By PwC Deutschland | 19 January 2011

Tax rules on redundancy payments relaxed

The finance ministry has followed two recent Supreme Tax Court cases and relaxed the spreading rules for the taxation of redundancy payments.

Redundancy payments in compensation for loss of future earnings potential – but not those in satisfaction of claims for compensation already earned, such as for a current year's bonus – can be taxed under a favourable rule designed to relieve the burden of the progressive rate scale on the concentration of non-recurring income in a single tax year. Briefly, the tax on a qualifying payment is five times the incremental tax on one-fifth of the amount when added to the regularly taxable income for the current year. To qualify, redundancy compensation must be paid out in a single tax year. If the employee's salary fluctuated and he was dismissed during the year, his regularly taxable income is to be based on his previous year's earnings. Both rules have recently been held by the Supreme Tax Court to be too rigid and the finance ministry has now issued a decree ordering a corresponding relaxation:

- entitlement to the favourable non-recurring income taxation will no longer be lost if no more that 5% of the main payment is paid out in a different period. This enables small payments in advance to meet an immediate personal need and may also be useful if part of the redundancy settlement is met in kind – such as allowing the redundant employee to keep his company car.
- the effects of unusual events are to be eliminated from the previous year's earnings before taking the total as the basis for the current year's regularly taxable income.

Keywords

Redundancy payments, compensation payment, redundancy compensation