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Refusal to deduct French social security contributions not compatible with EU law

The German refusal of a deduction for social security contributions paid by a German resident French government official does not meet the EU-requirement for free movement of workers, since its effective exclusion under German law placed her at a comparative disadvantage vis-à-vis her German colleague.

A French tax official (appellant) lived in Germany with her German civil service husband. Under the terms of the double tax treaty, her salary was excluded from German taxation, but taken into account when establishing the rate to be applied to the rest of the couple's income (principally the husband's pay and allowances). However, the German tax office refused to take the French social security contributions into account – as a deduction because they were directly connected with tax-free income and in the rate calculation (special tax rate) because they were in the nature of a personal relief rather than a cost of earning income. The net result was that the contributions at issue were unrelieved in Germany, whereas a full deduction would have been available had the same amounts been paid under a German scheme. The ECJ now held that this is indeed a discrimination and in violation of Article 45 of the Treaty on the Functioning of the European Union (TFEU).

The refusal to calculate the special tax rate without deducting the social security contribution might discourage resident workers from looking for or accepting employment in another Member State. Such restriction under Article 45 TFEU would only be permissible if it related to a situation which is not objectively comparable or if it is justified by an overriding reason in the public interest. Both alternatives do not apply in the case at hand. The appellant and her husband were taxed jointly and thus Germany would be in position to grant her the advantages resulting from her personal or family circumstances, despite the fact that the appellant did not have a significant German source income. That puts her in a situation comparable to that of a resident taxpayer receiving income in his State of residence.

Moreover, the restriction can also not be justified by overriding reasons in the public interest. The German government had argued that the refusal to allow the deduction is justified to secure a balanced allocation of the power of taxation between Germany and France and the consistency of the national tax system. The ECJ objected. First, the right of taxation in this instance is clearly and specifically dealt with in the double tax treaty concluded between France and Germany (taxation of salaries and wages in the country of source on the one hand and corresponding tax exemption in the country of residence, without limiting the right – in this instance - of Germany to take the exempt income into account in setting the rate to be applied to the couple's other income). This leads the ECJ to conclude that, whilst Germany agreed in the double tax treaty that income received in France is solely taxed in that State, it cannot now assert that the disadvantage arising from the refusal to deduct the social security contributions is offset by the fact that that income is not taxed in Germany. Such an argument would, according to the ECJ, undermine the allocation of powers of taxation freely agreed by Germany in the double tax treaty.

The ECJ case reference is C-20/16 *Bechtel* judgment of June 22, 2017

Keywords

free movement of workers, social security contributions, special tax rate