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Recurring remuneration from employee profit participation right taxed as capital investment income

Recurring remuneration from an employee's mandatory employee profit participation right (PPR) is not generally covered by the provisions of Section 19 (1) sentence 1 no. 1 Income Tax Act (ITA) for income from employment. This was decided by the Supreme Tax Court in a most recently published judgment.

Background

According to **Section 20 (1) No. 7 ITA** capital investment income includes income from other capital claims of any kind if the repayment of the capital asset or remuneration for the transfer of the capital asset for use has been promised or paid even if the amount of the repayment or remuneration depends on an uncertain event. This applies regardless of the description and civil law structure of the capital investment.

Section 39 (2) Fiscal Code deals with the attribution of assets to persons other than the legal owner: „Where a person other than the owner exercises effective control over an asset in such a way that he can, as a rule, economically exclude the owner from affecting the asset during the normal period of its useful life, the asset shall be attributable to this person (…)".

The case in dispute concerns the classification of profit participation distributions from the employer company (B-AG) as income from employment or as income from capital investment. Participants in the PPR program were subject to restrictions on disposal. The PPRs were not transferable and could not be used as collateral, and they could be issued to a select group of employees and executives to allow them to share in the jointly generated success of the company. If the participant's service or employment relationship ended during the term of the PPR the company had the right of termination. In this case, the nominal amount of the PPR had to be increased by any outstanding interest amounts and reduced by any losses which had not yet been offset.

The tax office took the view that the interest payments from the plaintiff's profit participation rights in 2018 (year in dispute) constituted income from employment. The plaintiff's appeal against this decision was dismissed by the tax court of first instance.

Decision

The Supreme Tax Court upheld the plaintiff's appeal. In the year in dispute, the plaintiff‘s interest on profit participation rights had to be taxed as income from capital investments.

In order that interest from profit participation rights may be considered as a special legal relationship under company law and thus be separate from the employment relationship, the owner of profit participation rights must be the legal and economic owner of the right. Furthermore, the profit participation arrangement must be seriously agreed upon, implemented, and structured in such a way that it has independent economic substance and apart from the employment relationship.

The attribution of an asset (in this case: the profit participation rights) that deviates from civil law pursuant to Section 39 (2) Fiscal Code can only be taken into account if, based on the overall circumstances, a party other than the owner under civil law (in this case: B-AG) exercises actual control and bears the risk of loss for the profit participation capital and, upon termination of the profit participation right due to the expiry of time and in the event of termination, can demand repayment of the capital. The restrictions on disposal resulting from the exclusion of transferability do not establish economic ownership of B-AG as the issuer.

The argument put forward by the lower tax court that the interest on the profit participation capital is not at arm's length does not preclude the classification of the interest as capital investment income within the meaning of Section 20 (1) No.7 ITA. This provision only addresses the generation of income from capital investment income for the transfer of (in this case: profit participation) capital. The profit participation interest is not to be classified as wages, either in whole or in part. Therefore, such a classification does not take precedence over the taxation of profit participation interest as capital gains, the Supreme Tax Court said.

According to established case law of the Supreme Tax Court, a benefit which is granted because of relationships between the employee and employer that are not based on the employment does not constitute pay for work. In the case in dispute, the interest from the profit participation rights is based on the profit participation rights as a separate special legal arrangement under company law.

Source:

Supreme Tax Court, decision of 21 October 2025 (VIII R 14/23), published on 22 January 2026.

Schlagwörter

employment income, profit participation rights