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Article

The Impact of European Union Law on the Interaction of Members States' Sovereign Powers in the Policy Fields of Social Protection and Personal Income Tax Benefits

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In almost all Member States social security benefits are financed by a mix of social security contributions and taxes, albeit with great differences between the Member States regarding the share and the design of each of these methods of financing. As to the benefits, social benefits are traditionally defined by the various social security branches. But sometimes tax systems provide for certain advantages with a social goal, such as tax reductions for children or for disability. In all these cases Member States conduct their social policy partly through tax measures.

This article explores these interactions between social and tax policy from the perspective of Member States' sovereignty. To which extent does European Union (EU) law limit the powers of Member States to decide for themselves which policy field (social or tax) is used to obtain social goals? And how can EU law be applied and interpreted to respect or to restore this sovereignty?

The article firstly outlines the basic features of EU social security coordination and EU personal income tax law. It then analyses how EU law and in particular case law of the Court of Justice deals with situations where these policy fields interact and how it impacts on Member States' choices to integrate elements of social policy in their tax policy. Finally it draws some conclusions.

1 Introduction

Within the context of the European Union (EU), Member States continue to have the sovereign power to define their social protection and personal income tax systems. Direct taxation in general and personal income taxes in particular also remain part of the sovereignty of the Member States.[1] The institutions of the EU do not have the power to levy direct taxes.[2] Moreover, unlike indirect taxes, the TEU and TFEU do not even mention direct taxes. Therefore only Article 115 TFEU seems to be the legal basis for possible harmonization in the field of direct taxes. It authorizes the Council to issue directives to approximate laws, regulations and provisions directly affecting the establishment and functioning of the internal market. However, these directives may be only adopted on the basis of unanimity in the Council. It explains why only a few directives on direct taxation were issued.[3] In the absence of more unifying or harmonizing measures adopted by the EU, each Member State executes its own taxing powers through domestic tax laws. According to the subsidiarity principle the Union shall take action with regard to direct taxation, only if and in so far as the objectives of the action cannot be sufficiently achieved by the Member States and can therefore be better achieved by the Union

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1 Arts 3–6 TFEU and Art. 5 TEU. M. Isenbaert, *The Contemporary Meaning of 'Sovereignty' in the Supranational Context of the EC as Applied to the Income Tax Case Law of the ECJ*, 6 EC Tax Rev. 264–278 (2009); M. Helminen, *EU Tax Law. Direct Taxation*, 3 (Amsterdam: IBFD 2015); Ł. Adamczyk & A. Majdańska, *The Sources of EU Law Relevant for Direct Taxation*, in *Introduction to European Tax Law on Direct Taxation* 14 (M. Lang, P. Pistone, J. Schuch & C. Staringer eds, 4th ed., 2016).

2 *See* however Art. 13 special Protocol of 8 Apr. 1965 on the privileges and immunities of the European Union, according to which officials and servants of the European Union are liable to a tax for the benefit of the European Union on salaries, wages and emoluments paid to them by the European Union.

3 *Parent Subsidiary Directive* Council Directive 2011/96/EU of 30 Nov. 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345, 8 (29 Dec. 2011), and subsequent amendments); the *Merger Directive* (Council Directive 2009/133/EC of 19 Oct. 2009 on the Common System of Taxation Applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States and to the Transfer of the Registered Office of an SE or SCE Between Member States (Codified Version), OJ L 310, 34 (25 Nov. 2009); the *Interest and Royalty Directive* (Council Directive 2003/49/EC of June 2003 on a common system of taxation applicable to interest and royalty payments, OJ L 157, 49 (26 June 2003)); the *Mutual Assistance Directive* Council Directive 2011/16/EU of 15 Feb. 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64, 1 (11 Mar. 2011), and subsequent amendments); *the Recovery Assistance Directive* (Council Directive 2010/24/EU of 16 Mar. 2010 concerning mutual assistance for recovery of claims relating to taxes, duties and other measures, OJ L 319, 21 (29 Nov. 2008)); the (former) *Savings Directive* (Council Directive 2003/48/EC of June 2003 on taxation of savings income in the form of interest payments, OJ L 157, 38 (26 June 2003), recently repealed by Council Directive (EU) 2015/2060, of 10 Nov. 2015 repealing Directive 2003/48/EC on taxation of savings income in the form of interest payments, OJ L 301, 1 (18 Nov. 2015)); *Anti-Tax Avoidance Directive*, (Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 1 (19 July 2016)).

(Article 5(3) TEU). There is no single EU Regulation entirely devoted to direct taxes. However, Article 7(2) Regulation 1612/68[4] (now replaced by Article 7(2) Regulation 492/2011[5]) on freedom of movement for workers within the EU requires that all workers who are nationals of a Member State enjoy in the territory of other Member States the same social and tax benefits as nationals working there. It is also settled case law of the Court of Justice of the European Union (CJEU) that even though direct taxation falls under the purview of the Member States, these States must follow the EU rules and principles when exercising this power, including the rules on free movement for persons within the EU.[6]

As for social security, Article 153 (2) TFEU empowers the EU to adopt minimum requirements in the field of social security and social protection of workers, but these powers have never been used and there seems to be no political intention to do so. In the absence of social security harmonization at EU level, EU law does not detract from the powers of the Member States to organize their social security and social assistance systems. However, the CJEU has always emphasized that the Member States must nevertheless comply with EU law when exercising these powers.[7] In particular the principles of free movement of persons (now Articles 21, 45, 49 and 56 TFEU) played and continue to play an important role in this field. These principles are laid down in the relevant secondary legislation. The most important piece of EU legislation in the field of social security is the EU social security coordination system, which until 1 May 2010 was formalized by Regulation 1408/71[8] and Regulation 574/72[9] and from this date by Regulation 883/2004[10] and Regulation 987/2009.[11] Also the equal treatment provision for social advantages in the above-mentioned Article 7(2) of Regulation 1612/68 (now Regulation 492/2011) plays a role in this respect.

At the national level these two policy fields (social protection and personal income tax) interact. Indeed, in almost all Member States social security benefits are financed by a mix of social security contributions and taxes, albeit with great differences between the Member States regarding the share and the design of each of these methods of financing. Some Member States levy taxes – the so-called 'socially earmarked taxes' or 'social security earmarked taxes' – that are not affected to the State's general budget but only to a special part of that budget (a special fund) meant to finance social security.[12]

As to the benefits, social benefits are traditionally defined by the various social security branches.[13] But sometimes tax systems provide for certain advantages with a social goal, such as tax reductions for children or for disability, advantages for elderly persons, compensations for high health care costs or special tax rates for certain groups of people. Sometimes these tax advantages may result in negative taxes and hence lead to the payment of sums of money to the tax payer who in fact becomes a net receiver of financial benefits from the tax authorities. For instance, if the tax debt of a person is so low that it cannot cover the amount of the tax reduction, the tax provision may stipulate that the difference is paid to the taxpayer. These negative taxes or refundable tax credits are sometimes also qualified as 'social tax benefits'.[14]

In all these cases Member States conduct their social policy partly through tax measures. These interactions between social and tax policy in principle also belong to the sovereign power of the Member States. This includes the definition under national law which policy measures belong to the social policy sphere and which to the tax one as well as to the corresponding legal frameworks. It also includes the power to design the financing schemes of the granted social and tax benefits. However, it appears that this sovereignty is also curtailed by EU law, more specifically by EU free movement law. Indeed, the above-mentioned EU legal instruments that deal with cross-border aspects of social security and taxes, delineate their field of application according to their own criteria. This may result in the application of EU

[4] Regulation (EEC) 1612/68 of the Council of 25 Oct. 1968 on freedom of movement within the Community, OJ L 257, 2 (19 Oct. 1968) (hereinafter referred to as 'Regulation 1612/68').

[5] Regulation (EU) 492/2011 of the European Parliament and of the Council of 5 Apr. 2011 on freedom of movement for workers within the Union, OJ L 141, 1 (27 May 2011) (hereinafter referred to as 'Regulation 492/2011').

[6] E.g. CJEU 14 Feb. 1995, C-279/93 *Schumacker*, para. 21 and CJEU 21 Feb. 2013, C-123/11, *A Oy*, para. 29.

[7] *See* for instance CJEU 28 Apr. 1998, C-158/96, *Kohll,* paras 17–19 and CJEU 11 Sept. 2008, C-228/07, *Petersen*, para. 42.

[8] Regulation (EEC) 1408/71 of the Council of 14 June 1971 concerning the application of the social security schemes to employees and self-employed persons, as well as to their family members travelling within the Community (hereinafter referred to as 'Regulation 1408/71').

[9] Regulation (EEC) 574/72 of the Council of 21 Mar. 1972 laying down the procedure for implementing Regulation (EEC) 1408/71.

[10] Regulation (EC) 883/2004 of the European Parliament and the Council of 29 Apr. 2004 on the co-ordination of social security systems, OJ L 200, 1 (7 June 2004) (hereinafter referred to as 'Regulation 883/2004').

[11] Regulation (EC) 987/2009 of 16 Sept. 2009, OJ L 294, 1 (30 Oct. 2009) 1 (hereinafter referred to as 'Regulation 987/2009'). For a recent overview of this EU coordination system: *EU Social Security Law. A Commentary on EU Regulations 883/2004 and 987/2009* 554 (M. Fuchs & R. Cornelissen eds, Baden-Baden: Nomos 2015) and F. Pennings, *European Social Security Law* 386 (Antwerp-Cambridge: Intersentia 2015).

[12] *See also*: B. Spiegel (ed.), K. Daxkobler, G. Strban & A.P. van der Mei, *Analytical Report 2014: The Relationship Between Social Security Coordination and Taxation Law*, Report prepared under Contract No VC/2013.0300 – FreSsco at 15 (B. Spiegel ed. European Commission Apr. 2015).

[13] Art. 3 of Regulation 883/2004 refers to the following branches of social security: sickness benefits; maternity and equivalent paternity benefits; invalidity benefits; old-age benefits; survivors' benefits; benefits in respect of accidents at work and occupational diseases; death grants; unemployment benefits; pre-retirement benefits and family benefits.

[14] *See also* Spiegel (ed.), Daxkobler, Strban & van der Mei, *supra* n. 12, at 17.

social security coordination rules to what in the Member States is considered as belonging to the field of tax law, limiting their tax sovereignty. It may also lead to disregarding the principles of EU social security coordination, because of the close link between a social security benefit and the tax system of a Member State, hence restoring the Member State's sovereignty in this field.

This article explores these issues from the perspective of Member States' sovereignty in social and tax matters. To which extent does EU law limit the powers of Member States to decide for themselves which policy field (social or tax) is used to obtain social goals? And how can EU law be applied and interpreted to respect or to restore this sovereignty?

The article is structured as follows. First it outlines the basic features of EU social security coordination and EU personal income tax law. It then analyses how EU law and in particular case law of the Court of Justice deals with situations where these policy fields interact and how it impacts on Member States' choices to integrate elements of social policy in their tax policy. Finally it draws some conclusions.

2 The basic features of EU social security coordination and EU personal income tax law

2.1 EU Social Security Coordination

2.1.1 *The General Principles of EU Social Security Coordination*

The objectives of the EU social security coordination system directly follow from the Treaty provisions on the right to free movement of persons, more specifically from the right to free movement for workers. These entail that migrant workers must not lose their right to social security benefits or have the level of these benefits reduced because they have exercised the right to free movement.[15]

The EU coordination system merely aims at coordinating the social security legislation of the Member States and does not seek to harmonize or align the Member States' respective regimes. [16] Indeed, the coordination system does not affect the material and formal differences between the social security systems of the various Member States and hence it does not affect differences in persons' rights either.[17] This means among other things that (labour) migration between the Member States can result in more or in less comprehensive social protection for the individual concerned, depending on the systems in force in the former and the new country of employment or residence. The CJEU has indeed held that the EU Treaties offer a worker no guarantee that extending his activities to more than one Member State or transferring them to another Member State will be neutral with regard to social security. Given the disparities in the social security legislation of the Member States, such an extension or transfer may be to the worker's advantage in terms of social security or not, according to circumstance.[18]

In the absence of harmonization, it is for each Member State to determine the conditions governing the right or duty to be insured with a social security scheme, the level of contributions payable by insured persons [19] and the income to be taken into account when calculating social security contributions.[20] However, Member States, when exercising their power in the field of social security must comply with EU law.[21] Hence, the EU social security coordination system intervenes directly or indirectly into the national social protection systems by implementing different coordination techniques. The most important one, in particular for the issues raised in this article, is the determination of the applicable social security legislation in cross-border situations (see further for more details in point section 2.1.2). The principle of equal treatment, or the prohibition of discrimination on grounds of nationality, either direct or indirect, guarantees that nationals of a Member State are treated in social security matters by any other Member State as if they are nationals of the latter State.[22] This principle is deeply rooted in EU law [23] and has always been interpreted broadly by the CJEU in social security matters.[24] This principle is

[15] *See* recently CJEU 21 Jan. 2016, C-515/14, *Commission v. Cyprus*, para. 34.

[16] *See*, inter alia, CJEU 19 Mar. 2002, C-393/99, *Hervein*, para. 59; CJEU 3 Apr. 2008, C-103/06, *Derouin*, para. 20 and CJEU 3 Apr. 2008, C-331/04, *Chuck*, para. 27 and the case-law cited therein.

[17] *See* inter alia CJEU 15 Jan. 1986, 41/84 *Pinna*, para. 20; CJEU 30 Jan. 1997, C-340/94, *De Jaeck*, para. 18; CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, paras 19–20; CJEU 18 July 2006, C-50/05 *Nikula*, para. 20; CJEU 3 Apr. 2008, C-103/06, *Derouin*, paras 20 and 23; CJEU 11 Sept. 2008, C-228/07, *Petersen*, para. 41; CJEU 16 July 2008, C-208/07, *von Chamier-Glisczinski*, para. 84; CJEU 14 Oct. 2010, C-345/09, *van Delft*, para. 99; CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak*, para. 42 and CJEU 21 Feb. 2013, C-282/11, *Salgado Gonzalez*, para. 35.

[18] *See* inter alia CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, para. 34; CJEU 16 July 2008, C-208/07, *von Chamier-Glisczinski*, para. 85; CJEU 1 Oct. 2009, C-3/08 *Leyman*, para. 45; CJEU 14 Oct. 2010, C-345/09, *van Delft*, para. 100 and CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak*, para. 43.

[19] CJEU 8 Sept. 2005, C-512/03, *Blanckaert*, para. 49.

[20] *See*, inter alia, CJEU 26 Jan. 1999, C-18/95, *Terhoeve,* para. 51 and CJEU 3 Apr. 2008, C-103/06, *Derouin*, para. 26 and CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, para. 32

[21] *See*, inter alia, CJEU 28 Apr. 1998, C-158/96, *Kohll*, para. 19; CJEU 3 Apr. 2008, C-103/06, *Derouin*, para. 25; CJEU 21 July 2011, C-503/09, *Stewart*, para. 77 and CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, para. 33.

[22] Art. 4 Regulation 883/2004. The prohibition of discrimination on grounds of nationality with regard to 'social advantages' in Art. 7 (2) Regulation 492/2011 (former Regulation 1612/68) also applies to social security benefits. *See*, inter alia, CJEU 27 May 1993, C-310/91, *Schmid* and CJEU 31 May 2001, C-43/99, *Leclere*.

[23] *See*, inter alia, Arts 18 and 45 TFEU.

[24] *See*, inter alia, CJEU 15 Jan. 1986, 41/84 *Pinna*, para. 20; CJEU 30 Jan., C-340/94, *De Jaeck*, para. 18; CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, paras 19–20 and CJEU 18 July 2006, C-50/05, *Nikula*, para. 20.

further developed in a provision on the equal treatment of benefits, income, facts or events.[25] It makes sure that aspects of a person's situation which might be relevant for his/her social security rights but which occur in another Member State, should be taken into account. It is likely to have an impact on the interference between social security law and tax law. Indeed taxes paid in another Member State should be considered as facts occurred in that other Member State and therefore have to be taken into account by the competent Member State.[26]

In addition, the EU social security coordination system provides for general as well as a number of detailed rules on aggregation of periods of insurance, employment, self-employment or residence. Member States must, to the extent necessary, take into account such periods completed under the legislation of any other Member State as though they were periods completed under the applicable legislation.[27] Additionally, Article 7 Regulation 883/2004 formulates a general clause on the waiving of residence rules, thereby confirming the export of benefits as a general coordination principle. This principle applies notwithstanding special provisions and exceptions provided for elsewhere in the regulation, as is the case for unemployment benefits (Article 63) and for special non-contributory cash benefits (Article 70).

2.1.2 *The Rules on the Determination of the Applicable Legislation*

One of the most important tasks of the coordination system is to determine the legislation applicable in cross-border situations. The relevant rules are contained in Title II of Regulation 883/2004.[28] They are considered to constitute a complete and uniform set of conflict rules so that Member States can no longer determine at their discretion the ambit and the conditions for the application of its national legislation and the territory within which that legislation takes effect.[29] So, these rules are mandatory, also for the persons concerned. The worker and the employer or the self-employed person do not have the freedom to choose the applicable social security legislation. This should ensure the predictability of the conflict rules as well as legal certainty.[30] The only exception is the power offered by Article 16 to two or more Member States to provide by common agreement for exceptions to these rules in the interest of certain persons or categories of persons.

These provisions are in the first place intended to ensure that persons in a cross-border situation between Member States are not left without social security cover because there is no legislation applicable to them.[31] Secondly, they also intend to prevent the simultaneous application of a number of national legislative systems and the complications this might ensue,[32] including the double payment of contributions in respect of the same income.[33] Therefore the person in question shall be subject to the legislation of a single Member State only (exclusivity rule; see Article 11(1) Regulation 883/2004).[34]

The governing principle is that the law of the State of employment applies (*lex loci laboris*) for economically active persons (Article 11(3)(a) Regulation 883/2004). The criterion of the State of employment has been the underlying principle of EU social security coordination since 1958.[35] The choice for the application of this principle is inspired by, among other things, the legal context in which European social security coordination is applied, namely to ensure the free movement of workers. Such freedom of movement entails a prohibition of discrimination based on nationality by the Member State where the migrating worker is employed (Article 45(2) TFEU). This prohibition does not only hold for all conditions of employment and remuneration that apply in the State of employment, but also for social security provisions.[36] Hence, the State of employment principle is an expression of the premise that a

[25] Art. 5 Regulation 883/2004.

[26] For a similar approach in tax matters *see* CJEU 23 Apr. 2009, C-544/07, *Rüffler* and CJEU 19 Nov. 2009, C-314/08, *Filipiak*, in which the Court obliged a Member State to take social security contributions paid in another Member State into account for the calculation of income taxes.

[27] *See* for a general clause on aggregation Art. 6 Regulation 883/2004.

[28] On the rules determining the applicable legislation *see also*: P. Schoukens & D. Pieters, *The Rules Within Regulation 883/2004 for Determining the Applicable Legislation*, Eur. J. Social Security, 81–117 (2009); H.-D. Steinmeyer, *Determination of Legislation Applicable*, in *EU Social Security Law. A Commentary on EU Regulations 883/2004 and 987/2009* 144–192 (M. Fuchs & R. Cornelissen eds, Baden-Baden: Nomos 2015) and R. Cornelissen, *Conflicting Rules of Conflict: Social Security and Labour Law*, in *Residence, Employment and Social Rights of Mobile Persons. On How EU Law Defines Where They Belong* 257–271 (H. Verschueren ed., Antwerpen-Cambridge: Intersentia 2016).

[29] *See*, inter alia, CJEU 12 June 1986, 302/84, *Ten Holder*, para. 21; CJEU 10 July 1986, 60/85, *Luijten*, para. 14; CJEU 11 Nov. 2004, C-372/02, *Adanez-Vega*, para. 18. *See* more recently: CJEU 5 Nov. 2014, C-103/13, *Somova*, para. 54; CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 35 and CJEU 26 Oct. 2016, C-268/15, *Hoogstad*, para. 34.

[30] CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak*, para. 67.

[31] This had been confirmed by long standing case-law of the CJEU. *See* e.g. CJEU 11 June 1998, C-275/96, *Kuusijärvi*, para. 28; CJEU 19 Feb. 2000, C-202/97, *Fitzwilliam*, para. 20; CJEU 7 July 2005, C-227/03, *van Pommeren-Bourgondiën*, para. 34 and CJEU 4 Oct. 2012, C-115/11, *Format*, para. 29.

[32] *See* already in CJEU 10 July 1986, 60/85, *Luijten*, para. 14 and more recently in CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak*, para. 41; CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 36 and CJEU 23 Apr. 2015, C-382/13, *Franzen*, para. 41.

[33] *See*, inter alia, CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, paras 24, 27 and 28.

[34] CJEU 12 June 1986, 302/84, *Ten Holder*, paras 13 and 23; CJEU 10 July 1986, 60/85, *Luijten* and more recently CJEU 23 Apr. 2015, C-382/13, *Franzen*, paras 42–43.

[35] On the State of employment principle, *see* among others: F. Pennings, *Co-Ordination of Social Security on the Basis of the State-of-Employment Principle: Time for an Alternative?*, CMLRev 67–89 (2005) and Schoukens & Pieters, *supra* n. 28, at 103–105.

[36] *See* for instance CJEU 15 Jan. 1986, 41/84, *Pinna*.

migrating worker is entitled to the same rights in the State of employment as workers of that Member State.[37]

However, the Court of Justice has confirmed that the application of the State of employment principle does not preclude a migrant worker from entitlements pursuant to the national legislation of another State, such as the State of residence. A State other than the competent State according to the conflict rules of the EU social security coordination regulations cannot be prevented from granting benefits in so far as the possibility of doing so arises under its legislation.[38] In some cases this State is even obliged to grant benefits to such persons. This is for instance the case if these benefits are financed by taxes and the persons concerned are subject to unlimited income tax liability in that Member State.[39]

The principle of the State of employment is the starting point for economically active persons, but Regulation 883/2004 does contain a number of exceptions and special rules. Civil servants are subject to the legislation of the Member State to which the administration employing them is subject and persons called up or recalled for service in the armed forces or for civilian service in a Member State shall be subject to the legislation of that Member State (Article 11(3)(b) and (d)). An unemployed frontier worker receiving unemployment benefits in accordance with Article 65 under the legislation of the Member State of residence shall be subject to the legislation of that Member State (Article 11(3)(c)). Article 11(3)(e) states that a person who cannot be considered as pursuing an economic activity, shall be subject to the legislation of the Member State of residence.

The most important special rules on the determination of the applicable legislation are the ones on posting (Article 12 Regulation 883/2004) and on the simultaneous pursuit of activities in two or more Member States (Article 13 Regulation 883/2004).[40]

2.2 EU and Personal Income Tax Law

2.2.1. *EU and Tax Sovereignty of the Member States*

2.2.1.1 Generalities

As previously mentioned (sub 1) – within the EU – direct taxation as a policy area remained part of the sovereignty of the Member States. They are competent to decide on the criteria that determine the scope of direct taxation. These criteria can be defined by reference to a connection between the relevant aspects of taxable persons or events and a territory. The reference may be subjective taking into account the residence, domicile or in some countries even the nationality[41] of the taxable person. The reference may also be objective taking into account e.g. the place of occurrence of the taxable event.[42]

The *residence principle* is generally connected with an 'unlimited tax liability' since it taxes persons (residents) on all of their income,[43] whereas the *source principle* is generally connected with a 'limited tax liability' since it only taxes income (or property) originating in or related to the taxing country.[44]

2.2.1.2 Theoretical Foundations for the Different Types of Connections

Fiscal sovereignty entails that each country is in principle free to choose between the different types of connection. The theoretical justifications for these different optional vary widely. In the general International Fiscal Association-report (IFA) of 2005 *Schindel* and *Atchabahian* distinguish the following justifications[45]: (1) inter-individual equity, (2) inter-nation equity[46] and (3) efficiency-neutrality.[47] Especially with respect to the taxation of income, particularly on individuals, the inter-

[37] The relevance of the principle of equal treatment to the rules governing the determination of the applicable legislation was underlined by the CJEU in, among other judgements: CJEU 8 Mar. 2001, C-68/99, *Commission v Germany*, paras 22 and 23; CJEU 26 May 2005, C249/04, *Allard*, para. 31; CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, para. 19; CJEU 1 Apr. 2008, C-212/06, *Government of Communauté française and Gouvernement wallon v Gouvernement flamand* (Flemisch Care Insurance case), para. 48 and CJEU 3 Apr. 2008, C-103/06, *Derouin*, para. 20. *See also* Recital no 17 to Regulation 883/2004 that says that: '*With a view to guaranteeing the equality of treatment of all persons occupied in the territory of a Member State as effectively as possible, it is appropriate to determine as the legislation applicable, as a general rule, that of the Member State in which the person concerned pursues his/her activity as an employed or self-employed person*'.

[38] CJEU 20 May 2008, C-352/06, *Bosmann*, paras 27-29 and 33; CJEU 16 July 2008, C-208/07, *von Chamier-Glisczinski*, paras 55–56; CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak*, paras 51–59 and CJEU 23 Apr. 2015, C-382/13, *Franzen*, paras 60, 65 and 66.

[39] As demonstrated by the *Hudzinski* and *Wawrzyniak* judgement. *See* further on this issue point 3.3.

[40] For more details *see* the articles referred to in fn. 28.

[41] In the United States for instance the nationality criterion is based on the principle of state protection afforded to its nationals, even when they reside abroad. The tax liability linked to the nationality criterion is then considered as the price to be paid for the political privilege of being a national of the concerned state. In the EU Member States the use of a nationality criterion to define the scope of application *ratione personae* of personal income tax is exceptional and if so, conditional. Only a few EU Member States refer to the nationality criterion in defining some specific categories of 'residents' (e.g. Latvia, Lithuania, Portugal and Sweden). In a recent judgement the Court of Justice repeated that nationality can be used as a criterion to distinguish in the tax treatment, if nationality is the criterion to apportion taxing competences (*See* CJEU 19 Nov., C-241/14, *Bukovansky*, paras 37–38).

[42] A. Schindel & A. Atchahian, *General Report*, in *Source and Residence: New Configuration of Their Principles* vol. 90a, 28–29 (IFA 2005).

[43] In almost all EU Member States resident individuals are taxed on their worldwide taxable income.

[44] Schindel & Atchahian, *supra* n. 42, at 29.

[45] *Ibid.*, at 31–37.

[46] Inter-nation equity concerns the equitable distribution of the tax base between countries involved in international transactions.

[47] The efficiency principle refers to the optimal allocation of production resources, and, from the taxation point of view, the minimization of any distortion caused to the private sector by the tax system. Efficiency requires that the total burden of taxes levied

individual equity rationale seems to be deeply rooted and is seen as the most valuable one. The equity principle may, however, be based either on the benefit rule or the ability-to-pay rule. Under the benefit rule, the tax burden is distributed among taxpayers in proportion to the actual or potential level of benefit they attain from government-supplied goods and services. This rationale goes well with a broad application of source-based taxation, normally on the ground that they benefit from the legal and economic framework and the public goods and services offered by the source country. Although the equity justification based on the benefit rule can justify a source-based taxation of both residents and non-residents, it seems that many countries in case of the taxation of *resident* individuals prefer the equity principle based on the ability to pay rule as rationale. It allows an equal tax treatment under the law regardless of where income is derived from and justifies a (more or less) comprehensive worldwide income taxation. Some scholars also invoke a practical aspect to argue that in the case of individuals, the primary taxing powers should rest with the country of residence.[48] They argue that the residence of an individual is relatively easy to establish whereas determining the source of income is more difficult.

The foregoing explains why states when taxing residents generally take into account the worldwide income. It also explains why the taxation of non-residents is limited to the source income. In general the taxation of both categories will therefore differ. It also explains why states in general grant personal tax allowances and reliefs for family responsibilities only to residents. These tax reliefs and deductions are not linked to the taxable income as such but rather to the *taxpayer's ability to pay*. In an international tax context the different treatment of residents and non-residents is therefore generally accepted. Article 24.3 of the OECD Model Tax Convention explicitly mentions that the provision on non-discrimination: '*shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents*'.

According to the OECD Commentary[49] this exclusion is designed to ensure that non-residents do not obtain greater advantages than residents by receiving personal allowances and reliefs for family responsibilities both in the State of which they are residents, by the application of its domestic laws, and in the other State by virtue of the principle of equal treatment. It should however be noted that the Commentary leaves it to the source State to offer these reliefs to the persons concerned '*in the proportion which the amount*' of the source profits bears to the world income taxable in the other State.[50]

2.2.2 *The Influence of the EU on Member States' Competence to Grant Individuals Personal and Family Allowances by Tax Measures*

Whereas Member States are in principle free to choose the connecting factor for the allocation of their fiscal jurisdiction, this sovereign power is not absolute. As already mentioned, Member States must exercise their taxing powers in a manner consistent with EU law. In adopting and applying national and bilateral rules in the field of taxation they are obliged to act in accordance with the EU rules on the fundamental freedoms (goods, services, capital and persons) and non-discrimination on grounds of nationality.

The treaty provisions on the free movement of persons, for instance, seek an optimal allocation of supply and demand in the internal market by an overall mobility of economic agents.[51] They prohibit Member States to discriminate or impose restrictions on both workers (Article 45 TFEU) and self-employed persons (Article 49 TFEU) who are nationals of another Member State. This prohibition also includes direct taxation. However, while the CJEU has ruled that the fundamental freedoms require cross-border situations to be treated not worse than internal situations, it has accepted the occurrence of double taxation in cross-border situations, where there would be no double taxation in purely internal situations.[52] According to the Court it is up to the Member States to lay down rules on the avoidance of double taxation. If they fail to do so, and both Member States exercise their taxing rights, not treating the cross-border situation differently from the purely internal situation, the CJEU finds itself not competent to allocate the taxing rights and deems itself unable to detect a breach of the fundamental rights.[53] Moreover, case law established that fiscal limitations on the free movement of persons originating in an inadequate conjunction, overlapping or even mismatch between the independent tax systems of two or more Member States, do not as

on taxpayers investing in foreign countries is not higher than the taxes imposed on domestic enterprises in those countries.

[48] R. S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 Tax L. Rev. 1301, 1311–1314 (1996).

[49] S. 36 OECD Commentary on Art. 24.

[50] *See also*: Ba. Peeters, *Kieback: When Schumacker Emigrates*, 2 EC-Tax Review 59 (2016), who refers exemplary to the Belgian double tax conventions with France (Art. 25, § 2 Conv.) and the Netherlands (Art. 26 §2 Conv.). Both conventions provide a *pro rata* for individuals. The Belgian convention with Luxembourg provides this only for residents of Luxembourg earning income in Belgium (Art. 24, § 4b Conv.).

[51] K. Lenaerts & P. Van Nuffel, *Europees Recht* 161, no. 211 (Intersentia, Antwerp 2011).

[52] *See* e.g. CJEU 14 Nov. 2006, C-513/04, *Kerckhaert-Morris*; CJEU 20 May 2008, C-194/06, *Orange European Smallcap Fund NV*; CJEU 16 July 2009, C-96/08, *Damseaux* and CJEU 19 Sept. 2012, C-540/11, *Levy and Sebbag*.

[53] *See* e.g. CJEU 14 Nov. 2006, C-513/04, *Kerckhaert-Morris*; CJEU 16 July 2009, C-96/08, *Damseaux* and CJEU 19 Sept. 2012, C-540/11, *Levy and Sebbag*.

such imply any forbidden discrimination. Nevertheless, these cross-border activities are not regarded by definition as tax neutral.[54]

In order to assess the tax payer's personal ability to pay taxes, Member States often take into account his or her personal and family circumstances as codetermining the tax burden to which they are subjected.

Unlike income related tax deductions (such as business expenses), personal and family related tax reductions (such as tax free basic amounts; splitting of income between spouses etc.) are connected to the taxpayer himself and not to any income source or to a particular part of the tax base. Therefore, in a cross-border situation the question arises which state (the State of residence and/or the source State) should take into account these personal and family circumstances.

In the past the EU Court of Justice has had several occasions to clarify its point of view on this issue, starting with the *Schumacker* case.[55] A summary of the Court's case law can be derived from the following considerations of two recent rulings, namely *Imfeld and Garcet* and *Kieback*.

According to the Court, Member States still retain competence to determine the criteria for taxation on income and capital with a view to eliminate double taxation by means inter alia of international conventions. In that context Member States are free to determine the connecting factor for the allocation of fiscal jurisdiction in bilateral conventions for the avoidance of double taxation.[56] But, as far as concerns the exercise of the power of taxation so allocated, Member States must comply with EU rules.[57] The Court stresses that it is a matter for the *State of residence, in principle*, to grant the taxpayer all the tax advantages relating to his personal and family circumstances, because that State is, without exception, best placed to assess the taxpayer's personal ability to pay tax since that is where his or her personal and financial interests are centred.[58] In that respect a Member State cannot rely on the existence of an advantage granted unilaterally by another Member State to escape its obligations under the treaty.[59] The Court apparently assumes that normally a non-resident receives personal (and family) allowances at home and therefore does not need any in the source State. Notwithstanding Article 7(2) Regulation 1612/68 on the free movement for workers which explicitly entitles non-national workers to the same tax benefits as nationals, the Court seems to fear that requiring also the source State to grant those benefits to non-residents, might lead to unjust enrichment (double allowances).[60]

However, there are under EU Law no specific requirements with regard to the way in which the State of residence must take into account the personal circumstances of a taxpayer, except that it should not be done in a discriminatory manner.[61] In view of their fiscal sovereignty Member States autonomously determine the personal and family allowances they want to grant.

In relation to direct taxation, residents and non-residents are according to the Court generally not in comparable situations because the income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence, and because a non-resident's personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, which in general is the place where he has his usual abode.[62]

Consequently, the Court holds that the fact that a Member State does not grant to a non-resident certain tax advantages which it grants to a resident is not, as a rule, discriminatory, having regard to the objective differences between the situations of residents and non-residents, from the point of view both of the source of their income and of their personal ability to pay tax or their personal and family circumstances.[63]

There could, however, be discrimination between residents and non-residents if, notwithstanding their residence in different Member States, it were established that, having regard to the purpose and content of the national provisions in question, the two categories of taxpayers are in a comparable situation.[64] This is according to the Court for instance the case when a non-resident taxpayer receives no significant income in his Member State of residence and derives the major part of his taxable income from an activity pursued in the Member State of employment, so that the Member State of residence is not in a position to grant him the advantages which follow from taking into account his personal and family circumstances.[65] In such a case,

[54] CJEU 12 May 1998, C-336/96, *Gilly*, para. 46.

[55] CJEU 14 Feb. 1995, C-279/93, *Schumacker*. *See also*: CJEU 14 Sept. 1999, C-391/97, *Gschwind*; CJEU 16 May 2000, C-87/99, *Zurstrassen*; CJEU 12 Dec. 2002, C-385/00, *de Groot*; CJEU 1 July 2004, C-169/03, *Wallentin*; CJEU 12 July 2005, C-403/03, *Schempp*; CJEU 8 Sept. 2005, C-512/03, *Blanckaert*; CJEU 25 Jan. 2007, C-329/05, *Meindl-Berger*; CJEU 23 Apr. 2009, C-544/07, *Rüffler*; CJEU 10 Sept. 2009, C-269/07, *Commission v. Germany*; CJEU 19 Nov. 2009, C-314/08, *Filipiak*; CJEU 31 Mar. 2011, C-450/09, *Schröder*; CJEU 15 Sept. 2011, C-240/10, *Schulz*; CJEU 10 May 2012, C-39/10, *Commission v. Estonia*; CJEU 28 Feb. 2013, C-168/11, *Beker*; CJEU 28 Feb. 2013, C-425/11, *Ettwein*; CJEU 12 Dec. 2013, C-303/12, *Imfeld and Garcet* and CJEU 18 June 2015, C-9/14, *Kieback*.

[56] E.g. CJEU 12 Dec. 2013, C-303/12, *Imfeld and Garcet*, para. 41.

[57] *Ibid.*, para. 42.

[58] *Ibid.*, para. 43.

[59] *Ibid.*, para. 61.

[60] B. Terra & P.J. Wattel, *European Tax Law* 980 (Alphen aan den Rijn: Wolters Kluwer 2012).

[61] CJEU 12 Dec. 2002, C-385/00, *de Groot*, paras 114–115.

[62] E.g. CJEU 18 June 2015, C-9/14, *Kieback*, para. 22.

[63] *Ibid.*, para. 23.

[64] *Ibid.*, para. 24.

[65] *Ibid.*, para. 25. In the *Wielockx* case (CJEU 11 Aug. 1995, C-80/94, *Wielockx*), the Court applied the same principle for self-employed workers.

discrimination arises from the fact that the personal and family circumstances of a non-resident who receives *the major part of his income and almost all his family income* in a Member State other than that of his residence are taken into account neither in the State of residence nor in the State of employment.[66] More specifically the discrimination consists in the fact that the State of employment does not grant to the non-resident the personal and family allowance it grants to their own residents despite the fact that the non-resident earns (like the residents) (almost) all their taxable income in that State of employment.

In order to establish whether that is the case, all of the necessary information must be at hand for assessing a taxpayer's ability to pay tax in the aggregate, having regard to the source of his income and his personal and family circumstances. In order for such an assessment to be sufficiently relevant in that regard, the situation which must be taken into consideration must relate to *the financial year in question in its entirety*, since that period is generally accepted, in the majority of the Member States, as forming the basis for charging income tax.[67]

The results of the *Schumacker* doctrine is that a State of employment being confronted with a non-resident who receives the major part of his or her taxable income and almost all family income in this state,[68] has to grant this non-resident – when taxing him – the same benefits as it does vis-à-vis residents, which result from taking into account his or her personal and family circumstances. This method implies that the discrimination of the non-resident is remedied in giving him in the State of employment a treatment equal to that of a resident of that same State. From the point of view of the non-resident this equal treatment is not (necessarily) neutral since his or her tax regime in the State of residence is swapped for the tax regime of a resident in the State of employment. In view of the tax sovereignty of both states their tax regimes may more or less differ.

In the *Schumacker* case, only one State of employment took part in the proceedings.

The question remains what should happen when the total income is received in different states of employment, where they are taxed each time for a part. This situation occurred in the *de Groot* case.[69] Mr de Groot was a resident of the Netherlands and was employed in the Netherlands as well as in other Member States. Due to a proportionality factor[70] applicable in the Dutch tax system, a portion of the personal tax relief to which Mr de Groot was entitled, did not give rise to an actual tax reduction in the Netherlands. The Court decided that this national rule precludes Article 45 TFEU (former Article 39 EC). This judgement has been criticized by many scholars, pleading in one way or another for a proportional national tax treatment of non-residents (fractional taxation of non-residents).[71]

[66] E.g. CJEU 18 June 2015, C-9/14, *Kieback*, para. 31. In earlier rulings, the Court also pointed out that *income by its nature not subject to tax*, received in the State of residence, should not be taken into account: CJEU 1 July 2004, C-169/03, *Wallentin* and CJEU 5 July 2005, C-375/03, *D*, paras 41–42. The notion of 'income non-taxable by its nature' is however not very clear: B. Peeters, *The Fiscal Aspects of the Free Movement of Workers in the EC Context*, in *Fiscal Sovereignty of the Member States in an Internal Market*, 28 Eucotax Series on Eur. Tax. 87–88 (J.M. Jansen ed., Kluwer Law International, Alphen a/d Rijn 2011); B. Terra & P.J. Wattel, *European Tax Law* 982 (Alphen aan den Rijn: Wolters Kluwer 2012). *See* in this respect also CJEU 10 May 2012, C-39/10, *Commission v. Estonia*, paras 54–55.

[67] E.g. CJEU 18 June 2015, C-9/14, *Kieback*, para. 31.

[68] The European Commission has indicated in its Recommendation 94/79 of 21 Dec. 1993, which is not binding for the CJEU that the taxpayer should have earned at least 75% of total taxable family income. In the *Gschwind* case, the CJEU did not explicitly react to this recommendation, but referred to *a minimum threshold* of 90% (CJEU 14 Sept. 1999, C-391/97, *Gschwind*, para. 32). This approach is in keeping with the terms in the *Schumacker* judgement (CJEU 14 Feb. 1995, C-279/93, *Schumacker*, para. 38). *See also* CJEU 25 Jan. 2007, C-329/05, *Meindl*, para. 32. Still the question remains what should happen when the threshold of 90% is not reached in the source State, but nevertheless the taxpayer is not able to enjoy the personal and family allowances in his State of residence. *See* in this context CJEU 10 May 2012, C-39/10, *Commission v. Estonia* concerning a person of Estonian nationality residing in Finland. He received pension benefits of almost the same amount from both Finland (his State of residence) and Estonia, which in total were slightly above the supplementary allowance threshold as proved under Estonian income tax. The Estonian tax authorities refused to apply the tax allowance threshold and the supplementary tax allowance threshold due to the low income level of the complainant. The Court decided as follows (paras 54–56):

55. (…) in a case such as that of the complainant, who because of the modest amount of worldwide income is not taxable in the Member State of residence, under that State's tax legislation, that State is not in a position to take into account the ability to pay tax and the personal and family circumstances of the person concerned, in particular the consequences for that person of taxation of the income received in another Member State.

56. In those circumstances, the refusal of the Member State in which the income in question is received to grant an allowance provided for under its tax legislation penalizes non-resident taxpayers such as the complainant simply because they have exercised the freedoms of movement guaranteed by the FEU Treaty.

[69] CJEU 12 Dec. 2002, C-385/00, *de Groot*.

[70] This factor is represented by a fraction, in which the numerator is the foreign gross income and the denominator the total gross income (CJEU 12 Dec. 2002, C-385/00, *de Groot*, para. 18).

[71] *See* for more details: K. Van Raad, *Fractional Taxation of Multi-State Income of EU Resident Individuals – A Proposal*, in *Liber Amicorum Sven-Olof Lodin, Melz & Silfverberg* 211–221 (2001); B. Terra & P. Wattel, *European Tax Law* 993 (Alphen aan den Rijn: Wolters Kluwer 2012). H. Niesten, *Invloed van het Unierecht op persoonlijke belastingvoordelen van de grensoverschrijdende economisch actieve EU-persoon: quo vadimus?*, 479 Tijdschrift voor Fiscaal Recht, 284–305 (2015). Note in this context that in a judgement of 22 May 2015, the Hoge Raad of the Netherlands referred a new case to the Court of Justice (C-283/15), concerning a Spanish resident earning income from services executed all over the world, but from which 60% would be taxable in the Netherlands and 40% would be taxable in Switzerland (Hoge Raad 22 May 2015, no 13/03468, www.rechtspraak.nl). In his opinion of 17 June 2014 the Dutch Advocate General Niessen concludes to refer this case to the Court of Justice and even suggests a solution in which the personal allowances are granted in each source State, but in proportion to the number of source States. "See in this respect also the Opinion of 7 Sept. 2016 of Advocate General M. Wathelet in case C-283/15 *(X v Staatssecretaris van Financiën) : "where a taxpayer has no significant income in his State of residence, which for that reason cannot grant him the tax advantages associated with his personal and family*

Note also that the Court extends the *Schumacker* case law to *all* the tax advantages connected with the non-resident's ability to pay tax which are granted neither in the State of residence nor in the State of employment.[72] The Court's wording seems to make clear that only *tax* advantages are targeted. Other non-fiscal advantages are excluded. The right qualification of benefits (fiscal or not) is therefore of great importance.

3 Interaction between EU social security law and personal income tax law

3.1 EU Definition of Social Security Contribution Interfering with National Definitions of Taxes

The social security schemes of the Member States are financed by social security contributions as well as by taxes. The systems of the various Member States differ a great deal in this respect. Bismarckian oriented systems are mainly funded by social security contributions, the Beveridgean systems primarily by general taxes. Most systems are financed in a mixed manner: partly by social security contributions, partly by taxes. What is more, financing by taxes can occur by means of the general income tax or by means of specific taxes intended to finance part of social security, such as social value-added tax (VAT) or social levies on services like insurance.

In order to determine in which Member State a person in a cross-border situation has to pay such contributions or taxes, two sets of rules are applicable: the conflict rules of the EU social security coordination system and the conflict rules in the bilateral tax conventions. It is therefore crucial to determine which set of rules is applicable to a certain levy.

As far as social security is concerned the material scope as defined by Article 3 of Regulation 883/2004 is not influenced by whether the scheme involved is contributory or not. This means that benefits financed by social security contributions as well as those financed out of the general budget, and therefore by taxes, are covered by the rules of the regulation. Moreover, we can infer from the CJEU's case law that the contributions themselves also fall under the regulation's scope, more specifically under the conflict rules of Title II, including the State of employment principle and the rule that only one legislation is to be applicable.[73]

Less clear, though, is how a distinction is to be made between levies and contributions which come under the social security regulation and those that do not.

An answer to this question can be found in the CJEU's case law starting with the French CSG and CRDS cases. These cases dealt with the levy of the *Contribution Sociale Généralisée* (CSG) ('General Social Contribution')[74] and the *Contribution pour le Remboursement de la Dette Sociale* (CRDS) ('Social Debt Repayment Contribution')[75] on employment income and substitute income.

Under French tax law all natural persons domiciled in France for income tax assessment purposes were liable to pay CSG and CRDS, in particular on their employment income and substitute income. This was also the case even if according to the, at that time, applicable Regulation 1408/71 these persons were not subject to French social security law, for instance because they were working in another Member State. However, the CJEU stated that there is a direct and sufficiently relevant link between the CSG and the CRDS and the legislation governing the branches of social security listed in Article 4 of Regulation 1408/71. Therefore, according to the Court these levies can be regarded as covered by the regulation.[76] For the purpose of the application of the rules on the determination of the applicable legislation in the EU social security coordination regulations to levies and contributions, the decisive criterion for the CJEU is that of the specific allocation of a contribution to the financing of the social security scheme of the Member State, irrespective of whether benefits in return are obtained or not.[77] This

circumstances, each Member State in which an activity if performed and which is competent to tax the income from that activity must, by taking into account the taxpayer's personal and family circumstances, authorise the deduction of the negative income, in proportion to the income which it taxes, provided that the income in that State is sufficiently large to grant him the advantages in questions" (para. 86 (2)).

[72] E.g. CJEU 18 June 2015, C-9/14, *Kieback*, para. 27.

[73] *See* inter alia CJEU 29 June 1994, C-60/93, *Aldewereld*; CJEU 8 Mar. 2001, C-68/99 *Commission v. Germany*; CJEU 26 May 2005, C-249/04, *Allard*; CJEU 9 Mar. 2006, C-493/04, *Piatkowski* and CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 22.

[74] The CSG is a contribution of 7.5% levied on a wide range of incomes, from employment income, over substitute income to income from assets and investments. The proceeds from these are directly allocated to funding the National Family Allowance Fund, the Old-Age Solidarity Fund and the compulsory sickness insurance scheme.

[75] The CRDS is a contribution of 0.5%, likewise levied on a wide range of incomes, and it is intended to help in paying back a very large loan taken out to pay off the debts accumulated by the various social security branches in the past.

[76] CJEU 15 Feb. 2000, C-34/98, *Commission v. France*, para. 35 and CJEU 15 Feb. 2000, C-169/98, *Commission v. France*, para. 33, recently confirmed by CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 23 and CJEU 26 Oct. 2016, C-269/15, Hoogstad, paras 28-29.

[77] CJEU 15 Feb. 2000, C-34/98, *Commission v. France*, para. 40 and CJEU 15 Feb. 2000, C-169/98, *Commission v. France*, para. 38; CJEU 26 May 2005, C-249/04, *Allard*, para. 16 and more recently CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 26. Note that the existence of a direct link between the contribution and the benefit does matter in determining the material scope of double tax conventions. In section 3, last (fifth) sentence of the Commentary on Art. 2 of the OECD Model Conventions (defining the notion 'taxes covered') it is stated that '*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*'.

The criterion whether there is or not a direct connection between the levy and the individual is a matter of debate, because – as

can be ascertained if the legislation explicitly states that levies and contributions are collected for a specific branch of social security, or if it can be determined from the contributions' purpose as inferable from the context of the legislation involved.

However, it is not quite clear whether one can infer from these judgements that all taxes which contribute directly or indirectly to the financing of social security fall under the rules regarding the determination of the applicable legislation of Regulation 883/2004. Indeed, there are a lot of different direct and indirect taxes which are allocated, directly or indirectly, to financing social security. Nonetheless, from *Piatkowski* we can infer that it concerns tax on income of persons. This case dealt with the levy by the Netherlands of social security contributions on interest payments in respect of a claim. The CJEU stated that the rule prohibiting the levy of double contributions applies not only to income from gainful employment and income from self-employment, but extends to all income.[78]

This position has more recently been confirmed by the CJEU in *de Ruyter*. It applied the same principles as in the CSG and CRDS cases to levies not imposed on the employment income and substitute income of workers, but which are imposed on income from assets when these levies are allocated specifically and directly to the financing of certain branches of social security or to discharge their debts.[79] The absence of a link between income from assets of taxable persons and the pursuit of a professional activity by them, is not relevant for the Court. The EU social security coordination rules apply to all persons who make use of their right to freedom of movement, irrespective of the circumstances thereof, so also in case the objective of the movement is not pursuing an economic activity in the host State.[80] Limiting the application of the provisions of Regulation 883/2004 to the income that migrant persons derive from their employment relationship would lead to disparities in the application of the mandatory rules of conflict in that regulation. It would lead to require residents of a Member State, who are insured under the social security scheme of another Member State to finance in addition, even if only partially, the social security scheme of the Member State of residence. This would give rise to an unequal treatment since all other residents of the latter Member State would only be required to contribute only to its social security scheme.[81] The fact that this income from assets is not subject to a levy in the form of social security contributions in the Member State of employment, does not alter this conclusion.[82]

The question arises whether this case law unjustifiably impacts on the Member States' sovereignty in tax matters. In this respect we should first refer to the fact that the CJEU in the French cases has only decided whether or not the levy concerned falls under the scope of the EU social security regulations, but did not really deal with the question of the qualification of this levy as a social security contribution or as a tax. The Court left that aside. So the Court did not re-qualify this levy according to national law. There is nothing to prevent this levy from remaining a tax under French law and from applying other relevant rules of national tax law. However, the fact that a levy is categorized as a tax under national legislation does not mean that the same levy cannot be regarded as falling within the scope of Regulation 883/2004.[83] Therefore it is not excluded that social security contributions may also fall under the scope of double tax conventions. Hence, in an EU/European Economic Area (EEA)-context the conflict rules of European social security coordination are applicable and not those of the applicable bilateral tax agreement.[84]

Second, the CJEU also confirmed in *Derouin* that it is for the legislation of the Member State concerned to determine the income to be taken into account when calculating those contributions and to determine their tax base.[85] This means that a Member State is entitled to forgo, unilaterally or in the context of a double tax convention, the inclusion in the tax base for such contributions of income earned in another Member State.

already mentioned – many social security systems are financed in a complex way (*see* sub 1). For more details: *see* a.o. P. Brandstetter, *'Taxes Covered', A Study of Article 2 of the OECD Model Tax Conventions* 280 et seq. (Amsterdam, IBFD Publications 2011)(sub interpretive results and outlook); K. Van Raad, *The Concept of Tax in the OECD Model*, in *The Concept of Tax*, Eatlp International Tax Series 3, 259–263 (IBFD s.l. 2005); M. Lang, *'Taxes Covered'- What Is a 'Tax' According to Article 2 of the OECD Model?*, in *The Concept of Tax*, Eatlp International Tax Series 3, 265–277, esp. 268–269 (IBFD, s.l. 2005).

[78] CJEU 9 Mar. 2006, C-493/04, *Piatkowski*, para. 30.

[79] CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, paras 28–29.

[80] *Ibid.*, paras 30–34. *See also* CJEU 3 Apr. 2008, C-103/06, *Derouin*, para. 20.

[81] CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 39. In this case Mr de Ruyter was a Dutch national resident in France, but employed by a company in the Netherlands and therefore, in accordance with the conflict rules of the EU social security coordination, subject to the Dutch social security scheme.

[82] CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, paras 24 and 41 and CJEU 26 Oct. 2016, C-269/15, *Hoogstad*, para. 29.

[83] CJEU 15 Feb. 2000, C-34/98, *Commission v. France*, para. 34 and CJEU 15 Feb. 2000, C-169/98, *Commission v. France*, para. 32. This is more recently confirmed in CJEU 3 Apr. 2008, C-103/06, *Derouin*, para. 22 and CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 24.

[84] *See also* A.J.M.Jiménez, *Defining the Objective Scope of Income Tax Treaties: The Impact of Other Treaties and EC Law ON THE Concept of Tax in the OECD Model*, in *The Concept of Tax*, Eatlp International Tax Series 3, 279–299, esp. 284 (B. Peeters ed., IBFD, s.l. 2005).

[85] CJEU 3 Apr. 2008, C-103/06, *Derouin*, paras 24–26. In this case Mr Derouin was a resident in France where he practices as a lawyer in a self-employed capacity, while at the same time being a partner at a law firm based in the United Kingdom. He received shares on the profits made by this law firm in the UK. According to the EU social security coordination rules, he was subject to French social security for all his professional activities in the EU. However, under the France-UK Double Taxation Convention the UK-source income is taxed in the UK and only income taxable in France is subject to the CSG and CRDS.

For the CJEU there are indeed no provisions in the social security coordination regulations that require to do so.[86] Consequently, the CJEU decided in *Derouin* that France could exempt Mr Derouin's UK-source income from the tax base of levies which fall under the scope of EU social security coordination (CSG and CRDS), despite him being subject to French social security legislation.

However, in the *de Ruyter* case, the French government submitted that applying the conflict rules of the EU social security coordination to personal income encroaches on Member States' competences to organize the financing of their social security schemes or on the competence to tax. The CJEU did not explicitly respond to this submission, but Advocate General *Sharpston* observed that the fact that the national rules at issue concern financing social security through taxes does not exclude the application of the Treaty rules on the freedom of movement for workers. This does not as such call into question Member States' freedom to secure social security funding through fiscal measures. It only concerns the freedom to tax in so far as the latter affects the income of migrant workers who are subject to the social security legislation of another Member State.[87]

In addition, the Advocate General submitted that the CJEU's reasoning not necessarily means that any tax which contributes to the financing of social security is regarded as having a direct or sufficiently relevant link with social security legislation. For instance consumption tax, unlike income taxes, are levied by a State on purchases of goods and services on its territory, irrespective of the place of residence and the place of employment of the consumer. Consequently, argued the Advocate General, if a person as Mr de Ruyter buys goods and services on French territory, that purchase normally gives rise to the payment of consumption taxes in France only, even if the person is employed (and insured) in another Member State.[88] Thus, charges not levied on a person's income or elements thereof, but included in the price of goods and services or levies on financial or other transactions, do not seem to fall under these rules even if they are allocated to financing social security.[89] Also taxes which are allocated to a State's overall budget and which are neither directly nor indirectly allocated to financing the social security schemes, do not fall under the rules on the determination of the applicable legislation of Regulation 883/2004. The rules of the bilateral tax conventions are applicable in that case.

However, the latter situation may lead to persons contributing to the financing of social security systems in more than one State, which may be problematic from the point of view of free movement. The CJEU itself observed in *de Ruyter* that the principle of freedom of movement for workers would not be respected if a migrant worker would be required not only to finance the social security system of the State where he works, but also, as a resident and tax payer of another Member State, to finance in addition, even if only partially, the social security scheme of the Member State of residence. For the CJEU this would give rise to unequal treatment since all other residents of the latter Member State would only be required to contribute only to its social security scheme.[90] Such situation also arises when a migrant person has to pay social security contributions in a State where social security is mainly financed through such contributions, and at the same time general taxes in a State where social security is partly or even mainly financed through such general taxes. This person runs the risk of getting a double burden, occasioned by the fact that he/she made use of the right to free movement within the EU. Indeed, general taxes are not earmarked for the financing of social security and are only subject to the conflict rules in tax matters (bilateral conventions) and not to the conflict rules of the EU social security coordination.

3.2 EU Definition of Social Security Benefits Interfering in National Definitions of Tax Advantages

Comparable issues on the applicable conflict rules are raised with regard to national tax systems which provide for certain advantages with a social goal, such as tax reductions for children or for disability, advantages for elderly persons, compensations for high health care costs or special tax rates for certain groups of people. Sometimes these tax advantages may result in negative taxes and hence lead to the payment of sums of money to the tax payer who in fact becomes a net receiver of financial benefits from the tax authorities. What would be the consequences for the Member States' sovereignty in this field if the EU social security coordination rules would apply to such advantages?

This issue was raised in the recent CJEU *Lachheb* judgement. Under Luxemburg tax law tax reductions for children are paid in the form of 'child bonuses' by way of an automatic rebate. The legal dispute in this case was about the implementation of the non-cumulation rules with regard to the entitlement for family benefits in more than one Member State. Mr and Mrs Lachheb resided with their children in France. Mr Lachheb was employed in Luxembourg, while his wife worked in France. In such cases the couple is in principle entitled to family benefits in both Member States where the parents work. However, where, during the same period and for the same family members, the

[86] CJEU 3 Apr. 2008, C-103/06, *Derouin*, para. 27.
[87] Opinion of 21 Oct. 2014 in C-623/13, *de Ruyter*, paras 45–46.
[88] *Ibid.*, paras 47–50.
[89] In the same vein: Schoukens & Pieters, *supra* n. 28, at 114–115.
[90] CJEU 26 Feb. 2015, C-623/13, *de Ruyter*, para. 39.

family is entitled to benefits in more than one Member State, Article 76 Regulation 1408/71 and Article 10 Regulation 574/72 provided for priority rules. These rules are now laid down in Article 68 Regulation 883/2004. In the case where rights are available on the basis of the exercise of an economic activity in more than one Member State, priority is given to the benefits of the State where the children reside (France in this case). However, the other Member State (Luxembourg in this case) has to pay a differential supplement for the sum of its family benefits which exceeds the amount paid by the first Member State. The question raised in this case was whether the Luxembourg 'child bonus', which, under national law, is a tax advantage, can be taken into account by the Luxembourg family benefits institution, when calculating the differential supplement this institution has to pay by virtue of the EU social security coordination system, as a family benefit already paid by Luxembourg. In the positive, the final differential amount Luxembourg has to pay in accordance with the EU social security coordination rules would be lower.

The position of the Lachhebs was that the 'child bonus' was a tax advantage that could not be taken on board when calculating the differential amount Luxembourg had to pay by virtue of the EU social security coordination. The Luxembourg family benefits institution was of the opposite opinion. The CJEU was quite straight forward in its position. It referred to the fact that the material scope of the EU social security coordination regulations (Article 4 Regulation 1408/71; now Article 3 Regulation 883/2004) refers to '*legislation concerning the … branches of social security*', one of which is family benefits. It repeated that the distinction between benefits excluded from this scope and those which fall within its scope is based essentially on the constituent elements of each particular benefit, in particular its purposes and the conditions on which it is granted, and not on whether a benefit is classified as a social security benefit by national legislation. Characteristics which are purely formal must not be considered relevant criteria for the classification of benefits. Consequently, the fact that a benefit is governed by national tax law is not conclusive for the purpose of evaluating its constituent elements.[91]

The CJEU found that the Luxembourg 'child bonus' is indeed a social security benefit since it is automatically granted in the case where there is a dependent child in order to compensate for the maintenance of that child, and since it corresponds to a set amount, granted automatically, without any link to income or to any taxes owed by the applicant.[92] The CJEU added that the method by which a benefit is financed is immaterial for the purposes of its classification as a social security benefit and that the legal mechanism by which the Member State implements the benefit has no bearing on the question of whether that measure is to be classified as a social security benefit.[93] And since the 'child bonus', which is paid for each dependent child, represents a public contribution to a family's budget to alleviate the financial burdens involved in the maintenance of children, it constitutes a family benefit within the meaning of the EU social security coordination regulations. The fact that the public contribution to a family's budget takes the form of a cash benefit payable under the national tax law regime and that the child bonus has its origin in a tax reduction for children has for the Court no bearing on the classification of that benefit as a 'family benefit' under the EU social security coordination rules.[94]

This judgement raises a number of questions relating to the Member States' sovereignty in the field of taxation. As already mentioned, Member States' tax systems often provide for certain advantages with a social goal. The implementation of these advantages in cross-border situations may give rise to disputes to the extent that Member States may themselves, or in common agreement via bilateral tax conventions, decide on the rules of conflict that should be applied to such advantages. If the EU social security coordination rules apply, the room for manoeuvre for Member States is very limited, taking into account the above-mentioned mandatory nature of the rules of conflict set out in the EU regulations, including also the rules on benefit overlap. In that case also internally within each of the Member States, the competent tax and social security institutions should cooperate when implementing these rules, so that the latter may even interfere with the national division of competences and responsibilities.

However, it does not seem that this case law directly intervenes into national tax law and tax policy. Indeed, as the CJEU pointed out, the 'child bonus' is granted automatically without any link to the income or the tax owed by the applicant.[95] Therefore granting such a benefit is not really a tax measure, but the tax system and tax institutions are rather used as instruments to apply a measure which basically is only of a social kind.

3.3 System of Financing Social Benefits via Taxes Interfering with EU Social Security Coordination Rules

In the previous paragraphs we examined instances in which the EU social security coordination system

[91] CJEU 24 Oct. 2013, C-177/12, *Lachheb*, paras 27–28. *See* earlier: CJEU 16 July 1992, C-78/91, *Hughes*, para. 14 and CJEU 11 Sept. 2008, C-228/07, *Petersen*, para. 21 and the case-law cited therein.

[92] CJEU 24 Oct. 2013, C-177/12, *Lachheb*, para. 31

[93] *Ibid.*, paras 31–32. *See also*: CJEU 16 July 1992, C-78/91 *Hughes*, para. 21 and CJEU 15 Mar. 2001, C-85/99, *Offermanns*, para. 46.

[94] CJEU 24 Oct. 2013, C-177/12, *Lachheb*, paras 36–37.

[95] *Ibid.*, para. 31.

intervenes in Member States' tax policies. This may occur when this policy has a close link with social policy either by financing it or by guaranteeing advantages to the tax payers which can be qualified as social security benefits. But the impact can also be the other way around. Member States' policies of financing social security benefits via general taxes can also have an impact on the functioning of the EU social security coordination system. This was illustrated by the *Hudzinski* and *Wawrzyniak* cases.[96]

As already mentioned above, the EU social security coordination system contains a number of conflict rules which determine the social security legislation applicable in cross-border situations. They are considered to constitute a complete and uniform set of rules so that Member States can no longer determine to whom their legislation applies and the territory within which that legislation takes effect. These provisions are intended to prevent the simultaneous application of a number of national legislative systems and the complications this might ensue, including the double payment of contributions in respect of the same income. Therefore the person in question shall be subject to the legislation of a single Member State only, and that legislation is to be determined in accordance with the provisions of the EU social security coordination regulations alone.

The issue raised in the cases *Hudzinski* and *Wawrzyniak* was whether, despite the fact that the conflict rules of the EU social security coordination regulations determine the legislation of a specific Member State to be applicable, another Member State could also be obliged under EU law to grant a social security benefit to the persons concerned because of the financing through general taxes, and not through social security contributions, of this benefit. A positive answer to this question would mean that the mandatory rules determining exclusively the applicable legislation in social security would be overruled by the fact that under national law some social security benefits are financed via general taxes.

Both cases concerned Polish workers who lived with their family in Poland, but worked as posted workers for some time in Germany. Under the EU social security coordination rules they remained covered only by the Polish social security system during that period of work in Germany. They indeed fulfilled the, at that time applicable, conditions in Articles 14 and 14a Regulation 1408/71 to remain under the social security system of the sending State as being the single legislation applicable. During that period they and their family were in fact covered by the Polish social security system and they received for their children, who resided in Poland, family benefits from Poland.

However, during the period they worked in Germany they were also subject to unlimited income tax liability in that State. For that reason they claimed also family benefits in Germany, arguing that these benefits are financed in that State by general taxation and that they, being unlimitedly liable to pay taxes in Germany, contributed to the financing of the German family benefit system. It appeared that under German law the entitlement to family benefits is based in the first place on whether the children reside in Germany. But it can also be based on the sole fact that their parents are subject, or are treated as being subject, to unlimited tax liability in Germany, even if the family, including the children, do not reside in that Member State. However, the same legislation excluded such entitlement if a comparable benefit is paid in another Member State. Therefore, the application for family benefits by these Polish workers were denied, since they were entitled to family benefits in Poland.

In its judgement the CJEU first confirmed that the mandatory and exclusive rules of determination of the applicable social security legislation in the EU coordination regulations, do not preclude a Member State other than the competent Member State, from granting family benefits in accordance with its national law to a migrant worker, even if the children do not reside in that Member State and even if the workers concerned continue to receive family benefits for their children from the State designated by the EU conflict rules.[97] This was just a confirmation of previous case law according to which Member States are not prohibited by EU social security coordination from granting workers and members of their family broader social protection than that arising from this coordination system.[98]

However, the CJEU went even further when it assessed the provision in the applicable German legislation which excluded entitlements to child benefits if a comparable benefit was paid by another State. The Court found that such a clause constituted a substantial disadvantage affecting in reality a greater number of migrant workers than settled workers and is therefore discriminatory. For the Court, such disadvantage is not justifiable since the benefit at issue is financed by tax revenue and since the workers concerned are in principle entitled to that benefit in Germany due to the fact that they were subject to unlimited income tax liability in that State. Such exclusion would be contrary to the aim of the Treaty provisions on the free movement for workers (Articles 45 and 48 TFEU) because the migrant workers would lose a social security advantage as a result of the exercise of their freedom of movement.[99] For the Court, only a reduction in the amount of the

[96] CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak* .

[97] CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak*, paras 66–68.

[98] CJEU 20 May 2008, C-352/06, *Bosmann* and CJEU 16 July 2008, C-208/07, *von Chamier-Glisczinski*.

[99] On this point, the decision of the Court was against the opinions expressed in the proceedings by the European Commission, the German government and even the Advocate General.

benefit corresponding to the amount of a comparable benefit received in another State, would be in line with EU law.[100]

This judgement demonstrates that in some circumstances national tax law or at least the national decision to finance some social security benefits exclusively via general tax revenues, may have an impact on the implementation of the EU rules on the determination of the applicable social security law in cross-border situations. Despite the fact that these rules are considered as mandatory and as determining which Member State is exclusively responsible for the social security protection of migrant workers, including to which system these migrant workers and their employers should contribute, national tax law, combined with the general principles of EU law on free movement for workers, can in some circumstances overrule these EU provisions. In a way this judgement disregards the principles of EU social security coordination, because of the close link between a social security benefit with the tax system of a Member State.

Still, the CJEU's argument that the German legislation would disadvantage migrant workers compared to settled workers, is not convincing. If Mr Hudzinski and Mr Wawrzyniak would have stayed in Poland and not have migrated as posted workers to Germany, they would never even have had a right to family benefits in Germany. Moreover, posted workers are not integrated into the social security system of the Member State to which they are temporarily posted.[101] We are also critical about the Court's reference to the free movement of workers provision in the TFEU (Article 45). This contradicts previous case law of the Court in which it ruled that posted workers cannot rely on this provision since posting of workers is only covered by the Treaty provision on the free movement of services.[102]

On the other hand, this judgement seems to draw the full consequences of a Member State's choice to finance social security benefits by the general tax revenues. The Court links the entitlement to such benefit to being liable to pay income tax in that State, despite the fact that such link is normally immaterial under the social security coordination rules of conflict. In fact the Court forces the relevant Member State to accept the full consequences of its sovereign choices in this field.

4 Conclusion

The interaction between social security and taxes is very complex. On the financing side, social security benefits are financed by a mix of social security contributions, taxes specifically earmarked to fund social security expenses and general taxes financing the State's general budget – part of which is used to finance social security. On the benefits side, social security systems provide for a large number of benefits covering various risks. But also tax systems provide for certain advantages with a social goal such as tax reductions for family reasons. Social and fiscal policy clearly interact.

In a purely national context each Member State has all the instruments in order to pursue a coherent and consistent policy in those two areas. Therefore in a purely national context, the fact that on the one hand social security contributions are normally used to finance specific social benefits (benefit principle) and on the other hand taxes generally are not directly affected by expenditure, is not an obstacle to the implementation of a consistent policy. In such a purely national context, persons paying social security contributions as well as taxes to the same State, and receiving social benefits as well as tax advantages from that State, are only subject to the legislation of that single State. Thus, any inconsistencies in policy are only the result of inconsistencies in that Member State's own regulations, which it may remedy autonomously.

In a cross-border context the implementation of a coherent policy between granting social benefits and their financing is less obvious. In principle the EU does not interfere in national legislation on social security and tax policy. However, Member States must follow EU rules and principles when exercising their powers, in particular the principles of the internal market with the free movement of persons. Member States' sovereignty in the area of social security and taxation must be exercised with due respect to these freedoms.

In order to guarantee the right to free movement for persons within this context, the EU as well as the Member States have developed an intricate set of conflict rules bilaterally, dealing with cross-border implementation of national social security and tax systems. Corresponding case law of the CJEU has guided the implementation of these rules. These rules not only impact on the implementation of each of these policy fields as such, but also on their interaction. This is the result of the important differences in the principles underlying these conflict rules. The EU social security coordination system is built on the State of employment principle and the unicity of the legislation applicable, both concerning the payment of contributions and the

[100] CJEU 12 June 2012, C-611/10 and C-612/10, *Hudzinski and Wawrzyniak*, paras 77–85. *See* for a detailed and critical comment on this line of case-law: Cornelissen, *supra* n. 28, at 258–266; M. Fuchs, *Conflicting Rules of Conflict: Social Security and Labour Law. A Response*, in *Residence, Employment and Social Rights of Mobile Persons. On How EU Law Defines Where They Belong* 285–299 (H. Verschueren ed., Antwerpen-Cambridge, Intersentia 2016) and N. Rennuy, *The Emergence of a Parallel System of Social Security Coordination*, Common Market L. Rev. 1221–1266 (2013).

[101] *See* in the same vein, Fuchs, *supra* n.100, at 293 et. seq. and Rennuy, *supra* n. 100, at 1252 and 1257–1259.

[102] For more details *see* H. Verschueren, Being Economically Active: How It Still Matters, in *Residence, Employment and Social Rights of Mobile Persons. On How EU Law Defines Where They Belong* 203–204 (H. Verschueren ed., Antwerpen-Cambridge, Intersentia 2016).

entitlement to benefits. The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons.[103] In view of eliminating double taxation Member States are free to choose the connecting factors for the division of their taxing jurisdictions and to design their own double tax relief mechanism.[104]

This may result in cross-border situations in which the person concerned has to pay social security contributions in one Member State and taxes in another. Such person runs the risk of getting a double burden when he or she has to pay social security contributions in a State where social security is mainly financed through such contributions, and at the same time through general taxes in a State where social security is partly or even mainly financed through such general taxes. In addition, the boundary between the scopes of these two sets of conflict rules is sometimes blurred. This may lead to the application of the EU social security coordination rules to situations which a Member State considers as belonging to the field of tax law as well as to disregarding these coordination rules, because of the tax policy of a Member State. Both situations are illustrated in this article.

As a result of this impact of EU law on the national social security and tax systems, the ability of the Member States to pursue a coherent and consistent policy in those two areas is curtailed. Indeed, EU law interferes into the interaction between these two policy fields in a way that is different than the way in which these policy fields interact internally in each of the Member States. This risks to undermine the coherence built at the national level. It appears that so far this outcome has been underestimated in EU policy and case law in these fields.

Therefore a more overall approach is recommended. Member States as well as the institutions of the EU need to be more aware of the specific problems – as discussed above – caused by the interaction in the national policy fields of social protection and personal income tax. In this respect within each Member State more coordination between the authorities concluding tax treaties and the authorities concluding social security agreements is useful. For instance, when a Member State replaces its contributory social security system (in whole or in part) by a system that is financed by general taxes, it must be aware that this change could have as a consequence that the conflict rules of Regulation 883/2004 are no longer applicable. The same Member State should also examine the impact of its decision on the applicability of the tax treaties it has signed.

A few years ago, the European Commission announced an initiative to carry out a thorough assessment of Member States' tax regimes to determine whether they create disadvantages for mobile EU citizens.[105] The Commission mentioned among others that citizens may suffer tax disadvantages because of the location of the taxpayer himself or due to the mere change of the taxpayer's residence; and because of the refusal of certain tax deductions or tax benefits. Hopefully, the Commission also pays attention in this respect to the interaction between some tax advantages on the one hand and social security benefits on the other hand.

[103] Model Tax Convention, OECD, condensed version 2014, Introduction, 7.

[104] All usual mechanisms hereto are acceptable. The CJEU states that it is 'not unreasonable' for the Member States, in defining and dividing taxing jurisdiction, to find inspiration in international practice, as embodied e.g. in the OECD Model Double Taxation Convention and its Official Commentary (e.g. CJEU 12 May 1998, C-336/96, *Gilly*, para. 31; CJEU 7 Sept. 2006, C-470/04, *N*, para. 45). The CJEU even accepts the absence of double tax relief as long as the States involved do not treat the cross-border situation differently from the purely internal situation and the situation of double taxation is the result of exercise in parallel of their taxing power (disparities) (*see* section 2.2.2).

[105] European Commission *Free Movement of People: Commission to Tackle Tax Discrimination Against Mobile EU Citizens*, Press Release (20 Jan. 2014); B. Peeters, *Mobility of EU Citizens and Family Taxation: A Hard to Reconcile Combination*, 3 EC Tax Review 318–320 (2014).