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BFH rules on tax treatment of accruals for contingent losses transferred in asset deal

The Federal Tax Court (BFH) recently decided on the tax treatment of accruals for contingent losses where the accrual had been transferred to the acquirer in the course of an asset deal (case reference I R 102/08).

In the case, the seller of a business unit transferred to the acquirer, inter alia, an accrual for contingent losses relating to lease agreements with third parties. The tax authorities took the position that the acquirer has to account for the accrual as of the acquisition date but has to release the accrual in the fiscal year-end tax balance sheet on the grounds that accruals for contingent losses may not be accounted for under German tax law.

The BFH disagreed, holding that the accrual may not be treated as an accrual for contingent losses after the acquisition. Instead, due to the acquisition, the accrual converts to an accrual for uncertain liabilities which may be shown in the tax balance sheet because the assumption of liabilities in the course of an acquisition constitutes part of the purchase price for the acquired assets. This purchase price obligation is subsequently fulfilled by assuming the liabilities. Thus, the obligation of the acquirer is to release the seller from its liabilities so that the accrual no longer reflects a contingency relating to a third party contract, but rather an uncertain obligation towards the seller.

With its decision, the BFH has upheld the overriding principle to treat acquisitions as tax neutral and thus put an end to a long-standing debate on how to deal with the tax prohibition on accounting for contingency accruals in asset deals.

If you have any questions, please contact the authors of this article at gtln@deloitte.de or your regular Deloitte contact.

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