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By PwC Deutschland | 17. Mai 2026

Compensation payments under the regime of the Insolvency Code are not business expenses

Compensation payments of the (insolvent) debtor to the insolvency estate as a result of the insolvency court’s approval of his self-employment do not constitute business expenses in connection with his income from self-employment, the Supreme Tax Court said in a most recently published decision.

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I. Background

Under German insolvency law, Section 295a of the Insolvency Code (IC), a compensation payment generally refers to the amount that a self-employed debtor must pay into the insolvency estate to place creditors in the same position they would be in if the debtor were an employee.

If a debtor is self-employed during his or her insolvency proceedings (or during the assignment period, commonly known as „period of good conduct“), the insolvency administrator may “authorize” the self-employment. The debtor may then continue the business operations but must in return make said compensation payment.

Section 295a Insolvency Code: (1) Debtors who are self-employed are obliged to satisfy the insolvency creditors by making payments to the trustee as if they were in appropriate employment. These payments are to be made each calendar year by 31 January of the following year. **(2)** At the debtor’s request, the court determines the amount which corresponds to the income from that employment which is to be used as the basis in accordance with subsection (1). The debtor is required to prove to the satisfaction of the court the amount of income which could be generated by being in appropriate employment.

Section 35 (2) Insolvency Code: If the debtor is self-employed or intends to become self-employed in the near future, the insolvency administrator is required to declare to the debtor whether the assets from such non-dependent employment are part of the insolvency estate and whether claims resulting from this business activity may be asserted in the insolvency proceedings. Section 295a applies accordingly. Upon request by the creditors’ committee or, if none has been appointed, the creditors’ assembly, the insolvency court declares such declaration legally invalid.

II. Case in dispute

The plaintiff, a certified public accountant and tax consultant, was subject to standard insolvency proceedings in the year in dispute, 2017. Despite the insolvency, he continued to carry out his previous work on his own responsibility. The insolvency administrator approved the plaintiff’s self-employment. At the same time, the insolvency administrator pointed out that the plaintiff was required under Section 35 (2) and Section 295 (2) IC in the version applicable in 2017 (now: Section 295a IC), to maintain the insolvency estate in the same condition as it would have been had the plaintiff been engaged in an appropriate employment relationship in consideration of his professional qualifications.

The plaintiff therefore made monthly compensation payments to the insolvency estate in the year in dispute which were calculated based on the average salaries of employed tax consultants. He sought a deduction as business expenses from the insolvency administrator for the compensation payments made and for the costs incurred in recognizing a liability or provision.

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III. Decision

The Supreme Tax Court took a different view. The compensation payments were neither withdrawn from the plaintiff's assets nor were they business-related.

The transfer of the authority to manage and dispose of the (insolvent) debtor’s assets to the insolvency administrator is based solely on insolvency law and has no bearing on income tax law. Furthermore, the compensation payments made did not leave the plaintiff’s (business) assets upon transfer to the insolvency estate’s escrow account. There is merely a reallocation within the same sphere of assets of the tax advisor operating as a sole proprietor which gives rise to a restricted use of the compensation payments (insolvency seizure).

The triggering event for the compensation payments into the insolvency estate, from the plaintiff’s perspective, namely that he was able to dispose of the economic proceeds of his self-employed activity “freely” - that is, without it being subject to insolvency proceedings, does not concern the generation or determination of income but rather its use and therefore cannot be for a business-related reason.

Nor does the fact that the compensation payments were directly caused by the insolvency proceedings give rise to a business-related reason. Rather, they served to prevent self-employed individuals from being placed in a more favorable position than employees in the insolvency proceedings. The recognition of an additional expense for the compensation payments to be made is also not possible.

Source: Supreme Tax Court, judgment of 3 March 2026 (VIII R 12/24) published on 15 May 2026.

Schlagwörter

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