HOT TOPIC

Structured Equity Transactions

Important debt-equity considerations

January 2026

Structured equity transactions may raise a number of complex accounting questions including appropriate balance sheet classification of the noncontrolling interest held by a third-party investor.

Access to capital is critical to an entity's operations, but certain transactions to raise new capital often raise complex accounting questions. An increasingly common and significant type of transaction (referred to herein as a 'structured equity transaction') we have seen involves an entity (Corporate Entity) forming a new subsidiary (NewCo) that issues a separate class of shares to a third party (Investor) in exchange for cash. The assets contributed to NewCo, the likelihood that they will generate cash flows, and the timing of any cash flows generated vary depending on the transaction (e.g. an under-construction plant that will manufacture a new product versus existing assets that already generate a steady stream of cash flows).

For purposes of this Hot Topic, assume that Corporate Entity consolidates NewCo (this depends on the specific facts and circumstances, including the rights of Investor). Based on that assumption, the remainder of this Hot Topic focuses on considerations for Corporate Entity in determining the appropriate balance sheet classification of the noncontrolling interest (NCI) in NewCo held by Investor.

The issue

The accounting for debt and equity financing transactions is widely considered one of the most complex topics in US GAAP. Structured equity transactions, as the name implies, are bespoke; in our experience, no two transactions are the same, and while many of the features in structured equity transactions exist individually in other capital transactions, they are typically 'stacked' in structured equity transactions. Said differently, when these features are considered collectively rather than in isolation, it may suggest that Corporate Entity is economically incentivized (or 'compelled') to redeem the NCI at some point in the future. Examples of common features in structured equity transactions are discussed later in this Hot Topic.

Finally, there is often an inherent balancing of interests between what each party is looking for in a structured equity transaction – specifically, Corporate Entity seeks to raise capital and classify the NCI as permanent equity whereas Investor wants to receive a steady return on investment with reduced equity risk, similar to a debt instrument.

Background

For Corporate Entity, the main question to consider is whether to classify the NCI as permanent equity, temporary equity or a liability. The array of accounting literature on financial instruments can be challenging to navigate. In evaluating the appropriate classification of NCI in a structured equity transaction, Corporate Entity primarily focuses on: FASB Accounting Standards Codification (ASC) Topic 480, *Distinguishing Liabilities from Equity*, and paragraph 480-10-S99-3A, which codifies an announcement by the SEC staff at a meeting of the Emerging Issues Task Force (EITF).

FASB Topic 480: Distinguishing Liabilities from Equity

Topic 480 establishes classification and measurement guidance for three classes of freestanding financial instruments with characteristics of both liabilities and equity. Under Topic 480, an instrument reflects an obligation of the issuer if it conditionally or unconditionally obligates the issuer to settle the instrument by transferring assets or by issuing its equity shares in certain circumstances. While Topic 480 applies to three classes of financial instruments, only two are financial instruments in the form of shares. Shares issued do not generally create an obligation of the issuer but may in certain situations. Under Topic 480, shares issued that create an obligation for the issuer could be either:

- a mandatorily redeemable share; or
- an unconditional obligation to settle the instrument in a variable number of shares – e.g. preferred shares of a fixed monetary amount required to be settled in a variable number of common shares.

These instruments are required to be classified as a liability. See section 6 of KPMG Handbook, Debt and equity financing (the KPMG Debt/Equity Guide) for additional guidance related to Topic 480.

Generally, in considering Topic 480 when evaluating whether a potential structured equity transaction represents a liability, we believe an issuer does not consider “economic compulsion”. This is based on paragraph B24 of the Basis for Conclusions of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*.[1] Statement 150 was codified by the FASB in Topic 480.

Generally, we believe economic compulsion should not be considered in determining whether an instrument represents a liability under Topic 480.

ASC 480-10-S99-3A: SEC staff announcement on classification and measurement of redeemable securities

This SEC staff announcement was originally issued as EITF Topic D-98, “Classification and Measurement of Redeemable Securities” and later codified by the FASB in paragraph 480-10-S99-3A. It may require that an issuer present an equity-classified instrument in ‘temporary equity’ (sometimes referred to as ‘mezzanine equity’), which is presented below debt but outside of permanent equity on the balance sheet. This distinction is important so that financial statement users can identify which of the issuer’s equity-classified instruments could result in future cash (or other assets) outflows that are outside the issuer’s control. In determining the classification, we believe an issuer should focus on the contractual rights of each party and the totality of the arrangement. This is discussed further in the next section.

The classification of an equity-classified instrument under paragraph 480-10-S99-3A (the ‘temporary equity guidance’) is summarized as follows.

Permanent equity	Temporary equity
Instruments that the issuer could never be required to redeem in cash	Instruments that the issuer could be required to redeem in cash

See section 7 of the KPMG Debt/Equity Guide for additional guidance related to temporary equity classification including measurement and disclosure requirements.

Common transaction features and interplay with classification guidance

Given the bespoke nature of structured equity transactions, careful analysis of the totality of the arrangement that includes all terms and conditions (regardless of whether pieces of the transaction are separate instruments or embedded within the arrangement) is needed to determine the appropriate classification of NCI on the balance sheet. Note that accounting for separate instruments or units of account within the arrangement may follow other guidance (e.g. Topic 460, *Guarantees*, or Subtopic 815-15, *Derivatives and Hedging – Embedded Derivatives*).

The following table includes common features that may significantly affect the NCI classification determination but is not meant to be an all-inclusive list as each transaction is unique and subject to negotiation. While one of these features alone may not lead to temporary equity or liability classification, it is important to look at all of the features collectively to understand the overall economics of the transaction before concluding on classification.

Feature	Key accounting considerations
Assets held by NewCo	As previously noted, the assets contributed to NewCo, the likelihood those assets will generate cash flows, and the timing of any cash flows generated vary depending on the transaction. Generally speaking, we do not believe the assets owned by NewCo (assuming they are nonfinancial assets) are solely determinative when determining the classification of NCI held by Investor; however, entities should consider remarks at the 2009 AICPA National Conference on Current SEC and PCAOB Developments by a member of the SEC staff related to financial assets. In those remarks, the SEC staff described a bank transferring loans to a consolidated subsidiary. The subsidiary contained only financial assets and did not engage in substantive business activities. The bank then sold senior interests in that subsidiary to outside investors. The SEC staff concluded that sales of interests in the subsidiary should be viewed as transfers of interests in the financial assets themselves and reflected either as a sale or collateralized borrowing rather than as the issuance of an equity interest. The SEC staff reached this conclusion, in part, by analyzing the substance of the overall arrangement and concluding that the arrangement is essentially the transfer of cash flows on financial assets. Therefore, presentation of the arrangement as a collateralized borrowing (liability) if sale accounting criteria were not met under Topic 860, *Transfers and Servicing*, was more appropriate than recognizing NCI. Overall, to the extent the assets held by NewCo are nonfinancial assets, it may not preclude permanent equity classification. Careful analysis is needed if

Feature	Key accounting considerations
	NewCo holds only financial assets and is similar to the situation described in the SEC staff's remarks.
Redemption features (e.g. call and put options)	A complete discussion on evaluating redemption features is beyond the scope of this Hot Topic and readers should consider guidance in sections 6 and 7 of the KPMG Debt/Equity Guide. A key point to remember as it relates to structured equity transactions is that because temporary equity classification hinges on whether redemption of an instrument is beyond the issuer's control, it is necessary to assess an instrument's redemption features. The term 'redemption feature' is not defined in the temporary equity guidance or in Topic 480. However, the stated purpose of the temporary equity guidance is "to highlight the future cash obligations attached to an issued security so as to distinguish it from permanent capital." That is, if there is any chance (regardless of probability) that the reporting entity must provide cash to the instrument holder and cash settlement is not solely within the control of the reporting entity, the equity-classified instrument should be reported as temporary equity. We believe a feature generally must have the following characteristics for it to be a redemption feature: • it triggers the repurchase or the effective cancelation of the instrument, or a portion of it; and • it is settled in cash or other assets. Common examples of redemption features in structured equity transactions are put options held by Investor and/or call options held by Corporate Entity. In many instances, the underlying redemption price varies based on the performance of NewCo and the redemption price may include provisions to ensure that Investor achieves a specified rate of return on its initial investment in NewCo. The redemption price may also be structured such that it decreases based on previous distributions by NewCo and/or may contain a floor. Careful analysis of legal documents is required to identify and understand redemption features. Further, a call option that can be exercised by the issuer, which is normally considered to be within the issuer's control, could be outside the issuer's control based on the interaction of various terms (e.g. Question 7.3.180 of the KPMG Debt/Equity Guide describes a situation in which a class of preferred shareholders can take control of the board on failure to pay required periodic dividends on preferred shares that include a call option). Overall if, in all circumstances, the redemption features are within the control of Corporate Entity or arise only upon an ordinary liquidation event (i.e. an event involving the liquidation and sale of all of NewCo's assets and distribution of the proceeds to all of NewCo's equity instruments on a pro rata basis consistent with their ownership interests), these features may not preclude permanent equity classification.
Distributions rights	When a dividend is declared by an entity's Board of Directors, equity investors are typically entitled to a pro rata share based on their relative ownership percentages. In contrast, structured equity transactions often involve complex distribution provisions with terms such as the following:

Feature	Key accounting considerations
	• distributions each period are mandatory and not subject to declaration by the entity's Board of Directors; • investor receives all distributions first until a specified target rate of return on its original investment is achieved; • distributions are not based on the relative ownership percentages of each investor in the initial periods with the Investor receiving a higher percentage until a specified target rate of return on its original investment is achieved; • distributions represent a 'return of capital' and affect the instrument's redemption amount if it is redeemed; and/or • a dividend pusher feature, e.g. Corporate Entity (or another entity that it controls) is precluded from making distributions to its investors until NewCo makes distributions in accordance with the terms of the structured equity transaction. Collectively, the distribution provisions of the structured equity transaction may act essentially as a partial redemption or guarantee a fixed return for Investor. Whether and when distribution rights give rise to an obligation (e.g. when declared by the Board of Directors or earlier) and whether they give rise to redemption outside the issuer's control should be carefully analyzed. Overall if, in all circumstances, dividends are not mandatory and are declared and paid at the discretion of NewCo's Board of Directors, these features may not preclude permanent equity classification.
Financial guarantees by Corporate Entity	Corporate Entity may agree to provide additional capital contributions to NewCo if NewCo is not able to generate sufficient cash flows through the use of its own assets to fund its operations (e.g. capital expenditures) or provide the specified target rate of return to Investor. If, contractually, Corporate Entity is required to make cash payments in situations outside of its control (e.g. due to adverse business conditions) that are akin to redemption payments, it may result in the NCI being temporary equity classified. Overall if, in all circumstances, Corporate Entity is not required to provide additional funding to NewCo (i.e. NewCo can only request capital contributions from Corporate Entity and Investor), these features may not preclude permanent equity classification.
Drag-along and tag-along rights	'Drag-along' and 'tag-along' rights are common contractual provisions. Upon a contingent event occurring (e.g. a change of control in NewCo) or the passage of time, Investor may have the right to transfer its interests in NewCo either by participating in Corporate Entity's sale of its interests to a third-party or forcing NewCo or Corporate Entity to purchase its holdings. In analyzing these rights, it is important to understand how they are triggered (i.e. is the event outside of the control of Corporate Entity), what would be sold (e.g. is it the entire entity or only one investor's shares), the sale price including whether Corporate Entity would need to provide any consideration to Investor, and which entity is required to make the payment. Overall if, in all circumstances, all shares would be sold to a third party for their then-current fair value with the proceeds

Feature	Key accounting considerations
	allocated to investors on a pro rata basis consistent with their ownership interests, these rights may not preclude permanent equity classification.

Registrants with questions on applying GAAP to structured equity transactions can submit them to the SEC's Office of the Chief Accountant.

We believe it may be possible to conclude that a transaction with several of the features discussed in this section results in NCI that is appropriately permanent equity classified. However, that conclusion may not apply to seemingly similar transactions. Due to the bespoke nature of these arrangements, it is important to consider all facts and circumstances and we believe there could be other fact patterns in which economic compulsion due to the combination of these features is so significant as to make future redemption of the NCI highly likely and temporary equity classification may be appropriate in those circumstances.

Other issues

Topic	Comments
Analysis of embedded features for bifurcation	Shares issued in a structured equity transaction often include 'embedded features' (i.e. provisions of the instrument that could affect the instrument's contractually promised cash flows or the values of its other exchanges). These features should be analyzed separately under Subtopic 815-15 to determine whether the features are required to be bifurcated and accounted for as a derivative. One of the criteria to evaluate in determining whether an entity needs to bifurcate the embedded feature is whether the economic characteristics and risks of the embedded feature are clearly and closely related to the economic characteristics and risks of the host contract. If an instrument with an embedded feature (i.e. a 'hybrid instrument') is issued in the form of a share, the determination of the nature of the host contract is made based on an evaluation of the overall nature and substance of the hybrid instrument. The determination of the nature of the host contract is critical because the analysis of whether an embedded feature needs to be bifurcated differs depending on whether a host instrument is more like debt or equity. For example, a put or call option embedded in a debt host may need to be bifurcated because the potential settlement on exercise of a put or call option meets the net settlement criterion of a derivative but that is not always the case in an equity host as discussed in Questions 9.3.110 and 9.3.120 of the KPMG Debt/Equity Guide. See section 9 of the KPMG Debt/Equity Guide for additional guidance related to analysis of embedded features in a hybrid instrument.
Credit rating agency determinations	A key reason Corporate Entity may enter into a structured equity transaction is to raise capital without adding debt to its balance sheet. As a result, Corporate Entity may seek the views of credit rating agencies

Topic	Comments
	(e.g. Standard & Poor's, Moody's, and/or Fitch) on the transaction. However, how the credit rating agencies view a transaction may not align with GAAP. It is advisable that Corporate Entity seeks the input of its rating agencies before entering into these types of arrangements.
Disclosures	To the extent the structured equity transaction is material, Corporate Entity should include robust disclosure in the notes to its financial statements describing the risks and characteristics of the arrangement. Additionally, Corporate Entity should consider the specific disclosure requirements of US GAAP depending on the classification of the NCI to ensure users of the financial statements can evaluate its economic exposure. For example, see sections 6.4.70 and 7.5.10 of the KPMG Debt/Equity Guide related to mandatorily redeemable financial instruments and temporary equity classified instruments, respectively.

KPMG resources

For further guidance related to the classification of structured equity transactions and related topics, we recommend the following KPMG resources as a starting point.

- Handbook: Debt and equity financing
- Financial instruments

Contact us

Patrick Garguilo
Partner, Dept. Of Professional Practice, KPMG US
pgarguilo@kpmg.com

Mahesh Narayanasami
Partner, Dept. Of Professional Practice, KPMG US
maheshnarayanasami@kpmg.com

Wade Fanning
Director, Dept. Of Professional Practice, KPMG US
wfanning@kpmg.com

Michael Nesta
Partner, Accounting Advisory Services, KPMG US
mnesta@kpmg.com

David Augustyn
Partner, Accounting Advisory Services, KPMG US
daugustyn@kpmg.com

---

[1] Paragraph B24 of Statement 150 states in part: “Some commentators proposed that increasing-rate preferred stock be classified as a liability on the grounds that the increasing rate made redemption economically compelling or created an implied mandatory redemption date. The Board reconsidered that issue during its redeliberations but did not resolve it. The Board deferred until the next phase of the project a decision about whether an increasing-rate dividend provision, as well as other forms of economic compulsion, imposes an obligation on the issuer that causes the instrument to be a liability.”