<u>Accounting</u>

There are two types of accounting treatment (as disconnected from tax treatment)

The desired treatment is **Pooling of Interests**

- Add up the balance sheets of the two companies at historical cost (assets, liabilities, other equity) <-- very simple
- **A marriage of two companies**
- Difficult to pass all of the requirements that FASB has set up for pooling (7 tests), including:
    - No assets sales for x # of years
    - No pre-agreed buyouts for a group of shareholders
    - Cannot merge acquired company into a sub
    - Cannot acquire a sub of a bigger company, merge it and call it a sub
    - Generally, only financial institutions qualify for pooling (Fed requires an immediate writeoff of goodwill ag. Reg. Capital)
- Tax and accounting treatment very similar
    - Tax basis not adjusted, simply carried over
- Biggest failure to qualify for pooling: A subsidiary, contrived acquisition vehicle (a single purpose acquisition entity) typically bids
    - Not a true merger of equals, per se

Alternative is **Purchase Treatment**

- Assets of one (and possibly both) must be written up to their Fair Market Value
- Liabilities are restated at market
- Any difference between FMV and the purchase price becomes goodwill
- Goodwill is expensed --> lowers earnings
- **Book value is written up**
- Possible to have tax-free carryover of basis while writing up the basis for accounting purposes --> 2 sets of books

Statutory Merger:

Tax Treatment:

- If pooling --> tax basis not adjusted, just carried over; tax-free transaction
- If purchase --> could be either taxable or tax-free

Accounting Treatment

Could be either pooling or purchase

Asset Purchase:

Tax Treatment

Almost always taxable

Acquirer writes up the value of the assets and enjoys a depreciation benefit ("step up") going forward
Seller pays tax on any difference between price and basis **at ordinary rates if asset is depreciable, capital gains otherwise**

Accounting Treatment

Must use **purchase accounting**

Stock Acquisition:

Occurs when the acquirer obtains stock in the target in consideration for cash

Tax Treatment

Selling shareholders pay capital gains tax
Acquiring company does not revalue the assets of the target, carrying over the old basis in assets and liabilities
Unless the acquirer makes a 338(h)(10) election in which they have a deemed sale and repurchase of the assets, effectively marking-to-market the position

Accounting Treatment

Purchase accounting

	Accounting Treatment	**Tax Treatment**
Stat. Merger	Pooling or Purchase	Follows accounting treatment
Asset Purchase	Purchase	Taxable with step-up and taxable to selling shareholders
Stock Acquisition	Purchase	Tax-Free (no write-up) unless 338(h)(10) election; CG tax to selling S/H