

# FAS 141(R) – Impact On The Accounting For Income Taxes

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*Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations, (FAS 141(R)) becomes effective for most organizations with fiscal years beginning during 2009, and significantly changes acquisition accounting and the accounting for income taxes.*

The issuance of FAS 141(R) in December 2007 and the issuance of International Financial Reporting Standard 3 (revised 2007), Business Combinations, completed a joint effort by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to improve financial reporting of business combinations and to further the international convergence of accounting standards.

The objective of FAS 141(R), per Paragraph 1, "...is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects..." To accomplish this objective, FAS 141(R) establishes guidance for how an acquirer recognizes and measures identifiable assets, assumed liabilities, and any noncontrolling interest in an acquiree and also how an acquirer recognizes and measures goodwill related to a business combination. FAS 141(R) also requires additional financial statement disclosures to assist financial statement users with the evaluation of the economic impact of a business combination.

FAS 141(R) applies to all business combinations in which an acquirer obtains con-

trol of one or more businesses. However, it does not apply to the formation of a joint venture, the acquisition of an asset or a group of assets that does not constitute a business, a combination between entities or businesses under common control, or a combination of not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization.

FAS 141(R) retains the "acquisition method" (formerly known as the "purchase method") of accounting for all business combinations and requires an acquirer to be identified for each business combination. The acquirer is the entity that obtains control of one or more businesses in the business combination and the acquisition date is the date that the acquirer achieves control. The "measurement period" gives an acquirer up to one year after the acquisition date to finalize business combination accounting.

## Effective Date

FAS 141(R) applies to business combinations that are completed during a year beginning on or after December 15, 2008. However, there are certain provisions that may apply to acquisitions completed in years beginning prior to December 15, 2008 (i.e. acquired uncertain tax positions and acquired valuation allowances as explained below).

## Highlights – Accounting for Income Taxes

Some of the changes under FAS 141(R) that impact the accounting for income taxes, pursuant to Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (FAS 109), are discussed below:

### Acquired Uncertain Tax Positions

Under FAS 141(R), the determination of unrecognized tax benefits of the acquired entity as of the acquisition date will be subject to the measurement and recognition provisions of FASB Interpretation No. 48, Accounting for Uncertainties in Income Taxes (FIN 48). Any changes to the unrecognized tax benefits during the measurement period (that do not relate to facts and circumstances that existed as of the acquisition date) and subsequent to the measurement period are recorded as an adjustment to

income tax expense. Under prior guidance, any changes in acquired tax contingencies would generally have been an adjustment to goodwill and other intangibles.

As noted above, the accounting treatment for changes to uncertain tax positions is one exception to the prospective application of FAS 141(R). Regardless of the acquisition date of a business combination, changes in acquired tax uncertainties beyond the measurement period are recorded as adjustments to income tax from continuing operations.

### Acquired Valuation Allowances

FAS 141(R) amended FAS 109 to include the effect of a reduction in an acquired entity's valuation allowance to be recognized through the income tax provision. However, if the change occurs in the measurement period and relates to facts and circumstances that existed at the acquisition date, then the change will be recorded to goodwill. Reductions in acquired valuation allowances are also an exception to the prospective application of FAS 141(R), and are recorded as a reduction to income tax expense.

### Change in Acquirer's Valuation Allowance

Prior to FAS 141(R), a reduction in an acquirer's valuation allowance due to a business combination was recorded in goodwill. After the adoption of FAS 141(R), the reduction is a discrete item in the acquirer's income tax provision for the quarter in which the acquisition is consummated.

### Tax Deductible Goodwill in Excess of Book Goodwill

FAS 141(R) amended FAS 109 to require a deferred tax asset to be recorded for the excess of tax deductible goodwill over book goodwill as of the acquisition date. This change in accounting ultimately increases the deferred taxes recorded as of the acquisition date as part of a business combination and decreases goodwill recorded for financial reporting purposes. Under prior guidance, a deferred tax asset was not recorded and the tax effect of the excess tax deductible goodwill was reflected as an adjustment to book goodwill in the period in which it became deductible for tax purposes.

### Restructuring Costs

Under FAS 141(R), restructuring costs of

the acquiree that are not obligations as of the acquisition date are charged to post-acquisition earnings. In certain circumstances, if restructuring costs are "liabilities" as of the acquisition date, then the liabilities can be accounted for as part of a business combination. For acquisitions occurring after the effective date of FAS 141(R), the book and tax treatment of restructuring costs will need to be determined and deferred taxes established as required.

### Transaction Costs

Under FAS 141(R), transaction costs incurred as part of a business combination such as fees for investment banking, advisory, attorneys, accountants, valuation and other experts are to be expensed as incurred. For tax purposes, a determination of the future tax treatment of such costs needs to be made as the costs are incurred. If the costs will be tax deductible in the future (i.e. not capitalized in the tax basis of stock), then a deferred tax asset should be established in the period the costs are incurred.

This change in financial accounting can result in a significant impact on an entity's quarterly and annual effective tax rates. For example, if an entity incurs significant non-deductible costs for a potential acquisition, the quarterly effective tax rate would be increased by the resulting permanent difference. If later the acquisition is abandoned, the costs incurred could be deductible, resulting in a favorable permanent difference.

## Assessing The Impact

The financial accounting changes included in FAS 141(R) have a significant impact on the accounting for income taxes related to business combinations. Many of the changes not only impact an acquirer's net income, but they also impact the quarterly and annual effective tax rates, making it even more important for financial and tax professionals to focus on and plan for the tax treatment of transaction costs incurred and the financial statement implications related to current and prior acquisitions.

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