Goodwill Included in Subsidiary Valuation for Holding Company Apportionment Test

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Although Pennsylvania Capital Stock and Franchise Taxes are being phased out, a recent case demonstrates that the taxes still generate significant issues. In *Systems & Computer Technology Corp. v. Cmwlth.*, 77 F.R. 2009 (April 18, 2012), the taxpayer had reported Franchise Tax utilizing statutory 10% "holding company apportionment." The Department of Revenue increased the tax by several hundred thousand dollars, on the basis that the value of the company's subsidiaries, as reflected by the "investment in subsidiary" on its balance sheet was less than 60% of the value of its total assets - violating the "asset test" in the statute.

On appeal the taxpayer pointed out that the company and its subsidiaries had been acquired for a price well in excess of the value of recognizable assets. The difference was reflected as "goodwill" on the company's balance sheet, but really reflected value attributable to its operating subsidiaries. The company, itself, merely acted as a holding company.

Noting that the statute's "asset test" refers to "actual value," the Commonwealth Court cited several precedents from varying areas of taxation to support its conclusion that the goodwill must be attributed to the operating subsidiaries in order to determine their "actual value." The taxpayer and its subsidiaries had been purchased in an arms-length transaction and looking only to the book investment in subsidiary would have ignored the portion of the real value which had been recorded as goodwill. The court reversed the Department's balance sheet-based determination.