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presents

Meeting FAS 109 Compliance Challenges

Tackling Allowance Releases, Return-to-Tax-Provision Reconciliations and Other Complex Issues

A Live 110-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

Jim Parks, Tax Partner, **Burr, Pilger & Mayer**, San Jose, Calif.

Luke Coombs, Managing Director, **WTAS LLC**, Baltimore

Andrew Cates, Tax Partner, **Moss Adams**, Seattle

Mark Young, Managing Director, **Alvarez & Marsal Taxand LLC**, Houston

Thursday, September 9, 2010

The conference begins at:

1 pm Eastern

12 pm Central

11 am Mountain

10 am Pacific

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Meeting FAS 109 Compliance Challenges Webinar

Sept. 9, 2010

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Today's Program

- Traps For The Unwary
(*Jim Parks*) Slides 6 through 12
- Error Vs. Estimate
(*Mark Young*) Slides 13 through 19
- Handling Of Valuation Allowances
(*Andrew Cates*) Slides 20 through 27
- FAS 141(R) New Implications
(*Luke Coombs*) Slides 28 through 58
- FIN 48 Issues
(*Jim Parks*) Slides 59 through 65
- State Tax Issues
(*Luke Coombs*) Slides 66 through 72
- Carve-Out Financial Statements
(*Mark Young*) Slides 73 through 78

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Traps For The Unwary

Jim Parks, Burr, Pilger & Mayer

Goals For This Section

1. Gain an appreciation of proven FAS 109 approaches that work
2. Learn about pitfalls and traps for the unwary
3. The importance of debriefing



Mom And Dad Really Did Know Best

Execution – Dick “Night Train Lane”

- Set clear expectations
- Document
- Trust, but verify



"I WAS JUST TELLING THEM THAT THERE USED TO BE
A TV SHOW CALLED 'FATHER KNOWS BEST' "



The Importance Of Technology

- Clearly formulated provision workpapers are essential
- Proper documentation saves time and money
- Your workpapers must be integrated
- The rate reconciliation is most revealing

“Technology is a way of organizing the universe so that man doesn't have to experience it.” Max Frisch



Experience - The Very Best Teacher

- The importance of “trueing-up” the prior provision
- The need for a clear handle on DTAs/DTLs
- Knowing that deferred tax expense or benefit can be the net change in DTAs/DTLs
- Stock options – what to know



Experience - The Very Best Teacher (Cont.)

- Brief international comments
- State tax issues
- Credits are your friend
- Rate reconciliation tips

“Experience is a hard teacher. She gives the test first , the lesson afterwards.” Dick Enberg

Debriefing – Ensuring Better Results

- Seek feedback and short-cut next year's process
- Learn what worked well and what not to do
- Get team commitment for better results
- Have some fun

“The first step in exceeding your customer's expectations is to know those expectations.” Roy J. Williams



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Error Vs. Estimate

Mark Young, Alvarez & Marsal Taxand LLC

Error Vs. Estimate

- **FASB Accounting Standards Codification Section 250** (formerly SFAS 154, APB 20 and SFAS 3)

- **Definition of an error**
 - ▲ “An error in financial statements result from **mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared.** In contrast, a change in accounting estimate results from new information or subsequent developments and accordingly from better insight or improved judgment. Thus, an error is distinguished from a change in estimate. A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error for purposes of applying this Opinion.” – APB 20

- **Definition of a change in accounting estimate**
 - ▲ “A change that has the effect of adjusting the carrying amount of an existing asset or liability or altering the subsequent accounting for existing or future assets or liabilities. A change in accounting estimate is a necessary consequence of the assessment, in conjunction with the periodic presentation of financial statements, or the present status and expected future benefits and obligations associated with assets and liabilities. **Changes in accounting estimates result from new information.**”– FASB Glossary

Correction Of An Error

➤ Causes of an error

- Mathematical mistake
- Mistake in the application of GAAP
- Oversight or misuse of facts that existed at the time the financial statements were prepared
 - Was information readily available?
 - Would the application of that information known by other tax professionals *at that time* result in different reporting?

➤ Need to always consider **materiality**

- Several non-material mistakes could lead to an error

➤ Correction of an error could lead to a **financial restatement**

➤ Financial statement presentation

- One year: Adjustments to opening balance of retained earnings
- Multiple years: Net income, retained earnings and relevant balance sheet accounts should be retroactively restated

Change In Accounting Estimate, In General

➤ Causes of a change in estimate

- ▲ New Information
- ▲ Later identification of facts that were **not** known at the original date
 - Results in better judgment

➤ Nature of accounting to require estimates

➤ Reflected in the current period and if necessary, future periods

➤ Change in estimate results from new information that shows either:

- ▲ An asset's or liability's current carrying amount should be changed.
- ▲ An existing or future asset's or liability's subsequent account should be changed.
- ▲ Example : Change in the service life or salvage value of depreciable assets

➤ Methods

- ▲ Prospective method
 - Used for revisions of useful lives and salvage value changes
- ▲ Catch-up method
 - Most common approach

Examples Of Tax-Related Errors

- Mathematical error
- Misapplication of ASC 740
- Estimating rather than obtaining an amount for the tax provision that is or should be available in the company's books and records, and the amounts differ
 - ▲ Need to consider the nature, complexity, relevance and frequency
 - ▲ Always facts –and-circumstance-based decision
 - ▲ Example: Lobbying fees vs. transaction cost study
 - Lobbying fees: High frequency, “routine”, fairly simple
 - Probably viewed as an error, since data should be readily available
 - Transaction cost study : Complex, time-consuming, unique
 - Probably viewed as a change in estimate
 - Should disclose if estimates are expected to change within the next year

Examples Of Tax-Related Changes In Accounting Estimates

- Application of new information
 - ▲ Making a retroactive tax election that affects positions on prior tax returns based on new facts
- Change in facts and circumstances
 - ▲ New software becomes available that makes new information in books and records accessible
- Settlement reached with a taxing authority
- Case law/ruling developments or changes in interpretation thereof
- Additional expert technical insight regarding complex, highly specialized or evolving areas of tax law interpretation and knowledge
 - ▲ Company gains new insight with the help of specialized experts with respect to prior tax return positions involving the research tax credit
- Additional information becomes known based on other taxpayers similar situations

Thoughts For Consideration

- What is the impact of the following?
 - ▲ Filing of an amended return
 - ▲ IRS audit adjustment
 - ▲ Accounting method change (Form 3115)

- Judgment – Audit firm vs. audit team/national office

- SOX 404 considerations/documentation
 - ▲ Significant deficiency/material weakness



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Handling Of Valuation Allowances

Andrew Cates, Moss Adams



Agenda For This Section

- When to add or release a valuation allowance
- Evidence vs. assertion
- Scheduling and netting
- Tax planning strategies
- Disclosures

Adding Or Releasing The Valuation Allowance

- Changing circumstances
 - Business combinations
- Three-year (or 36-month history) standard
- Partial release or addition
- Best practice: Specifically identify the conditions in advance. Support measurement if partial valuation allowance is needed.

Evidence Vs. Assertion

- Must be commensurate with the extent to which it can be objectively verifiable
 - The farther into the future, the less reliable
 - How does history support ability to project?
- Challenges around substantiation
 - Specific industry or geographic risk?
 - Industry consolidation?
- Best practice: Establish a methodology and be consistent

Scheduling And Netting


- Schedule only if needed
 - Can be extremely technical
- Reversing taxable temporary differences
 - Systematic and logical
 - Consistently applied
 - Only those differences at the balance sheet date
- Best practice: Minimize complexity; go to the easiest sources first

Tax Planning Strategies

- Prudent and feasible, AND
- Would not ordinarily take, AND
- Would result in realization of a deferred tax asset
 - Isn't just a substitution
- Best practice: Support management's intentions and document decision-making processes

Disclosures

- Consistency with other parts of the financial statements
- Clarify reasoning if not obvious
- Consider additional disclosure if a material change is expected in near term
- Best practice: If the change isn't obvious, clarify the reasoning and evidence relied on



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FAS 141(R) New Implications

Luke Coombs, WTAS LLC

Topics For This Section

- FAS 141(R) overview
- Impact on valuations
- FAS 141(R) impact on tax accounting for:
 - Goodwill
 - Contingent consideration
 - Transaction costs
 - Other costs
 - Tax valuation allowances
 - Tax contingencies
 - Tax indemnifications
 - Tax valuation allowances
 - In-process R&D
 - Bargain purchase
- Quarterly and annual financial statement impacts

FAS 141(R) Background

- Issued in December 2007
- Part of joint effort by FASB and IASB to improve the financial reporting for business combinations and to promote international convergence of accounting standards

FAS 141(R) Objective

- Improve financial data related to business combinations
- Improve financial statement disclosures to allow for better analysis of economic effect of a business combination

OBJECTIVE

1. The objective of this Statement 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 that, this Statement establishes principles and requirements for how the acquirer:

- a. Recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree
- b. Recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase
- c. Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

Effective Date

- FAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after Dec. 15, 2008.
 - Calendar-year corporations: Effective date Jan. 1, 2009
 - Fiscal-year corporations: Effective during 2009
- Certain tax provision changes (related to valuation allowances and tax uncertainties) **do apply** to transactions that occurred prior to Dec. 15, 2008.

Effective Date And Transition

74. This Statement shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier application is prohibited.

75. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this Statement shall not be adjusted upon application of this Statement.

Income Taxes

77. For business combinations in which the acquisition date was before the effective date of this Statement, the acquirer shall apply the requirements of Statement 109, as amended by this Statement, prospectively. That is, the acquirer shall not adjust the accounting for prior business combinations for previously recognized changes in acquired tax uncertainties or previously recognized changes in the valuation allowance for acquired deferred tax assets. However, after the effective date of this Statement:

- a. The acquirer shall recognize, as an adjustment to income tax expense (or a direct adjustment to contributed capital in accordance with paragraph 26 of Statement 109), changes in the valuation allowance for acquired deferred tax assets.
- b. The acquirer shall recognize changes in the acquired income tax positions in accordance with Interpretation 48, as amended by this Statement.

Applicable Transactions

- Applies to all business combinations
- **Business combination:** A transaction or other event in which an acquirer obtains control of one or more businesses
- Exceptions

Scope

2. This Statement applies to a transaction or other event that meets the definition of a *business combination in paragraph 3(e)*. *This Statement does not apply to:*
- a. The formation of a joint venture
 - b. The acquisition of an asset or a group of assets that does not constitute a business (paragraphs D2–D7)
 - c. A combination between entities or businesses under common control (paragraphs D8–D14)
 - d. A combination between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization.

Key Terms

- **Acquiree:** Business or businesses that the acquirer obtains control of in a business combination
- **Acquirer:** Entity that obtains control of the acquiree.
- **Acquisition date:** Date on which the acquirer obtains control of the acquiree
- **Fair value:** The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (FASB Statement No. 157, Fair Value Measurements, paragraph 5).
- **Goodwill:** An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized

Measurement Period

- Up to one year after the acquisition date to finalize business combination accounting
- Measurement period could end sooner if all information is received and additional information is not obtainable.

Measurement Period

51. If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date. **The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable.** However, the measurement period shall not exceed one year from the acquisition date.

FAS 141(R) Impact On FAS 109

- Changes in accounting
- Changes to FAS 109

Accounting For Goodwill

- For GAAP purposes, goodwill is not amortized, but it is tested under Statement 142 for impairment, at least annually.
- FAS 109 paragraph 262 basis for deferred taxes



Goodwill And Deferred Taxes

- Financial reporting goodwill > tax-deductible goodwill – no deferred tax liability recorded
- Tax deductible goodwill > financial reporting goodwill – record deferred tax asset

$$\text{DTA} = (\text{tax rate} / (1 - \text{tax rate})) \times \text{preliminary difference}$$

Prior Guidance

Prior to 141(R), a deferred tax asset was not recorded for tax deductible goodwill in excess of financial statement goodwill. 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.

Goodwill Example

- Tax deductible goodwill > book goodwill

Assume Acquisition Occurs on January 1, Year 1				
GOODWILL		Book	Tax	
Component 1		800	800	
Component 2		-	200	
Total Goodwill		<u>800</u>	<u>1,000</u>	
Calculation of Deferred Tax Asset		40%	Tax Rate	
(40% / (1-40%)) * \$200		133		
GOODWILL AFTER DTA ADJ		Book	Tax	
Component 1		667	667	
Component 2		-	333	
Total Goodwill		<u>667</u>	<u>1,000</u>	
Assume Goodwill Amortizable for Tax over 2 Years				
	At Acquisition	Year 1	Year 2	Total Temp.
Component 1 Temp.	-	(333)	(333)	(667)
Component 2 Temp.	333	(167)	(167)	-
DTL	-	(133)	(133)	(267)
DTA	133	(67)	(67)	-

Contingent Consideration

- Acquirer recognizes contingent consideration as part of the consideration transferred as of the acquisition date
- Can either be classified as a liability or equity
 - Classified as equity: Contingent payment of a fixed number of shares
 - Measured at the acquisition date
 - All deferred tax consequences run through equity
 - Classified as a liability: Fixed amount that is payable in a variable amount of shares or cash
 - Re-measured to fair value until contingency is settled
 - After initial measurement, most changes will be recorded through earnings.

Contingent Consideration (Cont.)

- For tax purposes, acquirer generally does not recognize contingent consideration until the contingency is settled or the amount becomes fixed and determinable with reasonable accuracy.
- Tax structure will dictate deferred tax accounting.
 - Non-taxable: Contingent consideration increases tax basis of stock
 - Taxable: Contingent consideration increases basis in assets/goodwill

Contingent Consideration: Non-Tax Example

Assume Acquisition Occurs on January 1, Year 1
 Pay \$100 for a company with \$100 Fair Value of assets in NON-TAXABLE acquisition
 Tax Basis of acquired Assets is \$75
 Also agree to pay \$50, if earnings Target is met as of June 30, Year 1

Assume \$50 is a contingent liability obligation for book purposes as of Acquisition

January 1, Year 1

TARGET	Debit	Credit
Assets	100	
Goodwill	110	
DTL		10 (100-75) *40%
Contingent Consideration Liability		50
Cash		150
Total	210	210

As of March 31 Year 1, Assume that the FV of contingent liability obligation decreases to \$20 (Assume 40% Tax Rate)

March 31, Year 1

ACQUIRER	Debit	Credit
Contingent Liability	30	
Income	-	30
Total	30	30

As of June 30, Year 1, Assume the FV of contingent liability obligation increases to \$100

June 30, Year 1

ACQUIRER	Debit	Credit
Expense	80	
Contingent Liability	-	80
Total	80	80

Contingent Consideration – Taxable Example

Assume Acquisition Occurs on January 1, Year 1

Pay \$100 for a company with \$100 Fair Value of assets in TAXABLE acquisition

Also agree to pay \$50, if earnings Target is met as of June 30, Year 1

Assume \$50 is a contingent liability obligation for book purposes as of Acquisition

January 1, Year 1

TARGET	Debit	Credit
Assets	100	
Goodwill	50	
Equity		150
Total	150	150

As of March 31 Year 1, Assume that the FV of contingent liability obligation decreases to \$20 (Assume 40% Tax Rate)

March 31, Year 1

ACQUIRER	Debit	Credit
Contingent Liability	30	
Income	-	30
Income Tax Expense	12	
Deferred Tax Liability		12
Total	42	42

As of June 30, Year 1, Assume the FV of contingent liability obligation increases to \$100

June 30, Year 1

ACQUIRER	Debit	Credit
Expense	80	
Contingent Liability	-	80
Deferred Tax Asset	32	
Income Tax Expense		32
Total	112	112

\$30 of income for tax purposes is treated as write-off of tax deductible GW which creates a DTL

Transaction Costs

- Per paragraph 59 of FAS 141(R), acquisition related costs are expensed as incurred.
 - Attorney's fees
 - Accountants
 - Investment bankers
 - Valuation experts (fair value determination)
 - HSR (Hart-Scott-Rodino fees)
- How to account for deal costs prior to acquisition date?

Transaction Costs (Cont.)

- Anticipate transaction structure
 - Record DTA for costs that are anticipated to be deductible for tax purposes in the future
 - If the transaction changes, DTA may need to be adjusted up or down.
- Determine deductibility if transaction did not occur
 - If costs would be deductible, establish DTA
 - Once transaction is finalized, reassess need for DTA
- Once an approach is taken, it should be applied consistently.

Transaction Cost Example

- Taxable business combination

Purchase Price for Target	\$2,000		
Transaction Costs	\$250		
Fair Value of Target's Assets	\$1,500		
Tax Rate	40%		
Acquisition Accounting			
		Debit	Credit
FV of Assets		1,500	
Goodwill		500	
Cash			2,000
		<u>2,000</u>	<u>2,000</u>
Accounting for Transaction Costs			
Transaction Costs		250	
Cash			250
Deferred Tax Asset		100	*
Income Tax Expense			100
		<u>350</u>	<u>350</u>
* Acquisition Costs \$250			
Tax Rate <u>40%</u>			
DTA <u>\$100</u>			

Transaction Cost Example (Cont.)

- Non-taxable business combination

Purchase Price for Target	\$2,000	
Transaction Costs	\$250	
Fair Value of Target's Assets	\$1,500	
Tax Basis of Assets	\$1,000	
Tax Rate	40%	
Acquisition Accounting		
	TAX BASIS	
	Debit	Credit
FV of Assets	1,500	
Goodwill	700	
DTL		200 *
Cash		2,000
	<u>2,200</u>	<u>2,200</u>
Accounting for Transaction Costs		
Transaction Costs	250	
Cash		250
	<u>250</u>	<u>250</u>
* Book Basis of Assets	\$1,500	
Tax Basis of Assets	<u>\$1,000</u>	
Difference	<u>\$500</u>	
Tax Rate	40%	
DTL	<u>\$200</u>	

Other Costs

- Debt issuance costs
 - Generally for GAAP, capitalized and amortized over life of debt utilizing an effective interest rate
- Stock issuance costs
 - Stock registration and issuance costs are generally treated as a reduction in paid-in capital.
- Restructuring costs
 - Generally not considered as part of business combination accounting
 - In certain circumstances, if restructuring costs are “liabilities” as of the acquisition date, then such liabilities can be accounted for as part of a business combination.

Acquiree Valuation Allowance

- 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.
- 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 **an exception** to the prospective application of FAS 141(R), and are recorded as a reduction to income tax expense.

Acquirer 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.

Acquired Tax Contingencies

- Prior to 141(R), modifications to acquired entity's uncertain tax positions, recorded as adjustments to goodwill
- After 141(R), if a change in tax contingency relates to new information about facts and circumstances that existed as of the acquisition date and occurs during the measurement period, then the change is recorded to goodwill.
- After 141(R), all other changes in acquired tax contingencies are recorded as income tax expenses.
- Changes in acquired tax contingencies are also **an exception** to the prospective application of FAS 141(R).

Indemnification Of Tax Contingencies

- Seller, as part of business combination, may indemnify the acquirer for certain income tax uncertainties
- Indemnification asset is measured on the same basis as indemnified liability.

30. In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a noncontractual contingency that is not recognized at the acquisition date because it does not satisfy the more-likely-than-not criterion at that date. **Alternatively, an indemnification may relate to an asset or a liability, for example, one that results from an uncertain tax position that is measured on a basis other than acquisition-date fair value (paragraphs 26 and 27). In those circumstances, the indemnification asset shall be recognized and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectability of the indemnification asset and any contractual limitations on the indemnified amount.** Paragraph 64 provides guidance on the subsequent accounting for an indemnification asset.

In-Process R&D

- Acquired entity in business combination may have in-process R&D
 - Under 141(R) and 141(2), acquiring entity records at fair value
 - Accounted for indefinite life asset until completed or abandoned
- For GAAP, R&D expenses outside of a business combination are expensed as incurred [not changed by FAS 141(R)]

Bargain Purchase

- A bargain purchase occurs when FMV of assets acquired and liabilities assumed (including deferred taxes) exceeds consideration paid.
- Prior to FAS 141(R), “negative” goodwill was allocated as a pro rata reduction of amounts assigned to particular non-current assets acquired.
- Under FAS 141(R), gain is recognized

Bargain Purchase – Example

- Taxable transaction

Purchase Price for Target	\$1,500		
Fair Value of Target's Assets	\$2,000		
Tax Rate	40%		
TARGET		Debit	Credit
FV of Assets		2,000	
Deferred Tax Liability			200 *
Equity			1,800
		<u>2,000</u>	<u>2,000</u>
ACQUIRER			
Investment in Target		1,800	
Cash			1,500
Bargain Purchase Gain			300
		<u>1,800</u>	<u>1,800</u>
* Deferred Tax	\$2,000		
Less Tax Basis	\$1,500		
Difference	\$500		
At 40% Tax Rate	\$200		

Bargain Purchase - Example

- Non-taxable transaction
- Not bargain purchase – after deferred taxes recorded

Purchase Price for Target	\$1,500	
Fair Value of Target's Assets	\$2,000	
Tax Basis of Assets	\$750	
Tax Rate	40%	
TARGET		
	Debit	Credit
FV of Assets	2,000	
Deferred Tax Liability		500 *
Equity		1,500
	<u>2,000</u>	<u>2,000</u>
ACQUIRER		
Investment in Target	1,500	
Cash		1,500
Bargain Purchase Gain		-
	<u>1,500</u>	<u>1,500</u>
* Book Basis		
	\$2,000	
Less Tax Basis	<u>750</u>	
Difference	<u>\$1,250</u>	
At 40% Tax Rate	<u>\$500</u>	

Quarterly And Annual Provision Impacts

- Effective tax rate impacts
 - Contingent consideration
 - Change in valuation allowances
 - Transaction cost treatment
 - Change in acquired tax contingencies
 - Prior acquisitions

- Disclosure

Summary

- Change to FAS 109 accounting of goodwill
- Contingent consideration
- Transaction costs
- Valuation allowance
- FIN 48 liabilities
- Indemnification of tax contingencies
- In-process R&D
- Bargain purchases

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FIN 48 Issues

Jim Parks, Burr, Pilger & Mayer

Goals For This Section

1. Overview of FIN 48
2. Learn proven processes and approaches
3. Make it better





FIN 48 – We Knew It Was Coming, But

Hopefully, you've done something by now

- Private company compliance after 12/15/08
- Learn from public companies' experience
- Improve the documentation process

“Failure to prepare is preparing to fail.” John Wooden



The Process – My Recommendations

- Review all open-year tax returns
- Review open years' detailed trail balances
- Review the FAS 109 workpapers
- Review the company's accounting policies
- Review prior year's financial statements
- Review prior-year tax authority audits/adjustments
- Hold discussions with internal personnel
- Document the findings

Recognition And Measurement

- Focus on tax positions with a 40% to 70% range of meeting the “MLTN” threshold
- Transfer pricing, R&D and cost segregation studies rarely provide a “MLTN” opinion.
- Monitoring positions going forward is essential

“One accurate measurement is worth a thousand expert opinions.” Admiral Grace Hopper





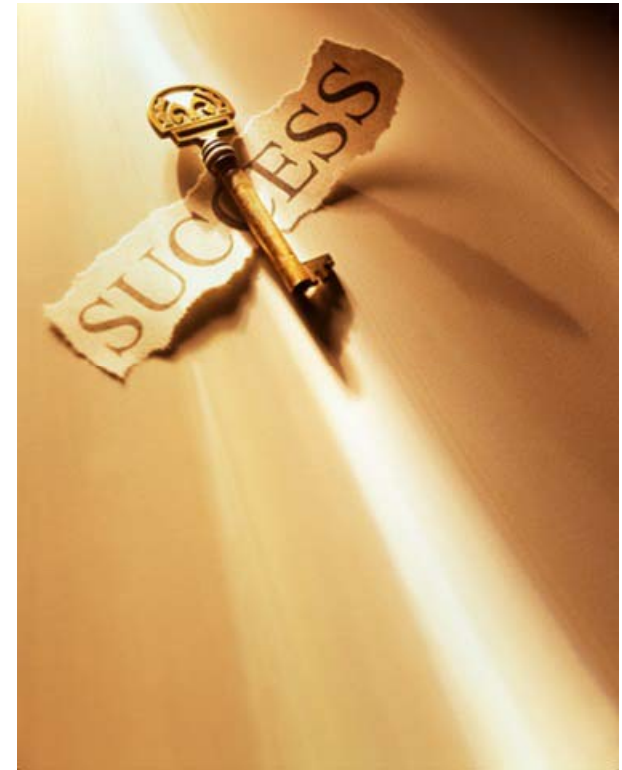
Analyzing The Effects Of FIN 48

- SOL differences
- State issues abound
- Brief international comments
- Private companies aren't required to disclose:
 - Tabular disclosures of UTBs
 - The impact of UTBs on the effective tax rate

Make It Better

- Plan ahead
- Apply yourself; learn what worked well
- If you don't understand something, ask
- Get comments from your team
- Apply the recommendations
- And, remember success leaves clues

“Excellent firms don't believe in excellence - only in constant improvement and constant change.” Tom Peters



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State Tax Issues

Luke Coombs, WTAS LLC

State Tax Considerations

- Separate valuation allowance evaluation
- Blended rate vs. separate state calculations
- State law changes
 - Changes to apportionment
 - Changes to tax base
- Elimination of inter-company transactions

Separate Valuation Allowance Evaluation

- Common error for overall profitable consolidated groups
 - Winners and losers
 - Need to evaluate each separate entity and jurisdiction to determine if losses can be benefited
- Common error caused by using a state rate net of the federal benefit
 - Occurs when there is a federal valuation allowance, but not a state valuation allowance

Blended Rate Vs. Separate State Calculations

- A flat 39% rate that never changes is no longer being accepted by many auditors.
- Due to increased complexity in state calculations, more companies are moving to preparing separate deferred and current payable calculations for each jurisdiction.
- Materiality and state complexity are drivers for decision

State Law Changes

- Apportionment changes
 - Need to stay informed of all state law changes and date of enactment
 - Many states moving towards heavier-weighted sales factor

State Law Changes (Cont.)

- Changes to tax base
 - Michigan
 - Texas
 - Ohio (phase out complete)
- Need to evaluate what deferred items would affect the tax calculation, to determine if the deferred item exists for state purposes
- Often causes significant modifications and complexity to provision workpapers

Elimination Of Inter-Company Transactions

- Inter-company interest
 - Need to consider state modifications in calculating current payable and certain deferred items
 - Accrued Interest

Strafford

Carve-Out Financial Statements

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Carve-Out Financial Statements

- What is a carve-out financial statement?
 - ▲ Separate financial statements for a division, business unit, subsidiary or set of assets that necessitate a business

- Why would an entity need to prepare carve-out financial statements?
 - ▲ Pending transactions (*i.e.*, initial public offering, required by a bank or third party, spin-off or business combination)
 - Not required for the sale of assets, but a group of assets could be determined to be a “business”
 - ▲ Statutory filings
 - ▲ Regulatory filings

- What information needs to be included in a carve-out financial statement?
 - ▲ Depends on the type required
 - ▲ Unaudited, audited but not compliant with SEC, “special purpose” financial statements, audited and compliant with SEC, audited and compliant with SEC and PCAOB



Carve-out Financial Statements (Cont.)

- SEC Staff Accounting Bulletin (SAB) 1B details the requirements for carve-out financials prepared for an entity about to initiate an initial public offering .
 - ▲ Should include all expenses incurred by the parent on the subsidiary's behalf ("all costs of doing business")
 - ▲ General types of costs that are allocated using different methods
 - Costs that are easily identifiable as incurred by the subsidiary
 - Costs of centralized departments that serve all operations
 - Costs of corporate activities
 - Costs for interest and income taxes
 - ▲ Requires disclosure if management's estimates of what expenses would have been if the subsidiary had been a stand-alone business, if they are significantly different than those reflected on the income statement

Methods Of Carve-Out Financial Statements For Income Taxes

- Acceptable methods: Must be systematic, rational and consistent with ASC 740 (FAS 109)
 - ▲ Separate return method
 - Based on what it would have been had the subsidiary filed a separate tax return
 - Preferred but not required
 - Sum of the parts may not equal the whole
 - The need for a valuation allowance (VA) must be considered without regard to the consolidated group
 - ▲ Pro rata method
 - Takes the subsidiary's share of consolidated group income and allocates the group's income tax expense based on that percentage
 - Will result in a similar result as the separate return method for a company in income position, but a significantly different result for a company in a loss position
 - The sum of all of the provisions must equal the consolidated provision under this method.
 - If the consolidated group does not have a VA, then no subsidiary will report a VA.

Methods Of Carve-Out Financial Statements For Income Taxes (Cont.)

➤ Acceptable methods (Cont.)

▲ Benefits for loss method

- Modifies the separate return method
- Tax attributes are realized by the subsidiary when they are utilized on the consolidated return and reflected as an I/C receivable from the parent
- If cash is settled differently, then the difference is booked as a distribution/contribution.
- VA is not necessary unless required for the consolidated group

➤ Unacceptable methods – ASC 740

- Methods that allocate only current taxes payable to a member of the group that has taxable temporary differences
- Methods that allocate deferred taxes to a member of the group using a method fundamentally different from its asset and liability method
- Methods that allocate no current or deferred tax expense to a member of the group that has taxable income, because the consolidated group has no current or deferred tax expense



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Methods Of Carve-Out Financial Statements For Income Taxes (Cont.)

- Should pick method that is consistent with the entity's tax-sharing agreement
 - ▲ If there is a difference between amount paid/received under the agreement and the expected settlement based on tax allocation, then the difference is treated as a dividend/capital contribution.

- Method should be applied consistently

- Generally, a method for allocating income taxes within a consolidated group should be applied consistently.
 - ▲ However, an entity should reflect income taxes under the separate return method if it is about to initiate an IPO.

- A subsidiary should disclose significant temporary differences and carryforwards, and if these items have been paid to or received from the parent.