Taxation and International Community

Marco Greggi
Visiting Research Fellow at China University of Political Sciences and Law

Academic Year 2022 - 2023

Lesson 02

Programme of the Day 02

1. The development of the International Tax System and the development of the Law in the International Community;
2. The Connection between Sovereign power and the power to Tax;
3. External limitations to the Power to Tax (the European case).

Sovereignty and Taxation

- The International Community is composed by the States the Earth is divided into;
- Each state, to be sovereign, has to be (claim to be) *superiorem non recognoscens* (second to none) and exercise its powers in a specified territory, including:
  1. The monopoly of the use of Force;
  2. The law;
  3. Political self determination.

The Many faces of Sovereignty

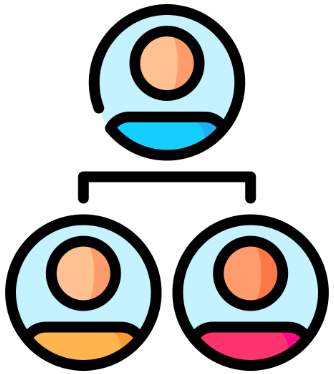
- China
  - Population: 1 433 783 686 (2019, and counting !!!)
  - Surface: approx. 9.596.000 (square km)

- Republic of San Marino
  - Population: 33.909 (in 2020, and counting !!!)
  - Surface: 61,19 (square km)

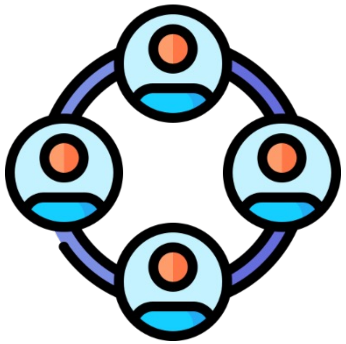
The Influence of this Scenario on Taxation

- Taxation is one of the prerogatives of the Sovereign State as they are progressively adjusted in history:
  - Use of Force;
  - Domestic Currency;
  - Taxes.
- The apparent paradox:
  - Each state sovereign in the choices it makes;
  - Each state member of a broader (and ordered) community.

Two Ideas of Order (East and West)



- In the East:
  - Order demands hierarchy;
  - Central authority is needed to coordinate periphery;
  - Central authority is needed to preserve growth and harmony.



- In the West:
  - Order demands agreement;
  - No central authority but coordination via negotiations;
  - Growth needs consensus (each authority rules, risk of no harmony).

The Western, Westphalian Model

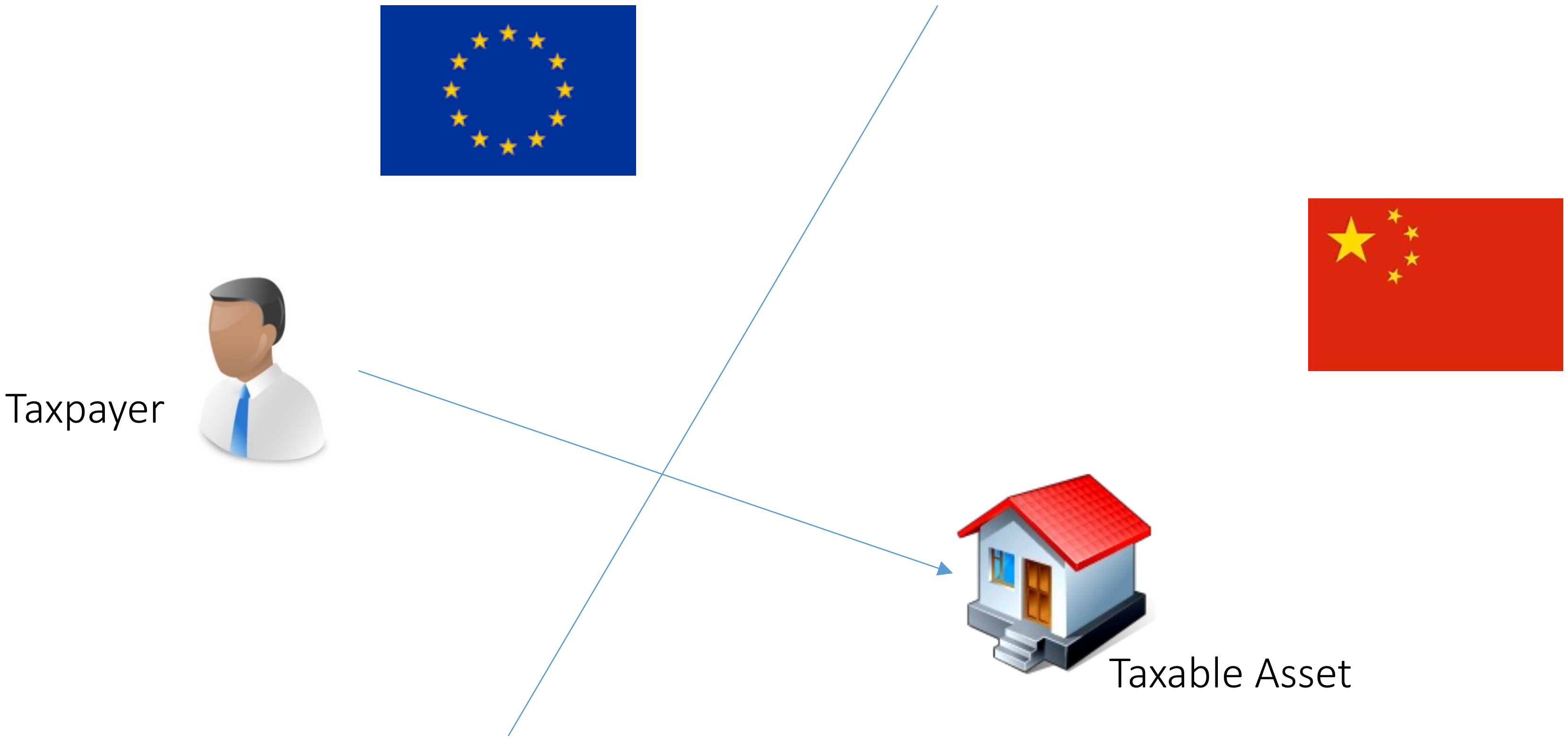
- Taxation has always been connected with the territory (on some occasions, with citizenship);
- Power to tax has been traditionally justified on different grounds with a link (allegiance) with (to) the territory and the state;
- European Concept of sovereignty (*Cuius Regio, Eius Tributum*) – (Whose Realm, Its Tax).

1648, in cities of Osnabrück and Münster
the European wars of religion ended

Land and Taxation

- We live in a Digital Era … but yet it is the land to draw the most important limitations to the power to tax;
- As sovereignty can be exercised in the territory, so taxation can …
- … Yet in practice this link with the territory is anything but clear to settle and regulate;
  - What does “Link” mean for tax purposes ?

Not so Easy in Practice



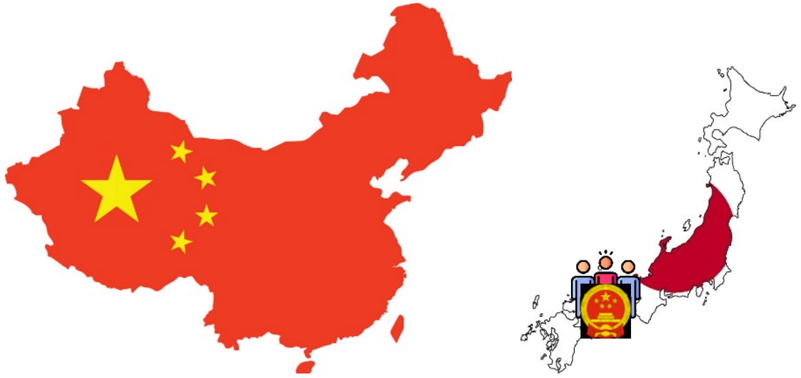
Question: who is entitled to tax the Estate ?

The Decisions of the Courts …

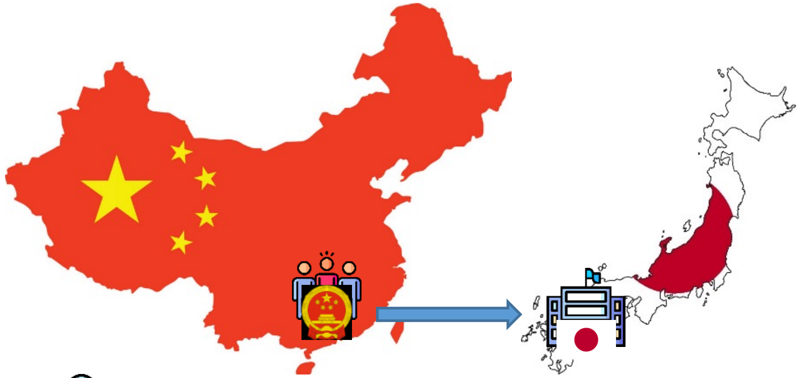
- Taxation may be exercised freely by States in their territory;
  - **Principle of non interference in internal affairs of the States**;
- The S.S. Lotus Case P.C.I.J. (Permanent Court of International Justice) Ser. A, No. 10, p. 4 (1927);
  - Lotus Principle: Sovereign States may act in any way they wish so long as they do not contravene an explicit prohibition;
  - S.S. Lotus was a Criminal law case.

Some Cases

Stay in China



Move to Japan



Stay in China

Invest in Japan

What do We learn from These Cases ?

- Important: a State may tax if the taxpayer has **some kind of connection** with the (State or its) territory;
- Legal terminology:
  - Genuine link;
  - Nexus;
  - …
- Items of possible connection:
  - Taxpayer (individual or Corporation);
  - Taxable base (taxable asset).

Corporations (as used in *Slide 11*)

- The Incorporation doctrine was unknown to the earlier developments of the Law (Roman Law);
  - Corporation (from Latin "**Corpus**" – Body –) is a **fictitious concept**: to pretend that something exists and is different from individuals … and it owns assets and liabilities;
- Earliest examples of **Corpus** (pl. Corpora):
  - Universities (XI Century);
  - Religious bodies (Chapters and Orders, in the Middle Ages);
  - … and eventually some companies (West and East Indies Companies).

End of the Digression

- **Consequences** of incorporation:
  - Limitation of liability to the assets attributed to the corporation;
  - Profits of the Company to be attributed to the individuals it belongs to: the shareholders;
- And in the case of **Taxation**:
  1. Different body means different taxpayer ?
  2. Autonomous tax liability of the Company;
  3. Necessity to distinguish between company and taxpayer;
  4. Necessity to prevent double taxation.

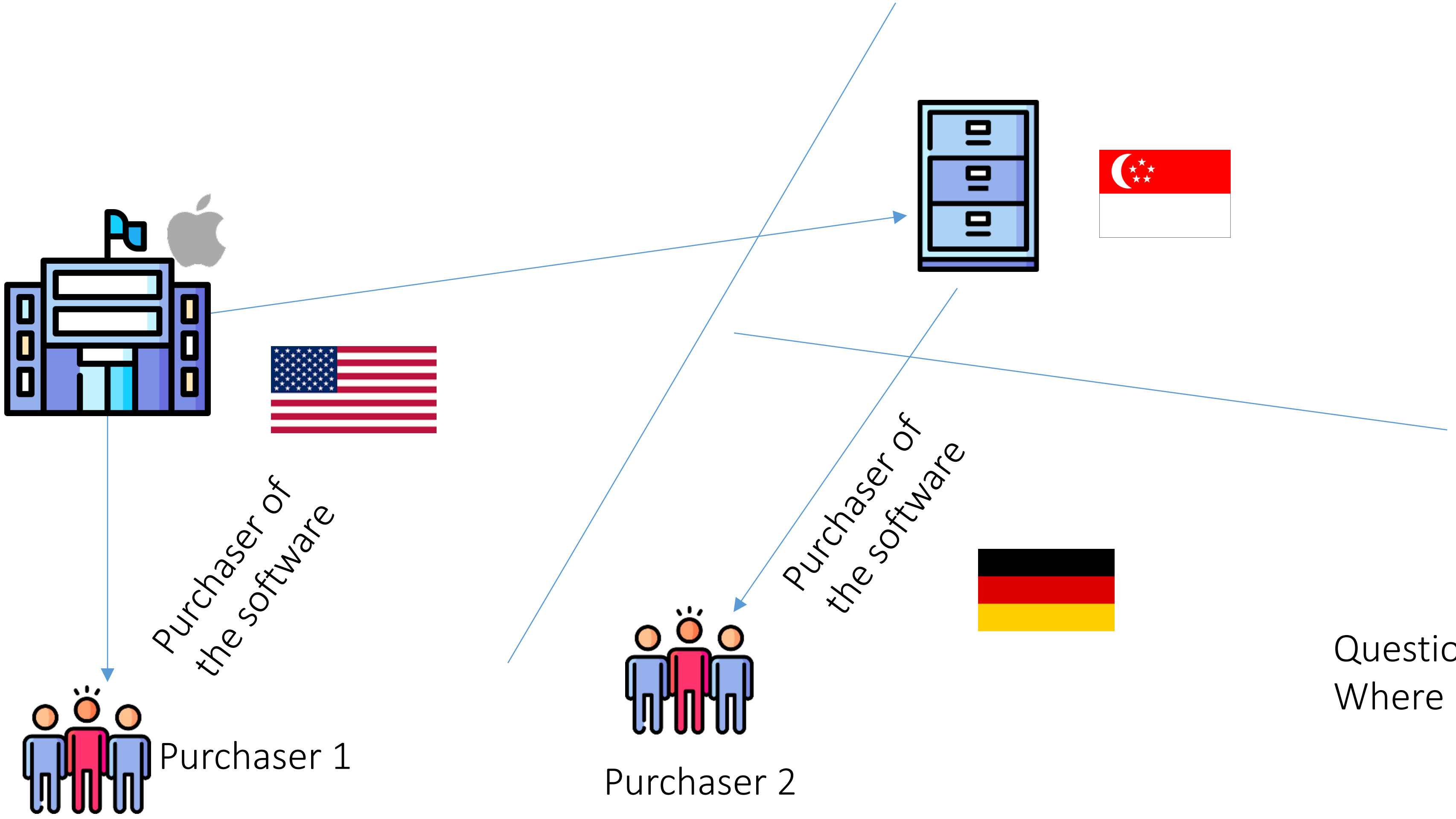
Internal and External Limits to Taxation

- The Power to Tax belongs to the State, in the current era;
  - It is part of its Sovereign Powers;
  - It is exercised consistently with Domestic Law and qualified supra-national constraints;
  - State and Tax (*Steuer* and *Staat* in German language);
- Limits to the power to Tax:
  - Logical:
    - Neutrality;
    - Equity;
  - Formal:
    - Consistency with Constitution (if any) and International law.

Public International law and Taxation

- Public international law is the set of legal rules governing international relations between Public Bodies such as States and international organizations.
- Conventions and Customary law are common instruments of public international law.
  - **Conventions**: agreements signed between states to regulate matter of common interest;
  - **Customary law:** when a certain legal practice is observed and the relevant actors consider it to be part of the Law (*opinio iuris ac necessitatis*)

The Everyday Scenario



Question:
Where are Apple's profits taxed ?

The Lesson We are learning …

- **Overlapping** of taxing powers is more than frequent in International Tax Law;
- Risk of **Double taxation** depending on different criteria, including:
  1. Source;
  2. Residence;
  3. (Citizenship): basically USA only.
- The risk is maximum when the **taxable base considered is income**, but …
- … There’s also a risk of **double … non taxation**.

Europe's Ties That Bind

The U.K.'s plan to leave the European Union has focused attention on long-standing pacts that govern trade, immigration and the common currency

European Union
28-nation single market of free trade and shared regulation; includes "free movement" of goods, services, capital and people

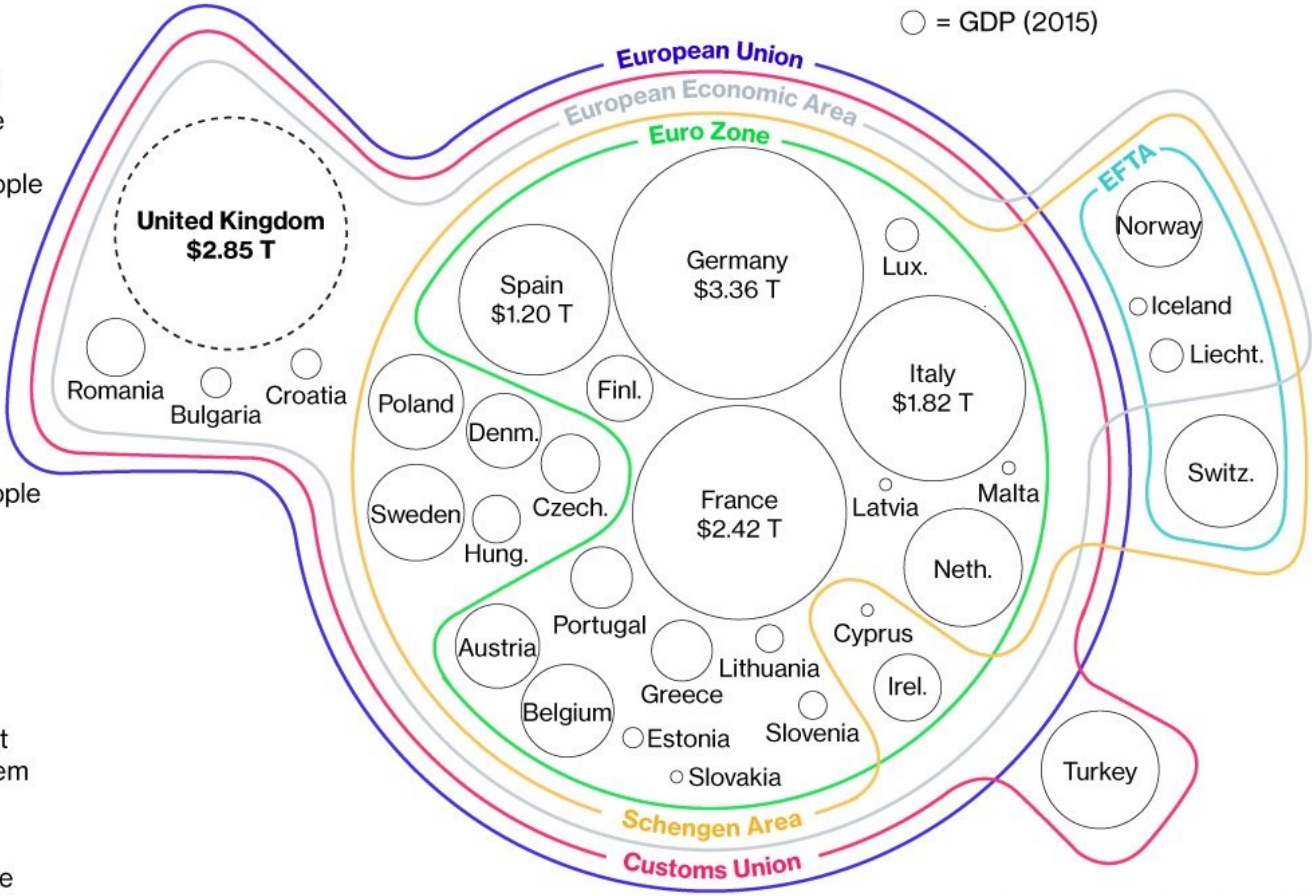
Euro Zone
19 countries using the euro currency

European Economic Area provides access to single market in exchange for payments; has "emergency brake" on free movement of people

European Free Trade Association
Free-trade zone and network of agreements with other countries

Customs Union
Circulates goods without duties, has uniform system for handling imports

Schengen Area
26-country passport-free travel zone



Sources: EU, ETRA, IMF

Bloomberg Graphics

Making of the Union: the Essentials

- European Union:
  - Treaty Based union (Treaty on the Functioning of European Union - Lisbon 2009) aimed at a more federal political structure;
  - Tax legislation is harmonized in some fields (ex. Consumption tax);
- European Economic Area:
  - Agreement between the EU and EFTA Countries;
    - No customs at borders (excepts agriculture goods);
    - Extension of some freedoms and rules of the Union to the whole area.

Continued …

- European Free Trade Association:
  - Created in 1960 in response to the European Communities;
  - Free trade area in goods without an external tariff;
- Council of Europe:
  - Founded in 1949 and based in Strasbourg (some non European Countries are Observers);
  - Goals:
    - Facilitate social progress;
    - Spread principles of Parliamentary democracy;
    - Protection of Human Rights (European Convention on Human Rights, European Court on Human Rights).

The EU Tax System

- A Union based on Freedoms and Goals (more details during Lesson 3):
- The Four Fundamental Freedoms:
  1. Free movement of persons;
  2. Free movement of goods;
  3. Free movement of services;
  4. Free movement of capitals;
- The Goals of the Union:
  A. Level playing field for business;
  B. No discriminations and distortions;
  C. States should step aside from development of economy and market (no State aids to the business).

Europe and Taxation

- Business and Taxation:
  - No discrimination (no tax dumping);
  - No limitation to cross-border investments;
  - No ring-fencing approach to taxation or unfair tax competition between states or territories;
    - No distortive State aids via tax reduction;
- Fields of Priority:
  1. Customs Duties;
  2. Consumption taxation;
  3. Income taxation (where needed and necessary for the functioning of the market);

End of Lesson 02

- Suggested reading (B, elective): A. H. Qureshi, *The Freedom of a State to Legislate in Fiscal Matters under General International Law*, IBFD Bulletin, 1987, pages 14 - 22.