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Pre-retirement pay taxable in country of employment

The Supreme Tax Court has held that the pre-retirement pay of an employee with no further duties remained taxable in Germany as employment income despite his move to France.

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Up to December 31, 2009 many larger employers operated a state-subsidised pre-retirement scheme for their older long-serving employees. The subsidies were then withdrawn for new joiners, although existing rights remained protected. Thus the concept in its original form will not entirely disappear until 2018. Broadly, the schemes operate on the principle that a qualifying employee need only work at 50% of his capacity for the six, or eight, years immediately prior to his retirement, but will continue to receive a higher proportion of his former net pay. This higher amount - typically up to 90% - is made up of 50% of the previous salary together with a tax-free supplement paid by the employer. This supplement was wholly, or partly, subsidised by the government employment agency (labour exchange). The 50% working time was agreed with the employer - often individually. Three models were common: half-day work for the full period, seasonal full-time employment and the "block" model of working full-time under otherwise unchanged conditions for the first half of the pre-retirement period, followed by full work dispensation for the remainder. An employee on the block model who moved to France on completion of his period of active duty claimed that his pre-retirement pay should be treated as a company pension under the French double tax treaty, that is, that it should be taxed in France, as the country of residence, rather than in Germany.

The Supreme Tax Court has now rejected this claim. At least the 50% base-pay portion of the pre-retirement salary had been earned during the active part of the employee's pre-retirement period. As such, it was a delayed payment of remuneration for work performed in Germany for a German employer. The treaty does not make the taxation of employment income dependent upon the time of payment, so there was no reason to treat the pre-retirement pay of the employee after his move to France differently than during his period of active duty. This contrasted with the position after formal retirement; a company retirement pension was to secure an employee's future and was not deferred compensation for work performed in the past. It was taxable in the country of residence under the treaty, but could not offer an analogy appropriate to pre-retirement pay schemes.

The court did mention that one might take a different view of the supplementary portion of the pre-retirement pay. Arguably, this had not been earned during the active period of work, but was being paid as a current inducement to the employee not to seek further employment. On that basis, the supplement would be taxable in the country of residence, at least under treaty provisions corresponding to those of the OECD model. However, those of the French treaty were different, providing that all payments relating to an employment were taxable in the country of employment. This applied to the supplement here at issue; thus the more general question could not be decided on the basis of the present case.

Supreme Tax Court judgment I R 49/10 of January 12, 2011 published on March 30

Schlagwörter

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