COMMISSION OF THE EUROPEAN COMMUNITIES

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Brussels, 21 December 1993

COMMISSION RECOMMENDATION
of 21 December 1993
on the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident

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EXPLANATORY MEMORANDUM

I. General conditions

1. Freedom of movement for persons is one of the Community's essential objectives and is enshrined in Articles 3, 48, 49, 52 and 53 of the Treaty of Rome. It is also a fundamental element of the internal market, which the Treaty defines as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty".

   Freedom of movement for workers and their families is a fundamental right. The Community attaches great importance to the promotion of workers' mobility, in particular in the border regions. The Commisson has indeed underlined recently in its White Paper on growth, competitiveness and employment, the need for flexibility in the labour market. It has listed, as a first step in this direction, the need to improve the geographical mobility of workers by suppressing the obstacles that hamper it.

   Indeed, freedom of movement for persons is still frustrated by the existence of a number of tax provisions which, when applied, often cause persons exercising freedom of movement for the purpose of carrying on an activity in a Member State other than the one in which they are resident to be taxed in the other Member State in a less favourable manner than the residents of that other Member State.

   Hundreds of thousands of people are subject to frequent discriminations. This is testified by the great number of complaints that the Commission receives as well as by petitions addressed to the European Parliament.

   The fundamental principle of non-discrimination, being an underlying principle of the Treaty, claims for a quick and clear solution.

   The problem affects the following categories of person:

   - frontier workers;
   - other persons in paid employment;
   - recipients of pensions and other similar remuneration in consideration of past employment;
   - persons exercising a professional activity or some other self-employed activity, including performing artists and sportsmen and sportswomen;
   - persons exercising agricultural and forestry activities;
   - persons exercising industrial and commercial activities.

2. In principle, such persons are taxed in the country in which they carry on their activity, and most Member States apply to them tax arrangements (the non-residents' regime) which differ from those applied to residents. Generally speaking, under these arrangements, only income from sources within the country in which the activity is exercised is taxed, with no provision being made for tax reliefs on grounds of family circumstances or for the various deductions for which residents are eligible, considering that such advantages should be granted by the country of residence.

These advantages can be grouped in different categories, taking into account the taxpayer's contributive capacity:

- as regards the worker itself, there are, for instance, the basic allowance (which provides a tax exemption for low income), but also specific deductions for medical expenses or for exceptional expenditures;
- if he is married, this statute may offer him a right, depending on the Member State concerned, to a joint assessment with his spouse, through a "splitting" system if relevant, or a family coefficient relief or other allowances;
- as regards children, there are often special deductions, grossed up in the case of handicapped children, deductions for school expenses, etc.

However, the persons in question are very often precluded from the benefit of such reliefs in their country of residence too since they have no or insufficient taxable income in that country.

An exception to this rule is the tax treatment of the income of certain frontier workers in that Member States have concluded bilateral agreements under which such income is taxed in the country in which those workers are resident (of the 26 possible bilateral arrangements, 14 provide for taxation in the country of residence and 12 for taxation in the country of activity). It is only where frontier workers are taxed exclusively in their country of residence that they are not discriminated against, being taxed in the same way as other residents.

By contrast, persons who exercise an activity in an employed or self-employed capacity, agricultural and forestry activities, or industrial and commercial activities in a Member State other than the one in which they are resident and who are taxed in their country of residence are, in most cases, subject to a higher level of taxation than persons exercising the same activities in the country in which they are resident.

3. With a view to correcting this situation, the Commission presented, in 1979, a proposal for a Directive concerning the harmonization of income taxation provisions with respect to freedom of movement for workers within the Community. The Commission has also initiated infringement proceedings against some Member States with regard to tax provisions which discriminate against non-residents.

4. Despite discussions stretching over a period of years, the Council has not been able to act on this proposal since some Member States are opposed to the principle of taxing frontier workers' income in their country of residence. Furthermore, some associations of frontier workers have argued that taxation in the country of residence would lead, in many cases, to heavier taxation than under current circumstances (e.g. under arrangements between Belgium and Luxembourg or between Denmark and Germany).

Finally, many Member States have felt that the general problem of taxing non-resident workers may be more suitably resolved by bilateral agreements.

5. In view of this situation, the Commission last year withdrew its 1979 proposal, and it considers that the time has now come for fresh steps to be taken to encourage Member States to eliminate discriminatory provisions from their legislation on the taxation of non-residents and to amend their laws on the basis of common rules of conduct.

   This is made all the more necessary by the fact that some Member States have, at their own initiative, already amended their tax rules in this area, and others are planning to do so.

   The Commission therefore believes that, unless guidelines are established at Community level, there is a risk that very divergent new rules will be introduced in various Member States.

6. As regards case law, it should be noted that on 26 January 1993 the Court delivered a judgment on this matter (Case C-112/91 Werner v Finanzamt Aachen-Innenstadt).

   The Court held that "Article 52 of the EEC Treaty does not prevent a Member State imposing a heavier burden on its own nationals who carry out their professional activity within its territory and who reside in another Member State". In its judgment the Court did not, however, make any statement on the possibility of a Member State treating nationals of other Member States in the same way. A new case has since been referred to the Court for a preliminary ruling (Case C-279/93 Finanzamt Köln-Altstadt v Roland Schumaekers), in which it must be decided whether application of the non-residents' tax regime to a national of another Member State is compatible with Community law.

7. This Recommendation forms an integral part of the action that the Commission intends to pursue actively, so as to ensure, in particular by infringement procedures, that the fundamental principles of the Treaty, which the European citizen should be able to benefit from, are fully respected.

8. For these reasons, the Commission has drawn up the attached Recommendation defining the principles and rules which should underlie Member States' legislation on the tax treatment of non-residents.

9. It seems pertinent to underline the essential elements of this Recommendation.

   - Its scope covers the income of all persons, whether salaried or self-employed, pensions and income from other economic activities. Compared to the 1979 proposal, it has thus been extended to cover the self-employed and agricultural, forestry, industrial and commercial activities, about which ever increasing numbers of petitions and complaints are received concerning the tax provisions applying to them.

- The allocation of the right to tax non-residents between the state of activity and the state of residence, as determined by the double-taxation agreements concluded between the Member States, is respected as regards the income of frontier workers. Consequently, they may be taxed either in the state where they work or the state in which they reside.

- Precise rules are laid down to ensure non-discriminatory taxation of non-residents by the state of activity where they are in a comparable position to its own residents. A comparable situation is deemed to exist where the income received in the state of activity is at least 75% of the non-resident's total taxable income.

- The option remains for the Member State of residence not to grant to a taxpayer the benefit of certain reliefs or deductions if these have already been accorded by the state of activity. The aim here is to ensure that the persons covered by the recommendation are not discriminated against, and not that they be placed in a more favourable position than other taxpayers.

The Commission considers that these provisions are clear, balanced and simple to apply, and that they will provide a fair solution to the large majority of problems posed by the taxation of non-residents.

10. Implementation of the mechanism established by the Recommendation may, in the Commission's opinion, require a more intensive exchange of information between the tax administration of the taxpayer's country of residence and that of his country of activity. The Commission would stress in this context that the provisions applied under Directive 77/799/EEC[1] allow Member States to exchange any information necessary for that purpose.

    If it should emerge that this exchange does not function adequately in practice, the Commission is ready to examine with the Member States the measures required to improve the situation.

11. Given the importance of fully achieving the free movement of persons, which forms a vital element of the single market, the Commission recommends that the Member States adopt the necessary tax measures as quickly as possible.

    The Commission will assess the measures taken by the Member States in implementing this Recommendation and will decide to take further action if necessary, taking account, inter alia, of how the Court's case law develops in this field.

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[1] OJ No L 335, 27.12.1977, p. 15.

II Comments on certain Articles

Article 1

12. Paragraph 1 of this Article defines the scope of the Recommendation as regards the categories of persons involved. The Recommendation covers natural persons who are resident in one of the Member States and subject to income tax in another Member State without being resident there.

    Paragraph 1 also lists the categories of income falling within the scope of the Recommendation. The first two categories (income from dependent personal services and pensions) were already included in the 1979 proposal for a Directive. Income from professional occupations or other self-employed activities, from agricultural and forestry activities and from industrial and commercial activities has been added in order to ensure that individuals engaged in such occupations or activities are treated in the same way as wage and salary earners and those receiving pensions.

    The definitions used for these income categories are based largely on those used in the OECD Model Convention.

13. Paragraph 2 sets out the criteria for establishing an individual's residence status. For this purpose, reference has to be made first to the relevant provisions of the double taxation agreements concluded between Member States, since those provisions clearly establish the place of residence of a person who has tax links with two Member States.

    In the Commission's view, reference to national legislation relating to residence for tax purposes would pose more problems, since such legislation may differ from one Member State to another. Recourse should be had to such legislation only where no agreement has been concluded between the two Member States concerned[(2)].

Article 2

14. Paragraph 1 of this Article establishes the principle that the persons and income covered by Article 1 may not be subjected in the Member State imposing tax to any more burdensome taxation than if the taxpayer were resident in that Member State.

    In accordance with that principle, the individuals in question should benefit, in the country of activity, from the same special deductions for determining taxable income and from the other general deductions or tax reliefs granted to residents.

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(2) The following combinations of Members States are not covered by bilateral agreeents (situation at 1 January 1993):

Greece-Portugal	Portugal-Ireland
Greece-Spain	Spain-Ireland
Greece-Ireland	Portugal-Luxembourg
Greece-Luxembourg	Portugal-Netherlands

If the Member State of activity applies a special tax system to families (e.g. splitting, allowances for dependants), this advantage should also be applied to the incomes referred to in Article 1(1) obtained by the non-resident in that State. Special systems of this nature are generally linked to aggregate taxation of the individuals concerned (spouse and, in some cases, children), and if this is the case the Member State of activity has the option of taking account of the income of such individuals in determining the rate of taxation applicable to the incomes which it is entitled to tax.

15. Paragraph 2 of this Article establishes that this principle applies only where the income derived by the individuals in question from the country of activity constitutes at least 75% of their total taxable income.

The Commission considers that treatment identical to that of residents is justified only where non-residents are in a situation comparable to that of residents. Such a situation is deemed to exist where a non-resident derives the preponderant part of his income (i.e. at least 75% of his total taxable income) in the country of activity. In that case, the amount of income taxable in the country of residence is unlikely to be sufficient for the deductions and other reliefs provided for in that country's legislation to apply.

Where, by contrast, the non-resident derives a large share of his income in his country of residence, it would not seem justified to require the Member State of activity to grant him the deductions applicable thereto. The 75% threshold also offers the advantage that the Member State of activity might abstain from taking into account the income obtained outside that state (in applying progressivity), and the task of the tax administration would thus be made considerably easier.

The Commission considers that this approach would solve virtually all the problems which non-residents encounter when their income is taxed in the country of activity.

The general point should be made that an entirely fair and neutral treatment of all situations in this field is impossible under current circumstances. It would be possible only if income tax legislation were completely harmonized in the Community.

16. In the same second subparagraph of paragraph 2, it is also stipulated that a Member State may ask a non-resident to prove that he derives at least 75% of his income on its territory. In the Commission's opinion, such proof can be provided by means of documents, such as a copy of a tax return, a written statement from an employer, a copy of a balance sheet, etc.

17. Under the terms of Article 1, the tax treatment provided for in the Recommendation applies only to income derived from employment or self-employment, and to pensions and the other economic activities mentioned.

It is possible, however, that a person receiving such income in a Member State other than that of his residence may also have other sources of income in that Member State, for example property income. Article 2(3) is designed to ensure that the same tax treatment is applied to those other sources of income.

18. Article 2(4) permits the Member States not to grant deductions or other tax reliefs connected with income which is not taxable in the Member State of activity. It would not seem to be justified to grant certain deductions closely connected with income which is not taxable in that Member State. One example is provided by deductions for the purchase of certain securities, given that income from capital is generally taxable in the country of residence.

Article 3

19. The aim of this Recommendation is to ensure that individuals receiving certain types of income in a Member State in which they are not resident are taxed on a fair and non-discriminatory basis.

It is also necessary to ensure, however, that non-residents do not benefit from more favourable tax treatment than other taxpayers. This could happen if they were to benefit, in the Member State of residence, from the same deductions or other tax reliefs which they had already been granted in the Member State of activity.

This Article accordingly makes it possible for the Member State of residence to refuse to grant deductions or other tax reliefs in such cases.

However, the Commission takes the view that application of this option should be limited in practice. It has thus been observed that if the Member State of residence applies the ordinary imputation method to take account income obtained in other States - this method already being applied by most Member States - deduction should not normally occur twice.

Article 4

20. This Recommendation lays down minimum conditions for ensuring that non-residents are not taxed in a discriminatory manner in the country of activity.

It does not prevent Member States from retaining or introducing arrangements which are more favourable to taxpayers.

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THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the second indent of Article 155 thereof,

Whereas the internal market comprises an area without frontiers in which the free movement of goods, persons, services and capital is guaranteed;

Whereas the free movement of persons may be impeded by personal income tax arrangements which have the effect of imposing a heavier tax burden on non-residents than on residents in comparable situations;

Whereas steps should be taken to ensure that free movement of persons is fully guaranteed in the interests of the proper functioning of the internal market; whereas it is necessary to bring to the notice of the Member States the provisions which, in the Commission's view, are likely to guarantee that non-residents enjoy the same tax treatment as residents;

Whereas this initiative does not affect the Commission's conduct of policy in the field of infringement procedures to ensure that the fundamental principles of the Treaty are respected;

Whereas no distinction should be made under this approach between the taxation of income from dependent personal services, income from professional activities of a self-employed nature, and income from agricultural and forestry activities and from industrial and commercial activities, the rules of equal treatment and non-discrimination compared to residents applying equally to persons receiving such items of income;

Whereas the principle of equality of treatment stemming from Articles 48 and 52 of the Treaty requires that persons receiving the items of income in question should not, where the preponderant part of their income is received in the country of activity, be deprived of the tax reliefs and deductions enjoyed by residents;

Whereas it might reasonably be assumed that a person receives the preponderant part of his income in the country of activity where such income constitutes at least 75% of his total taxable income;

Whereas the Member State in which a natural person is resident should continue to have the option of not granting the deductions or other tax reliefs granted to residents where that person benefits from identical or similar deductions or other reliefs in the Member State of activity;

Whereas the Member States continue to have the option of maintaining or introducing arrangements more favourable to taxpayers than those set out in this Recommendation,

HEREBY MAKES THE FOLLOWING RECOMMENDATION:

Scope

Article 1

1. Member States apply the provisions of this Recommendation to natural persons who are residents of one Member State and who are subject to income tax 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;
   - income from professional occupations or other self-employed activities, including that of performing artists and sportsmen and sportswomen;
   - income from agricultural and forestry activities;
   - income from industrial and commercial activities.

2. For the purposes of this Recommendation, the term "resident" is to be defined according to the provisions of the double taxation agreements concluded between Member States or, in the absence of any such double taxation agreement, according to national law.

Taxation of the income of non-residents

Article 2

1. Member States do not subject the items of income specified in Article 1(1), in the Member State of taxation, to any heavier taxation than if the taxpayer, his spouse and his children were resident in that Member State.

2. Application of the provisions of paragraph 1 shall be subject to the condition that the items of income specified in Article 1(1) which are taxable in the Member State in which the natural person is not resident constitute at least 75% of that person's total taxable income during the tax year.

   The Member State of taxation may ask the natural person in question to provide any evidence necessary to prove that he derives at least 75% of his income from that Member State.

3. Where a natural person benefiting from the tax treatment referred to in paragraph 1 has, in the Member State of taxation, income other than that referred to in Article 1(1), the provisions of that paragraph shall also apply to that other income.

4. By way of derogation from the provision of paragraph 1, the Member State which taxes the items of income referred to in Article 1(1) may decide not to grant deductions or other tax reliefs connected with income which is not taxable in that Member State.

Double grant of deductions or other tax reliefs

Article 3

The Member State in which a natural person is resident may decide not to grant deductions or other tax reliefs which it normally grants to residents if that person benefits from identical or similar deductions or other reliefs in the Member State which taxes the items of his income specified in Article 1.

More favourable provisions for taxpayers

Article 4

Member States may opt to maintain or introduce more favourable provisions for taxpayers than those set out in this Recommendation.

Final provisions

Article 5

Member States are invited to communicate to the Commission before 31 December 1994 the texts of the main laws, regulations and administrative provisions which they adopt pursuant to this Recommendation, and to notify the Commission of any subsequent changes in this field.

Article 6

This Recommendation is addressed to the Member States.

Done at Brussels, 21 December 1993

For the Commission

Ch. SCRIVENER
Member of the Commission

CERTIFIED COPY
The Secretary General,

D.F. WILLIAMSON