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No hidden distribution of severance pay for pension commitment

The Supreme Tax Court once again decided on pension promises to a managing director who is also the majority shareholder of the employer company and specified in more detail the rules for distinguishing allowable business expenses from disallowable “hidden distributions”. In the case at hand the plaintiff received compensation for early termination of pension claims as a result of significant financial difficulties of the company.

Background

Pensions promised or paid to company owner/managers (majority shareholders who also hold the position of managing director) remain a recurrent bone of contention with the tax office. The director claims the benefits to have been earned as part of his arm's length salary package and the costs to the company to be allowable as acceptable business expenses. Tax offices often respond with claims that the promises would not have been given in the form under review to third parties as directors and that the expense was affected by the shareholding relationship.

Case in dispute

From 2009 onwards, the sales of the GmbH declined, which was partly due to the loss of two major customers. In June 2011, the plaintiff's salary as managing director was reduced. In October 2011, the shareholders' meeting decided to suspend the vacation and Christmas bonuses stipulated in the plaintiff's managing director contract until the GmbH's financial situation would allow such payments to be made again. By 30 September 2012 the GmbH was facing insolvency. The plaintiff and the GmbH then agreed to the settlement of the plaintiff's pension entitlements. Accordingly, the GmbH made a one-off payment to the plaintiff in December 2012. The settlement was concluded in 2012 together with other restructuring measures in the interests of the limited liability company (GmbH).

The tax office took the view that, in light of the judgment of the Supreme Tax Court of 11 September 2013 – I R 28/13, a so-called “spontaneous settlement” constituted a hidden distribution of profits in the amount actually paid.

Decision

The Supreme Tac Court took a different view and held in favor of the plaintiff. There is no hidden distribution if the controlling shareholder of a limited liability company waives his claims from a pension commitment before the pension becomes due and receives a settlement from the company in return if the pension commitment is settled for business and operating reasons.

The case in dispute was different from the one dealt with by the Supreme Tax Court in its decision of 11 September 2013 as referred to by the tax office. There, the lump sum settlement of the future pension liability at its actuarially calculated present value to an owner/manager prior to retirement was a “hidden distribution” for lack of any indication in the pension promise of the possibility of such a settlement. It was not disputed that the amounts involved were reasonable or that the settlement was in the best interests of the company. The promise was for a pension on retirement at the age of 65 or later and the settlement was made on the occasion of the transfer of the majority holding from father to son when the former was 52. However, the father continued in office as (joint) managing director after the transfer.

Source:

Supreme Tax Court, decision of 17 September 2025 (VIII R 17/23), published on 11 December 2025.

Schlagwörter

hidden distributions, pension, severance payment