Compatibility with EU Law of Domestic Tax and Social Security Benefits Available Solely for Construction Sector Employees Operating Locally

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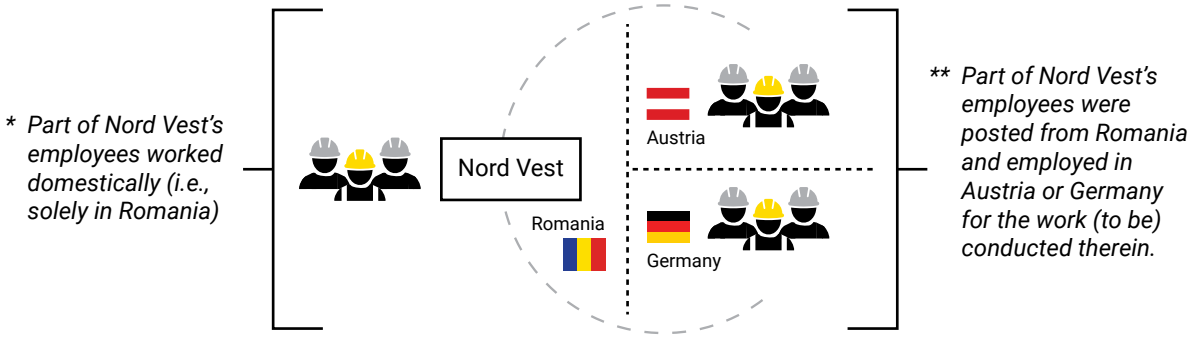
On 26 September 2024, the Court of Justice of the European Union (ECJ) issued its judgment in *Nord Vest* (Case C-387/22), following the request for a preliminary ruling by a Romanian regional court. The question concerns Romanian tax law and the potentially different treatment it establishes between Romanian companies operating in the construction sector domestically vis-à-vis Romanian companies in the construction sector that also operate abroad. This is because Romanian law, effectively, allowed for tax and social security benefits only to employees of undertakings in the construction sector that carried out their activities in Romania. This note provides an overview of the facts applicable to the case, sheds light on the judgment and comments on the position taken by the ECJ.

1. Factual Background

The applicant company, Nord Vest, was registered in Romania and was active in the construction sector. Besides operating in Romania, it also posted workers to Austria and Germany to conduct services related to construction there.

After an assessment, the Romanian tax authorities determined that Nord Vest had incorrectly claimed income tax exemptions for its employees working in Austria and Germany. According to Romanian law, this exemption applied, under certain conditions, only to employees working in the construction sector within Romania's borders. The tax authorities also found that Nord Vest mistakenly considered that their employees were covered by the lower rate in social security contributions and the exemption from the payment of health insurance contributions.



2. The ECJ Decision

The reference for the preliminary ruling concerned the compatibility of the Romanian measures at issue, which provided certain tax and social security advantages only to employees of undertakings in the construction sector that operated exclusively in the territory of Romania, with the freedom to provide services (article 56 of the Treaty on the Functioning of the European Union (TFEU)). The referring court also invoked article 26 of the TFEU, the "explanatory" of the internal market provision, as potential grounds of infringement by the Romanian measures, but the Court dismissed this basis in favour of article 56, which effectively constitutes *lex specialis*. This is because, as per settled case law, posted workers (i.e. workers who carry out work in another Member State in the framework of the provision of services by their employer and who return to their country of origin after the completion of their work) are covered by article 56.

Restriction on the freedom to provide services

In its analysis, the ECJ first identified a restriction on the freedom to provide services for companies that operated cross-border through the application of more onerous tax and social security legislation in comparison to those that operated only domestically. As it observed in paragraph 43, although the legislation that established a different tax and social security system based on whether employees work domestically or in other Member States applied without distinction to both Romanian and foreign undertakings in the construction sector, it was nevertheless capable of dissuading Romanian undertakings from providing construction services in another Member State by posting workers to the territory of that Member State.

Comparability of situations

The Court proceeded by assessing whether the two situations – Romanian companies providing construction services domestically and those posting workers abroad – were objectively comparable in light of the *purpose* and *content* of the legislation. If the two were found comparable, equal treatment would be necessary under EU law. Two main arguments arose regarding comparability. The first, by the Commission, found in favour of finding the two situations comparable, on grounds of their carrying out the same activities and being subject to the same scheme under Romanian law concerning their *obligations*, both as regards income tax and as regards health insurance and social security contributions. In contrast, the second, by the Romanian Government, contended that the two situations were not objectively comparable, as, even with the benefit of the advantages conferred, employees active in Romania received salaries that were significantly lower than the minimum salaries laid down in other Member States, e.g. Austria and Germany. The ECJ observed that the difference in treatment resulting from the national legislation did not appear to reflect an objective difference in situations, but it referred the matter back to the referring court to ascertain.

Justifications

A restriction on the freedom to provide services is warranted if it is justified by overriding reasons in the public interest and observes the principle of proportionality. To the question of whether this different treatment could be justified on grounds of overriding reasons in the public interest, the Romanian government argued that the legislation at issue aimed (paragraph 55 of the judgment)

> to ensure the social protection of employees in the construction sector and to ensure fair working conditions in the context of the internal market by reducing the pay gap at EU level, next, [to meet] the objective of combatting undeclared work and thereby tax fraud and, lastly, the specific issues of the Romanian construction sector linked to the shortage of labour which that sector faces on account of the alarming migration abroad of qualified workers in that field for wage purposes.

The Romanian government argued that the legislation aimed to (i) ensure social protection and fair working conditions in Romania's construction sector; (ii) combat undeclared work and tax fraud; and (iii) address a labour shortage driven by migration.

In relation to the first claim, the ECJ has repeatedly held that the protection of workers and the maintenance and promotion of employment are legitimate objectives of social policy. Thus, improving workers' living and working conditions and affording them proper social protection constitute valid social policy objectives that may justify restrictions on the freedom to provide services. With reference to the proportionality test, the ECJ asked the referring court to ascertain whether the legislation was appropriate for the purpose of ensuring, in a consistent and systematic manner, the social security protection of employees in the construction sector by reducing the pay gap existing at the EU level. That would entail, in the Court's view, that the undertakings/employers actually pass on the tax and social security advantages received to the salaries paid to employees, leading to an increase in those salaries.

In relation to the fight against concealed employment and tax fraud, the ECJ reiterated that, while those reasons have been accepted by the Court as possible overriding reasons in the public interest, it is not clear in the present case how such dangers would arise only in cross-border situations.

Finally, as regards the promotion of labour in the construction sector due to the experienced shortage of labour on account of the migration of qualified workers in that field abroad for wage reasons, the Court reiterated its settled case law that "purely economic grounds, such as, in particular, promotion of the national economy or its proper functioning, cannot serve as justification for obstacles prohibited by the Treaty" (paragraph 63). Despite this reference to settled case law, the Court (and Advocate General Kokott) also noted that if, however, the construction sector is suffering from systemic risks that may endanger its continuity and viability, then the restriction could be justified on these grounds, provided that the proportionality test, in both its appropriateness and necessity limbs, is met. The proportionality test was implicitly left to the national court to perform; however, the Court ruled in a rather cryptic manner that allowing the tax and social security benefits only to employees of undertakings in the construction sector which carry out their activities in the territory of that Member State is compatible with the freedom to provide services, "provided that that national legislation is justified by overriding reasons in the public interest and complies with the principle of proportionality".

3. Conclusion and Some Remarks

The ECJ placed the responsibility to evaluate the comparability of the situations in light of the purpose of the domestic measures at issue and to conduct the proportionality test in both its suitability and necessity limbs on the national court. The contribution of the judgment lies in the acknowledgment that the improvement of the living and working conditions of the employees of undertakings operating in the construction sector in Romania could justify the restricting measure of the exemption from income tax and the lower rate of social contributions for domestic operations only. This is useful, as the tax incentive applies between 1 January 2019 and 31 December 2028 and is intended to prevent migration abroad, where the minimum salary is usually higher. The policy aspect of the case, i.e. whether the construction sector suffers so significantly from worker migration that it risks disappearing, or whether the measures at issue represent merely an economic policy choice, was left to be determined under the proportionality test.

In the open question of the compatibility of the Romanian legislation with State aid rules, which was raised by the Commission but not addressed by the ECJ as falling outside the subject matter of the referred question, it should be noted that the Court has held in the past that (paragraph 40) a

> partial reduction of social charges devolving upon undertakings of a specific industrial sector constitutes aid for the purposes of Article 107(1) TFEU if that measure is intended partially to exempt those undertakings from the financial charges arising from the normal application of the general social security system, without there being any justification for this exemption on the basis of the nature or general scheme of this system.

Under a State aid assessment, the social character of State assistance is not sufficient to exclude it outright from being categorized as "aid" for the purposes of article 107 of the TFEU. However, in the present case, if it could be shown that the tax and social security advantages were passed on to the employees, the undertakings would act as mere intermediaries between their employees and the benefits at issue and would thus not receive an advantage from a State aid standpoint.

IBFD references

- For an overview of the incentive for employees in the construction industry, *see* R. Rusu, Romania - Individual Taxation sec. 3., Country Tax Guides IBFD.
- ECJ case summaries are published in the IBFD Case Law database.
- O. Popa, Recent Tax Amendments, 64 Eur. Taxn. 1 (2024), Journal Articles & Opinion Pieces IBFD.
- EU tax law developments are reported in the daily IBFD Tax News Service.