



The Profit Statement

Significant changes (again) in fair value accounting for mergers and acquisitions

By Brent Solomon and Chris Reinholz

Statement of Financial Accounting Standards No. 141, *Business Combinations* (SFAS 141), issued by the Financial Accounting Standards Board (FASB) in 2001, significantly changed the accounting treatment of mergers and acquisitions. Most important for many acquiring companies was the requirement to report the fair value of intangible assets separately from goodwill. As a result, trademarks, trade names, patents, technology, customer or supplier contracts/relationships, and other

intangibles must now be reported at fair value, not historical cost.

In December 2007, FASB released Statement of Financial Accounting Standards No. 141 (Revised 2007), *Business Combinations* (SFAS 141(R)). The revised statement, which makes additional significant changes in accounting standards, is one of the first produced through the collaboration of U.S. and international authorities. SFAS 141(R) will apply to almost

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The 2008 acts that keep on giving

EESA and WREERA can help you save tax in 2009

The Emergency Economic Stabilization Act of 2008 (EESA) extends through 2009 some important tax breaks for businesses and individuals. And the Worker, Retiree and Employer Recovery Act of 2008 (WREERA) provides 2009 relief to employers and seniors. As you develop your tax strategy for 2009, be sure to keep the following in mind.

Tax relief for businesses

Research tax credit. Businesses can take advantage of the alternative simplified credit method to compute the research tax credit for qualified research expenses paid or incurred in 2008 or 2009. The credit for 2009 is equal to 14% of qualified expenses exceeding 50% of the average qualified expenses for the three preceding tax years.

Accelerated depreciation for leasehold and restaurant improvements.

Lessors and lessees can depreciate qualified leasehold and restaurant improvements over 15 years instead of 39 years. Certain new construction for restaurant property and improvements to retail property also qualify, provided the property is placed in service during 2009.

Enhanced deduction for certain donations. Certain contributions of food to charity and of books and computer equipment to qualifying schools enable businesses to deduct the items' cost plus one-half of any increase in value, not to exceed double the cost.

Tax-savers for individuals

Qualified tuition deduction. Eligible taxpayers who don't qualify for higher

education tax credits can deduct "above the line" up to \$4,000 in qualified higher education tuition and fees paid during 2009 for a dependent, a spouse or themselves, subject to income limitations.

State and local sales tax deduction.

Individuals can deduct state and local general sales taxes in lieu of state and local income taxes. If you live in a state with a low or no income tax — or buy expensive items in 2009 — you may benefit more by deducting sales tax.

Tax-free IRA distributions for donations. Seniors age 70½ or older can distribute tax free up to \$100,000 from their IRAs (traditional or Roth) to tax-exempt charities this year. But they can't take a charitable deduction for any portion of their withdrawals that would have otherwise been taxable.

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Significant changes ...

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all transactions involving a change in control, including mergers, acquisitions, leveraged buyouts and other recapitalizations. The chart at right highlights differences between SFAS 141(R) and SFAS 141.

Treatment of contingencies

Another major change concerns contingent assets and liabilities, whether recorded or not recorded on the target's balance sheet. SFAS 141(R) divides contingencies into two categories — contractual (for example, warranties) and noncontractual (for example, lawsuits). Contractual contingencies are to be measured at fair value, while noncontractual contingencies will be measured at fair value only if the contingency's probability of existence is greater than 50%.

The fair value measurement of contingent consideration in the deal, as well as of contingent assets and liabilities, may require sophisticated techniques such as simulations. Furthermore, the inclusion of contingent consideration in the purchase price may increase the

The 2008 acts ...

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Teachers' classroom expense deduction. Qualified educators can take an above-the-line deduction of up to \$250 for certain out-of-pocket expenses incurred for books,

Differences between SFAS 141 and SFAS 141(R)

| Issue | Under SFAS 141 | Under SFAS 141(R) |
|--|--|--|
| Bargain purchases | Fair value of certain acquired assets reduced for the bargain purchase | Excess of fair value over the purchase price may be recorded as a gain |
| Contingent consideration (including earnouts) | Generally not recorded until the contingency is resolved | Must be measured at fair value and considered as part of purchase price |
| Direct transaction costs | Capitalized as part of purchase price | Expensed when incurred |
| Acquired in-process research and development (IPR&D) | Expensed at acquisition | Must be measured at fair value and reported as an indefinite lived asset |
| Intended use of an acquired intangible asset | Intended use generally considered — assets not intended to be used generally assigned no value | Intended use not considered — all assets measured at fair value based on market based inputs |

amount of goodwill recorded in most transactions. This inclusion increases the risk of goodwill impairment if the transaction does not perform as expected in the original projections.

The standard applies now

The changes associated with SFAS 141(R) are effective for fiscal years beginning after December 15, 2008. But as you may have seen in the financial press, this effectiveness date has become controversial because of current market conditions and because some aspects of SFAS 141(R) are still being deliberated by the FASB.

The FASB has also issued SFAS 157, *Fair Value Measurements*. This statement establishes a framework for measuring fair value and increases the required disclosures concerning fair value measurements, including the valuing of acquired intangible assets.

Because accounting rules and market conditions continue to change, consultation with a technical reporting and valuation advisor is critical when planning and implementing future acquisitions. So please call Reznick Group's Brent Solomon at 301-280-3660 or Chris Reinholz at 301-718-7132 to see how SFAS 141(R) may affect your deal. ■

supplies, equipment and software used in the classroom — whether they itemize or not.

Mortgage debt forgiveness allowance. EESA extends through 2012 a provision that generally allows homeowners to avoid paying federal

income taxes on debt forgiveness received in connection with a foreclosure or a mortgage workout on a principal residence.

New relief for seniors. WRERA suspends for 2009 the excise tax that seniors age 70½ or more would otherwise owe on any shortfall in their required minimum distributions (RMDs) for IRAs and defined contribution plans, including 401(k), 403(b) and 457 plans. Seniors can therefore opt to keep more funds in their plans for another year without incurring a tax penalty — so their investments can perhaps recoup recent losses.

To save the most, start now

Please let us know if you would like more information about these EESA and WRERA tax breaks or other ways to reduce your tax liability. The earlier you start developing a tax strategy for 2009, the more likely you'll be to maximize your savings. ■

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Don't let taxes ruin your M&A deal

Know what you'll owe before you sign on the line

By Cheryl Carter

In the heat of negotiating a business sale, merger or acquisition, you might be so focused on negotiating the terms that you overlook the tax impact of the transaction. But taxes can turn what looks like a good deal into a big loss for buyers, sellers or both. Before you close a deal, make sure you know the tax consequences and take steps to minimize them.

Buyers like asset deals

Business acquisitions can be structured as either stock or asset purchases. If you're the buyer, you'll probably want an asset transaction because it allows for a step-up in the acquired business's basis to fair market value. This gives you the benefit of increased depreciation deductions, lower taxes and increased future cash flow. In addition, you'll avoid any contingent liabilities that might transfer in a stock purchase.

An asset deal also allows you to purchase only the parts of the target company you want. Plus, it can yield a bigger tax write-off because you can begin reducing your taxes right away by taking depreciation deductions.

Sellers prefer stock transactions

If you're the seller, you probably will prefer a stock transaction. Why? Because gain on a stock sale is taxed at the relatively low capital gains rate, rather than at a higher ordinary income tax rate.

If you're selling a C corporation, asset sales can be particularly unfavorable because your corporation would have to pay ordinary income tax (as high as 35%) on the amount by which the assets' sale price exceeds their tax basis. In addition, when sale proceeds are distributed as dividends or the corporation is dissolved, the shareholders pay tax on what they receive. So you'll typically save tax by negotiating a stock sale.

A TDR can benefit both

When the buyer purchases a company's stock or assets, the seller realizes a taxable gain or loss on the transaction. But when the buyer acquires stock or assets in exchange for stock in its own company, there's no immediate gain or loss to the seller or shareholders. If the IRS considers the transaction a tax-deferred reorganization (TDR), this type of "sale" can be advantageous for both buyer and seller.

If you're the seller, with a stock-for-stock TDR, you transfer at least 80% of the stock in your business to another corporation, receiving the buyer's stock in exchange. To the extent no cash is received during the transaction, no tax is due on this exchange and your new stock assumes the same tax cost and holding period of the old.

As long as you hold the new stock for more than a year, you pay long-term capital gains tax on any gain when you sell.

A stock-for-stock TDR can benefit buyers, too. If you're the acquirer and you have a net operating loss carryover, you may be able to use that carryover to lower your taxes. A TDR can also help buyers looking for an alternative to debt financing. For example, you may prefer a stock transaction if your stock is highly priced — and is thus good "currency" — or if your existing level of debt makes additional borrowing difficult.

Sec. 338 election also attractive

If you do purchase stock, you might also want to consider a Section 338 election.

Under the right circumstances, a Sec. 338 election can benefit both buyers and sellers by allowing a deal structured as a stock purchase to be considered an asset purchase for tax purposes.

The buyer benefits from the step-up in basis on the acquired assets and is able to claim the acquired company's financial and tax liabilities resulting from the transaction.

So even though the buyer pays tax on the transaction, it can use any net operating loss or tax credit carryforwards the acquired business has to offset this tax liability.

Although the seller treats any asset sale gains above the tax basis as ordinary income, the bulk of the transaction is likely to be taxed as capital gains. And adjustments in the purchase price can offset the ordinary income amount, so the seller can get a good deal, too.



Don't forget the other taxes

Even if you plan carefully to minimize federal taxes, you'll need to consider how state, local and foreign income, sales, property and transfer taxes may affect the transaction. This is especially important when either the buyer or the seller does business in several states or internationally.

The key is to take tax consequences into consideration early on — during due diligence and deal structuring — as well as after the deal is shaped. So if you're planning a business sale, merger or acquisition, check with us first. Our advisors can show you what the tax impacts of the transaction will be and how to minimize them for buyers and sellers alike.

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The following Reznick Group conferences will be held in the coming months:

Historic Tax Credits for Developers Conference

February 5 – 6, 2009
Miami Beach, FL

Reznick Group's Renewable Energy Conference

April 6 – 8, 2009
Denver, CO

Reznick Group's New Markets Tax Credits Summit

May 13 – 15, 2009
Miami, FL

Reznick Group Developer's Conference

August 18 – 19, 2009
Atlanta, GA

Reznick Group's Real Estate and Market Update II

November 2009
San Juan, PR

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