EC: Income Taxation of Foreign Workers

*PROPOSAL FOR A COUNCIL DIRECTIVE CONCERNING THE HARMONIZATION OF INCOME TAXATION PROVISIONS WITH RESPECT TO FREEDOM OF MOVEMENT FOR WORKERS WITHIN THE COMMUNITY**

(presented by the Commission to the Council)

Explanatory Memorandum

1. General Considerations

1. The free movement of persons is a basic Community objective enshrined in Articles 3, 48 and 49 of the Treaty of Rome. It affects in particular employed persons and within this groups, the special category of frontier workers. Figures for 1977[1] show that there were approximately 1.600.000 EEC nationals working in Member States other than their own: most of them came from Italy (696.000) and Ireland (456.000), and most of them went to the United Kingdom (632.000, mainly Irish), Germany (407.000), France (300.000), and Belgium (170.000). Frontier workers accounted for another 150.000, concentrated in the Belgium-Netherlands-Germany border area (the Maas-Rhine Euregion) and in Luxembourg.

2. The principle of equal treatment for persons employed in such circumstances has already been laid down by the Council: its Regulation of 15 October 1968 on freedom of movement for workers within the Community provides, inter alia, that a worker who is a national of another Member State 'shall enjoy the same social and tax advantages as national workers'.[2] It is also clear from the steady stream of Parliamentary Questions that the tax problems of these workers are of particular concern to Parliament.

3. The tax problems arise from the fact that employees, and especially frontier workers, who reside in one Member State and work in another, are generally taxed, under long-standing international practice, in the country of activity. The only exception to this rule is to be found in certain tax conventions which provide for exclusive taxation of frontier workers, narrowly defined in terms of geographical frontier zones, in the country of residence.[3]

However an employed person who is taxed in the country of activity may suffer disadvantages stemming from the fact that most countries have different systems for taxing residents and non-residents. Residents, on the one hand, are taxable on their whole income, but, on the other hand, have their personal

* COM(79) 737 final; Brussels, 13 December 1979.

1. Commission document no. V/727/78.
2. Council Regulation 1612/68, Article 7 paragraph 2 (OJ L 257, 19 October 1968).
3. See table on page 195 for further particulars.

circumstances, and in particular their family responsibilities, taken into account through deductions etc. The tax situation of non-residents is more circumscribed: they are taxable only on certain items on income from sources in the State of imposition but have a simplified tax system applied to those items. It may thus happen, where employed persons are being taxed as non-residents, in the country where they carry on their activity, that their personal circumstances are not taken into account or not as much as if they were resident, while at the same time, because they have insufficient other income, their circumstances cannot be taken into account in their country of residance (where, to avoid double taxation, their employment income is exempt).

4. The Commission has been guided, in its approach to the taxation of frontier workers, by the following considerations:

a. Income tax, being a direct tax, constitutes only a part of the whole tax charge; the other part consists of the indirect taxes charged on consumption. The fact that the frontier worker and his family continue to incur normal living expenses in the country of residence and are thereby subject to indirect taxation at the level prevailing in that country militates in favour of subjecting them also to the level of direct taxes in the same country. This is an aspect which has also been stressed by the Economic and Social Committee, in its recent report on the problems of frontier workers.[4]

b. Taxation in the country of residence carries with it the great advantage of simplicity in as much as the frontier worker has only to deal with the tax authorities of his country of residence. This is particularly true where he has, in addition to employment income, other income which is liable to tax in the residence country.

5. It is therefore the Commission's considered opinion that frontier workers should by reason of their extremely close links with their country of residence, exemplified in the basic requirement of daily return be taxed at the level prevailing in the country of residence. This principle should be uniformly applied to all internal EEC frontiers (Part II of the directive). It does not, however, follow that the State of residence should also have exclusive rights to the receipts from such taxation. On the contrary, the taxation arrangements and the allocation of receipts should be dissociated, leaving the latter question to be settled between the Member States.

6. In the case of other non-resident employees, there is no reason to depart from the traditional rule under which they are taxed in the country of activity. However, it is important to ensure that their taxation in that country will not be less favourable than that of resident employees. Such a guarantee is given in Part III of the directive.

The directive does not, on the other hand, provide for non-residents to be treated more favourably than resident employees: this is an aspect to which the Economic and Social Committee attaches particular importance.[5]

7. Finally, Part IV deals with the situation where payments to certain insti-

4. Opinion of the Economic and Social Committee on the problems of frontier workers (OJ no. C 128, 21 May 1979).
5. Para. 1.1.6, ibid.

tutions, like insurance companies and banks, are taken into account for tax purposes (usually by way of general deductions from the tax base) only if the recipient is a resident of the taxing Member State and not of another Member State. This is a problem which affects both the freedom to provide services throughout the Community and the treatment of the taypayer whether resident or non-resident who is refused a deduction. Hence the present directive also settles this problem by laying down a general non-discrimination clause.

Income Tax Treatment of Non-Resident Workers under Bilateral Double Taxation Treaties

	Employment income taxable in country of	
	Frontier Workers	*Other Non-Resident Workers*
Belgium-France	Residence	Activity
Belgium-Germany	Residence	Activity
Belgium-Luxembourg	Activity[6]	Activity
Belgium-Netherlands	Residence	Activity
Denmark-Germany	Activity	Activity
France-Germany	Residence	Activity
France-Italy	Activity	Activity
France-Luxembourg	Activity	Activity
Germany-Luxembourg	Activity	Activity
Germany-Netherlands	Activity	Activity
Ireland-United Kingdom[7]	Activity	Activity

II. Comments on Certain Articles

Article 3

8. Whereas Article 1 defines the scope of the directive and Article 2 lists the national income taxes to which it applies, Article 3 contains the important operational definition of frontier worker. Such a definition is necessary since the principle of taxation in the country of residence is to be applied to this category of workers but not to other non-resident employed persons.

6. Belgian frontier workers in Luxembourg have the option to be treated as resident in Luxembourg.
7. Non-residents are entitled to personal allowances and reliefs in the proportion that their UK or Irish income bears to their world income.

9. The definition follows as closely as possible the definition already in use by the Community for social security purpose.[8] In particular, it lays down the condition of daily return to the country of residence and refrains from prescribing a frontier zone which would only produce arbitrary results. It is thus wider than the definition normally to be found in bilateral tax conventions and must be substituted for that definition whether the convention concerned is based on the principle of taxation in the country of activity or that of taxation in the country of residence.

As with the social security definition, a frontier worker does not lose his status simply because he is sent to work for a limited period to another place inside the Community from which he is unable to return daily to his place of residence.

While, however, the essence of the social security definition has been preserved, certain adaptations have been made to render it suitable for use in a taxation context.

Article 4

10. Paragraph 1 lays down the principle of taxation in the country of residence.

This principle does not however preclude the country of activity from levying a withholding tax so as to guarantee a minimum taxation (paragraph 2). So long as the withholding tax is levied on non-residents and residents alike, it may not be higher for non-residents than for resident employees.

In order to avoid double taxation, the withholding tax has to be credited against the tax due in the country of residence, and where the withholding tax is greater, the excess must be refunded (paragraph 3). This ensures that the taxpayer is always taxed at the level prevailing in the country of residence.

Article 5

11. This Article provides that allocation between the two Member States concerned of the tax receipts from frontier workers' employment income shall be by agreement between those two Member States. It also lays down the system to be applied until an agreement has been reached.

Article 6

12. Article 6 specifies those items of income ranking for equal treatment, under Article 7, as between non-residents and residents in the country of activity. Retirement income from past employment is put on the same footing as income from current earnings.

Article 7

13. Paragraph 1 establishes the principle that non-resident employees should not be subject to more burdensome tax in the country of activity than their resident

8. Council Regulation 1408/71 of 14.7.71, Article 1 (OJ L 149, 5.7.71.)

fellow-workers. It is self-understood that Member States should take such measures as are necessary to remove any procedural obstacles to the universal observance of this principle.

It is, on the other hand, important to ensure that, so far as his employment income in the country of activity is concerned, the non-resident employee does not receive unjustified tax advantages. If, for instance, he is in receipt of other income, the tax burden on his employment income could be affected and could, in fact, be higher than in the present situation of unequal treatment. It is, however, only right that he should take the rough with the smooth.

14. In application of the principle laid down in paragraph 1, the non-resident employee is to be granted the same allowances, exemptions, deductions and other tax reliefs in the country of activity as are granted to residents. This is true just as much for the special deductions for expenses incurred in obtaining the taxable employment income as for general deductions and reliefs available against the taxpayer's whole income.

Where, however, in addition to employment income qualifying for equal treatment under paragraph 1, the employee has other income — whether in the country of activity, the country of residence or in a third country — it would not be right to insist on the full grant of general reliefs against the whole of such income, especially since those general reliefs might well be granted a second time in respect of the other income taxable in the country of residence. Paragraph 2 accordingly provides that, by way of derogation from paragraph 1, the non-resident employee may be granted the *general* reliefs only in so far as they are related to the taxable employment income in the country of activity, i.e. in the proportion that the taxable net employment income bears to the total net income. Net income, in this context, means gross receipts less costs incurred in obtaining, and other special deductions related to, those receipts. However the directive does not in this case make it obligatory to reduce general reliefs; it simply permits such an option to be exercised by the Member States. They may prefer in certain circumstances, e.g. where the other income is comparatively small, not to do so.

15. A further option is provided (in the second sub-paragraph of paragraph 2) for reservation of the progression: Member States may apply to the taxable employment income the progressive rate applicable to a resident, i.e. as if the other income were taxable or, if negative, were deductible in the country of activity.

Article 8

16. The principle of equal treatment laid down in Article 7 is extended in Article 8 to those cases where the tax advantages depend not only on whether the taxpayer is himself resident but also on whether his spouse or children are resident in the country of activity.

Article 9

17. This Article imposes an obligation on a Member State which grants income tax relief for payments only when made to a national insurance company, bank

or other recipient, to confer equal treatment on payments made to a corresponding institution in another Member State. This principle is to have the widest possible application.

Article 10

18. As with most measures of tax relief, this directive is open to abuse. Article 10 accordingly arms the Member States with sufficient general powers to prevent abuse of any of its provisions, especially where a change of domicile is carried out for taxation reasons.

Article 11

19. The period of between two and three years is designed to permit Member States to take all measures necessary to apply the directive and in particular to reach agreement upon the budgetary arrangements in accordance with Article 5.

Proposal for a Council Directive Concerning the Harmonization of Income Taxation Provisions with Respect to Freedom of Movement for Workers within the Community

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof;

Having regard to the proposal from the Commission;

Having regard to the opinion of the European Parliament;

Having regard to the opinion of the Economic and Social Committee;

Whereas freedom of movement for workers is a fundamental objective of the Treaty;

Whereas the present systems of income taxation have different rules for residents and non-residents; whereas these differences may penalise workers who exercise their employment in Member States where they are not resident for tax purposes; whereas these differences are most acute in the case of frontier workers;

Whereas, in order to ensure greater freedom of movement for workers, it is essential to reduce the differences that exist in the taxation of the employment income of resident and non-resident workers;

Whereas a frontier worker returns as a rule daily to the Member State where he resides and pays his indirect taxes for the most part to that Member State; whereas it is much simpler for the frontier worker to have to deal only with the tax authorities of that Member State; whereas these considerations militate in favour of taxing the frontier worker in that Member State in respect of his employment income derived from another Member State;

Whereas the Member State in which a frontier worker exercises his employment must nonetheless be able to levy a withholding tax on the income of such a worker; whereas the withholding tax should not, however, be greater than that levied on the income of a resident worker in otherwise identical circumstances;

whereas the Member State of which the frontier worker is a resident must credit the withholding tax against the tax it levies on his employment income and repay any excess, thus assuring taxation at the level prevailing in that Member State;

Whereas, in order to ensure the uniform application of these rules of taxation, it is necessary to establish a common definition of 'frontier worker';

Whereas it may be left to the Member States concerned to regulate by agreement the allocation between themselves of the revenue accruing from this taxation;

Whereas it is expedient to lay down at the same time common rules for taxing the employment income of other non-resident workers, including income from public, private or social security pensions; whereas such income should be taxed in the Member State in which it arises, but should not be subjected to more burdensome taxation than in the case of a resident worker; whereas there are grounds for applying a pro rata rule to the general tax reliefs granted by that Member State where the worker has other income; whereas Member States should be left free to determine the progressive rate applicable to the employment income by taking into account all the worker's income, both positive and negative, just as if he were resident;

Whereas provision should also be made, in order to ensure equal treatment between resident and non-resident workers, for the case where complete equality requires the worker's spouse or children to be resident in the Member State in which employment is exercised by granting the worker the option to have them so regarded;

Whereas the rule under which payments of interest, insurance premiums, pension contributions etc., rank for tax relief only when they are made to an institution resident in the taxing Member State can affect both freedom of movement for workers and freedom to provide services within the Community; whereas it is therefore desirable to eliminate this discrimination by making such relief available in the case of payments to corresponding institutions in other Member States,

HAS ADOPTED THIS DIRECTIVE:

Part I. General Provisions and Definitions

Article 1

Each Member State shall apply the provisions of the following articles to:
— the taxation of the income of frontier workers,
— the taxation of the income of other non-resident employed persons,
— the taxation treatment of certain payments.

Article 2

1. The taxes to which this Directive applies are taxes on income. All taxes imposed on total income or on elements of income, irrespective of the manner in which they, shall be regarded as taxes on income.

2. The taxes referred to in paragraph 1 are at present:

in Belgium:	impôt des personnes physiques/Personenbelasting
	Impôt des non-résidents/Belasting der niet-verblijfhouders
in Denmark:	Indkomstskat til staten
	Kommunal indkomstskat
	Amtskommunal indkomstskat
	Folkepensionsbidrag
	Sømandsskat
	Særlig indkomstskat
	Kirkeskat
	Bidrag til dagpengefonden
in Germany:	Einkommensteuer
in France:	Impôt sur le revenu
in Ireland:	Income tax
in Italy:	Imposta sul reddito delle persone fisiche
in Luxembourg:	Impôt sur le revenu des personnes physiques
in the Netherlands:	Inkomstenbelasting
in the United Kingdom:	Income tax

3. The provisions of paragraph 1 shall apply also to any identical or substantially similar taxes imposed subsequently, whether in addition to or in place of the taxes listed in paragraph 2. The Member States shall inform one another and the Commission whenever such a tax enters into force.

Article 3

1. For the purposes of this Directive, the term 'resident' is to be interpreted according to national tax provisions and the relevant double taxation agreements.

2. For the purposes of this Directive, 'frontier worker' means any individual:

1. deriving income from employment;
2. who exercises that employment in a Member State where he is not resident and
3. who is resident in another Member State to which he returns as a rule daily.

A frontier worker who is posted by his employer to a place inside the Community other than his usual place of work so that he is prevented from returning daily to the place where he resides shall not thereby lose his status of a frontier worker as regards the States mentioned in the first subparagraph, provided that such posting does not exceed in aggregate one third of the day in the calendar year for which he has, or would have if the posting were disregarded, the status of a frontier worker.

Part II. Taxation of Frontier Workers

Article 4

1. The employment income of a frontier worker shall be subject to tax in the Member State of which he is a resident.

2. The Member State in which employment is exercised may, however, levy

a tax on that income, but only by means of a withholding tax. Where a withholding tax is levied on residents and non-residents alike, it shall not be greater in the case of a non-resident than it would be for a resident in the same circumstances.

3. The tax which has been levied in accordance with paragraph 2 shall be credited against the tax levied on that employment income in the Member State of which the frontier worker is a resident. To the extent that the tax levied in accordance with paragraph 2 exceeds the tax levied in the latter Member State, the latter Member State shall refund the excess to the frontier worker.

Article 5

1. The two Member States concerned shall agree upon the apportionment between them of the tax receipts and amounts of refund.

2. Until such time as an agreement is reached, the said receipts shall continue to be apportioned in the same way as the apportionment which would result from the application of double taxation agreements.

Part III. Taxation of Employed Persons other than Frontier Workers

Article 6

The provisions of Articles 7 and 8 shall apply to natural persons other than the frontier workers referred to in Article 3 (2) who are residents of one Member State and who are taxed in another Member State, without being resident there, on the following items of income:

— income from dependent personal services;
— pensions and other similar remuneration received in consideration of past employment, including social security pensions, as well as pensions and other similar remuneration paid by a Member State or a political subdivision or a local authority thereof in respect of past services rendered to that Member State or subdivision or local authority thereof in the discharge of functions of a governmental nature.

Article 7

1. The items of income specified in Article 6 may not be subjected in the taxing State to any more burdensome taxation than if the taxpayer were resident in that State.

2. By way of derogation from the provisions of paragraph 1, the Member State may, in taxing the income specified in Article 6 where a taxpayer has other income, grant that taxpayer the allowances, exemptions, deductions and other general tax reliefs reserved for resident taxpayers only in the proportion that the net income mentioned in Article 6 bears to the total net income.

That Member State may also provide that the tax rate applicable to the income taxable under Article 6 is to be computed as if the taxpayer were a resident of the Member State.

Article 8

Where the tax payable on the items of income specified in Article 6 in the taxing Member State depends upon whether the spouse or children of the taxpayer is or are resident in that Member State, that Member State shall, in taxing those items of income, grant the same tax treatment, if the taxpayer so requests, as if the spouse or children were resident in that Member State.

The provisions of Article the second subparagraph of 7 (2) shall apply correspondingly.

Part IV. Tax Relief for Certain Payments

Article 9

1. Where a Member State grants an advantage for the purposes of income tax within the meaning of Article 2, whether by way of deduction from the tax base or otherwise, for payments made by a natural person to an insurance company, bank, pension fund, building society or any other recipient, such a tax advantage shall not be refused solely because that recipient is situated, established or resident in another Member State.

2. The Member State which is first mentioned in paragraph 1 may, as a condition for applying that paragraph, require the recipient to be subject to similar tax obligations to those which would be required of the corresponding recipient resident in its own territory.

Part V. Final Provisions

Article 10

The provisions of this Directive shall not constitute an obstacle to the application of national provisions necessary to avoid fraud and abuse.

Article 11

Member States shall bring into force the legal and administrative provisions necessary to comply with the provisions of this Directive not later than 1 January of the third year following the year of its adoption. They shall forthwith inform the Commission thereof.

Article 12

This Directive is addressed to the Member States.

Done at Brussels, the

For the Council
The President