

Belgium, Germany Sign Agreement on Taxation of Workers' Compensation

by Marc Quaghebeur

The finance ministries of Belgium and Germany have signed an agreement on the taxation of workers' compensation in accordance with the mutual agreement procedure of article 25 of their April 11, 1967, income tax treaty, as modified by a protocol of November 5, 2002. (For prior coverage, see *Tax Notes Int'l*, Nov. 11, 2002, p. 518.)

The purpose of the agreement is to determine the tax regime that applies to compensation paid to workers, as determined by the economic nature of the compensation. The agreement makes a distinction between compensation paid to provide for the worker's future and compensation paid for past employment.

In the former case, the compensation qualifies as a pension payment, which is subject to tax in the state of residence under article 18 of the treaty. In the latter case, if the compensation is a payment of arrears of wages, salaries, or other remuneration, or if it is paid for the termination of an employment contract, it is taxable in the state in which the activity has been carried out (article 15, section 1), but only if the worker had been working outside his state of residence (but not necessarily in the other state) before his employment was terminated.

The amount of compensation that can be taxed in the other state will be calculated as the percentage of the remuneration received in the previous calendar year that was subject to tax in the other state in accordance with article 15, sections 1 and 2. That understanding does not apply to remuneration for cross-border employment (article 15, section 3) or remuneration for government service or national insurance benefits (article 19).

Moreover, the tax authorities of a contracting state will inform each other of any compensation granted.

The agreement entered into force on December 15, 2006, when it was signed by the Belgian tax authorities. It will apply to any situations that have not yet been resolved or for which a mutual agreement procedure has been started.

The understanding is consistent with the change of position taken by Belgian tax authorities in Practice Note AFZ 2005/0652 (AFZ 08/2005) of May 25, 2005. (For prior coverage, see *Tax Notes Int'l*, Sept. 12, 2005, p. 1013.) The tax authorities abandoned the position that compensation in lieu of notice was taxable only in the state of residence, unless the purpose of the compensation is to provide for the needs of the worker until he can take his pension, or unless it supplements a pension. Those situations will still be covered by article 18.

In their practice note, the Belgian tax authorities had considered the possibility of splitting the compensation over the different states where the worker had been active over his entire international career. The December 15, 2006, agreement offers a workable solution in that the split applies only during the past calendar year.

Following is an unofficial English translation of the text of the agreement:

Mutual Agreement

Signed on the basis of Article 25 section 3 of the Belgian-German Convention for the prevention of double taxation.

Based on Article 25 section 3 of the Convention signed on April 11, 1967, between the Federal Republic of Germany and the Kingdom of Belgium for the avoidance of double taxation and for the regulation of certain other issues in respect of income and wealth tax, including the taxation of enterprise profits and real estate income, as modified by the

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protocol of November 22, 2002, the competent authorities of both Contracting States have agreed as follows with respect to workers' compensation.

(1) The tax regime of compensation depends on the economic nature of this compensation. If the compensation is characterized as a pension, it is liable to tax only in the state of residence in accordance with Article 18 of the Convention.

(2) However, if the compensation indemnity qualifies as arrears of salaries, wages or other remuneration granted in respect of an employment contract, or if the indemnity is generally granted for the termination of an employment contract, it is taxable in accordance with Article 15, paragraph 1 of the Convention, in the state where the activity has been carried out.

If the worker was active in his state of residence and in the territory of third states and in the other state in the period before the termination of the employment contract, the compensation can be taxed in this other state but only to the extent that it corresponds proportionately to the part of the remuneration received during the calendar year before the termination of the employment contract that could be taxed in the other state in accordance with Article 15 paragraphs 1 and 2 of the Convention.

(3) This agreement does not apply to income referred to in Article 15 paragraph 3 and Article 19 of the Convention.

(4) In accordance with article 26 of the Convention, the tax authorities of a Contracting State shall spontaneously inform the tax authorities of the other Contracting State of the granting of compensation.

(5) This agreement comes into force on the day after its signing and shall remain in force as long as the Convention does. The day of reference will be the last day of signing. This agreement shall also apply to any situations that have not yet been resolved when the agreement enters into force or that will be the object of a procedure of mutual agreement.

For the Federal
Ministry of Finance
Federal Republic of Germany

Berlin, September 13, 2006

For the Federal
Department of Finance
Kingdom of Belgium

Brussels, December 15, 2006

♦ *Marc Quaghebeur, partner, Vandendijk & Partners, Brussels*