

GMS Flash Alert

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Germany-Luxembourg – Tax Treaty Changes with Important Impact for Cross-Border Workers

In July 2023, Luxembourg and Germany concluded an amending Protocol to the Germany-Luxembourg tax treaty (hereinafter ‘amended DTT’),¹ which is applicable as of 1 January 2024. Among other topics, this Protocol includes new regulations and clarifications for cross-border workers. In addition, a new consultation agreement between Germany and Luxembourg was concluded on 11 January 2024, which is intended to clarify these new regulations.²

This *GMS Flash Alert* explains some of the key changes for cross-border workers – especially for those resident in Germany with an employer located in Luxembourg.

WHY THIS MATTERS

Many clarifications to the amended DTT were previously only available in the form of consultation agreements. This was particularly problematic from a German perspective, as consultation agreements are not binding for German tax courts. The inclusion and extension of certain provisions in the DTT text or the protocol to the DTT create legal certainty from a German perspective, which should aid tax practitioners, employers, and their cross-border workers in terms of planning and fostering compliance. The amended DTT also includes new regulations to mitigate double taxation, which will have direct impact on income from employment of cross-border workers.

1. The “Tolerance Threshold”

According to the new provision included in Article 14 para. 1a of the amended DTT, remuneration received by an employee resident in one state for work carried out in his home country or in third countries may only be taxed in the other contracting state if the work is carried out in whole or in part in the home country or in one or more third countries for fewer than 35 working days per calendar year.

In the past this “tolerance threshold” was 19 days. The regulation was previously also not anchored in the DTT but only in a consultation agreement.³

Example

A cross-border worker living in Germany works for a Luxembourg company. The Luxembourg company pays and bears the cross-border worker's salary. He works 200 days per calendar year at the Luxembourg employer's office, 15 days in his home office in Germany and another five days on business trips to various third countries.

As the employee works for less than 35 days in the calendar year in the country of residence, Germany, and in various third countries, Art. 14 (1a) of the amended DTT assigns the right to tax the entire annual salary to Luxembourg. Germany avoids double taxation in accordance with Art. 22 (1)(a) of the amended DTT by exempting the salary from German taxation (it is only considered for the determination of the German tax rate – so-called “progression clause”).

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According to Section 9 of the Protocol to the amended DTT, a working day within the meaning of this provision is deemed to exist if the employee works in this state for at least 30 minutes. For the correct application of this regulation, it is important to know which days count as full working days and whether the “tolerance threshold” can be reduced proportionately in certain cases. The new consultation agreement dated 11 January 2024, contains more detailed information on these issues in section III.

2. Avoidance of Double Taxation

Normally, for a taxpayer resident in Germany, double taxation of employment income for which the DTT assigns the right of taxation to Luxembourg is avoided by the so-called “exemption method.” According to Art. 22 (1) (e) of the amended DTT, this does not apply if the other contracting state applies the paragraph in such a way that this income is exempt from tax. In certain cases, the right of taxation reverts to Germany and the Luxembourg tax is credited. According to Art. 22 (1) (f) of the amended DTT, this should be the case if Luxembourg is entitled to tax income or assets under the DTT but does not actually tax them.

This subject-to-tax clause is applied if the income was not “effectively taxed” in Luxembourg. This term is described in more detail in point VII of the consultation agreement dated 11 January 2024. It specifies that:

- income or items of income are deemed to be effectively taxed when such income or assets form part of the total amount of income or assets on the basis of which the tax is calculated in the state of source of the income;
- income or items of income are also deemed to be effectively taxed if they are only partially taxed or not taxed at all due to the application of an allowance, income-related expenses, or losses carried forward;
- the wage supplements paid for work performed at night, on Sundays, and public holidays paid in addition to the basic gross wage are also deemed to be actually taxed, provided that they do not exceed the basic gross wage in a calendar year;
- the following income items are not deemed to be actually taxed in Luxembourg:
 - income not in scope of the Luxembourg Income Tax Law, such as lottery gains, and
 - wages and supplements paid for overtime worked by the employee, which are completely exempt from Luxembourg income tax.

In such a case, Germany would retain the right to tax this income according to the subject-to-tax clause mentioned above, and would mitigate double taxation, if any, based on the tax credit method.

Example

A cross-border worker resident in Germany who works for an employer based in Luxembourg receives a total of EUR 5,000 tax-free in 2024 for overtime worked in Luxembourg. Considering this income would be fully tax exempt in Luxembourg, the right of taxation would revert to Germany in accordance with the subject-to-tax clause.

In this case, the employee would have to declare the EUR 5,000 overtime pay in her 2024 German income tax return. The remaining salary subject to taxation in Luxembourg would be exempt from German tax but would be taken into account to determine the applicable German tax rate (so-called “progression clause”). This ultimately means that even if the overtime remuneration is below the German basic tax-free allowance, there could be a tax burden in Germany due to the progression clause.

As far as the German taxable income basis is concerned, an annual employee allowance of EUR 1,230 in 2024 (“Arbeitnehmer-Pauschbetrag”) would be deductible from the overtime income, meaning that the remuneration for overtime work would be exempt from personal tax in Germany to the extent the overtime income would not exceed the annual employee allowance and if no other employment income was taxable in Germany. (Note that the individual may also claim other standard or itemised deductions in the tax return (e.g., donations, private health insurance contributions, etc.), which could further reduce the taxpayer’s German taxable basis.)

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These regulations deserve a recommended case-by-case tax check considering the variety of situations that can occur.

With regard to the “tolerance threshold,” whether the period of 34 days is exceeded must be monitored exactly. If the limit is exceeded, the corresponding salary will be subject to tax in the home country of the employee.

A German resident employee must be aware that his/her overtime remuneration paid tax-free in Luxembourg will be subject to tax in his/her personal German income tax return. The part of his/her salary taxable in Luxembourg according to the DTT must be determined when calculating the German tax rate. Other salary components that can be paid tax-free in full or in part under Luxembourg law must also be carefully reviewed in light of this regulation.

For Luxembourg-based employers, it is recommended they monitor this overtime application, and inform the potentially-exposed workers of this reality – and of course consult in case of doubt or questions.

The consultation agreement is also intended to have retroactive effect in certain areas for cases that are still open or subject to a mutual agreement. Some German tax authorities want to retroactively apply the right of taxation for overtime remuneration exempt from tax in Luxembourg so that it applies to periods before 2024. Each situation should therefore be carefully examined to determine whether it is possible to apply the subject-to-tax clause before 1 January 2024.

FOOTNOTES:

1 For the text of the Luxembourg law* ratifying the Protocol to the Treaty and the text of the Protocol/Treaty, see: <https://wdocs-pub.chd.lu/docs/exped/0142/099/284992.pdf>.

For the text of the German law** ratifying the Protocol to the Treaty and the text of the Protocol/Treaty, see: <https://www.recht.bund.de/bgbl/2/2023/334/VO.html?nn=55640>.

* *Projet de loi portant approbation de l'Avenant modifiant la Convention du 23 avril 2012 entre le Grand-Duché de Luxembourg et la République fédérale d'Allemagne tendant à éviter les doubles impositions et à prévenir la fraude fiscale en matière d'impôts sur le revenu et sur la fortune, et le Protocole y relatif, fait à Berlin, le 6 juillet 2023.*

** *Gesetz zu dem Protokoll vom 6. Juli 2023 zur Änderung des Abkommens vom 23. April 2012 zwischen der Bundesrepublik Deutschland und dem Großherzogtum Luxemburg zur Vermeidung der Doppelbesteuerung Verhinderung der Steuerhinterziehung auf dem Gebiet der Steuern vom Einkommen und vom Vermögen (Deutsch-luxemburgisches Steuerabkommen) vom 08. December 2023, BgBl. II 2023, 334.*

2 BMF-Schreiben vom 15.01.2024, Gz: IV B 3 – S 1301 – LUX/23/10001:001, DOK 2024/0031769_and by the Luxembourg tax circular ([Circulaire du directeur des contributions](#) L.G. - Conv. D.I. n° 71 du 18 mars 2024).

3 BMF vom 14.04.2011, Gz: IV B 3 – S 1301 – LUX/10/10003, DOK 2011/0440238.

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