TAX ACCOUNTING (ASC 740) DEVELOPMENTS

FASB Accounting Standards Update (ASU) 2014-02 – Private Company Alternative for Goodwill and Tax Accounting Implications

7/15/2014

On January 16, 2014, FASB issued ASU 2014-02 describing a simplified, alternative approach for eligible private companies to account for goodwill.

Scope:

A private company may make an accounting policy election to apply the accounting alternative described in ASU 2014-02. A private company is an entity other than a public entity, a not-for-profit entity, or an employee benefit plan.

A public entity is generally defined as an entity that is required to file or furnish financial statements with the Security Exchange Commission (SEC), a regulatory agency other than the SEC or a foreign or domestic regulatory agency in preparation for the sale or the issuing of securities. In addition, an entity is a public entity if it has issued securities or bonds that are traded, listed or quoted on an exchange or over-the counter market or it has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis.

Financial Accounting Provisions:

ASU 2014-02 allows eligible private companies a financial accounting alternative (election) for the subsequent measurement of goodwill:

- Allows private companies to amortize goodwill on a straight line basis over 10 years or less than 10 years if the entity demonstrates that another useful life is more appropriate.
- Required to make an accounting policy election to test goodwill for impairment at either the entity level or the reporting unit level.
- Goodwill should be tested for impairment when a triggering event occurs that indicates that the fair value of an entity (or a reporting unit) may be below its carrying amount.
- When a triggering event occurs, an entity has the option to first assess qualitative factors to determine whether the quantitative impairment test is necessary. If that qualitative assessment indicates that it is more likely than not that goodwill is impaired, the entity must perform the quantitative test to compare the entity's fair value with its carrying amount, including goodwill. If the qualitative assessment indicates that it is not more than likely than not that goodwill is impaired, further testing is unnecessary.
- The goodwill impairment loss, if any, represents the excess of the carrying amount of the entity over its fair value. The goodwill impairment loss cannot exceed the entity's carrying amount of goodwill.
- The disclosure required under this alternative is similar to existing U.S. GAAP.
- An entity that elects the accounting alternative is not required to present changes in goodwill in a tabular reconciliation.

Differences from Current U.S. GAAP:

Current U.S. GAAP requires at least an annual test of goodwill impairment. ASU 2014-02 requires only a "triggering" event test. Current U.S GAAP requires impairment for reductions in goodwill. ASU 2014-02 elects 10 year or less (if demonstrated) amortization of goodwill. ASU 2014-02 eliminates step two of the current impairment test, which requires the hypothetical application of the acquisition method to calculate the goodwill impairment amount. In effect, the election for the alternative goodwill treatment under ASU 2014-02 may provide eligible private companies less complexity and cost in accounting for their goodwill assets. Due to the availability of amortizing book goodwill overtime the risk of impairment will be reduced.

Tax Accounting Implications:

ASC 740 implications depend on whether the goodwill is non-tax deductible or tax deductible:

- **Non-tax deductible goodwill:** Does not change the prohibition on the recognition of a deferred tax liability on goodwill that is not deductible for tax purposes (ASC 740-10-25-3(d)). Financial reporting or book amortization of goodwill will result in an unfavorable permanent difference and a corresponding effective tax rate reconciling item
- **Tax deductible goodwill:** Book amortization typically is a timing difference that would either (1) increase a deferred tax asset for goodwill that has excess tax over book basis, or (2) decrease a deferred tax liability previously recognized for historical tax amortization.
- **Goodwill amortization that includes both tax deductible and non-tax deductible components:** Allocation to each component based on policy choice. Common approaches include pro rata allocation to tax-deductible and nondeductible goodwill.
- **Valuation Allowance Considerations:** Prior to ASU 2014-02, tax amortization of goodwill may have created a deferred tax liability (DTL) that was associated with an indefinite lived asset. A Goodwill DTL would generally not be considered a source of income to support the realization of deferred tax assets when considering the need for a valuation allowance against such deferred tax assets. The election to amortize goodwill over a finite period (e.g. 10 years) may change such a determination and the reversal of the DTL could potentially support the recovery of deferred tax assets.

Effective Date:

ASU 2014-2 is effective for annual periods beginning after December 15, 2014 and interim periods within annual periods beginning after December 15, 2015. Early adoption is permitted. The goodwill alternative would be applied on a prospective basis, with amortization of existing goodwill commencing at the beginning of the period of adoption.

For more information, contact:

Keith E. Winchester, Tax Director
(703) 336-8183
keith.winchester@experis.com
experis.com