German-Dutch tax treaty: 30% facility does not trigger a reversion of the right to tax to Germany

The Dutch 30% facility is a favorable tax regime for highly qualified employees from abroad who work in the Netherlands. In a recent case ruled on by the German Federal Fiscal Court, it was disputed whether Germany could tax the tax-free salary component paid for days worked in the Netherlands based on the 30% facility. Going against the lower court, the court ruled that Germany is not allowed to do so. The ruling is relevant both for cross-border commuters and employees seconded to the Netherlands.

30% facility

The facility enables employers to pay a tax-free allowance of up to 30% of the (Dutch) salary as compensation for additional costs incurred in connection working in the Netherlands instead of reimbursing the actual incurred and documented costs. The main beneficiaries are those with special skills and expertise that are in demand on the Dutch labor market. They must also have been transferred from abroad or recruited there. The facility is subject to further conditions as well as approval by the Dutch tax authorities.

However, the tax benefit is ineffective if triggers a reversion of the right to tax to Germany, which is precisely what the Federal Fiscal Court had to rule on.

Subject-to-tax clause in the German-Dutch tax treaty

In principle, the Netherlands has the right to tax wages for work carried out in the Netherlands for a Dutch employer. Germany must exempt these wages from taxation and can only take them into account when determining the tax rate for taxable income in Germany. However, the double taxation treaty (DTT) between Germany and the Netherlands contains a subject-to-tax clause.

Under subject-to-tax clauses, the exemption of foreign income stipulated in a DTT is tied to the condition that this income is actually taxed abroad. As such, Germany only exempts income from employment for work carried out in the Netherlands if it is taxed in the Netherlands (Art. 22 (1) (a) DTT Netherlands). There are also subject-to-tax clauses in other DTTs concluded by Germany, such as those in place with Italy, Luxembourg, the UK and the US, as well as those contained in local laws.

Application of the 30% facility and subsequent taxation

The dispute concerned a cross-border commuter (plaintiff) who lived in Germany in 2019 and worked in the Netherlands on 157 out of 237 working days for an employer in the Netherlands. He worked in Germany on the other working days. His employer applied the 30% facility.

The German tax office corrected the information provided by the plaintiff in his income tax return and levied tax on the portion of the remuneration that was tax-exempt in the Netherlands under the 30% facility. The Düsseldorf Finance Court dismissed the action following an unsuccessful appeal.

Federal Fiscal Court: No reversion of the right to tax

The Federal Fiscal Court took a different view to the lower court. The Netherlands has the right to tax the plaintiff's income from employment to the extent that he carried out his work there (Art. 14 (1) DTT Netherlands). Germany exempts Dutch income from taxation if it is actually taxed in the Netherlands and (as in the case in dispute) does not fall under Art. 22 (1) (b) DTT Netherlands.

Inclusion in the assessment basis sufficient

It is sufficient for the income in question to be included in the tax assessment base to be deemed as actually taxed. This does not necessarily have to give rise to a tax burden. Consequently, non-taxation is harmless to the exemption of income in Germany if it stems from:

- Allowances
- Loss offsetting
- Foreign provisions on how income is calculated that result in a lower tax assessment base than under German tax law.

Harmful non-taxation

Non-taxation is harmful to the exemption of income if it is due to an inability of the other state to tax it because:

- The income is not taxable or is substantively tax-exempt or
- The taxpayer is personally tax-exempt or
- The tax has been waived or the state is not aware of the income in question.

30% facility as a flat-rate deduction of income-related expenses

According to these principles, the income in question was actually taxed. The 30% facility is based on the assumption that the employees incur higher costs when working in the Netherlands. These can include, for example, costs for commuting to work every day, for relocating or living costs that are higher than in their home country.

The 30% facility is a lump-sum reimbursement of such expenses and not a personal or substantive tax exemption. This remains the case regardless of whether the tax assessment base should be reduced or not increased by tax-free reimbursements from the employer. It also makes no difference whether the expenses reduce the assessment base at a fixed rate, as is the case with the 30% facility, or by the amount of actual costs.

It is also irrelevant whether German tax law contains the same or a similar rule or whether the compensation is perceived as being higher than the actual expenses. How the rule is legally implemented is likewise irrelevant, e.g., whether the employee is compensated when wage tax is withheld or when the tax is assessed. Taxation arrangements are up to the state that has the right to tax.

Conclusion

To conclude, Germany may only consider the income in question by applying the progression rule (i.e., when determining the tax rate applicable to the taxable income).

The decision by the Federal Fiscal Court is a welcome one. In addition to the points already mentioned by the court, it should be borne in mind that a flat-rate deduction requires significantly less administrative effort compared to taking actual expenses into account on the basis of itemized receipts. It therefore makes sense to not set the flat-rate deduction too low.

Outlook

There is nothing to suggest this is a special case. We therefore believe that the decision by the Federal Fiscal Court can be applied to other cases in which the 30% facility has been chosen. However, the German tax authorities have not yet commented on whether they intend to apply the court ruling. It remains to be seen to what extent the court ruling can be applied to similar rules in other countries if the relevant DTT contains a subject-to-tax clause. Nevertheless, the court ruling sends a positive signal, at least for cases in which flat-rate income-related expenses are taken into account in other countries – regardless of whether or not Germany has a comparable rule.

Recommended action
Employers can now (again) apply the Dutch 30% facility without the threat of negative tax consequences in Germany. As a rule: If a double taxation treaty contains a subject-to-tax clause, the taxpayer must prove that their income was or will be subject to taxation in the other state.

Use of the 30% facility is shown on the Dutch wage tax certificate. Information on the amount covered by this rule is contained in the wage tax certificate, but not in the income tax return. If both a German and a Dutch income tax return have to be filed, the wage tax certificate should therefore be submitted to the German tax office as evidence.

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