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Write-off of worthless loan to employer as expense of earning income

The Supreme Tax Court has held that an employee can write off a bond issued by his now insolvent employer as an expense of earning income if he accepted the bond as the only possible remuneration for work down.

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An employer in financial straits agreed with the workers' council (shop stewards) on a longer working week without immediate reward. Rather, the extra time worked would be recorded for later recognition in a manner still to be determined. Some two years later, the shop stewards agreed to an arrangement whereby the employer would make no cash payment, but would issue a profit-related interest bond (with an interest range of 2%-8%) in redemption of the previously unrewarded time worked. Those accepting the offer found themselves faced with income tax and social security charges on the nominal (taken as being market) value on the securities received. Five years later, the company went into insolvency and the receiver notified employee bondholders that assets were insufficient to meet the claims of the ordinary creditors and that those claims took precedence over those of bondholders. Accordingly, employees must consider their bonds to be worthless.

An employee took this statement as an invitation to claim a write-off of his investment in his tax return as a cost of earning employment income. The tax office refused on the grounds that that bondholder had suffered the loss as an investor and not as an employee. The Supreme Tax Court, however, held that it is necessary to strike a balance between the two concepts based on the actual circumstances. In this case, the employees had worked extra time for the promise of future reward. This had been granted to them in the form of bonds. At no time had there been any question of a cash settlement and it was clear to the court that the employees had accepted the bonds as the only form of payment for work done that they could realistically expect. The loss on the bonds when they became worthless was thus incurred by the holders as employees, rather than as investors. A tax deduction was therefore compelling.

Supreme Tax Court judgment VI R 57/13 of April 10, 2014 published on August 13

Keywords

bond, profit-related interest, write-off