

Tax and Social Security: EU perspective

24 January 2018



Summary of workshops in Copenhagen and Prague, September/November 2017

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Each EU Member State can decide freely on how to design its personal income tax and social security systems, as there is no harmonization in these areas within the EU. The same is true for the financing of the social security systems. In most of the EU countries, the personal income tax and social security contributions are separate payments. Some countries rely on the financing of social security systems mainly with the social security contributions, while other countries finance their social security systems with the personal income tax revenue or tax revenue in general. Both payments, personal income tax and social security contributions, share many similarities and often interact with each other on the international as well as the national level.

In cross-border situations, both double tax treaties and EU Regulation on the coordination of social security apply. These are two very different legal instruments and it is therefore important to identify and discuss the issues arising from the similarities and differences between the double tax treaties and EU Regulation on coordination of social security when dealing with the mobile workforce. This would then lead to a discussion on possible solutions to prevent undesirable outcomes for all stakeholders (individuals, employers and authorities administering the payments, states).

(1) With kind revision by the speakers and panelists.

In 2015, a group of independent experts made an important step in this area by publishing a FreSsco report (2) devoted to the subject of mismatches between international treatment of personal income tax and social security. In the report, they suggested some theoretical solutions. Unfortunately, there was no noticeable follow-up to this initiative, neither by the EU nor any Member State.

The University of Economics, Prague, the University of Copenhagen and KPMG organized two workshops on the subject "Tax and social security: the EU perspective" in September and November 2017. The workshops explored the most important and acute issues surrounding the (lack of) interaction between personal income tax and social security. Once the most important issues were identified, the discussion moved towards the possible solutions to the problems in the light of the developments on the field of personal income tax and social security, respectively.

(2) B. Spiegel (ed), K. Daxkobler, G. Strban & A.P. van der Mei, Analytical report 2014: The relationship between social security coordination and taxation law, FreSsco, European Commission, January 2015, 60 p.

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Copenhagen Workshop

On 20th September 2017, the first workshop with the topic of “Tax and Social Security: EU Perspective” took place at the premises of the University of Copenhagen. After warm welcome given by Karina Kim Egholm Elgaard, assistant professor at University of Copenhagen and leading researcher of FIRE (Fiscal Relations Research Group), the workshop was launched with excellent speakers – Prof. Frans Pennings from the University of Utrecht and Mr. Malcolm Scicluna, Director of International Relations Department of Social Security at the Ministry for the Family and Social Solidarity of Malta.

Prof. Pennings provided the audience with an introduction to the problem of mismatches between personal tax and social security in cross border situations. He pointed out that the coordination of social security is regulated by an EU Regulation while personal tax is regulated by double taxation treaties between the countries. Further, while the EU Regulation is geographically limited to the EEA area and Switzerland double taxation treaties have a more global reach and easily include countries outside of the European Union.

The tax residence of a person and rules for source taxation determine the country where the personal income tax must be paid. At the same time, the social security follows the EU coordination rules which determine the competent country for the payment of social security contributions.

As a result of what the country competent for receiving both levies depends on several different elements for different working situations.

When a person is “in between” these rules – paying personal income tax in one state and social security contribution in another – significant differences in payments may arise. Prof. Pennings concluded that the mismatches between tax and social security hinder free movement, and he provided recommendations to address these mismatches: clarification of the terminology, harmonization of the approach in posting (24 months for social security purposes versus 183 days according to tax treaties), searching compromises for frontier workers and multi-state activities.

Malcolm Scicluna focused on potential barriers to the right of free movement related to social security. He pointed out what the “coordination” means, defined it against harmonization and emphasized substantial differences in social security systems of the Member States and different financing methods, in particular. The lack of synchronization between social security and tax laws in cross-border situations can lead to significant differences from country to country in the level of levies to be paid and in the term of (future) benefits to be paid out, e.g. pension, unemployment benefits etc. Different levels of social security contributions could give rise to opportunities for employers for “contribution shopping”, by creating so called letterbox companies. Further, there are potential barriers created by the system of social security coordination and he included the lack of coordination between the national institutions, ignorance about the aggregation of insurance periods, lack of knowledge

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about the applicable legal framework, lack of recognition of documents issued by other Member States etc. Malcolm discussed a number of cases decided by, or pending before the European Court of Justice, including C-620/15 A-Rosa Flussschiff GmbH (binding effect of social security certificate), C-527/16 Alpenrind (binding effect of social security certificates), as well as the case 4/15 Austria and Hungary (replacement of posted workers) dealt with by the Administrative Commission's Conciliation Board.

The workshop moved to a panel discussion with the participation from: Prof. Pennings, Mr. Scicluna, Chief advisor Stig Hansen Nørgaard from the Danish Ministry of Employment, Chief advisor Søren Lange Nielsen from the Danish Construction Association, Group Tax Adviser Heidi V. Hjelmgård, FLSmidt and Global Mobility Tax Specialist Hannah Paludan, Rambøll. The panel discussion was moderated by Daida Hadzic, Director at KPMG Acor Tax.

The ideas raised during the panel discussion:

- The panelists representing business suggested that tax is generally not an administrative problem as it is "paid here and now". However, the social security is the complicated area that is problematic in practice and it would be better if social security is digitized and more uniform from country to country both in terms of practical administration and the amount.
- Younger generation does not seem to be interested in social security coverage, and they generally consider the social security contribution a tax.
- A mistrust between the Member States was mentioned several times during the discussion. The mistrust is especially connected to the quality of the assessment made by the national institution when A1-certificates are issued. There seems to be lack of uniformity in the interpretation of the European rules which may lead to the consequence that the social security coverage approved during a posting from one country is rejected in another country, even though the situation is identical. This then has a significant influence on the amount of contributions to be paid and the rights to benefits for the worker in question and his family.
- "One stop shop" in social security was mentioned, however, this concept was considered to be helpful primarily for improving the communication between different parties, rather than changing rules and principles within the social security that would bring social security treatment closer to tax.
- The shortening of the posting rule of 24 months was discussed in order to achieve better alignment with tax. However, there was no conclusion on the subject.
- An interesting question was raised about the social security coordination; is it the right approach to base the EU legislation on the coordination of social security only around the protection of rights of the workers and not employers?



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- “The contribution shopping”, however, was considered not to be a significant problem; there are some cases, but it does not seem as an issue of any considerable magnitude.
- General agreement is that the solution to a lot of practical issues connected to the social security coordination is to be found in a much better communication and information sharing. This includes the communication between institutions nationally and internationally as well as the communication between the competent institutions and employers and workers.
- The question was raised whether all Member States are ready for a European social security number and whether this would help to overcome some problems?
- The panel discussed the question of retroactive change of social security coverage. The general approach is that the correction of coverage should be made retroactively, as there is no legal basis on the EU level not to make such a change. However, the Member States have an option to conclude an agreement and not to correct the coverage of social security retroactively in order to avoid the considerable administrative burden involved with any retroactive change of social security coverage. It is up to each Member State to decide whether they want to conclude such an agreement or not. Some states are concerned that if they conclude an agreement to avoid making retroactive change of coverage, it could send a signal that wrong coverage for social security is acceptable if one can keep it from the authorities.

- Businesses are looking forward to digitalization of A1- certificates of coverage both on national level and through the electronic exchange of information in the EU. They expect that it will be more effective and faster.

Prague Workshop

The second “Tax and Social Security: EU Perspective” workshop took place at the premises of the University of Economics, Prague, on 15th November 2017. As both workshops were connected by its topic, the organizers and some of the speakers, the intention was to take the discussion a step further. The structure of the workshop was the same as in Copenhagen with the two main speeches provided by Prof. Frans Pennings and this time Mr. Albrecht Otting, former seconded national expert to the EU Commission, Directorate General for Employment, Social Affairs and Inclusion, followed by a panel discussion.

Prof. Frans Pennings kindly provided a similar speech as in the Copenhagen workshop and he introduced the topic and issues concerned. (Please, see the summary of Copenhagen workshop.)

Mr. Albrecht Otting informed about the work of the Administrative Commission in the field of social security and he provided an overview of the latest legislative developments in this area. Further, he emphasized the differences between tax and social security and he highlighted the “grey zones where both areas interact” as described in the FrEsco report from January 2015. (dtto).

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Possible conflicts occur in particular in case of tax exemptions pursuing a social purpose, earmarked taxes used to finance exclusively social security systems and where social security is financed by general taxes, which not necessarily connected to an individuals' income. In 342nd AC Meeting (March 2015), the FrSSco report was discussed. However, no further steps or follow up process was adopted. In this context, Mr. Otting also mentioned relevant judgements of the European Court of Justice (ECJ) such as cases C-279/93, Schumacker (equal treatment of EU nationals for tax purposes) and Case C-623/13, de Ruyter (tax earmarked for the financing of social security).

The Commission considered legislative amendments after de Ruyter ruling aimed at clarifying the differences between taxes and social security contributions, but this idea was discarded later as no definite clear distinction between taxes and social security contribution could be made. Mr. Otting further presented the legislative amendments proposed by the Commission in the framework of the so-called Labour mobility package from 2016 (3). He emphasized the balanced approach pursued by the package taking into account both the right to free movement and the prevention of social dumping fraud and abuse. Finally, he introduced the latest developments in Electronic Exchange of Social Security Information (EESSI) that must be implemented in all Member States by summer 2019.

The electronic exchange of information on social security, including A1 certificates on social security coverage, is expected to improve significantly the efficiency of case handling in the Member States as well as the cooperation between the administrations and to minimize fraud and error in the area of social security.

The workshop moved to a panel discussion with the participation from: Prof. Prans Pennings, Albrecht Otting, Daida Hadzic, Director in KPMG Acor Tax, Gabriela Vokněrová, Manager in KPMG CZ, Vít Holubec, the Czech Ministry of Labour and Social Affairs, Daniel Krempa, CEE HR Business Partner at Generali CEE Holding B.V. The panel discussion was moderated by Jana Tepperová, University of Economics, Prague.

Following the discussion in Copenhagen, the panelists were provided with the following questions:

- Is a different treatment of personal income tax and social security a problem (for states, employers, individuals)?
- If it is a problem, where/when do the main problems arise? What are the possible solutions?
- Should coordination rules for personal income tax (Double tax treaties) and for social security (EU Regulations) be unified to overcome the differences? In the affirmative, to what extent?

(3) <http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-labour/package-labour-mobility-package>

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- Do the ECJ's decisions help (or might help) to overcome the differences?
- Should systems of personal income tax and social security be harmonized on national level, as this might reduce the differences in cross-border situations.
- If harmonization is the way to go, should the states focus more on taxation (more like Denmark) or separate financing from tax and social security contribution (more like the Czech Republic)?

The discussion confirmed the complexity of the issue and the fact that there are no clear and obvious solutions.

- The panelists agreed that the mismatches between coordination of tax and social security together with different national systems may create problematic situations with undesirable consequences, especially if the national systems concerned differ considerably as regards the rates and setup of levies (taxes and social security contributions).
- Problems arise when tax is paid in one Member State and social security contribution in another Member State. However, employers will adjust their assignment policies accordingly and consider administration process related to cross-border employment as the main obstacle in this connection. Alignments of some aspects of coordination of tax and social security would not provide a significant reduction of differences. What is therefore needed is a better communication among all stakeholders.

- The panelists discussed an alignment of rules for short-term assignment (so called posting rule). Would an alignment of the 2 years posting rule in social security and 183 days taxation rule make a positive difference?
 - It was concluded that both rules have their own underlying reason. The 183 days in taxation is considered to be too short for social security, and 2 years are considered to be too long for tax purposes. Therefore, a compromise of 1 year for both was not considered to be suitable.
- Necessity of better communication was emphasized several times during the discussion, not only the communication of institutions involved with the employers and migrating individuals, but also the communication between the tax and social security administrations on the conceptual level. Such cross-sectional discussion of experts within tax and social security should be promoted systematically.
- Local institutions might sometimes struggle with the application of the international rules as some branches deal with cross-border cases on very rare basis and the staff lacks practical experience with such situations. Foreign employers are often subject to complex administrative procedures related to the payments of contributions since they have to register with a foreign social security scheme and follow administrative rules which are different from those which apply in their State of establishment.

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- Member States often apply different interpretations of the rules stated in the EU Regulation, for example when calculating 25% of work for assessing a substantial activity.
- harmonization of national legislations in both social security and personal income tax across Europe could be a theoretical solution to the problem of cross-border situation when a person is covered by taxation in one country and social security in another country. However, it is hard to see that harmonization of tax and social security systems across all Member states has any chance of realization in a foreseeable future.

During both workshops, it was concluded that the discussion of interaction of both tax and social security is very important. The problems arising from mismatches of tax and social security can be significant and should be given attention and priority. However, as any conceptual solution in this matter would require significant and complex changes, a discussion of possible solutions does not take place and is replaced by a discussion of more obvious issues at hand that each of the system of tax and social security faces on its own. It can be concluded that within the current setting a better and efficient administration, communication and knowledge sharing would be a way to minimize, at least to some extent, undesirable outcomes of the mismatches between the two systems.

A fundamental arrangement overcoming the differences in long term would require complex legislative changes in both systems. Further analysis and continuing discussion across the two disciplines is therefore needed to find strategic solutions which are fit for the purpose.

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