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COMMISSION STAFF WORKING DOCUMENT

**Accompanying Commission Communication "Removing cross-border tax obstacles for
EU citizens"**

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Instruments available to EU citizens for resolving cross-border tax obstacles and examples of resolved cases of tax discrimination

1. INTRODUCTION

It is inevitable that EU citizens investing, working or operating across borders will have to contend with two or more sets of tax rules that can differ quite considerably. This is because EU Member States exercise sovereignty in the tax area, except to the extent that EU-wide rules exist (such as in the VAT and excise duties areas) and they are free to establish the tax rules and rates that they wish, according to their political preferences.

However, Member States are obliged under EU law to ensure that their tax rules do not discriminate between EU citizens on the basis of nationality. Nor can Member States, via their tax systems, impose unjustified restrictions to the exercise by EU citizens of the fundamental Treaty "freedoms". One of the great achievements of the EU has been to create a frontier-free area within which (1) people, (2) goods, (3) services and (4) capital can all move around freely. The Court of Justice of the EU has in many cases ruled that elements of Member States' tax laws constituted a restriction to these freedoms.

The European Commission, as guardian of the Treaty, is responsible for taking action against any Member States that apply tax rules that conflict with EU law.

Any EU citizen has at his/her disposal easy-to-use ways of contacting the Commission to enquire or make a complaint about an element of the tax law of an EU Member State contravenes EU law.

2. REDRESS AT NATIONAL LEVEL

It is national courts and administrative bodies that are primarily responsible for ensuring that national legislation complies with EU law.

Therefore, an EU citizen that considers a particular measure (law, regulation or administrative action) or administrative practice of a Member State as incompatible with EU law, could, either prior to or in parallel with his complaint to the Commission, seek redress from national administrative or judicial authorities (including national or regional ombudsmen) and/or through the arbitration and conciliation procedures available.

It is advisable for citizens to use those national means of redress because of the advantages they may offer.

By using the means of redress available at national level an EU citizen should, as a rule, be able to assert his rights more directly and more personally than he could following infringement proceedings successfully brought by the Commission which may take some time.

Only national courts can issue orders to administrative bodies and annul a national decision. It is also only national courts which have the power, where appropriate, to order a Member State to make good the loss sustained by individuals as a result of the infringement of Community law attributable to it.

3. HOW THE EUROPEAN COMMISSION HELPS EU CITIZENS TO TACKLE CROSS-BORDER TAX OBSTACLES

3.1 Informal Channels

As announced in the EU Citizenship Report 2010 (COM (2010) 603), the Commission is currently developing a one-stop shop information point on the rights of citizens and businesses in the EU. Citizens will be able to use its services from anywhere in the EU to find answers to questions they may have about very practical issues related to taxation. The one-stop shop consists of:

- *The EU Europe Direct Contact Centre*¹, which offers a free telephone and e-mail service which citizens can use from anywhere in the European Union to find answers to questions they may have about the EU and EU-related issues, including about very practical issues related to taxation.
- *The Europe Direct Information Centres*², which are located in all the EU Member States and which EU citizens can visit, call or e-mail for information
- The *Your Europe* web portal which contains user-friendly information for mobile citizens in the European Union. In addition to information, Your Europe also guides users to the most appropriate assistance services, notably
 - *Your Europe Advice*³ (until recently called the Citizens Signpost Service or CSS) which is an EU legal advice service for the public.
 - *SOLVIT*⁴, an EU problem solving network closely associated with *Your Europe Advice*, which tries to resolve problems between individuals or companies and the authorities of another country in cases where there is a possible misapplication of EU law. The SOLVIT network will endeavour to resolve the matters without resorting to legal proceedings and is successful in over 90% of cases.

Finally, EURES⁵, a cooperation network between the European Commission and the Public Employment Services of the Member States of the European Economic Area, provides information, advice and recruitment/placement services for the benefit of workers and employers. EURES advisers working in EURES cross-border partnerships – composed of Public Employment Services and social partners organisations – offer client services to mobile cross-border workers in order to meet their specific needs for information and advice in areas such as social security and taxation.

3.2. Formal Channels

Furthermore, all EU citizens have a right to lodge a complaint with the European Commission about any practice of an EU Member State believed to be incompatible with EU law. Practical information on the steps to be followed can be found at the following Internet link - : http://ec.europa.eu/taxation_customs/common/rights/index_en.htm.

Under an EU Pilot project⁶ that is operating in conjunction with 18 Member States since April 2008 to resolve problems more quickly, the Commission may forward the enquiry or complaint to the Member State authority concerned with any questions or indications

¹ http://ec.europa.eu/europedirect/index_en.htm

² http://europa.eu/europedirect/index_en.htm

³ http://ec.europa.eu/citizensrights/front_end/index_en.htm

⁴ <http://ec.europa.eu/solvit/>

⁵ <http://ec.europa.eu/eures/>

⁶ See http://ec.europa.eu/community_law/infringements/application_monitoring_en.htm

identified by the Commission service. The Member State has to reply within 10 weeks. The Commission will not identify the complainant unless he/she has specifically authorised the Commission to do so.

If the complaint appears to be founded, and the Pilot approach does not achieve results, the European Commission will consider making use of its Treaty powers to take legal action against the Member State concerned by opening infringement proceedings. Many Member States will change the offending law following the Commission's action. However, if, a given Member State fails to change its national law although the Commission has formally stated its incompatibility with EU rules, the Commission can refer the Member State to the Court of Justice. Where the Court of Justice finds that the Treaty has been infringed, the Member State in question is required to take the measures necessary to conform. The EU Treaty also gives the Commission power to act against a Member State that does not comply with a previous judgment of the European Court of Justice and allows the Commission to ask the Court to impose a financial penalty on the Member State concerned.

4. EXAMPLES OF AREAS WHERE MEMBER STATES' TAX LAWS HAVE BEEN FOUND TO CONFLICT WITH EU LAW

The following overview describes cases of discrimination in the tax area that have been resolved, either via a request by a national court of a Member State for a preliminary ruling of the Court of Justice or via infringement proceedings launched by the European Commission. The overview will help both citizens and Member States to understand the principles involved in tax cases that have been examined and the impact of EU law on national tax laws.

Cross frontier workers

Example: Christophe lives in Belgium and works in Germany. His wife Aurélie lives with Christophe in Belgium and does not work so Christophe's salary in Germany is their main source of income. Christophe pays taxes in Germany where he works. Although not tax resident in Germany, Christophe should be entitled to obtain all the tax deductions and reliefs against his tax in Germany that he would obtain if he lived in Germany. This is because his global family income is mainly from Germany sources.

If a citizen who lives in one state earns all or almost all of his income in another State the other state should treat him as a resident; that is the other state should give him the same tax relief and tax exemptions it would give to a resident, following the Court of Justice's decision in the *Schumacker* case⁷. In a number of infringement cases, Member States granted personal allowances only to nationals or residents. For example, sometimes a joint tax assessment of spouses was granted only to residents, even where non-residents earned all or almost all of their income in the Member State granting the joint assessment option. In other cases, frontier workers did not qualify for certain other allowances, such as family or pension allowances.

Pensioners and students

Example: Paivi who is a Finnish pensioner lives for most of the year in Spain so is resident for tax purposes in Spain. Her sole income is derived from a pension and investments in Finland. Finland must allow Paivi the same tax deductions as those available to residents, and

⁷ Case C-279/93, *Finanzamt Köln-Altstadt v Schumacker*, judgment of 14 February 1995

cannot apply higher tax to her income than it would apply if she resided in Finland.

The principle of the *Schumacker* case mentioned above also applies to pensioners and students. So students or pensioners earning all or almost all of their income in a state in which they are not resident should be treated for tax purposes by that state as if they were residents of that state and get the same deductions and allowances as residents of that state⁸.

For example, one Member State provided for a scheme of pension savings accounts. Income paid out to a pensioner from this scheme was exempt from personal income tax but only if the pensioner was resident in that Member State. In reaction to the Commission's request the Member State concerned has extended the exemption to individuals resident in all EEA states.

Note, however, that, under the terms of most double taxation treaties between EU Member States, a pension will only be taxable in the country where the pensioner is actually resident. If he has moved to another country on retirement, the pension might only be taxable there.

The exception to this is a pensioner receiving a public sector pension (if he worked as a civil servant). He will, normally, under the terms of most bilateral double taxation treaties concluded between Member States, be taxable on his pension only in the country that pays the pension, irrespective of his place of residence.

Higher taxation of non-nationals

In a number of Member States workers of a foreign nationality were taxed in situations where nationals would be exempt or partly exempt. For example, a Member State imposed a higher tax on the income of sailors and pilots who were nationals of other Member States than on income of national sailors and pilots performing the same duties, who indeed benefited from full or partial exemption. As a result of the action taken by the Commission, the Member States in question extended the favourable regime to non-national workers and the workers were allowed to request reimbursement for previous tax years.

Denial of tax deductions for contributions to foreign pension funds (or foreign life assurance or sickness funds)

Example: Sven, a Swedish national employed in Denmark, is continuing to pay premiums to a Swedish pension fund under a contract that he concluded prior to his arrival in Denmark. Denmark must allow Sven a tax deduction against Danish tax due on his employment income in respect of the premium he pays to the Swedish pension fund, if it would allow such a tax deduction if Sven paid the premium to a Danish pension fund.

Many Member States did not give citizens tax relief for contributions paid to foreign pension funds, whereas they would allow relief for contributions paid to domestic funds. The Commission therefore launched nine infringement procedures. Seven Member States complied after the formal notice or reasoned opinion while two Member States had to be referred to the Court of Justice. The Court ruled as suggested by the Commission⁹: if domestic pension contributions qualify for tax relief, then contributions paid to pension funds elsewhere in the European Economic Area should also qualify for tax relief.¹⁰ As a result of these cases,

⁸ Wallentin, Case C-169/03 for students and Turpeinen, Case C-520/04, for pensioners.

⁹ Case 150/04, Commission v Denmark; Case C-522/04, Commission v Belgium

¹⁰ Cf. also Danner (Case C-136/00) and Skandia/Ramstedt (Case C-422/01)

mobile workers can now remain in their home pension schemes if they wish and multinationals can set up pan-European pension funds. The same applies for contributions made to foreign life assurance or sickness schemes.

Denial of tax deductions for school fees paid to a foreign school

The Commission has taken action against some Member States which did not allow a tax deduction for school fees paid to foreign schools while fees paid to local schools were tax deductible. These restrictions place at a disadvantage both foreign schools which wish to provide services and parents who move abroad while remaining subject to unlimited tax liability in their home Member State. These rules therefore violate EU law rules concerning people's rights to reside, work and establish themselves in other EU Member States and concerning schools' right to provide services in another Member State. The Court ruled against a Member State in one case on this point and other Member States changed the relevant law before the matter went to Court.

Denial of tax deductions for mortgage interest paid to a foreign bank or in respect of a foreign property

Example: Pedro is a Spanish national working in Luxembourg and has taken out a mortgage with a Spanish bank to buy a house in Spain. Under EU law, the Luxembourg tax authorities will have to give Pedro a mortgage deduction in respect of the interest paid to the Spanish bank on his Spanish house, if they would give Pedro such a tax deduction if he was paying the mortgage interest to a Luxembourg bank or in respect of a house in Luxembourg.

In *Svensson & Gustavsson*¹¹ the Court ruled that where mortgage interest to domestic banks is tax deductible, the same should apply to interest paid to a bank established elsewhere in the EU. The Commission has opened a number of infringement cases on this issue. In all instances the Member States concerned have changed their law.

Some Member States allowed a deduction for mortgage interest only in connection with properties within their territories. After Commission action, the Member States in question amended their law

Another Member State required non-residents to register loans, in order to be able to deduct interest in respect of mortgage interest payments. There was also a limit to the mortgage interest deduction available to non-residents while residents were not subject to this limit. After being contacted by the Commission, the Member State in question amended its law to bring the tax treatment of mortgage interest paid by non-residents into line with that applied to residents.

Denial of tax deductions to non-resident sportsmen, artists and consultants

Certain Member States did not allow non-resident service sportsmen, artists and consultants and other service providers to deduct professional expenses related to income that was earned, and therefore taxable, in those Member States, whereas service providers resident in those countries were entitled to those deductions. These expenses could, for example, include travel and hotel expenses, insurance premiums, and so on.

Effectively, the non-resident service providers were subject to a withholding tax on the gross amount of their income whereas comparable resident service providers were subject only to

¹¹ C-484/93.

taxation on their net income, after deduction of expenses. This difference in taxation is contrary to EU law. As a result of the actions taken by the Commission, the Member States concerned changed their legislation so as to allow the deduction of expenses by non-resident service providers.

Exit taxes applied when an individual leaves a country to move to another

Example: Christos and Athena decide to move back to Greece after ten years working in Germany. Although moving from Germany they decide to let rather than sell their house in Germany and to retain their German investments. They should not be liable to any taxes in Germany on accrued capital gains on their assets retained in Germany after their move if they would not be liable to such an accrued capital gains tax if they had stayed in Germany

Exit taxes are taxes levied on accrued capital gains when taxpayers move their residence or transfer individual assets to another Member State. In domestic situations, such capital gains will usually be taxed only when they are actually realised; that is, when the assets are sold or otherwise disposed of. However, if an individual taxpayer moves to another Member State before selling his assets, his original state of residence risks losing the taxing rights on the capital gains which have accrued on those assets, because he will become taxable in his new State of residence. Many Member States have attempted to deal with this issue by taxing accrued, although as yet unrealised, capital gains at the moment of transfer of the residence or assets by the taxpayer. However, the Court of Justice ruled that such immediate taxation of latent capital gains on assets transferred to another Member State infringes the principle of freedom of movement, where no such taxation occurs in similar domestic situations. Member States should therefore provide for an unconditional deferral of collection of the tax due until the moment of actual realisation. Several Member States have, as a result of Commission infringement action, changed their exit tax laws.

Discriminatory taxation of dividends paid to another Member State or received from another Member State

Example: Peter resides and works in the Netherlands. He is employed there by an Italian company and, under an employees' savings plan, has shares in that company. The Netherlands must give Peter any Dutch tax exemptions in respect of dividends from that Italian company that would be available to him if he received dividends from a Dutch company rather than an Italian company.

The Court of Justice has ruled that a Member State cannot tax dividends which leave that State to go to another Member State ("outbound dividends") at a higher rate than dividends which remain in that Member State in the country ("domestic dividends")¹², unless the other Member State compensates for the higher taxation on the outbound dividends. Similarly, a Member State cannot tax dividends coming from another Member State ("inbound dividends") at a higher rate than domestic dividends¹³. Essentially the Court stated that higher taxation of inbound or outbound dividends constitutes a restriction on the free movement of capital within the Internal Market. The Commission has launched over forty infringement

¹² European Commission v Kingdom of Spain (C-487/08)

¹³ Verkooijen Case C-35/98

cases against Member States because of their discriminatory tax rules in this area. A number of Member States have already made changes to their tax laws as a result and, in two cases that went to the Court of Justice, the Court found the rules incompatible with EU law.

For example, the Commission commenced infringement proceedings against one Member State which exempted a certain amount of dividend income from income tax only if the related shares were issued in that Member State. The Commission informed the Member State that this rule could be in conflict with the principle of freedom of movement of capital and as a result the exemption has been extended also to dividends from shares issued in other countries.

Discriminatory taxation of investment in securities

In principle heavier or discriminatory taxation of investments with cross-border element is prohibited under the EU law. The Commission has investigated a case where a Member State did not tax capital gains from the disposal of shares on a regulated market of that Member State but did apply tax to capital gains from the disposal of shares traded on regulated markets in other Member States. This was not in compliance with the principle of the free movement of capital.

Another Member State applied higher taxation to bonds issued in foreign currencies than bonds issued in the local currency.

In both cases the Member States decided, after being contacted by the Commission, to extend the preferential treatment also to investments made into other Member States.

Property taxes

Capital gains taxes on sales of houses

Example: Dorota has sold her house in Portugal, and bought a house in Poland in order to live there. Dorota should benefit from any Portuguese tax relief in respect of her capital gains from the sale of the house that she would enjoy if she purchased her new home in Portugal rather than Poland.

Some Member States allowed an exemption from capital gains tax on the sale of a property if the vendor bought a replacement property in that Member State but did not allow the exemption if the vendor bought the replacement property in another Member State. This was an obstacle to the right to move and reside freely within the EU. Most of the Member States in question have now changed their law.

Capital gains taxes on sales of holiday homes

Some Member States levied higher capital gains taxes on non-residents selling their holiday home. After Commission action, the Member States concerned amended their law.

Inheritance taxes on houses and other real estate

Some Member States had a favourable mechanism for the calculation for inheritance tax purposes of the value of domestic immovable property, whereas the value of property situated abroad was set at the normal market value¹⁴. After Commission action, the Member States concerned amended their law. Similarly national rules that provide more favourable tax

¹⁴ Jäger, Case C-256/06.

deductions if the deceased was resident in the Member State in question before death are also illegal.

An exemption from inheritance tax on property situated in the taxing Member State that is not available in relation to property situated in other Member States is also illegal. One Member State limited inheritance tax reliefs to forestry land and agricultural land situated within that Member State. The Commission informed the Member State concerned that such a restriction appears to be contrary to the principle of the free movement of capital. As a result, the Member State extended the relief to all such properties and land in EEA countries.

Tax exemptions on purchase

Tax deductions for the construction or purchase of a dwelling that are only available if the dwelling is situated in the territory of the Member State concerned are illegal as are exemptions from purchase taxes available only to citizens of the Member State granting the exemption. For example, one Member State allowed a tax exemption for the first purchase of real estate in that Member State, but did not allow that exemption in respect of property purchased abroad. As a result of the Commission's infringement action the Member State has changed its law.

Taxation of income from letting or leasing of real estate

Tax deductions available only if the real estate is located in the Member State in question are illegal.

So is a system whereby residents are taxed on a net basis, while non-residents are taxed on a gross basis, resulting in higher tax for non-residents.

Higher taxation of foreign investment funds and companies in relation to income from real estate is contrary to EU law.

For example, in one case, a foreign national who lived and was subject to tax in a certain Member State owned a house in his Member State of origin which was let out to tenants. He was unable to reduce his taxable rental income by an amount representing depreciation for wear and tear as he would have been able to do if the house had been situated in the Member State in which he lived. The Commission requested the Member State concerned to change its law and as a result the favourable depreciation regime was extended to buildings situated in all EEA countries.

Donations to foreign charities

A number of Member States did not grant the same tax relief for donations to foreign charities as for donations to domestic charities. Most Member States complied with the Commission's request to change their law, while a few cases are still pending.

Tax problems related to the registration of imported second hand cars

Example: Michael, who has been living for a few years in Hungary, has retired and decided to change his normal residence to Ireland, where he has a holiday house. To take his car, previously bought and registered in Hungary, to Ireland, he will have to re-register it in Ireland and pay registration tax there. EU rules do not require Ireland to refrain from applying tax to a car which has already suffered registration tax in Hungary and nor do they require Hungary to partially refund registration tax. However, the amount of registration tax to be paid in Ireland should, under EU non-discrimination rules, take account of the age of the vehicle.

EU law does not preclude Member States from imposing a registration tax on a car when it is used for the first time in that Member State. Therefore, when a second hand car is brought in from abroad, a Member State can impose a registration tax even if a similar tax was also applied in the original country when the car was new. However, the registration tax on the imported second hand car should be applied in a non-discriminatory way. This means that the amount of tax on the imported second-hand car should correspond to the residual amount of tax contained in the value of a similar car that was registered in that Member State when new. In practice, however, the methods applied for calculating the tax on imported cars may in certain Member States be based on criteria such as mileage or the age of vehicles and these are not always sufficient to reflect accurately changes in the cars' values. The result can be that the amount of registration tax on imported cars is higher than the equivalent tax included in the prices of domestic cars. This contravenes EU law that prohibits discriminatory treatment of goods which should be able to be moved freely across borders within the EU. Following the Commission's actions in this area, one Member State has abolished registration tax on second hand cars and others have adjusted their method of valuation of second hand cars or brought their legislation into line with EU law in other ways. The Commission is continuing its investigations into Member States' tax rules in this area.

Difficulties with purchases of alcohol and tobacco from other Member States for own use in Member State of residence

Example: Marina, who is English, has been in Spain on her holidays and has purchased a case of 12 bottles of wine and 600 cigarettes to bring back with her to the UK. As long as the goods are for her personal use and not for resale she will not have to pay excise duty in the UK. However, if she is bringing alcohol and tobacco which is not for her personal use excise duty on them becomes liable in the UK.

Under EU legislation, EU citizens are entitled to bring back to their home country excise goods (tobacco and alcoholic beverages) which have been bought in another Member State without incurring further tax in their Member State of residence.

However, this only applies if 1) the goods are transported by the individuals themselves and 2) the goods are for the individuals' own use; the rule does not apply if the goods are bought on behalf of a third party.

Where Member States suspect that such goods are not for own use, they are required to have regard to specified criteria before concluding that the goods are not, in fact, for own use. One such criterion is the quantity of goods¹⁵. However quantity is only one criterion that should be taken into account for excise duty purposes and the Member States may not apply any strict quantitative limits (except in respect of certain new Member States whose duty rates do not meet EU minimum levels). If a Member State decides in a particular case that goods are not for own use, it is entitled to apply sanctions, but these must be reasonable and proportionate in accordance with general principles of EU law.

Some Member States take account only of the criterion of quantity. This is not in conformity with the spirit of EU legislation and the Commission has, therefore, opened infringement procedures against these Member States.

¹⁵ See "Your Europe" website at http://ec.europa.eu/youreurope/citizens/travel/allowed-banned/alcohol-tobacco-cash/index_en.htm?profile=0

Higher administrative burdens on non-residents

Sometimes Member States impose heavier tax compliance burdens on non-residents compared to residents. For example, one Member State required its non-resident taxpayers to appoint a fiscal representative when registering with tax authorities. As a result of the action taken by the Commission the Member State in question has recently abolished this requirement.