

By PwC Deutschland | 08 May 2018

Principle of deemed single uniform compensation

Where an employer contractually obliges himself to make several payments to an employee in connection with a termination of employment, the payments will only be considered as a single uniform compensation payment if there is clear evidence that all instalments were paid "as compensation for lost income or expected loss of income".

Background

According to Section 24 (1) No.1a) (read in conjunction with Sections 2 (1) and 19 (1)) of the Income Tax Act income from employment also includes compensation, which is paid "as compensation for lost income or for expected loss of income". According to its wording, the provision only applies to compensation for losses of income suffered or expected to be suffered; this does not include compensation paid for any other type of damage.

The case revolved around a contract signed by the appellant and his former employer, which split the compensation to be paid into severance pay and damages.

Damages or additional severance pay

The dispute before the Supreme Tax Court related to how the compensation payments, which were designated in the contract partially as severance pay and partially as damages, should be treated for tax purposes, in particular whether the instalments should each be viewed on an isolated basis or whether the principle of a single uniform compensation should be applied.

Sending the case back to the tax court for a further review of the facts, the Supreme Tax Court laid down the following principles:

- Where an employer contractually obliges himself to make several payments to an employee in connection with the termination of employment, the principle of deemed single uniform compensation is only to be applied where there is real evidence to show that each of the partial payments (i.e. each instalment / indemnity), viewed separately, were made "as compensation for lost income or expected loss of income".

Where the circumstances indicate that a payment is not made as compensation for lost income, it cannot be treated as such merely on the basis of the principle of deemed single uniform compensation.

- In circumstances where an additional payment is significantly higher than the compensation paid for the lost income, which itself cannot be considered to be out of the ordinary, then this should generally indicate that the additional payment is not compensation for lost income.
- The additional payment will be considered significantly higher, where the total amount received is doubled through the addition of the second instalment.

Source: Supreme Tax Court decision (IX R 34/16) of 9 January 2018, published on 25 April 2018

Keywords

Income Tax Act, compensation, damages, employee taxation