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Compensation for loss of office taxable in Switzerland despite mutual agreement to contrary

The Supreme Tax Court has held that compensation for loss of office is taxable in the state of residence under the German/Swiss tax treaty and not in the state of employment. A mutual agreement between the two revenue authorities to the contrary is not to be applied for lack of an adequate legal basis.

The German/Swiss double tax treaty taxes compensation paid to former employees for their loss of employment in their country of current residence. They are only taxable in the country of former employment on compensation for benefits, such as accrued bonus or holiday entitlement, already earned. This treaty interpretation, usual in Germany, is not fully followed in Switzerland. Accordingly, the two finance ministries agreed a mutual interpretation of the treaty to the effect that compensation for loss of employment should be taxed in the country of the employment if paid to mitigate the loss of income, and in the country of residence if paid in order to provide for the continued subsistence of the recipient. The agreement was felt to be necessary in the interests of avoiding “white income”. A manager who lost his job in Germany and who then moved to Switzerland to take up a new employment there found himself faced with German taxation on his not inconsiderable compensation for loss of office.

The Supreme Tax Court has held for the taxpayer. Under the treaty as interpreted by the German courts, compensation for loss of office was taxable in the country of residence of the employee when paid. This treaty had been implemented into German law by act of parliament. A mutual agreement between the two fiscal authorities could not change the treaty or its full legal status. An enabling provision in the Foreign Tax Act allowing the finance ministry to transpose mutual agreements into German law by ordinance requiring the approval of the *Bundesrat* was not sufficiently precise to provide a legal basis for what effectively amounted to a treaty change. That provision could not therefore be applied here. Rather, the change should be documented by treaty amendment which would then require the full process of enactment if it were to attain legal force.

Supreme Tax Court judgment of I R 79/13 of June 10, 2015 published on September 30

Keywords

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