Editorial

Taxation of Non-Residents in the European Union: Tax Equality or Patchwork Quilt

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Descending from a country reclaimed from the sea, it is normal to be confronted with waves and tidal movements. Therefore it is no surprise that, after the flood of 'proposed directives to attempt harmonisation in the field of direct taxation,' which was met with faint success, one feels the silence of the low tide. No new proposals, no formal discussions, not even a broad outline for the 20 years to come. In this relative calm line, it seems as if the Commission issues unilateral recommendations, which it tries to back up with a threat of legal action. This line cannot be based on a misguided understanding of the principle of subsidiarity.[1] Is a recommendation just as harmless as its mirror role among the European instruments requires, or is it a powerful and therefore threatening way to avoid the Community's constitutional rules, among which the rules of unanimity and subsidiarity?

An example of this approach is the recommendation concerning taxation of non-residents.[2] With its recommendation the Commission, having abandoned earlier attempts at harmonisation, then tries to encourage Member States to remove discriminatory provisions from their legislation and to adjust their legislation on the basis of common rules of conduct.

The Commission tries to formulate a set of rules without the discussion required for a directive, but with an esteemed influence on the decision of the European Court of Justice.

On 14 February 1995 the Court issued its decision in the Schumacker case.[3] The Court held, roughly in line with the Commission's recommendation, that there is discrimination if a Member State taxes a foreign non-resident employee who obtains his income entirely or almost exclusively from employment in that Member State less favourably than a resident employee and the foreign state of residence cannot take the personal and family circumstances of the employee into account because there is insufficient taxable income.

The Court's decision could have considerable impact on the tax laws of not only Germany but of other Member States as well. As regards the fiscal sovereignty of Member States, what was given with one hand seems to be taken by the other. Should one conclude then that the Commission's new approach is a success? In my opinion, a closer look will reveal serious flaws. First of all, the Schumacker decision leaves many questions unanswered.[4] Future court

[1] In my opinion subsidiarity in direct taxes should in the first place lead to an analysis of which problems can be left for the Member States to solve themselves, and which problems should be dealt with at the Community level. The former category should not be addressed in EU recommendations either, and the latter should be addressed effectively, for which a directive generally will be more appropriate. Another example concerns the 'detournement' of the legislative procedure when the Commission proceeds unilaterally.

[2] Recommendation of the Commission 94/79/EC dated 21 December 1994, concerning the taxation of certain items of income received by non-residents in a Member State other than that in which they are resident, PB L 39/22. Another example is the Recommendation of the Commission C 94/3312 dated 7 December 1994, concerning the transference of small and medium size enterprises.

[3] Case C-279/93, *Finanzamt Köln-Altstadt* v. *Roland Schumacker*.

[4] For instance, does the Court recognize the 90 per cent threshold of the Germany-Netherlands Border Workers Agreement (now extended to all non-residents in the 'Grenzpendlergesetz') by saying 'entirely, or almost exclusively', or is the Court referring to the 75 per cent threshold the Commission mentioned in its recommendation, or does the Court perhaps have no specific percentage in mind? To me it seems that a 90 per cent threshold could be defended, since in the recommendation the 75 per cent threshold is connected with a 'preponderant part', which seems to be much less than 'entirely, or almost exclusively'. Assuming a 90 per cent threshold, the question arises whether all or only certain tax reliefs should be available to non-residents fulfilling the 90 per cent requirement. In its decision the Court refers to 'personal and family circumstances' and it should be noted that the Commissions' recommendation allows a Member State to refuse tax deductions or reliefs connected with income which is not taxable in that Member State. Perhaps the Court will shed light on this question in the Wielockx case. Possibly, the question whether Community law is indeed silent in all cases in which a non-resident earns less than 90 per cent of his taxable income in the State of activity, will be answered in the Asscher case.

procedures may clarify some of them, but since the Court is not equipped with the precision tools of the legislator, this can only result in a fiscal 'patchwork quilt' without even the assurance that all discriminatory elements concerning taxation of non-residents will be eliminated. Furthermore, the Court can decide whether or not a tax system of a Member State conflicts with EU-legislation, but it can never settle rules for taxation, which are not already found in the fiscal code of that Member State. This indicates that it lies not in the Court's power to build up a complete tax system. Above and beyond that, the Court should not wear the cloak of the legislator. If they do so, the Court's judges may risk, as do politicians, being shelved.

Unfortunately, the Commission's recommendation, considering its undue stress on taxation in the source state, is only a makeshift solution, which cannot lead to real equality. To me it seems that taxation of cross-border income in the country of residence is the most desirable option. Only where cross-border income is exclusively taxed in the country of residence real equality of treatment can be achieved. Furthermore, in this option the taxpayer has only to deal with one tax administration, namely that of the country of residence. This approach does not necessarily imply that no consideration should be given to rights of taxation of the source state. The regulation of taxation of cross-border workers in effect between Germany and Switzerland provides a creative example of a combination of both principles in which revenue is shared. The state of residence, which has the rights of taxation, pays a partial compensation to the new source state.

I wonder, if even a Member State and a third country are able to come to such an agreement, whether the European Union will be able to achieve even more far-reaching solutions? Possibly, this bold approach should also be considered for social security at the same time, since both areas are generally closely connected.[5]

Member States should primarily have regard for the needs of individuals for a fair and equal tax system, subsequently the needs of the business community and only then the needs of the governments of the Member States. Individuals should be able to move within the European Union without any fiscal hindrance, while tax avoidance and evasion should be counteracted at the same time. Non-taxation and double taxation both are long term threads for prosperity and stability. Aside from the fact that solutions should now be found on the level of the European Union, this is not a new phenomenon, since in former days Member States dealt with similar problems within their borders.

Tax payers moving from Amsterdam to Maastricht, or even from Kiel to Munich (to take an example within a federal state) will not encounter any tax barriers. In those cases we accept that revenue is shared on the basis of a macro-economic clearing system.

The question we are faced with is whether we can establish the same for a taxpayer who moves for instance the rather small distance from Maastricht to Aachen, or lives in one and works in the other city. The urgency of this question will be reinforced by the ever increasing mobility of workers, which perhaps in future will be similar to the mobility of workers within the United States of America.

In parallel to such a solution a regulation on the mutual assistance, which aims at the conservation of fiscal claims in the European Union, would also be necessary, to ensure that postponement of taxes does not lead to cancellation. Clearly it is beyond the Court to achieve such solutions. Therefore, Member States will have to ask themselves whether they want to play the ostrich and let the Commission and Court decide for them, or whether they want to take up the reins and find answers concerning the problem of taxation of non-residents themselves.

It is no good trying to dodge this issue. The Commission and Member States should start an open discussion and should be willing to leap over their own shadow. Difficult as such a task may be, the Commission and the Member States may take heart from a quote by William the Silent, who, against many odds, turned out to be successful as well: 'Point n'est besoin d'espérer pour entreprendre ni de réussir pour persévérer'.[6]

[5] *See* for instance case C-18/95, *Terhoeve* v. *Inspecteur der directe belastingen*, and case C-107/94, *Asscher* v. *Staatssecretaris van Financien*.

[6] Attributed to William the Silent by Jules Verne in '*L'ile Mysterieuse*' part. 1, Chapter II, p. 14.