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Share exchange on merger at nominal value releases hidden reserves

The Supreme Tax Court has held that a share exchange at nominal value leading to a transfer of hidden reserves abroad triggers a taxable capital gain for the transferring shareholder.

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A resident natural person shareholder held a 50 percent investment in one GmbH directly and 44.25 percent in a second GmbH through his Dutch investment vehicle, a B.V. His resident natural person partner held the remaining holdings in both GmbHs through his own GmbH. The second GmbH was merged onto the first against an increase in capital represented by two new shares in the survivor issued to the former shareholders of the merged business. The amounts and ratios were set at nominal value of the shares. This approximately equalled the market value of the merged business, but was only somewhat less than 3 percent of that of the survivor. Effectively, therefore the natural person shareholder transferred significant value in the form of hidden reserves to his B.V. through the share exchange.

The Supreme Tax Court has now held that this transfer of value is effectively a hidden contribution of capital to the B.V. Because it now held shares in the acquiring GmbH, it participated in that company's hidden reserves represented by the difference between the book and market values of the shares. Since the merged GmbH had not held hidden reserves to compensate, the natural person shareholder in the survivor faced a dilution in the value of his investment, balanced by an accretion in value to his holding in the B.V. This was equivalent to a realisation of an inherent gain and taxable as such.

Supreme Tax Court judgment IX R 24/09 of November 9, 2010 published on January 26, 2011

Keywords

Share exchange, capital gain, hidden contribution merger, hidden reserves, transfer