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By PwC Deutschland | 14 October 2015

Bribes taxable as other income

The Supreme tax court has held that bribes received are taxable as other income with the consequence that any damages payable later cannot be offset against income from other sources.

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An employee in purchasing regularly took bribes from a supplier. Initially, he issued invoices in his wife's name for (non-existent) services rendered and taxed the amounts as business income. However, the fraud came to light and he was dismissed by his employer. He accepted his dismissal and agreed to pay a substantial part of his total bribe receipts over the years to his employer as damages and also agreed to loss of pension rights and to waive his bonus entitlement from the previous year. He claimed an expense deduction in the amount of the damages paid, the bonus waived and the capital value of the pension rights lost. This deduction was from employment income and was therefore deductible from taxable income in general. The excess was a loss that could be carried back for one year or forward to all future years until fully offset against positive earnings.

The tax office refused this deduction. Rather, it reclassified the bribe receipts as other income and the compensation to the employer as expenses of earning that other income. That meant that the expenses could only be offset against the other income earned in the year they were incurred (zero), carried back against other income earned in the previous year (minimal) and forward against future other income (no concrete prospects of future receipts).

The Supreme Tax Court sided with the tax office. The bonus and pension waivers were not deductible at all, as the income would only have been taxable when paid. The compensation payment to the employer was neither an expense of earning employment income leading to a generally deductible loss, nor was it a repayment of previously taxed income that would similarly have been generally deductible. It was a payment for damages caused by the employee's dishonesty and was thus linked to the fruits of that dishonesty – to the bribe receipts taxed as other income. It could therefore only be set against other income, either now or in the future as and when other income came to be earned.

Supreme Tax Court judgment IX R 26/14 of June 16, 2015 published on October 14

Keywords

bribes, expense deduction, other income