Article

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Tax or social security contribution, a world of difference?

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Abstract: Cross-border employees and self-employed workers are confronted with the regulations of at least two states when it comes to taxation and social security. Without delving into the specifics of national regulations, this article examines the applicable rules concerning the levy of taxes and social security contributions in the context of cross-border employment. Regulations aimed at avoiding double taxation are different from those aimed at avoiding the double payment of social security contributions. Because social security in the Member States can be financed in different ways, the levying of so-called economic double taxation is possible. This is true in particular where states use a large part of the tax revenues to finance their social security system. Cross-border workers that are required to pay taxes in these states and also pay social security contributions in another state can feel that they are paying double social security contributions. This contributes to a sense of injustice and is undesirable. The conclusion is that possible double economic contributions must be studied in a broader European context. First, the problem must be identified and then solutions formulated in order to prevent double levying.

Keywords: cross-border workers; international taxation; social security contributions; financing

1 Introduction

A person engaging in cross-border employment activity is confronted with taxation and social security in two or more states. In both areas of law,[1] conflict of law rules are applicable. In the area of tax law, double taxation treaties are available. A multilateral treaty deserves mention in this regard as well, the Convention between the Nordic Countries for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (1996) (Nordic Convention).[2] The Nordic countries include Denmark, the Faroe Islands, Finland, Iceland, Norway and Sweden. With respect to social security in Europe, Regulation No. 883/2004[3] and Implementing Regulation No. 987/2009[4] are applicable; this is applicable also to Denmark, Finland and Sweden, which are EU Member States. Since 1 June 2012, the regulations are also applicable to Iceland and Norway, which are EFTA-countries. I limit myself here to the collection of social security contributions and do not treat the issue of social security benefits payment. A separate Nordic Convention on Social Security (2012) applies with respect to social security.[5] Comments related to the Nordic Convention will be made below where relevant. In short, applicable conflict of law rules work as follows.

In general, the work state is authorized to levy taxes pursuant to Article 15 of the OECD Model Convention concerning cross-border workers, providing the requirements set out in Article 15, para. 2 have been met. I will not treat these requirements further, but I will point out that pursuant to the Nordic Convention a resident of Finland, Sweden or Norway is subject to a residency state taxation

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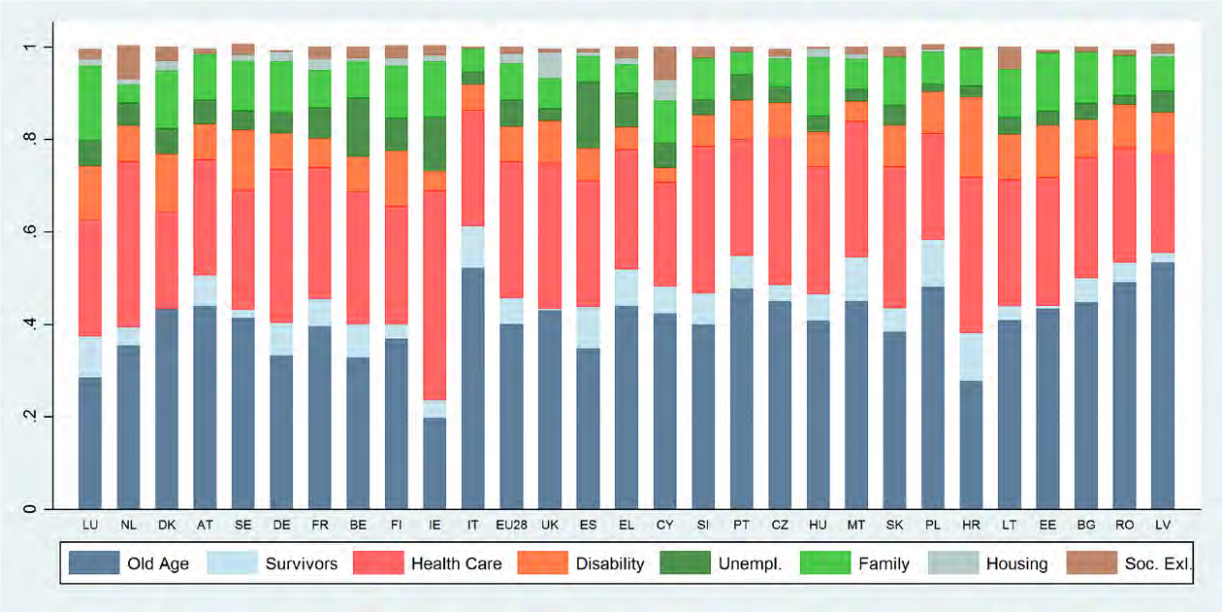
1 Also, for the applicable labor law there are conflict rules, see for example, Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ 177, p. 109.

2 The Convention was signed on 23 September 1996 and entered into force on 11 May 1997. It is based on the OECD Model Convention but has some differences. See Marjaana Helminen, Scope and Interpretation of the Nordic Multilateral Double Taxation Convention, Bulletin for International Taxation 2007, (Volume 61), No. 1, p. 23.

3 Regulation (EC) No. 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems, OJ L 166, p. 1, last amended by Regulation (EC) No. 2017/492, OJ L 76, p. 13.

4 Regulation (EC) No. 987/2009 of the European Parliament and of the Council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No. 883/2004 on the coordination of social security systems, OJ, L 284, p. 1, last amended by Regulation (EC) No. 2017/492, OJ L 76, p. 13.

5 The Convention entered into force on 1 May 2014 (Denmark, Finland, Iceland, Norway, Sweden) and on 1 May 2015 (Faroe Islands and Greenland).



Source: Eurostat ESSPROS. Sorted by total social protection spending (in PPS) per inhabitant.

Figure 1: Allocation of social protection benefits across functions (2011)

for cross-border activities, on condition that the worker is present in the state of residence on a regular basis. This also applies to public officials. "Regular presence" is understood to mean that the person is present at least one time per week for a period of at least two days. "Day" is understood to mean a part of a day.[6] For self-employed cross-border workers, Article 7 of the OECD Model Convention applies: taxation in the state of residence, unless one has a permanent presence in the other state.

With respect to social security in the European context, the main rule of Article 11, para. 1 of EU Regulation No. 883/2004 applies: exclusive allocation to the work state. This is the "lex loci laboris" principle and applies to both employees and self-employed workers.[7]

At first, blush taxation and social security contribution collection would seem to constitute two separate areas of law, each of them having its own rules. But if the manner of financing in these areas is taken into consideration, the areas can be seen to be more connected to each other. This is the case, for example, if social security is financed through tax revenues. In a purely domestic situation, in which a person both resides and works in the same state, this does not lead to significant problems. The Netherlands can be taken as an example. Social security contribution levies in the Netherlands consist of social security premiums, employment insurance premiums and the income-dependent Health Insurance Act (Zwv) contribution.[8] The rates of wage and income taxes and the rate of the public health insurance contributions often function as communicating vessels. In general, if the tax rates of the first income tax bracket rise, the contribution levels for public health insurance drop, and vice-versa.[9]

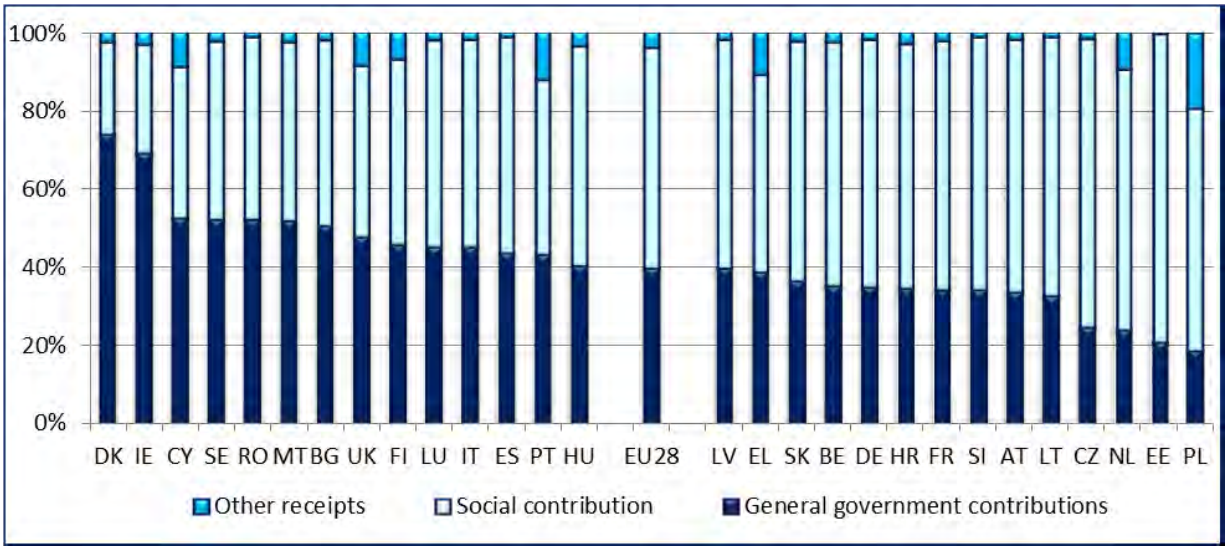
In practice, the cross-border worker can feel subjected to double taxation. In a number of countries, social security is financed to a large extent from tax revenues. See, for example, the differences between Sweden and Denmark. In Sweden, a large part of the social welfare system is funded and provided for at county level; Sweden also levies social security contributions at a high rate, while in Denmark, the system relies much more heavily on financ-

6 See Protocol, to the 1996 Treaty (1997), VI. With references to Articles 15 and 19, which entered into force on 31 December 1997.

7 The rules concerning the posting of workers and deployment of work activity in two or more Member States are not treated in this article. See Articles 12 and 13 of Regulation No. 883/2004 and Article 14 of Regulation No. 987/2009.

8 Zvw is the Dutch Health Care Act (Zorgverzekeringswet) and concerns a Regulation for the Provision of Medical Care (Regeling inzake de gevolgen van behoefte aan geneeskundige zorg), Stb. (trans: Law Gazette) 2005, 358, last amended by Stb. 2017, 146.

9 See also Sverre Hveding and Finn Backer- Grøndahl, who describe the international consequences of increased social security contributions payable by employers in Norway in 2002. Sverre Hveding and Finn Backer- Grøndahl, The Concept of Residence for Tax Purposes in Norway, Bulletin for International Taxation 2002, (Volume 56), No. 8, p. 436.



Source: Eurostat, ESSPROS.

Figure 2: The structure of social protection financing by type of receipt (2011)

ing through taxation.[10] Where social security is financed to a relatively small extent through general tax revenues, no major problems are likely to ensue. An example in the Netherlands is the General Child Allowance Act (Algemene Kinderbijslagwet), which is financed by tax revenues. But financing a large portion of social security benefits via general tax levies can lead the cross-border workers to feel that they are being forced to make double social security contributions without being able to take advantage of the social security laws of the State imposing the payment contribution.

It is in this way that the cross-border workers can be confronted with divergent social security systems. In this connection, the following figure regarding the allocation of resources across social protection functions is interesting. Social protection arrangements in the EU differ considerably with respect to the allocation of resources within the systems. Figure 1 maps the distribution of benefits across the social protection functions in 2011.[11]

In this article, first a global description will be given of the ways in which social security can be financed; through social security contributions and/or general means. A decision of the Netherlands Supreme Court (Hoge Raad) will be used to illustrate the problem of financing social security through general taxation in respect of an Australian civil service pension. This will be followed by a brief description of the Dutch rules applicable in cases involving cross-border employment, bringing into relief the differences between social security and tax law. The view of the Dutch Supreme Court regarding the concept of tax as compared to Australia as well as the vision of the European Court of Justice will follow. What applies with respect to Australia is also the case in some of the Scandinavian countries that also finance their social security systems via general tax levies. This article will close with a conclusion which includes a recommendation.

2 Ways of financing social security

As noted above, the way social security is financed plays an important role in the discussion concerning possible double social security contribution. Financing via taxation applies in particular to some Scandinavian countries. This is reflected in figure 2 and 3.[12]

Large portions of the social security systems of Denmark and Sweden are financed by general government

10 Mattias Dahlberg and Ali Sina Önder, Taxation of Cross-Border Employment Income and Tax Revenue Sharing in the Öresund Region, Bulletin for International Taxation 2015, (Volume 69), No. 1. p. 31.

11 Social protection systems in the EU: financing arrangements and the effectiveness and efficiency of resource allocation, report jointly prepared by the Social Protection Committee and the European Commission Services 2015, p. 30.

12 Social protection systems in the EU: the financing arrangements and the effectiveness and efficiency of resource allocation, report jointly prepared by the Social Protection Committee and the European Commission Services 2015, p. 9 and 108.

Source: Calculations of the Social Protection Committee and European Commission Services. Note: 2000 data for EU-27, BG and HR - not available

Figure 3: The changes in the structure of social protection financing (pp differences, 2000-2011)

contributions. A problem arises in cases where the right to levy taxes is allocated to Denmark or Sweden and the obligation to provide social security to a State other than Denmark or Sweden, creating a sense that (former) cross-border workers pay social security contributions twice. Suppose, for example, that a (former) cross-border worker resides in State A. This worker is required to pay taxes in that state but also pays social security contributions in State B. State A has a high tax rate and a portion of the income tax revenues is used for financing the social security system of that state. The (former) cross-border worker senses that he is paying twice for social security.

Before going into the possible differences between the concepts of tax and social security contribution below, I note that the financing of social security via taxation raises the issue of how to characterize a levy. Recently, the European Commission asked Denmark and Sweden, for example, questions about the nature of certain tax levies. In the case of Denmark, the inquiry concerned a so-called labor market contribution (8%). One of the Commission's questions was that if the contribution was considered a tax, why not raise the tax on income. Denmark responded that a general increase in the income tax would have negative effects on persons with low incomes as well as on the labor market. Social security benefits are calculated based on sums that are not subjected to the labor market contribution. The levy has to be viewed as a tax and not as a social security premium, argued the Danish government.[13]

At issue in the Swedish situation was the levy of a particular tax in the event of a non-resident earned income in Sweden through so-called "passive entrepreneurial activity," such as the receipt of royalties. Whether such a person is covered by and thereby entitled to benefit from the Swedish social security laws or not is irrelevant. The Commission questioned whether this conflicted with EU Regulation No. 883/2004 and the free movement of services (Art. 56 VWEU). Sweden has a special income/wage tax

13 Memorandum, File No 2012-339-0029, 16 May 2012.

law.[14] Sweden answered that the tax could not be characterized as a social security contribution under EU Regulation No. 883/2004 because the tax gives no right to claim social security benefits. The tax was introduced in order to create a neutral levy on income derived from lucrative activities, comparable to a Value Added Tax (VAT). [15]

The fact that national law characterizes a levy as a tax[16] does not mean, however, that the tax cannot be considered to come within the scope of the European law concerning the coordination of social security systems, whereby the rule of non-aggregation of relevant laws would not be applicable to the tax. In this regard, the European Court of Justice has ruled that the national social security schemes in their entirety are subject to the application of the rules of the European Union transnational coordination law. Here, the determining factor is the direct and sufficiently relevant coherence that a particular provision tax provision has to demonstrate with the laws that fall under the material scope of EU Regulation No. 1408/71 and now EU Regulation No. 883/2004.[17] In other words, the way in which a social security system is financed is irrelevant for the application of the regulation.[18] Paragraph 40 of the ECJ decision, Commission v. France is relevant here: "for the purposes of the application of Article 13 of Regulation No. 1408/71, the decisive criterion is that of the specific allocation of a contribution to the funding of the social security scheme of a Member State. Whether benefits are obtained or not in return is therefore irrelevant in this connection."[19]

3 Judgment Netherlands Supreme Court (Hoge Raad) concerning an Australian pension

3.1 Case[20]

The Netherlands Supreme Court handed down an interesting judgment on April 22, 2016, which aptly illustrates the problem of financing.[21] This case, concerning a resident of the Netherlands who is entitled to an Australian pension, can also apply to the Dutch residents in relation to the Scandinavian countries. The Supreme Court ruled that the Australian civil service pension enjoyed in 2009 by a resident of the Netherlands with both Dutch and Australian citizenship, was rightly subjected to the levy of the Dutch social security contributions. This pension was the only income for that year and was accrued during the government employment in Australia. The pension is taxed in Australia. The social security scheme in Australia is financed from the general tax revenues. The question before the Supreme Court was whether the Australian civil service pension was correctly subjected to the levy of the Dutch social security contributions. The pension was implicitly involved in financing the Australian social security via the Australian tax system. For the party concerned, this caused the sense that he was being doubly taxed for a single activity. In essence, the question was whether a substantive or a formal definition of tax should be used in such a situation. The Supreme Court applied a formal definition. This raises the question whether in a cross-border situation, a substantive definition of the concept of tax should be used.

3.2 Applicable Dutch law

A number of regulations can be brought to bear on the situation of a Dutch national insured via a foreign tax levy, in this case Australia, who thereby contributes to a foreign social security scheme. In the first place, the bilateral tax treaty between the Netherlands and Australia and

14 In Swedish: Lag om särskild löneskatt på vissa förvärvsinkomster (1990:654).

15 See also Björn Westberg, Sweden, European Taxation 2001, (Volume 41), No. 13, p. 67-S: the Swedish general salary levy was introduced in order to finance EU membership and is considered as tax.

16 See, *e.g.*, the decision Derouin, ECJ 3 April 2008, Case C-103/06, ECLI:EU:C:2008:185, NTFR 2008/757, with note by J.C.L.M. Fijen, RSV 2008/181.

17 Decisions Commission v France, ECJ 15 February 2000, Case C-34/98, ECLI:EU:C:2000:84, ECR 2000, p. I-00995, para. 36 and 37, and Commission v. France, ECJ 15 February 2000, Case C-169/98, ECLI:EU:C:2000:85, *V-N* 2000/36.18, ECR 2000, p. I-1052, para. 34 and 35. See also the decision De Ruyter, ECJ 26 February 2015, Case C-623/13, ECLI:EU:C:2015:123, NJ 2015/317, and note by B. Barentsen and decision in Hoogstad, ECJ 26 October 2016, Case C-269/15, ECLI:EU:C:2016:802.

18 See also the opinion of the European Commission concerning a special income tax law, Question from the Commission regarding the Special Wage Tax Act (EU-pilot EMPL/4625/13), 24 April 2013, R2013/1081.

19 Decision Commission v. France, ECJ EC 15 February 2000, Case C-34/98, ECLI:EU:C:2000:84, ECR 2000, p. I-00995. See further para. 7.

20 Also see M.J.G.A.M. Weerepas, Australisch pensioen in premieheffing (trans: Australian Pension in Social Security Charges), Sdu, NTFR-B 2016/32.

21 HR 22 April 2016, No. 15/03689, BNB 2016/132, with note by Kavelaars.

the social security treaty between these countries[22] are applicable. Also relevant are the Act to Finance Social Insurance (Wet financiering sociale verzekeringen, abbreviated as Wfsv), the Decision to Expand and Limit Recipients of Social Protection Insurance 1999 (Besluit uitbreiding en beperking kring verzekerden volksverzekeringen 1999, hereafter: KB 746) and then Article 2.3 of Regulation Wfsv and Article 5.6 of Regulation Zvw. None of these regulations turn out to successfully prevent the Australian pension from being subject to the levy of Dutch social security contributions. The pension was taxed in Australia pursuant to Article 19 of the Netherlands-Australia Tax Treaty. This rule follows the general rule laid down in the OECD Model Convention, application of the so-called paying state principle. So far, there is nothing new under the sun.

The Arnhem-Leeuwarden Court of Appeals[23] ruled that the tax treaty was not applicable to the case because the levy of social security contributions cannot be characterized as taxation, and social insurance contributions do not fall within the scope of the tax treaty.[24] The Netherlands-Australia social security treaty is also inapplicable. An interested party comes within the personal scope of the treaty, if he satisfies its criteria: either he is or was a resident of Australia, or Dutch law is or was applicable. Noteworthy is that this treaty has no allocation provisions. Article 2, para. 7 of the social security treaty provides that the treaty does not apply to regulations concerning social and medical benefits. In other words, the Dutch social and medical benefits regulations (such as the Dutch regulations for extraordinary and long-term sickness - AWBZ/Wlz, and the Health Insurance Act – Zvw), do not fall within the scope of the treaty. This is rather remarkable. Most social security treaties do concern these regulations. Why this treaty explicitly excludes these regulations is unclear.[25]

We then turn to the national regulations concerning the avoidance of double taxation, such as KB 746, to see if they offer a different outcome. The Australian civil service pension is subject to the levy of Dutch social security contributions pursuant to Article 8 Wfsv. This provides that only long-term and extraordinary sickness (formerly AWBZ and now WLZ) contributions, and impliedly also Zwv (General Health Care Act) contributions, are owed. The Social Insurance Administration (Sociale Verzekeringsbank) provides an exemption for old-age pensions (AOW), national survivor benefits (Anw) and child allowance (AKW), but not for AWBZ (General Act for Extraordinary Illness benefits).[26] The interested party is a resident of the Netherlands and therefore required by Article 6 of the Old-age Pension Act (AOW) to be insured in the Netherlands. It is unclear what the basis of the exemption is, but it is probably Article 22 KB 746, which applies to the Dutch residents who receive a foreign statutory benefit.[27] Article 21 KB 746 does not apply because this case does not involve costs of care that have to be borne by Australia.[28]

Lastly, the method for calculating deductions that allows the amount of social security income to be deducted from the Dutch social security contribution levy, as provided by Article 2.3, part b of Regulation Wfsv and Article 5.6, part b of Regulation Wwv, could not be applied. The Court of Appeals found that no portion of the social security income was taken to pay social security in the other state on the basis of an international social security regulation between the Netherlands or another state or, an absent international regulation, any other legal basis upon which to base a social security levy in the other state. One cannot say that the tax paid in Australia is part of Australia's social security income. It is a tax and not a required social security payment. In short, no portion of the Australian tax can be viewed as a social security contribution.[29] In sum, the Court of Appeals Arnhem-Leeuwarden ruled that Australian pension is subject to the levy of Dutch social security contributions. The Supreme Court adopted the same reasoning.

22 Trb. 2001, 125 en 95. The treaty came into force and entered into effect in 1976, see Trb. 1976, 41 and was amended in 1987, see Trb. 1986, 89.

23 Hof Arnhem-Leeuwarden 30 June 2015, nr. 14/00605 and 14/00606, NTFR 2015/2213.

24 See Article 2 of the Treaty Netherlands-Australia, in which *inter alia* wage and income taxes are addressed, but not contributions.

25 Furthermore, non-residents are not required to pay for the so-called "Medicare" program. "Medicare" allows access to the Australian health care system and is partially financed by taxpayers. The contribution constitutes 2% of taxable income. See https://www.ato.gov.au/Individuals/Medicare-levy/ (August 8, 2017).

26 The exemption was not an issue, and therefore, no decision was taken concerning it.

27 Compare Kavelaars in his note on HR 22 April 2016, nr. 15/03689, BNB 2016/132.

28 See V-N 2016/27.18.

29 In addition, ruled the Court of Appeals, leving a contribution on the pension does not violate the treaty.

4 The Dutch view: formal definition of contribution

The Supreme Court held in its judgment HR 22 April 2016, no. 15/03689, BNB 2016/132, that an Australian government pension enjoyed by a Dutch resident was correctly subjected to the levy of Dutch social security contributions, despite the fact that the pension is taxed in Australia, a country that finances its social security scheme with general tax revenues. The Supreme Court employed a formal definition of social security contribution. It may be wise to continue the discussion about using a more substantive definition, due to severe consequences of the involved cross-border worker.

The Court of Appeals Arnhem-Leeuwarden also employed a formal definition of social security contribution in the above case. The Supreme Court held in cassation that when using the term "levy of social security contributions," the legislator did not have in mind the levy of taxation in a tax system partially aimed at financing social security. The Supreme Court's application of the term is formal in this sense. There is no specification of an Australian social security contribution in the amount of Australian tax levied. It is certainly true that a formal definition of social security contribution provides clarity and is a logical consequence of the applicable regulations.[30] There is much to be said for this, but it cannot be denied that this can have untoward consequences for persons, retired or not, who pay taxes in one state and are required to pay social security premiums in a different state. The Netherlands Supreme Court's decision was legally accurate, and cannot be faulted, given the judiciary's role as the interpreter of law, rather than a policy-maker or legislator. However, the decision highlights the vacuum that exists in rules regarding relief from double charges – one of income taxes, and the other of social security contributions in cross-border scenarios – and the need to explore and devise mechanisms to avoid such double charges.

The crux of the matter is that in fact a double payment obligation is imposed. If we assume that this can happen, could we not resolve the problem by recognizing a portion of the tax revenues collected as social security contributions? I agree that it may be difficult to determine which portion of the tax revenues to characterize as social security contributions, and that this will inevitably generate new discussion, but it would help to satisfy parties now having to pay double social security contributions. Before answering this question, a few considerations follow about the differences between social security law and tax law with respect to the characterization of their respective payments.

5 Differences social security law and tax law

With no intent to be exhaustive, the following important differences between social security law and tax law in the European Union can be identified. An important initial difference lies in the aim of financing. Taxes can be used for an unlimited number of provisions, including social security. Social security contributions are generally meant to finance social security benefits payments. A second difference has to do with the principles and allocation rules that underpin social security law and tax law. A person engaged in cross-border work activities should be subject to only one social security system[31] – an application of the exclusivity principle – and is subject to more than one tax system. States can determine among themselves in tax treaties to which state to allocate fiscal taxation authority with respect to particular sources of income. This is an important difference as compared to social security law, where Member States are required to apply the mandatory allocation rules of Regulation No. 883/2004. Regulation No. 883/2004 also applies to Norway, Iceland and Lichtenstein, the so-called EFTA States. As indicated above, a separate Nordic Convention on Social Security exists, which follows the principles of Regulation No. 883/2004. For countries outside of the European Union, social security treaties can also play a role where applicable. If no treaty applies, national regulation is applicable.

The allocation of the authority to levy taxes has to do with the right to levy taxes, while allocation of the obligation to provide social security has to do with the award and payment of entitlements to individuals. This makes it difficult to ensure that the systems neatly overlap. Making rules simpler is also challenging. In the area of social security, moreover, the primary concern is to be insured upon the basis of which entitlements are awarded to individu-

30 Compare Kavelaars in his note to HR 22 April 2016, no. 15/03689, BNB 2016/132. Other authors, however, are of a different mind. Schouten, for example, argues that it is not clear that a formal regulation is *per se* necessary. See the commentary on Hof Arnhem-Leeuwarden 30 June 2015, nos. 14/00605 and 14/00606, NTFR 2015/2213.

31 See Article 11, para. 1 of Regulation No. 883/2004.

als, and in the second place, the payment of social security contributions. The coordination of these entitlements is a necessary condition for promoting the free movement of workers.[32] In the case of taxation, other aims play a role, which can justifiably even hinder the free movement of workers. A third difference concerns the fact that the system of taxation, unlike social insurance law, has avoidance techniques, such as the exemption, offset and deduction for expenses. Avoidance is generally not necessary for social security contributions. After all, the levying authority is generally exclusively allocated to a single State.[33]

It is sometimes argued that in the future, social security should be financed by taxation so that more people can contribute to the payments.[34] In other words, social security should be fiscalized. Kavelaars argues that it is not a good idea to fiscalize social insurance schemes given the different allocation rules in taxation and social security in cross-border situations.[35] He is also of the opinion that uniformity between both systems is virtually impossible to achieve. In his view, this is in particular the case of workers who are active, also retired, in more than one Member State.[36]

I subscribe to this view, especially with respect to long-term payments, the various allocation rules should be maintained. But that does not change the fact that a number of states have systems funded almost entirely by tax revenues. The question arises whether contribution systems should not be introduced, or in some cases, reintroduced?

6 Characterization of payments: social security contributions or taxes?

As has been demonstrated, how a Member State financing its system of social security contributes to the complexity of cross-border work movement. It is sometimes difficult to determine whether one is dealing with a tax or with a social security contribution.[37] Distinguishing between the two is especially important for determining which regulation is applicable. For the purpose of avoiding double taxation a tax treaty or national regulations often apply, while Regulation No. 883/2004 is applicable for allocating the exclusive obligation to provide social security. Payment of a social security contribution often obligates a counterperformance, namely the right to claim benefits in the event the insured event occurs.[38] The discussion about tax and contribution can be seen in the light of today's reality. The Social Protection Committee and the European Commission Services report in a study that today we face a scarcity of public resources, a shrinking employment market and that social cohesion is showing signs of division. In this sense, social policy needs to be more effective and efficient.[39]

But what falls within the concept of "tax" and what comes under "social security contribution"? Article 2 of the OECD Model Convention describes the taxes to which the convention applies. Social security contributions do not belong to the taxes that fall within the ambit of the Model Convention, according to Paragraph 3 of the Commentary on Article 2 of the Model Convention. "Social se-

32 See Preamble Regulation No. 883/2004.

33 I refer to the social security contribution deduction available in the Netherlands pursuant to Article 2.3 Regeling Wfsv. Under certain conditions, foreign income can be exempted by which the social security contribution income is lowered.

34 See, *e.g.*, L.G.M. Stevens, Vereenvoudiging en herstructurering Wet IB 2001 (trans: Simplification and restructuring Law IB 2001), Weekblad fiscaal recht 2010/744.

35 See Kavelaars in his note to HR 22 April 2016, no. 15/03689, BNB 2016/132.

36 P. Kavelaars, Toewijzingsregels in het internationaal fiscaal en sociaal verzekeringsrecht (trans: Allocation rules in international taxation and social security law), Fiscale monografieën, No. 108, Deventer: Kluwer 2003, p. 24 and chapter 9.

37 In a report by FreSsco a social security contribution is described as follows: "A levy which is meant to finance a social security benefit which forms part of that list. For present purposes, taxes involve any other levies which are not directly and specifically meant to finance one of the listed benefits" (read: as specified in Article 3 of Regulation No. 883/2004, MW). B. Spiegel (ed.), Analytical report 2014, The relationship between social security coordination and taxation law, FreSsco January 2015, p. 10.

38 Social protection systems in the EU: financing arrangements and the effectiveness and efficiency of resource allocation, report jointly prepared by the Social Protection Committee and the European Commission Services 2015, p. 25.

39 Social protection systems in the EU: financing arrangements and the effectiveness and efficiency of resource allocation, report jointly prepared by the Social Protection Committee and the European Commission Services 2015, p. 83. For an overview of all contributions owed by employers and employees in the Member States, the report refers to http://ec.europa.eu/taxation_customs/tedb/taxSearch.html, (July 31, 2017).

curity 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". [40]Discussion on interpretation of this commentary can be found in the literature. An argument that supports characterizing a social security contribution as a tax, and as such covered by, a tax treaty, is that payroll taxes come within the scope of the Model Convention. In some States, the payroll taxes are nothing more than a vehicle for financing social security benefits.[41] States are allowed to bring certain levies within the reach of article 2 of a tax treaty. An example is Brazil that in a protocol to certain tax treaties, namely the tax treaties with Belgium, Portugal, Trinidad and Tobago, and Turkey, expressly recognizes that a social security contribution (CSLL[42]) is covered by Article 2.[43]

Compare in this regard also Article 2 of the Nordic Convention. Taxation that comes within the scope of the Convention are, for example, state income taxes, corporate taxes, municipal income taxes, church taxes and wealth taxes. Value added taxes, transfer taxes, real estate taxes and inheritance and gift taxes are not covered by the Nordic Convention. Social security contributions also fall outside the scope of the Nordic Convention.[44]

As indicated above, social security contributions in the Netherlands are in principle divided into national insurance and employee insurance. National insurance contributions are collected along with tax levies by the Tax Service (Belastingdienst). This in itself does not turn the contribution into a tax.[45] Given the difference in applicable regulation, an important question is if the payments made by the employee and/or employer must be seen as a social security contribution or as a tax.

Without going into the definition discussion of what a tax is at length, I give only a brief reflection on the concept "tax," in the Dutch literature, in which it appears that the difference between tax and contribution is not entirely clear. A commission set up in 1990 by the Dutch Association for the Study of Taxation declared that all social security contributions are in a legal sense taxes. This does not deny the special nature of contributions. The Commission made a distinction between contribution and benefit; on the contribution side, the character of a tax is dominant, and on the benefit side, the insurance element prevails.[46] The Commission formulated the concept of taxation in legal terms as payments levied with compulsion and pursuant to general rules, based on public law regulation exclusively for the purpose of collecting income, and otherwise on the basis of private law contracts.[47] Niessen maintains a similarly widened tax definition.[48] He argues that social security contributions are really earmarked taxes; they serve to finance the benefits payments to others. This applies to a lesser degree to employee insurance; while there is an exchange relationship between contribution and claim to an insurance benefit, these contributions can nonetheless be more fittingly designated as taxation.[49] A counterargument to the position that social security contributions are really earmarked taxes is that while contributions for national health insurance finance payments to others, a condition for entitlement to Old-age pension (AOW) benefits is a requirement to be or have been insured. Vording argues that the differences between social security contributions and taxes are partially attributable to historical reasons and are therefore more or less based on coin-

40 Deciding whether or not the social security contributions and taxes that finance social security are included in the scope of an income tax treaty is not easy, argued Martin Jiménez. Adolfo J. Martín 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, Bulletin for International Taxation 2005 (Volume 59), No. 10, p. 436.

41 See Adolfo J. Martín 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, Bulletin for International Taxation 2005 (Volume 59), No. 10, p. 433.

42 Contribuição social sobre o lucro liquido.

43 João Francisco Blanco and Ramon Tomazela Santos, The Social Contribution on Net Profits and the Substantive Scope of Brazilian Tax Treaties – Treaty Override or Legislative Interpretation?, Bulletin for International Taxation 2016, (Volume 70), No. 9, par. 5.5.

44 See Marjaana Helminen, Scope and Interpretation of the Nordic Multilateral Double Taxation Convention, Bulletin for International Taxation 2007, (Volume 61), No. 1 , p. 25.

45 See Hof Amsterdam 4 August 1993, no. 92/3667, V-N 1994, p. 695.

46 Rapport van de Commissie ter bestudering van het begrip 'belastingen' (trans: Report of the Commission to Study the Concept of "Taxes"), Geschriften van de Vereniging voor Belastingwetenschap, No. 184, Deventer: Kluwer 1990, p. 45.

47 Rapport van de Commissie ter bestudering van het begrip "belastingen", Geschriften van de Vereniging voor Belastingwetenschap, No. 184, Deventer: Kluwer 1990, p. 63.

48 H.J. Hofstra, edited by R.E.C.M. Niessen, Inleiding tot het Nederlands belastingrecht, Fiscale studie- en handboeken, Deventer: Kluwer 2010, p. 40.

49 H.J. Hofstra, edited by R.E.C.M. Niessen, Inleiding tot het Nederlands belastingrecht, Fiscale studie- en handboeken, Deventer: Kluwer 2010, p. 41. The earlier-mentioned Commission claims that with respect to national insurance there was never an equal exchange between premiums paid and benefits paid. Rapport van de Commissie ter bestudering van het begrip "belastingen", Geschriften van de Vereniging voor Belastingwetenschap, nr. 184, Deventer: Kluwer 1990, p. 35.

cidence. The choice for social security contributions is arguably an attempt to give employees a feeling of "ownership" and responsibility for the contributions. Considering that a social insurance contribution is generally required, it would appear that social security contributions should belong to the broad concept of taxes.[50] Whatever the merits of this discussion, it is clear that the financing of social security plays an important determining role. Bourgeois argues that the differences between both payments are becoming increasingly small. This makes justification grounds for the differences less persuasive.[51] Bourgeois and Vording argue that it is not necessary to distinguish social security contributions from the payment of taxes.

From the foregoing one can conclude, in my view, that an obvious distinction between taxes and contributions is not so easy to make, while the respective allocation rules work very differently. In my opinion, it is justified to ask if we should consider applying a more substantive definition of contribution.[52]

7 View of the ECJ

Just as in the Australian case discussed above, the financing of social security is an element that can cause confusion in characterizing a payment as a contribution or as a tax. As said, according to the ECJ, in the EU context the method of financing is irrelevant for the application of Regulation No. 833/2004. The case Commission v. France[53] raised the issue of whether a contribution charged to residents of France for financing social security, the *Contribution pour le remboursement de la dette sociale* (hereafter: CRDS), should be viewed as a social security contribution or as a tax. It was not relevant if the French residents worked in France or not. The ECJ ruled that France acted in violation of 1408/71 (now Regulation No. 883/2004) because the French residents who worked outside of France were required to contribute to the social security of the state of residence, while they also contributed to the work state. This conflicts with the exclusivity principle of Regulation No. 1408/71 (par. 45-46). The contribution could not be considered a tax, ruled the ECJ, but as a social security contribution. The fact that the contribution was defined as a tax had no effect. That case concerned a supplement to compensate a shortage in the French social security system and was not intended as financing from general revenues. Certain contributions could be characterized as both social security as well as taxation. Financing of specific risks via a tax levy does not change the nature of a social insurance risk. According to the ECJ, what is important is that a direct link exists between the specific payment and the risk covered in Article 4 of Regulation No. 1408/71 (now: Art. 3 Regulation No. 883/2004). An example of this reasoning can also be found in the later Derouin decision.[54] That case concerned a contribution that a self-employed worker domiciled in France engaged in work activities in Great Britain was charged for his activities there. The contributions, CSG[55] and CRDS, are intended to equalize social debt. The question was if the contribution concerned fell under the France-United Kingdom tax treaty or under the then in effect Regulation No. 1408/71. It must be noted that the CSG and the CRDA were not yet specifically named in the tax treaty as taxes. The CSG and CRDS contributions were calculated on the basis of earned income in France and income generated in the United Kingdom. Derouin argued that since the income earned in the United Kingdom was taxed in that state, only the earnings in France could be subject to CSG and CRDS charges. The French social security administration argued that the payments were contributions and could be included in calculating income from the UK. The ECJ considered in paragraph 22 that the circumstance that a levy is characterized in national regulation as taxation does not mean that the levy cannot be found to fall within the scope of a regulation. Falling within the substantive scope are those rules which have as their determining element a direct and sufficiently relevant relationship between the given provision and the laws that regulate aspects of social security as named in Article 4 Regulation No. 1408/71.[56] The CSG and

50 H. Vording and W. Barker, in: B. Peeters, The Concept of Tax, 2005 EATLP Congress, EATLP International Tax Series, Volume 3, 2008, p. 46.

51 M. Bourgeois, in: B. Peeters, The concept of tax, 2005 EATLP Congress, EATLP International Tax Series, Volume 3, 2008, p. 183.

52 Compare also T. El Ouardi in HR 22 April 2016, nr. 15/03689, NTFR 2016/1315.

53 ECJ 15 February 2000, Case C-34/98, ECR 2000, p. I-995.

54 ECJ 3 April 2008, Case C-103/06, ECR 2008, p. I-01853.

55 Contribution sociale généralisée. This can be regarded as a socially earmarked tax. There is a borderline between contributions and taxes. B. Spiegel (ed.), Analytical report 2014, The relationship between social security coordination and taxation law, FreSsco April 2015, p. 37.

56 See Commissie v. France, ECJ 15 February 2000, Case C-34/98, ECR 200, p. I-995, para. 35 the decision named there: Rheinhold & Mahla, ECJ 18 May 1995, Case C-327/92, ECR 1995, p. I-1223, para. 15 and 23.

CRDS contributions can be viewed as a contribution, but also as a tax.[57]

8 Cross-border asymmetry of taxation and social security; solution?

The difficulty arising from Australia financing its social security system from tax revenues is not unique. In a majority of the Scandinavian countries, social security schemes are also financed by tax resources. In cross-border situations, this often gives workers the sense that they contribute twice to social security; once by paying contributions in one state, and once by paying taxes in the other state. The opposite can also be the case. A worker does not contribute either by paying taxes to finance social security, nor by making social security contributions, but does have a right to receive social security benefits.

Once in while, the governments attempt to address the first situation. For example, with respect to the Dutch citizens living in Denmark, who received a Dutch pension without also receiving a Danish pension,[58] the Danish Ministry of Healthcare and Prevention recommended that they contact the Danish tax service to request that their tax obligation be adjusted. The Danish ministry decided to do this at the time the Dutch Health Care Act (Zorgverzekeringswet) took effect in 2006. The amount that was available for an adjustment was equal to the amount required in the Netherlands to pay for health care contributions.[59] In other words, it would appear that a substantive definition of contribution was applied. It is unclear if this compensation is still being allowed. But it makes a positive impression in any case.

In addition to losing the desired clarity created by using a formal definition of contribution, the application of a substantive definition could also lead to – possibly insurmountable – execution problems. A portion of the tax levied will have to be designated as a contribution. This can only be done by the authorized authority of the state in which social security is financed via a tax levy, with or without consultation with the other state in which the interested person is insured. In States where many cross-border work activities occur, it would make sense to make new agreements at a bilateral level. This could lead to a greater administrative burden for the agencies involved, but once a portion of the tax owed has been labeled as "contribution," similar situations could be treated in the same way. This could take some time, and will require customizing and consultation between both states.[60] Following what I call the Danish Model above, the state in which taxes are paid could indicate an amount that for tax purposes can be deducted from the state in which the insured person owes contributions. Here, it is relevant to know which taxes are used to finance social security. An important condition, in my view, is that situation must involve cross-border employment. This will prevent, for example, that foreign tourists who do not fall under the social security scheme of the state they are visiting, pay less value added tax in the event that VAT is used in that state to finance social security.

Characterizing foreign contributions and concomitantly, foreign social insurance, is not entirely new. A decree issued by the Dutch Secretary of Finance about a way to calculate taxable wages for a cross-border worker who comes under a non-Dutch social security system according to the Dutch taxation standards, comes to mind.[61] This kind of computation also requires active consultation with the other state.

The different ways of financing lead, according to Verschueren and also in my opinion, to misunderstanding, dissatisfaction and frustration among cross-border workers. A direct relationship between the payment of contributions and the right to receive social security benefits is important to the cross-border worker. In order to strengthen this relationship, a solution needs to be found.[62] Verschueren suggests a possible adjustment to regulation, better coordination of the conflict of law rules concerning social security and taxes, and ad hoc solutions, such

57 One of the benefits of this "hybrid" characterization is that a deduction for tax purposes is possible. See F.P.G. Pötgens, W.W. Geursen, Derouin, Tax Treaties and Regulation No. 1408/71 – Double or Nothing, European Taxation 2009, (Volume 49), No. 3, p. 149.

58 Pursuant to Article 28 Regulation No. 1408/71, a person was insured for health care in the Member State awarding the pension. In this case that was the Netherlands.

59 See the letter of Ministry of Health Prevention, 17 June 2008, No. 2008-11413-169.

60 See, for example, the consultation between the Netherlands and the Belgium to determine the extent to which Belgian social security contributions match the Dutch national health care contributions in order to apply a compensation regulation indicated in Article 27 of the Treaty Netherlands-Belgium, Kamerstukken I, 2001-2002, 2-1293/2, p. 44.

61 Decree by State Secretary of Finance of 24 March 2014, No. DGB 2014/144M, Stcrt. (trans: Law Gazette) 2014, 9763.

62 H. Verschueren, Financing Social Security and Regulation (EEC) 1408/71, European Journal of Social Security 2001, p. 7-24.

as Article 17 Regulation No. 1408/71 (now: Article 16 Regulation No. 883/2004).[63] People with pension rights are sometimes taxed in their state of residence and pay health care contributions in another state. When health care is financed in the state of residence from general revenues, one can speak of a double economic levy. In this case, Member States that finance social security via taxes could determine the portion of the social security scheme that is financed by social security contributions and provide a commensurate compensation in the taxes levied.[64] The Commission to examine tax measures for Cross-Border Workers recommended in its report, Cross-Border Workers in Europe, that the European Commission introduce a draft directive for avoiding double taxation,[65] where in addition to addressing double taxation, attention also be paid to the avoidance of double economic taxation.[66] The pros and cons of levying double economic contributions for both cross-border workers as well as Member States need to be addressed.[67]

9 Conclusion

Regarding the differences between taxation and social security contributions, clear definitions should be used. The Netherlands Supreme Court applies a formal definition of contribution with respect to judging cross-border work situations. This creates clarity for the cross-border worker, but in the case of the recipient of the Australian pension, this gave him the nagging feeling that he was being forced to make contributions to two systems while being allowed to enjoy the benefits of only one. Given the fact that states apply different methods for financing social security, and that the distinction between contribution and tax is apparently less evident than at first glance, any discussion aiming at a more substantive definition would be highly welcome. A more substantive definition of contribution would satisfy the sense of fairness of cross-border workers affected by this issue. I realize that this may take a long time to resolve.

One would hope that the recommendation of the Commission Cross-Border Workers to the European Commission that it effectively address the issue of double economic taxation in its proposed draft directive to avoid double taxation be taken seriously. The advantages and disadvantages of double economic contribution levies certainly need to be resolved. I hope that a discussion about the topic will be started.

63 He refers to Regulation No. 1408/71, but in my view this also applies with respect to Regulation No. 883/2004. H. Verschueren, Financing Social Security and Regulation (EEC) 1408/71, European Journal of Social Security 2001, p. 7-24.

64 Denmark has given an offset in the past. This is based on a letter from the Ministry of Health Prevention, dated 17 June 2008. Sweden also recently granted an offset from the Swedish income taxation of a resident of Sweden who received a Dutch pension and was charged a Dutch health care contribution. The offset allowed was in the amount of the Dutch health care contribution.

65 Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union, COM(2016)686, CELEX:52016PC0686.

66 Already in 2001, Westberg proposed that the question regarding the distinction between taxes and contributions must be examined further in an international context. Also, the rather strict borderline between tax treaties and social security treaties must be delineated. Björn Westberg, Sweden, European Taxation 2001, (Volume 41), No. 13, p. 67-S.

67 Rapport van de Commissie Grenswerkers in Europa (trans: Report of the Commission to Study Cross-Border Workers in Europe), Geschriften van de Vereniging voor Belastingwetenschap, No. 257, Deventer: Kluwer 2017, p. 23.

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