

EITF ABSTRACTS

Issue No. 93-7

Title: Uncertainties Related to Income Taxes in a Purchase Business Combination

Dates Discussed: March 16, 1993; May 20, 1993

References: FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*
FASB Statement No. 109, *Accounting for Income Taxes*
FASB Statement No. 141, *Business Combinations*
FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*
FASB Special Report, *A Guide to Implementation of Statement 109 on Accounting for Income Taxes: Questions and Answers*

ISSUE

A number of uncertainties related to income taxes may exist at the time of or arise in connection with a purchase business combination. Examples include uncertainties about the allocation of the purchase price to individual assets and liabilities for income tax purposes in a taxable business combination, uncertainties about the carryover bases of assets, liabilities, and carryforwards at the date of acquisition in a nontaxable combination, or uncertainties about tax returns of the acquired company for periods prior to the acquisition date.

Statement 38 provides that the fair value of a preacquisition contingency that can be determined during the allocation period is included in the purchase price allocation. Adjustments from a preacquisition contingency that occur after the end of the allocation period are included in the determination of net income. Statement 38 did not apply to the potential tax benefits of an acquired loss carryforward. The amending language of Statement 109 indicates that Statement 38 "does not apply to potential income tax effects of (a) temporary differences and carryforwards of the acquired enterprise that exist at the acquisition date and (b) income tax uncertainties related to the acquisition (for example, an uncertainty related to the tax basis of an acquired asset that will ultimately be agreed to by the taxing authority) or adjustments that result from

realization of those benefits." Footnote 2 of Statement 38 was amended to indicate that the potential income tax effects of those items should be accounted for in accordance with Statement 109.

The issues are whether Statement 38 is applicable to any income tax uncertainties and, if not, how income tax uncertainties should be accounted for under Statement 109.

EITF DISCUSSION

The Task Force reached a consensus that all income tax uncertainties that exist at the time of or arise in connection with a purchase business combination should be accounted for pursuant to Statement 109 rather than Statement 38. [Note: See STATUS section.] Further, the Task Force reached a consensus that the guidance contained in question 17 of the Special Report on Statement 109 should be applied to changes in estimates and final settlements of all income tax uncertainties that predate or result from a purchase business combination with the exception of uncertainties related to the valuation allowance of a deferred tax asset. The Task Force observed that this consensus does not apply to changes in judgment about the realization of deferred tax assets because paragraphs 26 and 30 of Statement 109 provide guidance for changes in a valuation allowance related to an acquired deductible difference or carryforward. Further, the Task Force noted that the requirement in paragraph 30 for reduction of a valuation allowance established at the acquisition date applies only to initial recognition of an acquired benefit. All other changes in the valuation allowance due to a change in judgment about the realizability of the deferred tax asset should be included in income from continuing operations pursuant to paragraph 26.

As indicated in question 17 of the Special Report, deferred tax assets and liabilities at the date of a purchase business combination should be based on management's best estimate of the ultimate tax basis that will be accepted by the tax authority, and liabilities for prior tax returns of the

acquired entity should be based on management's best estimate of the ultimate settlement. At the date of a change in management's best estimate of the ultimate tax basis of acquired assets, liabilities, and carryforwards, and at the date that the tax basis is settled with the tax authority, deferred tax assets and liabilities should be adjusted to reflect the revised tax basis and the amount of any settlement with the tax authority for prior-year income taxes. Similarly, at the date of a change in management's best estimate of items relating to the acquired entity's prior tax returns, and at the date that the items are settled with the tax authority, any liability previously recognized should be adjusted. The effect of those adjustments should be applied to increase or decrease the remaining balance of goodwill attributable to that acquisition. If goodwill is reduced to zero, the remaining amount of those adjustments should be applied initially to reduce to zero other noncurrent intangible assets related to that acquisition, and any remaining amount should be recognized in income.

The Task Force observed that interest on the final settlement with the tax authority that accrues subsequent to the acquisition date should not be included in the goodwill adjustment.

The Task Force also reached a consensus that the guidance in question 17 of the Special Report is applicable to all purchase business combinations, regardless of whether the combination occurred prior to the adoption of Statement 109 and regardless of the transition method used to adopt Statement 109.

The SEC Observer noted that Statement 38 continues to apply to all other preacquisition contingencies and that application of this consensus should be limited solely to income tax uncertainties relating to purchase business combinations. [Note: See STATUS section.]

STATUS

Statement 141, which supersedes Statement 38, was issued in 2001. The guidance on preacquisition contingencies from Statement 38 was incorporated into paragraph 40 of Statement 141 without reconsideration and is still applicable as discussed above.

Interpretation 48 was issued in June 2006. Interpretation 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement 109, including tax positions that pertain to assets and liabilities acquired in business combinations. Therefore, the guidance in this Issue that pertains to the recognition and measurement of deferred tax assets and liabilities at the date of a business combination is no longer necessary.

Interpretation 48 does not affect the guidance pertaining to the accounting for the effects of adjustments.

No further EITF discussion is planned.

INDEXING TERMS FOR EITF ISSUE NO. 93-7

BUSINESS COMBINATIONS

Preacquisition Contingencies

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Purchase Method

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INCOME TAXES

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