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By PwC Deutschland | 02 August 2024

Provision for contingent liabilities in case of working time reduction for older employees

A provision for contingent liabilities (for payments in arrears) must be recorded in the tax accounts for the employer's obligation to grant paid time off (two days per year of service) which is available to employees who are at least 60 years old and have been with the company for at least ten years. With its decision the Supreme Tax Court contradicts the previous view of the tax administration.

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Background

For older employees, there are some additional options to reduce their working hours as part of phased retirement plans. Some collective agreements and company policies may therefore provide part-time paid leave or special provisions for older workers to ensure their well-being and work-life balance.

According to Section 249 (1) sentence 1 of the German Commercial Code (HGB) „*provisions are to be recorded for contingent liabilities and for anticipated losses on pending transactions*…". This is a fundamental requirement under commercial law and one of the principles of proper accounting and also applies for tax accounting purposes in accordance with Section 5 (1) sentence 1 Income Tax Act.

The Supreme Tax Court had to deal with the question whether a (collectively agreed) entitlement to retirement leave, which is still dependent on conditions to be realized in the future, must be accrued as payment in arrears in the tax balance sheet.

The employees of the plaintiff - a partnership in the legal form of a general partnership - were entitled to old-age working time reduction of two working days per full year of service in accordance with the standard collective wage agreement, provided they had been with the company for at least ten consecutive years and had reached the age of 60.

The plaintiff recorded a provision of some EUR 338,000 as a liability in the annual financial statements as per 31 December 2016 (2016 tax balance sheet). The tax office disagreed and saw no outstanding obligation for the employer at b/s year-end as the employees did not provide any additional services, such as in the savings period under a partial retirement agreement.

Decision

Both the tax court of first instance and now also the Supreme Tax Court rejected the view of the tax office. There is still an outstanding obligation for the employer under the semi-retirement scheme which he must account for.

The liability is based on a binding provision in the framework collective agreement. Due to the contractual obligation, a provision must also be accrued for a liability that will only arise in the future. From an economic point of view, the obligation originated already prior to the balance sheet date since the retirement leave must be earned through at least 10 years of service.

Due to the dependence on the duration of company service, the pre-retirement leave is a payment for work performed during this period and for not exercising the right of termination. From this perspective, the plaintiff is indeed in a settlement deficit as of the balance sheet date and has therefore legitimately recognized a corresponding provision. The **time off** for old agers reflects **past work**. **Both** are - economically - interactive and mutually dependent and allocable in terms of time.

In summary, the plaintiff still must provide its service in return by way of paid time off. As at the balance sheet date, the plaintiff has contributed less than he is obliged to contribute under the employment contract

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and the provisions of the general collective agreement. In this respect, the plaintiff is in default of fulfillment.

Source:

Supreme Tax Court, decision of 5 June 2024 (IV R 22/22) – published on 25 July 2024.

Keywords

liabilities, pre-retirement