

DEVELOPMENT AND CURRENT CRITICISM OF ASSET IMPAIRMENT IN GERMAN TAX ACCOUNTING

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Abstract

In German tax accounting, the going concern value (“Teilwert”) is the central measurement of asset impairment since 1934. The conceptual weaknesses of the concept have set the future of the 80-year old fiscal measurement tradition up for discussion. First, I shed light on the development of the accounting measurement concepts from Prussian Civil Code 1794 (ALR) to the German Income Tax Act 1934. Then, I analyse the main results of the current tax jurisdiction and draw a comparison to the German commercial law and the IFRS. I state that the creation of a common basis for measurement under commercial and tax law would be desirable, since the going concern value was understood as neither an exception, nor as being subject to the whims of targeted tax accounting policies. The provision of a purely indicator-based impairment test by the IASB is also recommended.

Keywords: Going Concern Value; Tax Accounting; Asset Impairment; Fair Value; Cash Generating Units

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1. Introduction

Under German Tax Accounting Law, the measurement of the going concern value (so called “Teilwert”) and the write-down of assets to going concern value have constituted fundamental controversies since the German Income Tax Act 1934 was introduced. The debate largely focuses on material conceptual weaknesses and room for interpretation in the company-specific calculation of the going concern value, as well as the proof of expected ongoing asset impairment. The German judiciary has invested a multitude of casuistic efforts to clarify the write-down to going concern value since the 1920s, some of which have been inconsistent with fiscal administration. In contrast to the principle of prudence pursuant to the German Commercial Code (HGB), the recent focus has been on the reporting and valuation of the options and exceptions provided for the write-down to going concern value in order to generate additional tax income. The conceptual weaknesses of the concept of the going concern value and the discretionary powers in the context of the write-down to going concern value are profound and have set the future of the 80-year old fiscal measurement tradition in Germany up for discussion. In light of this current situation, the objective of the analysis provided in this paper is to illustrate the historical development of the going concern value while taking into account the judiciary and the fiscal administration, and to offer recommendations for the future development of the write-down to going concern value. Comparable measurement standards under the German Commercial Code (HGB) and the

International Financial Reporting Standards (IFRS) are included in the discussion of an appropriate reform of the write-down to going concern value.

The course of examination is broken down as follows: Before the legitimacy of a write-down to going concern value on account of an expected ongoing asset impairment is discussed in detail, chapter two will provide a detailed analysis of the definitional classification of the going concern value. In this context, the development of the measurement concepts of the lower applicable value and the going concern value from Prussian Civil Code of 1794 (ALR) to the German Income Tax Act 1934 will be the starting point for the present discussion. Fictions in connection with the understanding of the going concern value for income tax purposes, the lower and upper limit of the going concern value, as well as the assumptions relating to the going concern value and their company-specific refutation round off the second chapter. The third chapter begins with an examination of the controversial reporting and valuation options for the write-down to going concern value for tax purposes, taking particular account of the principle of consistency. Next, the requirements for an expected ongoing asset impairment or reversal of the impairment are explained. With a view to a future modification of the write-down to going concern value, the fourth chapter comprises a comparative appraisal of the relevant measurement concepts for assets under the German Commercial Code and international standards (lower applicable value, fair value, value in use and net selling price). A summary of the findings is provided in chapter five.

2. Legal concept of the going concern value and judicial clarification

2.1. Diversity of the measurement standards in German law history

The adoption of the General German Commercial Code (ADHGB) 1861 established uniform measurement rules for the states of the German Confederation for the first time. It determined in article 31 that all fixed assets and receivables shall be recorded at their fair value at the time of recording. The definition provided by the legislature stood in contrast to that of the Prussian Civil Code (“Allgemeines Preußisches Landrecht (ALR)”) 1794, which provided for the measurement of assets at their fair market value. Consequently, an asset’s value would not be based exclusively on its net asset value, but would also include its benefit in the specific circumstances (Lange 2011, 55). The lower applicable value under ADHGB 1861 as an indeterminate legal concept proved a highly valuable guide and a standard requiring interpretation and improvement (Makower 1865, 10). The first attempt to provide guidance and clarification was based on the decision of principle of the Higher Commercial Court of the Reich (“Reichsoberhandelsgericht (ROHG)”) (1873). The lower applicable value was interpreted as a general market value that could not be set at equal with a value proposition based on subjective judgement or pure speculation. Although the market value has been justified as a selling price with the concept of accounts as statistics of divestiture (Koch 1957, 3), the ROHG (1873) unequivocally clarified that the objective is the going concern of the business and therefore any impact liquidation would have on an individual asset should not be taken into account in the determination and assessment of its value. However, the relevant decision contained no indication of an approach to the quantification of the difference between liquidation value and going concern value (Lange 2011, 75). Based on this issue, the Imperial Court of Justice (“Reichsgericht (RG)”) (1887) state that the value which the individual assets hold for the business should be taken into account, given that individual assets in themselves generate no income. In a later judgement, the RG (1899) realised that business yields could not be taken into account for the individual measurement it had demanded.

With the introduction of the authoritative principle (see Freidank and Velte 2010), first in Saxony and Bremen (1874) and later in Prussia (1891), the measurement rules according to the German Commercial Code were consulted for the determination of profits for tax purposes. Uniform tax laws for the entire Reich at the commencement of the Weimar Republic in 1919 created the foundation for a uniform measurement standard by means of the Reich Tax Code (“Reichsabgabenordnung (RAO)”) 1919. It provided the first codification of the fair market value,

i.e. the price which would be achieved for an item in the ordinary course of business on account of its condition and giving due attention to all factors that would influence such price. In this context, the going concern of the organisation was equally assumed, and the option to permit the recognition of assets permanently dedicated to the operation of the business at a lower value was included, if it truly equals the actual value at the time the accounts are prepared (section 139 RAO 1919). The intention was to capture impairment charges as the difference between the actual value of an asset and its depreciated acquisition and manufacturing costs. In this context, the RAO 1919 is considered the starting point of the going concern value concept from a fiscal perspective (Lange 2011, 98).

The German Income Tax Act (1920) implemented the requirement to apply the measurement principles defined in the RAO, giving priority to the RAO over the German accounting principles set out in the German Income Tax Act (“Einkommensteuergesetz (EStG)”), insofar as relevant provisions exist under RAO and these contain no gaps. Consequently, the fair market value could be higher or lower than the acquisition or manufacturing costs. In order to address inflationary trends, the Amendment of the Income Tax Act (1921) included the historical cost principle as an upper measurement limit, leaving only the option to recognise a lower fair market value. However, once the currency stabilised, EStG 1925 once again allowed an alternative measurement at (higher) fair market value and acquisition costs. Simultaneously, the Reich Valuation Law declared the fair market value as the decisive measurement standard. The (depreciated) acquisition or manufacturing costs set out in Section 6 EStG have been the predominant measure of value since the German Income Tax Act (1934) while also serving as a ceiling for non-current and current assets for tax accounting. From this point onwards, the fair market value of an asset could no longer be substituted for its (depreciated) acquisition and manufacturing costs; the only alternative measurement available now is the (lower) going concern value pursuant to Section 6 Subsection 1 no. 1 clause 2 and no. 2 clause 2 EStG. Meanwhile, Section 6 Subsection 4, 6 clause 1 EStG provides that the fair market value should be used in the case of a gratuitous asset transfer from the business assets of an entity subject to tax to the business assets of another entity, in the case of an exchange, as well as in the event of the exclusion, limitation or establishment of taxation in Germany. In accordance with Section 6 Subsection 1 no. 1 clause 3 EStG, the going concern value measures the amount which a buyer of the entire operation would estimate for the individual asset as part of the total purchase price of the business based on the assumption that the buyer will continue the operation of the business. This definitional understanding and its position on the adjustment value for the acquisition or manufacturing

costs have remained unchanged since the introduction of the German Income Tax Act of 1934.

The term and fundamental concept of the going concern value are based on a concept put forward by Mirre (1913) who criticised the consideration of individual asset values employed under the concept of fair market value, given that the enterprise value cannot be explained in its entirety by the sum of individual assets and liabilities. Rather, a multitude of synergy effects (Mirre 1913, 163) affect the original goodwill which is not eligible for recognition. The missing value which would reflect the economic value of the asset for the company as a whole (calculation of total value) should be expressed by means of the going concern value. From a fiscal policy perspective, the fact that the going concern value generally exceeds the fair market value constitutes a benefit, as the creation of unwarranted hidden reserves is prevented (BFH 1980). While the fair market value considers the disposal of an individual asset in isolation, the going concern value additionally captures the added value resulting from the combination of the individual asset and the total assets of the business. Nevertheless, this difference in conceptual understanding between the fair market value and the going concern value (BFH 1955) does not exclude the possibility of both values being equal (BFH 2001b).

2.2. Fictions of the going concern value and value range

The understanding of the going concern value pursuant to the German Income Tax Act (1934) constitutes a theoretical construct grounded in three hypothetical assumptions (BFH 1968). The first fiction refers to the acquisition of the entire business, whereby the legal permissibility or actual possibility of an acquisition by a third party is not material. The entity subject to tax might consider a disposal as entirely unacceptable. Although the going concern value was only explicitly codified through the German Income Tax Act of 1934, the Reich Court of Finance (“Reichsfinanzhof (RFH)” (1926)) had already confirmed it as a comparative value for the acquisition or manufacturing costs as defined in Section 19 Subsection 1 clause 2 EStG 1925. Here, a differentiation was made between the value of an asset as part of the economic unit (going concern value) and the value of an asset after removal from its economic context (individual value) (RFH 1926). In this respect, the central issue of the landmark decisions of the RG in 1887 and 1889 is raised again. The (added) value which should be allocated to an asset in the context of business operation, i.e. on account of its integration in business operations needs to be quantified. With respect to assets that cannot be sold individually for legal or factual considerations, the hypothetical buyer of the company must assume the position of the company owner and determine the

value of the asset from this perspective (BFH 1976). The fictitious buyer’s lack of interest in the acquisition of a particular asset or any incentive for the avoidance of specific incidental costs cannot be invoked (BFH 1966a). Moreover, the entity subject to tax must take into account the company-specific situation when determining the going concern value, giving due consideration to the market situation, the sector and location of the business premises as key factors of influence (BFH 1973a).

The second fiction is the determination of the going concern value in consideration of the going concern of the business and expectations for the future. The RFH (1928) had already clarified before the Amendment of the EStG that the fair market value as defined in EStG 1925 was not a liquidation value, but had to serve the going concern of the business. Therefore, the approach of considering the individual selling price in the fictitious context of asset stripping is excluded (BFH 2005). Rather, the going concern value must be understood as a going concern value in terms of affiliation with an active company that continues its participation in economic activities. The assumption is made that the fictitious buyer would continue the operation of the business in the same manner as the entity subject to tax did on the valuation date (continuity of business operations) (BFH 2002a). Insofar as no unsound measures have been taken, the fictitious buyer will be guided by the same considerations as the seller and appropriate the same value to the relevant asset as the entity subject to tax (BFH 1967). This only places the hypothetical buyer in the position of the relevant entity subject to tax for the purpose of measurement (BFH 1995). What are not recognised are the motives of the entity subject to tax which are entirely subjective and not based on the objective nature of the company, e.g. the business acumen of the managing director. This perspective also highlights the fiscal administration of Guideline 6.7 German Income Tax Guidelines (“Einkommensteuerrichtlinien (EStR)), given that the going concern value is an objective measure of value dependent on the market situation on the reporting date which must be determined by means of estimation in accordance with the individual situation. This implies a factual determination and free consideration of evidence, requiring conclusive, economically feasible and reasonable estimation results.

The third fiction requires the allocation of the total purchase price to the individual assets, given that the going concern value of an asset constitutes a part of the enterprise value. Thus, the going concern value calculated in accordance with the differential method represents the amount which the fictitious buyer would deduct from the purchase price of the company if the relevant assets were not included in the acquisition (RFH 1926). On account of logic inconsistencies, the differential method was abandoned in favour of purchase price allocation

methods (RFH 1928). Compliance with the individual measurement principle of the German accounting principles (“Grundsätze ordnungsmäßiger Buchführung (GoB)”) on the one hand, and the necessity of the determination of the income-related total value on the other hand, should provide an allocation of the fictitious total value to the going concern values of the individual assets (RFH 1935). In this respect, an identity between the sum of the individual values of the assets and the total value of the business had been simulated (RFH 1938). Even though the purchase price allocation method proved unsuitable, it materially influenced the legal definition of the going concern value pursuant to the tax law 1934.

Other methods proposed for the deduction of the going concern value presented in the literature (Gümpel 1987) did not prevail in the courts and were discontinued over time. To serve the purpose of the classic theory of the going concern value, the Federal Court of Finance (“Bundesfinanzhof (BFH)”) established going concern value assumptions within upper and lower limits by means of case-by-case decisions with case-by-case refutations as a second best solution (Löffler 2011, 83). Over time, these going concern value assumptions resulted in increasing fragmentation with respect to the determination of the going concern value for individual assets, and consequently there is no longer a conceptual relationship between the going concern value and the income-related total value pursuant to Section 6 Subsection 1 no. 1 clause 3 EStG. Nevertheless, the measurement of the going concern should be charged to the entity subject to tax in accordance with the total enterprise value (BFH 1968). Until today, the position of the judiciary has continued in favour of a price- or cost-based net asset valuation. In contrast to the RFH (1926; 1928), the BFH (1973b) clarified that the consideration of the total purchase price would not go as far as a pro rata allocation of the enterprise value calculated according to the capitalised earnings method to the individual assets (BFH 1973b). The determination of the total purchase price would only constitute a tool for the calculation of the share attributable to the assets included in the sale (BFH 1968). The total value of the business, including any existing goodwill, should not be determined from the top down (BFH 1973b), but rather developed from the bottom up by adding the individual going concern values. The court stated that the going concern value was introduced back in 1934 based on the concept of net asset value and not that of capitalised earnings (BFH 1999b). Otherwise, the formulation of Section 6 Subsection 1 no.1 clause 3 EStG would not have been placed in the context of the total purchase price, instead the term part of the total purchase price would have been used. The BFH (1999b) acknowledges the fact that the relationship between the going concern value for tax purposes and the principle of individual measurement is beset by

tensions. However, it requires that the individual measurement should not take priority over the concept of the going concern value. The buyer of an asset would include aspects of both the intrinsic value and capitalised earnings (BFH 1989a). While the BFH (1981) issued statements on the determination of the going concern value in later years that discuss a distribution of the total purchase price to individual assets, these are not convincing in the context of an overview on account of their conceptual inconsistencies.

The value range of the going concern value is defined by the individual selling price as a floor and the replacement or reinstatement costs as a ceiling. The RFH had already confirmed the replacement cost for the deduction of the going concern value as a net asset value in 1926. It constitutes the expenditures necessary to purchase or create assets of the same type and quality on the valuation date. This requires a company-specific measurement. The stock exchange or market price could act as a basis for the determination of the replacement costs if such prices exist for the asset on the valuation date; alternatively, the purchase price applies (BFH 1965). In contrast, reinstatement or reproduction costs describe the expenditures necessary for the reinstatement of an asset of the same type and quality and at the same stage of production on the valuation date by the fictitious buyer of the entire company (BFH 1970). Meanwhile, the individual selling price or market value constituting the lower limit for the going concern value measures the price that could be achieved for an asset in the event of an individual sale or liquidation (BFH 1987). Given the applicability of the principle of business continuity from a conceptual perspective - as discussed above - and the judiciary attempts to exclude isolated measurement, this constitutes a conflict. Consequently, the individual selling price may only be recognised as the going concern value if the relevant asset is dispensable in business operations, as, in this case, no added value is created within the context of business operations. In this case, the individual selling price equals the fair market value pursuant to Section 9 German Valuation Act (“Bewertungsgesetz (BewG)”) less the expected disposal costs (BFH 1986). It is also noted that the replacement cost and the individual selling price would frequently correspond. However, in certain instances, the individual selling price could also exceed the replacement costs (BFH 1983a).

2.3. Going concern value assumptions and their refutation

In order to mitigate the difficulties of the determination of the going concern value and to conceal the lack of conceptual development of the going concern value, the BFH had established refutable going concern value assumptions, which as a whole reflect the key practical cases of write-downs to

going concern value and therefore contain no systematic understanding (Knobbe-Keuk 1993, 177). They illustrate the rule-exception-relationship between acquisition or manufacturing costs and the going concern value or the corrective nature of the going concern value:

1. At the time of the acquisition or completion of an asset, the going concern value of this asset equals the acquisition or manufacturing costs (BFH 2007a). This assumption is based on the general economic experience that neither a merchant, nor a fictitious buyer would pay more for an asset than the benefit derived for his business (BFH 1998).

2. With respect to fixed assets not subject to wear, this assumption also applies on subsequent valuation dates (BFH 2007a).

3. With respect to fixed assets subject to wear, the going concern value on subsequent valuation dates equals the acquisition or manufacturing costs less the linear scheduled depreciation (BFH 2001a). Thus, the going concern value assumption does not apply, if the asset has been depreciated according to the declining balance method, or an amortization charge for an intangible asset with a finite useful life, special write-downs or increased amortisation charges have been applied (BFH 1989b).

4. The going concern value of current assets equals the presumed replacement or reinstatement costs (BFH 2000), whereby the expected sales revenue (stock exchange or market price) must also be included for goods held for sale (BFH 1983b). According to the differential theory, the fictitious buyer would procure or manufacture the asset himself, if it were missing in the acquisition of the business. Given that the factors of influence on the going concern value categorically take effect quicker for current assets than fixed assets, the going concern value assumption does not aim at the acquisition or manufacturing costs. In contrast to the fixed assets, fiscal administration has provided detailed explanations for the measurement of the inventory at going concern value in Guideline 6.8 EStR. Thus, for the inventory, the assumption that going concern value = replacement cost continues to apply if the purchase price on the reporting date is lower than the historical cost, even if a corresponding sales price reduction is not expected. For inventories not held for sale, the individual selling price is entirely irrelevant to the determination of the going concern value. For inventories held for sale, the going concern value must be recognised at the amount which remains after deduction of the average enterprise profit and the operating expenses still to be incurred after the reporting date from the expected achievable selling price (subtraction method). As a rule, the going concern value should equal the amount resulting from the deduction of the share of the average gross profit margin incurred after the reporting date from the achievable sales revenue.

5. Finally, a specific going concern value assumption is made for investments recorded at equity. With respect to the identity between the going concern value and the acquisition costs at the time of acquisition, the determination of the value based on the concept of total enterprise value must include the results of operations, the expected results of operations, as well as the assets and the functional significance of the holding (BFH 2003).

The refutations of going concern value assumptions are linked to restrictive conditions, given that the required facts must be stated explicitly to invalidate the assumptions. Documentation must provide the reason for and the amount of the write-down to going concern value in a manner verifiable by the fiscal authority (BFH 1975). This requires a substantiated description of the actual situation and effects on the costs, to facilitate a specific understanding of the impairment. They will therefore also stand up if excess prices are paid. A refutation of the going concern value assumption for an asset on the valuation date is tied to the existence of a lower going concern value compared to the book value for various items. In this context, and in accordance with objectively identifiable facts, the replacement or reinstatement costs on the reporting date must verifiably be lower than the going concern value (BFH 2002b), or the expected sales revenues must have dropped, or other circumstances must have materialised that reduce the going concern value of the asset.

On the other hand, a refutation of the going concern value assumption is possible for reasons of an unsound measure. For the purpose of such refutation, the entity subject to tax must show by means of specific facts and circumstances that the acquisition or production of the relevant asset constituted an unsound measure from the beginning, or that circumstances materialised between the point of acquisition or production and the reporting date that resulted in an ex post facto unsound measure. An unsound measure is defined in Guideline 6.7 EStR as the economic benefit of the acquisition or production of an asset irrespective of the results of operations of the business objectively and significantly lagging behind the expenditure incurred for the acquisition or production of the asset, resulting in an expenditure which is uneconomic to the extent that it would not be honoured in the purchase price by a fictitious buyer of the entire business (BFH 1988a). The entity subject to tax must have included incorrect or erroneous assumptions in its considerations that led to the purchase or production of the asset (BFH 1972). The extent to which misguided considerations might be deliberate is disputed. For a profit-oriented business, an unsound measure cannot be claimed for deliberate loss-making products that are intended to increase the attractiveness of the company as loss leaders. The BFH (1999a) justifies the inapplicability of the write-down to going concern value with the adoption of the

same strategy by the fictitious buyer of the business. However, this typified course of action has received critical commentary in the literature (Marx 2014, 592). If a business is unprofitable, lower going concern values can also not be claimed if the company fails to take measures to liquidate or close down the business as soon as possible (BFH 1973c). With respect to the acquisition of property, Guideline 6.7 EStR points out that the mere fact that an excessive price has been paid and consequently an unsound measure has been taken, does not establish a write-down to going concern value. Rather, the excess price can only be included in the write-down to going concern value to the proportionate amount that the comparative value has reduced compared with the time of acquisition if lower replacement costs can be proven on the valuation date (BFH 2002b).

3. Requirements for the recognition of write-downs to going concern value for assets

3.1. Fiscal reporting and valuation options and the principle of consistency

Since 2009, the prevailing view is that the write-down to going concern value constitutes fiscal reporting and valuation options which - contrary to the former scope of the authoritative principle - can be exercised independently from impairment charges pursuant to Section 253 Subsection 3 clause 3, 4 and Subsection 4 clause 1 German Commercial Code ("Handelsgesetzbuch (HGB)") (Günkel 2010, 513). This assessment is based on the limitation of the authoritative principle in Section 5 Subsection 1 clause 1(2) EStG ("unless a different approach has been chosen in the context of the exercise of fiscal reporting and valuation options"). Consequently, the entity subject to tax could equally waive a write-down to going concern value if an impairment charge has been recognised in the financial statements. The fiscal administration also highlights these autonomous fiscal reporting and valuation options in the circulars of 2010 by the German Federal Ministry of Finance ("Bundesministerium für Finanzen (BMF)") (2010) and Guideline 6.8 Subsection 1 clause 3 German Income Tax Guidelines ("Einkommensteuerrichtlinien (EStR)"). Such exercise in fiscal autonomy in terms of a waiver or regular refusal of a write-down to going concern value would highlight its exceptional character. Reporting and valuation options are meant to assist the prevention of the creation of hidden reserves in the interest of the ability-to-pay principle (Sittel 2003, 71). However, reporting and valuation options also create a basis for a targeted tax accounting policy, which in turn is not consistent with the supplementary principle of uniformity of taxation (Henrichs 2013, 535). Moreover, it should be noted that in the course of the legislative procedure law

reform 2009, the Federal Council of Germany had encouraged a clarification, while the Federal Government had no intention of changing the scope of the authoritative principle. Rather, it was established that the authority of the impairment charge under the German Commercial Code should continue to apply to the write-down to going concern value. The statement offered by the Federal Government in the explanatory memorandum was insufficient to abide by the authoritative principle for the write-down to going concern value. Nevertheless, it contradicts the prevailing view in the literature that the classification of the write-down to going concern value is an autonomous fiscal reporting and valuation option (Arbeitskreis Bilanzrecht der Hochschullehrer Rechtswissenschaft 2009, 2571).

Analogously to the impairment charge, the tax accounting policy is not limited by the principle of consistency in the context of the write-down to going concern value (Velte 2014, 240). Apart from the approach of lower going concern value or continuation with discounted acquisition or manufacturing costs, the prevailing view is that intermediate values may also be considered. The literature additionally considers as permissible the retrospective recognition of the write-down to going concern value over time and the alternation between a write-down to going concern value and a reversal of the impairment (Zwirner and Künkele 2013, 2078). However, with regard to the BMF (2010), the fiscal administration demands compliance with the principle of consistency in the event of conscious change between write-downs to going concern value and reversal of the impairments. This aims to ensure that the exercise of the reporting and valuation options is not based on arbitrary arrangements. The assessment in the literature only necessitates a consistency test, if the reversal of the impairment is only applied to the accounts for tax purposes and not to the financial statements for reporting purposes (Dietel 2012, 484). Overall, the discussion results in a broad range of fiscal accounting options when a write-down to going concern value is recognised, while the room for interpretation in the projection of the impairment has not yet been targeted.

3.2. Expected ongoing asset impairment

With respect to the interpretation of the indeterminate legal concept of expected ongoing asset impairment, the explanations of the BFH (2009) constitute tautology. A write-down to going concern value requires an expected reduction in value of the asset below the applicable book value. While the asset impairment need not be final, it equally must not be temporary (BFH 2011). Thus, the entity subject to tax must seriously expect an ongoing impairment on the reporting date on the basis of objective evidence (BFH 2007b). Moreover, the specific character of the relevant asset is granted a material significance for the

projection. From the perspective of a prudent and diligent businessman (BMF 2014), the reasons for the ongoing nature of the impairment must outweigh the reasons against the same. The statutory requirement of objectivity in the determination of the going concern value is mitigated by subjective influences (Prinz 2014, 1827). As a general guideline aligned with the requirement for the write-down to going concern value of fixed assets, the relevant asset must be expected not to achieve its (discounted) acquisition or manufacturing costs throughout a material proportion of its expected retention time within the company (BMF 2014). In the context, impairments for special cause, e.g. catastrophes or technological advances, are regularly considered ongoing.

The reporting date is the authoritative time of valuation for the going concern value (BFH 1997). Consequently, the circumstances that impair the going concern value on the reporting date, must have existed in the actual value relationship. This is consistent with the adoption of the principle of adjusting events pursuant to Section 252 Subsection 1 no. 3 German Commercial Code (HGB), according to which any information or events that may influence the result and which come to light after the reporting date known at the time of the preparation of the financial statements for reporting purposes or the accounts for tax purposes (if no obligation to prepare financial statements exists) (BMF 2014) must be included in the financial statements and accounts. A period-based consideration which had been included in the draft version of the new decree on the going concern value was not adopted. The BFH (2011; 2013a) emphasized the reporting date orientation, opening the door to criticism for the tacitly implied information efficiency hypothesis. At the same time, Guideline 6.7 EStR contained a note that the write-down to going concern value must be executed exclusively on the balance sheet date and not on any other random day between the balance sheet date and the reporting date.

3.3. Reversal of impairment

If write-down to going concern value has been performed and the value of the relevant asset subsequently increases, a reversal of the impairment at the next balance sheet date has been compulsory since the German Tax Relief Act (“Steuerentlastungsgesetz (StEntlG)”) 1999/00/02. The write-up is not subject to a de minimis limit of 5%, wherefore the write-down to going concern value and the reversal of the impairment are not treated equally (Prinz 2014, 1829). Thus, the extent to which the going concern value (valuation floor) is still below the discounted acquisition or manufacturing costs (valuation ceiling) should be examined. In this context, the continued existence of the specific reasons for the initial write-down to going concern value is immaterial. An adjustment of the balance sheet recognition is also necessary from other

perspectives, e.g. if the entity subject to tax is lacking opportunity or tendency to substantiate (BMF 2014). This constitutes de facto impairment reversal options at the expense of the principle of uniformity of taxation (Adrian and Helios 2014, 727). The entity subject to tax must categorically substantiate the valuation ceiling (historical acquisition or manufacturing costs) with appropriate documentation. For undeveloped real property, the notarised contracts held at the Land Registry would offer such substantiation (BMF 2014). If the substantiation of the historical acquisition or manufacturing costs is impossible, the book value in the oldest accounts still available will be considered as the valuation ceiling. However, the fiscal authority may determine a higher valuation ceiling.

4. Comparison of the going concern value concept with alternative accounting standards

4.1. Current value under German Commercial Law

The perpetuation of the going concern value concept has resulted in vigorous controversy in the German literature throughout recent decades (Hennrichs 2013, 523). This ambivalence characterises the 80-year old legal tradition of the going concern value under German Income Tax Law, whereby the calls or plans for its abolishment (e.g. Ernst & Young 2004) have not thus far been realised. We will compare the measurement concepts of the book value under German commercial law, as well as the fair value, the value in use and the net realisable value under IFRS, in order to develop the fiscal going concern value concept.

German commercial law has always shown a commitment to a strict interpretation of the creditor protection principle and categorically only permitted the (lower) book value for impairment charges in accordance with the principle of valuation at the lower of cost or market. However, the draft bill intended the replacement of the book value with the fair value in accordance with the IFRS, which should equal a market price pursuant to Section 255 Subsection 4 clause 1 draft of the German Commercial Code (HGB). While the book value as an adjustment benchmark for fixed and current assets has been retained in the final law version, the historical cost principle has been punctuated ever since. The specification of the book value in the context of the going concern value concept is riddled with difficulties and estimation issues, as has already been illustrated in the context of the introduction by means of the ADHGB 1861. Moreover, neither the German accounting principles, nor the rulings of the BFH insist on a compulsory method of measurement. The law reform 2009 was linked with an obligation to apply impairment charges in the event of an expected

ongoing impairment of fixed assets and the option of an impairment charge for an expected ongoing impairment of financial assets for the financial statements for reporting purposes which apply irrespective of the legal form of the entity (Section 253 Subsection 3 clause 3, 4 HGB). Meanwhile, impairment charges to the lower stock exchange or market price or book value in accordance with the principle of valuation at the lower of cost or market are now required for current assets irrespective of the duration of the impairment (Section 253 Subsection 4 clause 1 HGB). Analogue to the fiscal law, a requirement for the reversal of the asset impairment in the financial statements must also be observed under Section 253 Subsection 5 clause 1 HGB, whereby derivative goodwill is excluded.

The relevant supporting values of the book value must be derived from the procurement and sales market. Given that the assumption of the continued use of fixed assets categorically applies, the condition of the procurement market has priority. Accordingly, the replacement or reinstatement costs are relevant for the going concern value ceiling. If a stock exchange or market price value for an asset can be determined, the replacement cost is represented by the stock exchange or market price on the reporting date in accordance with the ruling of the BFH for publicly listed shares (Adler, Düring and Schmaltz 1995). The individual selling price as a going concern value floor only applies in exceptional cases for the deduction of the book value under commercial law. While the legal definition of the going concern value implies capitalised earnings, the rulings of the BFH do not require them for any specific estimation; and under commercial law, it is recommended as a supporting value if a value cannot be determined from the perspective of the buyer or seller, e.g. for investments recorded at equity or intangible assets (Adler, Düring and Schmaltz 1995). In contrast, the stock exchange or market price should be the primary measure for current assets pursuant to Section 253 Subsection 4 clause 1 HGB, insofar as it exists. This point also corresponds to the rulings of the BFH on the going concern value. If the stock exchange or market price cannot be determined, Section 253 Subsection 4 clause 2 HGB provides for an alternative recognition at the lower book value. Guidance by the procurement market once again considers the replacement or reproduction costs; the sales market considers the selling price less the expenditures still arising until the point of sale (Freidank and Velte 2013, 469).

In the context of the principle of prudence, the recommendation for the interpretation of an expected ongoing asset impairment is to assume such an impairment if in doubt, unless specific evidence of a temporary opinion exists. Here, the legislature in its justification for the draft bill the law reform 2009 had assumed a temporary impairment, if there is a reasonable prospect that the evidence for an impairment would cease within twelve months. The

assumption of a projection horizon of one year for reasons of prudence was also taken into account for the reform of the group management report pursuant to the German Accounting Standards 20.127. In the case of fixed assets subject to wear, for the assessment of durability under commercial law, half the remaining useful life or a reasonable period of 3-5 years (as is used in operational organisational planning) is assumed in accordance with the rulings of the BFH. A restriction of the time period is especially useful for assets with a longer useful life, as it avoids an over-complication of impairment charges.

As shown above, the ceiling and floor for the book value and the going concern value are identical; therefore, a substitution of the going concern value with the book value had been discussed in the course of earlier tax reforms in order to strengthen the authoritative principle, e.g. by the Major Tax Reform Commission 1971, in the draft of the Third Tax Reform Act of 1974 and in the consultations on the StEntlG 1999/2000/2002. In the literature, a stronger functional alignment of the going concern value concept with the German accounting principles was demanded, given that the purposes of the measurement concepts were not in conflict (Euler 1991, 191). The BFH (1985) only offered the cryptic response that the book value and the going concern value were not identical, but merely equal. Differences in content between the going concern value dependent on capitalised earnings and the book value free of surplus expenditure were highlighted in the literature. Factors relating to the enterprise value would be included in the determination of the going concern value which would not be taken into account for the book value. In addition, the differences in interpretation of the principle of loss-free measurement based on two rulings of the BFH (1966b) are stated for a value deviation. For instance, the going concern value assumes the fictitious profit-oriented buyer who, in theory, would need to deduct a calculated share in profits which is inconsistent with the measurement under German commercial law (Herzig 2012, 1345). However, the validity of this approach is increasingly questioned, especially since not even the inclusion of overheads for the determination of losses is clarified in BFH rulings. Outside of this issue, the loss-free measurement and the consideration of a profit margin are not considered incompatible for the rendering of accounts for reporting purposes.

Moreover, disagreement exists as to whether a measurement at the lower going concern value can (still) be considered an expression of the German accounting principles, and in particular, the imparity principle. The restriction of the devaluation option for tax purposes compared to reporting purposes is due to a broadening of the basis of tax assessment (Prinz 2014, 1826). The diminishing of the authoritative principle in Section 5 Subsection 1 EStG and the qualification of the write-down to going concern value

as autonomous reporting and valuation options for tax purposes equally takes account of these tax policy motives. However, the adoption of the concept of expected ongoing asset impairments from commercial law was intentional and aimed to prevent the introduction of an indeterminate legal concept (Hörhammer and Schumann 2014, 552). The BMF (2014) also contains an explicit reference to the German commercial law with respect to the concept of the expected ongoing asset impairment. Consequently, a uniform understanding of the term continues to exist and a deviation from it is only possible under specific aspects of German tax law (BFH 2011). This reference instruction suggests a congruence of the regulations under commercial and tax laws in accordance with the authoritative principle, even though the write-down to going concern value requires separate interpretation (Adrian and Helios 2014, 722). The BFH (2013b) confirmed this with respect to the purpose of the subjective definition of error for legal financial issues, based its statement on the explanatory report to the tax reform 1999/00/02 and specified that while the concept of ongoing impairment has been adopted from commercial law, the principle of prudence has been diminished in favour of the ability-to-pay principle (BFH 2009a). Furthermore, the BFH qualified the significance of the principle of valuation at the lower of cost or market for the determination of profits for tax purposes in another ruling. Even before the German commercial law reform, if the book value was lower than the going concern value under commercial law, this value was not authoritative, because a higher going concern value in relation to the present value takes priority over the value measurement according to commercial law (BFH 1988b). Thus, the going concern value should constitute a measurement limit preventing undervaluations in its substantive legal function for the consideration of the ability to pay of the entity subject to tax; specifically, to prevent the creation of unwarranted hidden reserves in accordance with the principle of valuation at the lower of cost or market. However, the associated decoupling of the impairment charges under commercial law and the fiscal write-down to going concern value would result in the latter clearly qualifying as a reservation of measurement pursuant to Section 5 Subsection 6 EStG. This has not yet been explicitly confirmed by the BFH. Apart from this interpretation, the going concern value continues to serve the anticipation of losses and therefore the imparity principle. In this context, the BFH also stressed that a prudently measuring businessman should determine the going concern value in accordance with his general experience and the specific circumstances in each case (BFH 2009b). Consequently, the controversy is reduced to the measurement of the subjective ability-to-pay in accordance with the full profits or the profits in anticipation of a loss.

4.2. Fair value, value in use and net selling price according to IFRS

Given that - unlike the annual financial statements under HGB - the IFRS only serve to provide information, not as a basis for the assessment of payments, (depreciated) acquisition or manufacturing costs need not reflect the value ceiling of the assets, but a measurement may equally be recognised directly in equity (e.g. pursuant to IAS 16 or 38), or recognised in the profit and loss account (e.g. pursuant to IAS 40) at the higher fair value. In addition, the recognition of the fair value is obligatory e.g. for certain financial instruments. As a framework standard for the determination of the fair value in different circumstances, IFRS 13 considers the fair value as the price that would be achieved for an asset in the course of a proper business transaction between market participants at the valuation date, or which would have to be paid in the case of a debt transfer (IFRS 13.9). Thus, the fair value must be understood as the market or commercial value in the form of a selling price, whereby a fictitious transaction as in the going concern value concept is assumed (Theile and Pawelzik 2012, 210). The market participants in this context are independent, possess sufficient knowledge and information and are willing and able to perform the transaction (IFRS 13.22).

Moreover, the IASB has specified three levels of the fair value hierarchy in IFRS 13, in analogy to the going concern value assumptions. On the first level, current prices in an active market with asset and debts identical to the object of measurement should be taken into account (IFRS 13.76). If no active market exists, the second level calls for the consultation information about similar assets or debts that exist in an active market. If such market prices cannot be determined either, the third level requires the alternative consultation of valuation methods (IFRS 13.89). The methods used here can be market price-based, cost-based or income-based (IFRS 13 B.5-33).

Apart from the general deduction of the fair value in IFRS 13, the impairment charge on assets pursuant to IAS 36 should be noted, which is exercised if the recoverable amount falls below the book value. The impairment test pursuant to IAS 36 differs from the rendering of accounts under German commercial or fiscal law because the duration of the impairment is not taken into consideration. Rather, the International Accounting Standards Board (IASB) adopts an indicator-based approach, whereby the internal and external indicators for impairment that must be reviewed on each valuation date can be permanent or temporary indicators for impairment depending on the context (IAS 36.12). This approach aims to mitigate the issues of projecting the temporal scope of the impairment, as well as the margin of discretion and flexibility of arrangement. This would also serve the comparability of the accounts. Moreover, the value indicators pursuant to IFRS are

also similar in content to the measurement concept under German commercial and fiscal laws (Lange 2011, 208).

The central measurement standard for impairment charges is the recoverable amount, which equals the higher of net selling price or value in use (IAS 36.6; 36.8). Similar to the rulings of the BFH which only recognises a measurement at the individual selling price for assets not material for business operations, the IAS 36 assumes that the entrepreneur would only sell an asset if the net realisable value was higher (Lange 2011, 210). In contrast to this understanding specific to the relevant sales market, use of the asset will continue if the value in use is higher, and in this case, it would be considered material for business operations, which is equally consistent with the rulings of the BFH. IAS 36.6 defines the value in use as the present value of future cash flows that would be expected based on the continued use of the asset in business operations. This creates parallels to the concept of the going concern value which equally represents a company-specific measure of value (Lange 2011, 209). The difference is that the rulings of the BFH provide a market-oriented measurement standard by defining the replacement or reinstatement costs as a value ceiling in accordance with German commercial law.

IASB attempts to solve the age-old problem that the determination of the value in use requires an earnings-related total enterprise value despite the individual measurement principle by means of the allocation of cash generating units (CGU) (Lange 2011, 211). For certain assets, an isolated estimation of the value in use is not possible (IAS 36.66). According to IAS 36, this applies to corporate assets and derivative goodwill. An allocation to a CGU as the smallest possible group of assets within a business which generates cash flows (largely) independent of other assets transfers elements of the overall assessment to IFRS accounting (IAS 36.69). The formulation that largely independent cash flows should be considered for the definition of the CGU constitutes an indeterminate legal concept and therefore an implicit measurement and reporting option. IASB deliberately avoids the definition of threshold values, creating additional potential margins of discretion and flexibility of arrangement for the management. Even in the event of a warranted change in CGU composition, a deviation from the requirement of consistency may occur (IAS 36.72). Through the incorporation of the maximum number of assets with a strong cash flow in the CGU, an increase in cash flows is achieved that stands in relation to an increase in the value in use (Klingels 2005, 245). For companies enjoying organic growth, this strategy results in a potentially complete offset of the difference between the book value and the recoverable amount (balancing effect) and therefore in an omission of any impairment charges.

It should be noted in this context that a pooling of assets as corporate assets had been planned for German commercial law to minimise the difference to the IFRS (Section 253 Subsection 3 clause 5 HGB draft). The planned requirement received heavy criticism on account of the margin of discretion and the flexibility of arrangement. While increased consideration of synergies and economies of scope on account of compliance with the principle of overall assessment might strengthen the informative function, it also poses the risk of diminished objectivity in the rendering of accounts. These reform plans were dropped in light of the above considerations. A corresponding discontinuation of the principle of prudence is not provided for in the current reform of accounting pursuant to the German Commercial Code.

A potential allocation of individual assets to CGUs also conflicts with the ability-to-pay principle under German fiscal law, even though the measurement synergies would result in a trend move towards lesser or even fewer write-downs to going concern value for profitable companies, which would be beneficial from a fiscal policy perspective. The BFH (1967) also rejected a write-down to going concern value on account of additional costs for a production facility, because sufficient profitability for overall business operations was verified. However, an overall assessment was fabricated in this case which is inconsistent with an objective determination of profits for tax purposes, presumably based on earlier rulings of the RFH on the allocation method. Earlier parallels in the content are also apparent with respect to the derivative goodwill, which must equally be allocated to CGUs pursuant to the IFRS and which has been assessed before the law for the streamlining of taxation 1986 in accordance with the entity theory (Velte 2008). Both the former entity theory and the impairment-only approach pursuant to IFRS only permit an impairment charge, if the value of the goodwill is impaired in its entirety, including its original components (former tax law) or the CGUs carrying the goodwill (IFRS). This is due to the judgement that a de facto separation of derivative and original goodwill components becomes impossible over time. A retrospective recognition of the original goodwill is permissible in spite of the prohibition of recognition. This highlights the highly restrictive possibility of a write-down to going concern value for tax purposes pursuant to the former entity theory which frequently equalled a total write-down prohibition for the derivative goodwill.

Similar to German commercial law, IAS 2.9 provides for a strict principle of valuation at the lower of cost or market for the measurement of inventories, by recognising the lower of acquisition or manufacturing costs and the net realisable value. An impairment charge may apply in the event of damage, obsolescence, sales price decreases or increases in the estimated production costs or the estimated costs incurred until the point of sale; therefore, a write-

down to going concern value is permissible (IAS 2.28). However, given that inventories are held for sale, the IASB bases its measurement on the sales market, whereas the BFH is guided by the procurement (replacement or reinstatement costs) with respect to current assets. Meanwhile, IAS 2.32 provides a restriction with respect to raw materials, consumables and supplies for which the replacement costs are a reliable basis for the determination of the net realisable value of the inventories of goods. This constitutes factual reporting and valuation options pursuant to IAS 2.

5. Summary

The concept of the going concern value codified in the German Income Tax Act exists in an unresolved area of tension between capitalised earnings and net asset value despite its 80 years of existence. Following the unsuccessful attempts of the judicature to operationalise the concept of the going concern value, typifications were developed for both the development of the going concern value and the expected ongoing asset impairment. Apart from the prevailing view in the literature which assumes autonomous reporting and valuation options for tax purposes with respect to the write-down to going concern value, the typecast formulas and restrictive perspectives of the BFH for the expected ongoing asset impairment have provoked sustained criticism. This applies especially to the tautologous clarification of the expected ongoing asset impairment. Moreover, the requirement for the reversal of the impairment under fiscal law is mutating into a factual write-up option, which is inconsistent with the ability-to-pay principle on account of the clarifications provided by the BFH.

In light of the exposed weaknesses of the going concern value concept and the room for interpretation in the determination of individual going concern values, the question arises as to what extent comparable measurement concepts under German commercial law and the IFRS are suitable for the progression of the write-down to going concern value for tax purposes with respect to an appropriate measurement of the ability to pay of the entity subject to tax. The diminishment of the authoritative principle and the enhancement of the discretionary powers associated with the reporting and valuation options for the write-down to going concern value must be rejected from the perspective of the tax system. In contrast, the creation of a common basis for measurement under commercial and tax laws would be desirable, if the write-down to going concern value was understood as neither an exception, nor as being subject to the whims of targeted tax accounting policies, but rather as the interpretation of the imparity principle. After all, the ceiling and floor values (replacement cost and individual selling price) of the book value and the going concern value are identical

and the marginal differences with respect to the consideration of a calculated share in profits can be overcome. Moreover, the abolishment of the existing devaluation options for expected temporary impairments of financial assets in line with the fiscal law should be considered with respect to a restriction of commercial accounting policies.

The discontinuation of the separation between expected, ongoing and temporary asset impairment and the provision of a purely indicator-based impairment test by the IASB in contrast to German commercial and tax law should be welcomed. In particular, with respect to current assets which according to their nature will only remain in the company for a short period, the requirement of permanent impairment under tax laws should be abolished in accordance with commercial law. The allocation of corporate assets and the derivative goodwill to CGUs pursuant to IAS 36 would represent a conceptual continuation of the judicature's failed attempts to distribute the total purchase price across the individual going concern values of the assets. The judicature had included elements of an overall assessment with the former entity theory for the derivative goodwill to limit the write-down to going concern value. However, the CGU concept pursuant to IFRS is suitable for neither the impairment charge under German commercial law, nor the write-down to going concern value for tax purposes on account of the associated diminished objectivity of asset valuation and the disregard for material German accounting principles.

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