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THE MAIN CHARACTERISTICS OF STATE'S JURISDICTION TO TAX
IN INTERNATIONAL DIMENSION

by

ALFRED NIZAMIEV

(Under the Direction of Professor Walter Hellerstein)

ABSTRACT

This thesis analyzes the general characteristics of a state's fiscal jurisdiction and how they influence the process of interaction with other national tax jurisdictions. The paper figures out essential internal substance of fiscal jurisdiction and its reflection on the necessity of interstate fiscal cooperation. After considering this substance the thesis goes on to explore the limits beyond which national jurisdictions cannot go in collection of taxes. Absence of common bases of these limits leads to conflicts between national jurisdictions and calls for close international fiscal cooperation. The thesis argues that the process of cooperation becomes more evident. In summary the thesis states that today's main characteristics of a state's jurisdiction to tax do not comply with the necessity of effective administration of national fiscal law in the integrated world. Thus, a particular fiscal jurisdiction needs another qualitative dimension, which can be achieved on the higher level of international systematic cooperation.

INDEX WORDS: Jurisdiction to tax, Jurisdiction to prescribe, Jurisdiction to adjudicate, Jurisdiction to enforce, Sub-national jurisdiction, National fiscal jurisdiction, Tax treaties, Tax evasion, Tax bases, Taxation of e-commerce, Tax havens, Fiscal cooperation, International tax system.

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IN INTERNATIONAL DIMENSION

by

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IN INTERNATIONAL DIMENSION

by

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DEDICATION

To my wife and children.

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CHAPTER 1

INTRODUCTION

The actuality of this thesis is determined by the conflict between development of world economic relations in the process of globalization and more conservative development of international fiscal relations. The implications of globalization are profound. Tax policy requires not only the identification of the tax bases, but also the ability of governments to tax them.¹ As Reuven Avi-Yonah justly said: “Taxes are the last topic on which one would expect sovereign nations to reach a consensus”.²

In the modern world of freedom of movement of persons, capital, and goods conservative self-limitations of national tax systems can propose only one method of the solution of tax problems arising out of mobility of businesses and people – extraterritorial legislation, i.e. jurisdiction to prescribe taxes. But exercise of only one type of jurisdiction – jurisdiction to prescribe taxes – is not enough for effective administration of national tax law. It is necessary also to find means to follow the mobile factors and ensure fulfillment of national fiscal laws outside territorial borders. For this purpose national systems should seek international cooperation. Unfortunately, this cooperation does not have long history and need to achieve the same level of internationalization as

¹ Jack M. Mintz, *National Tax Policy and Global Competition*, 26 BROOKLYN J. INT'L L. 1285, 1288 (2001).

² Reuven Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1303 (1996).

do the business and social life. The general view today is that national tax regimes need to take global economic integration into account.³

The most important features of a state's jurisdiction to tax taken in international scope is the objective of this thesis. Within the topic of fiscal jurisdiction this paper deals mostly with income taxation, even though customs, value-added, excise, gift, and other taxes imposed by various jurisdictions can have international implications.

The objective has determined the purpose of the thesis, which is to analyze general characteristics of a state's fiscal jurisdiction and how they influence the process of interaction with other national jurisdictions.

As the basic method of the present research the systematic method was used. National tax systems were analyzed as elements of more general international system. The method of comparative jurisprudence was used as subsidiary method. The study of the experience of different countries, including international organizations, helps to see the general tendency in the development of the approaches to the solution of problems existing in the sphere of implementation of national tax law in international scale.

The novelty of the thesis is determined by the systematic approach to the problems of implementation of national tax laws on the interstate level. The thesis contains an effort to put together analyses of different aspects of fiscal jurisdiction and to consider the process of interaction among national tax systems.

The main statement (thesis) of my research is: the globalization, development of e-commerce, and worldwide trade cooperation makes it evident that national fiscal systems cannot operate separately any more. Thus the role of international law in this

³ Stephen G. Utz, *Taxation Panel: Tax Harmonization and Coordination in Europe and America*, 9 CONN. J. INT'L L. 767, 767 (1994).

traditionally domestic branch of law, as tax law, will increase tremendously. We believe that the international community is now moving towards the creation of an integrated world tax system. As far as national tax systems began to interact more and more intensively, they become elements of more general system, which will obtain characteristics different and independent from ones of particular jurisdiction.

The idea of a world tax system or international tax regime is not shared by everybody. For instance, David Rosenbloom denies the existence of an international tax system, because in the real world, only the different tax laws of various countries exist, and those laws vary greatly from each other.⁴ But there are supporters. Reuven Avi-Yonah argues that the network of 1500 or more bilateral treaties that are largely similar in policy, and even in language, constitutes an international tax regime, which has definable principles that underlie it and are common to the treaties.⁵

We would argue that the modern world tax system consists of national tax systems. These national fiscal jurisdictions constantly interact on bilateral or multilateral bases. This process of interaction cannot be stopped and it is based on international law.

In order to support this thesis, I address different characteristics of national tax jurisdictions, which today are vital for their existence. Consequently, the structure of my thesis reflects the logic of the research, namely, to explore step by step the internal and external environment of a state's jurisdiction to tax. The thesis will be divided in four main parts. The first part (Chapter II) analyzes general characteristics or essence of national fiscal jurisdiction. The second part (Chapter III) explores the form or limits

⁴ David Rosenbloom, *The David R. Tillinghast Lecture International Tax Arbitrage and the "International Tax System"*, 53 TAX L. REV. 137, 140-1 (2000).

⁵ Reuven S. Avi-Yonah, *Commentary on David Rosenbloom's, The David R. Tillinghast Lecture International Tax Arbitrage and the "International Tax System"*, 53 TAX L. REV. 167, 169 (2000).

beyond which national jurisdictions cannot go in collection of taxes. The third part (Chapter IV) is dedicated to the problems, which arises out of conflicts between taxing authorities of states. The forth part (Chapter V) explores questions of cooperation between national fiscal jurisdictions.

CHAPTER 2

DESCRIPTION OF JURISDICTION TO TAX

A. In General

The main purpose of this chapter is to look inside fiscal jurisdiction and to figure out its essential internal substance and how this substance reflects the necessity of interstate fiscal cooperation in modern world.

The term jurisdiction is commonly used to describe authority to affect legal interests.⁶ In the tax context this authority relates to such functions as establishment and collection of taxes, including functions relating to resolution of tax disputes and enforcement in the case of a violation of tax laws.

Fiscal jurisdiction is an attribute of statehood and sovereignty. Jurisdiction is based on a state's sovereignty and can be exercised only when a sovereign (i.e. a state) has the sovereign right to realize appropriate competence under international law. Thus, we can talk about fiscal sovereignty, which was determined by Swiss Professor of Law Jean-Marc Rivier as: "Le pouvoir d'édicter des norms de droit fiscal et de les appliquer

⁶ LORI F. DAMROSCH ET AL., INTERNATIONAL LAW: CASES AND MATERIALS 1088-9 (4th ed. 2001).

pour lever l'impôt".⁷ It means that without sovereignty jurisdiction does not exist.⁸ Limits of sovereign power determine limits of jurisdiction.⁹

There is no unanimity on the question of limits of tax jurisdiction. On the one hand, it was stated that jurisdiction can be exercised along with observance of the principle of substantial and genuine connection¹⁰ between the subject matter of jurisdiction and reasonable interests of the jurisdiction sought to be exercised.¹¹ On the other hand, based on the territorial character of jurisdiction it was proposed that a state could impose taxes on any activity by any taxpayer within its territorial scope, regardless of the extent of the connection of the taxpayer with the state.¹²

There are two opposing approaches to the question whether a state's jurisdictions to tax is limited by international law. The opponents of limitation deny the existence of any principles of customary international law limiting fiscal jurisdiction.¹³

The proponents of limitations insist on the existence of different restrictions,¹⁴ including restrictions imposed by customary international law, which deal with

⁷ JEAN MARC RIVIER, *DROIT FISCAL SUISSE: LE DROIT FISCAL INTERNATIONAL* 31 (1983).

⁸ RUTSEL SILVESTRE J. MARTHA, *THE JURISDICTION TO TAX IN INTERNATIONAL LAW: THEORY AND PRACTICE OF LEGISLATIVE FISCAL JURISDICTION* 15 (1986).

⁹ Rutsel Silvestre J. Martha, *Extraterritorial Taxation in International Law*, in *EXTRATERRITORIAL JURISDICTION IN THEORY AND PRACTICE* 23 (Dr. Karl M. Meessen ed., 1996).

¹⁰ *E.g.*, Cornelis Van Raad speaks about four main theories justifying the right of a state to tax aliens. Under the contractual theory, taxation is regarded as an aspect of a bilateral contract between the State and the alien taxpayer. Another theory is the ethical theory. In this theory, benefits received from the State, and the capacity to pay, determine the exercise of sovereign taxing power over aliens. The third theory is the sovereign theory, in which the right to tax aliens is considered an attribute of (territorial) statehood or sovereignty. The most important contribution to modern international taxation, however, was the theory of economic allegiance. In this concept the duty of aliens to pay taxes to the foreign State stems from their residence, economic activity, or possession of property within the boundaries of that State. CORNELIS VAN RAAD, *NONDISCRIMINATION IN INTERNATIONAL TAX LAW* 20-1 (1986).

¹¹ IAN BROWNLEE, *supra* note 11, at 298.

¹² DAVID W. WILLIAMS, *TRENDS IN INTERNATIONAL TAXATION* 101 (1991).

¹³ *See* Frederick Mann, *supra* note 13, at 109.

¹⁴ *E.g.*, Cornelis van Raad states that with regards to matters of taxation a State's capacity to tax, particularly in cases concerning taxation of persons of foreign nationality or residence and of objects abroad, is subject to general restrictions of various natures. These restrictions can stem from international and supranational law, or from general rules of domestic law of the State concerned. CORNELIS VAN RAAD,

immunities, discrimination and confiscation.¹⁵ Some of them determine the scope of national fiscal jurisdiction more broadly by using notions of economic efficiency, equity, economic growth, and the influence of static-political thinking.¹⁶

Professor Walter Hellerstein, when speaking about jurisdiction-to-tax issues regarding indirect taxes, notes that indirect taxes, in contrast to direct taxes, even though not covered by treaty system, where the world generally agrees about a permanent establishment as a basis for obligations, are, nevertheless, subject to international norms. These norms generally require some kind of presence or fixed establishment, but the standards are not identical from country to country.¹⁷

From the perspective of the present research it seems more justifiable when there is a connection between jurisdiction and facts.¹⁸ It deserves to be supported that an unreasonable exercise of jurisdiction to tax, for instance, to tax a nonresident alien who is temporarily present within a state, by measuring his worldwide income, could be challenged as a violation of international law by both the taxpayer and the state of the taxpayer's nationality.¹⁹

supra note 10, at 19. Silvestre Martha speaks about two elements – fiscal attachment (relationship between state and fiscal subject or object of taxation) and fiscal liabilities (the scope of a sovereign's fiscal power), – which become crucial tests for determining the legitimacy of a state's jurisdiction in tax matters. Rutsel Silvestre J. Martha, *supra* note 9, at 23. She also notices four spheres of validities of national tax orders, namely: temporal, personal, spatial, and material. *Id.* at 33-34. Edward Stimson states that a sovereignty's legislative power is limited, except as to its citizens located abroad, to persons and property within its own territory. EDWARD S. STIMSON, JURISDICTION & POWER OF TAXATION 1 (1993).

¹⁵ CORNELIS VAN RAAD, *supra* note 10, at 25.

¹⁶ David Glikberg, *The Effect of the Statist-Political Approach to International Jurisdiction of the Income Tax Regime – the Israeli Case*, 15 MICH. J. INT'L L. 460, 465 (1994).

¹⁷ Walter Hellerstein, *Roles of States/Provinces in Taxation in the Canada/U.S. Context*, 27 CAN.-U.S. L.J. 75, 78 (2001).

¹⁸ The authors of a casebook on international law justly wrote: "Under international law, the jurisdiction of a state depends on the interest that the state, in view of its nature and purposes, may reasonably have in exercising the particular jurisdiction asserted and on the need to reconcile that interest with the interests of other states in exercising jurisdiction". LORI F. DAMROSCH ET AL., *supra* note 6, at 1090-1.

¹⁹ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 411 (1987).

When we analyze the legitimacy of jurisdiction we address the rules of customary or conventional international law. International law plays a significant role in the process of tax administration in an international scale. First, it legitimizes the exercise of fiscal jurisdiction; whether it be legislative, executive or adjudicative jurisdiction. Second, it creates international fiscal law through its law-making process.²⁰

The international legal regime contains different rules concerning the realization of a state's jurisdiction. These rules serve as a basis for distinguishing different types of jurisdiction. We can talk about civil, criminal, monetary and fiscal jurisdiction.²¹ Fiscal jurisdiction is usually divided into three types: jurisdiction to prescribe taxes, jurisdiction to adjudicate tax cases and jurisdiction to enforce tax law. Depending on the subject matter of fiscal jurisdiction, we can also talk about jurisdiction over the parties and jurisdiction over the transactions.²²

In national tax regimes there are two general approaches to establishing criteria of jurisdiction. The first approach is territorial, whereby the existence of relevant tax events within the territory of a particular state will cause tax liability to accrue in that state. The second approach is personal, whereby individuals and legal entities are taxed by a particular state without regard for the territory in which the income was produced.²³

²⁰ Rutsel Silvestre J. Martha, *supra* note 9, at 31-2.

²¹ IAN BROWNLIE, *supra* note 11, at 310.

²² JON E. BISCHER & ROBERT FEINSHREIBER, FUNDAMENTALS OF INTERNATIONAL TAXATION 4-5 (2nd ed. 1985).

²³ See David Gliksberg, *supra* note 16, at 460-2. The author points out that territorial approach takes no account of the identity of the person producing the income is centered on source rules, which determine whether particular income has been earned within a certain territory. Personal approach based on a link between the taxpayer and that state which would justify imposing the tax, *id.* at 460-3.

B. Types of tax jurisdiction

Jurisdiction to prescribe

Legislative jurisdiction should be defined as a state's right under international law to create legal rules.²⁴ In more details, this jurisdiction can be understood as including authority to make a state's law applicable to the activities, relations, or status of persons, or the interests of persons in things, whether by legislation, by executive act or order, by administrative rule or regulation, or by determination by a court.²⁵ Legislative jurisdiction may be extraterritorial. For instance, by customary law, the international system early recognized the authority of a state to prescribe law for its nationals even when they were outside its territory.²⁶

Discussion about limits of prescriptive jurisdiction was noticed in literature.²⁷ Some authors in the field of taxation state that jurisdiction may be asserted in relation to persons or transactions having a valid nexus with that state²⁸ and this jurisdiction should be subject to the limitation of reasonableness. But others incline to consider that

²⁴ RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 64. The author actually notices that the creation of law can occur either through "vertical prescription", legislation *stricto sensu* (as in the civil law tradition) what may be called active exercise of legislative jurisdiction, or through "horizontal prescription", legislation *lato sensu* (as in the common law tradition, in which there is implicitly a basis norm which is the reason of validity of commonly created law), and may be called the passive exercise of legislative jurisdiction. In studying fiscal jurisdiction attention must primarily be concentrated on the right of a state to create fiscal law under international law, *id.* at 64.

²⁵ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 401 (1987).

²⁶ Louis Henkin, *International Law: Politics, Values and Functions*, 216 HAGUE ACAD. OF INT'L L. 285 (1989).

²⁷ Karl Zemanek, *The Legal Foundation of the International System*, 226 HAGUE ACAD. OF INT'L L. 71 (1998).

²⁸ SOL PICCIOTTO, *INTERNATIONAL BUSINESS TAXATION: A STUDY IN THE INTERNATIONALIZATION OF BUSINESS REGULATION* 308 (1992).

extraterritorial legislation even if it purports to apply to persons or activities abroad, does not really raise an international problem, as long as it is not forcibly applied abroad.²⁹

Being an attribute of sovereignty, legislative jurisdiction should be based on the same principles as those in which the sovereignty rests. There are two principle bases for the exercise of jurisdiction to prescribe, namely, territoriality and nationality. However, an exercise of extraterritorial jurisdiction on a basis other than nationality is *prima facie* illegal, with minor exceptions. Further, jurisdiction based on nationality is secondary, and in the case of conflict bows to the jurisdiction of the territorial state.³⁰

In the modern integrated world a state cannot make steps without taking into account possible effect on the interests of other states. We agree that today one can talk about an international tax regime that is a coherent set of principles that in many ways constrains the ability of countries to adopt any international tax laws that they please. This regime is embodied principally in the more than 2,000 existing bilateral tax treaties, but it also incorporated in the domestic international tax laws of most countries.³¹

Prescriptive jurisdiction is the primary one among other types of jurisdiction. It gives start to exercise of judicial and enforcement jurisdiction. There can be no enforcement jurisdiction unless there is prescriptive jurisdiction. But at the same time there may be a prescriptive jurisdiction without the possibility of an enforcement jurisdiction. Thus, jurisdiction hinges, fundamentally, on the power to prescribe.³²

²⁹ See Karl Zemanek, *supra* note 27, at 70.

³⁰ Louis Henkin, *supra* note 26, at 286-7.

³¹ REUVEN S. AVI-YONAH, U.S. INTERNATIONAL TAXATION: CASES AND MATERIALS 1 (2002).

³² D. W. Bowett, *Jurisdiction: Changing Patterns of Authority over Activities and Resources*, in INTERNATIONAL LAW: CLASSIC AND CONTEMPORARY READINGS 207 (1998).

Jurisdiction to adjudicate

Jurisdiction to adjudicate generally can be described as a competence of appropriate state's authorities to resolve tax disputes, or, generally speaking, to subject persons or things to the process of a state's courts or administrative tribunals.³³ This type of jurisdiction is not exercised only by the courts, but by tax authorities in the course of administrative procedure as well.

Judicial jurisdiction is closely connected with jurisdiction to prescribe. As far as legislative jurisdiction is considered here as having limits under international law the scope of adjudicative jurisdiction should also have corresponding limitations including ones belonging exclusively to adjudication.³⁴

Louis Henkin noted that even when the state has jurisdiction to prescribe – to declare its law applicable to a particular activity, adjudication – bringing the accused to trial in the particular circumstances – may nonetheless violate norms of international law.³⁵ Professor Henkin proposed different tests for the determination of legitimacy of exercise of jurisdiction to resolve tax disputes. He noticed, in particular, that international law governing jurisdiction to adjudicate began to move beyond rigid categories of territoriality and nationality and introduced considerations of reasonableness.³⁶ Further, he mentioned such criteria as the interests of the territorial state and those of the state of

³³ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 401 (1987).

³⁴ For instance, states could exercise jurisdiction to adjudicate on the basis of various links, including defendant's presence, conduct, or, in some cases, ownership of property within the state; conduct outside the state producing certain kind of injury within the state; or the defendant's nationality, domicile, or residence in the state. Exercise of judicial jurisdiction on the basis of such links is on the whole accepted as reasonable; reliance on other bases, such as the nationality of the plaintiff or the presence of property unrelated to the claim, is generally considered exorbitant. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 421 (1987).

³⁵ Louis Henkin, *supra* note 26, at 310.

³⁶ *Id.* at 309.

the nationality of the persons subject to the law, as well as human values, ordinarily considerations of fairness to the persons affected.³⁷

Adjudicative jurisdiction relates mostly to procedural questions of the choice of competent forum. Usually disputes involving private parties are to be resolved in national courts. In general, foreign nationals paying taxes in a foreign country have access to the judicial system of that country to resolve disputes about taxation.

It is not the case, when tax disputes arise between sovereigns. Alvin Warren says that there is no international adjudicatory body with the authority to resolve such disputes. He notices that the specific character of resolution of interstate tax disputes is determined by diplomatic rather than legal procedure of that resolution in the sense that it is up to the representatives of the two countries to come to agreement. A few bilateral tax treaties and regional agreement provide for arbitration, but binding dispute settlement remains the exception in international taxation. Disputes between the contracting parties about the application of the tax treaties are commonly to be resolved by mutual agreement between the competent authorities of each country, which are generally tax agencies of each government.³⁸

Based on the particularity of tax disputes resolution between sovereigns Professor Robert Green calls its procedure antilegalistic. He supports his statement by the fact that under most tax treaties, consultations and negotiations between designated tax officials of the two treaty countries are the exclusive means for resolving disputes. There is no assurance, he says, that this process actually will produce a resolution. Even if it does, the resolution is likely to represent a political compromise rather than a reasoned decision

³⁷ *Id.* at 308.

based on the application of legal rules and the resolution of such disputes likely will require resort to diplomatic channels.³⁹

But not everybody excludes the possibility of resolution of interstate tax disputes by neutral authority. For examples, authors of a book about tax arbitration consider it possible for the International Court of Justice to form from time to time one or more chambers, for dealing with particular categories of cases, e.g. tax cases.⁴⁰ They even go further and argue that it may be advisable to work with arbitration commissions as an intermediate stage. Their argumentation is based on the assumption that an arbitration procedure involves many practical questions, which can most easily be dealt with by a permanent body. A permanent operating institute, in its turn, would lend a certain stability to the arbitration procedure.⁴¹

The territorial character of sovereignty determines the limit of sovereignty and comprises the power of a state to exercise the supreme authority over all persons and things within its territory.⁴² This territorial restriction in the procedure of tax dispute resolution can distort fair decision in cases where foreign element is involved. That is why adjudicative jurisdiction of a particular state should be more cooperative in the international context. This inevitably demands not only cooperation between courts and other competent authorities at the stage of case hearing, but also cooperation between legislatures in passing appropriate procedural laws, as well as cooperation on the level of enforcement. This outcome is based on the fact that the exercise of jurisdiction by courts

³⁸ Alvin C. Warren, *Income Tax Discrimination Against International Commerce*, 54 TAX L. REV. 131, 140 (2001).

³⁹ Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 YALE J. INT'L L. 79, 137 (1998).

⁴⁰ GUSTAF LINDENCRONA & NILS MATTSON, *ARBITRATION IN TAXATION* 16 (1981).

⁴¹ *Id.* at 17-18.

⁴² Rutsel Silvestre J. Martha, *supra* note 9, at 23.

of one state that affects interests of other states is now generally considered as coming within the domain of customary international law and international agreement.⁴³

Jurisdiction to enforce

Jurisdiction to enforce is defined by the Restatement (Third) as the authority of a state “to employ judicial or nonjudicial measures to induce or compel compliance or punish non-compliance with its laws or regulations, provided it has jurisdiction to prescribe”.⁴⁴

In the international dimension the governing principle is a principle of territorial limitation on enforcement,⁴⁵ which means that a state cannot take measures on the territory of another state by way of enforcement of national laws without of the consent of latter. Consequently, tax investigation may not be mounted on the territory of another state, except under the terms of a treaty or other consent given.⁴⁶

Besides territorial limitations, enforcement of national law abroad is subject to additional legal limitations because in particular circumstances it might implicate the interests of another state.⁴⁷ First, a state may enforce its law – whether through courts or otherwise – only if it has jurisdiction to prescribe the law sought to be enforced. Second, enforcement measures are exercises of jurisdiction, and under international law are subject to the requirement of reasonableness.⁴⁸

Professor Henkin made three suggestions about enforcement jurisdiction, which, really, ought to be met with little opposition.

⁴³ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 421 (1987).

⁴⁴ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 431 (1987).

⁴⁵ SOL PICCIOTTO, *supra* note 28, at 308.

⁴⁶ IAN BROWNLIE, *supra* note 11, at 307.

1. No state may exercise enforcement jurisdiction outside its own territory in the absence of its own legislature authorizing it to do so, that is to say, in the absence of legislative jurisdiction.
2. The mere existence of legislative jurisdiction is insufficient to justify the state to exercise enforcement jurisdiction in another state's territory.
3. The mere fact that a state can enforce its legislation within its own territory and in this sense has enforcement jurisdiction, does not mean that it necessarily has legislative jurisdiction, and does not therefore render the enforcement valid in public international law.⁴⁹

Enforcement abroad demands not only a valid basis for jurisdiction and accidental consent in a particular case, but also involves the problem of comity in international relations. Unfortunately, long-standing international practice has denied the application of comity in the case of attempts to litigate to enforce the tax laws of another country. This statement is supported by practice of the courts. In *Milwaukee County v. M.E. White Co.*⁵⁰ the Supreme Court stated that there is exception to the rule of recognition of the tax obligation because the courts of one state should not be called upon to scrutinize the relations of foreign state with its own citizens, such as are involved in its revenue laws.⁵¹ In *Government of India v. Taylor*, [1955] A.C. 491, the plaintiff sought to prove before English courts an Indian tax claim in the course of liquidation of an English company. Enforcement of revenue claim was denied. In a Canadian case, *United States v. Harden*, [1963] Can. Sup. Ct. 366, 41 D.L.R.2d 721, the court denied enforcement to a consent

⁴⁷ Louis Henkin, *supra* note 26, at 277.

⁴⁸ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 431 (1987).

⁴⁹ Frederick Mann, *supra* note 13, at 34-5.

⁵⁰ *Milwaukee County v. M.E. White Co.*, 296 U.S. 268 (1935).

judgment of a United States district court rendered on a claim for taxes. The Supreme Court of Canada held that a foreign cause of action did not merge into the foreign judgment and that a foreign revenue claim would not be enforced directly or indirectly.⁵² In *Her Majesty the Queen in Right of the Province of British Columbia v. Gilbertson*⁵³ the court affirmed the dismissal of appellant Canadian province's action to collect a tax judgment from a Canadian court issued against appellee individuals for failure to state a claim on which relief could be granted because the court determined that the revenue rule, which provided that courts of one jurisdiction did not recognize the revenue laws of another jurisdiction, applied and prevented the courts from enforcing foreign tax judgments. This position of the court is clearly predictable because in section 483 of the Restatement (Third) one can find the rule that courts in the United States are not required to recognize or to enforce judgments for the collection of taxes, fines, or penalties rendered by the courts of other states.⁵⁴

These enforcement problems determine the main shortcomings of national tax systems. Even developed countries find it hard to effectively enforce residence-based taxation on the global income of individuals, especially from tax havens, and developing countries find this task impossible. As portfolio investment grows and becomes increasingly more mobile, this problem becomes more and more acute. Source-based taxation of income is much more effective than residence-based taxation because the source country has information needed to enforce the tax of it wishes to do so.⁵⁵

⁵¹ *Milwaukee County v. M.E. White Co.*, 296 U.S. 268, 275 (1935).

⁵² HENRY J. STEINER ET AL., *TRANSNATIONAL LEGAL PROBLEMS: MATERIAL AND TEXT*, 722-3 (4th ed. 1994).

⁵³ *Her Majesty the Queen in Right of the Province of British Columbia v. Gilbertson*, 597 F.2d. 1161 (9th Cir. 1979).

⁵⁴ *RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES* § 483 (1987).

⁵⁵ Reuven Avi-Yonah, *supra* note 2, at 1336.

One should take into account that the enforcement function is performed not only under adjudication, but also under administrative process. International law has begun to address also executive or administrative enforcement that is not ancillary to adjudication but often is a substitute for it, when such enforcement impinges on interests of other state and their nationals.⁵⁶ Unlike judicial enforcement, which has developed a body of jurisprudence and guidelines, international law relating to non-judicial enforcement is still primitive and inchoate. But the underlying principles are clear. The limitations on the exercise of jurisdiction to enforce by non-judicial means reflects concern for reasonableness, fairness to affected private interests, entitlement for due process, as well as proportionality and appropriateness of the penalties to violation.⁵⁷ As a compensation of the limits of the judicial enforcement jurisdiction and as an example of nonjudicial enforcement we can consider the provisions of national laws concerning withholding taxes.

From the perspective of these weak points of enforcement jurisdiction from the recent perspective of globalization the reluctance of states to cooperate in enforcement of tax law seems obsolete. We agree with the commentators of the Restatement when they doubt that judgments of foreign courts for payments of taxes cannot be enforced in the United States if such enforcement is consistent with general rules of international law on recognition of foreign judgments.⁵⁸

The need for cooperation becomes more urgent and should follow the development of means of conducting business. For example, today enforcement and compliance are the principal concerns about the way in which the Internet affects the

⁵⁶ Louis Henkin, *supra* note 26, at 314.

⁵⁷ *Id.* at 315.

income taxation, because it increases opportunities to engage in moneymaking activities offshore and, in effect, creates opportunities for the so-called “black market economy” to be accessed much more easily than it was in the past.⁵⁹

Unless the rules of international law governing interstate tax enforcement issues develop, it would, however, be reasonable to start unilaterally to collect taxes of other states hoping that the respective foreign state will then do likewise.⁶⁰ This proposal sounds promising because it helps, actually, to break up the circle, as far as states cannot reasonably be expected to collect taxes of other states where mutuality is lacking.

C. Sub-national tax jurisdiction

The problem of sub-national jurisdiction arises in the federal states, especially in those where the members of federation have broad competence and even are considered as quasi-sovereign. This means that in situations where a federal state is involved, it is necessary to consider the jurisdictional questions not only of these two states but also jurisdictional competence of federal units.

Professor Walter Hellerstein squarely addressed this issue in his article about the competence of states and provinces in, respectively, the United States and Canada. He underlined three structural sources of friction that arise out of sub-national taxing power in a federal system. The first source of friction is the existence of different rules at the national and sub-national levels. The second source of friction is different restraints on

⁵⁸ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 483 (1987).

⁵⁹ Peter Cobb, *Taxing E-commerce: The Landscape of Internet Taxation*, 21 U. PA. J. INT’L ECON. L. 659, 661, 665-6 (2000).

sub-national and national behavior. The third source of friction is that there tend to be more sub-national governments than national governments (the mere existence of the of a multiplicity of rules itself causes friction).⁶¹

These frictions may have negative effects on the international obligations of federal government. In particular, professor Hellerstein states that direct tax treaties do not govern sub-national governments⁶² and therefore there are some limitations on the national level, but at the sub-national level there are virtually no limitations at all.⁶³ To support his statement he turns to the case where Florida imposed a tax on the sale of fuel to airlines.⁶⁴ In this case the court held that the agreement did not preempt state regulation because the provision did not explicitly bind the states. Treating these national agreements as not binding sub-national jurisdictions the court, according to author factually said, “Look, Congress did not say anything about this. Indeed, by excluding states from this prohibition, Congress presumably approved this.”⁶⁵

It seems that such situations do not contribute to the development of stable and predictable international tax cooperation. It is the responsibility of federal government to secure that any international tax conventions it signs will remain in force over the entire territory of the federation. International tax cooperation should not be complicated by possible jurisdictional competence of a state’s unit in international scale. We think that relations between federal center and federal regions should remain of internal character and not attract international concern.

⁶⁰ Peter Schlosser, *Jurisdiction and International Judicial and Administrative Co-operation*, 284 HAGUE ACAD. OF INT’L L. 345-6 (2001).

⁶¹ Walter Hellerstein, *supra* note 17, at 75-6.

⁶² *Id.* at 77.

⁶³ *Id.* at 80.

⁶⁴ *Wardair Canada Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986).

⁶⁵ Walter Hellerstein, *supra* note 17, at 81.

D. Inferences

In conclusion, we believe that understanding the necessity of interjurisdictional cooperation becomes more and more apparent. The growing international fiscal relations should result in the existence of a coherent international tax regime that enjoys nearly universal support and that underlies the complexities of the international aspects of individual country's tax systems. The existence of this regime shows that despite each country's claim to sovereignty in tax matters, it is possible to reach an internationally acceptable consensus that will be followed by the majority of the world's taxing jurisdictions. This international tax regime, based on voluntary consensus, can be regarded as one of the major achievements of twentieth-century international law.⁶⁶

The general principle set forth in this chapter demonstrates that the analysis of features of three types of jurisdiction leads to the conclusion, that a particular state can effectively administer its tax law only within its territory. When a foreign element is involved in tax relations the national tax system often loses its logical completeness and even becomes helpless. The toothlessness of domestic tax laws outside a state's borders explicitly makes it necessary to establish the network or system of national fiscal jurisdictions.

⁶⁶ Reuven Avi-Yonah, *supra* note 2, at 1303-4.

CHAPTER 3

BASES OF JURISDICTION TO TAX

A. In General

The main purpose of this chapter is to explore the forms or limiting bases beyond which national jurisdiction cannot go in collection of taxes. If in the previous chapter it was stated that the essence of fiscal jurisdiction in modern world does not provide with sufficient qualities in tax administration, in this chapter it is stated that the form of jurisdiction to tax also demands international cooperation for effective functioning.

In presenting research into the bases of jurisdiction, it is that understood different facts that justify the exercise of fiscal competence. As will be shown below these bases are usually of a uniform and limiting character and provide tax competence with legitimacy under international law. Going beyond widely recognized bases exposes a state's fiscal competence to the danger of being deemed illegal.

Two main forms of fiscal attachment follow jurisdictional bases. The term "fiscal attachment", serves to explain the relationship between the holder of fiscal jurisdiction (the state) and the fiscal subject or object of taxation, which determines the legality of the exercise of fiscal jurisdiction. The first form is personal fiscal attachment, which is based on residence or nationality, and the second form is economic fiscal attachment, which

occurs in case of short of residence.⁶⁷ These kinds of attachments reflect the general division of the income tax base between the country of source and the country of residence, and this division is considered as a principal function of international income tax system.⁶⁸

Among the facts that justify fiscal attachment, those usually mentioned are nationality, domicile or residence, presence or doing business within the country, location within the country of property or transactions from which income is derived⁶⁹, which represent necessary nexus between subjects or objects and a state.⁷⁰

The modern states use a typical set of jurisdictional bases for tax purposes. Generally, source of income and residence of taxpayer are the common bases.⁷¹ Source-basis taxation depends, more or less, on the proposition that the country where income originates has a legitimate claim to tax that income. Residence-basis taxation relies on the notion that the country where taxpayer resides legitimately may impose tax in order to support the normal government activities that residents enjoy.⁷² Most countries rely on

⁶⁷ Rutsel Silvestre J. Martha, *supra* note 9, at 25.

⁶⁸ Alvin C. Warren, *supra* note 38, at 132.

⁶⁹ CHARLES H. GUSTAFSON ET AL., *TAXATION OF INTERNATIONAL LEGAL TRANSACTIONS: MATERIALS, TEXT AND PROBLEMS* 14 (2nd ed. 2001).

⁷⁰ See CORNELIS VAN RAAD, *supra* note 10, at 20-21. Johan Schipper argues that there is international unanimity of opinion on the point that certain economic ties should connect the non-resident to a country in order that it may levy a tax upon his income. There would also, in so far as we can see, be agreement on the proposition that the nexus between the non-resident and the country concerned should be pertinent to the income, which the country seeks to tax. JOHAN H. T. SCHIPPER, *supra* note 94, at 208.

⁷¹ See David H. Rosenbloom, *Taxing the Income of Foreign Controlled Corporations*, 26 BROOKLYN J. INT'L L. 1525, 1532 (2001). Restatement (Third) defines several bases for jurisdiction to tax. Such jurisdiction over persons could be based on nationality, domicile, or residence, as well as such facts as presence or doing business, or ownership of property. Jurisdiction also can be exercised over property within its territory, or transaction connected to the territory. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 411 (1987).

⁷² David Gliksberg justifies this approach by stating that personal jurisdiction is based on a statist conception that the state has the right to tax its citizens and residents, because the center of the state is not its territory but its population. The focus on person, rather than on territory, means that a taxpayer who complies with the personal link becomes liable for tax imposed by the state of residence, even though he did not produce the income there, because he is bound to participate in financing that government's expenditure. Such participation is derived from the fact that residence implies that the taxpayer belongs to a

both source taxation and residence taxation for their income tax base, and there is really no need to choose between these two jurisdictional grounds. A “mixed” system is common, justifiable, and reasonable.⁷³ It was even stated that that source and residence taxation, if not also citizenship taxation, now constitute customary norms.⁷⁴

In this chapter the logic of research follows the general types of fiscal attachment. In the part concerning personal fiscal attachment two bases will be considered, namely, nationality and residence. In the other part, which relates to economic fiscal attachment, the absence of strong connection between taxpayer and a taxing state determined study of such bases as place of activity (including questions of permanent establishment), source of income, and situs of property. There is also another part dedicated to taxation issues in e-commerce, because absence of geography and personality raises problems of reconsidering traditional approaches.

B. Personal fiscal attachment

Personal fiscal attachment assumes a personal relationship between the taxpayer and the country. For example, a country may wish to tax any individual who is either a citizen or a resident of the country. The concept of personal relationship also applies to corporations and other types of entities. A corporation may be considered a citizen of the

particular society and that he must therefore share in the expenses of that society. David Gliksberg, *supra* note 16, at 473.

⁷³ For instance, under U.S. tax system, personal relationships are the basis for taxing U.S. citizens, resident aliens, and domestic corporations, whereas the source of income is the basis for taxing nonresident aliens and foreign corporations. ROBERT E. MELDMAN & MICHAEL S. SCHADEWALD, *A PRACTICAL GUIDE TO U.S. TAXATION OF INTERNATIONAL TRANSACTIONS* 2 (3rd ed. 2000).

⁷⁴ Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 *LAW & POL’Y INT’L BUS.* 145, 148 (1998).

country in which it is organized. Similarly, a corporation can be considered a resident of the country in which its seat of management or principal place of business is located.⁷⁵

Nationality

The principle of nationality as a proper jurisdictional basis has been under constant criticism, and there are several respectable authors who advocate the banning of citizenship as a factor constituting fiscal attachment. However, if the view is taken that jurisdiction is an attribute of sovereignty and that originally sovereignty comprised basically two dimensions, a personal and a spatial dimensions, it becomes logical that jurisdiction based on nationality is as valid as jurisdiction based on territoriality.⁷⁶ This proposition was well elaborated by professor Mann, who stated that as between the national and his home country no problem of jurisdiction arises.⁷⁷

It is common view today that notwithstanding the questioning of nationality as a proper basis for fiscal attachment, from an international law perspective, a state is fully entitled to tax its nationals wherever they may be.⁷⁸ Nationality is also increasingly asserted as a basis for jurisdiction for a state's direct taxes over legal persons. The state of nationality, in this sense, is taken as the state of the laws of which give legal personality to a non-individual person, for example a company or partnership. Nationality is now the prevalent approach to asserting jurisdiction over such taxpayers.⁷⁹

A few states use nationality as a basis of taxation. In this context the U.S. experience in taxing their nationals deserves special attention. The United States

⁷⁵ ROBERT E. MELDMAN & MICHAEL S. SCHADEWALD, A PRACTICAL GUIDE TO U.S. TAXATION OF INTERNATIONAL TRANSACTIONS 1 (3rd ed. 2000).

⁷⁶ RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 66.

⁷⁷ Frederick Mann, *supra* note 13, at 116.

attributed overwhelming importance to the personal aspect and the personal link of citizenship was regarded in this country as a solid foundation for tax liability, based on the political outlook, which attached great importance to the concept of citizenship as a fundamental component of the state. This approach differs markedly from that of the vast majority of other countries that do not tax unrepatriated foreign earnings of citizens residing or domiciled abroad.⁸⁰ The most prominent expression of this is in the judgment of the Supreme Court of the United States in *Cook v. Tait* where the Court stated:

“In other words, the principle was declared that the government, by its very nature, benefits the citizen and his property wherever found and, therefore, has the power to make the benefit complete. Or to express it another way, the basis of the power to tax was not and cannot be made depended upon the status of the property in all cases, it be in or out of the United States, and is not and cannot be made dependent upon domicile of the citizen, that being in or out of the United States, but upon his relationship as a citizen to the United States and the relationship of the latter to him as a citizen.”⁸¹

⁷⁸ Rutsel Silvestre J. Martha, *supra* note 9, at 24.

⁷⁹ DAVID W. WILLIAMS, *supra* note 12, at 104.

⁸⁰ CHARLES H. GUSTAFSON ET AL., *supra* note 68, at 32.

⁸¹ *Cook v. Tait*, 265 U.S. 47, 56 (1924).

Nationality as jurisdictional basis can easily be the cause of extraterritorial application of national tax law. Such application causes double taxation and even could lead to tax migration. Exercise of jurisdiction on nationality basis poses question of fair allocation of taxing competence between state of nationality and state of residence. This distribution can be achieved only in the course of international cooperation either on bilateral or multilateral level.

Residence

Tax jurisdiction based on residence of the taxpayer can impose fiscal liability upon nationals, aliens as well as legal entities. David Rosenbloom argues, that it is possible, without much effort, to defend the residence basis as a jurisdictional ground for income taxation, because it fits nicely within all criteria of a good and proper income tax, does no violence to international understandings, and probably should be used by any country that has a formal income tax.⁸² Professor Peggy B. Musgrave shares this position stating that national right to tax the global income of residents is recognized in international law and the exercise of tax sovereignty over foreign source income is necessary to achieve equitable tax treatment of resident taxpayers by making all income, wherever earned, subject to tax, consistent with the accretion principle.⁸³ The use of residence basis and as a result the taxation of corporation and natural persons on their worldwide income is mostly found in the practice of industrialized countries.⁸⁴

⁸² David H. Rosenbloom, *Taxing the Income of Foreign Controlled Corporations*, 26 BROOKLYN J. INT'L L. 1525, 1534 (2001).

⁸³ Peggy B. Musgrave, *Sovereignty, Entitlement, and Cooperation in International Taxation*, 26 BROOKLYN J. INT'L L. 1335, 1336 (2001).

⁸⁴ Rutsel Silvestre J. Martha, *supra* note 9, at 20.

In modern times, most countries have imposed income taxes on individuals who bear a personal relationship to the taxing country in form of residence. Residence is differently defined in national tax laws but generally it assumes that the individual is living in the country on a more or less permanent or continuing basis. Double taxation agreements have not had a significant harmonizing effect on the national criteria of residence, as these agreements usually employ the domestic residence definitions of the contracting states. Only if domestic residence rules conflict, do these agreements usually apply independent criteria for the determination of treaty residence. But in any way residents fall within the class of those who “consume” governmental services and therefore must help bear the cost.⁸⁵

Residence has long been considered as a valid basis under international law for the taxation of aliens.⁸⁶ This means that resident aliens may be subjected to tax not only on the income within the State of residence, but also on income from outside that state.⁸⁷ In general, under international law, the taxation of aliens should be subjected to the criterion of presence within the territory of such state. Without such territorial link no characterization as resident would be lawful, because residence under international law presence is considered as the *conditio sine qua non* for exercising residence basis taxation.⁸⁸

In the case of determining the residence of companies and particularly multinational corporations it becomes a little harder to know just where its home can be

⁸⁵ DAVID R. TILLINGHAST, TAX ASPECTS OF INTERNATIONAL TRANSACTIONS 3-4 (2nd ed. 1984).

⁸⁶ Rutseel Martha argues that general international law entitles a state to tax if it chooses anyone present in its territory whether they are resident or transient. Be that as it may, the territorial supremacy of a state sufficiently legitimizes the taxation of aliens who are only temporarily within the territory of such state. However, states generally decline to impose direct personal taxes on tourists and the like, while they pay almost all indirect taxes. RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 94.

⁸⁷ CORNELIS VAN RAAD, *supra* note 10, at 22.

said to be. It can be assumed that transnational business entities consume governmental services all over the world. In many cases, perhaps, it is clear that its consumption is far greater in one country than in the others; but often this is debatable. Nor is it clear even whether the relative rates of consumption can accurately be determined.⁸⁹ Usually residence of a company refers in a much more general way to the link of a body corporate with a State. These links range between two extremes, the place of incorporation and the place where the activities are carried on.⁹⁰

Residence-based fiscal jurisdiction also raises questions of equity in tax matters. Some authors consider residence-basis taxation as preferable because it enables greater inter-taxpayer equity.⁹¹ Others do not agree that a taxpayer's entire income necessarily needs to be taxed by a single country – the residence country.⁹²

As in case of nationality basis jurisdiction, the residence-basis jurisdiction uses an extraterritorial approach as far as such jurisdiction seeks to tax worldwide income. Taxation of worldwide income, in part concerning income earned abroad inevitably overlaps with jurisdictional right of a foreign state where that income was originated. In this situation two interested states should interact and cooperate in order to prevent excessive taxation. In modern mobile world the states cannot exercise their taxing competence without taking into account interests of another tax sovereigns and taxpayers.

⁸⁸ RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 90-1.

⁸⁹ DAVID R. TILLINGHAST, *supra* note 84, at 4.

⁹⁰ CORNELIS VAN RAAD, *supra* note 10, at 22.

⁹¹ See Julie Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems*, 81 VA. L. REV. 1753, 1761-2 (1995).

⁹² See Nancy H. Kaufman, *Equity Considerations in International Taxation*, 26 BROOKLYN J. INT'L L. 1465, 1465 (2001).

C. Economic fiscal attachment

Place of activity and the concept of permanent establishment

This basis applies to so called active income. In this case the foreign person or entity, though not resident, is present in the taxing country in some meaningful way. Typically, this presence exists in the way of engaging in the conduct of business activity in the taxing country. This kind of source jurisdiction is a sort of *in personam* jurisdiction, based upon the participation by the foreign enterprise in the source country's economy.⁹³

Usually foreign entities doing business abroad are taxed in the foreign country to the extent that they have permanent establishment in that foreign country. The concept of permanent establishment justifies the fiscal attachment short of residence of juristic persons and is commonly understood to be a fixed place of business through which the business of an enterprise is partly or wholly is carried on.⁹⁴ The criterion of the exercise of a trade or business within the country through a permanent establishment, defined along the lines customary to most international treaties, constitutes a much more acceptable and workable test for subjecting non-residents to taxation in so far as it fully takes into account the requirements of both clarity and sharp limitation and the existence of definite ties of sufficient moment and permanency as an indication that the non-resident forms part of the economic and social structure of the country in question.⁹⁵

⁹³ DAVID R. TILLINGHAST, *supra* note 84, at 5.

⁹⁴ RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 94-5.

⁹⁵ JOHAN H. T. SCHIPPER, THE LIABILITY TO TAX OF NON-RESIDENT COMPANIES 215-6 (1958).

The notion of permanent establishment is one of the most important issues in treaty-based international fiscal law. This statement is confirmed by the fact that virtually all modern tax treaties use permanent establishment as the main instrument to establish taxing jurisdiction over a foreigner's unincorporated business activities.⁹⁶ The most important and obvious effect, both from a legal and practical point of view, is that the permanent establishment principle under the tax treaties is decisive for allocation of taxing jurisdiction over unincorporated business activities with economic allegiance to more than one country.⁹⁷

Despite the fact that the permanent establishment principle is used in all tax treaties in force today, this concept is still not part of customary international law. If not included in a treaty, the permanent establishment principle is not applicable.⁹⁸

Under tax treaties various exceptions apply, *inter alia*, to business activities abroad connected with foreign permanent establishments and to business real property located abroad, to holding foreign shares and to lending and licensing to a foreign party. For taxation purposes, in these latter instances the *situs* or source is assumed to be situated in the foreign state concerned.⁹⁹

The concept of a permanent establishment as found in the tax treaties provisions is a good example of how two countries can allocate between each other tax base. This allocation, actually, represents self-restraints in tax sovereignty and understanding that in an integrated world national tax policies should be subjected to some forms of international coordination. The network of such tax treaties is the strong sign of existence

⁹⁶ ARVID A. SKAAR, *PERMANENT ESTABLISHMENT* 1 (1991).

⁹⁷ *Id.* at 9.

⁹⁸ *Id.* at 2.

⁹⁹ CORNELIS VAN RAAD, *supra* note 10, at 23.

of international tax system, which is based on the principle of fair distribution of tax revenues among states.

Source of income

This part deals with so called passive income. The set of persons deriving income from sources within a country includes not only citizens and residents (those persons who already have a personal relationship with the country), but also foreign persons who are neither citizens nor residents of taxing country.¹⁰⁰ Most countries claim their entitlement to tax the income arising within their borders but accruing to foreign investors. Here the underlying theory appears to be that the source country has contributed to the ability of the foreign taxpayer to derive the income in question, and this justifies invoking the cost-sharing rule.¹⁰¹

In this case, the foreign taxpayer has no “personal” contact with the taxing country at all but derives particular items of income – most often investment income, such as dividends, interest or royalties – which are thought to have their source in the taxing country. This invokes a kind *in rem* jurisdiction based upon the particular items of income involved and imposed without regard to any “status” relationship of the recipient to the taxing country or any active participation in its economy.¹⁰²

In international tax conventions the question of entitlement to tax at source is the bedrock. The right of a jurisdiction to tax all income arising within its geographical borders is recognized as of fundamental character. This permits a country to share in the

¹⁰⁰ ROBERT E. MELDMAN & MICHAEL S. SCHADEWALD, A PRACTICAL GUIDE TO U.S. TAXATION OF INTERNATIONAL TRANSACTIONS 1-2 (3rd ed. 2000).

¹⁰¹ DAVID R. TILLINGHAST, *supra* note 84, at 5.

¹⁰² *Id.* at 6.

gains of foreign-owned factors of production operating within its borders; gains which are generated in cooperation with its own factors, whether they be natural resources, an educated and/or low cost work force, or the proximity of the market. The tax revenue so obtained may be thought of as a national return to the leasing of these complementary factors to non-resident investors or temporary workers, or, such taxation may be thought of in benefit terms, as a *quid pro quo* payment for cost-reducing, profit-enhancing services provided by the host country.¹⁰³

The main problem today is that the national legislations differ considerably with regard to the definition of domestic source income, which raises questions of extraterritoriality in their right. Besides the fact that taxation of foreign income is inherently extraterritorial, the problem of extraterritoriality is exacerbated by the fact that no established universal rule of conventional or customary international law exists concerning the delimitation between domestic source income and foreign source income, or even the attribution of income to the particular taxpayers.¹⁰⁴

The use of source of income basis can inevitably lead to double taxation if income earned within a particular state is accrued to foreigners, which are personally taxed by another country on residence or nationality basis. The exercise of fiscal jurisdiction based on source of income will not be followed by double taxation only in the case where international tax conventions exist. It means that most countries prefer peaceful tax coexistence rather than severe tax competition. This tax coexistence presumes application of internationally recognized rules of the game, which are attributable to the international

¹⁰³ Peggy B. Musgrave, *supra* note 82, at 1341-2.

¹⁰⁴ Rutsel Silvestre J. Martha, *supra* note 9, at 20.

tax regime and, thus, can be considered as characteristics of international tax system as different of characteristics of national tax systems.

Property

That the possession of property, if it has not merely a temporary character, is a legitimate and, indeed, very usual source of taxation by the state of the situs cannot be open to doubt.¹⁰⁵ In respect of the taxation of such foreign-owned property, the situs of this property within the territorial limits of a state is recognized as a connection to that state that suffices as a basis for that state to tax the property and the income it produces. However, the question, for tax purposes, of a property's exact location is relatively unexplored and, where explored, is not uniformly answered in national and international tax instruments.¹⁰⁶

A state has fiscal jurisdiction only if the situs of the object is within its territorial sphere of validity.¹⁰⁷ No state can legally establish an economic fiscal attachment with respect to property located beyond its scope.¹⁰⁸

The problem of economic attachment becomes more difficult with respect to movables. It is clear that whenever a movable is within the territorial sphere of validity of a state, such state can apply its legal categories on the object, irrespective the owner's location. On the other hand, the state of the owner's nationality or residence can attach the owner personally and tax the revenues derived from the movable property. However,

¹⁰⁵ Frederick Mann, *supra* note 10, at 112.

¹⁰⁶ CORNELIS VAN RAAD, *supra* note 10, at 23.

¹⁰⁷ RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 101.

¹⁰⁸ *Id.*

the latter state cannot attach the movable itself. Thus every state can impose taxes on goods, which are present within their territories, be they transitory or permanent.¹⁰⁹

But this proposition concerning the possibility to establish fiscal jurisdiction over movable property, which is of transitory character, should be backed by the existence of reasonable economic nexus with taxing state. Without such nexus, as it was discussed in the second chapter no jurisdiction to prescribe taxes can be accepted as legal. In the case of movable transient goods the country of destination has a strong justification for their taxation. And, thus, the country where property is temporarily located should take into account international consideration and behave on comity basis expecting that other countries will restrain from taxing of transient movable property heading to that country.

D. E-commerce: absence of territory and personality

Electronic commerce is the ability to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques.¹¹⁰ E-commerce is relatively new area of taxation, which has largely been immune from significant tax regulation. Most world governments have not yet instituted firm tax guidelines regarding electronic commerce over the Internet.¹¹¹ Before taxation of e-commerce is introduced the relative unanimity on the question of nature of Internet transactions should be achieved.¹¹²

¹⁰⁹ RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 102.

¹¹⁰ RICHARD A. WESTIN, INTERNATIONAL TAXATION OF ELECTRONIC COMMERCE 10 (2000).

¹¹¹ Fernando Piera, *International Electronic Commerce: Legal Framework at the Beginning of the XXI Century*, 10-SUM CURRENTS: INT'L TRADE L.J. 8, 18 (2001).

¹¹² A number of theories have been developed concerning Internet issues. The first method analogized Internet transactions to physical transactions. Subsequently, additional thought included modifying certain laws to deal with electronic transactions. The third method concerned changing the laws altogether and

In the process of prescribing tax law upon e-commerce it is necessary to keep in mind that the taxation of commerce conducted over the Internet should be consistent with the established principles of international taxation, should avoid inconsistent national tax jurisdictions and double taxation, and should be simple and easy to understand.¹¹³

One of the main problems of e-commerce taxation under international and municipal law is the determination of the place with which appropriate taxable events are connected. In other words, Internet transactions raise the critical issue of geographic jurisdiction because taxation and regulation are subject of geographical jurisdiction. Geography simply does not map on cyberspace. The reality is that the transaction did not take place in any geographic location.¹¹⁴

As we discussed above, the nexus between taxing state and tax events should exist for the purpose of legitimate jurisdiction to impose taxes. One of the kinds of nexus is the presence within the territory of a state sought tax authority. E-commerce creates taxation problem when the only presence that exists in a transaction is a company's server in the foreign country. Professor Richard Doernberg argues that the flow of information from company to server to end customer is not enough of a physical presence for a country to claim the right to tax.¹¹⁵

forming a body of law that specifically addresses the Internet. The fourth, and most recent method, dealt with regulating the Internet itself by placing restrictions and requirements for any and all Internet use associated with commerce. Jonathane M. Ricci, *Electronic Commerce and Non-Resident Aliens: The Internal Revenue Service Versus International Cyberspace Transactions*, 6 RICH. J.L. & TECH. 7, (1999) <<http://Richmond.edu/jolt/v6i2/article2.html>>.

¹¹³ Brian Fagan, *Taxation of Electronic Commerce: Avoiding an Inroad upon Federalism*, 49 DRAKE L. REV. 465, 471 (2001).

¹¹⁴ Stephen J. Korbin & Elizabeth Wagner, *Taxing Internet Transactions*, 21 U. PA. J. INT'L. ECON. L. 666, 671 (2000).

¹¹⁵ Richard Doernberg et al., *Electronic Commerce and International Taxation*, 24 SUFFOLK TRANSNAT'L L. REV. 233, 237 (2000).

The general question of determination of the geographical location of the taxable event raises the question of permanent establishment. Right now one of the burning debates in the area of e-commerce is whether a server constitutes a permanent establishment.¹¹⁶ The question whether a server or website owned or used by a foreign enterprise amounts to a fixed place of business in a particular country may result in modification to the definition of permanent establishment and clarification of what is excluded from its scope.¹¹⁷

From the one point of view, the presence of a server may be disregarded when it is only a communication device, not a true business location. Usage of facilities for the purpose of storage, display, or delivery of goods or merchandise does not create a permanent establishment. Nor do preparatory or auxiliary activities. The further a foreign corporation goes beyond advertising, collection of information, and purchasing of goods, the more likely it will be deemed to have permanent establishment.¹¹⁸

From the other point of view, the U.S. Department of the Treasury has expressed its concern in statement: "It is possible that such a server, or similar equipment, is not a sufficiently significant element in the creation of certain types of income to be taken into account for purposes of determining whether a U.S. trade or business exists. It is also possible that if the existence of a U.S.-based server is taken into account for this purpose,

¹¹⁶ Walter Hellerstein, *supra* note 17, at 77.

¹¹⁷ Andreas J. Sawyer, *Electronic Commerce: International Policy Implications for Revenue Authorities and Governments*, 19 VA. TAX REV. 73, 106 (1999).

¹¹⁸ Michelle Prettie, *Are There Any Tax Havens in Electronic Commerce?* 3 N.C. J.L. & TECH. 1, 14-21 (2001).

foreign persons will simply utilize servers located outside the United States since the server's location is irrelevant".¹¹⁹

The OECD determined its position on this question and said that the server on which the web site is stored and through which it is accessible is a piece of equipment having physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time, and to perform core functions for a particular enterprise.¹²⁰

E-commerce not only introduced geographical problems but also some others. One of them is the problem of identification of proper taxpayers. Actually, Internet-mediated activities emphatically present on very fundamental question: Over whom and what can a government legitimately exercise power?¹²¹ The other fundamental question, certainly, is whether government revenues will remain adequate.¹²²

As far as cyberspace cannot be geographically divided the major problems of e-commerce taxation should be addressed on multinational basis and by uniform rules.¹²³ For example, we agree that concepts such as permanent establishment and carrying on business will be more difficult to apply unless governments agree to a common set of

¹¹⁹ Office of Tax Policy, United States Department of the Treasury, *Selected Policy Implications of Global Electronic Commerce*, available at <http://www.ustreas.gov/offices/tax-policy/library/internet.pdf> (last visited March 20, 2003).

¹²⁰ COMMITTEE ON FISCAL AFFAIRS, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, TAXATION AND ELECTRONIC COMMERCE: IMPLEMENTING THE OTTAWA TAXATION FRAMEWORK CONDITIONS 82-4 (2001).

¹²¹ William V. Vetter, *Preying on the Web: Tax Collection in the Virtual World*, 28 FLA. ST. U.L. REV. 649, 664 (2001).

¹²² Stephen J. Korbin & Elizabeth Wagner, *Taxing Internet Transactions*, 21 U. PA. J. INT'L. ECON. L. 666, 668 (2000).

¹²³ See Sarah W. Salter, *E-Commerce and International Taxation*, 8 NEW ENG. INT'L & COMP. L. ANN. 5, 17 (2002).

rules to determine how Web-based transactions will be subject to tax.¹²⁴ We also think, that international organizations such as the OECD or the UN¹²⁵ can develop multilateral treaties that apply to those engaged in a significant amount of electronic commerce to answer many unresolved questions with respect to classification of income and jurisdictional issues.¹²⁶

E. Inferences

We think that Professor Nancy Kaufman reasonably said that in meaningful international tax cooperation it would be possible for each country with which a taxpayer had ties to impose its tax on that portion of the taxpayer's income arising within that country. In that event, she continues, the taxpayer's entire comprehensive income tax base would be subject to tax, different parts of it by different countries. A worldwide tax system of source taxation would thus achieve the income tax goal to which we all seem to subscribe: an income tax should apply to a taxpayer's entire income, wherever earned or derived. In her view, equity does not necessarily require the taxation of the taxpayer's worldwide income by a single sovereign, and she doesn't agree that personal taxes are inappropriate to a situation in which only part of the taxpayer's global income is taxed.¹²⁷

¹²⁴ See Jack M. Mintz, *supra* note 1, at 1291.

¹²⁵ In resolving e-commerce taxations problems it is necessary to take into account different, even competing, interests developed and developing countries. In this context, the U.N. Model Tax Convention promotes the source principle over a system of permanent establishment and appears to be in conflict with the OECD Model Tax Convention in this regard. Andreas J. Sawyer, *Electronic Commerce: International Policy Implications for Revenue Authorities and Governments*, 19 VA. TAX REV. 73, 104-5 (1999).

¹²⁶ Jonathane M. Ricci, *Electronic Commerce and Non-Resident Aliens: The Internal Revenue Service Versus International Cyberspace Transactions*, 6 RICH. J.L. & TECH. 7, (1999).

¹²⁷ Nancy H. Kaufman, *supra* note 91, at 1468.

The analysis of this chapter reveals that national means of tax law administration should be depended on the bases of limited character. When a particular state tries to broaden its jurisdictional basis it inevitably overlaps with tax bases established by another country. The absence of international coordination of interstate allocation of tax bases and different vision of limits of own jurisdiction both lead to conflicts between jurisdictions.

CHAPTER 4

CONFLICTS BETWEEN TAX JURISDICTIONS

A. In general

Professor David Gliksberg distinguishes three basic models of conflicts between concurrent jurisdictions of different states: conflict between personal jurisdictions, conflict between territorial jurisdictions, and conflict between personal and territorial jurisdictions. According to him, conflict between personal jurisdictions occurs where a particular taxpayer has personal links, which create a liability for tax imposed by two or more states (e.g. residence and citizenship). Conflict between territorial jurisdictions, he continues, will occur where each territorial jurisdiction has a different source rule determining the geographical source of income, so that a number of territorial jurisdictions demand tax for the same event. Finally, he states, that conflict between territorial and personal jurisdictions is the most frequent conflict, occurring where certain income was incurred in one state (state of source) by a taxpayer who maintains personal ties with another state, which create a tax liability in that state (state of residence or citizenship). Such a conflict is regulated by tax treaty or by unilateral provisions of national law.¹²⁸

¹²⁸ David Gliksberg, *supra* note 16, at 464-5.

Of course, there are other approaches to classification of types of sovereign fiscal conflicts¹²⁹, but they are all based on the fact that such conflicts arise out of the situation when one tax event is subjected to jurisdictional basis of more than one state inevitably leads to conflicts between sovereigns. As we have seen in previous chapters fiscal jurisdictions of different states are not harmonized. As a result, tax bases or limits of jurisdictions to tax of particular countries often overlap.

As matter of fact the conflict arises when two concurrent jurisdictions are legally entitled under international law to apply their laws to the same facts. As the causes of conflict can be mentioned the cases of double nationality, double residence or a combination of the two. It also takes place when either a resident or national of a given state has property or some kind of interest within the territory of another state.¹³⁰

Unfortunately, in modern international law there are no commonly accepted rules for resolution of fiscal conflicts, as a result a comprehensive concept is lacking, and procedures, which pretend to settle actual conflicts, are, in reality, lop-sided. There is not even agreement on the fundamental issue whether states are free to exercise jurisdiction as long as this is not expressly prohibited by a rule of international law or whether they may only exercise jurisdiction abroad on the basis of enabling rules of international law.¹³¹ Nor does general international law adequately deal with the disparity between fiscal concepts, such as the definitions of income, permanent establishment, residence, etc.¹³²

¹²⁹ For example, Rutsel Matha states that there are three instances of concurrence of fiscal jurisdiction: of unlimited fiscal liabilities, of limited fiscal liabilities, of limited and unlimited fiscal liabilities RUTSEL SILVESTRE J. MARTHA, *supra* note 1, at 141-4.

¹³⁰ *Id.* at 141.

¹³¹ Karl Zemanek, *supra* note 27, at 70.

¹³² Rutsel Silvestre J. Martha, *supra* note 9, at 21.

The existing conflicts between states concerning tax matters are the object of discussion between scientists. The fundamental problem here is the contradiction between the absence of formal rules of international rules dealing with such conflicts, thus, giving rise to unilateral national approach to enactment of national tax laws, and interdependence of modern world, which determines international approach to formation of national tax systems along with consideration of interests of other countries.

Professor Sol Picciotto when addressed this issue justly mentioned that from the point of view of formal sovereignty, there is no restriction on a state's right to tax, and it may be exercised without regard to its effects on other states.¹³³ At the same time, according to him, since economic activities and social relations are international or global, the reality of state power is not unlimited exclusive sovereignty, but interrelated and overlapping jurisdictions. Even, he concludes, if states exercise their own exclusive territorial competence this could produce overlapping and conflicting effects, due to the multiple geographic contacts of individuals and interrelated economic activities.¹³⁴

In the absence of international legal mechanism for prevention of tax conflicts the problems of finding compromise becomes more deep in relations between economic interests of developing and developed countries. It is debatable what principles should be regarded as fundamental in the context of relationships between developed and developing countries. In such relations traditional requirements of equity and neutrality are not always handle the problem adequately. The main point here is that tax incentives provided by developing countries in order to attract investments in reality constitute deviations from the principle of equity and neutrality. Thus, coordination of the tax

¹³³ SOL PICCIOTTO, *supra* note 28, at 307.

¹³⁴ *Id.*

incentives of developing countries and international taxation is, however, a subject area for which the standard argumentation based solely on these two concepts turns to be inadequate. In discussions concerning issues relating to developing countries, the economic sovereignty of each nation is often regarded as a fundamental principle.¹³⁵ Consequently, in this case we see that the developing world is increasing to use national rather than international approach to institute their tax systems.

In this chapter I will address first the problems of tax competition as a direct result of absence of the legal mechanism of resolution of conflicts between fiscal jurisdictions. Then I examine the tax haven issue, which can be considered as the extreme form of tax competition. After that I will turn to the analysis of the consequences of the tax competition.

B. Tax Competition

Professor Stephen Utz has described tax competition as both the deliberate attempt by a taxing sovereign to offer tax advantages to mobile taxpayers in order to attract them to its jurisdiction, and the unintended creation of such attractions. According to him, the examples of deliberate tax competition are few among the more advanced industrial democracies, as far as they can rarely achieve overall economic gains by flaunting the interests of their many trading partners, but examples of apparently

¹³⁵ See TIMO VIHARKENTTA, TAX INCENTIVES IN DEVELOPING COUNTRIES AND INTERNATIONAL TAXATION 40 (1991).

unintended or indirect tax competition are abundant.¹³⁶ As an example of indirect tax competition we can mention tax exemptions for interest on certain deposits.

There are different approaches towards tax competition. According to one view, tax competition is a strong factor in both maintaining and increasing the vibrancy of economies across the globe. The proponents of such approach argue that tax competition helps to reduce ineffective governmental expenses and criticize the OECD for trying to impose its will on nations that are not members of the organization by calling for draconian sanctions against so-called tax havens.¹³⁷ According to other more neutral approaches, tax competition as such is neither good nor bad. It can conceivably eliminate economic distortion due to national tax laws but it can also undermine the legitimate goals of supporting government and stabilizing or stimulating domestic economic activity.¹³⁸

There are different factors, which cause tax competition. One of the most important factor is globalization¹³⁹ and as its result increased mobility, which means that multinational business enterprises of all sizes will enjoy an unprecedented array of choices of regulatory and tax regimes, as well as unprecedented flexibility to take advantage of these choices without significantly altering or compromising their business plans. Another challenge for national tax administrations is development of the Internet, which creates possibility for taxpayers to move to tax havens and do everything that they

¹³⁶ Stephen G. Utz, *supra* note 3, at 770.

¹³⁷ Alexander Townsend, *The Global Schoolyard Bully: The Organization for Economic Cooperation and Development's Coercive Efforts to Control Tax Competition*, 25 FORDHAM INT'L L.J. 215, 215 (2002).

¹³⁸ Stephen G. Utz, *supra* note 3, at 773.

¹³⁹ Johan Deprez, *The Telecommunications Industry in the Information Age: A Case Study on Globalization, Deregulation, and Tax Competition*, 23 LOY. L.A. INT'L & COMP. L. REV. 537, 551 (2001). Indeed, in globalization a country that increases tax rates beyond those of competing nations will eventually lose business to those competitors. Michael A. Livingston, *Blum and Kalven at 50: Progressive Taxation, "Globalization", and the New Millennium*, 4 FLA. TAX REV. 731, 742 (2000).

need to do to make lots of money all over the world, without establishing any taxable presence in the major countries into which they sell – the world's big industrial democracies, thus, eroding their tax bases.¹⁴⁰

Another factor determining tax competition is the need for investment. Countries frequently engage in tax competition to attract investment from elsewhere, thereby undermining the tax bases of other countries. Multinational agencies typically discourage developing and transition countries from offering such incentives on the basis that business usually attracted by other factors and that precious revenue is being given away. Nevertheless, the existing international tax system does not give sufficient support to countries to move away from the investment incentive approach.¹⁴¹

Professor Musgrave, when she speaks about tax competition, concentrates on the opposing interests of the source country and the residence country. She writes, in particular, that to attract investments source country can offer profit tax incentives while applying relatively high withholding rates to encourage reinvestment of earnings. This pattern of behavior by the countries of source can lead to tax competition among-capital importing countries with the result that no one country can obtain enough additional investment from abroad to justify the lower tax. Furthermore, she argues, such tax competition can have damaging effects on domestic tax equity. In her point of view, these are highly relevant problems for the developing countries where foreign capital is needed

¹⁴⁰ Devid G. Noren, *The U.S. National Interest in International Tax Policy*, 54 TAX L. REV. 337, 339 (2001).

¹⁴¹ Victor Thuronyi, *International Tax Cooperation and a Multilateral Treaty*, 26 BROOKLIN J. INT'L L. 1641, 1647-8 (2001).

for the development process, yet government revenue also needed to create the infrastructure for that development.¹⁴²

To protect national interest and to ensure tax revenue each country should develop own anti-competition strategy. Doing this each sovereign is faced with two contradicting policy determinations: (1) to try and protect the revenue yielded from its tax base, and (2) to maintain a tax climate that favors the inflow of investment and discourages the outflow of domestic capital resources.¹⁴³

One of the possible measures is to deal with the problem unilaterally and to introduce the taxation of immobile factors. In the era of globalization and, as a result, of increased mobility of business inputs – especially capital – these inputs become much more sensitive to differences in net-of-tax incomes earned in countries. Thus, any changes in economic conditions, including fiscal policies of governments, would have a substantial impact on the flow of capital and other related business inputs between countries, and governments would tend to avoid taxing internationally mobile factors of production since the economic costs of the tax is greatest when business inputs easily flow to other jurisdictions. Afterwards, it will be difficult to measure the mobile tax base since income or transactions are not easily identified to a particular location. In this situation it is more preferable for governments to tax immobile factors, such as real estate and unskilled labor, since the economic cost of imposing the tax is less for these immobile bases.¹⁴⁴

¹⁴² Peggy B. Musgrave, *supra* note 82, at 1343-4.

¹⁴³ George M. Melo, *Taxation on the Global Arena: Preventing the Erosion of National Tax Bases or Impinging on Territorial Sovereignty?* 12 PACE INT'L L. REV. 183, 189 (2000).

¹⁴⁴ Jack M. Mintz, *supra* note 1, at 1287-8.

To resolve the problem on the multilateral basis, developed countries should acknowledge and respect economic decisions made by developing countries. Absence of examining developing country goals cannot be expected to foster progress.¹⁴⁵

The supporters of tax competitions argue that the elimination of all tax competition would be harmful indeed. Competition, according to them, denotes alternatives and alternatives give multinationals the opportunity to leave and take their investment with them. This opportunity to leave prevents governments from being tyrants.¹⁴⁶ Professor Jack Mintz states that differential tax policies across countries can impact on the efficiency of worldwide production since businesses seek to allocate resources to tax-favored regions of the world.¹⁴⁷ But another attitude should be developed by the international community towards harmful tax competition, which often occurs in case of tax havens.

C. Special remarks on conflict of interests between tax havens and countries with normal tax systems

Generally, tax havens are jurisdictions with nominal tax rates, or no tax rates, that fail to generate significant revenue.¹⁴⁸ The 1998 OECD report “Harmful Tax Competition: An Emerging Global Issue” (1998) enumerates specific criteria for identifying tax havens:

- the jurisdiction imposes no or only nominal taxes;

¹⁴⁵ Karen B. Brown, *Harmful Tax Competition: The OECD View*, 32 GW J. INT’L L. & ECON. 311, 321 (1999)

¹⁴⁶ See Kimberly Carlson, *When Cows Have Wings: An Analysis of the OECD’s Tax Haven Work as It Relates to Globalization, Sovereignty and Privacy*, 35 J. MARSHALL L. REV. 163, 174-5 (2002).

- the jurisdiction lacks policy of effective exchange information;
- the jurisdiction lacks transparency;
- the jurisdiction has no requirement of substantial activities.¹⁴⁹

The principal function of tax haven is the avoidance of high taxes. They may also serve the purpose of postponing the imposition of tax, and provide an effective shield against the dangers of confiscation and sanctions.¹⁵⁰

There two major types of tax havens. The first type is a production tax haven, where the country levies a very low tax rate on the income from manufacturing operations located in its jurisdiction. The main purpose to become productive tax haven is to attract real investment and economic activity into the country. The second type is a traditional tax havens, where the country offers a low tax on the income of corporations who establish their legal domicile in that country. In traditional tax havens the country essentially offers its services, for a fee, to individuals and corporations pursuing tax avoidance and evasion.¹⁵¹

Globalization facilitates the trend towards financial tax havens. Internet influenced tremendously on the ability of taxpayers to benefit from the connection of regional markets through networked computers and high-speed telecommunications increases the mobility of capital and financial flows between nations. Previously remote tax regimes are now readily accessible; communication improvements allow for the

¹⁴⁷ Jack M. Mintz, *supra* note 1, at 1288.

¹⁴⁸ Alexander Townsend, *supra* note 136, at 238.

¹⁴⁹ Organisation for International Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue*, available at <http://www.oecd.org/pdf/M00004000/M00004517.pdf> (last visited March 21, 2003).

¹⁵⁰ ANTHONY S. GINSBERG, INTERNATIONAL TAX HAVEN 3 (1990).

¹⁵¹ Joel Slemrod & Reuven Avi-Yonah, *Should Trade Agreements Deal with Income Tax Issues?* 55 TAX L. REV. 533, 544 (2002).

spreading and sharing techniques between regions. The result is the lost revenue for high tax jurisdictions.¹⁵²

Of course, countries with relatively high tax rates (which are, obviously, developed ones) could not tolerate loss of revenue and started coordinated attack against low tax jurisdictions. They introduced two general approaches to manage the problem. The first approach was targeted for closure of treaty shopping opportunity by way of the toughening up of treaty terms coupled by the termination of some treaties with tax havens. This was intended to dampen the extent to which havens could be used in combination with flows of money through treaty routes. The second approach can be characterized by unilateral legislative measures intended to tackle flows of money to and from havens. These have included in particular the adoption of legislation of a Subpart F pattern by most of the major world economies plus the moves on transfer pricing, bank secrecy, conduit companies and other areas studied in details by the OECD as well as individual states in the last decade. Both are partial answers to the problems presented to major economies by havens.¹⁵³

In addition to the exclusion of some tax havens from the tax treaty networks, toughening treaty terms, and adoption of appropriate national laws, some state in particular economic areas has joined the number of tax haven by providing with tax exemption of income earned from particular economic activities and, thus, stepped into direct competition with them. Also as an answer to tax avoidance and evasion, channeled through low tax jurisdictions, developed countries strengthened enforcement of tax laws including support by criminal provisions against taxpayers likely to be using haven roots,

¹⁵² Alexander Townsend, *supra* note 136, at 233-4.

¹⁵³ DAVID W. WILLIAMS, *supra* note 12, at 162.

both nationally and through international cooperation. In addition, these anti-offshore measures were backed by general reduction in direct tax rates.¹⁵⁴

Paradoxically, some scientists consider that the best way to deal with the problem is to propose more attractive environment for business rather than to propose new administrative counter-measures. It sounds reasonable, when they say that the competition rather than anything else that is likely to bring tax havens within tolerable level of activity. Witting or otherwise, income taxes are slowly being converted into expenditure taxes, and at the same time are being at the margin superseded by expenditure taxes. It was suggested, that tax havens will have problems legally sheltering taxpayers from expenditure taxes if expenditure occurs directly or indirectly within another state's jurisdiction.¹⁵⁵

The OECD plays especially active role in preventing tax avoidance and evasion through tax havens. In its 1998 report "Harmful Tax Competition: An Emerging Global Issue" (1998)¹⁵⁶ the OECD listed 19 recommendations for member states to counteract the negative impacts of the tax systems of these jurisdictions. In particular, members were provided with recommendations concerning domestic legislation and practices, treaties, intensification international co-operation in response to harmful tax competition.

Later in 2000 the OECD presented the report "Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices"¹⁵⁷ on implementation of the recommendations proposed by the 1998 Report. In this report it was stated that the

¹⁵⁴ *Id.* at 164.

¹⁵⁵ See DAVID W. WILLIAMS, *supra* note 12, at 164-5.

¹⁵⁶ Organisation for International Cooperation and Development, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*, available at <http://www.oecd.org/pdf/M00004000/M00004517.pdf> (last visited March 21, 2003).

initial reaction to the project of 1998 has been encouraging. A number of jurisdictions reviewed under the tax haven criteria and also a number of non-member economies have shown an interest in the project, resulting in an open dialogue. The process was characterized as open and dynamic; it aimed to move forward co-operatively so long as a co-operative approach bears fruit. It was also noticed that member countries are already working to eliminate harmful tax practices, and many jurisdictions meeting the tax haven criteria are actively considering taking a commitment within the next 12 months to eliminate harmful tax practices in accordance with the 1998 Report.

Not everybody considers the 1998 and 2000 Reports positively, because, according to them, the reports effectively dictate legislative and practice reforms targeted jurisdiction must enact, thus violating international taxation principle. Further, although the OECD claims that adoption of these fiscal reform recommendations are voluntary, the threat of targeted jurisdictions being subjected to the defensive measures outlined in the 2000 Report effectively coerces these jurisdictions into an involuntarily compliance.¹⁵⁸ Generally, the practice of the OECD aimed to reduce tax haven practice has often been under the criticism in legal literature.¹⁵⁹

¹⁵⁷ Organisation for International Cooperation and Development, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*, available at <http://www.oecd.org/pdf/M000014000/M00014130.pdf> (last visited March 21, 2003).

¹⁵⁸ See Alexander Townsend, *supra* note 136, at 252-3. He also argues, that the OECD seeks to reform the tax systems of these tax competitive nations and curb the resulting movement of capital into these jurisdictions to overcome the policies of many nations around the world purposed to provide favorable tax rates to individuals and corporations to induce investment. *Id.* at 215.

¹⁵⁹ For instance, Kimberly Carlson wrote that, the OECD, an exclusive membership of the leading industrialized nations, is not the appropriate forum for a worldwide discussion regarding global tax competition. In my opinion, the United Nations' policy of recognizing the needs of developing countries is a better forum to discuss these important worldwide issues. The United Nation is also better forum to create a solution, which can positively affect both developed countries and especially the developing countries. Kimberly Carlson, *supra* note 145, at 180.

In 2001 the OECD issued another report “The OECD’s Project on Harmful Tax Practices: The 2001 Project Report”.¹⁶⁰ The project, in general, expressed a positive approach towards tax competition, and noticed that more open and competitive environment of the last decades has had many positive effects on tax systems, including the reduction of tax rates and broadening of tax bases, which have characterized tax reforms over the last 15 years. In part these developments can be seen as a result of competitive forces, which have encouraged countries to make their tax systems more attractive to investors. According to the Report, in addition to lowering overall tax rates, a competitive environment can promote greater efficiency in government expenditure programs. But the Report stated the fact that some tax and related practices are anti-competitive and can undercut the gains that tax competition generates. This can occur, according to the Report, when governments introduce practices designed to encourage noncompliance with the tax laws of other countries.

Recently, the representatives of wealthy and Caribbean nations agreed to set up a task force to reform offshore financial centers during the two-day OECD-sponsored meeting in Barbados. This was a step in the creation of a multilateral forum for dialogue and decision-making regarding the elimination of harmful tax competition. The group is comprised of OECD Members and offshore centers, and will try to find a mutually acceptable process of turning the three principles of transparency, non-discrimination, and effective exchange of information into lasting commitments.¹⁶¹

¹⁶⁰ Organisation for International Cooperation and Development, *The OECD’s Project on Harmful Tax Competition: The 2001 Project Report*, available at <http://www.oecd.org/pdf/M00021000/M00021182.pdf> (last visited March 21, 2003).

¹⁶¹ Akiko Hishikawa, *The Death of Tax Havens?* 25 B.C. Int’l & Comp. L. Rev. 389, 390 (2002).

To date, the OECD's initiative to eliminate tax practices has not been completely successful. However, it has not been pursued in vain since the parties are still willing to continue the co-operative dialogue and seem optimistic of eventually reaching an agreement. With the passage of time, the death of tax havens seems to some to be inevitable.¹⁶²

D. Consequences of the conflict

Double taxation

International double taxation exists in its purest form when a single item of income is subject to income tax by more than one country. This happens when nation-states impose their taxes on a variety of jurisdictional bases under international law, and these bases often overlap.¹⁶³ Most countries impose taxes on income having its source within their territory and, additionally, many countries impose taxation on the basis that the taxpayer is resident within their jurisdiction. Other criteria such as nationality, domicile, centre of economic interests, may also be used as a basis for tax liability. Where these tax connecting factors are located in different jurisdictions, double taxation may result.¹⁶⁴

¹⁶² *Id.* at 417.

¹⁶³ CHARLES H. GUSTAFSON ET AL., *supra* note 68, at 18.

¹⁶⁴ DAVID R. DAVIES, *PRINCIPLES OF INTERNATIONAL DOUBLE TAXATION RELIEF* 1 (1985).

Therefore, double taxation consists of the concurrence resulting from applying a variety of rules to the same fact. Faced with various rules, the fact corresponds to what they all provide for, therefore, involving the respective applicability.¹⁶⁵

As it was stated above, under international law, there are some restrictions, which shape a state's jurisdiction to tax. But in the absence of uniform law the permissible power of a nation to tax will often reach beyond its own borders. The exercise of extraterritorial taxing jurisdiction necessarily implies a risk that income produced by a taxpayer from international transaction will be subjected to the demands of tax laws of two or more nations even though each nation is acting within the prescription of international law.¹⁶⁶

Personal fiscal attachment and economic fiscal attachment are the main factors, which, on the one hand, provide a country with a justification to impose taxes, and, on the other hand, cause the double taxation problem that usually arises when a taxpayer who has a personal relationship with one country (the home country) derives income from sources within another country (the host country). The host country will usually assert jurisdiction over the income on the basis of its economic relationship with the taxpayer. The home country may also assert jurisdiction over the income on the basis of its personal relationship with the taxpayer. In these situations, the countries involved must decide whether and how to adjust their tax systems so as to avoid international double taxation.

¹⁶⁵ MANUEL PIRES, INTERNATIONAL JURIDICAL DOUBLE TAXATION OF INCOME 36 (1989). The author states, that double taxation can be classified according to various criteria. Sometimes global aspects of the phenomenon are considered, other times the taxes it is derived from are taken into consideration and finally certain aspects relating to the elements of tax liability are used. In particular, the author distinguishes the following types of double taxation: factual and potential; intentional and unintentional; simple and compound; real, personal and mixed; vertical, horizontal and diagonal; material and formal; objective and subjective; legitimate and illegitimate; equitable and non-equitable; periodic and single. *Id.* at 55-62.

To avoid double taxation a particular country can take unilateral and bilateral measures. In case of unilateral measures the current international tax system generally leaves it to the residence country to alleviate double taxation.¹⁶⁷ Traditionally, it has been up to home country to solve the double taxation problems of its citizens and residents. The home country can accomplish this only by forfeiting part or its entire jurisdictional claim over the foreign-source income of its citizens and residents, either through a territorial system or a credit system.¹⁶⁸

There are two common methods of alleviating double taxation. The first is the worldwide or credit method in which the residence country taxes foreign source income but provides a credit for taxes paid to foreign jurisdictions. The United States and many other countries use a worldwide or extraterritorial system of for taxing international income. Under such a system, a domestic taxpayer's worldwide income, regardless of source, is subject to taxation in the United States or other country of residence. However, in order to mitigate international double taxation, the country of residence grants domestic taxpayer a dollar-for-dollar credit for foreign income taxes paid by the domestic taxpayer on foreign source-income.¹⁶⁹

The second is the exemption method under which the residence country cedes all taxing jurisdiction to the source country. Many countries, including a number of the European countries, use some version of exemption of territorial source system for taxing international income. Under such a system, many types, if not all, of a domestic

¹⁶⁶ CHARLES H. GUSTAFSON ET AL., *supra* note 68, at 14.

¹⁶⁷ Terrence R. Chorvat, *Ending the Taxation of Foreign Business Income*, 42 ARIZ. L. REV. 835, 838-9 (2000).

¹⁶⁸ ROBERT E. MELDMAN & MICHAEL S. SCHADEWALD, A PRACTICAL GUIDE TO U.S. TAXATION OF INTERNATIONAL TRANSACTIONS 2 (3rd ed. 2000).

¹⁶⁹ CHARLES H. GUSTAFSON ET AL., *supra* note 68, at 14.

taxpayer's income from foreign sources are exempt from tax in the country of residence.¹⁷⁰

Bilateral measures are taken by the conclusion of tax conventions on avoidance of double taxation, which we will discuss below. We agree with Professor Robert Peroni when he states that the central function of international tax rules should be to attempt to ensure that double taxation does not discourage the taxpayer from engaging in a cross-border transaction if it makes economic sense to do so.¹⁷¹

Absence of taxation

Absence of taxation has the same origin as double taxation, namely absence of a uniform approach to allocation of fiscal jurisdiction over income or tax events of international nature. But result of the imperfect fit of national tax systems could be different. If, in the case of double taxation, two or more jurisdictions overlap over the same basis, in case of absence of taxation neither residence jurisdiction nor source jurisdiction claim the right to tax. Inconsistent tax principles and source rules of different countries have been known sometimes to combine benignly and allow total escape from taxation by any country for those able to allow aligning their affairs artfully.¹⁷² Thus, when countries exercise that jurisdiction on their own, transactions that have a connection with more than one country may as a result of luck or tax planning escape the taxing grasp of any country.¹⁷³

¹⁷⁰ *Id.* at 15.

¹⁷¹ Robert J. Peroni, *The Proper Approach for Taxing the Income of Foreign Controlled Corporations*, 26 BROOKLIN J. INT'L L. 1579, 1582 (2001).

¹⁷² JOSEPH ISENBERGH, INTERNATIONAL TAXATION 13 (2000).

¹⁷³ Victor Thuronyi, *supra* note 140, at 1646-7.

In this case because of absence of international interaction between national tax systems both country of residence and country of source lose their revenues and taxpayer by means of jurisdiction shopping receives unjust enrichment.

E. Inferences

In a world economy with free movements of capital and labor, the ability of governments to impose a high tax burden on such internationally mobile factors of production is severely restricted unless a high degree of international coordination and tax enforcement is reached among national authorities. Consequently, the tax burden is likely to shift to some extent toward the internationally immobile factors of production such as land or low-skilled labor. This tax shift limits the ability of national governments to pursue independent policies of distribution and subsidized public services, which are at the center of the welfare state.¹⁷⁴

Whatever its consequences, tax competition is not under the control of government of one particular state, even very powerful. The alternative is the conscious mutual adjustment of tax systems to eliminate differences that might make one tax jurisdiction more attractive than another as a place for investment or business activity. If the tax laws of all countries were harmonized, i.e., had similar effect on commercial and investment decisions, tax competition would obviously be avoided.¹⁷⁵

This tax adjustment is possible only when two or more states agree upon the division of sovereign power. This division will allow excluding unreasonable and

¹⁷⁴ JACOB A. FRENKEL ET AL., INTERNATIONAL TAXATION IN AN INTEGRATED WORLD 211-4 (1991).

¹⁷⁵ Stephen G. Utz, *supra* note 1, at 773.

harmful tax competition and avoiding double taxation including escaping from taxation.

This outcome path the way to analysis of problems arising out of international cooperation on tax matters.

CHAPTER 5

COOPERATION BETWEEN STATES ON TAX MATTERS

A. In General

There is a tremendous history of international cooperation in tax area – probably greater than in any other legal area.¹⁷⁶ It can be easily assumed, that the existence of this history was determined by the fact, that taxation policies of one jurisdiction not only have a significant impact on the efficiency of its own economy but also on the efficiency of other economies linked to it.¹⁷⁷

In international cooperation on tax matters the countries seek to achieve equity in international taxation, and, thus, provide the foundation for an equitable international tax system. Equity exists in the international tax system only when states distribute among themselves the competence to tax in a way that conforms to prevailing views of justice internationally. An equitable international tax system will not exist until some international consensus can be reached on how countries should share among themselves the competence to tax.¹⁷⁸

International cooperation allows countries to improve the coordination of tax policies on international level. We can talk about several types of coordination. For

¹⁷⁶ David H. Rosenbloom, *Sovereignty and the Regulation of International Business in the Tax Area*, 20 CAN.-U.S. L.J. 267, 267 (1994).

¹⁷⁷ Jack M. Mintz, *supra* note 1, at 1291.

¹⁷⁸ Nancy H. Kaufman, *supra* note 73, at 202.

instance, one type is aimed to make a country's tax system more similar to others – in other words, harmonize taxes. Other types aim to minimum or maximum rates of tax, to avoid the double taxation of cross-border flows of income, to prevent transfer pricing, to agree on competent authority arrangementg, and to curtail harmful tax competition.¹⁷⁹

In recent time of increasing e-commerce, international fiscal cooperation obtains special importance. In the area of e-commerce, international cooperation is strongly recommended. It is crucial that taxpayers know where the borderlines are and not be put in a position to have a taxable presence in a country without even knowing that they have business presence in that country.¹⁸⁰

International cooperation on tax matters still leave to wish the better, because despite the worldwide consensus on the principles of international taxation, it is fair to say that nations are quite reluctant to surrender their autonomy in this area.¹⁸¹ But new challenges of modern era, such as growing mobility of assets of multinational enterprises and growing use of cyberspace, will inevitably push countries to close cooperation. It may well be that these continuing developments eventually will compel the transfer of national responsibility for some taxes to an international authority.¹⁸²

¹⁷⁹ Jack M. Mintz, *supra* note 1, at 1296.

¹⁸⁰ Michelle Prettie, *supra* note 117, at 34.

¹⁸¹ David H. Rosenbloom, *supra* note 175, at 268.

¹⁸² Peggy B. Musgrave, *supra* note 82, at 1349.

B. Bilateral cooperation on tax matters

Bilateral tax treaties

Tax lawyers recognized very early that under international law situations of concurrent jurisdictions may arise and that general international law does not contain rules to settle conflicts of concurrent jurisdictions. Hence a practice has developed to issues of extraterritorial taxation by double taxation treaties.¹⁸³

Today the public international law of taxation is dominated by over 1500 bilateral treaties for the prevention of double taxation of income and capital. This treaty network has been called a “triumph of international law” and a framework for an international tax regime based on the principles underlying in these treaties.¹⁸⁴ This network of bilateral tax treaties for the prevention of double taxation of income and capital constitutes one of the main avenues of cooperation for coordination of the international tax system.¹⁸⁵

The essential purpose of the tax treaties is to allocate the tax base between two contracting parties. This allocation divides tax base in the following way: active business should be taxed in the country in which it originates (the source country) and passive income should be taxed in the country in which the recipient of the income resides (the residence country). Under active business treaties understand business activity through permanent establishment and give the source country the primary right to tax the profits from that operation. The residence country is required to exempt those profits from tax, at least to the extent they were taxed by the source country. Passive income (such as interest, dividends, royalties) is usually taxed at reduced rates or totally exempted from taxation in

¹⁸³ Rutsel Silvestre J. Martha, *supra* note 9, at 29.

¹⁸⁴ Victor Thuronyi, *supra* note 140, 1641.

the source country, leaving the right to tax that income to the residence country.¹⁸⁶ The provisions of typical tax treaty include an enumeration of specific abatement or exemption of taxation for residents of one country on certain type of income from the other.¹⁸⁷

Technically, the typical treaty provides that business profits are usually exempt from tax in the country of source unless the profits are attributable to a permanent establishment in the source country. The tax treaty often provides an exemption from tax in the source country for income from personal services performed in an independent capacity. The tax treaty also often provides an exemption for an employee's personal service income provided that the employee is present in the country for not more than a specified period of time and the compensation is by a nonresident employer that does not have a permanent establishment. The treaty typically reduces or eliminates the withholding tax on at least some items of investment-type income such as interest, dividends, rents and royalties not attributable to business conducted through a permanent establishment. The tax treaty also provides that the country of residence may tax capital gains.¹⁸⁸

The delimitation of the tax base between sovereign fiscal jurisdictions prevents taxes from interfering with the free flow of international trade and investment. Their basic thrust is the avoidance of double taxation of income from international transactions

¹⁸⁵ *Id.* at 1648.

¹⁸⁶ Reuven Avi-Yonah, *supra* note 2, at 1306-7.

¹⁸⁷ JOSEPH ISENBERGH, *supra* note 171, at 195.

¹⁸⁸ CHARLES H. GUSTAFSON ET AL., *supra* note 68, at 56-57.

by limiting jurisdiction to tax.¹⁸⁹ Treaties typically are concerned with the apportionment of the tax revenues between the treasuries of the treaty countries.

Formally, in tax treaties one can find different governmental statements of the purpose of double taxation conventions. These purposes might include the following objectives: eliminating double taxation in order to prevent the discouragement of international trade; providing for cooperation between tax administrations to combat tax evasion; providing certainty as to the tax regime faced by investors and traders – again to prevent to discouragement of international trade; the elimination of discriminatory taxation; the sharing of tax revenue.¹⁹⁰

Tax treaties can be classified into two groups. The first group consists of the tax convention itself, namely, for the avoidance of double taxation on income and capital or on estates. In these treaties the contracting states agree on reciprocal restrictions on the exercise of their tax jurisdiction. The second group consists of treaties, which cover tax issues along with different commercial matters. In this type of treaty, states mutually confer on each other national treatment or most favored nation treatment, often specifically with regard to income taxes. It can be said that there is also group of human rights treaties. Some of these treaties have the potential of being developed by the courts into effective weapons against tax discrimination.¹⁹¹

In addition it should be said that tax treaties must not only deal with jurisdictional issues and prevention of extraterritorial taxation, but also must unify the existing fiscal

¹⁸⁹ *Id.* at 53.

¹⁹⁰ PHILIP BAKER, DOUBLE TAXATION CONVENTIONS AND INTERNATIONAL TAX LAW: A MANUAL ON THE OECD MODEL TAX CONVENTION ON INCOME AND CAPITAL OF 1992 12 (1994).

¹⁹¹ CORNELIS VAN RAAD, *supra* note 10, at 27.

concepts by providing exhaustive definitions that are not dependent on national regulations or concepts.¹⁹²

Special note should be made in respect to conventional tax relations between developed and developing countries. Tax treaties are intended to shift revenues from source to residence jurisdictions by reducing source-based taxation. This shift is generally acceptable, however, only if the reduction in source-based taxation is reciprocal and capital flows in each direction are broadly similar. In that situation, which is typical between developed countries, it makes sense to mutually reduce source-based taxes because each country will collect more residence-based taxes. The pattern of economic relations between developing and industrialized countries is characterized by income flows largely from the former to the latter countries. This makes the revenue sacrifice on the basis of source one-way and prejudicial to the tax interests of developing countries.¹⁹³ This explains why there are relatively fewer treaties between developed and developing countries.¹⁹⁴

Double taxation treaties are concluded on a bilateral basis. This bilateral character of treaties may raise specific problems in situations where more than two states are involved, for example the problems raised by typical triangle cases, i.e. those in which: income from dividends, interest or royalties is derived from a source in state S; such income is received by a permanent establishment in state P; the permanent establishment depends on an enterprise resident in state R.¹⁹⁵ Such an example means, that

¹⁹² Rutsel Silvestre J. Martha, *supra* note 9, at 26.

¹⁹³ KIBUTA ONGWAMUHANA, *THE TAXATION OF INCOME FROM FOREIGN INVESTMENTS: A TAX STUDY OF SOME DEVELOPING COUNTRIES* 36 (1991).

¹⁹⁴ Joel Slemrod & Reuven Avi-Yonah, *supra* note 150, at 549.

¹⁹⁵ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *MODEL TAX CONVENTION: FOUR RELATED STUDIES* 28 (1992).

internationalization of business goes beyond the ability of a bilateral treaty to properly respond to the increasing degree of mobility of business factors.

These examples show that bilateral tax treaties by their nature have limits when interests of third country are involved. These shortcomings inevitably call for cooperation on multilateral basis.

Model treaties

At this moment model treaties can be considered today as a proper substitution for agreements on multilateral basis, because voluntarism, which followed from state sovereignty, made it hard to achieve agreement on a multilateral arrangement of any substance, unless common interest or universalist sentiments were very strong. The use of a Model treaty is a very flexible technique, which provides the basis for negotiation of bilateral agreements suitably adapted for the particular characteristics of the particular parties' national systems and their interactions, notably for coordinating income taxation.¹⁹⁶

The most successful attempt to create a model treaty has been made under the auspices of the Organisation for International Cooperation and Development. Formed in an effort to represent the concerns of its member nations, the OECD is now rapidly transforming itself into a global consultant. In an area of international taxation, the OECD made a major contribution to the alleviation of double taxation with its Model Double Tax Convention of 1977, which served as a template for subsequent treaties.¹⁹⁷ It appears likely, in consequence, that OECD text will become increasingly firmly rooted as

¹⁹⁶ Sol Picciotto, *Networks in International Economic Integration: Fragmented States and the Dilemmas of Neo-Liberalism*, 17 NW. J. INT'L L. & BUS. 1014, 1029-30 (1996-1997).

the international standard, while variations from it to accommodate the special concerns of the developing countries may continue to evolve.¹⁹⁸ In addition to a series of model treaties the OECD also issued valuable commentaries on the model treaty provisions. The OECD Model Treaty is intended mostly in relations between developed countries. This Model Treaty mostly requires the country of source to give up revenue.

Another model treaty prepared by the United Nations aimed to deal with tax issues between developed and developing countries. The UN Model does not seek to allocate primary tax jurisdiction on a basis other than the residence used by the OECD Model. What it does is to expand the tax right of the source country within the basic framework of the OECD Model. The UN Model restricts the source country's power to tax profits of foreign enterprises to cases where the enterprise of one country operates in the other country through permanent establishment. The UN Model adopts a much wider definition of the phrase "permanent establishment" and allows for wider taxation at source of such income as interest, dividends, royalties and profit from international traffic.¹⁹⁹

The existence of model treaties represents a strong example of the possibility of reaching consensus on multilateral bases. These model treaties encourage the introduction of uniform understanding of important fiscal concepts, which is shared by a lot of number of countries. Model treaties prove that multilateral consensus is, in principle, possible. This possibility opens the door for increasing multilateral fiscal cooperation.

¹⁹⁷ Alexander Townsend, *supra* note 136, at 227.

¹⁹⁸ DAVID R. TILLINGHAST, *supra* note 84, at 10.

C. Multilateral fiscal cooperation

Multilateral treaties

The common model for treaties intended to eliminate international double taxation is bilateral. It was justly stated that the bilateral approach seems anomalous in an era where taxpayers have become global and many other regulatory areas increasingly are being dealt with globally by governments.²⁰⁰

The bilateral character of the treaties has its shortcomings in the modern integrated world. To achieve their objectives, it clearly is desirable for double tax treaties to be as broadly based and as wide in application as possible, yet this ideal is constrained by practical factors, such as the degree of consensus that can be reached between states, and the need to employ precise language while attempting to accommodate the differing concepts and policies of national tax systems.²⁰¹ Thus, the way to the conclusion of multilateral tax treaties does not appear to be paved. The more states – and interests – involved, the less are the chances of concluding a final agreement.²⁰² Even the OECD has been unsuccessful in translating bilateral treaties into anything resembling a multilateral treaty.

¹⁹⁹ KIBUTA ONGWAMUHANA, *supra* note 192, at 34-6.

²⁰⁰ Victor Thuronyi, *supra* note 140, at 1641.

²⁰¹ DAVID R. DAVIES, *PRINCIPLES OF INTERNATIONAL DOUBLE TAXATION RELIEF* 36-7 (1985).

²⁰² Not everybody will sign under this proposition. For example, Nils Mattsson states, that some of the articles of a multilateral treaty will necessary be lengthier and probably more complicated than similar provisions in a bilateral treaty. On the other hand – and this is my point – many of the articles in multilateral and bilateral treaties are the same, despite the fact that they apply to several contracting parties instead of two. Nils Mattsson, *Multilateral Tax Treaties – a Model for the Future?*, in *INTERNATIONAL STUDIES IN TAXATION: LAW AND ECONOMICS* 251 (Gustaf Lindencrona et al. ed., 1999). David Rosenblomm argues, that although there is near unanimity at the level of principle, in practice and administration it is virtually impossible to pass beyond the bilateral level. David H. Rosenbloom, *supra* note 175, at 268.

But multilateral treaties do, however, exist. Of those still in force, at least one is undoubtedly of great importance for the contracting countries, namely treaty between the Nordic countries for the avoidance of double taxation with respect to taxes on income and capital.²⁰³ There are other multilateral conventions, for example, such as Convention of Andean Group for avoidance of double taxation, the Brazzaville Convention concluded by four states of Equatorial Africa and some others.

The fact that some multilateral conventions have been concluded – although in insignificant numbers – could point to the development of this course. Development in terms of reconciling different tax systems followed by equality would make conclusion of multilateral agreements easier. Moreover, bilateral conventions with essentially the same rules can lead to conclusion of conventions with a greater number of parties. However, conclusion of multilateral conventions between countries with different interests would not seem possible.²⁰⁴

Institutional framework of cooperation

An important role in multilateral cooperation on tax matters, unquestionably, belongs to the WTO. Two main topics on the agenda of the WTO are directly related to tax issues: liberalizing trade in goods, which recently has been extended in part to services and intellectual property and prohibitions against certain subsidies.

The basic approach to liberalizing trade under GATT has been to couple reduction of import barriers with the requirement of nondiscrimination for imports once in the country. Nondiscrimination under GATT includes an obligation of national treatment,

²⁰³ Nils Mattsson, *Multilateral Tax Treaties – a Model for the Future?*, in INTERNATIONAL STUDIES IN TAXATION: LAW AND ECONOMICS 243 (Gustaf Lindencrona et al. ed., 1999).

which in this case prohibits discriminatory treatment of foreign goods. This obligation specifically applies to domestic taxation, which cannot be used “so as to afford protection” to domestic products. The one of the key substantive provision in the GATT approach to reduce import barriers is to bound tariffs to agreed-upon levels in specific schedules.²⁰⁵

The second topic concerning certain subsidies was addressed by GATT in the way of their prohibition. The Uruguay Round yielded a new Subsidies Code included in the 1994 version of GATT. The Subsidies Code defines subsidy as including cases where government revenue that is otherwise due is foregone or not collected. The language of Subsidy Code recognizes that the direct tax system can be the vehicle for providing export subsidies, such as when income ascribe to the production of goods for export is given preferential tax treatment.²⁰⁶

It can be said that production tax havens constitute prohibited export subsidies under the GATT. They invariably involve foregone revenue, are specific to certain taxpayers, and are, in fact, contingent on export performance because the products they involve cannot be targeted at the domestic market.²⁰⁷

The WTO also may lead to the creation of world tax rules by its dispute resolution practice. International tax and trade law have developed differently with respect to dispute resolution. Unlike tax law, international trade law has evolved over the years, so that there is now a substantial component of binding adjudication, particularly since

²⁰⁴ MANUEL PIRES, *supra* note 164, at 255-6.

²⁰⁵ Alvin C. Warren, *supra* note 38, at 142.

²⁰⁶ Joel Slemrod & Reuven Avi-Yonah, *supra* note 150, at 535-6.

²⁰⁷ Reuven S. Avi-Yonah, *Treating Tax Issues Through Trade Regimes*, 26 BROOKLYN J. INT’L L. 1683, 1687 (2001).

Uruguay Round.²⁰⁸ For example, the Appellate Body of the WTO recently upheld a Panel decision that the U.S. tax treatment of FSCs contained within sections 921 to 927 of the Internal Revenue Code constitutes an illegal export subsidy under WTO rules. FSCs are subsidiaries of U.S. corporations, which carry out certain export-related activities on behalf of their U.S. parents. Income attributed to FSCs is partly exempt from U.S. income taxes.²⁰⁹

Analyzing correlation between development of international trade law and international tax law professors Joel Slemrod and Reuven Avi-Yonah pose the question, whether development of current trade and tax policies complementary or potentially conflicting? According to them the answer is that these policies are complementary, because free trade requires single taxation of factor incomes, which is goal of bilateral treaties.²¹⁰

Preparation of multilateral treaties concerning tax issues was attempted within the OECD. Since 1995, a Multinational Agreement on Investment has been under negotiation at the OECD. The basic nondiscrimination concepts of national treatment most-favored-nation treatment would apply to foreign investment, along with a commitment to the free flow of funds in and out of member countries. The official commentary states that the parties recognize the importance of nondiscrimination in the taxation of foreign investors and investments, but that nondiscrimination is to be implemented under the double taxation treaties.²¹¹

²⁰⁸ Alvin C. Warren, *supra* note 38, at 146.

²⁰⁹ Wolfgang Deselaers & Louise Bennette, *WTO Appellate Body Upholds Panel Decision That US Tax Treatment of "Foreign Sales Corporations" Constitutes Illegal Export Subsidy*, INT. T.L.R. 2000, 6 (4), N42-49, N42 (2000).

²¹⁰ Joel Slemrod & Reuven Avi-Yonah, *supra* note 150, at 534.

²¹¹ Alvin C. Warren, *supra* note 38, at 145-6.

The activity of WTO witnesses that national tax policy at least in some part is not anymore business of one particular state. WTO contributes considerably in the area of multilateral tax cooperation and coordination especially by providing member states with an international mechanism of tax dispute settlement.

Unification and harmonization of tax law

In 1963 Arthur Dale in his book about tax harmonization in Europe distinguished two types of harmonization: harmonization of laws and harmonization of rates and types of tax. According to him, harmonization of laws consists of adopting the same rules, for example, for calculating depreciation, and this type of harmonization has perspective to proceed fairly quickly. This is not the case with the second type of harmonization, because types and rates of tax are directly connected to social, economic, religious or political motives. Thus, the author concludes, the balance will have been established over many years, and to try to force harmonization quickly would seriously disturb the equilibrium and do more harm than good.²¹²

First of all, the tax treaties should unify the fiscal concepts by providing exhaustive definitions that are not dependent on national regulations or concepts.²¹³ One of the main notions of international and national tax systems is the notion of income. For international tax system to work everyone has to agree on what constitutes income, when to tax it, and how to coordinate those issues on an international basis.²¹⁴ This agreement will allow every item of income to be taxed once and allocate the income fairly among

²¹² ARTHUR DALE, TAX HARMONIZATION IN EUROPE 24 (1963).

²¹³ RUTSEL SILVESTRE J. MARTHA, *supra* note 8, at 185.

²¹⁴ Peter Cobb, *supra* note 58, at 661.

the jurisdictions in which the people who possess that income, whether businesses or individuals, enjoy the services provided by those jurisdictions.

In addition, the obvious advantage of having uniform definitions of income is administrative. Tax administration and enforcement could become much simpler. Given preexisting differences in language and culture and the political sensitivities that are implicated in the operation of a tax system, it strains credulity to believe that standardization would lead to the creation of a single international tax enforcement agency.²¹⁵

The problems of unification and harmonization remain extremely important for Internet taxation. Professor Richard Doernberg along with other authors of book, dedicated to problem of e-commerce taxation, argues that countries must unify conflicting tax laws to effectively tax e-commerce because without unification the potential exists for countries to double tax these transactions.²¹⁶

D. Administrative cooperation against tax evasion and avoidance

Many problems of enforcement of national tax laws in the international context dictate the necessity for multilateral cooperation on administrative level. The fundamental factors, which determine such cooperation, are the removal of capital controls and the continuing liberalization of the financial markets, which increased the flows of cross-border investment and accelerated the pace of integration of national economies. Improved global communication technologies have enabled large

²¹⁵ Julie Roin, *Taxation without Coordination*, 31 J. LEGAL STUD. S 61 (2002).

²¹⁶ Richard Doernberg et al., *supra* note 114, at 245-6.

corporations and financial institutions to develop global strategies. Whilst these developments have lead to a rapid expansion of cross border activities they have also increased the geographical mobility of national tax bases and the scope for tax avoidance and evasion.²¹⁷ Developing avoidance techniques, such as use of tax havens and transfer-price adjustments, has spurred national tax administrations to accept the need for tax treaties, realizing that regulatory enforcement on a purely national basis would be ineffective in view of the opportunities for avoidance and evasion available to internationally-operating businesses.²¹⁸

Because jurisdiction to enforce national tax laws is restricted in international law by national boundaries, without an established treaty network on administrative cooperation few countries will permit a foreign tax inspector, collector, or prosecutor to ply his trade within their borders. If he is permitted any entrance at all, he is under strict limitations of an ad hoc arrangement.²¹⁹

The same could be said about extradition, as far as one of the most effective ways to secure implementation of national tax worldwide is to conclude bilateral treaties providing extradition of tax criminals. Extradition is the surrender of an individual accused or convicted of a crime by the state within whose territory he is found to the state under whose laws he is alleged to have committed or to have been convicted of the crime.²²⁰ Such extradition of tax criminals, definitely, will require high degree of congruence of the tax laws of different states, because under the requirement of “double criminality”, extradition is available only when the act is punishable under the law of

²¹⁷ ORGANISATION FOR INTERNATIONAL CO-OPERATION AND DEVELOPMENT, TAX SPARING: A CONSIDERATION 9 (1998).

²¹⁸ Sol Picciotto, *supra* note 175, at 1026-7.

²¹⁹ LEON YUDKIN, A LEGAL STRUCTURE FOR EFFECTIVE INCOME TAX ADMINISTRATION 6/C(1) (1971).

both states. Consequently, the name of the offence and the elements that make it criminal need be approximately the same.²²¹

This question of prevention of tax crimes on the international level remains difficult, as far as under general international law, co-operation in the enforcement of fiscal laws has been treated anomalously. On the one hand, courts have frequently taken the firm position that they can not assist in the enforcement of the revenue laws of another state: this can best be explained as part of the general international law principle that states do not enforce each other's penal or public laws. On the other hand, arrangements for international co-operation in penal or criminal matters, notably for the extradition of alleged offenders, normally exclude fiscal matters even tax fraud. Hence, in the absence of specific treaty provisions, tax authorities may have little remedy against even a blatant tax evader who is neither present nor has assets in their country.²²²

This policy of states based on rejection to enforce foreign tax laws is not unanimously supported. Some people state that never was it possible to develop a coherent reasoning for why, in the field of public law, co-operation among courts and court related administrative authorities was less proper than co-operation in civil and commercial matters.²²³

The problems of international administrative tax cooperation on tax matters do not always arise out of legal shortcomings. One should take into account economic reasons of tax evasion treaties being unsuccessful. Developing countries refused to enter

²²⁰ LORI F. DAMROSCH ET AL., *supra* note 6, at 1177.

²²¹ *Id.* at 1179.

²²² SOL PICCIOTTO, *supra* note 28, at 300.

²²³ Peter Schlosser, *supra* note 59, at 330.

into tax evasion treaties because of the unilateral harm they receive due to decreased tax revenue and resulting lack of offsetting investments.²²⁴

The main purpose of treaties in area of international administrative cooperation is the prevention of fiscal evasion. Tax treaties contain provisions for the exchange of information. They simply have the advantage of providing for exchange of information on a reciprocal basis, plus the opening of a channel for this cooperation.²²⁵ In addition to the problems of tax evasion the tax treaty now also is intended to facilitate a coordinated administrative approach to avoidance.²²⁶

Usually, the tax treaty rules provide for an exchange of information that will enable the tax administration to verify whatever facts it deems necessary for effecting a proper tax examination. The treaties typically authorize parties to exchange information filed by, and relating to the activities of, taxpayers engaged in international business. Administrative cooperation also includes provision that authorizes both countries to challenge transfer prices between associated enterprises.²²⁷ By providing for direct contact between administrators, without the need for communication through diplomatic channels, the tax treaties established a process of administrative internationalization, which was, and to a considerable extent remains, unique. The tax treaty administrative provisions have gone further than others since they cover not only exchange of information and policy concentration, but also explicitly provide for coordinated

²²⁴ Alexander Townsend, *supra* note 136, at 226-7.

²²⁵ PHILIP BAKER, DOUBLE TAXATION CONVENTIONS AND INTERNATIONAL TAX LAW: A MANUAL ON THE OECD MODEL TAX CONVENTION ON INCOME AND CAPITAL OF 1992 12 (1994).

²²⁶ SOL PICCIOTTO, *supra* note 28, at 252.

²²⁷ CHARLES H. GUSTAFSON ET AL., *supra* note 68, at 60.

enforcement in individual cases, which has also led to establishing procedures for simultaneous examination of related taxpayers.²²⁸

For the obtaining of information in foreign country the help of foreign tax administration is used under special request, and any information so obtained should be subject to the same secrecy as other tax information. In obtaining of information several restrictions should be observed. For example, the treaty should not require the country supplying the information to carry out administrative measures at variance with its laws and practices or to supply information that is not obtainable under its laws or in the normal course of its domestic tax administration. The assistance should not be so broad as to allow the enforcement of arbitrary foreign taxes. It should be given only with respect to taxes that have been finally determined. Collection in the foreign country would be in accordance with the collection laws of that country.²²⁹

In addition to the provision dealing with the exchange of information the agreements include resolution methods for tax disputes related to international enforcement issues. Nations entering into these arrangements contribute to the intangible benefits of improved foreign relations and increased clarity for non-resident investors of another country's tax system and administration.²³⁰

Professor Peter Schlosser states that the most recent trend in international administrative cooperation is mutual collection of taxes. He takes as an example Article 23 of the German-French Double Taxation Convention. He finds this convention as particularly far-reaching because it also contemplates tax claims, which have not yet definitely been settled by an unappealable decision. He also addresses two German-

²²⁸ SOL PICCIOTTO, *supra* note 28, at 253-4.

²²⁹ LEON YUDKIN, *supra* note 218, at 6/C(2).

Swedish (1992) and German-Danish (1995) conventions the principle of mutual collection and quote the following provisions: “On the request of the competent authority of one Contracting State, the other Contracting State carries out, subject to ..., the collection of tax claims as if they were its own claims”.²³¹

The OECD Model Treaty in Article 26 permits the competent authorities of the two contracting state to exchange such information as is necessary for carrying out two purposes: firstly, for carrying out the provisions of the convention, and, second, for carrying out the domestic laws of the contracting state concerning the taxes covered by the convention.²³²

But this trend in collection of foreign taxes still exists on bilateral basis and even within the European Union there is no general rule attributable to the EU’s committing the member states to collect each other’s taxes. In collection of value added taxes, the cooperation among the taxation authorities must by necessity be particularly close.²³³ By contrast, the directive 77/799/EEC of 19 December 1977 is limited only to providing for mutual information.²³⁴

Existing examples of multilateral administrative cooperation shown above prove that this process is difficult and will take time. The disparities in national tax laws and

²³⁰ Alexander Townsend, *supra* note 136, at 226.

²³¹ Peter Schlosser, *supra* note 59, at 341-2.

²³² PHILIP BAKER, DOUBLE TAXATION CONVENTIONS: A MANUAL ON THE OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 344 (2001).

²³³ Peter Schlosser, *supra* note 59, at 343-4.

²³⁴ In general Directive concerns to direct taxes. Article one of the Directive states that the competent authorities of the Member States shall exchange any information that may enable them to effect a correct assessment of taxes on income and on capital. There shall be regarded as taxes on income and on capital, irrespective of the manner in which they are levied, all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the disposal of movable or immovable property, taxes on the amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation. Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, *available at*

practices and the difficulties of reaching agreement on general principles of fairness in defining and allocating the international tax base make it hard to obtain a political support for a comprehensive agreement.²³⁵ Also international tax law should provide some measure of agreement on procedural safeguards for administrative arrangements.²³⁶ An Internet development introduced additional problems in tax administration, and these problems are increasing faster than their multilateral solutions.²³⁷

Nevertheless the multilateral administrative cooperation on tax matters is developing. The most progress in the area of multilateral cooperation in tax matters has occurred in Europe.²³⁸ Under the 1978 Additional Protocol to the European Convention on Mutual Assistance in Criminal Matters, members of the Council of Europe abandoned their discretion to refuse assistance in relation to fiscal matters.²³⁹ As of the beginning of 2003 thirty-five states have ratified this protocol. The various successes within the EU and among its members are relevant only on a regional level. To deal with non-criminal

http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31977L0799&model=guichett (last visited March 22, 2003).

²³⁵ SOL PICCIOTTO, *supra* note 28, at 256.

²³⁶ *Id.* at 256-7.

²³⁷ Jonathan Gaskin reasonably states: The phenomenon of Internet commerce may herald the end of effective extra-national fiscal regulation. Certainly, anonymous remailers and Web sites are here to stay. Anonymous communication accompanies those tools. Tax havens and other jurisdictions that seriously enforce anonymity and privacy abound and do not seem to be waning. Digital cash is in its infancy, but will most likely sweep the world. The need to comply with complex and burdensome extra-territorial tax regulations will likely be swept away by it. Regulation of tax evasion, tax avoidance may become moot. Jonathan Gaskin, *Policing the Global Marketplace: Wielding a knife in a Gunfight*, 38 COLUM. J. TRANSNAT'L L. 191, 210 (1999).

²³⁸ Benjamin R. Hartman, *Coercing Cooperation from Offshore Financial Centers: Identity and Coincidence of International Obligations Against Money Laundering and Harmful Tax Competition*, 24 B.C. INT'L & COMP. L. REV. 253, 280-1 (2001).

²³⁹ The Protocol withdraws the possibility offered by the Convention to refuse assistance solely on the ground that the request concerns an offence which the requested Party considers a fiscal offence. It extends international co-operation to the service of documents concerning the enforcement of a sentence and similar measures (suspension of pronouncement of a sentence, conditional release, deferment of commencement of enforcement of a sentence or interruption of such enforcement). Finally, it adds provisions relating to the exchange of information on judicial records. Additional Protocol to the European Convention on Mutual Assistance in Criminal Matters of March 17, 1978, *available at* <http://conventions.coe.int/Treaty/EN/CadreListeTraites.htm> (last visited March 22, 2003).

tax matters, as it was mentioned above, the Council of European Communities issued Directive 77/799/CEE. This enjoys no application outside Europe. The Nordic Countries have further implemented regionally the Nordic Convention on Mutual Assistance in Tax Matters, which has been in force since 1991. Attempts to extend such a uniform approach to legal assistance in tax matters outside Europe have not been as successful.

In 1988, the OECD, together with Council of Europe, drafted the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.²⁴⁰ This convention has not been broadly accepted. It has finally come into force seven years after it opened for signature. The convention, however, was especially intended to establish assistance, which comprises all mutual assistance activities in tax matters, which can be carried out by the public authorities, including the judicial authorities, and which are not covered by criminal law. Any information or assistance, which judicial bodies may need in order to judge and punish criminal offences in tax matters, must, therefore, be obtained under the conventions for mutual assistance in criminal matters.²⁴¹

²⁴⁰ This convention allows the parties, the member States of the Council of Europe and the member countries of OECD, to develop, on common foundations and respecting the basic rights of tax-payers, extensive administrative co-operation covering all compulsory taxes, with the exception of customs duty. The types of assistance are varied, covering the exchange of information between parties, simultaneous tax examinations and participation in tax examinations carried out in other countries, the recovery of taxes due in other Parties and notification of documents issued in other parties. Moreover, any State wishing to accede to the Convention may tailor the extend of its obligations, by virtue of a detailed system of reservations expressly provided for in the text; it may restrict its participation to certain types of mutual assistance or to assistance in connection with certain taxes. This enhanced mutual assistance is intended to help combat tax evasion, and is accompanied by safeguards to protect tax-payers, whether individual or corporate, and national economies. Thus a party may refuse to supply information when this would mean divulging trade, industrial or professional secrets, or to provide assistance in connection with a tax which it regards as incompatible with the generally accepted principles of taxation. Moreover, application of the Convention may not restrict the rights and guarantees accorded to individuals by the law of the assisting state. There are strict rules covering the secrecy of information obtained in application of the text. Convention on Mutual Administrative Assistance in Tax Matters, *available at* <http://conventions.coe.int/Treaty/EN/CadreListeTraites.htm> (last visited March 22, 2003).

²⁴¹ COUNCIL OF EUROPE, EXPLANATORY REPORT ON THE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS 7 (1989).

E. Inferences

In the absence of international tax treaties, it is evident that the taxation of foreign income earned by residents and of domestic income earned by non-residents, can raise problems of inefficiency of allocating of foreign investment and predatory inequities in the tax shares of that income. Cooperative rules are needed both for reasons of economic efficiency and inter-nation equity. Cooperation also is essential for administrative reasons, in particular for reporting purposes. Such cooperation can take various forms. It may be presented by the current network of bilateral tax treaties between countries of residence and source; which broadly follows an internationally accepted model tax treaty format. Such tax treaties may be supplemented by multilateral agreements, particularly among countries of source to prescribe rules for the division of base and rates of tax. Finally, a higher degree of international cooperation may be called for which assigns certain taxes, such as the corporation income tax, to an international authority.²⁴²

Professor Nancy H. Kaufman poses a question: What is it that has kept us from achieving greater international cooperation in substantive tax matters? Her answer is: A good bet is that the stumbling blocks have somewhat less to do with economic analysis and more to do with various sovereign actors' perceptions of the fairness of the distribution of tax base internationally.²⁴³

In this chapter I tried to support my thesis by the examples of bilateral and multilateral cooperation. The latter is considered today as the preferable solution but at the same time most difficult to achieve. The diversity of national interests makes the

²⁴² Peggy B. Musgrave, *supra* note 82, at 1344.

²⁴³ Nancy H. Kaufman, *supra* note 91, at 1470.

process of multilateral cooperation extremely difficult, and only when there is understanding that there is a common denominator under different national tax policies will this process become more evident.

CHAPTER 6

CONCLUSION

If we look at the modern world we can see that little can stop its steady integration. In the last years, most of the economies, which have tried to stand apart – like those of Russia and Eastern Europe, Brazil and other South American states, and some of the states of Asia, have found themselves unable to do so.²⁴⁴ In the course of this integration, old principles of international jurisdiction and sovereignty simply do not provide an adequate basis for the preservation of national tax systems.²⁴⁵ Nations can no longer worry solely about the national effects of a chosen taxing scheme. Because of the increased integration of national economies, nations must now also factor into their tax system design the potential interactions their system may have with the systems of their sovereign global neighbors, and take on the often-impracticable task of designing tax systems that interact well with those systems.²⁴⁶

Let me return to the world tax system and to look at it again through new perspective of the results of present research. The cooperative ties on bilateral and multilateral bases become more and more stronger. This cooperation is an inevitable process as far as there are such common problems for all nations as avoidance of double taxation, transborder enforcement of national tax laws, and equitable distribution of tax revenues between nations.

²⁴⁴ DAVID W. WILLIAMS, *supra* note 12, at 158.

²⁴⁵ Stephen G. Utz, *supra* note 1, at 773.

In summary, my thesis may be succinctly stated as follows: Today's main characteristics of a state's jurisdiction to tax do not comply with the necessity of effective administration of national fiscal laws in integrated world. This explains why a particular fiscal jurisdiction needs another qualitative dimension, which can be achieved only on the higher level of international systematic cooperation.

²⁴⁶ George M. Melo, *supra* note 142, at 189.

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