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By PwC Deutschland | 05 May 2011

Tax-free portion of redundancy payment does not effect tax on remainder

The Supreme Tax Court has held that the tax-free portion of a redundancy settlement should be deducted from the down-payment in determining the income accumulation entitlement to progressive rate spread.

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Redundancy payments rank as "extraordinary income". If a taxpayer receives extraordinary income in any one year, he is entitled to relief from the direct application of the progressive rate scale. This relief is granted by taxing the item at five times the incremental tax on the addition of one-fifth of the amount to his other income in the year of receipt. Entitlement to the relief is lost if the pay-out is spread over more than one year, as the consequent diminution of the effect on the progressive rate is considered to be sufficient to avoid hardship; however the Supreme Tax Court has previously held that minor payments in advance (or arrear) are not to be taken into account. The court has now held that the tax-free portion of a redundancy payment is to be deducted from the smaller instalment, when measuring immateriality in this connection. The reasoning was simple: the tax-free portion of a redundancy payment does not affect the rate to be applied to the remaining income and thus should be ignored when determining entitlement to relief from the effective accumulation of a multi-year income item (compensation for loss of future earnings) in a single period. In the case decided, a down-payment of €10,000 on a total settlement of €78,000 did not destroy the relief entitlement for the main payment in the following year, as the first €7,200 was, at the time, tax-free. The taxable portion of the down-payment was €2,800, that is, an immaterial amount within the context of the main receipt of €68,000.

This case is not directly relevant to present redundancies as the tax-exemption has been withdrawn. However, it is a precedent for open cases of settlements agreed up to December 31, 2005 and paid out by December 31, 2007.

Supreme Tax Court judgment IX R 20/10 of January 26, 2011 published on May 4

Keywords

extraordinary income, redundancy