18.4. Conclusion

In its decision, the *Bundesfinanzhof* confirmed its view that severance payments are exclusively taxable in the residence state. The Court disregarded a mutual agreement and a regulation arguing that a primary taxing right for the former state of work would be contrary to the wording of the treaty. The author believes that the better arguments speak in favour of a primary taxing right for the former state of work; at least such interpretation is not contrary to the wording of the treaty. The *Bundesfinanzhof* was not allowed to disregard the regulation. However, as the jurisprudence of the *Bundesfinanzhof* is now settled case law, the German tax administration should change its view and negotiate a new mutual agreement with the Swiss competent authorities to avoid double non-taxation in future.[27]

27. The German tax administration has already followed the jurisprudence of the *Bundesfinanzhof* in its administrative guidance and regards severance payments as exclusively taxable in the residence state. However, with regard to the tax treaties with Belgium, Luxembourg, the Netherlands, Switzerland and the United Kingdom, the tax administration sticks to its former interpretation and regards severance payments as primarily taxable in the former state of work; *see Bundesministerium der Finanzen*, 12 Nov. 2014, BStBl. I 2014, 1467, para. 178 and for the exception regarding Belgium, Luxembourg, the Netherlands, Switzerland and the United Kingdom, para. 183 et seq.

Chapter 19

Austria: Termination Payments[1]

Michael Lang, Selina Siller and Stephanie Zolles

19.1. Introduction

Article 15 of the OECD Model (2014) is the core provision in double taxation conventions for income from employment. Pursuant to article 15(1) of the OECD Model (2014), the residence state is entitled to tax income from employment unless the activity is exercised in another state. If the employment is exercised in another state – commonly referred to as the source state – article 15(1), second sentence, of the OECD Model (2014) stipulates that the state of exercise is entitled to tax. Whether the state of residence must exempt the income received from activities carried out in the source state or whether the tax on such activities must be credited depends on which method is prescribed in article 23 of the OECD Model (2014).

There are various special provisions that prevail over article 15(1) of the OECD Model and stipulate different legal consequences.[2] One of these is the 183-day rule prescribed in article 15(2) of the OECD Model (2014), which attributes the taxing right back to the residence state. Also, article 15(3) of the OECD Model (2014) provides a special rule according to which remuneration from employment exercised on board a ship or aircraft is taxed in the state in which the place of effective management of the enterprise is situated. Article 16 of the OECD Model (2014) (Directors' Fees), article 17 of the OECD Model (2014) (Entertainers and Sportspersons), article 19 of the OECD Model (2014) (Government Service) and article 20 of the OECD Model (2014) (Students) are *leges speciales* in relation to article 15 of the OECD Model (2014).[3] Hence, if income from an employment relationship falls within the scope of one of the aforementioned articles, the respective article prevails over the general rule of article 15 of the OECD Model (2014).

1. AT: *Verwaltungsgerichtshof* (Supreme Administrative Court) (VwGH), 26 Feb. 2015, no. 2012/15/0128.
2. *See* L. De Broe, *Article 15. Income from Employment*, in *Klaus Vogel on Double Taxation Conventions*, 4th edn, vol. II, para. 24 (E. Reimer & A. Rust eds., Kluwer Law International 2015).
3. *See* E. Burgstaller & M. Lang, *Mitarbeiter Stock-Options im Recht der Doppelbesteuerungsabkommen* p. 57 (Linde 2006).

Furthermore, the relationship between article 18 of the OECD Model (2014) (Pensions) and article 15 is particularly interesting. Article 18 of the OECD Model (2014) encompasses income received as a consideration of past employment, thereby the scope of article 15 of the OECD Model (2014) is restricted in relation to such income. Under article 18 of the OECD Model (2014), only the residence state is entitled to taxation. If neither article 15 nor article 18 is applicable, article 21 of the OECD Model (2014) may come into play: under this provision the residence state is entitled to exclusive taxation.[4]

19.2. Facts of the case

In its decision of 26 February 2016, 2012/15/0128, the Supreme Administrative Court had to decide a case that was subject to the Austrian-Swiss Income and Capital Tax Treaty.[5] The original version of the double taxation convention was concluded in 1974.[6] It corresponds to the 1963 OECD Model as this was the basis for the treaty negotiations. The Austrian-Swiss Income and Capital Tax Treaty has hitherto been amended numerous times. The provisions relevant for the present case are similar to the provisions of the OECD Model (2014).

The claimant of the present case was employed by a company set up in the Austrian province of Vorarlberg. The employment relationship was terminated at the beginning of May 2010 and the claimant was granted a leave of absence from 1 May 2010 until 31 January 2011. Accordingly, the employment relationship ended on 31 January 2011. Until then, the claimant received continued payments of the remuneration. At the end of the employment relationship, the claimant received an additional severance payment. Until the end of July 2011, the claimant lived in Switzerland and had no domicile in Austria.

The lower instance courts calculated the proportion of income that was not subject to taxation in Austria from 2007 onwards. They then computed the

4. *See* F.P.F. Pötgens, *The "Closed System" of the Provisions on Income from Employment in the OECD Model*, 41 Eur. Taxn. 7, p. 255 (2001); S. Dommes, *Pensionen im Recht der Doppelbesteuerungsabkommen* p. 226 et seq. (Linde 2012); *OECD Model Tax Convention on Income and on Capital: Commentary on Article 18*, para. 26 (2014).
5. AT: VwGH, 26 Feb. 2016, 2012/15/0128.
6. *Abkommen zwischen der Republik Österreich und der Schweizerischen Eidgenossenschaft zur Vermeidung der Doppelbesteuerung auf dem Gebiete der Steuern vom Einkommen und vom Vermögen* (31 Jan. 1975).

average percentage for the non-taxable proportion for the years 2007 to 2009. This average percentage was then used as a basis for calculating the non-taxable proportion of income received during the leave of absence. As regards the tax liability for the periods prior to 2010, the average percentage calculated for the foregoing years was applied to calculate the proportion of income received for employment exercised abroad. This proportion was then deducted from the total income from employment in 2010. The remaining proportion, i.e. the proportion that was allocated to Austria according to the calculations, was then taxed according to the provisions of the Austrian Income Tax Act. Since the authorities initially also treated the payments received as "termination pay", i.e. as severance pay income subject to tax in Austria, the lower instance courts decided to tax the respective proportion of the income from the termination pay in Austria.

19.3. The Court's decision

At the beginning of its reasoning, the Supreme Administrative Court clarified that the present case falls within the scope of article 15 since the claimant's employment relationship did not end until 31 January 2011. Thus, the employment relationship remained in effect until that date irrespective of the claimant's absence of leave. With reference to a previous judgment of the Supreme Court of Justice,[7] the Court recalled that a "leave of absence" be defined as an employer's renunciation of the employee's obligation to work during a specific period of time. The Court further held that during a leave of absence all other obligations, as for example the employee's obligation of loyalty, are not affected and are therefore still applicable.[8]

The Court continued by focusing on the relationship between taxation in the residence state and taxation in the source state within article 15: as a general rule, article 15(1) of the Austrian-Swiss Income and Capital Tax Treaty (1975) grants the residence state the taxing right for income from employment. This general rule is not applicable if the employment is "exercised" in the other contracting state. As a legal consequence, the income is then taxed in the source state. Article 15(2) of the Austrian-Swiss Income and Capital Tax Treaty (1975) provides exceptions to the source taxation rule prescribed in article 15(1), second sentence, of the Austrian-Swiss Income and Capital Tax Treaty. Accordingly, the employment exercised in

7. AT: *Oberster Gerichtshof* (Supreme Court of Justice) (OGH), 25 May 1994, 9 Ob A 61/94.
8. Id.

the source state is essential for determining whether the source state is entitled to taxation.

As regards individual payments, the question as to which state is assigned the taxing right has to be decided on the basis of whether a causal link exists between individual payments and the previously exercised employment. This follows from article 15(2), second sentence, of the Austrian-Swiss Income and Capital Tax Treaty (1975), the wording of which explicitly refers to "remuneration as is derived therefrom", i.e. the remuneration derived as a consequence of the employment exercised. Accordingly, the remuneration must have its cause in the employment exercised in the source state.[9] The time, form or designation of a payment received for an employment exercised in the source state is not decisive for the application of article 15.[10]

With respect to the principle of causality, the Supreme Administrative Court does not regard payments received by an employee during a leave of absence as payments received for the non-performance of work during the period of the absence. Rather, such continued payments – as well as severance payments – result from the employment exercised prior to the leave of absence and from the contractual conditions. It therefore becomes evident that a special causal link exists between the payments and the previously exercised employment. Similar to severance payments, the continued payments received during the leave of absence may be considered as the "final act" of the employment.[11] The Court further held that the parties to the employment contract are free to decide whether the termination of the employment relationship constitutes a high severance pay or long-term continued payments. However, the Court further emphasized that this shall not lead to different tax consequences, particularly with regard to the principle of causality.

Finally, the Supreme Administrative Court pointed out that this position is also confirmed by academic writing and by the Commentary of the OECD Model (2014): the Court concluded that as a consequence of the above-mentioned causal link, the continued payments received during the leave of absence are subject to the source taxation rule of article 15(1), second sentence, of the Austrian-Swiss Income and Capital Tax Treaty. The Court's

9. *See* R. Prokisch, in *Doppelbesteuerungsabkommen, Kommentar*, 6th edn, Art 15 MA, m.no. 16 (K. Vogel & M. Lehner eds., C.H. Beck 2015).
10. *See* F. Wassermeyer & M. Schwenke, in *Doppelbesteuerung: DBA* 121th suppl., Art 15 MA, m.no. 77 (H. Debatin & F. Wassermeyer eds., C.H. Beck 2013).
11. *See* id., at Art. 15 m.no. 56e.

decision therefore contained a number of references to literature sources and to the Commentary of the OECD Model (2014) and added a direct citation of paragraph 2.6 of the Commentary on Article 15 of the OECD Model (2014).[12]

19.4. Comments on the Court's reasoning

In its reasoning, the Supreme Administrative Court referred to the Commentary of the OECD Model (2014). At first glance, this appears to be odd since the applicable double taxation convention had been concluded in 1975. According to the prevailing opinion, a double taxation convention should be interpreted according to the version of the Commentary of the OECD Model that existed at the time the treaty had been concluded.[13] The question arises whether the Court took the view that the latest version of the OECD Commentary is also relevant for the interpretation of a double tax treaty.[14]

12. Such as H. Loukota & H. Jirousek, *Internationales Steuerrecht*, no. 15, m.nos. 31-44 (Manz 2013); M. Tumpel & R. Jahn, *Termination of Employment*, in *The OECD Model Convention and its Update 2014* pp. 121-146, at p. 121 et seq. (M. Lang et al. eds., Linde 2015). Note that this clarification of the treatment of termination payments was incorporated in the 2014 Update of the OECD Commentary; para. 2.6 *OECD Model: Commentary on Article 15* (2014): "In some cases, the employer is required (by law or by contract) to provide an employee with a period of notice before terminating employment. If the employee is told not to work during the notice period and is simply paid the remuneration for that period, such remuneration is clearly received by virtue of the employment and therefore constitutes remuneration 'derived therefrom' for the purposes of paragraph 1. The remuneration received in such a case should be considered to be derived from the State where it is reasonable to assume that the employee would have worked during the period of notice. The determination of where it is reasonable to assume that the employee would have worked during the period of notice should be based on all facts and circumstances. In most cases it will be the last location where the employee worked for a substantial period of time before the employment was terminated; also, it would clearly be inappropriate to take account of a prospective employment period in a State where the employee might have been expected to work but did not, in fact, perform his employment for a substantial period of time."
13. E.g. *see* F. Engelen, *Interpretation of Tax Treaties under International Law* p. 57 et seq. (IBFD 2004); M. Lang, *Wer hat das Sagen im Steuerrecht? Die Bedeutung des OECD-Steuerausschusses und seiner Working Parties*, 370 Österreichische Steuerzeitung 10, p. 203 et seq. (2006); M. Lang, *Introduction to the Law of Double Taxation Conventions* m.no. 65 (Linde 2012); M. Lang, *Die Bedeutung des OECD-Kommentars für die DBA-Auslegung*, in *Nationale und Internationale Unternehmensbesteuerung in der Rechtsordung: Festschrift Dietmar Gosch* p. 235 et seq. (J. Lüdicke, R. Mellinghoff & T. Rödder eds., C.H. Beck 2016).
14. Such an approach is also taken by several authors, e.g. *see* H. Loukota, *Die aktuelle österreichische DBA-Politik*, Österreichische Steuerzeitung, p. 249 et seq. (1995); H. Jirousek, *Kritische Anmerkungen zur Auslegung von Doppelbesteuerungsabkommen*, SWI, p. 112 et seq. (1998).

Such speculation may be dismissed since the Court merely indicated that the Commentary of the OECD Model (2014) provides an interpretation similar to the one applied by the Court itself. Hence, the Court did not base its reasoning on the approach described in the Commentary but rather merely emphasized that it found its reasoning in good company. Thus, besides providing its own interpretation, the Court pointed out that the latest version of the Commentary on the OECD Model (2014),[15] as well as two literature sources,[16] come to the same result. Therefore, it appears that the Court gave the Commentary of the 2014 OECD Model the same importance as a literature source, which effects a decision only in so far as it provides convincing arguments and not because it was written by a specific author. The person of the author of a literature source himself, irrespective of his prominence, may not have an influence on the decision or validity of an argument.

The Court held that the income received during the leave of absence be subsumed under article 15 of the OECD Model (2014). Based on a cursory reading, the application of article 15 of the OECD Model (2014) to the payments received until the end of January 2011 is not surprising since the employment relationship was valid at the time the claimant received the payments. However, as regards the severance pay, the application of article 15 of the OECD Model (2014) is rather controversial. Particularly in cases where the payment fulfils an aim of care, it is also conceivable to subsume the severance payments under article 18 of the OECD Model (2014).[17] If article 18 of the OECD Model (2014) is applicable, the residence state is entitled to exclusive taxation. The Court justified its decision to qualify both the continued payments and the severance payments in the same way by arguing that long-term continued payments and severance pay are interchangeable when it comes to the termination of employment relationship. This particular justification is not convincing for the application of article 15 of the OECD Model (2014) in the present case. The claimant and his employer could have already agreed to immediately terminate the employment relationship at the beginning of May and arranged a severance payment that also covers the remuneration until the end of January 2011. In such a case, it would be conceivable to subsume both payments under article 18 of the OECD Model (2014). From the perspective of the two parties, i.e. the employer and employee, such an agreement would hardly make any material differences for either of the two parties compared to the agreement in the present case.

15. *See* para. 2.6 *OECD Model: Commentary on Article 15* (2014).
16. *See* Loukota & Jirousek, *supra* n. 12, m.no. 31 et seq.; Tumpel & Jahn, *supra* n. 12, p. 121 et seq.
17. *See* Tumpel & Jahn, *supra* n. 12, p. 123 et seq.

In the present case, the employer granted a leave of absence instead of a higher severance payment. The reasons behind this agreement are unknown. If the employer intended to prevent the employee from entering into a new employment relationship until the end of January 2011, he could have also made this a condition to the termination of the employment with effect from May 2010. Consequently, the severance payment would have been connected to a non-competition obligation. The Court considered it decisive that other obligations, such as the obligation of loyalty, must be complied with during a valid employment relationship irrespective of a leave of absence. However, labour law also provides obligations that continue to have an effect after the termination of the employment relationship.[18] With regard to the application of article 15(1) of the OECD Model (2014), no essential difference can be established between obligations arising during a current employment relationship and those which must be complied with after the termination of an employment relationship.

Article 15(1) of the OECD Model (2014) distinguishes between two situations, namely one which assigns the taxing right to the residence state and one which assigns it to the source state. The Austrian authorities calculated the proportion of income that is not subject to Austrian taxation according to the ratio between the work performed domestically and the work performed abroad since 2007. The Court confirmed this approach on the basis of the aforementioned principle of causality. The Court held that such payments – as well as the severance payment – result from the employment exercised before the leave of absence and the contractual conditions. It is certainly true that in the absence of any employment relationship, there would not have been any continued payments or severance payments.[19] However, this is also true for pensions that are subject to article 18 of the OECD Model (2014). Furthermore, the continued payments as well as the severance payments were made regardless of the relationship between the domestic and foreign work.[20] In other words, a different relationship would not have affected the payments during the leave of absence or the severance payment. Moreover, the payments would also have been made had the work been solely carried out in Austria or abroad.

18. *See* AT: OGH, 12 July 1989, 9 ObA 151/89.
19. De Broe, *supra* n. 2, m.no. 53; Tumpel & Jahn, *supra* n. 12, at p. 127 et seq.; A. Binder & I. Vock, *Bezüge anlässlich der Beendigung eines Dienstverhältnisses: Doppelbesteuerung und doppelte Nichtbesteuerung im Verhältnis zu Deutschland*, SWI, p. 290 et seq. (2016).
20. Tumpel & Jahn, *supra* n. 12, at p. 134 et seq.

Despite raising various practical problems, an approach that distinguishes between the places where the previous work had been exercised indicates that there is no standard of comparison at all: in the present case, the Austrian authorities based its calculations on the average proportion of work performed abroad from 2007 until 2009. The Court refrained from explaining why it accepted this calculation method. It also remains unclear whether the claimant entered into the employment relationship in 2007. If the employer had entered into the employment relationship 30 years ago, the question arises whether the basis for the calculations would be the average proportions of the previous 30 years. Furthermore, it remains unclear whether the same calculation method should be applied if the amount of the foreign proportion changes over the course of time, e.g. if the employee exercised his employment solely abroad in the last 2 years and solely in the residence state during the previous years. Furthermore, it may be questioned that the time spent abroad is relevant for the calculations, whereas the amount of income received for the work exercised abroad is not considered at all.[21] Accordingly, if the remuneration increases in the course of time, higher importance would be attributed to the work exercised abroad in the preceding 2 years.

19.5. Conclusion

In the light of the above arguments, a calculation method that focuses on past employment work should be rejected. Alternatively, it would be possible to take the actual abode during the period the continued payments were made as a standard of comparison. However, such an approach strongly relies on coincidences and the result may easily be manipulated. In this context, a parallel may be drawn between unused holiday payments and such continued payments. According to the prevailing view, the unused holiday payments are part of the remuneration of work that generated the holiday payments and should be treated in the same manner as remunerations for holiday taken during the employment.[22] Thus, the state where the holiday is spent does not have a right to tax. Instead, such payments should be allocated to the state where the work was actually performed and not where the taxpayer spent his holiday. Taxation should only take place in the residence

21. The following authors speak for the use of the time spent abroad for the calculation: Wassermeyer, *supra* n. 10, Art. 15, para. 143; Prokisch, *supra* n. 9, at para. 68b.
22. This clarification for the treatment of unused holiday payments was incorporated in the 2014 Update of the OECD Commentary; *see* para. 2.5 *OECD Model: Commentary on Article* 15 (2014); De Broe, *supra* n. 2, at m.no. 40; Tumpel & Jahn, *supra* n. 12, at p. 129.

state if the work is carried out in that state. If the work was not carried out in the residence state, the allocation of the taxing right should take place on a pro rata basis.[23] The same result is achieved if the employment in the present case is no longer exercised in another state. As a consequence, the residence state is entitled to taxation under the first sentence of article 15(1) of the OECD Model (2014). This result may also be supported by the above considerations concerning the comparability of payments and pensions in this case under article 18 of the OECD Model (2014) with respect to the aim of care of the payments. Under article 18 of the OECD Model (2014), the residence state would be entitled to taxation.

There are valid arguments for assigning the exclusive taxing right for continued remuneration payments and severance pay to the residence state. Nevertheless, there are hardly any arguments that support the solution provided by the Supreme Administrative Court. Overall, the Court endeavoured to defend Austria's taxing right. The Court even approved of highly questionable arguments and calculation methods. Upon closer examination, the decisions of Austrian high courts may give the impression that for decisions on tax treaty law, an invisible principle of *in dubio pro patria* plays an underlying role for the outcome of the decision.

23. *See* para. 2.5 *OECD Model: Commentary on Article 15* (2014); De Broe, *supra* n. 2, at m.no. 40 et seq.; Tumpel & Jahn, *supra* n. 12, at p. 129.