

By PwC Deutschland | 08.08.2016

Negative Goodwill in the case of a contribution

The Federal Supreme Tax Court upheld a decision of the Münster Tax Court and held:

Where the total value of the goodwill of a business/business unit, which has been contributed into a corporation as a contribution-in-kind under the terms of the Reorganisation Tax Act, does not exceed the total book values of the individual business assets because of the existence of negative goodwill, the acquiring company may not step-up the book values of the individual assets of the business property to a higher value, even if the fair market value of those individual assets exceeds their book value.

The case in question related to a contribution of a business unit into a corporation in exchange for new shares under the Reorganisation Tax Act 1985. (This Act has since been amended, but the judgment should still be relevant to the Reorganisation Tax Act 2006.)

Under Section 20 of the Act the acquiring company may elect to record the contributed assets at their tax book value or a higher value, provided the value recorded does not exceed the fair market value of the business/business unit.

In the instant case, the acquiring company (the appellant) recorded in the relevant balance sheet the assets of the contributed business unit at a value higher than their tax book value, but not in excess of their fair market value. The business unit in question was as a whole loss-making with a negative goodwill, so that the fair market value of the business unit as a whole was less than the total market value of the individual assets together. It had been accepted by the lower court (following the agreement of the parties) that the value of the business unit as a whole corresponded to the previous tax book values of the individual assets applied previously by the contributor.

The Court held that in the case of the contribution of a business/business unit, it was not only the values of the individual capitalised assets that were relevant, but also the value of the contributed business/business unit as a whole. Thus, it was not possible for the acquiring company to step up the value of the individual assets contributed to a value which would be higher than the going concern value of the assets as a whole, taking into account the negative goodwill.

The Court, following settled case law, further held that the contribution of a business, of a business unit or of share in a partnership for new shares in the acquiring company amounts to a barter transaction, and is thus a sale on the one side and an acquisition on the other. It follows, therefore, that the value which the company attributes to the contributed assets in its books, constitutes the sales proceeds for the contributor (as well as the acquisition costs for the new shares) and the relevant acquisition costs of the individual assets for the company.

Referring to its earlier dicta, the Court stated that, in the case of a contribution, available hidden reserves relating to particular business assets cannot just be allocated at will, but rather any available good will to be stepped-up is to be allocated equally among the assets. As a consequence, the Court stated, in calculating the maximum step-up, the value of the contribution as a whole must be observed and any negative goodwill should be considered.

Supreme Tax Court judgment I R 33/14 of 28 April 2016, published on 4 August 2016

Keywords

Negative Goodwill, Reorganisation Tax Act, Step up, contributions