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By PwC Deutschland | 28 October 2024

Taxation of severance payments for cross-border commuters under the German-French double tax treaty

In a recent judgment the Supreme Tax Court decided that - according to Article 13 paragraph 1 of the double tax agreement (DTT) with France - Germany has the right to tax the severance pay as a result of the termination of an employment relationship insofar as the compensation relates to the period during which the employee (who was subject to unlimited tax liability at the time) lived and worked in Germany. The taxable amount must be calculated by considering the duration of the domestic residence compared to the term of the employment. The so-called cross-border commuter rule in Article 13 para. 5 of the DTT does not preclude Germany’s right of taxation.

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Background

The wording of the dependent personal services (employment income) article of the double tax treaty between Germany and France links all remuneration and benefits of any kind “stemming” from an employment to that employment and allocates the taxing right to the state where the work is or was performed (subject to special provisions for visitors and cross-border commuters, as described in more detail below).

The plaintiff worked for a group in Germany for a total of 245 months. In the first 129 months (February 1995 to October 2005) he was subject to unlimited tax liability on his income from employment because of his domestic residence in Germany. After moving to France, he was exempted from German (wage) tax for the remaining 116 months from November 2005 up to and including June 2015 based on corresponding exemption certificates from the tax office as a cross-border commuter in accordance with Article 13 para. 5 DTT. The plaintiff's income from his domestic employment relationship was thus subject to income tax in France.

Upon termination of the employment relationship the taxpayer was granted a severance payment for his total of 245 months of service in the group, which the tax office split into a taxable (129/245) and a tax-free part (116/245) based on the months for which the taxpayer was taxed in Germany (time-apportioned severance payment).

The Baden-Württemberg Tax Court had dismissed the appeal brought by the plaintiff.

Decision

The Supreme Tax Court confirmed the view of the tax court of first instance and held that the plaintiff was not entitled to any further tax exemption for the severance payment than that granted by the tax office. Due to the wording of Article 13 para. 1 DTT-France, which deviates from Article 15 para. 1 of the OECD-Model Treaty, the right of taxation for severance payments is generally granted to the country of employment and thus, in the case in question, to Germany.

Special rules exist for income from employment of persons who work in the border area of a contracting state (here: Germany) and have their permanent residence, to which they usually return every day, in the border area of the other contracting state ("cross-border commuters"). Though it is true that in those situations income from employment will only be taxed in this other state (here: France) the circumstances in the case of dispute warrant a different approach.

The specific cross-border commuter rule of Article 13(5) DTT-France does not preclude Germany's right to tax the compensation for the termination of an employment relationship pursuant to Article 13(1) DTT-France insofar as the severance payment relates to the period during which the employee (who was subject to unlimited tax liability at the time) lived and worked in Germany.

Taxation of the severance payment in France is hence possible as far as it relates to the period (129 months) in which the plaintiff was resident in Germany and carried out his work there. This is because the

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plaintiff was exclusively subject to unlimited tax liability in Germany with his income during this period and thus was not covered by the DTA-France.

Source:

Supreme Tax Court, decision of 1 August 2024 (VI R 52/20) - published on 24 October 2024.

Keywords

cross-border commuters, severance payment