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By PwC Deutschland | 25. Mai 2026

Taxation of compensation for continuing to serve as managing director after sale of GmbH shares

Whether a payment made in connection with the sale of a share in a corporation for the selling shareholder’s continued service as managing director is classified as capital gain under Section 17 Income Tax Act or as income from employment shall be determined based on the economic context and motivation, the Supreme Tax Court said in a most recently published decision.

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Background

Under Section 17 of the German Income Tax Act (ITA), capital gains from the sale of shares in a corporation (e.g., a GmbH or AG) are taxable if the shareholder held a material interest (at least 1%) at any time in the last 5 years. Capital gains from the sale of these shares are not taxed at the standard flat rate. Instead, they are taxed under the partial-income method: 60% of this income is taxed at the personal income tax rate while 40% remains tax-free. Conversely, only 60% of associated expenses or capital losses can be deducted.

The plaintiff held 50% interest in X GmbH and also was its managing director. He received an annual managing director's salary of €180,000, plus a Christmas bonus of €8,000 and a profit-sharing bonus. In 2020, the plaintiff and the other shareholder (B) sold their shares in X GmbH to Y GmbH. Half of the purchase price of €4.5 million was attributable to the plaintiff.

Part of the purchase price was an amount of €1.25 million, which the plaintiff and B – half each - received for continuing to serve as managing directors of X GmbH for a period of at least five years following the sale of the shares. This payment was subject to a proportional reimbursement in the event of premature termination of their duties as managing directors. To secure a claim for refund, the plaintiff and B were each required to provide a bank guarantee.

The tax office classified the payment of €625,000 as income from employment. It further recognized the guarantee commission as income-related expenses from employment only to the extent of the payments actually made in the year in question. As a result, the plaintiff's income from employment increased to €857,586, while the taxable portion of the capital gain was reduced correspondingly. **The lower tax court** dismissed the appeal.

Decision

The Supreme Tax Court upheld the appeal. This decision alone is not all too surprising but rather the criteria that the Supreme Tax Court presented when referring the case back to the lower tax court for further hearing and final decision. According to the Supreme Tax Court, the lower tax court - without sufficient establishment of facts - wrongly assumed that the amount of €625,000 paid by Y GmbH to the plaintiff should be classified as income from employment. The same applies to the allocation of the guarantee commissions paid by the plaintiff to income-related expenses in connection with his employment. Specifically, the following issues remain to be clarified in some detail:

The legal and factual connection between the payment of the portion of €625,000 and the continuation of the managing director's duties, as pointed out by the lower tax court, is not a suitable basis for classifying this payment as income from employment. Rather, the key issue is whether Y GmbH, as the purchaser, made this payment to the plaintiff as consideration for the business value of X GmbH inherent in the transferred shareholding,

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or as compensation for his continued work as its managing director.

Another important question is whether the additional service agreed upon in the purchase agreement is of independent economic significance. If this is not the case, the amount paid is a part of the sales price within the meaning of Section 17 ITA. It also matters whether the quality and stability of the management of an acquired company are, as a rule, a dependent cost factor in the buyer's overall price calculation and are therefore typically part of the acquired goodwill.

Furthermore, there is no assessment whether Y GmbH would have paid the plaintiff the sum of €625,000 even if he had not been the managing director of X GmbH but rather a third party with no ownership in the company, and if this third party had agreed to continue working for the company.

If expenses—as in the present case—are related to several types of income from an objective point of view, they must be allocated to the type of income with the closest economic connection and based on a direct or indirect underlying cause. The economic nature (substance) of the payment is decisive.

In the case of a shareholder-managing director, a high shareholder-managing director's interest makes it more likely that a connection with the shareholding rather than with the employment relationship exists. The provision of a guarantee or a loan (combined with a subordination clause, if applicable) which is waived upon the sale also supports the conclusion that there is a connection with the income referred to in Section 17 ITA.

Conversely, in the case of an employee with only a very small stake in the company, there is strong evidence that the proceeds qualify as income from employment within the meaning of Section 19 ITA.

Source: Supreme Tax Court, judgment of 3 March 2026 (IX R 1/25) published on 21 May 2026.

Schlagwörter

Sale of shares, compensation payment