolidated
Miscellaneous revenues	–	1,200	–	1,200
Miscellaneous expenses	–	(950)	–	(950)
Equity pick-up expense	(492)	–	492	–
Amortization expense	–	–	(742)	(742)
<b>Net income</b>	<b>(492)</b>	<b>250</b>	<b>(250)</b>	<b>(492)</b>

Source: Prepared by the authors.

## 7. FINAL REGARDINGS

This research indicated the existence of a risk of assessment by the tax authority when a transaction that results in the acquisition of control does not qualify as a business combination, but as an acquisition of assets, and the acquirer (i) deducts the "tax goodwill" underlying the transaction after incorporation, merger or spin-off of the acquired company in violation of the legislation, which requires the preparation of the purchase price allocation report by an independent expert and the breakdown of the acquisition cost of the investment in the subaccounts "net equity value", "capital gain or loss" and "goodwill", or (ii) take tax deductibility of the depreciation or amortization expense generated by the acquired assets. On the other hand, accounting for the transaction as a combination of businesses (with capital gains or goodwill) in the consolidated financial statements, with reflections on the investment sub-accounts in the individual financial statements to comply with tax legislation, is inconsistent with CPC 15 (CPC, 2011) when the transaction does not meet the definition of business.

In addition, it was found that the classification of the transaction as an acquisition of assets, rather than a business combination, would result in differences between the shareholders' equity and the result presented in the individual and consolidated financial statements.

This is because, in the individual statements of the acquirer, equity would be recognized based on the result of the acquiree, while in the consolidated statements the depreciation or amortization of the acquired assets would be accounted for.

The tax goodwill originated in a transaction between independent parties, carried out with fairness, which resulted in obtaining control, should not be tainted by an accounting discipline not addressed by the tax legislation. After all, the legal form of the transaction (acquisition of control over another entity, in an operation between non-dependent parties) is the same as that provided for in the legal system, differing only in its economic essence, whose relevance, according to Ludicibus (2007) and Mello and Salotti (2013), is from the accounting regulations. Thus, to remedy this impasse, the paper proposed a model understood as the most appropriate while the tax legislation is not updated to deal with the tax treatment of transactions classified as acquisition of assets, rather than business combinations.

It is hoped that this research will (i) help companies that are faced with the problem addressed here throughout their operations, (ii) foster discussions on the subject, both in the academic and market environments, among accounting and legal professionals, and (iii) demonstrate to regulators the need to discipline the matter so that there are no doubts about the accounting and tax treatments to be followed.

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