TAXATION OF EXPATRIATES

FROM THE PERSPECTIVE OF TAX COMPETITION

Thesis:

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Preface

In September 2007 I heard about the opportunity to participate in the Eucotax Wintercourse 2007-2008 program. The main subject of this 2007-2008 program of the European Universities COoperating on TAXes was Tax Competition. One of the subtopics was expatriates. Because of my wish to work in the international field of Human Capital, this was the perfect opportunity for me to do research in this inspiring field. This thesis contains the results of my research.

For this wonderful Wintercourse experience I would very much like to thank those who supported me through the process and those who helped me with the international information. Therefore I give many thanks to my fiancé Sven and my international Eucotax friends Adam, Caroline and Jo. Furthermore I would like to thank Prof. dr. P H.J. Essers, Prof. mr. E.C.C.M. Kemmeren and Mr. E. Alink for their guidance and the opportunity they gave me to participate in the 2007-2008 Wintercourse program.

Ria Eikelenberg
Eindhoven, May 28th, 2008

Introduction

The mobility of the world's economy has increased enormously over the past few years. This increased mobility is the main reason why the EU is focussing more and more on "tax competition" and in particular "harmful tax competition". Due to the increased mobility, taxation has become of great importance for the location decisions of companies. Such an increased mobility has resulted in an increased tax competition between countries. All Governments are trying to improve their investment climate at the cost of other countries. By doing this they hope domestic tax payers and foreign tax payers will (re)locate their activities to their country.

This thesis focuses on the factor "human capital" in the scope of tax competition. Within Europe, many countries have introduced specific tax provisions to attract inpatriates and to encourage cross border employment. The factor "human capital" is not often mentioned as a factor that influences the location-decision of a company, even though its impact is enormous. What are the main characteristics of the diverse regulations and how do they compete with each other within the light of diverse European regulations, such as the non-discrimination principle, the EU Code of Conduct and the State-Aid regulations? The research question is therefore:

Is the Dutch 30%-ruling a type of harmful tax competition according to the non-discrimination principles, the State-aid regulation and the EU Code of Conduct, and how competitive is it compared to foreign expatriate and inpatriate regulations?

This thesis will essentially focus on the Dutch provision for inpatriates. The main Dutch regulation for inpatriates is the 30% ruling. Even though this regulation is also applicable on expatriates, this will only be discussed very briefly insofar as there is little discussion to make on this point. Before we can determine whether the 30% ruling for inbound employees is tax competitive, some questions have to be answered. In the first part, I will take a closer look at the definition of tax competition in connection to the factor "human capital". Then I will discuss the Dutch 30% ruling. What are the conditions for the 30% ruling, who has the real advantage of the ruling and what were the Government's objectives by introducing this ruling? Secondly I will give a brief overview of foreign expatriate regulations. In the third and fourth part I will compare the expatriate and inpatriate regulations as described in part two to the national and international non-discrimination principles. In part five the characteristics of the state-aid regulation and the EU code of conduct in respect to the regulations will be discussed. Last but not least I will give a recommendation to the European Union for harmonising these different regulations. In this paper I refer to the Dutch law unless mentioned otherwise.

1. Human Capital and Tax Competition

Before presenting the Dutch and other European expatriate provisions, it is important to understand how these regimes can cause harmful tax competition. Most of the experts working with the expatriate and inpatriate regimes will immediately agree that these special regimes can lead to an advantage or disadvantage for an employee, and as such they can be considered tax competitive. However most of the time it is the employer who has the main advantage of the regime, and as such, these special regimes can also be considered as having an impact on company taxation. This will be explained below.

1.1. Human Capital

The different expatriate and inpatriate regimes influence the factor “Human Capital”. The factor “Human Capital” is one of the main decision-making factors of a company. Although an organisation or business constitutes a separate legal entity, it ceases to exist if it has no people; employees are required in order to maintain an organisations existence. In other words, “*only individuals create income and things in themselves cannot*[1]”.

One of the aims of the European Union is *"to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion."*[2] The factor “Human Capital” is of more importance if an economy is more knowledge based. The people, the employees make the economy knowledge based. Highly skilled employees (the human capital) can therefore be considered as a determining factor of the competitiveness of a company. The ability to attract these employees, and the taxation of these employees, influences therefore more and more the location decisions of a company[3]. In the past decades, payroll taxes have increasingly become a form of employer’s taxation. Professor Ellis is of the opinion that *“facilities relating to payroll and income taxes could therefore be considerably more effective than corporate tax related facilities in determining the location of business activity within Europe.*[4] Whether they indeed are more effective than corporate taxation could be argued, however I can agree that they do have a high impact on the location decision of a company.

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[1] Professor Kemmeren E.C.C.M., *Principle of Origin in Tax Conventions, A Rethinking of Models,* Conclusion, p. 524 and Eucotax Conference, *Tax competition,* April 2008, Budapest.

[2] strategic goal for 2010 set for Europe at the Lisbon European Council - March 2000),

[3] See: Kiekebeld, B, *Harmful tax competition in the European Union, Code of Conduct countermeasures and EU law, p. 4 and Pinto, C.EU and OECD to Fight Harmful tax competition: Has the right path been undertaken,* Intertax vol. 26-12, 1998, p.394

[4] Ellis, M.J., VNO/NCW, Conference papers 1999, 56

The foreign assessment leads to additional costs for the employee; the extraterritorial costs. In most situations, these additional costs are borne by the employer. This can be done by granting the employee a higher gross salary or by granting him an extra allowance to cover these additional costs. As a consequence, the higher salary leads to a higher tax base of the employee and the aim of bearing the employee's additional expenses will not be achieved, because the net-salary will be lower due to the higher tax that has to be paid.

The special expatriate and inpatriate regimes in the Netherlands and the other European countries aim to attract highly skilled employees to their country by enabling the employers to reduce their labour costs[5]. Most of the time this is done by giving the employer the possibility to give his employees a tax free allowance for extraterritorial costs. These regimes are very tax competitive since the special expatriate regimes provide a benefit to the company and as such influence the location of a company. This is especially the case if the economy is knowledge based.

1.2. Tax competition

In International and European law, diverse regulations have been introduced in order to eliminate and to avoid specific regulations that cause harmful tax competition.

Tax competition can be defined as follows: *"Improving the relative competitive position of one country vis-à-vis other countries by reducing the tax burden on businesses and individuals in order to retain, gain or regain mobile economic activities and the corresponding in tax base, whether at the expense of other countries or otherwise[6].* Or in other words: *"Tax competition occurs when a state grants special tax regimes and preferential tax treatments to attract foreign investors or to increase the competitiveness of local businesses to improve the state's economy and welfare.[7]*

Tax Competition can be separated in two different categories of regimes. The first category contains the regulations that are meant to promote the export of domestic

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[5] Also: Kiekebeld, B, *Harmful tax competition in the European Union, Code of Conduct, countermeasures and EU law.*"These expatriate regimes often compromise a partial or complete exemption from income tax on income paid to highly skilled foreign nationals working in management, R&D or ICT. Their primary objective is to make it attractive for international corporations to base certain activities in a country.

[6] Kiekebeld, B, *Harmful tax competition in the European Union, Code of Conduct, countermeasures and EU law,* p. 8-9

[7] Pinto, C, *Tax Competition and EU Law*, The Hague, Kluwer Law International, 2003,1.,

businesses. In the field of Human Capital this is called the expatriate regimes. The second category is designed to attract foreign investment and capital. These regimes are in the field of Human Capital referred to as the inpatriate regimes, Even though in the Netherlands both regimes are called expatriate regimes, for practical reasons, the above separation will be used throughout this thesis.

Most specific regulations are tax competitive; most regulations are designed to attract highly skilled employees and foreign investors. However, the EU and the OECD do not mind tax competition as long as it does not have harmful aspects. The question therefore is when a regulation becomes harmful, as only harmful regulations are unwanted and need to be eliminated or avoided. In literature diverse harmful aspects of tax competition have been put forward; i) lower efficiency, ii) tax base erosion, iii) shifting of the tax burden, iv) tax race to the bottom. The (financial) effects of a specific regulation are most of the times hard to calculate. It must therefore be checked that the regulation does not distorts tax competition or threatens to distort tax competition.

In Europe, there are three regulations that have defined “harmful tax competition” and that are created to eliminate or to avoid harmful tax measures. These regulations are the non-discrimination principle, the Code of Conduct on business taxation and the State Aid regulations. All three will be discussed respectively in parts 3, 4 and 5.

2. 30% ruling: Compensation for extraterritorial expenses for inpatriates

2.1 History of the 30% ruling

The 30%-ruling was created in the first years after World War 2. Due to this war, the infrastructure of the Netherlands had been destroyed. Dwellings, bridges, roads, factories all had to be rebuilt. In these post-war reconstruction years, the Netherlands needed more highly skilled employees than the Dutch labour market could offer. Therefore companies started recruiting highly skilled employees in other countries. They only had one major problem: the highly skilled employees had extra costs due to their stay in the Netherlands. The employees required these costs to be reimbursed by the employer, which made the total remuneration-package very expensive. As these attractive remuneration-packages were hard to pay by the companies, the companies requested the Government to make a regulation which would make it more interesting for them to employ highly skilled employees from abroad. In the late fifties this request resulted in the first (unpublished) regulation.

The regulation granted a deduction of 40% of the income to a maximum of NLG 40,000 (€18,151) during a maximum period of three years. As a result of World War 2 most countries in Europe were in the same situation. The United States of America had an economic and technical advantage in these years which made American employees very valuable in all European countries, and therefore very scarce. Accordingly, the Government decided, given the situation, that the regulation was –at the beginning- only applicable to Americans.
In the late sixties more and more people were aware of the existence of the regulation. It became very difficult to keep the regulation secret. The Government therefore decided to implement the regulation in the (unpublished) Decree of May 4, 1970, B 70-6417. At the same time the deduction was lowered to 30% of the income, with no maximum basis.

This (unpublished) Decree was changed several times before it became a new shape in 1992. As of this date the reduction-facility was transferred into a compensation-facility. A maximum tax free compensation of 35% of the taxable income could be given to a highly skilled employee whose expertise was scarce or absent on the Dutch labour market. The employee needed to be recruited from abroad or to be seconded in the Netherlands within a group. In 2001 the 35% ruling was transferred into the 30% ruling, which is laid

down in the Wage Tax Act 1964 (hereafter: Wage Tax Act). The conditions, policy and case law on the 35% ruling are also applicable to the 30% ruling. In this paper I will refer to the 35% ruling if it is useful or necessary for understanding of the current ruling.

2.2 The 30% ruling for inpatriates in general

The 30% ruling is laid down in the Wage Tax Act. The most important article of this Act is Article 10 which provides a definition of "taxable income". Taxable income is defined as *"all that is received in connection with an employment or former employment.*

In Article 11 exemptions to Article 10 are laid down. Advantages which have been laid down in this article (and related articles) are not considered to be "income" and are therefore not taxable according to the Wage Tax Act.

Article 15 a section 1 part j Wage Tax Act is one of these exemptions. This article gives employers the possibility to grant their employees a tax free allowance for extraterritorial expenses made in connection to a *temporarily*[8] stay outside the country of origin. If an employee makes these expenses, the incurred extraterritorial expenses can be reimbursed tax free but the incurred expenses must be proved

For certain groups of employees these expenses can be compensated up to a fixed percentage of 30% of the taxable income (hereafter: the 30% ruling). In addition to this tax free compensation, the amount of the tuition fees for an international school can be compensated tax free. This fixed compensation and the compensation for tuition fees can only be granted tax free for a maximum period of ten years[9]. The conditions under which the fixed percentage and the tuition fees can be granted tax free are laid down in Articles 8 thru 9h section 1 of the 1965 Implementation Decree for Wage Tax [10]. If an employee meets all conditions a tax free allowance can be given without having to prove the actual expenses.

2.2.1 Conditions

The regulation is designed to attract employees with specific skills/knowledge that are scarce on the Dutch labour market. In order to make sure that only these employees can

[8] Temporarily : the regulation is however also applicable if an employer becomes a permanent resident of the Netherlands
[9] After this ten year period you are deemed to be in the same position as a "Dutch" resident.
[10] See appendix 1 for an English version of the 1965 Implementation Decree for Wage Tax.

benefit from the 30% ruling, a certain number of conditions have to be fulfilled. These cumulative conditions are laid down in the 1965 Implementation Decree for Wage Tax and are as follows:

1) The employee must be recruited in another country by an employer or must be seconded to an employer in the sense of Article 2 of the Wage Tax Act;
2) The employee must have a specific expertise that is scarce or absent on the Dutch labour market;
3) The employee must be working on an employment basis[11].

The first criterion states that the 30% ruling can only be granted to an employee who is recruited from abroad or who is sent to an employer pursuant to Article 2 of the Wage Tax Act. This criterion has to be met at the precise moment of recruitment. If the employee was already living in the Netherlands for, e.g. a month at the moment of recruitment he will not be considered as having been recruited abroad and as such he will not be able to benefit from the 30% ruling. If the employee already had another employment in the Netherlands to which the 30% ruling was available, the employee will be able to benefit from the 30% ruling as well with the new employer, even though he was not abroad at the exact moment of recruitment. If this is the case the employee and his new employer can request the tax authorities for a continued application of the 30% ruling[12]. However, this can only be done if the period of time between the former employment and the new employment is less than three months and the specific knowledge of the employee is still scarce on the Dutch labour market.
Since you can only receive the 30% ruling if you are recruited from abroad, the 30% ruling in fact is only applicable to non-residents. Once the 30% ruling is granted it is not relevant whether the employee is a resident of the Netherlands or not. The regulation is applicable in both situations. Because the employee is in fact working on the Dutch labour market he does bring his specific knowledge to the Netherlands. This means that the regulation meets its goals, even if the employee is still living abroad. In this case however it is however doubtful if this employee does in fact incur extraterritorial expenses.

The second criterion is that the employee must have specific expertise that is scarce or absent on the Dutch labour market. In 1992 the State Secretary gave the following five

[11] An employment basis may be defined as: "The situation in which a person is in the service of another under any contract of hire, express or implied, oral or written, where the employer has the power or right to control and direct the employee in the material details of how the work is to be performed."
[12] This request can also be done if the employee did not receive the 30% ruling with his former employer even though he did qualify for the 30% ruling at the moment of recruitment by his former employer. Decree of the State Secretary of Finance, October 21 2005, no. CPP2005/2378M.

criteria that are relevant in determining whether the employee fulfils this condition: the level of education, education on a territory in which very few Dutch people graduate, the level of expertise/experience, work experience in a specific qualified function and the salary-level in the country of origin[13]. All these criteria have to be interconnected evaluated and are nowadays implemented in Article 9a of the 1965 Implementation Decree for Wage Tax. The State Secretary also mentioned that top managers from international groups, scientists with specific expertise and product specialists are deemed to meet the criteria for specific expertise. These people do not have to prove their specific expertise.

In order to apply to the 30% ruling, a joint request has to be made with the tax authorities by the employer and the employee. On request of the tax inspector, the employer and the employee have to proof that the employee meets the various criteria for the 30% ruling. The tax inspector will decide on the request with a decision that is applicable for objection.

2.2.2 Term of validity and reduction rule

According to Article 9b of the 1965 Implementation Decree for Wage Tax, the 30% ruling for inpatriates can be granted for a maximum period of ten years[14]. In principle the 30% ruling is applicable from the start of the employment of the extraterritorial employee[15]. This maximum period can however be shortened for several reasons.

The first reason for shortening the maximum duration of the regulation is that the application request is filed too late. According to Article 9f of the 1965 Implementation Decree for Wage Tax the request has to be made within four months from the start of the employment. If the request is made within this four months period, the decision shall have effect from the start of the employment of the entered employee. However if the request is made later, the decision shall have effect starting the first day of the month following the month in which the request is made. This means that if the request is done after five months, the validity term will be reduced to 9 years and 7 months. This means a reduction of five months if the request is done one month (or even one day) too late.

[13] In the decree of the State Secretary of Finance November 26,2001 CPP 2001/2970M, the State Secretary mentioned that if an employee has worked in a comparable function for more than 2,5 years, he is deemed to have the necessary experience. According to the Court in The Hague, this does however not exclude an employee with less than 2,5 years experience in a comparable function. Court in ’s-Gravenhage, March 18, 2008, nr. BK-05/00260

[14] The validity term has, during the years, been lengthened from 60 months, to 96 months to 120 months.

[15] Article 9h 1965 Implementation Decree for Wage Tax.

The maximum duration of the regulation can also be shortened due to a period of previous stay or employment in the Netherlands[16]. This is called the “reduction rule” which applies in three situations. The principal rule is that if the entered employee has worked or stayed in the Netherlands prior to the start of the employment the term shall be reduced by the periods of prior employment/stay. These periods of stay/employment will be rounded up to full calendar months. This means that if an employee has been in the Netherlands for only one day, the duration will be shortened by a full month![17] If the last stay or employment in the Netherlands has ended less than 15 years but over 10 years prior to the employment, the periods of stay/employment will not be taken into account if the employee has not worked or stayed in the Netherlands for the last ten years. Periods that ended over 15 years prior to the start of the employment shall never be taken into account.

Example

An employee is recruited from abroad in February 2008 and stayed in the Netherlands during the following periods:

October 1991 – September 1992
January 1997 - December 1997
March 1999 - February 2001

The employee has left the Netherlands less than 10 years ago (2001). Therefore the maximum term of 120 months (10 years) must be reduced by the periods of earlier stay in the Netherlands.

Total period:		*1 20 months (maximum)*
Less:	*1991 – 1992*	*0 months (more than 15 years ago)*
	1997 – 1997	*12 months (10 to 15 years ago)*
	1999 – 2001	*24 months (less than 10 years ago)*
		86 months

Due to the reduction rule The 30% ruling applicable for a maximum period of 72 months.

The third situation in which the maximum duration can be shortened is if the employee no longer possesses specific expertise that is scarce on the Dutch labour market. In that situation the 30% ruling ends at the moment the situation arises, but not earlier than after an application period of five years. As from the start of the sixth year of using the 30% ruling, the tax inspector can request the employer and employee to prove that the employee still has the required specific expertise. If the employer and employee succeed, the validity term cannot be reduced from the sixth to the tenth year if the

[16] Article 9e 1965 Implementation Decree for Wage Tax.
[17] Each period has to be rounded up to a full calendar month. In case of 14 periods, each shorter than 1 month, the validity term is reduced with 14 months, Court in Haarlem, March 25, 2008 nr. 2006/08645,

employee no longer possesses the specific expertise during this period. This proof can also be given at the employer's and employee's own initiative.

2.2.3 Extraterritorial expenses

Article 15a section 1 part j of the Wage Tax Act gives employers the possibility to grant a tax free compensation for extraterritorial expenses made in connection to a temporarily stay outside of the country of origin. This means that only costs that are made, in addition to the usual costs, can be reimbursed tax free under this regulation.
The Wage Tax Act also gives the employer the possibility to grant a tax free allowance for various other costs to the employee. It is discussed whether an inbound employee can receive a tax free allowance for all these costs, in addition to the 30% ruling. For example Article 15b section 1 part i of the Wage Tax Act gives the possibility to grant a tax free allowance for double housing costs during a maximum period of two years. These costs can appear in both national and international situations and are therefore, in my opinion, not extraterritorial. However, according to the State Secretary these double housing costs are extraterritorial costs and as such they cannot be compensated tax free next to the 30% allowance. This point of view has recently been confirmed by Court 's-Hertogenbosch[18]. The State Secretary has published a Decree in which he gives a clarification of what, in his opinion, are extraterritorial costs[19]. The following costs are extraterritorial costs: costs of living, relocation expenses, expat allowance, house hunting costs, permits, storage expenses, free accommodation, broker's fees, home leave etc. This means that if an employer wants to give an expatriate (who meets the criteria) a tax free allowance e.g. double housing costs, this allowance has to be deducted from the 30% allowance[20].

2.3. Procedure and practical application

As mentioned before a request for applying the 30% ruling has to be made with the tax inspector. The tax inspector will investigate whether the employee meets the criteria laid down in the 1965 Implementation Decree for Wage Tax. If the employee qualifies, the tax inspector will decide that the employer can use the 30% ruling for this employee. Furthermore he will decide during what period the 30% ruling can be used (validity term). The tax inspector's decision is applicable for objection.

[18] Court 's-Hertogenbosch, 28 February 2008, no. 07/00233. The claimant has appealed against this decision.
[19] Decree from the State Secretary of Finance, February 11, 2004, no. CPP2003/641M (replaced by: Decree of the State Secretary of Finance, August 24, 2005, no. CPP2005/464M)
[20] In the opinion of the State Secretary of Finance

Article 9 of the 1965 Implementation Decree for Wage Tax explains how the 30% ruling should be calculated. According to this article the compensation for extraterritorial expenses is in any case deemed to be for extraterritorial expenses up to 30% of the basis, the basis being the sum of the wage received regularly associated with the stay outside the country of origin[21]. A compensation of more than 30% can be given under the condition that the costs incurred can be proven. Recently the High Court of Justice decided that the basis for the 30% ruling is the sum of the present wages[22]. In addition to this 30% compensation tuition fees for international schools can be compensated tax free.

The 30% allowance has to be agreed upon separately from the gross salary in the employment contract. The 30% allowance can be given in addition to the gross salary. In some cases the employer chooses to attach an addendum to the employment contract. There are two different addenda that can be used. The first addendum splits the granted wages in a taxable and tax free part. This in fact means that the gross income of the employee remains the same and that the advantage partly goes to the employee[23]. The second addendum states that the net income of the employee remains the same, with or without the use of the 30% ruling[24]. This in fact means that the total advantage of the 30% ruling is going to the employer.

The application of the 30% ruling by using the addenda has an effect on the basis used for the pension scheme and social securities of the employee. As the taxable gross salary of the employee is lower when using the addenda, the basis for the pension scheme and social facilities will also be lower[25]. This is because the basis for both regulations is the taxable salary, and therefore does not include the tax free allowances.

2.4. Deemed non-resident status

An employee who lives in the Netherlands qualifies as a resident taxpayer. A resident taxpayer is taxed in the Netherlands over his worldwide income. This includes income that is not taxable in the Netherlands according to tax treaties. If the income may not be taxed in the Netherlands according to a Tax Treaty, one can request for a relief of double taxation. If the employee lives abroad and receives income from the Netherlands

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[21] To the extent the entered or transferred employee has no right in this regard to prevent double taxation, and remuneration for extraterritorial expenses.
[22] Supreme Court, January 25, 2008, no. 43396; the applicant in this case was of the opinion that the basis of the 30% ruling was the sum of the wages for both present and former employment.
[23] See appendix 1
[24] See appendix 2
[25] Decree of the State Secretary of Finance, October 21, 2005, no. CPP2005/2378M

that is taxable in the Netherlands, the employee qualifies as a non-resident taxpayer. A non-resident is only taxed in the Netherlands over his Dutch sourced income. For qualifying employees who live in the Netherlands, there is the possibility to opt for a deemed non-resident status for the Income Tax Act. This option is laid down in Article 2.6 of the Income Tax Act and is applicable to boxes 2 and 3 of the Income Tax Act (income from a substantial interest and income from savings and investments)[26]. Under this deemed non-resident status only Dutch sourced income (i.e. Dutch real estate, substantial interest in a Dutch company) is taxable in the Netherlands.
At the beginning (1970) this non-resident status was only applicable to employees not having the Dutch nationality and it was applicable to all income (including foreign sourced employment income). As from the 1988 Decree[27] the deemed non-resident status is no longer applicable to foreign sourced employment income. The State Secretary made this decision in order to make sure that foreign sourced employment income can be taxed in the Netherlands. The option for the deemed non-resident status has to be made in the tax return. No separate request has to be filed for using this option. The deemed non-resident status can give a great advantage to the taxpayer compared to a "normal" resident. However, one should bear in mind, that dividend withholding tax is not refundable if Article 2.6 is used[28].

2.5. The Character of the 30% ruling

The 30%-ruling is two folded. Firstly, it is a possibility for employers to reduce their labour costs; secondly it is a way to attract highly skilled employees from abroad. As shown in section 2.3, the employer has different options to deal with the financial effects of the 30% ruling. An employer can choose to use the addendum to receive the advantage himself, or he can give the advantage to the employee. In this respect the question is (i) whether this 30% ruling is a labour costs reduction or an expense allowance and (ii) who has the real advantage of this 30% ruling.

Expense allowance (advantage employees)

If we look at the wording of Article 15 section a part j of the Wage Tax Act, the 30% ruling seems to be an expense allowance. It is a tax free allowance for extraterritorial expenses made. The advantage of the 30% ruling is first of all an administrative advantage since

[26] The Dutch income tax act has three types of income which have been classified in so called "boxes", Box 1: taxable income from employment and home ownership; Box 2: taxable income from a substantial interest and Box 3: taxable income from savings and investments
[27] Decree of the State Secretary of Finance, August 19, 1988, no. DB88-5011
[28] Except dividend withholding tax related to a substantial interest in a Dutch company.

one does not look at the actual expenses made. A fixed allowance of up of 30% of the income can be given tax free. The actual costs made are only of importance if the total costs are over 30% of the income. In that case also the additional costs can be given tax free, provided they can be proven.

According to the wording of the article, the 30% allowance is meant to cover extraterritorial expenses made due to a *temporarily* stay outside of the country of origin. Although this is mentioned in the literal text of the article this is not entirely true. As already mentioned before, it is not necessary for a qualifying employee to come living in the Netherlands. If for example a German or Belgian employee decides to keep his residence in his home country he still can benefit from the 30% ruling. In this situation it must be wondered to what extent the employee make extraterritorial costs at all. For instance a Belgian employee who already speaks and understands the Dutch language fluently will most probably have less costs than an employee who does not speak or understand the Dutch language. Furthermore the 30% ruling can also be granted to an employee who has already decided to emigrate to the Netherlands, and in that respect searches for a job in the Netherlands. The employee will only be willing to move to the Netherlands after he has found a proper job. In that situation the costs are not solely made due to the new employment contract but moreover due to the private decision to move to the Netherlands.

Example

A Belgian employee and an Indian employee are both being recruited from abroad and receive the 30% ruling. Both the employees have a gross income of € 5,000 a month. The allowance for extraterritorial expenses is given by using addendum 1, which splits the gross income in a taxable part (€ 3,500) and a tax free part (€ 1,500). The Belgian employee makes € 200 extraterritorial costs a month whereas the Indian employee makes € 1,500 extraterritorial costs a month. The tax rate is 50%.

	Belgian	*Indian*	
Taxable salary:	*€ 3,500*	*€ 3,500*	
Less: taxes	*€ 1,750 -*	*€ 1,750 -*	
Net salary	*€ 1,750*	*€ 1,750*	
30% ruling (tax free)	*€ 1,500 +*	*€ 1,500 +*	*(30%/70% x € 3,500)*
	€ 3,250	*€ 3,250*	
Less: expenses	*€ 200 -*	*€ 1,500 -*	
Disposable income	*€ 3,050*	*€ 1,750*	

If we look at the example above we can see that a qualifying employee who makes no or just little extraterritorial costs can benefit a lot from the 30% ruling. This employee will only use a small part of the tax free allowance to cover extraterritorial costs. However, an employee who incurs important extraterritorial costs (up to 30% of his income) does not (or only to a small extent) benefit from the 30% ruling. In that situation the 30% ruling

mainly results in an administrative advantage, as in that situation the total tax free allowance will indeed be used to cover extraterritorial expenses.

As shown in section 2.4 the qualifying employee who is living in the Netherlands has the possibility to opt for the deemed non-resident status laid down in Article 2.6 of the Income Tax Act, which can give him a significant advantage with regard to the taxation of his savings and investments and his substantial interests in foreign companies compared to the other Dutch residents.

Labour costs reduction (advantage employer)

If however, we look at the original goal of the Government by introducing this ruling in the first years after World War 2, we have to conclude that it is in fact a labour cost reduction facility. The 30% ruling was introduced because of a request from the companies. Furthermore the State Secretary has mentioned that the 30% ruling is a regulation to make the Netherlands a more attractive country for employees and employers [29] . The 30% ruling aims therefore to improve the investment climate of the Netherlands[30].

As already stated before, the 30% ruling can be granted in addition to the gross salary, but the employer can also choose to add an addendum to the employment contract. This addendum splits the granted wages into a taxable and a tax free part. In this situation the gross income of the employee will be set at a lower amount. This way, the employer makes sure that it's labour costs are reduced when the 30% ruling is granted. If the qualifying employee has no or just little extraterritorial expenses, the reduction of the labour costs is very limited. In that case the employer would only have to pay no or only a small additional amount next to the fixed employment income. If however the qualifying employee makes high costs (up to 30% of his income) the reduction of the labour costs is very high. Since most inbound employees work on a net- contract basis the employer will most likely has to give an allowance to cover these costs, next to the fixed employment income if the 30% ruling is not used.

If the employer chooses not to reduce the gross income and gives the 30% allowance next to the fixed salary, there is no advantage for the employer (other than an administrative advantage). In international employment situations (inpatriates and expatriates), the employees normally work on a net-contract basis. The employer does not want the taxation in a country to influence the decision of the employee to go and

[29] State Secretary of Finance, October 20, 2003, no. 03-244, sections 6 and 7

[30] In this respect it is odd that there is no similar facility for foreign entrepreneurs. They do bring their specific knowledge from abroad but cannot benefit from the 30% ruling since they are not subject to the Wage Tax Act.

work in a specific country. Furthermore, the employer does not want to benefit certain employees more than others, just because of taxation issues.

In figure 1 the Effective Average Tax Rate (EATR) has been calculated[31]. This EATR shows the tax wedge for the employer [32]. The lower the EATR, the less the employer has to spent in order to compensate an internationally mobile employee. If we look at these EATR's we can see that if the 30% ruling is used (either with or without using the addendum), the EATR is reduced. In other words; using the 30% ruling gives an advantage to the employers. This will only be the case if the actual extraterritorial costs are less than the tax free 30% allowance.

Situation	Disposable Income	Labour Costs	EATR	Disposable Income	Labour Costs	EATR
No tax free allowance possible	€ 3,700	€ 7,400	0.50	€ 4,500	€ 9,000	0.50
Tax free allowance possible	€ 3,700	€ 6,700	0.45	€ 4,500	€ 7,500	0.40
Addendum 1	€ 3,700	€ 5,700	0.35	€ 4,500	€ 6,925	0.35

Figure 1; EATR

If we summarise the above we can see that the 30% ruling is mainly a possibility for employers to reduce their labour costs. The employer has the opportunity to use the addendum (and have the advantage himself) or not to use the addendum (and give the advantage partly to the employee). Since most employees work on a net-contract basis it is very clear that the advantage goes to the employer. The EATR of the employee (in the situation given above), will in that situation be reduced to 0,35. That the employee might have a tax advantage by opting for the deemed non-resident status does not affect any of this. The main goal of the 30% ruling is to improve the Dutch investment climate by giving the employers a possibility to reduce their labour costs[33].
The conclusion therefore is that the 30% ruling is in fact a labour costs reduction facility and as such, it should be checked whether it is in accordance with the national and

[31] See Elschner, Schwager, *The Effective Tax Burden on Highly Qualified Employees, An International comparison,* ZEW Economic Studies, p 11, for a more detailed explanation of an EATR.
[32] See appendix 3 in which the calculation methods are explained/given.
[33] The Dutch Government has laid the 30% ruling down in the Wage Tax Act to make sure that it cannot be seen as a subsidy on labour costs and as such could be recognized as forbidden state aid. In chapter 4 we will see whether it worked out and if it was really necessary to lay it down in the Wage Tax Act.

international non-discrimination principles and whether it leads to harmful tax competition[34].

2.6 The 30% ruling for expatriates

As mentioned in the introduction the 30% ruling is also applicable to outbound employees (expatriates) . Since the conditions for using the regulation for expatriates are different from the conditions for the inpatriates this regulation is discussed separately.

Goal of the regulation

Whereas the goal of the inpatriate regulation is to attract highly skilled employees with a specific expertise that is scarce on the Dutch labour market from abroad, the expatriate regulation has a total different goal. The goal of this regulation is to stimulate employers and employees to go to help developing countries.

Conditions

According to Article 8 section 2 sub c 1965 Implementation Decree for Wage Tax, employees that have been seconded abroad for one of the following reasons can benefit from the regulation: (i) the employee is a government employee posted to a foreign mission of the Netherlands, (ii) the employee is a government employee posted abroad and working as a civil servant, judicial officer or military in the Netherlands Antilles or Aruba, (iii) the employee is a military stationed abroad, (iv) the employee is posted to a region mentioned in the list, (v) the employee is posted abroad to conduct research or teach[35].

Only an employee who has spent at least 45 days within a period of twelve months in one or more locations abroad for the purpose of performing the job can benefit from the 30% ruling. Periods of less than fifteen days are not taken into consideration and days spent travelling to and from the location of secondment are regarded as days of residence in that location. If the employee meets the conditions of the 45-day provision, then he will also be deemed to be seconded for any other secondments of at least ten days.

[34] also: mr. B.R.R. James, Fiscale zakenreeks 09, De 30%-regeling voor ingekomen werknemers, chapter 7.6

[35] Listed regions are: Asia, Africa, Latin-America, Albania, Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, the Federal Republic of Yugoslavia (Serbia and Montenegro, including Kosovo), Latvia, Lithuania, the former Yugoslav Republic of Macedonia, Moldova, Poland, Rumania, the Russian Federation, Slovakia and Slovenia.

Procedure and Practical application

The 30% ruling can be used without a request for application. There is also no maximum duration for the regulation to apply. As long as the employee meets the conditions the 30% ruling can be used. The basis for calculating the 30% allowance is the income earned in connection with the secondment abroad plus the 30% allowance. This means that the 30% allowance is calculated in the same way as for the inpatriates[36].

2.7 Foreign expatriate and inpatriates regimes

In this section the expatriate and inpatriate regimes of most of the Eucotax countries are discussed very briefly. What are the main characteristics of the diverse regulations and what are the goals of the different regulations. Some countries only have an inpatriate or expatriate regime, others have no special regime at all.

2.7.1. Austria

Austria has a different regulation for inpatriates and expatriates

Inpatriates

The special tax provision for inpatriates can be found in section 103 of the Austrian Income Tax Act. This article provides in a favourable tax treatment for scientists, researchers, artists or athletes moving to Austria if their move is in the public interest. The regulation is limited to these persons for reasons of promoting the move of foreign top executives to Austria and limiting the possible tax burden arising from the settling in Austria. Furthermore, the expatriates' decree provides a simplified administration concerning certain income-related expenses and extraordinary charges of expatriates. According to this expatriate decree expatriates are: *"individuals who have not resided in Austria for the past ten years, who are sent on business to Austria by order of a foreign employer".*[37] Furthermore they are not allowed to stay for more than five years in Austria.

Expatriates

The special provision for the expatriates can be found in section 3 (1) (10) of the Austrian Income Tax Act. This article provides a tax exemption for the income of employees sent abroad for plant engineering and construction purposes. The tax exemption depends on certain conditions that first have to be met before the income derived out of the

[36] See section 2.5 for the calculation of the 30% allowance
[37] According to the LStR 2002, marginal number 1038a

preferential foreign activity may be exempt from taxation. The tax exemption is applicable to the total income derived out of the foreign activity.

2.7.2. Belgium

Like Austria, Belgium has different provisions for inpatriates and expatriates

Inpatriates

Belgium has a special non-resident tax regime, which is applicable to certain inpatriates who work temporarily in Belgium. This special regime is laid down in the Administrative Circular of August 8, 1983. The inpatriates are deemed to be non-residents and as such they will only be taxable on their Belgian sourced income, this is called the travel exclusion. Furthermore, they will not be taxed on allowances for costs made in connection with their employment. A detailed list of tax free allowances possible is laid down in the Circular. In Belgium only the actual extraterritorial costs can be reimbursed tax free, the employee has to prove that the costs are actually made. The goal of this inpatriates' regulation is to decrease the employment costs of these inpatriates in order to attract multinationals.[38]

Expatriates

For expatriates, Belgium has a regime for employees who go and work in third countries. The circular of March 5, 1992 (ABOS-circular), is applicable to all Belgian residents who are employed abroad in a country outside the EU with whom Belgium has no tax treaty. An employee who is a non-resident of Belgium during the employment abroad, receives an exemption of the remuneration for the foreign employment as far as it is for the account of the foreign establishment of the employer. In addition some costs made due to their temporarily stay abroad can be reimbursed tax free (e.g. housing allowances, extra school fees, travel expenses). Furthermore they receive a special costs deduction on their foreign salary. Employees, who are residents of Belgium during the foreign employment, are deemed to be non-residents for tax purposes and as such, they are only taxed on their Belgian sourced income. In addition they receive a special tax reduction for the tax levied abroad[39].

[38] Circular Ci.RH. 624/325.294 dd. 08.08.1983,II,3.

[39] Article 156 Belgian Income tax Act 1992, The tax on the remuneration obtained abroad is reduced by half as far as the income was obtained and also taxed abroad. In case of lack of evidence of the normal taxation, there is a presumption that the remuneration obtained and taxed abroad is 30% of the taxable gross remuneration.

2.7.3. France

Like Austria and Belgium, France differentiates inpatriates from expatriates

Inpatriates

Article 81B of the French Tax Code exempts the expatriation bonuses inpatriates receive, from French income tax. Furthermore Article 83 of the French Tax Code enables these inpatriates to deduct the social security contribution paid to their county of origin from their taxable income. This provision is designed to attract foreign employees and directors to France, and to make the French tax regime more competitive.

Expatriates

Article 81A of the French Tax Code provides a special regime for expatriates. Those French tax residents can benefit from a full or partial income tax exemption. French expatriates whose foreign income is taxed at a level equal to at least two thirds of the tax which would have been due in France, will be exempt from French income tax on the income derived from their employment abroad. This full exemption is also granted to those who take part in French building sites, the research of natural resources, activities of navigation on French ships or commercial prospecting (provided these activities are performed for 183 days in the first 3 cases or 120 days in the last case). Furthermore, if the employee cannot benefit from a full exemption, his expatriation bonus will be, in certain circumstances, exempt from French Income Tax.

2.7.4. Germany

Germany only has a regime for expatriates and no regime for inpatriates. That there is no regime for inpatriates is due to the fact that in Germany the principle of equal treatment is of very high importance (Art. 3 of the German Constitution). That is the reason, why Germany does not allow both negative and positive forms of discrimination.

Expatriates

The special regime for expatriates is enacted by the German financial authorities on the basis of section 34c paragraph 5 of the EStG. This special regime is called the "Auslandsstätigkeitserlass", and provides a tax exemption for foreign sourced income for certain categories of employees, upon approval of the Ministry of Finance[40]. Only employees who perform certain activities during a certain period of time can benefit from this regulation. Furthermore this regulation is only applicable if the employee is working in a country with which Germany has no double tax treatment. The goal of this expatriate

[40] BstBl. I 1983, p.470

regulation is to promote the German export economy and to encourage German employees to work abroad for a certain period of time[41].

2.7.5. Hungary

Hungary having only just joined the European Union, is still working on setting up an effective set of provisions for expatriates and inpatriates.

2.7.6. Italy

Like Germany, Italy has no special regime for inpatriates. For expatriates they do have certain provisions, even though according to Italy these are not considered special regimes for expatriates

Expatriates

Article 51, 8 bis of the Italian Income Tax Act, determines the taxable income for employment performed abroad. According to this article, income derived from employment performed abroad is taxable on the basis of salaries determined annually by a decree of the Ministries of Labour and Social Security, instead of the actual salary received. This regulation is only applicable if the employee stays abroad for more than 183 days within a twelve month period, the employment is performed abroad without interruption and is the exclusive object of the employer.

2.7.7. Spain

Spain has specific provisions for inpatriates as well as for expatriates.

Inpatriates

Inpatriates in Spain have the option to be taxed according to the IRNR (non-resident income tax act) in stead of the IRPF. The main advantage is that the IRNR has a fixed tax rate of 25% whereas the IRPF has a progressive tax rate up to 45%. The measure is designed to promote the internationalisation of the Spanish economy by attracting foreign entities and often highly skilled employees to Spain.

[41] Böcker, Steuerwarte 1991, p. 201 (204); FG Köln EFG 2001, p. 974 (977).

Expatriates

Article 7 of the IRPF exempts the income from work performed abroad from the Spanish income tax. This exemption is limited to an amount of € 60,101.21. The tax exemption is only given if the work abroad is carried out by a company or entity which is not a resident of Spain or by a permanent establishment situated in another country. The goal of this regulation is to promote certain activities performed abroad.

2.7.8. Sweden

Sweden has a different set of provisions for inpatriates and expatriates

Inpatriates

In order to recruit highly qualified foreign employees, Sweden introduced a special regime for foreign experts, researchers and key personnel in 2001. The regime gives a tax exemption of 25% of the individual's salary and is laid down in Chapter 11, Sections 22-23a of the Swedish Income Tax Act. In addition some costs can be reimbursed tax free by the employer. The tax relief is only granted for three years under the presumption that the stay in Sweden does not exceed 5 years.

Expatriates

Sweden has two different regimes for expatriates, (i) the six-month rule and (ii) the one-year rule. According to the six-month rule, employment income for work performed abroad is not taxable in Sweden if the stay abroad exceeds six months and the employment income is taxed in the work state[42]. The one-year rule exempts the income for work performed abroad if the employee stays abroad for more than one year (the income does not have to be taxed in the work state)[43].

2.7.9. Comparison of the regimes

At first sight the different inpatriate and expatriate regimes within Europe are very different. Whereas in the Netherlands the inbound employees can receive a tax free allowance for extraterritorial costs, in France the inpatriation bonuses are tax exempt, and where in the Netherlands the inpatriate regulation is open to employees in all sectors, in Austria the inpatriate regime is only open for scientists, researchers, artists and athletes.

[42] Chapter 3, Section 9, Paragraph 1 of the Swedish Income Tax Act; several work states possible
[43] Chapter 3, Section 9, Paragraph 2 of the Swedish Income Tax Act; only one work state allowed

Even though the regimes are very different, their objectives are the same. All the inpatriate regimes in Europe have the main aim to attract highly skilled employees from abroad and all the regimes try to reach their goal by covering the extraterritorial costs of the employees. Since the regimes all have the same objective, the question is how competitive they are compared to each other. Therefore I have compared three elements of the regimes.

Deemed costs or actual costs

Sweden and the Netherlands are the only two countries in which the actual costs incurred are of no (or just little) importance. In Sweden a tax exemption of 25% is given and in the Netherlands an amount up to 30% of the taxable salary is deemed to be a tax-free allowance for extraterritorial costs. Other countries, like Belgium, prefer only to compensate the actual costs incurred.

Validation period

The validation period is different in some of the regimes. Whereas in Sweden the regulation can be applied for a maximum period of three years and in Austria for a maximum period of five years, in the Netherlands the regulation is applicable for ten years.

Transparency

In Austria and Belgium the tax authorities do have a wide discretionary power to decide who can benefit from the special regulations. In the Netherlands on the other hand it is very transparent who can benefit from the regulation. The Netherlands has chosen to implement the conditions for using the regulation in the Wage tax act. Furthermore the Dutch inpatriate regulation can only be used after a prior decision of the tax authorities. This decision is applicable for objection.

Based on the above mentioned elements, the 30% ruling can very well compete with the other European regulations. The 30% ruling is applicable for maximum a maximum period of 10 years and gives a tax free allowance to a deemed percentage. This deemed percentage gives a huge benefit if the actual costs incurred are low. If the costs turn out to be higher than 30% of the income, the actual costs incurred can be compensated tax free. Furthermore the fact that the Dutch regulation is very transparent gives more certainty than the regulations of Austria and Belgium (where the tax authorities have a wide discretionary power). If an employer decides to attract employees from abroad it is better for them to know the fiscal consequences in advance.

3. National non-discrimination principle: The principle of equality

3.1. Discrimination

The non-discrimination principle (hereafter: principle of equality) is laid down in Article 1 of the Dutch Constitution.

Art 1: All persons in the Netherlands shall be treated equally in equal circumstances. Discrimination on the grounds of religion, belief, political opinion, race or sex or on other grounds whatsoever shall not be permitted.

The principle of equality is a general principle of good governance and is of high importance under the Dutch tax law. If taxpayers are treated unequally, the tax administration will have to give the reason for the unequal treatment. The tax administration can give three types of reasons; (i) policy, (ii) aim of favourability or (iii) a mistake. In case of a mistake, the majority rule will apply. According to Dutch case law a Dutch citizen can therefore only appeal on the principle of equality in the following situations:

- *The tax authorities pursue a favourable policy*
  The favourable policy can be a policy that is published or not published. In case of a non-published policy, it is the taxpayer who believes that there is a policy, without having any evidence of it. In that situation, it is the Tax Authorities who have the burden of proof that there is no policy. In both situations the following four questions need to be answered (i) Is the policy applicable to the applicant, (ii) does the policy lead to an unequal treatment of persons in an equal situation, (iii) does the policy have a favourable character and (iv) is there a justification for the differential treatment.

- *The tax authorities pursue an aim of favourability*
  The principle of equality can also be applicable if the unequal treatment of persons in equal circumstances is due to an aim of favourability. In that situation four conditions need to be fulfilled[44]; (i) unequal treatment of taxpayers in equal

[44]Happé, Drie beginselen van fiscale rechtsbescherming, blz. 320, Deventer: Kluwer 1996

circumstances (ii) a group of taxpayers (iii) the aim of favourability at the treatment of one or more taxpayers within the group of taxpayers and (iv) an authorised tax inspector.

- *By applying to the Majority rule*
  The principle of equality can also be applied when the law has been explained incorrect to a majority of taxpayers, in equal circumstances to the applicant. In that situation it is not necessary that the favourable treatment is due to an aim of favourability.

Besides the principle of equality there is also the principle of legality. The principle of legality states that in principle the law has to be obeyed. However the Supreme Court of the Netherlands has provided guidelines to decide which of these two principles is to prevail in a specific case.

The principle of equality applies if two or more persons in situations which are legally and actually equal, receive a different treatment. If a person is in a different position, this in principle justifies the different treatment. However, this can be different if the different treatment is out of proportion, in which case an appeal on the principle of equality can also succeed. Secondly the principle of equality applies if two or more persons are in situations which are legally and actually unequal but who receive the same treatment.

As shown in Part 2 the 30% ruling has many aspects. Some of these aspects could possibly be in conflict with the principle of equality. Two of these aspects are discussed below. Are they indeed in conflict with the principle of equality or is there a proper justification for the differential treatment of the employees?

3.2. Reduction Rule

The first of the two aspects of the 30% ruling that will be discussed is the reduction rule. The reduction rule reduces the validity term of the 30% ruling with earlier periods of stay or employment in the Netherlands.

There has already been a lot of case law concerning the question whether the reduction rule is in conflict with the principle of equality. As of today, there has been no decision yet that the reduction rule is in conflict with this principle. In the cases at hand Dutch citizens who stayed abroad for less than ten years made an appeal on the principle of equality.

These people do not benefit from the 30% ruling and believe their unequal treatment is discriminative. The Supreme Court and several lower Courts have given explanations why the employees in the cases at hand were not in an equal position. And if the employees were considered to be in an equal situation the Courts have given justifications for the differential treatment of employees in equal situations. We will see what reasons and justifications are given in the jurisprudence and whether these decisions can be criticised.

In 2000, the Court in The Hague was of the opinion that the reduction rule was mainly based on the idea that a foreign employee only needs to be compensated for various extraterritorial costs made in connection with the employment, during a certain acclimatisation period [45].In that respect it is, according to the Court, logical to reduce the validity term (acclimatisation period) by earlier periods during which the employee had a connection with the Netherlands. This connection can be found in earlier periods of stay or employment in the Netherlands.

In 2001, the Supreme Court stated his position in the following case; Mr. X lived in the Netherlands from his birth to September 1995. In October 1995 Mr. X. moved to Belgium in connection with an employment in Belgium[46]. As of January 1998 the applicant was employed in the Netherlands again, and requested for application of the 30% ruling. The tax inspector applied the reduction rule and disapproved the application of the 30% ruling. According to the applicant the reduction rule should not be applied since it leads to a differential treatment of persons who are in a legally and actual same position. The applicant was comparing his treatment to the hypothetical situation of a Dutch speaking Belgian coming to the Netherlands and benefiting from the 30% ruling for ten years. In this case the Supreme Court gave the following justification for the existence of the reduction rule:

" *The State Secretary has for practical reasons decided to make no difference in the application of the reduction rule for reasons of nationality, mother language and the country of origin. The Supreme Court therefore is of the opinion that the reduction rule is not in conflict with the principle of equality. If due to the nationality, mother language or the country of origin the costs for living or the willingness of the employee to be employed in the Netherlands are considered to be equal, the different treatment can be justified by the fulfilment of the regulation for practical reasons".*

According to the Supreme Court, the main idea behind the 30% ruling is that inbound employees incur higher expenses in connection to gaining the income than employees

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[45] Court in The Hague, September 21, 2000, no. 99/02299

[46] Supreme Court, May 30 2001, nr. 35 903, translated by the author.

who have already resided in the Netherlands for many years. Persons who have recently (within the last ten years) emigrated and returned to the Netherlands have, in this respect, less extraterritorial expenses. Furthermore since the 30% ruling is in fact a labour costs subsidy, the main goal of the 30% ruling is to attract highly skilled people from abroad[47]. For persons who had a previous connection with the Netherlands, it is not necessary to make such a regulation. Those people are much easier to recruit than real foreigners.
The comparison the applicant made with a Belgian employee is a logical comparison. It is very unlikely that this Belgian, for whom Dutch is the mother language, incurs higher costs of living in the Netherlands. This is even more the case if the Belgian decides to keep his residence in Belgium. Although there is indeed a differential treatment, this differential treatment is not discriminative. As mentioned by the Supreme Court the differential treatment can be justified by the fulfilment of the regulation for practical reasons.

In 2003 the Court in ‘s-Hertogenbosch gave a similar justification for the 10-years term in the reduction rule under the 35% ruling[48]. The justification given was that an employee with the Dutch nationality can only be considered to be in the same situation as a foreign employee if he has been abroad for over ten years. An employee who has been abroad less than ten years still has a connection with the Netherlands. Therefore the Court considers his situation to be equal to the situation of a Dutch employee, and consequently he cannot have extraterritorial costs due to a stay outside of the country of origin. The court therefore decided that the reduction rule was not in conflict with the anti-discrimination rule.

As stated above the reduction rule, according to the jurisprudence, is not in conflict with the principle of equality for the two following reasons:

- A person who stayed or was employed in the Netherlands before has no or a shorter acclimatisation period and therefore no or lower extraterritorial expenses.
- The distinction made is allowed for practical reasons

The reduction of the validity term is logical in the situations given, since they indeed have a shorter acclimatisation period. Even though they have been living for nine years abroad, they likely will acclimatise more easily in the Netherlands. They have, in many situations, had some connection with the Netherlands during their stay abroad. They for

[47] Decree of the State Secretary of Finance, DB93/835, V-N 1993, page 1416
[48] Court in ’s-Hertogenbosch, EK VI, January 27, 2003, no. 00/1318

example still had friends and family in the Netherlands, they took their vacations in the Netherlands, their children went to a Dutch or international school abroad etc. In my opinion the reduction rule is therefore not in conflict with the principle of equality. However it can be discussed whether the acclimatisation period of ten years is too long.

3.3. School Fees

The second of the two aspects that will be discussed is the possibility for an employer to grant a tax free allowance to their employees for school fees for an international school. These school fees can, according to the wording of Article 15 section a part j of the Wage Tax Act, only be granted to a qualifying employee. An employee who does not meet the criteria for the 30% ruling can only be given a tax free allowance for extraterritorial costs made outside of the country of origin. Only the costs that are made in connection with the employment can be reimbursed tax free.

In 2002 the Court in ‘s-Hertogenbosch[49] decided that a compensation for school fees for an international school is taxable income for employees who do not benefit from the 30% ruling. In the case at hand, Mr. X. was seconded abroad by his employer and in this respect he moved to Switzerland with his family. His children have visited an international school in Switzerland. In 1997 Mr. X. returned to the Netherlands and was expected to be seconded abroad at short notice. For that reason the children of Mr. X. went to an international school in the Netherlands. According to Mr. X he should receive a tax free allowance for these school fees, since he is in an actual and legal equal situation as an employee who benefits from the 30% ruling. Mr. X. is employed with a company who is liable to withhold Wage Tax. Mr. X. does have a specific knowledge, was working abroad and will be sent abroad at short notice again.
According to the Court, the costs of schooling the children cannot be seen as costs made in relation to gaining an income. There is no direct connection between paying the school fees for the children of the employee and the employment. The school fees have to be seen as spending the income instead of gaining an income.

This decision of the Court seems odd because the employee most probably will only be willing to come to the Netherlands if his family can move with him. In this respect the employee has to make these extraterritorial costs (high school fees) in order to gaining the income. Furthermore it can be questioned whether all the school fees should be compensated. The 30% ruling was actually made for extraterritorial costs. This means that only the additional costs should have to be compensated, however this is not the

[49] Court in ’s-Hertogenbosch, MK I, February 22, 2002, no. 98/5745

case. With regard to the school fees for the international school there is in my opinion no conflict with the principle of equality. The Government is entitled to decide which costs can be compensated tax free and which costs cannot. The Government in this respect is of the opinion that a tax free compensation facility is only granted if it was really necessary to make these costs. Furthermore the nature of the costs: extraterritorial, cannot appear in a purely domestic situation. A person who is in the same position as an ordinary resident, should therefore indeed not receive the 30% ruling. In my opinion this differential treatment can thus be justified because of the nature of the costs.

3.4. Conclusion

The conclusion, in my opinion, is that the 30% ruling is not in conflict with the principle of equality. The reduction rule and the granting of the school fees do not discriminate between employees based on their nationality or their country of origin.

3.5. Comparison to other EU- regimes

The principle of equality is in most of the countries the same as in the Netherlands. Taxpayers who are in a legal and actual same position should be treated the same. If tax payers are not in the same situation, they should be treated proportionally differently.

Belgium

In Belgium, the Constitutional Court has set out a procedure to determine whether a regulation is in conflict with the non-discrimination principle. Like in the Netherlands, all tax measures should treat persons in an equal situation equally. However, whereas in the Netherlands the proportionality seems only to be important in the situation that people are in different situations, it is in Belgium also of importance to people in equal situations. The different treatment of persons in an equal situation is in Belgium only justified if the different treatment is in proportion with the objective[50]. The Belgian inbound regulation, *Circular of 1983,* favours the inpatriates compared to other non-residents. The Belgian outbound regulation is open to all Belgian residents and therefore there does not appear to be any form of discrimination.

Germany

In Germany the non-discrimination principle is laid down in the Constitution[51]. Like in the Netherlands the following two criteria have to be fulfilled; there has to be a different

[50] Cass. January 13m 1194, www.cass.be
[51] Article 3, Paragraph 1, Grundgesetz

treatment of two groups of people in comparable situations and the different treatment must not be justifiable. However, Germany has a different approach of the non-discrimination principle. Where the Netherlands only forbids negative discrimination, Germany does also not allow positive discrimination. This is why Germany has no inpatriate regime at this moment. However, as concluded the economic beneficiary of the examined expatriate and inpatriate regimes is the employer. Germany could therefore easily introduce an inpatriate regulation which is open to all employers, without being in conflict with the domestic non-discrimination principle.

Although Germany does have no inpatriate regime, it does have an expatriate regime. According to German law, inland-working employees and expatriates are employees in a comparable situation (under a common umbrella-term: German employees). Furthermore since the main goal of the “Auslandsstätigkeitserlass” is to support the German export economy, the regulation pursues economic intentions. This different treatment of comparable groups of employees (inland-working and expatriates), can therefore considered to be justified. Whereas this would be enough in the Netherlands to conclude that there is no conflict with the principle of equality, in Germany there are three more conditions that need to be fulfilled. First of all the regulation has to be able to achieve the aim, secondly the regulation has to be necessary to achieve the aim and thirdly the regulation must not be excessive or disproportionate in comparison with the importance of the aim. The “Auslandsstätigkeitserlass” fulfils all three criteria and as such is not in conflict with the Constitution.

Sweden

The Swedish regulation has been subject to a lot of discussion since it’s introduction in January 2001. The Ombudsman is of the opinion that the regulation is in conflict with the Swedish Constitution. According to the Government this is incorrect, insofar as the Swedish Constitution only prohibits measures discrimination on grounds of race, colour or ethical origin, A favourable tax treatment of a minority through a tax relief is thus not contrary to the principle of equality in Sweden.

As shown above, the principle of equality is applied in a similar way throughout Europe. In some countries there is little discussion whether the regulations are in conflict with this principle. However, like in the Netherlands, in none of the Eucotax countries the regulation is in conflict with the national non-discrimination principle

4. International non-discrimination principles

4.1. EC Treaty

Besides the Dutch non-discrimination principle " the principle of equality", there are also the international non-discrimination principles. These non-discrimination principles can be found in the EC Treaty Freedoms and the bilateral Tax Treaties. In Article 12 section 1 EC Treaty the general non-discrimination provision is laid down.

Art 12(1): "Within the scope of application of this treaty and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited"

The EC Treaty is only applicable to economic situations with a cross-border element. If a certain situation is purely domestic or non-economic they do not fall within the scope of the EC Treaty. The Goal of the European Union is to integrate several domestic markets into one EU-wide single market, the Common Market. This EU-wide single market is laid down in Article 14 section 2 EC Treaty and is defined as *"an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured".* In Article 3 section 1 EC Treaty is laid down that this goal has to be reached by the abolition of obstacles to freedom of movement of goods, persons, services and capital. Article 12 section 1 is the lex generalis to these specific prohibitions: the EU freedoms (lex specialis)[52].

The EU freedoms have to be split in prohibitions of discrimination and prohibitions of restriction. A regulation is discriminative if they clearly cause unequal treatment in a certain respect. If the differential treatment is not caused by a formal distinction the regulation has to be considered restrictive instead of discriminative. A clear example of this is the exit tax for emigrants. There is no formal distinction in the regulation but the regulation works out restrictive. The separation is important for the justification of a potentially discriminative regulation. Where a discriminatory provision can only be justified on grounds explicitly mentioned in the EC Treaty, a restrictive provision can also be justified under the unwritten "rule of reason". There is a cooperation of both prohibitions, depending on the type of national measure that is to be tested for its compatibility with EC law[53].

[52] In Metallgesellshaft the Court decided that the general article 12 is not applicable if there is a special provision in the EC Treaty, CoJ 8 March 2001, C-397/98 and C-410-98, Metallgesellschaft,

[53] F. Vanistendael, *EU freedoms and Taxation,* Chapter 1.1.

A regulation is discriminatory if equal situations are treated unequally on grounds of nationality, and if unequal situations are treated equally. This is not different from the definition of discrimination under the Dutch domestic law. In Biehl and other ECJ Case law the ECJ decided that distinctions made on other grounds than nationality, but which result in the same effect, represent a covert form of discrimination, and are therefore also prohibited[54]. The non-discrimination principle, in the EU-context, is equally to the Dutch principle, structured as an "equality right". The non-discrimination principle cannot work in a vacuum but always needs a point of reference. If one believes that a certain regulation is an obstacle of the freedom of movement of goods, persons, services and capital, a comparison has to be made with a purely domestic situation. How would the regulation have worked out if there is no-cross border element? There can only be a potential discrimination if a Member State treats a cross-border situation worse than a purely domestic situation (negative discrimination). If however the purely domestic situation is treated worse this does not lead to international potential discrimination (positive discrimination). This is logical since this means that it is attractive to go abroad, which is in line with the EU-goal: a Common Market.

4.2. Free movement of workers (Articles 39-42 EC Treaty)

Article 39 section 2 EC Treaty states that *" the freedom of movement shall entail the abolition of discrimination based on nationality between workers on the Member States as regards employment, remuneration and other conditions of work and employment".* According to Regulation 1612/68 this also contains the taxation and social provisions [55]. It is therefore not allowed to treat workers from other Member States different than workers form the home state. According to ECJ Case law, this article prohibits both discrimination and restriction however only discrimination is explicitly mentioned in this article.[56] Below I will discuss two interesting cases which can be of importance for determining whether the 30% ruling and the deemed non-resident status are prohibited.

Schumacker[57]

This case dealt with the possibility for a non-resident to deduct expenses from their taxable income. In this case it has been decided that the income related deductions follow the income to the source state. However if the non-resident already gets a deduction in his home state, which can be effected, the source state does not have to

[54] European Court of Justice, May 8, 1990, C-175/88m para 13
[55] Regulation of 15 October 1968m 1612/68, article 7, elaboration.
[56] Shanton, Kraus, Bosman, p.56 Kiekebeld, *Harmful tax competition in the European Union*, EFS 2004
[57] European Court of Justice, February 14, 1995, C-279/93

give this deduction as well.

Schumacker /Wielockx[58]

Personal related tax-benefits follow the tax payer to the home state. The ECJ does in this respect not consider residents and non-residents to be in the same position. The source state therefore does not have to give the tax-benefits to non-residents, considering that those have to be granted by the home states. See in this respect sections 4.4.1 and 4.4.2 for the Tax Treaties between the Netherlands and Belgium and Germany.

Justification

The unequal treatment of persons in an equal position can be justified. A restriction to the free movement of workers may be justified if it pursues a legitimate aim compatible with the EC Treaty or it may be justified by pressing reasons of public interest, such as, for example, the coherence of the tax system. Even though it is widely accepted in literature that the fiscal treatment in another state cannot justify the differential treatment, this is under discussion again. Professor Kemmeren and Mr. Peeters are of the opinion that the fiscal treatment in another Member State is of importance for the question whether a specific regulation causes a distortion of fundamental freedoms[59]. The opinion of Kemmeren en Peeters is logical if we look at the goal of the fundamental freedoms: "*abolish regulations that lead to negative discrimination"*. In order to have discrimination there has to be a cross-border element. A cross-border element automatically means that the law of two Member States is involved. If the discrimination of a regulation of the first Member State is adjourn by the regulation of the other Member State, there in fact is no discrimination. However, the regulation can than only cause distortion if the discrimination is not adjourn in one of the Member States. However, several authors under which Professor Lang do not share the opinion of Professor Kemmeren and Mr. Peeters. Professor Lang if of the opinion that as long as direct taxation is not harmonised, it does not make sense that the Member States may justify their discriminatory measures by reasons of excluding double taxation or ensuring single taxation[60]. However, the fact that direct taxation is not harmonised yet does in my opinion not automatically mean that this is not a valid reason since the Member States have agreed that they will give their effort in trying to avoid double taxation (and double non-taxation).

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[58] European Court of Justice, February 14, 1995, *Schumacker,* C-279/93 and European Court of Justice, August 11, 1995, *Wielockx,* C-80/94

[59] Kemmeren, E., Peeters, P, *Wisselwerking in Europese driehoeksverhoudingen bij voorkoming van dubbele belasting*, WFR 2008/350.

[60] Lang, M, *The Marks & Spencer Case – The open issues following the ECJ's Final Word,* IBFD February 2006, 3.2

30% ruling for inpatriates

The question is whether the Dutch 30% ruling of Article 15 section 1 part j Wage Tax Act and the deemed non-resident status of Article 2.6 Income Tax Act are discriminatory or restrictive according to Articles 39-42 EC Treaty.

The 30% ruling can give an advantage to an employee who is recruited from abroad and who has a specific expertise that is scarce on the Dutch labour market. The 30% ruling for inbound employment does not make a difference on nationality. The 30% ruling is open to every employee who is recruited from abroad and who meets the criteria. Once the 30% ruling has been granted it does not make any difference if the employee lives in the Netherlands or abroad. Will the regulation be discriminative than a non-resident has to be treated worse than a resident of the Netherlands. This will never be the case with the 30% ruling. It can never be that a non-resident is worse of than a resident of the Netherlands.

However a person who is a resident of the Netherlands and who receives the 30% ruling, has the option to opt for the deemed non-resident status of Article 2.6 Income tax Act. As described in part 2 section 5, this deemed non-resident status works for the articles regarding income from substantial interest and income from savings and investments.

For the articles regarding income from employment and housing he is regarded a resident of the Netherlands. If this person has only income from the Netherlands and no income from abroad he is treated different from a non-resident. The non-resident who is in the same situation, is taxed for the same source income as the deemed non-resident. However the deemed non-resident receives all kind of tax credits and deductions. These tax credits and deductions are income related deductions and personal related tax benefits. This means that the non-resident who is in the same situation is treated worse than the deemed non-resident. With regard to the personal related tax benefits the ECJ decided that residents and non-residents are not in the same position. Therefore the worse treatment cannot be discriminative since the situations are not equal.

With regard to the income related deductions the Schumacker-case is of importance. In this case the ECJ decided that the personal related tax-benefits follow the tax payer to the home state. The Netherlands have reacted on this case by implementing Article 2.5 Income Tax Act. This Article gives the non-resident the option to opt for a deemed resident status. By opting for this status he is treated as a resident and he receives these personal related tax benefits. The Court in Breda recently decided that implementing

Article 2.5 is a decent codification of the Schumacker-case in the Dutch tax law[61]. As stated above the 30% ruling and the deemed non-resident status of Art 2.6 Income Tax Act do not lead to a discrimination or restriction of the free movement of workers, as laid down in Articles 38-42 EC Treaty.

4.3. Free movement of establishment (Articles 43-49 EC Treaty)

Article 43 EC Treaty states that *"restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State"*.

Besides the free movement of establishment there is also the freedom of capital (Article 56 EC Treaty). It is important to know which freedom is applicable in a certain situation since the freedom of Capital is the only fundamental freedom that extends to third States. In a Communication of the European Commission the following is stated: "*Thus, the acquisition of controlling stakes, as well as the full exercise of the accompanying voting rights … is also considered to be a form of capital movement"* and "*Freedom of establishment shall include the right to set up and manage undertakings""*[62]
It is not always clear which of the two freedoms is applicable. Terra and Wattel are of the opinion that if the economic operator is merely making a portfolio investment the freedom of capital is applicable (minority holding), whereas the right of establishment is involved if the economic operator is in fact investing in a business continuation or start-up abroad (majority holding)[63]. However, according to Peeters it is not clear which freedom prevails in which situation. He is of the opinion that in certain situations both freedoms are parallel applicable[64]. However, as this discussion falls out of the scope of this paper it will not be further discussed.

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[61] Court Breda, October 23, 2007, no. AWB 06/05869, NTFR 2007/2297; contrary: Arendonk (*Inkomstenbelasting en Europa: nationale folklore met een Europees sausje,* 2008 03) and Opmeer (*De keuzeregeling voor binnenlandse belastingplicht: facelift noodzakelijk*, MBB 2005, nr. 11) are of the opinion that an employee can still opt for the Schumacker-case in the situation that he does not opt for the deemed resident status of article 2.5 income tax act.

[62] Communication of the Commission on certain legal aspects concerning intra-eu-investment, official journal C220, 19/07/1997, points 3 and 4.

[63] Terra/Wattel *European tax law*, page 49

[64] Peeters, P, *Meerderheidsdeelnemingen: bestaat er en rangorde tussen art. 43 en 56 EG?,* WFR 2007/777,

30% ruling for inpatriates

If we look at the 30% ruling and the character of the 30% ruling the only conclusion can be that the free movement of establishment is applicable.

As stated in part 2.5. , in my opinion, the 30% ruling is a labour costs reduction facility. As shown in figure 1, the EATR is lower if the 30% ruling is granted. The employer has the option to give the advantage to the employee or to use the advantage for herself. In this last situation the employee receives a certain net-income regardless whether the 30% ruling is granted. This means that the whole advantage is going to the employer.

In order to be able to receive the 30% ruling the employer has to withhold wage tax in the Netherlands. If the employer is not liable to withhold wage tax, the 30% ruling cannot be used. According to Article 6 of the Wage Tax Act a company is liable to withholding wage tax if she has one or more employees. A foreign company can only be liable to withholding wage tax if he has a permanent establishment or a permanent representative in the Netherlands, or if he has one or more employees whose income is taxable under the Income Tax Act in the Netherlands and who maintains a salary administration in the Netherlands. The above means that a foreign company can use the 30% ruling for an employee if and to the extent that the employee is working in the Netherlands, the income is taxable in the Netherlands and he holds a salary administration in the Netherlands for this employee. The taxability for the Income Tax Act has to be seen in accordance with the tax treaties applicable[65].

As stated the 30%-ruling is open for a foreign company with a permanent establishment or permanent representative in the Netherlands. Therefore there is no difference between the treatment of a subsidiary (who is liable to withholding wage tax according to Article 6 section 1 Wage Tax Act), and the permanent establishment[66]. Furthermore a foreign company (without a permanent establishment in the Netherlands) can also have to withhold wage tax. However, whereas this company can only be liable to withhold wage taxes if the income of the employee is taxable in the Netherlands, there is no restriction for the Dutch company. This foreign company is treated different from the Dutch company. Whereas the Dutch company only has one salary administration, the foreign company is liable to have two salary administrations (Netherlands and home state). In my opinion therefore there is a differential treatment between a resident company and a non-

[65] Decree of the State Secretary of Finance, December 17, 1996, nr. SV/AVF/96/4987, Stcrt. 1996, 247.

[66] In several cases of the European Court of Justice is decided that tax benefits accorded to resident companies must be accorded to the same footing to permanent establishments of foreign companies. However non of these cases deal with Wage Tax, in my opinion it can be widened to this type of taxation.

resident company.

In my opinion this small differential treatment can be justified. The salary administration is necessary for the Dutch tax authorities to check whether everything is calculated in the correct way. Besides this small restriction there are no other restrictions or discriminations. Both companies have to inform the tax inspector that they are liable to withhold wage tax. Therefore the 30% ruling does not lead to a discrimination or restriction of the free movement of establishments, as laid down in Article 43 EC Treaty.

30% ruling for expatriates

Equal to the 30% ruling for the inpatriates, both the employer and the employee benefit from the 30% ruling for expatriates. Since all the employees can qualify for this regulation as long as they are seconded to a listed country or for a listed reason, there is no discrimination. Besides this it cannot lead to international non-discrimination since non-resident tax payers are not in the same position as resident tax payers. Non-resident tax payers who are seconded to e.g. Egypt are not liable to the Dutch tax system for their labour income and can therefore not profit from Dutch labour regulations.

4.4. Tax Treaties

Besides the non-discrimination principles as laid down in the EC Treaty there are also the non-discrimination principles in the different Tax Treaties. The most non-discrimination articles in the Tax Treaties concluded by the Netherlands are in accordance with the OECD Model Convention. In the Tax Treaties with Germany and Belgium the Netherlands have a different non-discrimination article. Therefore these non-discrimination principles will be discussed separately in sections 4.4.1 and 4.4.2.

According to Article 24 section 1 OECD "*for purposes of taxation discrimination on the grounds of nationality is forbidden and the nationals of a Contracting State may not be less favourable treated in the other Contracting State than nationals of the latter State in the same circumstances*"[67]. According to the clarification of this article the expression 'in the same circumstances' establishes that a taxpayer who is resident of a Contracting State is not in the same circumstances as a resident of that State. According to the OECD the comparability has to be solely based on the difference that is prohibited by the

[67] This has been further explained in the OECD, *Application and Interpretation of Article 24 (Non-discrimination),* Public discussion draft, May 3, 2007, p.6: "*Whilst the article seeks to eliminate distinctions that are solely based on certain grounds, is not intended to provide foreign nationals, non-residents, enterprises or other States or domestic enterprises owned or controlled by non-residents with a tax treatment that is better than that of nationals, residents or domestic enterprises owned or controlled by residents*".

relevant provision. A different treatment does therefore not automatically result in a violation of these provisions[68].

4.4.1. Belgium

Most non-discrimination articles in the Dutch Tax Treaties are in accordance with the OECD Model Convention. However in the Dutch-Belgium Tax Treaty a different non-discrimination principle is laid down. In Article 26 section 2 of the Tax Treaty is laid down that a resident of a Contracting State who receives income from the other Contracting State has a proportional right to personal related tax benefits if he is in an equal situation as a resident of the other Contracting State.

In the ECJ Cases Schumacker and Wielockx the ECJ decided that personal related tax-benefits follow the tax payer to the home state. This means that the source state does not have to give the tax-benefits to non-residents, considering that those have to be granted by the home states. Normally a non-resident has to opt for the deemed-resident status of Article 2.5 Income Tax Act to receive those benefits. However for residents of Belgium it is not necessary to opt for this status since they already receive those tax-benefits based on the Tax Treaty.

4.4.2. Germany

In the Tax Treaty between the Netherlands and Germany in Article 24 the non-discrimination principle is laid down. In Article 24 section 1 is laid down that "Residents of a Contracting State may not be taxed worse in the other Contracting State than a resident of that Contracting State. This article is also applicable to personal related tax-benefits. This article seems the same as the article with the Tax Treatment between the

Netherlands and Belgium but in fact it is a bit different. Whereas residents of Belgium receive these pro-rata, the Germans only receive this if 90% of their income is taxable in the Netherlands[69]. Furthermore the Germans receive more personal related tax benefits than the Belgians.

Conclusion

Equal to the non-discrimination principles under EC law, in the clarification of Article 24 OECD is laid down that it is allowed to treat a non-resident better than a resident. It is

[68] OECD, *Application and Interpretation of Article 24 (Non-discrimination),* Public discussion draft, May 3, 2007, p.4
[69] ECJ, *Schumacke*r, February 14, 1995, C-279/93

therefore only applicable to negative discrimination[70]. This is the same for the non-discrimination principles in the tax treaties with Belgium and Germany. The non-discrimination principle of Article 24 section 1 OECD is therefore “equal" to the non-discrimination principles in the EC Treaty.

As already said in parts 4.2 and 4.3 about the fundamental freedoms, the 30% ruling for inbound employment does not make a difference on nationality. Will the regulation be discriminative according to Article 24 section 1 OECD than a non-resident has to be treated worse than a resident of the Netherlands. This will never happen at the 30% ruling. The 30% ruling for inpatriates and expatriates is therefore not in conflict with the non-discrimination principle of article 24 OECD.

4.5. Comparison to other EU- regimes

As shown the principle of non-discrimination is laid down in the fundamental freedoms of the EC Treaty and in the bilateral tax treaties.

All the inpatriate measures of the Eucotax-countries are designed to attract foreign employees and foreign investors to the Member States. All expatriate provisions promote cross-border employment (some to promote their own economy, others to promote developing-aid). Since the fundamental freedoms of the EC Treaty only prohibit negative discrimination, these provisions (which are clearly all a form of positive discrimination) are not prohibited by the fundamental freedoms of the EC Treaty.

Most inpatriate and expatriate provisions of the Eucotax countries are based on the criterion of residency. Most European countries follow article 24 of the OECD Model Convention in their tax treaties. As article 24 of the Model Convention only prohibits measures that treat non-nationals differently based upon their nationality, those that differentiate on grounds of residency or other grounds are not discriminatory for OECD purposes[71] The 30% ruling does not differentiate on grounds of nationality, and is for that reason not in conflict with the non-discrimination principle. Furthermore, equal to the EC Treaty, the non-discrimination principle of Art 24 OECD only prohibits negative discrimination. As said before, this will never be the case at the 30% ruling.

[70] see part 4.2 for an explanation of positive discrimination and negative discrimination.
[71] G. Toifl, *“EC fundamental Freedoms and Non-Discrimination Provisions in Tax Treaties”,* in W. Gassner, M. Lang and E. Lechner, *Tax Treaties and EC law,* London, Kluwer Law International, 1996, 131 and 1997 OECD Commentary on article 24, section 4.

5. State Aid and the EU Code of Conduct

Within the European Union the past years the main focus has been on the creation of a Common Market. To serve this goal diverse actions have been undertaken such as the introduction of the Euro and the implementation of the diverse directives (for instance the parent-subsidiary directive and the royalty-directive). As a result of these developments direct taxation is one of the few instruments left for a Government to influence their own economy.

Within the European Union we have two instruments to determine whether a specific tax measure is considered to be (harmful) tax competition. First we have Articles 87-89 EC Treaty in which the criteria for State-Aid are laid down. Second there is the Code of Conduct in which the criteria for determining whether a regulation is considered to be harmful tax competition are laid down. Furthermore in both Article 87 EC Treaty and the Code of Conduct is laid down what amendments have to be made by a Government if a certain tax measure is considered to be State Aid or harmful tax competition.

5.1. State Aid

As we have already seen the different inpatriate and expatriate regulations in the different Member States are designed to attract certain groups of employees from abroad or to promote domestic enterprises to start cross-border activities. Therefore we need to consider whether these regulations constitute a State Aid under Article 87 of the EC Treaty.

In Article 87 EC Treaty is laid down under what conditions a specific tax measure is considered to be State-Aid and is therefore incompatible with the Common Market. The purpose of this article is to make sure that tax measures do not cause a distortion in the European Common Market[72]. Article 87 EC Treaty defines State Aid as follows:
" Any aid granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in as far as it affects trade between member states, be incompatible with the common market".

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[72] Article 2 EC Treaty: " *The community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and a social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic an social cohesion and solidarity among Member States".*

According to the EJC in the Denkavit-case[73] Article 87 EC Treaty should be read as follows: *" This refers to the decisions of member states by which the latter, in pursuit of their own economic and social objectives, give, by unilateral and autonomous decisions, undertakings or other persons resources or procure for them advantages intended to encourage the attainment of the economic or social objectives sought".*

In order to define a regulation as incompatible State Aid there are four criteria to be fulfilled:

1. *an advantage in any form whatsoever conferred on a firm or firms;*
   In the Notice of the European Commission of State Aid rules on tax measures, the European Commission explained the meaning of this condition: *the measure has to confer an advantage for the recipients and relieves them from a tax burden that would otherwise have to be borne by them"[74].* Furthermore the Commission Notice states that the advantage may be provided through a reduction in the firm's tax burden in various ways, including: (i) a reduction in the tax base (e.g. special deductions), (ii) a total or partial reduction in the amount of tax (e.g. a tax credit) or (iii) deferment, cancellation or special rescheduling of tax debt).
2. *from state-originated resources;*
   This condition is also fulfilled if the advantage is not granted by the State, but by regional or local bodies in the Member States. Furthermore the advantage can be given by provisions of legislative, regulatory or administrative nature. State-originated resources do also include a loss of tax revenue by the State[75].
3. *causing a distortion of competition and having an impact on intra-Community trade;*
   In order to distort the competition, or at least threaten to distort the competition, the beneficiary of the regulation has to exercise an economic activity. The Commission Notice also states that the major fact that the aid strengthens the firms' position compared to that of other firms, is enough to conclude that the intra-community trade is affected[76].
4. *having a specific or selective character.*
   The fourth condition makes a distinction between general measures (which are open to all firms) and measures that are targeted at selective addressees. The single fact that some taxpayers benefit more from a measure than others, does not automatically mean that the measures is selective[77].

[73] European Court of Justice, March 27, 1980, case 61/79, 61979J0061
[74] See *Commission notice on the application of the State Aid rules to measures relating to direct business taxation, points 8 and 9.*
[75] See *Commission notice on the application of the State Aid rules to measures relating to direct business taxation, point 10 and* Kiekebeld, *Harmful tax competition,* p. 71.
[76] See *Commission notice on the application of the State Aid rules to measures relating to direct business taxation, point 11*
[77] See *Commission notice on the application of the State Aid rules to measures relating to direct business taxation, points 12-14*

30% ruling

As described earlier, the 30% ruling is in fact a labour costs subsidy for companies. In this respect the 30% ruling clearly gives an advantage to a company. Besides the financial advantage the 30% ruling also grants an administrative advantage, since these companies do not have to prove the expenses made. The second criterion is also fulfilled very clearly. The 30% ruling is an advantage by paying less wage tax than in a normal situation. This means that the advantage given is from State originated resources.

Since most Member States have similar regulations to attract highly skilled employees, and thereby investments, to their countries, the question is whether the 30% ruling does cause a distortion. Generally it is accepted that the fiscal treatment in another Member State does not affect the conclusion whether a regulation causes discrimination or a prohibition of the fundamental freedoms. However, since the Amurta-case the importance of the fiscal treatment in another Member State is part of discussion again for the non-discrimination principles. In my opinion this does not automatically apply to the State Aid provision of Article 87 EC Treaty. Contrary to the non-discrimination provisions a cross-border element is not necessary for a regulation to be State Aid. It should therefore not make any difference whether other states have a same sort of regulation. Therefore, if the regulation leads, or can lead, to a distortion of the competition, this criteria is met. The 30% ruling for inpatriates clearly threatens to distortion the competition, since the regulation is made to attract highly skilled people from abroad. The 30% ruling for expatriates, does also fulfil this condition. The regulation strengthens the firms' position compared to that of other firms. That the main aim of the expatriate regulation is to promote developing-aid does not make this any different.

The fourth criterion is that the regulation has a specific or selective character. If only non-residents benefit from the low taxation, the selectivity criterion is met[78] The 30% ruling is in fact only applicable to a non-resident (recruited from abroad), and as thus could be selective. In order to fall under the scope of State Aid the regulations have to grant an advantage to a firm. When the economic beneficiary of a regulation is the employee, the regulation cannot fall under the State Aid provisions. As the 30% ruling is a labour cost reduction facility one should check whether there is selectivity at that level. Since both resident and non-resident employers can use the 30% ruling for inpatriates, if and to the extent that the employees income is effectively taxed in the Netherlands, there is no selectivity. The 30% ruling for expatriates is also not specific or selective. It is open to all firms as long as they send their employees to a listed region. In my opinion the 30% ruling for both inpatriates and expatriates are therefore not to be regarded as State Aid. Futhermore, even if the 30% regulation for expatriates should be regarded as selective, it still does not constitute incompatible State Aid, since in Article 87 (3)

[78] See Mr. B.J. Kiekebeld, *Harmful tax competition in the European Union*, EFS 2004

(a) is laid down that *measures aimed at promoting the economic development of areas in which the standard of living is abnormally low or where there is high unemployment* are regarded as compatible with the Common Market.

Other European regulations

As already described for the Dutch 30%-ruling, in my opinion, the economic beneficiary of this regulation is the employer. This turns out to be the same for the Austrian, French, Spanish and Swedish inpatriates and expatriate regimes. Al those regimes have the aim to make it easier for employers to attract highly skilled employees from abroad by reducing their labour costs. Even though all these regulations are laid down in Acts and regulations relating to individual taxation, the economic advantage of the rules goes to the employer. The special tax regimes give the employers the possibility to reduce the labour costs[79]. Since the employees are only interested in their net income, these regulations can be seen as labour costs reduction facilities. Both inpatriates and expatriates work (mostly) on a net-contract. The employer does not want an employee working in one country to receive a higher net disposable income, than an identical employee in another country,

The second criterion is that the advantage has to be granted by a Member State or through State resources. The different Member States have different ways of granting the advantage. In the Netherlands and Sweden a fixed allowance/reduction is granted of respectively 30% and 25%. In Belgium however, they only allow a tax free reimbursement of the incurred extraterritorial expenses, which is equal to the French regime that exempts bonuses for inpatriates from taxation. In contrary, Spain gives the advantage by applying a flat rate of 25% instead of a progressive tax rate up to 45%, and Austria tax exempts the additional tax burden that can appear due to the move to Austria.
Even though all regimes have a different way of granting the advantage to the employee, it is very clear that all regimes grant their advantages through state originated resources. All the regimes therefore fulfil the second criterion.

In order for a regulation to be State Aid the regulation has to distort or at least threaten to distort the competition. Since all the inpatriate regimes make it more attractive for employers to attract highly skilled employees from abroad, the regulations make the Member State at hand more attractive for foreign employers. The regulation gives employers more possibilities to attract the best employees possible. Furthermore the reduction of the labour costs reduces indirectly the cost price of the activities of the company. The regulation therefore encourages foreign companies to (re)locate their activities in the country.

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[79] See part 2.5 for some calculations for the Dutch 30% ruling

The expatriate regimes on the other hand do not all have the same goal. Whereas most countries have the aim to promote domestic companies to start cross border activities, in the Netherlands the aim of the 30% ruling is to promote developing aid. Besides the Dutch regime, all regimes again distort or threaten to distort the competition.

So far all the regimes (besides the Dutch expatriate regime) fulfil the State Aid criteria. The fourth criterion is however not fulfilled by all of the regimes. In Austria and Belgium the Tax Administrations have a wide discretionary power to decide whether someone can benefit from the regimes[80]. As mentioned in the Commission Notice and by the European Court of Justice, this discretionary power can result in favouring certain undertakings and therefore may be regarded as State Aid[81]. For these regimes it is in fact the lack of transparency which makes the regulations State Aid.

With regard to the expatriate regimes, both Austria and Germany fulfil the selectivity criterion. In Austria the regulation is restricted to employees of domestic businesses that act in plant engineering abroad. The tax regime is thus restricted to employees of certain undertakings, and therefore selective. The German expatriate regime is only applicable to employees of providers, producers or owners of a mining right in a foreign country, and thus selective. Those regulations are therefore considered to be an incompatible form of state-aid.

5.2 . Code of Conduct

If a specific tax measure is not considered to be State Aid than one should check whether this measure could be harmful tax competition according to the Code of Conduct for business taxation[82]. The European Code of Conduct is a form of soft law. The Code of Conduct does not have a binding legal effect, but aims to a change in the behaviour of Member States. Since the Member States agree that tax competition can have harmful effects which have to be abolished, and harmonization is difficult due to political reasons, the European Commission has chosen for soft law to end harmful tax competition between the Member States[83].

The code of conduct defines harmful tax practices as measures that: *1. " affect, or may affect, in a significant way the location of business activity in the Community". 2. "provide for a*

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[80] In Austria it is dicussed whether or not the regulation is indeed State Aid. Some authors are of the opinion that the effects of the regime on the Common Market cannot be evaluated because of the broad range of addressees.

[81] Commission Notice, MN 21 and EcJ September 26, 1996, C-241/94, France v. Commission (Kimberly Clark Sopalin).

[82] The Code of Conduct has been adopted through a resolution of December 1, 1997, which was published on January 6, 1998

[83] Gribnau, *The Code of Conduct for Business Taxation als soft law-instrument,* TFB 2008/02

significantly lower effective level of taxation, including zero taxation than those levels that generally apply in the Member State in question".

Member States have committed themselves to not introduce new measures which are harmful within the meaning of the Code and to re-examining their existing laws and established practices. Both Article 87 EG-Treaty and the Code of Conduct rule out preferential tax measures (specific measures). Besides those specific measures, general measures can also lead to harmful tax competition. A general measure is a measure which is designed to achieve an overall improvement of a country's fiscal competitive position, for example, an overall reduction of the tax rate. Since harmful tax competition can occur in a wider range than only the specific measures.

5.2.1. Code of Conduct at this moment

In the draft version of the Code of Conduct, the expatriate and inpatriate regimes were included; "*This code covers those business measures which affect, or may affect, the location of business activity in the Community in a significant way. Business activity in this respect includes all activities carried out within a group of companies. The Code also covers those special tax regimes for employees which have a similar effect on the location of business activity"*[84].

Within the Human Capital factor the tax burden has shifted from the highly skilled employees to the less-mobile employees. As shown there are several regimes within the European Union which are specifically designed to attract highly skilled (mobile) employees from abroad. The Commission defined those regimes as "*measures that have a significant influence on the location of economic activities within the European Community".* This opinion is shared by Mr. Kiekebeld who is also of the opinion that these preferential tax regimes in the field of taxation of persons could be regarded as creating harmful tax competition. Those regulations are designed to attract mobile economic activities from abroad[85]. Despite the recognition by the European commission in 1997 of the harmful aspects of the shift of taxation to labour income, the expatriate and inpatriate regulations were excluded from the final version of the Code of Conduct. It turned out to be impossible for the Member States to reach an agreement. At this point some of the Member States found the provisions to encroach too much on their sovereignty in direct taxation. The Code of Conduct is reviewed each two years, which could lead to an extension of the Code in the future with taxation of persons. At this moment the Code of Conduct does however not cover the expatriate and inpatriate regimes.

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[84] COM(97) 495 FINAL 1/10/97 Annex to draft of Code of Conduct paragraph C
[85] B.J. Kiekebeld, *Harmful tax competition in the European union,* EFS 2004

5.2.2. Code of Conduct in the future

As already mentioned when discussing the Dutch expatriate and inpatriate regime, most expatriates and inpatriates work on a net-contract. Employees are only interested in their net-income and the employers do not want taxation to be of influence on the employees' decision. The net-income contract has the effect that the net disposable income of the employee is the same, regardless the taxation of the country he is working in. As already explained for the Dutch regulation this means that the employer is the real economic beneficiary of the expatriate and inpatriate regime.

This is the same for the Austrian, Belgian, French, Spanish and Swedish inpatriate regimes. All those inpatriate regimes have the aim to make it easier for employers to attract highly skilled employees from abroad by reducing their labour costs. Even though all those regulations are laid down in Acts and regulations relating to individual taxation, the economic advantage of the rules go to the employer. The special tax regimes give the employers the possibility to reduce the labour costs[86]. Since the employees are only interested in their net income, these regulations can be seen as labour costs reduction facilities.

The same works for the expatriate regimes of Austra, Belgium, France, Germany, Spain and Sweden. Equal to the inpatriates also the expatriates (mainly) work on a net-contract. The employer does not want an employee working in one country to receive a higher net disposable income, than an identical employee in another country. This results in the situation that the taxation of the labour income is for the account of the employer. A regulation which reduces the taxation on the labour income of the employee does therefore indirectly reduce the labour costs of the employer. The employers are therefore the real economic beneficiaries of the regulations.

Since the real economic beneficiaries of the expatriate and inpatriate regimes are the employers, the regimes are in fact labour cost reduction facilities. As stated by the Commission in the draft of the Code of Conduct, the Code of Conduct should also be applicable on those regimes, since they have a significant influence on the location of economic activities within the Community[87].

If the Code of Conduct will be applicable in the future, many countries might have a problem. In order to qualify as a harmful tax measure according to the Code of Conduct, two criteria have to be met; (i) objective criterion: only measures that deviate from the general tax system in the State can be considered to be harmful and (ii) subjective criterion: measures that affect

[86] See part 2.5 for some calculations
[87] Kiekebeld, B, *Harmful tax competition in the European Union, Code of Conduct, countermeasures and EU law, Rotterdam ,* 2004, p. 28

or may affect in a significant way the location of a business activity in the Member State are harmful.

The first criterion is met by all the expatriate and inpatriate regimes. All those regimes deviate from the general tax system in the state.

The second criterion is also met. All the expatriate and inpatriate regimes have an important influence on the location decisions of companies. In specific for the Netherlands, one of the main goals of the 30% ruling is to make the Netherlands an attractive and competitive investment country[88]. This would mean that the regulation could be harmful tax competition. The institute for the Study of Labor made an employer survey in the year 2000[89]. According to their calculations 33.33% of the Dutch surveyed firms employ highly skilled employees. Within those firms 17% of the highly skilled employees were foreign. This means that the average proportion within Dutch firms is 5,6%. Compared to the other surveyed countries (Germany, France and the UK) this is the highest percentage. Dumont and Lemaitre conclude in their 2000 report that in most OECD countries, the number of immigrants with tertiary education exceed the number of highly qualified expatriates to other OECD countries[90]. This means that most OECD countries profit from the international mobility of the highly skilled. The report, however, does not show what the reasons are for this migration.

Both reports state that the highly qualified workforce is very mobile and that many companies recruit their employees from abroad. A specific tax regulation which gives an advantage to those employees/employers can succeed in attracting highly skilled employees from abroad. Although specific numbers are hard to find, the figures given above do show the mobility of the workforce. Since the main goal of the 30% ruling is to improve the investment climate of the Netherlands by attracting highly qualified employees from abroad, the competition factor is very clear.

Divers studies however show that taxation is not the only factor for an employee to decide to come to the Netherlands. A study from the Dutch migration service shows that after simplifying the regulations for receiving a Dutch work permit, the amount of highly skilled employees has doubled[91].

[88] State Secretary of Finance, 20 October 2003, nr. 2003/244, V-N 2003/60.16
[89] Winkelmann, *Why do firms recruit internationally? Results from the IZA international Employer Survey 2000,* July 2001, Institute for the Study of Labor.
[90] Dumont, JC and Lemaitre, G, *Counting Immigrants and Expatriates: A New Perspective,* OECD, Social Employment and Migration Working papers.
[91] European Migration Network, *Highly educated migrants from third countries*, April 2004

The sub conclusion therefore is that the 30% ruling is tax competitive, however the next question is whether it is harmful tax competition. In the 2000 OECD report of Dumont and Lemaitre is concluded that in the Netherlands the number of highly skilled immigrants is equal to the highly skilled emigrants to OECD countries. The 30% ruling therefore clearly does not attract more highly skilled employees to the Netherlands than highly skilled employees who decide to leave the Netherlands. However, up till now it is generally accepted that the taxation of employees in other countries are of no importance when answering the question whether a regulation leads to harmful tax competition. The conclusion for the Dutch regulation is therefore, that as soon as the Code of Conduct is applicable, the Dutch Government really should consider revising the Dutch regulation. However as explained above, this is the same for the other Eucotax countries.

6. Conclusion and Recommendations

One of the aims of the European Union is *"to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion."*[92] The factor "Human Capital" is of great importance for this knowledge-based economy since the employees make the economy knowledge-based.

Comparison

The different expatriate and inpatriates regimes influence the factor "Human Capital".
The regimes aim to attract highly skilled employees to their country by enabling the employers to reduce their labour costs. This reduction of the labour costs gives employers the possibility to attract the best employees available and to reduce the cost prices of their activities. At first sight the different inpatriate and expatriate regimes within Europe are very different. Whereas in the Netherlands the inbound employees can receive a tax free allowance for extraterritorial costs, in France the inpatriation bonuses are tax exempt, and where in the Netherlands the inpatriate regulation is open to employees in all sectors as long as the employees are highly skilled and scarce on the Dutch labour market, in Austria the inpatriate regime is only open for scientists, researchers, artists and athletes.

Even though the regimes are very different, their objectives are the same. All the inpatriate regimes in Europe have the main aim to attract highly skilled employees from abroad and all the regimes try to reach their goal by covering the extraterritorial costs of the employees. Since the different Member States are trying to reach their goal in different ways, this means that most likely one regime is more tax competitive than another. Furthermore it could mean that some regimes have to be considered harmful, where other regimes are not. Within Europe there are different measures to avoid harmful tax competition. In this respect the following question has to be answered.

Is the Dutch 30%-ruling a type of harmful tax competition according to the non-discrimination principles, the State-aid regulation and the EU Code of Conduct, and how competitive is it compared to foreign expatriate and inpatriate regulations?

Competitiveness

If the different regimes are compared, the conclusion can be drawn that the 30% ruling can very well compete with the other European regulations. First of all the 30% ruling is applicable for a maximum period of 10 years, whereas other regimes are applicable for a maximum

[92] strategic goal for 2010 set for Europe at the Lisbon European Council - March 2000),

period of 3 to 5 years. Furthermore the 30% ruling gives a tax free allowance to a deemed percentage. This deemed percentage give a huge benefit if the actual costs incurred are low. If the costs turn out to be higher than 30% of the income, the actual costs incurred can be compensated tax free. The Dutch regulation is therefore more advantageous than a regulation in which the actual costs incurred are covered. Last but not least is the transparency of the 30% ruling a very competitive element, since a transparant regulation gives more certainty than e.g. the regulations of Austria and Belgium (where the tax authorities have a wide discretionary power). If an employer decides to attract employees from abroad it is better for them to know the fiscal consequences in advance.

Non- discrimination principles

The non-discrimination principle is laid down in European law (fundamental freedoms of the EC Treaty), International law (bilateral tax treaties), and in Domestic law. For the regimes in the Netherlands and most of the other countries the conclusion is that they are not in conflict with the domestic non-discrimination principle. However, Germany has a different approach of the non-discrimination principle. Where most countries (including the Netherlands) only forbid negative discrimination, Germany does also not allow positive discrimination. This is why Germany has no inpatriate regime at this moment. However, as concluded the economic beneficiary of the examined expatriate and inpatriate regimes is the employer. Germany could therefore easily introduce an inpatriate regulation which is open to all employers, without having a conflict with the domestic non-discrimination principle.

The international non-discrimination principles can be found in the EC Treaty and in the bilateral tax treaties. The non-discrimination principles in the tax treaties of the examined countries are in accordance with the Model Convention. Both the EC Treaty and the Model Convention do not allow negative discrimination, whereas positive discrimination is allowed. The Dutch 30% ruling and the other inpatriate and expatriate regulations promote cross-border employment and are not restrictive. They are therefore in line with the goal of the European Union, the Common Market. The expatriate and inpatriate regimes are therefore not in conflict with the fundamental freedoms of the EC Treaty or the non-discrimination principles in the tax treaties.

State-Aid

In article 87 EC Treaty is laid down under what conditions a specific regulation is considered to be State Aid and therefore incompatible with the European Common Market. In order for a regulation to be State Aid four conditions have to be fulfilled. The 30% ruling and most of the other examined regulations do not fulfil the State Aid criteria

of Article 87 EC Treaty. Only the inpatriate regimes of Austria and Belgium do fulfil all four criteria and are thus considered to be State Aid. The only reason why these regimes fulfil the criteria is because the Tax Administration has a wide discretionary power in their decision whether the regime can be applied. These regimes are therefore not transparent and are for that reason considered to be selective.

Code of Conduct

Even though included in the draft version of the EU Code of Conduct, the final version of the Code of Conduct is not applicable to inpatriate and expatriate regimes. It turned out to be that the Member States could not agree on this point since it encroached too much on their sovereignty in direct taxation. However, if the Code would be applicable, which I believe it should, then all the regimes are in conflict with the Code. Since the expatriates and inpatriates normally work on a net-contract, the taxation on the labour income is carried by the employer. The economic beneficiaries of all the regimes are therefore the employers. This means that the different expatriate and inpatriate regimes do influence the location of a company. As stated by the Commission in the draft version of the Code, it should also be applicable on those regimes, since they have a significant influence on the location of economic activities within the Community. Since the Code of Conduct is a form of soft-law, the conflict with the Code does only mean that the different Member States should consider revising their regimes.

<u>Recommendations</u>

Since all regimes have the same goal: giving employers the possibility to attract highly skilled employees from abroad by reducing their labour costs, the European Union should think about harmonising the different regimes. However, in practice harmonisation turns out to be very difficult because of the necessity of unanimity. The European Commission therefore recently mentioned that harmonisation is no longer the guideline of the Commission[93].

Since harmonisation is a difficult option, it would be advisable to choose for soft law and to give certain guidelines to the Member States for the creation of a good/solid expatriate regimes. Even though it is soft law, in the past it turned out to be very effective as almost all the regimes that were indicated as potentially harmful according to the Code of Conduct do not longer exist.

[93] Communication on a comprehensive strategy to promote tax co-ordination in the EU – frequently asked questions, COM(2006) 823 final.

One regime

For transparency and practical reasons it would be advisable to only have one regime that covers both inpatriate and expatriate regulations, since an expatriate of one country is in fact an inpatriate in another country. By giving a clear definition of an expatriate and inpatriates, the risk of qualifying for both could be eliminated.

Actual costs incurred

In Sweden and the Netherlands, they have chosen to grant a tax free allowance to a fixed percentage. In Belgium on the other hand, only certain actually incurred costs can be compensated tax free. In my opinion it would be best for the regimes to cover the real economic situation. This means that the regime should cover certain clear types of extraterritorial costs that incur. Such a regime deletes obstacles for cross-border employment without giving unrealistic advantages.

Application period

Several inpatriate and expatriate regulations are applicable during a certain period of time. Whereas the Dutch inpatriate regulation is applicable for maximum ten years, the Swedish regulation is applicable for a maximum of three years and other countries have no application period at all. I would prefer to let the regulation apply during a certain period of time, the acclimatization period. Only the extraterritorial costs that incur during this period can be reimbursed tax free. The extraterritorial expenses that incur after the fixed period are for the account of the employee, since the employee is then deemed to be in the same position as an ordinary resident.

Decision

Furthermore it would be advisable to only grant the regulation after a prior request to the Tax Authorities. The Tax Authorities need to respond to this with a decision that is applicable for objection. By doing this, the regulation, on this point, will be transparent. The regime will then not be considered (forbidden) State Aid, as nowadays is the situation for Austria and Belgium.

Code of Conduct

Even though I am of the opinion that the Code of Conduct should be applicable to the expatriate and inpatriate regimes, this is of no importance if the regimes are "harmonised". The Code of Conduct only tries to abolish harmful tax competition within the European Union. However, if all the regimes have common factors, there is no more tax competition within Europe on this point.

To conclude it is in my opinion therefore advisable to introduce guidelines for one European measure. By doing this the tax competition on the field of “Human capital” can be reduced within Europe. The European Union can than solely focus on the competition with third states, such as India, Japan and the United States of America.

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Table of Abbreviations

ART	Article
EATR	Effective Average Tax Rage
EC	European Commission
ECJ	European Court of Justice
e.g.	For example
EstG	German Einkommenssteuergesetz
EU	European Union
Eucotax	European Universities Cooperating on TAXation
i.e.	That is
IRNR	Spanish Non-residents income tax
IRPF	Spanish Personal income tax
OECD	Organisation for economic Co-operation and Development

Appendix 1

Addendum to the Employment Agreement (dated) between (Employer) and (Employee)

a) If and to the extent that the employee may receive a tax-free reimbursement for extra-territorial expenses based on Article 9 of the 1965 Wages and Salaries Tax Implementation Decree, it will be agreed that the pay for present employment as mentioned in article 3 of your employment agreement, will be reduced for labour law purposes in such a way that 100/70 of the thus agreed pay for present employment is equal to the originally agreed pay for present employment.
b) If and to the extent that part (a.) is applied, the employee shall receive from the employer a reimbursement for extra-territorial expenses equal to 30/70 of the thus agreed pay for present employment.
c) The employee is aware of the fact that adjustment of the agreed remuneration pursuant to part (a.) may in view of the applicable regulations have consequences for all pay-related benefits and payments such as pension payments and social security benefits.

Made up in twofold, dated and signed in ,

On behalf of (Employer)

By:

Title:

Date:

Employee

By:

Date:

Appendix 2

Dear ,

With reference to the offer letter, dated , we would like to inform you that pursuant *inter alia* to the Decree of the Dutch State Secretary of Finance dated 26th November, 2001 (No. CPP2001/297OM), the 30%-arrangement is applicable to you from to inclusive. This means that, for as long as this 30%-arrangement is effective, your total Gross remuneration will be reduced and then supplemented by a 30% tax-free allowance for so-called extraterritorial costs. Your total pay is determined so that your net pay is equal to what you would have received if the 30%-arrangement had not been applied. This arrangement, compiled by FSXN Department (Personal' Tax), is enclosed for your information (Section 3.1.6 "Administrative Procedure" of particular relevance for you).

Please sign and return the enclosed copy of this letter to signify your agreement with its contents.

We hope to have you informed accordingly.

Yours sincerely,

Agreed,

(Employer)

(Employee)

Date:

Situation

The employee receives a net salary of € 3,000 a/m (disposable income). The employee has extraterritorial expenses of € 700 a/m (€ 1,500 a/m), which are reimbursed by the employer. The tax rate applicable is 50%.

No tax fee allowance possible

Taxable salary:	€ 6,000	€ 6,000
Taxable allowance	€ 1,400 +	€ 3,000+
	€ 7,400	€ 9,000
Less: taxes	€ 3,700 -	€ 4,500
	€ 3,700	€ 4,500
Less: expenses	€ 700 -	€ 1,500 –
Disposable income:	€ 3,000	€ 3,000
Labour costs:	€ 7,400	€ 9,000

Tax free allowance possible

Taxable salary:	€ 6,000	€ 6,000
Less: taxes	€ 3,000 -	€ 3,000 -
	€ 3,000	€ 3,000
Tax free allowance	€ 700 +	€ 1,500 +
	€ 3,700	€ 4,500
Less: expenses	€ 700 -	€ 1,500 –
Disposable income:	€ 3,000	€ 3,000
Labour costs employer:	€ 6,700	€ 7,500

Situation

The employee receives a net salary of € 3,000 a/m (disposable income). The employee has extraterritorial expenses of € 700 a/m (€ 1,500 a/m), which are reimbursed by the employer. The tax rate applicable is 50%.

Use of the 30%-ruling, addendum

Taxable salary:	€ 4,000	€ 4,850
Less: taxes	€ 2,000 -	€ 2,425 -
	€ 2,000	€ 2,425
30%-allowance	€ 1,700 +	€ 2.075 + (approximately)
	€ 3,700	€ 4,500
Less:	700 -	€ 1,500 –
Disposable income:	€ 3,000	€ 3,000
Labour costs employer:	€ 5,700	€ 6,925