Downloaded from Blogs on 03.11.2026 03:54

By PwC Deutschland | 21 March 2013

Asset transfer costs from sidestream and downstream mergers not deductible

The Supreme Tax Court has held that the exclusion of merger cost as part of the non-taxable profits and losses on merger also applies to indirect shareholdings.

Downloaded from Blogs on 03.11.2026 03:54

The Reconstructions Tax Act explicitly excludes merger profits and losses from taxation. Merger profits and losses are defined as the difference between the transfer value of the assets transferred and the book value of the shares cancelled, less the direct expenses incurred in completing the transaction. Many commentators take the view that this explicit link to the shares cancelled implies that the exclusion does not apply where there are no shares to be cancelled. Differences between the transfer values of assets and the nominal value of new shares issued should be taken to capital reserve as those arising from any other capital contribution in kind. The direct costs of the transfer are deductible as general business expenses for want of a specific disallowance. Thus the costs of completing a sidestream merger (the assumption of assets from a fellow subsidiary in exchange for new shares issued to the common shareholder) or a downstream merger (the transfer of a business segment to a subsidiary in exchange for new shares in that subsidiary) as opposed to those of an upstream merger (the transfer of assets to the parent and the cancellation of the shares issued by the company) are deductible.

The Supreme Tax Court has now rejected this view. The case involved a sidestream merger, but the ruling applies equally to a downstream merger or dropdown. The court found that the context and object of the disallowance provision in the act made clear that it should apply to all share transfers governed by the act, even if the no shares are cancelled. Thus the costs of completing the asset transfer are disallowable regardless of whether shares are issued or cancelled.

Supreme Tax Court judgment I R 24/12 of January 9, 2013 published on March 20

Keywords

downstream merger, merger, sidestream merger