Case 13-11B

LOL — Business Combination

Assume a valuation allowance of $105 million is recorded in Issue 1 as of December 31, 2010 ($150 million deferred tax assets (DTAs) less $45 million reversing deferred tax liabilities (DTLs)).

On June 30, 2011, the Company acquires a Utah ski manufacturer, Sundance Alpine Ski Co. (Sundance). Sundance has a net DTA of $200 million but also has a valuation allowance of $200 million before the acquisition.

At the time of the acquisition, LOL determines that there is sufficient objective and verifiable evidence to support removing all of the $105 million LOL valuation allowance and not recording in acquisition accounting $150 million of the Sundance valuation allowance previously recorded (the valuation allowance needed on the Sundance $200 million net DTA as of the acquisition date is therefore $50 million).

On December 31, 2012, LOL determines that it is more likely than not that all DTAs will be realized and therefore reduces the $50 million valuation allowance recorded on the acquired Sundance DTAs.

Note: The case as presented is not considered normal as we would not expect the removal of valuation allowances of two entities when combined when they required valuation allowances when separate. This fact pattern is to illustrate the different accounting rules when valuation allowances are removed as a result of a business combination. Typically only one entity would have a valuation allowance before a combination. The removal of a valuation allowance should always consider all available evidence, both subjective and objective.

- The evidence provided by expected synergies of a business combination would typically be subjective evidence until such synergies are realized.
- The removal of a valuation allowance is assumed for this case, but the evidence supporting the removal has not been provided.
- An executed business combination may not provide such evidence independent of other evidence.

Required:

- Question 1 — Does the release of the $105 million LOL valuation allowance benefit the tax provision or is the adjustment considered an adjustment to acquired goodwill when applying the acquisition method of accounting?
- Question 2 — In adjusting the historical general ledger of Sundance (the acquired entity) in acquisition accounting, an entry will be made to debit the valuation allowance. Does the credit entry that corresponds to that debit relate to the LOL

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tax provision as an income tax benefit or is the entry simply reflected as a credit entry to goodwill as part of the accounting for the acquisition of Sundance?

- Question 3 — Does the release of the $50 million valuation allowance on the Sundance DTA on December 31, 2012 (resulting from new information after the date of acquisition), benefit the tax provision or is the adjustment considered an adjustment to acquired goodwill when applying the acquisition method of accounting?

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