

The Tax Treatment of Severance Payments Made in a Cross-Border Context – A Swiss Perspective

The tax treaty treatment of severance payments in relation to private employment in a cross-border context is described in this article. Qualification and allocation issues are examined, including the inherent risks of double taxation or double non-taxation in relation to such issues. Subsequently, the author highlights new developments brought about in the OECD Model (2014) and related Commentary on this topic and assesses the strengths and shortcomings of these developments. Finally, Switzerland is used as an example.

1. International Tax Treatment of Severance Payments

1.1. Introductory remarks

On 15 July 2014, the OECD Council approved the OECD Model (2014),¹ which, inter alia, included additions to the Commentary in relation to termination payments. The OECD Council attempted thereby to complement the limited guidance that had been given up to that point in the Commentary on the OECD Model concerning such payments.²

In fact, the tax treaty treatment of severance payments in relation to private employment in a cross-border context raises the following questions:

- how is a severance payment to be characterized: as income from employment (article 15 of the OECD Model), income from pensions (article 18 of the OECD Model) or other income (article 21 of the OECD Model)?
- should the taxation rights be allocated between the residence and source state and, if so, on what basis?

Answers to these questions are essential, since inconsistent treaty characterization and allocation of taxing rights, in

itself, implies the risk of double taxation or double non-taxation.

This article will analyse if and how these questions were addressed in both the Commentary and by national courts, prior to 2014, before examining new developments brought about by the OECD Model (2014), including a discussion of the strengths and shortcomings of such developments.

The definition of a severance payment in this article includes the following types of payments made by an employer:

- a payment in lieu of a required notice period (PILON), i.e. compensation for termination of employment in breach of a statutory or contractual obligation to respect a notice period;
- an additional payment based on criteria that need to be agreed on between an employer and employee (“other severance payments”);³ and
- a payment made as a “bridge” between the end of employment and ordinary retirement age.⁴

It does not, however, for example, include damages for unlawful dismissal or mental distress (moral injury), as well as non-competition payments.

1.2. OECD Model (2010)

1.2.1. Qualification of severance payments

1.2.1.1. Article 15 of the OECD Model (2010)

Article 15(1) of the OECD Model (2010)⁵ gives exclusive taxation rights regarding “salaries, wages and other similar remuneration derived [...] in respect of an employment” to the residence state, unless the employment was exercised in another state. In this instance, such remuneration as is derived from such exercise can be taxed in the source state.

Since the terms “salaries, wages and other similar remuneration” are not defined in the OECD Model (2010), the interpretation rules given by the OECD Model itself

* Tax manager, taxadvice ltd liab. co, Nyon, Switzerland. The author can be contacted at christine.ledure@taxadvice.ch. This article is based on the author's Master Thesis submitted for the purpose of fulfilment of the requirements of the Master of Advanced Studies in International Taxation (MASIT) at the University of Lausanne in 2015. The author would like to express her gratitude to Vikram Chand (Executive Director of the MASIT & Executive Program in Transfer Pricing at the University of Lausanne) who reviewed and made valuable comments on the article and to Danielle Axelroud Buchmann (Managing Partner taxadvice ltd liab. co in Nyon) for her continued support.

1. OECD Model Tax Convention on Income and on Capital (15 July 2014), Models IBFD.
2. See <http://www.oecd.org/tax/treaties/terminationpayments.htm> (accessed 7 Oct. 2015).

3. Such criteria might, for example, be the employee's previous salary level, his length of employment with the same employer or with the same group, the position he obtained, the probability he will find a new position, the remaining period until retirement, etc. See T. Urbásek, *Severance Payments and Golden Handshakes under DTC Law*, in *Taxation of Employment Income in International Tax Law* p. 504 (M. Lang, D. Hohenwarter & V. Metzler eds., Linde Verlag 2009).
4. Urbásek, id., at p. 488.
5. OECD Model Tax Convention on Income and on Capital (22 July 2010), Models IBFD.