



November 2024

New Risks for Employers when Agreeing Severance Payments due to Changes to the One-Fifth Rule introduced by the Growth Opportunity Act

Dear reader,

Just in time for Advent, we would like to present you with a small gift in the form of our first newsletter on a topic that is particularly relevant to tax law. We would like to draw your attention to new risks for employers when agreeing severance payments and present practical solutions for avoiding these risks.

I. Background: "One-Fifth Rule"

On March 22, 2024, the so-called Growth Opportunities Act was passed, which will now also have implications for wage tax law and payroll accounting for employers with regard to severance payments owed from 2025 onwards.

Severance payments are extraordinary income within the meaning of Section 34 (2) no. 2 in conjunction with Section 24 no. 1 Income Tax Act ("EStG"). These are privileged under income tax law in accordance with Section 34 (1) EStG. According to this, the tax burden for the employee can be reduced as part of the wage tax deduction procedure in such a way that only one fifth of this extraordinary income is taken into account in the year in which the severance payment is received. Income tax is calculated on this basis and then quintupled to ensure that the employer can pay tax on the entire severance payment amount. In mathematical terms, this means that the severance payment (extraordinary income)

is treated for income tax purposes as if the amount were spread evenly over five years. This avoids a one-off high tax burden for the employee due to the progression of the individual tax rate.

The payroll accounting of severance payments, which is regulated in Section 39 (3) sentences 9 and 10 EStG, was complicated and time-consuming for employers. The corresponding regulations will therefore be deleted by the Growth Opportunities Act with effect from 01.01.2025.

II. Change due to the Growth Opportunities Act

With the deletion of the provisions in Section 39 (3) sentences 9 and 10 EStG, employers can and must no longer account for severance payments from January 01, 2025 taking into account the one-fifth rule and pay out the resulting net amount.

Instead, from the new year onwards, only employees who receive the severance payment can make use of the one-fifth rule by submitting a tax return.

What at first glance sounds like a relief for employers, however, entails legal liability risks with regard to the way in which a severance payment is agreed.



In the past, it was common practice to include a clause in termination or settlement agreements or in social plans stating that severance payments must be calculated in accordance with Sections 34 and 24 EStG. If such a provision is also agreed for severance payments January 01, 2025, which is certainly already happening on a large scale at present, the provision must be interpreted. The question then arises as to whether the employer is also obliged to pay out the tax savings in accordance with the one-fifth rule in addition to the severance payment. Depending on the amount of the agreed severance payment, this can amount to several thousand euros.

III. Recommendation for action

In order to avoid this risk, severance payment provisions in termination or settlement agreements and social compensation plans should therefore avoid any reference to income tax classification or references to statutory provisions of the German Income Tax Act in future, but should only state the agreed gross amount.

Feel free to contact us! Our employment law team which also has tax expertise will be happy to answer any questions you may have regarding the legally compliant drafting of termination and settlement agreements.

Your employment law team



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