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By PwC Deutschland | 14 October 2024

German-Swiss double tax treaty: Right for taxation during layoff period

In a most recent judgment, the Supreme Tax Court decided that in a case where an employee working in both Germany and Switzerland until the termination of the employment relationship and thereafter is irrevocably released from his duties with continued payment of his salary, the income from employment pursuant to Art. 15 para. 1 sentence 1 of the double tax agreement between Germany and Switzerland is subject to tax only in Germany as the country of residence.

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Background:

The plaintiff worked at a Swiss employer who terminated the employment relationship during the year in dispute and irrevocably released the plaintiff from his duties and obligations with immediate effect. Subsequently, a dispute arose between the plaintiff, a German resident, and the tax office regarding the allocation of the right for taxation between Germany and Switzerland regarding the salary received in the year in dispute. There were different views between the parties as to which country should be entitled to tax the salary attributable to the period following the release.

The lower tax court of Hesse had dismissed the claims brought by the plaintiff with regard to the points in dispute (exemption of the entire salary payment for the early release and the entire severance payment from German taxation).

Decision

The Supreme Tax Court also held the appeal to be unfounded and rejected the claims. The right to the tax the income of an employee working both in Germany and Switzerland until he is irrevocably released from work following the termination of the employment with continued payment of remuneration belongs exclusively to Germany as the country of residence according to Art. 15 para. 1 DBA-Switzerland.

During the period of premature absence from work the plaintiff did not carry out his work in Switzerland within the meaning of Art. 15 para. 1 DBA-Switzerland. The immediate release from his duties removed the employee's obligation to work under the employment contract and his right to demand employment.

There is no "work carried out“ within the meaning of Art. 15 DBA-Switzerland because there is no other obligation of any kind towards his Swiss employer. As the plaintiff was irrevocably released from the obligation to work, he did not have to make himself available to his Swiss employer in any way during the release phase.

In the event of a premature and permanent release the employee is not paid for “doing nothing” at a specific location, i. e. the workplace or the location of work. Rather, he can fulfill his obligations arising from the modified employment relationship that still exists during the leave of absence at any location. In this respect, there is no direct connection between the plaintiff's “non-employment” and Switzerland as a place of work.

Furthermore, the plaintiff cannot successfully invoke the decision of 12 January 2011 in the case I R 49/10 where 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 (see our**blog post of 31 March 2011**). The remuneration received during the release phase of partial retirement constitutes remuneration for the work already performed during the active phase. The remuneration has therefore already been earned through the previous activity and is only paid out with a time delay. In the case in dispute, however, the plaintiff did not receive the current salary during the release phase because he had already earned this remuneration during the phase of active employment. Rather, the payments were a

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consequence of the remaining term of the employment relationship as modified by termination and leave of absence.

Source:

Supreme Tax Court, decision of 1 August 2024 (VI R 23/22) – published on 10 October 2024.

Keywords

allocation of taxing rights, employment income, employment termination