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10 Pitfalls

when granting bonus and other variable compensation in Germany

Variable compensation schemes, especially bonuses and commissions, are powerful tools for motivating employees and aligning their interests with company goals. In Germany, however, the legal framework governing such compensation is complex and strictly regulated. From drafting enforceable bonus clauses to proper target setting and works council involvement, employers must carefully structure their variable compensation programs to avoid costly disputes and ensure compliance. The following outlines ten common pitfalls that companies should be aware of when implementing bonus and other variable compensation schemes in Germany.

1 Clear contractual basis required

Variable compensation must be clearly defined in the employment contract or a separate written agreement. Vague or ambiguous bonus clauses are interpreted in favour of the employee under German law (Sec 305c (2) *Bürgerliches Gesetzbuch* – "**BGB**"). The agreement should specify the calculation method, payment conditions, performance criteria, goal-setting process, timing of payment, and whether the bonus is discretionary or contractual. Without a clear contractual basis, employees may claim entitlement to bonuses based on company practice (*Betriebliche Übung*) or legitimate expectations, even if the employer intended the payment to be purely discretionary. However, *Betriebliche Übung* cannot arise if the employer was already obligated by another legal basis or mistakenly believed itself to be so obligated. The burden of proof that the employer intended to grant benefits beyond existing legal obligations lies with the employee claiming such entitlement.

2 Discretionary vs. contractual bonuses

German law distinguishes strictly between **discretionary bonuses** (***freiwillige Boni***) and **contractual bonuses** (***verbindliche Boni***). A discretionary bonus gives the employer full freedom to decide whether and how much to pay, provided this is clearly communicated in writing with a valid reservation clause (***Freiwilligkeitsvorbehalt***). However, repeated payment of bonuses **without such a valid reservation** can create a binding entitlement under the doctrine of *Betriebliche Übung*. Contractual bonuses, once agreed, become part of the employee's remuneration and cannot be unilaterally withdrawn or reduced by the employer.

3 Reservation clauses must be carefully drafted

Reservation clauses preserving employer discretion must be drafted precisely. Generic statements such as "the bonus is voluntary" or "no legal entitlement exists" are insufficient under Federal Labor Court (*Bundesarbeitsgericht* - "**BAG**") jurisprudence. The clause must explicitly state that (i) there is no legal entitlement, (ii) payment in one year does not create entitlement for the future, and (iii) the employer reserves the right to modify or discontinue the scheme at any time. Courts scrutinize such clauses closely, especially in standard employment contracts (general terms and conditions), and may invalidate them if they are unclear or contradictory (e.g. combining a voluntariness clause with a performance formula). Clauses granting employers "free discretion" (*freies Ermessen*) are invalid because they deviate from Sec. 315(1) BGB without the corrective of full judicial review.

4 Pro-rata payment upon termination

German case law has established that employees who have rendered substantial performance during the reference period are generally entitled to proportionate payment if the bonus is **remunerative** (***Entgeltcharakter***) rather than **loyalty-based** (***Treueprämie***). Employers should therefore clearly state in which cases a bonus entitlement arises, and whether pro-rata payment applies upon termination, resignation, or dismissal. Clauses excluding payment if employment does not continue until a fixed date (e.g. 31 December) are often invalid if the bonus rewards past performance. Such cut-off date clauses (*Stichtagsklauseln*) contradict Sec. 611(1) BGB by depriving employees of earned wages and impermissibly restrict occupational freedom under Article 12(1) German Constitution (*Grundgesetz* - "**GG**"). Note: Employers can still grant pure loyalty bonuses (*Treueprämien*) with valid cut-off dates, provided these are separate from performance-based compensation and genuinely reward future loyalty rather than past work.

5 Clawback clauses

Clawback (repayment) clauses are permissible in principle under German law but only under **strict conditions**: they must be (i) clearly and unambiguously drafted, (ii) linked to specific, objectively defined triggers (e.g., serious misconduct, breach of fiduciary duties, material restatement of results), (iii) proportionate, (iv) time-limited (e.g., enforceable within a defined period after payment or vesting), and (v) introduced in appropriate contractual documentation. Clauses permitting repayment for undefined "business reasons" or "company interests" or after performance has already crystallized are likely to be invalid or unenforceable under German case law (including BAG jurisprudence). Employers should ensure clauses comply with the fairness test under Sec. 307 BGB if part of standard terms and conditions. For regulated sectors, special regimes apply (e.g. *Institutsvergütungsverordnung* for financial institutions).

6 Works council co-determination rights

If a works council exists, it has co-determination rights under **Sec. 87(1) Nos. 10 and 11 Works Consitution Act** (*Betriebsverfassungsgesetz* – "**BetrVG**") concerning remuneration principles and performance-related pay. This means that introducing, modifying, or abolishing **bonus systems applicable to groups of employees** requires works council consent. Individual arrangements with senior executives outside the scope of the Works Constitution Act (*leitende Angestellte*; typically C-level executives with independent decision-making authority and personnel responsibility) are exempt from co-determination requirements. Once a works agreement is concluded, it applies directly and mandatorily under Sec. 77(4) BetrVG. During its term, both the works council and employer are bound by its provisions and cannot unilaterally deviate from the agreed regulations. Failure to involve the works council may render the bonus scheme inapplicable and expose the employer to injunctions or claims for back pay.

7 Equal treatment and discrimination risks

Employers must **ensure equal** treatment among comparable employees. Differentiations must be based on **objective, transparent, and operationally justified** criteria. Discrimination based on gender, age, disability, race, or religion violates the **General Equal Treatment Act** (*Allgemeines Gleichbehandlungsgesetz* – "**AGG**") and can lead to compensation claims (Sec. 15 AGG). Employers should document objective performance metrics and apply them consistently.

Unequal bonus distribution can also trigger gender pay gap scrutiny under the **Transparency in Wage Structures Act** (*Entgelttransparenzgesetz* – "**EntgTranspG**").

8 Tax and social security implications

Bonuses and variable pay are subject to **wage tax** (***Lohnsteuer***) and **social security contributions**. Employers must withhold these at the time of payment. Large one-time payments can increase employees' annual tax burden ("progression effect"). Benefits in kind and share-based compensation may require separate valuation rules. Employers should also be aware that **special payments in December or upon termination** can affect contribution ceilings and settlement obligations. Tax advice is strongly recommended for complex or cross-border structures.

9 Target agreements and target setting procedures

Performance-based bonuses depend on realistic and properly communicated targets. Under German law, employers must set targets in good faith (*Treu und Glauben*) and exercise discretion according to equitable standards (*billiges Ermessen*) under Sec. 315 BGB. A performance determination corresponds to equitable discretion when the essential circumstances have been weighed and the mutual interests have been appropriately considered. The burden of proof that the performance determination corresponds to equity lies with the employer. Targets must be specific, objectively measurable, and achievable under normal business conditions and cannot be unilaterally changed mid-period unless expressly provided in the contract. The relevant time for assessing whether discretion was exercised equitably is when the employer must make the discretionary decision. If the employer fails to set targets on time or sets unrealistic ones, courts typically assume 100% target achievement and award the full bonus.

Performance determinations under Sec. 315 BGB have legally formative effect and are generally irrevocable once made. Employers should document the target-setting process, define responsibility and timing, and regulate adjustments for exceptional events (e.g. restructuring, force majeure). Employees can challenge discretionary decisions through full judicial review under Sec. 315(3) sentence 2 BGB. Courts will examine whether the employer's economic justification outweighs the employee's interest in receiving the agreed compensation.

10 Commission schemes for sales employees

Commission-based compensation requires detailed contractual regulation. The employment contract should specify **commission rates, calculation basis, timing of accrual and payment, and treatment of returns, cancellations, and post-termination business**. Under Sec. 87 Commercial Code (*Handelsgesetzbuch* - "**HGB**"), employees are entitled to commission on all transactions concluded during their employment and on follow-up business attributable to their efforts. Employers should address team commissions, pipeline allocations, and employees' rights to inspect commission accounting records (*Provisionsabrechnung*). Transparent reporting and periodic reconciliations help prevent disputes and ensure compliance.

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Dr. Christian Maron, a leading international labor and employment lawyer at Taylor Wessing Germany, has been advising global companies expanding into the German market for more than fifteen years. Alongside his dedicated team, they help businesses align their global operations with German labor and employment law, providing strategic guidance on HR matters, employment contracts, terminations, and litigation, while ensuring compliance and risk mitigation. With deep expertise in restructuring, corporate transactions, and works constitution law, Christian and his team support smooth workforce transitions and offer strong legal protection—both in and out of court.

Want to learn more?
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