M&A ACCOUNTING

Pooling Primer For Tax Pros

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High-tech prefers no changes. With poolings taking up so much of the accounting press these days, knowing the rules—even for tax pros—is essential. Companies whose primary assets go home at night do not want any changes in the pooling-of-interests accounting rules. Software development companies enjoy the benefits of pooling their business entities, meaning there will be no goodwill to reduce future earnings. They may have little on their balance sheets, since they do not treat development costs as assets until a detailed program design or working model of a product exists. Therefore, they are largely exchanging intangible assets, development rights, and bright ideas. Since these assets are not objectively quantifiable, large amounts of goodwill could result from a purchase transaction rather than a pooling of interests. The industry fears that the FASB's new project on pooling could establish a rule allowing it only if the companies are comparably sized and neither seems to be the acquiror.

Exchanging voting stock is key. For the merger to work as a pooling, the acquiring company must offer only voting common stock to all of the target's holders of common stock (and equivalents). These requirements, established over 30 years ago, still rule the roost and allow cash payments only for fractionals or dissenting shareholders and for less than 10% of the target's stock value. (Preferred shareholders and creditors may be paid off in cash.) The price paid for the target's shares must be fixed and not subject to earnings contingencies, as is often the case with cash acquisitions. The buyer may place a limited number of shares in escrow to secure claims or contingencies but must release them within a year. The combining companies may not treat the shares as additional consideration. If either has been a subsidiary or division of another entity, it must wait two years before qualifying for a pooling transaction.

Forbidden before and after. Companies in a pooling must not participate in any number of events, generally for two years before and after the pooling takes place. Neither company may purchase material amounts of treasury stock for two years before the pooling. Exceptions exist if the company reissues the stock or its repurchase is one of a series that the company uses for a specific purpose (for example, to satisfy stock option shares). Companies must also be wary if repurchasing shares within six months after the pooling, since that transaction is likely to disqualify the pooling retroactively. Major shareholders (10%) of either company may not dispose of their common stock within 30 days before or after the deal, nor may the combined entity dispose of a major portion of its assets within two years after completing the deal.

The Continued Controversy About Pooling Transactions, by Robert Wood. ***M&A Tax Report,*** Vol. 7, No. 6, Pgs. 1-3. Panel Publishers, 1185 Avenue of the Americas, New York, NY 10036. The role of pooling in mergers of Internet companies and the negative impact of the FASB proposal on these deals are discussed in "What Could Burst The Net's Merger Bubble" by Mike McNamee, *Business Week*, March 1, 1999, Pg. 98.