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Towards a convergence of coordination in social security and tax law?

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1. Introduction

Free movement of workers is one of the four pillars of the EC Treaty. For individuals, however, it is - even after 45 years since the creation of the European Community - still not always simple or financially attractive to start working in another Member State. For example, they can be required to pay social security contributions and tax in different Member States, and, as a result, be worse off than if they had kept working in the state of origin only.

For social security, it has, since the foundation of the European Community in 1957, been clear that, in order to promote free movement of workers, it is essential that EC/EU regulations ensure that migrant workers do not lose benefit rights as a result of their cross-border movement. For this purpose the 1958 Regulation 3 came into force,[1] which introduced an elaborate coordination system. This system has been further developed, largely influenced by the case law of the ECJ, and is now laid down, for the major part, in its successor Regulation 1408/71.[2] In the near future, Regulation 1408/71 will, in its turn, be succeeded by Regulation 883/2004, which maintains the major principles of coordination of Regulation 1408/71 (see section 2.1. of this article).[3]

Even though tax regulations may also be very relevant to cross-border migration, it was not seen necessary or possible to establish a comparable coordination system in this area. At present the EC Treaty still does not provide the Council with powers to make tax coordination rules; tax regulations have remained exclusively within the competence of the national states; currently the subsidiarity principle is often mentioned as an obstacle for changing this situation.[4] Meanwhile, EU Member States have made bilateral agreements with other states in order to avoid double taxation. For drafting these conventions they usually use the OECD Model Convention as example.[5]

As a result of the different approach in the Treaty, two separate systems of coordination are now in force, which are not adjusted to each other. It is possible, for instance, that a worker is subject to contributions in country x and subject to tax in country y, or, more often, partly in country x and partly in country y. The income effects of such disparity can be considerable. We will discuss some of the differences in the rules in section 3.4. of this article.

Within circles of tax experts, in particular, it is sometimes argued that there is no need to distinguish social security contributions from tax, as they both serve to finance public goods of services.[6] If the distinction will be removed, it seems possible to solve the problem of lack of coordination of tax and social security easily. In this article we will investigate whether the distinction is indeed not necessary and if so, whether it could solve the problems of differences in coordination.

Looking at the answer to this question as negative, we will study the principles underlying the coordination rules for social security and tax within the context of existing disparities and we will discuss areas where (partial) convergence is possible.[7]

2. Coordination of social security

2.1. The institutional framework for the coordination rules

Measures to promote freedom of movement focus on social security in particular, since workers cannot be expected to go abroad if doing so has negative effects

1 OJ, 30 of 16 December 1958.

2 OJ, 1971, 149, p. 2, last codified by Council Regulation 1318/93, OJ, L 28 of 30 January 1997. For the web site of the (non official, but most recent) consolidated version, *see* http://europa.eu.int/eur-lex/en/consleg/pdf/1971/en_1971R1408_do_001.pdf. See, for a thorough analysis of these legal instruments, F. Pennings, *Introduction to European Social Security Law* (4th ed., Antwerp, 2003).

3 OJ, L 2004, 2001/1.

4 Commitee over internationale pensioenen, *Belastingen over pensioenen in Europa*, Geschriften van de Vereniging voor Belastingwetenschap, no. 209 (Kluwer, Deventer, 1999), p. 33.

5 OECD Model Tax Convention on Income and Capital Version 2005.

6 H. Vording and W. Barker, 'The relevance of a concept of tax', Preliminary version, to be published in *EATLP Congress Proceedings* 2005, p. 23; M. Bourgeois, 'Constitutional (see: general) framework of the different types of income', Preliminary version, to be published in *EATLP Congress Proceedings 2005*, p. 131.

7 The issue of the relation between social security coordination and tax coordination is getting more and more attention of the experts working in this area; see for instance Michael Lang (ed.), *Double Taxation Conventions and Social Security Conventions*, Vienna 2006.

on their social security position. Without interference by international legislation, such negative effects are unavoidable.

Article 42 of the EC Treaty provides that:

> 'The Council shall, acting in accordance with the procedure referred to in Article 251, adopt such measures in the field of social security as are necessary to provide freedom of movement for workers; to this end, it shall make arrangements to secure for migrant workers and their dependants'.

The measures required by Art. 42 are elaborated in Regulation 1408/71. Regulation 1408/71 is not only applicable in the territory of the European Union, but also in that of the European Economic Area and in Switzerland. Protection of social security rights of migrant workers implies that at least the following essential problems have to be solved:

- conflicts of law have to prevented;
- unequal treatment on grounds of nationality must be forbidden;
- breaks in the career of a worker resulting from cross-border movement, which are disadvantageous to the fulfilment of the conditions for benefit and/or the calculation of the amount of benefit, have to be repaired;
- territorial requirements for payment of benefit rights have to be removed.

The Regulation applies to statutory social security schemes which are listed in Art. 4 of the Regulation and to employees and self-employed persons, as defined in the Regulation, having nationality of an EU Member State.

Article 42 of the EC Treaty contains the phrase 'which are necessary to provide free movement'. Consequently, Regulation 1408/71, based on this Article, has to be seen in the light of the Community objective to promote free movement. Other instruments, such as in bilateral agreements, may limit coordination of social security to administrative issues and provisions of these instruments need not necessarily be interpreted which is most advantageous for migrant workers. In the EU context, however, coordination is meant to promote free movement; the Court of Justice consistently holds that the interpretation of coordination rules must be in the light of the promotion of the mobility of workers. It has consistently sought and still seeks, where possible, such interpretations of coordination provisions that may remove negative effects of migration. Examples are the broad interpretations of the terms 'employed person' and 'self-employed person' in, respectively, the *Unger* judgment[8] and the *Van Roosmalen* judgment,[9] in order to have a broad personal scope of the regulation.

2.2. The rules for determining the legislation applicable

An essential task of the Regulation is to determine the legislation applicable. The general provisions of Regulation 1408/71 concerning the legislation applicable can be found in Arts. 13 to 17. These have to determine which national social security scheme is applicable. In addition they have to prevent the possibility of no legislation being applicable at all, which might otherwise be the case due to cross-border movement. The rules for determining the legislation applicable also have to avoid that more than one legislation is applicable at the same time.

The rules for determining the legislation applicable have *exclusive effect*. This means that at any given time the legislation of only one Member State is applicable. The exclusive effect follows from Art. 13(1), as this Article provides that, except for some specific exceptions, persons falling under the Regulation are subject to the legislation of only one Member State.[10] The rules are of a compulsory nature and leave no choice for the person concerned between a 'better' or 'worse' scheme. As a result of these rules, it can happen that a worker is insured under a scheme with less attractive conditions than the one of his state of origin or state of residence. The Court has accepted this, and argued that this is the result of the lack of harmonization in social security.[11]

2.3. The rules on posting

If the legislation of the state of employment were also applicable to employees who are sent by their employer to work in another Member State for a short period only, free movement of workers would be seriously affected. For example: if a Dutch professor of tax law goes to Brussels for only one day to give advice to the European Commission, it would be awkward for her and her employer if she had to pay social security contributions for this day in Belgium. Therefore an exception is made to the main rule, that the legislation of the state of employment is applicable. This exception can be found in Art. 14(1) of the Regulation. This Article provides that a person

[8] Case 75/63, [1964] *ecr* 369.

[9] Case 300/84, [1986] *ecr* 3097.

[10] There are situations which are more complicated than the one of an employee who accepts work in another Member State. The main rules are for the following situations:
- if a person is normally employed in the territory of two or more Member States, he is subject to the legislation of the state of residence (Art. 14(2)(b)(i));
- if a person works in more than one Member State and resides in neither of these states, the legislation of the Member State in whose territory the employer has his registered office or place of business is applicable (Art. 14(2)(b)(ii));
- if a person is simultaneously employed in the territory of one Member State and self-employed in the territory of another Member State, the legislation of the Member State in the territory of which he is engaged in paid employment is applicable (Art. 14*c*(a));
- a person normally working as self-employed in the territory of two or more Member States, is subject to the legislation of the state of residence if he pursues activities in the territory of that state. If he does not pursue activities in the state of residence, the legislation of the state where he performs the main activities is applicable (Art. 14*c*).

[11] See, for an extensive discussion of the principles underlying these rules, Frans Pennings, 'Co-ordination of Social Security on the Basis of the State-of-employment Principle: Time for an Alternative?', *Common Market Law Review* 2005, vol. 42, no. 1, pp. 67–89.

employed in the territory of a Member State by an undertaking to which he is normally attached who is posted by that undertaking to the territory of another Member State to perform work there for that undertaking shall continue to be subject to the legislation of the first Member State, provided that the anticipated duration of that work does not exceed twelve months and that he is not sent to replace another person who has completed his term of posting. Self-employed persons can also be posted. Posting is possible for a maximum period of twelve months. If the duration of the work to be done extends beyond the duration originally anticipated and this is due to unforeseeable circumstances, posting can be extended for a maximum period of twelve months. The employer and employee have to apply for an E 101 form at the competent institutions of the sending Member State in order to have proof of the posting situation.

Posting is a politically sensitive subject. This is because the result of posting is that the employee concerned continues to be subject to the legislation of the sending state, which means, in particular, subject to the rules on social security contributions of that state. This is attractive, for the employer in particular, if contributions in the sending state are lower than in the state of employment. The enterprise which makes use of the posting provisions of the Regulation has, in such a case, a competitive advantage compared to the employers who have to pay contributions in the state of employment. Still, it is clear that posting rules are indispensable for free movement. The new Regulation 883/2004, has even a longer posting period than Regulation 1408/71: the period will be 24 months, without, however, the possibility to extend this period.

In addition, it has to be remarked that under Art. 17 of Regulation 1408/71 it is possible to have considerable longer posting periods. This Article states that 'two or more Member States, the competent authorities of these States, or the bodies designated by these authorities may by common agreement provide for exceptions to the provisions of Articles 13 to 16, in the interest of certain categories of persons or of certain persons'. Consequently, if a person goes to work in another Member State, it can be defined by this agreement how long he will remain subject to the social security system of the state of origin. In many Member States, the competent bodies limit the duration of such agreements to a maximum period of five years.

2.4. The non-discrimination principle and social security for migrant workers

An important principle underlying the coordination of social security is that of non-discrimination on grounds of nationality. This is elaborated in Art. 3 of Regulation 1408/71. In addition, the principle of non-discrimination is laid down in Art. 39 of the EC Treaty and can be invoked in those cases in which Regulation 1408/71 is not applicable, for instance in respect of non-statutory social security.

If Regulation 1408/71 is applicable, it governs the application of the non-discrimination principle. This is relevant, among other things, to the choice of the group with whom the worker is to be compared and also for the assessment of the objective justification put forward by the Member State concerned. More concrete, non-discrimination means that the worker concerned is treated in the same way as the persons subject to the same system of social security. And for assigning the applicable social security system, the rules for determining the legislation applicable are decisive. For example: if a person works in Germany and lives in the Netherlands, he is subject to German social security law only. This means that he must not be treated differently from the German workers. He has to pay the same contributions and to receive the same family benefits as German workers working in Germany. The application of the non-discrimination principle is thus subject to the outcome of the rules for determining the legislation applicable. Consequently, the worker concerned is treated differently from persons living in the Netherlands, where he resides: the non-discrimination rules cannot be invoked to remove these inequalities.

2.5. Qualification of payments: social security contributions or tax?

An interesting question which sometimes arises is whether a particular payment has to be considered as tax or as social security contribution. Such an issue was raised before the EC Court of Justice in the *Commission versus France* case.[12] The case concerned the French Social Debt Repayment Contribution (CRDS). This contribution went to a special public fund which is placed under the joint supervision of the Minister for the Economy and Finance and the Minister for Social Security. The primary purpose of the fund was to finance the deficits accumulated in 1994 and 1995 by the general social security scheme and the scheme's estimated deficit for 1996. The European Commission brought this case before the Court as the contribution also relates to the employment income of employed and self-employed persons resident in France but working in another Member State. The Court agreed that by doing so France disregarded the rule set out in Art. 13 of the Regulation. This Article provides that the legislation of a single state is to apply, insofar as that same income has already borne all the social charges imposed in the Member State of employment, whose legislation is the sole legislation applicable by virtue of Art. 13. The Court did not accept the French argument that the contribution should be categorized as a tax, thereby falling out with the scope of the Regulation. The fact that a levy is categorized as a tax does not mean that, as regards Regulation 1408/71, that same levy cannot be regarded as falling within the scope of that Regulation and caught by the prohibition against overlapping legislation. The decisive factor for the purpose of applying the Regulation is that there is a direct and sufficiently relevant link between the provision in question and the legislation governing the branches of social security listed in Art. 4 of the

[12] ECJ, 15 February 2000, Case 34/98, [2000] ECR I-995.

Regulation. The CRDS meets this criterion, as it is not a levy designed to meet general public expenses. Instead, its purpose is specifically and directly to discharge the deficit of the general French social security scheme. The CRDS therefore falls within the scope of the Regulation. Consequently, the Commission was right in arguing that the application of the French levy to residents working in another Member State was contrary to Community law.[13]

2.6. Gaps in the coverage of Regulation 1408/71

Although Regulation 1408/71 prevents double levying of contributions in many situations, it does not cover all situations. Until recently, third country nationals were not covered by the coordination regulation, which could mean double coverage by social security systems. The extension of Regulation 1408/71 to third country nationals by Regulation 859/2003 means that this problem is (for the major part) solved.[14] Another gap of the present system is that the personal scope of Regulation 1408/71 is limited to persons who have been an employee or self-employed person; consequently non-active persons are not covered and can be subject to double coverage. However, given the fact that these persons do not belong to the working population, such double coverage seems to be highly theoretical, since it has to follow from residential schemes. More serious problems exist in respect of the material scope of the regulation, since non-statutory benefits are not covered by the regulation. Here, the problems are not theoretical, as appears from the *Guiot* judgment.[15] In this case, Climatec SA, a company governed by Luxembourg law, was accused of having failed to pay contributions in respect of loyalty and bad-weather stamps, payable under Belgian legislation by reason of the employment of four workers by Climatec at a site in Arlon (Belgium). The contributions were based on a Belgian Collective Labour Agreement. Furthermore, Climatec was liable in Luxembourg for two types of contributions to that state's social security scheme for the employees sent to work temporarily in Belgium (posting).

The Court considered that Art. 59 of the EC Treaty requires not only the elimination of all discrimination on grounds of nationality against providers of services who are established in another Member State. It also requires the abolition of any restriction, even if it applies without distinction to national providers of services and to those of other Member States, which is liable to prohibit, impede or render less advantageous the activities of a provider of services established in another Member State where he lawfully provides similar services. Even if there is no harmonization in the field, the freedom to provide services, as one of the fundamental principles of the Treaty, may be restricted only by rules justified by overriding requirements of public interest and applicable to all persons and undertakings operating in the territory of the state where the service is provided, in so far as that interest is not safeguarded by the rules to which the provider of such a service is subject in the Member State where he is established. The Court considered that the national court pointed out that the Belgian and Luxembourg contributions at issue in practice cover the same risks and have a similar, if not wholly identical, purpose and concluded that Arts. 59 and 60 of the Treaty preclude a Member State from requiring an undertaking established in another Member State and temporarily carrying out works in the first-mentioned Member State to pay employer's contributions on the basis of the collective agreement concerned, where that undertaking is already liable for comparable contributions, with respect to the same workers and for the same period of work, in the state where it is established.

We have reproduced the reasoning of the Court in the *Guiot* case to some detail, as it shows the approach of the court in social security cases;[16] it is interesting to compare this with the approach in tax cases, as we will do below.

2.7. Bilateral social security conventions

In addition to Regulation 1408/71, bilateral social security conventions are important for coordination of social security. These are made, in particular, with countries to which many people of the country concerned migrated and later also with the countries or origin of large groups of immigrants (Morocco, Turkey). In addition, EU Member States have made agreements with each other. Since Regulation 3 came into force, they have been made in order to supplement this regulation and its successors.

Article 6 of the Regulation gives a general priority to Regulation 1408/71 over social security conventions. This Article provides that Regulation 1408/71 replaces, as regards persons and matters which it covers, the provisions of any social security convention binding two or more Member States exclusively, or at least two Member States and one or more other states, where settlement of the cases concerned does not involve any institution of one of the latter states.

3. Principles underlying the coordination of taxation

3.1. OECD Model Convention on Income and Capital

As was mentioned in section 1 of this article, the European Council is not competent to make coordination rules for tax law.[17] The absence of these rules,

[13] The same approach was followed in a second infringement procedure started by the European Commission versus France, see ECJ, 15 February 2000, Case 169/98, [2000] ECR I-1049.

[14] Problems may exist, for instance, if a person works simultaneously in Denmark or in another country, as Denmark is not bound by Regulation 859/2003.

[15] ECJ, 28 March 1996, *Guiot*, Case 272/94, [1996] ECR I-1905.

[16] See also Mijke Houwerzijl and Frans Pennings, 'Double Charges in Case of Posting of Employees: The Guiot Judgment and its Effects in the Construction Sector', *The European Journal of Social Security* 1999, vol. 1, no. 1, pp. 91–112.

[17] Article 293 of the EC Treaty requires, however, that Member States have to work in mutual cooperation in order to abolish double taxation for their residents within the Community.

however, causes serious problems for migrant workers. This is because if a person works in a country other than the country in which he lives, he may be subject to tax in both states. Many states take the income of their residents into account for the purpose of tax, regardless of where this income is earned. This is in accordance with the so-called world income principle.

As states do not wish to lose revenues, they also impose tax on income earned in their territory, even if the person concerned lives in another state. This is the so-called source state principle.

As a result double taxation occurs. Double taxation can affect free movement of workers, since workers can be deterred from working in another country if higher charges are the result. It is, of course, also a matter of fairness that a person must not have to pay 'too much' tax. Therefore solutions have to be found in case of double taxation.

An important difference between taxes and social security is that taxes can be used to finance, in principle, an unlimited range of provisions, whereas social security contributions are meant to finance, in principle, solely social security benefits. This makes it much more difficult to have exclusive effect of the distribution rules for tax: a migrant worker makes use of the provisions in the state where he lives (education of his children, protection of his local community, library, theatre, roads etc) and of public provisions in the state of employment (e.g. roads or public transport), which are paid from taxes. This makes it for a state much more difficult to renounce from levying taxes than to accept the exclusive effect of social security contributions. In the latter case, the state where the person concerned does not work does not receive contributions, but this state is not liable for payment of the corresponding benefits either.

There are various arguments in favour for levying taxes in the state of employment, but also in favour of doing so in the state of residence. An argument for levying taxes in the state of residence is, for instance, that the employee has the centre of interest in this state; an example of an argument in favour of the state of employment is that wages are earned in that state. In that perspective it is reasonable that the state of employment is competent. Of course, the choice to be made is a political one.

Not only political considerations would prevent introducing a general principle of exclusive effect in the area of tax law, but also reasons of principle: if in both states substantial provisions are paid from taxes from which the migrant worker benefits, it is desirable that he contributes to these, as otherwise the community in which he lives has to bear the burden for these provisions.

This does not take away that double taxation has to be regulated and this has been done by bilateral tax conventions. For these conventions often – if not always – the OECD Model Convention is taken as example. The Model Convention is not binding on states; they can make an agreement of their own. In practice, the Model Convention is often used.

The Model Convention provides that a bilateral convention based on it applies to persons who are resident of one of the states or both states concerned, regardless of their nationality (Art. 1 of the Model Convention). Article 2 of the bilateral convention defines the taxes within the material scope of the tax convention.

Tax conventions do not cover social security contributions. The commentary to the OECD Model Convention explains: 'Social security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received, shall not be regarded as "taxes on the total amount of wages"'.[18]

In the case of trans-border income from dependent work, basically the state of employment principle applies for determining the competent tax state. This means that the state of employment is competent to levy tax on the remuneration for this work. If at the same time the state of residence also levies taxes on this income the problem of double taxation arises.

Such double taxation can occur since not all taxes of all countries are covered by tax conventions. If there is no tax convention, a resident of a state has to rely on the legislation of the state of residence solely. If this legislation does not prevent double taxation, the person concerned is seriously affected. Below, in section 5 of this article, we will discuss some case law of the Court of Justice on the basis of the non-discrimination principle which may give some protection in situations of double taxation.

3.2. The distribution rules in tax coordination

Article 15 of the Model Convention provides that the competence to levy tax is assigned, in principle, to the state of employment. A state other than the state of residence is competent only if all three of the following conditions are fulfilled:

1. the employee concerned must in a calendar year (or period of 12 months) be working no longer than 183 days in the state of employment;
2. the wage of the person concerned is not paid by or in name of an employer in the state of employment;
3. the wage of the person concerned is not due by a permanent establishment or permanent representative in the state of employment.

As can be easily seen, these conditions concern the situation of what is called posting in social security, but the definition and duration of the two systems differ considerably.

In brief, if the conditions are satisfied, the competence to levy taxes is assigned to the state of residence. Some of these conditions may give rise to dispute, in particular if the competent authorities of the states concerned give different interpretations of which is the competent state. Examples of concepts easily liable for differences in interpretation are: the meaning of 'reside no more than 183 days', 'by or in name of', 'permanent establishment' and 'permanent

[18] Commentary to Art. 2 of the OECD Model Convention.

representative'. The Model Convention's Commentary can be useful guidance in deciding on such interpretation matters.

3.3. *Frontier workers*

Some states deviate, in the case of frontier work, from the distribution rules of Art. 15 of the Model Convention. In some cases taxes are levied in the state of residence, whereas in some cases partial reimbursement rules. These reimbursements can be to the benefit of the employee or of the state of employment. In other situations the state of employment is competent for levying taxes, but reimbursement can be made to the state and/or employee concerned.

On the European level there are no special rules for levying taxes from frontier workers. In 1979 a draft directive was published, which required levying taxes in the state of residence, but this proposal was withdrawn later.[19] In 1993 the European Commission issued a Recommendation, which promoted the state of employment principle.[20] The recommendation, which is not binding on the Member States, requires Member States to guarantee a non-discriminatory treatment of non-residents who earn at least 75 per cent of their income in their territory. In this respect the already mentioned subsidiarity principle is relevant, which means that, in short, Member States have to find their own solutions in this area.

However, given the coordination rules in the area of social security there are strong arguments for the state of employment principle in levying taxes as well. This can be illustrated by the example of the bilateral convention between Belgium and the Netherlands. Before 2003 this Convention determined the state of residence as the competent state. Since, however, for social security the state of employment was competent, problems existed for frontier workers. These problems occurred, in particular, if a state decided, at a certain moment, that income taxes have to be raised, whereas social security contributions had to be reduced with the same amount. Such a measure could be considered desirable, as it made workers cheaper, whereas the total revenues for the state remained the same. For purely national workers this measure did not have income effects. For frontier workers this was different: persons living in the state with the increased taxes, and working in the other state, the increased tax was not compensated by a reduction in social security contributions: they suffer adverse income effects as a result of the differing coordination rules. Note, however, that the frontier workers which were in the opposite situation received a higher net income and have thus little reason to complain.

The differences in effects of the coordination rules of the old convention brought the Netherlands and Belgium to adopt a new double tax convention that no longer applies the state of residence principle, but levies – in principle – taxes in the state of employment (the Double Tax Convention Belgium-Netherlands 2003). The tax coordination system was thus adjusted to the social security coordination.[21] The then Dutch State Secretary preferred to compensate the other state (Belgium) for losses in revenues, if necessary, on a macro level and not on the individual level.[22]

Since (Dutch) frontier workers would lose as a result of the change, there are transitional provisions, which compensate the workers on an individual level, so that they are not worse off. One rule gives a permanent compensation, another gives a compensation only until the frontier worker adopts a new job.[23]

If we compare this with the approach in social security, we can see an important difference. In tax law, states can decide themselves which state is responsible for levying taxes, whereas this is not the case if Regulation 1408/71 applies. Secondly there is a reimbursement system in tax, whereas this is not possible under the regulation. Thirdly, workers are compensated for the effects of being subject to the foreign tax system. Such compensation does not exist in social security law, where persons can remain worse off as a result of the application of the rules of determining the legislation applicable.

3.4. (Non-)coordination of tax and social security contributions

As we have seen above, social security and tax have different rules for determining the legislation applicable. This can lead to differences in outcome: 'non-coordination'.

An important area where non-coordination can occur is that of frontier workers, which we discussed in the previous section. Another important area is that of posting. In accordance with Art. 14 of Regulation 1408/71, posting can take place for a period of 12 months, with, in exceptional cases, extension to 24 months. Posting for tax purposes lasts, following Art. 15(2) of the Model Convention, for a maximum period of 183 days. As a result it can happen that after this – rather short – period of 183 days the worker has to pay tax in the state of employment and social security contributions in the state of residence. The new coordination regulation, Regulation 883/2004, has an even longer posting period – two years – than

[19] Directive of 21 December 1979, 79/737, PB EG 1980, C 21, p. 6.

[20] Recommendation of 21 December 1993, 94/79/EG, OJ 10 February 1994, L 39, p. 22.

[21] Note that for tax there are several problems which do not exist for social security; for instance, that, in order to reach equal treatment, the Dutch rules which allow deduction of mortgage interest from tax must now also allow mortgage interest of houses in Belgium being deducted from Dutch taxes.

[22] Parliamentary Papers II 1997–1998, 25 810, no. 2, section 2.4.3.

[23] The compensation is not lost in some situations: if the job is changed due to the take-over of a company, merger or comparable situation and if the frontier worker resumes his job in Belgium after having been posted for a maximum period of 12 months in another state and if the frontier worker takes up a new job in the Belgian frontier area within six months of a involuntary and complete dismissal (letter of the Secretary of State, 13 January 2003, no. IFZ2003/21, V-N 2003/6.11). Note that in case of voluntary change of jobs within Belgium by a frontier worker the compensation is lost. This rule can therefore hinder free movement of workers. Note also that the situation can become complicated if this person receives income from a third country.

the present regulation, so the divergence increases instead of diminishes. Moreover, for posting in tax, additional conditions have to be fulfilled: the remuneration must not be at the charge of the employer in the state of employment nor due by a permanent establishment or permanent representative in the state of employment.

See, for an overview of the differences in the area of posting, Figure 1. In this figure we assume that the person was first working in his state of residence and then in another Member State and that posting means that he remains subject to the law of the state of residence.

	Tax	Social security
The employee is sent for a period of less than 183 days for the account of the employer in state of residence	State of residence	State of residence
The employee is sent for a period of more than 183 days for the account of the employer in state of residence	State of employment	State of residence
The employee is sent for a period of less than 183 days, but replaces another worker or is not working on account of the employer for whom he normally works	State of residence	State of employment

Figure 1 The Conditions for posting in tax and social security law

There are also smaller examples of non-coordination, which can be found in the tax treaties; these and vary from tax treaty to tax treaty. An example is the so-called professor provision in Art. 20 of the Netherlands Belgium Double Tax Convention. In this Article the competence on levying taxes on remuneration of professors and other teachers who live in one Member State and who teach in the other state is assigned to the state of residence, provided the research is in the general interest. The competent state for social security is assigned to the state of employment (see Art. 13(2)(a) of Regulation 1408/71).[24]

3.5. Summary

From the previous sections it follows that the principles underlying international coordination in tax and social security are different. A main difference is that a person can, in principle, be subject to only one social security system at the same time, whereas he can be subject to more tax systems simultaneously. We have seen that the reason for this is that social security contributions are paid for benefits and thus have a single function. This function can be left to the state that is responsible for the social coverage of the person concerned, even if the protection is to be based on the two incomes he earns simultaneously in two different states. Tax is used to finance very many functions, which cannot be attributed to one country (like schools for children, maintenance of roads, culture etc.).

A second difference is that tax coordination concerns the payment of levies only; social security coordination concerns also payments of benefits to individuals. This makes it difficult to adjust the system of coordination of social security to that of the tax coordination. It makes it also difficult to make the coordination rules much simpler.

A third difference is the technique of the distribution rules. In social security one state is the competent one and the contribution rules of that state are applied on the income earned in both states in case a person is working in both states. The state which is not competent is excluded from levying contributions. In tax the distribution rules mean that taxes are calculated in both states on the income of an employee, but subsequently the person concerned is exempted (partially of completely) from taxes in the state of residence. For other sources of income than from work as an employee, the distribution rules can make the state of residence competent. This is true, for instance, for persons receiving a pension.

A fourth difference is that coordination of social security is, within the EU, meant to promote the free movement of workers. The double tax conventions do not have such a basic objective.

4. Is there room for more convergence?

The differences between the systems as mentioned in the previous section make it very difficult to harmonise the tax and social security coordination rules. However, it should be possible to harmonize some categories of the rules, where the problems are most urgent. In this respect the area of posting rules is important. At present we see that there is even a growing divergence concerning the duration of the posting period; harmonization of the period would be desirable.

A solution for solving the problem could be that the social security rules follow the tax rules. Alternatively, tax rules could follow the social security rules. How to decide between the two alternatives?

A pragmatic approach could be: it is easier to change a tax convention than to change Regulation 1408/71, given the number of states involved. In a tax convention it is also possible to find pragmatic solutions on detailed issues, such as compensation between the states. On the other hand changing the regulation

[24] Another example concerns employment performed on a (non-sea) ship or airplane (Art. 15(3) of the Netherlands-Belgium Convention). Competent for taxes is the state where the establishment is located which actually governs the non-sea ship or airplane. This can be a state other than that where the work is performed. Art. 13(2)(a) of the Regulation assigns the state of employment as the competent state.

covers at once all Member States, which has also its advantages, but for this purpose unanimity is required.

We can approach this issue also from a more principal nature. We have seen that the social security rules are necessary to promote freedom of movement. It is consensus, though hard to prove, that a period of six months of posting is too short to allow free movement, as many projects rake longer. In the new Regulation the reason the period is even extended to 24 months. From this approach it follows that, if convergence is desirable, the social security rules have to be followed.

Another issue where the lack of coordination is felt is that of frontier workers. It is recommended that the rules for determining the legislation are coordinated, for which purpose the *lex loci laboris* seems to be the most appropriate for promoting free movement, as this approach avoids distortion of competition.[25] Also the other conditions for posting in social security law and tax law will have to be coordinated in the light of this principle.

Conclusion: if we wish to have more convergence, the convergence must be in the direction of that solution that fits best with free movement of workers. This still leaves some room for different outcomes and even for compromises, but this principle is essential to social security.

5. The application of EU non-discrimination law in tax cases

As we saw in the previous section, tax law is not governed by an overall principle, such as free movement. Moreover, there are no EU coordination rules on tax. Still, in the past decade the Court of Justice developed case law also on tax issues, which are based on discrimination. Here we will look at this case law, as also in social security the principle plays an important role, and it is interesting to identify differences in the application of this principle in both areas. We will first have a look at differences on nationality in tax law in this section. The differences with social security can be seen, in particular, in connection with bilateral agreements where a third nationality is involved. We will discuss these in section 6 of this article.

The case law on discrimination in tax schemes did not start promising: in 1992, in the *Bachmann* case,[26] the Court was unwilling to accept that a national rule which did not allow foreign social security contributions being deducted from tax payable in this country was a form of indirect discrimination. The Court ruled that 'it must be recognised that, in the field of pensions and life assurance, provisions such as those contained in the Belgian legislation at issue are justified by the need to ensure the cohesion of the tax system of which they form part, and that such provisions are not, therefore, contrary to Article 48 4|G1|"157E048" of the Treaty'.

However, already a couple of years later, the Court accepted that if national law constituted a form of discrimination, this was incompatible with EU law. The *Schumacker* judgment[27] concerned a person of Belgian nationality who complained about the conditions under which his income earned in Germany was taxed in Germany. The Belgium German Tax Convention involved that German aw applies; the problem was that Germany had different tax rules for those not residing in Germany. The Court ruled that Art. 48 of the EC Treaty (now Art. 39) must be interpreted as precluding legislation under which a worker who is a national of, and resides in, another Member State (Belgium) and is employed in the first state (Germany) is taxed more heavily than a worker who resides in the first state (Germany) and performs the same work there. So this is a form of indirect discrimination, forbidden by EU law. Actually, the Court supplemented the provisions of the double tax conventions: the assignment of German law is accepted, but this law must be applied in a non-discriminatory way, which was not required by the tax convention itself. This judgment caused Member States to adjust their legislation.

In the *Asscher* judgment[28] the Court followed a comparable approach. Mr. Asscher is the director of a private limited company in the Netherlands, of which he is sole shareholder. He also works in Belgium, where he is manager of a company. As regards taxation, Art. 16(1) of the bilateral convention provides that Mr. Asscher's income in the Netherlands is taxable exclusively in the Netherlands. In Belgium, where he resides, Mr. Asscher is taxed on the remainder of his income. After he moved to Belgium he has been subject solely to the Belgian social security legislation, in accordance with the Regulation.

Foreign persons liable for Dutch taxes who were not insured for national insurance schemes in the Netherlands had to pay, compared to internal tax payers, higher taxes. The Court considered that in relation to direct taxes, the situations of residents and of non-residents in a given state are not generally comparable, since there are objective differences between them, both from the point of view of the source of the income and from that of their ability to pay tax or the possibility of taking account of their personal and family circumstances. If there is a tax advantage which is not available to a non-resident, different treatment may constitute discrimination where there is no objective difference between the situations of the two such as to justify different treatment. In the present case there was no objective difference in the situation that can justify the difference in treatment.

Note that Mr. Asscher was subject to Belgium social security only and for the social security contributions he was compared with Belgian insured persons only. In tax, this was different, since the tax rules allowed

[25] See for a more detailed discussion, Frans Pennings, 'Co-ordination of Social Security on the Basis of the State-of-employment Principle: Time for an Alternative?', *Common Market Law Review* 2005, vol. 42, no. 1, pp. 67–89.

[26] ECJ, 28 January 1992, *Hanns-Martin Bachmann v Belgium*, Case C-204/90, [1992] ECR 249.

[27] ECJ, 14 February 1995, *Schumacker*, C-279/93, [1995] ECR I-225.

[28] ECJ, 27 June 1996, *Asscher*, C-107/94, [1996] ECR I-3089.

taxation in two countries. Therefore he had to be compared with the Dutch taxpayers as well. So here we have an important difference in the application of the non-discrimination principle.

In the *Zurstrassen* judgment[29] the Court considered that it is settled case law that the rules of equal treatment, both in the Treaty and in Art. 7 of Regulation 1612/68, prohibit not only overt discrimination based on nationality but also all covert forms of discrimination which, by applying other distinguishing criteria, lead in practice to the same result. In the present case, the entitlement of married couples to joint assessment to tax is subject to a residence condition for both spouses, which Luxembourg nationals will be able to satisfy more easily than nationals of other Member States who have settled in Luxembourg in order to pursue an economic activity there. This condition does not ensure the equal treatment required by the Treaty.

An interesting case of the interacting of social security contributions and tax in bilateral situations is the *Blanckaert* case.[30] The case concerned the refusal of the Dutch Tax Inspector to grant Blanckaert tax credits in respect of national insurance. Mr. Blanckaert is a Belgian citizen, resident in Belgium, who receives income from a holiday home in the Netherlands, on which income he has to pay taxes to the Netherlands. This was the only taxable income he receives in the Netherlands. Since he does not work in the Netherlands he is not insured under the Netherlands social security system. In the calculation of his taxes, no tax credit in respect of national insurance was granted to him, since the latter credit is awarded only to persons subject to Dutch social security. As we saw Mr. Blanckaert did not satisfy the latter condition.

Mr. Blanckaert fought the refusal of the credit. He compared himself with a person subject to Dutch social security legislation, who did not have to pay contributions, because of a lack of income.

The Court considered that the criterion of insurance chosen by the Netherlands legislation favours, in the majority of cases, persons resident in that Member State and is therefore capable of hindering the free movement of capital. There may however be objective justifications. The Court remarked that a person such as Mr. Blanckaert, who did not have to pay contributions in the Netherlands, is not really comparable with persons who are subject to Dutch contributions. Those who are subject to the Dutch contributions can deduct the credit from these contributions and that means that they still have t pay the full tax. Persons as Mr. Blanckaert cannot deduct the credit from contributions, since he is not liable for these, and he can deduct this credit from taxes. So, in fact, he would be better off than most of the persons subject to Dutch social security. As a result, the Dutch rules could be justified.

After all, we consider the outcome in Mr. Blanckaert's case as correct, as, if we follow Mr. Blanckaert's argument, he could benefit from tax credits in two countries, whereas purely national workers do not have this advantage. Moreover such double credits could undermine the progressive nature of the taxes.

It is, however, not so easy to analyse where Mr. Blanckaert's approach goes wrong. In our view it has to do again with the lack of coordination in tax. In social security the exclusive effect means that non-discrimination rule is applied solely in relation to the system that is applicable. For Mr. Blanckaert this is the Belgian system. For tax there can be more than one system in which discrimination issues may arise. Indeed, Mr. Blanckaert was subject to two systems. This causes problems, also from the point of view with whom he is comparable. Note also that by linking the tax rules to social security rules, it is easier for Member States to escape the judgment that the rules are discriminatory.

6. The difference in treatment of non-discrimination clauses in bilateral conventions of third countries

The application of the non-discrimination rule becomes even more complicated if a bilateral convention of a third country is invoked. The question is, simply put, whether a person can invoke a provision of a bilateral convention between two Member States of which he does not have nationality. An example of this situation is the *Gottardo* case. Ms. Gottardo switched to French nationality following her marriage.[31] She worked successively in Italy, Switzerland and France. She would be entitled to an Italian old-age pension only if account were also taken of the periods of insurance completed in Switzerland. This would be possible only if the Italy-Switzerland Convention was applied. This was refused on the ground that she was a French national and that the Italy-Switzerland Convention did not apply to her. A French national invoked the convention between two other Member States, in order to obtain a pension in one of these states; Art. 3 of Regulation no. 1408/71 provides:

> '1. Subject to the special provisions of this Regulation, persons resident in the territory of one of the Member States to whom this Regulation applies shall be subject to the same obligations and enjoy the same benefits under the legislation of any Member State as the nationals of that State … 3. Save as provided in Annex III, the provisions of social security conventions which remain in force pursuant to Article 7(2)(c) and the provisions of conventions concluded pursuant to Article 8(1) shall apply to all persons to whom this Regulation applies.'

The Court answered that the Convention had indeed to be applied, from the point of view of equal treatment.[32]

[29] ECJ, 16 May 2000, *Zurstrassen*, C-87/99, [2000] ECR I-3337.

[30] ECJ, 8 September 2005, Case 512/03, not yet published in the ECR.

[31] The *Gottardo* judgment was preceded by the *Maria Grana-Novoa* judgment (ECJ, 2 August 1993, Case C-23/92, [1993] ECR I-4505), in which the applicant was not successful, since the judgment was restricted to the question whether a convention concluded between a single Member State and one or more non-member countries was legislation in the sense of Regulation 1408/71.

This approach differs, at first sight, from *D*,[33] a case which concerned a German national who has real property in the Netherlands and who had to pay wealth tax in the latter country. According to the law, resident taxpayers were entitled to an allowance (a tax rebate) applied to their net worldwide assets while non-resident taxpayers taxed on their net assets in the Netherlands were not entitled to an allowance. However, the Belgium- Netherlands Convention allowed for such an allowance for persons resident in Belgium. Since Mr. D was a German he was refused this allowance. The Court argued that the question is whether Mr. D's situation can be compared to that of another non-resident who receives special treatment under a double taxation convention. In answer to this the Court refers to the reciprocal character of the Belgium-Netherlands Convention. The fact that those reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an inherent consequence of bilateral double taxation conventions. It follows that a taxable person resident in Belgium is not in the same situation as a taxable person resident outside Belgium so far as concerns wealth tax on real property situated in the Netherlands. A rule such as that laid down in the Belgium-Netherlands Convention cannot be regarded as a benefit separable from the remainder of the Convention, but is an integral part thereof and contributes to its overall balance. For this reason the tax allowance as granted under the Belgian Convention was not to be extended to nationals of other countries.

Thus Ms.Gottardo could invoke a bilateral convention whereas Mr. D could not. The main difference seems to be that the *Gottardo* case the multilateral instrument of Regulation 1408/71 was invoked (which requires equal treatment, including, in principle, the application of bilateral conventions with third countries). In the *D* case the convention concerned was a bilateral instrument with reciprocal elements which made it unsuitable for extension to a national of a non-Contracting Party.

Note that the difference can be explained, again, by the fact that taxation is possible in more than one country at the same time. In social security only one system is applicable, so the person concerned is to be compared with one reference group. Within this group all the advantages provided to the reference group have, in principle, to be provided to the foreign person as well.

Although the case law is complicated in the sense that for future cases the outcome will not always be easily predictable, the outcomes in the judgments are correct as they correspond to the difference in the coordination systems of tax and social security respectively.

Whereas social security coordination is a comprehensive system, that is not the case with tax. Indeed, under tax coordination it is possible to be subject to two different systems at the same time, like in the case of Mr.D. As a result he would be subject to two tax allowances at the simultaneously (which are not pro rata) which may overlap. Application of equal treatment may not only distort the capital and tax system, but also the market of real estate. For this reason the outcome is fully justified.

We can also learn from the comparison of tax and social security that the lack of coordination rules in the area of tax does not necessarily follow from the subsidiarity principle. Of course, from this principle it can follow that the Council does not have the power to decide on the *contents* of national tax systems. This is equally true for social security: Member States have maintained the powers to decide on these, as follows from consistent case law of the Court. However, for coordination in international situations, bilateral solutions are not always sufficient, certainly not if we wish to maintain the freedoms ensured by the Treaty, including the free movement of workers. Hence, we can see the rather complicated and not always predictable case law of the Court of Justice. It is therefore desirable to try again to make an EU instrument to coordinate tax for those issues which cannot regulated by the Member States themselves.

7. Conclusions

In the introduction we referred to the discussion of whether social security contributions could rather be treated as a form of tax. Actually, in several countries social security contributions are partly or completely collected by the tax offices and in others some social security schemes are financed from taxes. Moreover in internal situations differences between tax and social security rules can lead to a high administrative burden and this lead to internal harmonization. From time to time it is argued that contributory benefits should in future be paid from taxes, since this can broaden the group of persons contributing to the system. This will increase solidarity. Recently, Vording argued that the distinction between tax and contributions is partly due to historical reasons 'and can be seen as an attempt to give workers a feeling of "ownership" and responsibility for the insurance contributions'.[34] Bourgeois claims that the differences between both types of dues are becoming smaller and smaller and, for this reason, justifications for the distinction are becoming les convincing.[35]

There are also arguments for maintaining the difference between taxes and contributions, in particular in the case of long-term benefits. If persons have to contribute during long periods to benefit schemes, it is much more difficult to change the system to the disadvantage of the insured than in the case of tax financed schemes. Moreover, it is hard to maintain an earnings related scheme if paid from public means; it will soon become a flat-rate, means-tested scheme.

[32] Note that at the time Swiss law was not even within the scope of Community law.

[33] ECJ, 5 July 2005, Case C-376/03, not yet published in the ECR.

[34] H. Vording and W. Barker, 'The relevance of a concept of tax', Preliminary version, to be published in the *ETALP Congress Proceedings 2005*, p. 23.

[35] M. Bourgeois, 'Constitutional (see: general) framework of the different types of income', Preliminary version to be published in the *EATLP Congress Proceedings 2005*, p. 131.

Whether this is undesirable or not is a political issue and, within the context of this contribution, we cannot go into this further.

On the basis of our analysis of *international* legislation, however, we have shown that it is important to maintain the difference between taxes and social security contributions. First of all, this has to do with the definition of the rules for determining the legislation applicable relevant to social security. As we have seen, workers have to pay contributions in the state of employment only. If taxes have a direct link with funding social security, they are treated as contributions and that means that persons subject to another system do not have to pay these. However, if social security schemes are paid from taxes which do not provide criteria to distinguish the part of the taxes payable for social security and for other purposes, Regulation 1408/71 cannot be applied and the workers concerned have to pay 'double'; in fact they contribute to the social security system to which they are not subject. Because of this system it is important to remain or even (re)introduce contributory systems, as was the case with some Nordic countries when they became member of the EU.

Secondly, the distinction is important since social security does not only concern contributions, but also benefits. This means that special coordination rules remain necessary. Moreover, the objective of free movement of workers is decisive for the interpretation of the social security coordination rules. In the case of tax, other objectives may play a role, which may even justify hindering free movement. This is another reason for making a difference between tax and social security.

The analysis we made of the background of the tax and social security coordination rules proved useful for explaining differences in the case law of the Court of Justice. The different treatment of non-nationals in the *Gottardo* case was within the multilateral instrument of Regulation 1408/71, whereas there were no justifications for this difference. In the *D* case the convention concerned was a bilateral instrument with reciprocal elements which made it unsuitable for extension to a national of a non-Contracting Party.

Secondly, the analysis was also useful to identify the areas where partial convergence is necessary and possible and it also shows the direction into which this process should go. Free movement should be the guiding principle in order to keep the solutions consistent with the Treaty. This may not be necessarily so for tax, but it is required for social security. This principle itself requires convergence and more should be done than is done so far.