

MINUTES



To: Board Members

From: Short-Term Convergence—Income Tax Team (Gagon, Ext. 322)

Subject: Minutes of the April 22, 2004 Joint Board Meeting **Date:** April 29, 2004

cc: Bielstein, Smith, Petrone, Leisenring, FASB Project Team, IASB Project Team, Mahoney, Thompson, Vincent, Sutay, Gabriele, Swift, Polley, FASB Intranet (e-mail)

Topic: Acquired Temporary Differences in Asset Acquisitions (EITF Issue 98-11)

Basis for Discussion: Board memorandum 2 (EITF 98-11) dated April 6, 2004 and Agenda Paper 2

Length of Discussion: 9:00 a.m. to 9:50 a.m.(BST)

Attendance:

Board members present: FASB: Herz, Trott, Schipper, Batavick, Crooch, Seidman, and Schieneman

IASB: Tweedie, Jones, Barth, Bruns, Cope, Garnett, Gelard, Leisenring, McGregor, O'Malley, Smith, Whittington, and Yamada

Board members absent: None

Staff in charge of topic: Thomas, Bugg (IASB)

Other staff at Board table: None

Outside participants: None

Summary of Decisions Reached:

The IASB and FASB discussed the issue of accounting for the tax effects of acquisitions of assets that are not accounted for as a business combination if the amount paid is different than the tax basis of the asset acquired. At its March 2004 meeting, the IASB tentatively concluded that in these situations, an entity should allocate the consideration paid between the asset and the related deferred tax asset or liability using the simultaneous equations method; however, any tax benefit in excess of the cost of the related asset is recognized immediately in profit or loss.

The FASB recently began deliberations on this issue and considered three additional methodologies not considered by the IASB at its March meeting. Accordingly, the FASB asked that this issue be discussed at this joint meeting so that the IASB could consider the additional methodologies.

The IASB amended its previous decision, and the joint Boards tentatively concluded that the asset should be recognized at fair value (assuming full deductibility for tax purposes). The corresponding deferred tax asset or liability should be recognized as the difference between the fair value of the asset and its tax basis multiplied by the tax rate. Any difference between the consideration paid and the sum of the fair value of the asset and the recognized deferred tax amount is recognized as a purchase discount allowance on the deferred tax.

Objective of Meeting:

The objective of the meeting was to discuss recognition issues for deferred taxes in the initial acquisition of an asset other than a business combination and for the joint Boards to decide how to account for these transactions.

Matters Discussed and Decisions Reached:

Ms. Bugg began the meeting by providing a brief background on why income taxes were added to the Boards' short-term convergence project. She stated that the main purpose of the short-term convergence project for income taxes

was to eliminate differences that exist between IAS 12, *Income Taxes*, and FASB Statement No. 109, *Accounting for Income Taxes*. She continued by providing a brief background on the issue of acquired temporary differences in asset acquisitions in transactions other than business combinations and how U.S. GAAP differs from international financial reporting standards on this issue.

Mr. Thomas discussed how acquired temporary differences in asset acquisitions are currently accounted for in U.S. GAAP and provided a brief overview of EITF Issue No. 98-11, "Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations."

Ms. Bugg stated that the IASB Board had considered this issue at a previous Board meeting and discussed three different alternatives. She stated that the IASB put a premium on achieving convergence and therefore tentatively agreed with the approach in Issue 98-11; however, the IASB Board concluded that if any calculated deferred credits resulted when using the simultaneous equations method, that amount should be taken straight to profit or loss.

Mr. Thomas stated that the FASB considered five alternatives in its deliberations of this issue, three of which had not been considered by the IASB. These alternatives are:

1. Compute asset values and deferred taxes using the simultaneous equations method in Issue 98-11, any calculated deferred credits are immediately recorded in income.
2. Retain the guidance in Issue 98-11.
3. Compute asset values and deferred taxes using the simultaneous equations method in Issue 98-11, and record any calculated deferred credits as a purchase discount allowance to the deferred tax asset.
4. Record assets at fair value and deferred tax amounts using Statement 109; any calculated deferred credits are immediately recorded in income.

5. Record assets at fair value and deferred tax amounts using Statement 109; any calculated deferred credits are recorded as a purchase discount allowance to the deferred tax asset.

Mr. Thomas stated that the FASB staff recommends Alternative 5. Ms. Bugg stated the IASB staff recommends Alternative 4 since Alternative 5 would implicitly introduce discounting into deferred tax accounting, which is a fundamental change from the current literature on deferred taxes. Furthermore, she stated that Alternative 4 would be more consistent with both Boards' decisions on how to account for negative goodwill.

Mr. Tweedie asked if members of the joint Boards would object to only discussing Alternatives 4 and 5, which focus on fair valuing the asset. No members objected to Mr. Tweedie's proposal.

Members of the joint Boards that opposed Alternative 5 stated the following general arguments against Alternative 5:

1. Alternative 5 introduces implicit discounting for deferred taxes, which is contrary to current accounting literature for deferred taxes.
2. Alternative 5 would require an entity to forwards trace deferred taxes when Statement 109 does not allow backwards tracing for deferred taxes.
3. Alternative 5 is vague on how the deferred tax accounts and purchase discount accounts would be adjusted if there is a change in tax rates or tax status.
4. Alternative 5 would be anomalous for day-two accounting when compared with other deferred taxes (purchase discount account).
5. Alternative 5 makes forecasting deferred taxes even more difficult, which decreases the predictive value of financial statements.
6. Alternative 4 seems to be more consistent than Alternative 5 with prior decisions by the Boards on negative goodwill.

Members of the joint Boards that favored Alternative 5 stated the following general arguments in support of Alternative 5:

1. A purchase discount is reflective of what is actually going on in many transactions; many entities are able to purchase deferred tax assets for a discount due to the time value of money and the lapse of time before the entity will be able to realize the tax benefit.
2. Alternative 5 does not allow immediate recognition of an accounting gain or loss in profit or loss.
3. Deferred tax accounting can produce some results not reflective of economic reality; Alternative 5 would at least get the asset and deferred tax effects recorded at fair value on day one.
4. The Enron task force noted that deferred tax accounting had been used by Enron to produce financial statement income that was an accounting gain, not an economic gain. Alternative 5 would not allow recognition of those accounting gains.

The Boards decided that the asset should be recognized at fair value (assuming full deductibility for tax purposes). The corresponding deferred tax asset or liability should be recognized as the difference between the fair value of the asset and its tax basis multiplied by the tax rate. Any difference between the consideration paid and the sum of the fair value of the asset and the recognized deferred tax amount is recognized as a purchase discount allowance on the deferred tax.

Follow-up Items:

None

General Announcements:

None