Justice in International Tax Law

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A Normative Review of the International Tax Regime

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Preface

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Abbreviations

AG	Argentina
AL	Albania
AT	Austria
ATAD	Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
BE	Belgium
BEPS	Base erosion and profit shifting
BGE	Amtliche Sammlung der Entscheidungen des Schweizerischen Bundesgerichts
BRICS	Brazil, Russia, India, China and South Africa
CARICOM	Caribbean Community
CCCTB	Common Consolidated Corporate Tax Base
CFA	Committee on Fiscal Affairs
CFC	Controlled foreign company
CH	Switzerland
CHF	Swiss Franc
CMAATM	Convention on Mutual Administrative Assistance in Tax Matters (2011)
CRS	Common Reporting Standards
DE	Germany
ECJ	Court of Justice of the European Communities
ECOSOC	United Nations Economic and Social Council
ECR	European Court Reports
ES	Spain
EU	European Union
FATCA	Foreign Account Tax Compliance Act
FFI	Foreign Financial Institutions
FHTP	OECD Forum on Harmful Tax Practices
FIFA	Fédération Internationale de Football Association
GATS	General Agreement on Trade in Services (1994)
GATT	General Agreement on Tariffs and Trade (1947)
GDP	Gross Domestic Product
GOP	Grand Old Party (Republican Party)
HS	Holy See
IBFD	International Bureau of Fiscal Documentation
ICJ	International Court of Justice
ICJ Reports	International Court of Justice Reports

ICJ Statute	Statute of the International Court of Justice (1945)
IGA	Intergovernmental Agreement
IMF	International Monetary Fund
IN	India
IP	Intellectual property
IRS	Internal Revenue Service
IT	Information technology
ITA	Information Technology Agreement (1996)
LI	Liechtenstein
LOB	Limitation on benefits
MAP	Mutual agreement procedure
MCAA	Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information
MFN	Most-favored nation
MLI	Multilateral Convention to Implement Tax-Related Measures to Prevent BEPS (2017)
MNE	Multinational enterprise
MoU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement (1994)
NGO	Non-Governmental Organization
NL	Netherlands
OECD	Organisation for Economic Co-operation and Development
OECD Comm.	Commentary on the OECD MC (2014)
OECD Convention	Convention on the Organisation for Economic Co-operation and Development (1960)
OECD MC	OECD Model Tax Convention on Income and on Capital (2017)
OEEC	Organization for European Economic Co-operation
PCIJ	Permanent Court of International Justice
PDPT	Purely Domestic Poverty Thesis
PE	Permanent establishment
PPT	Principal Purpose Test
SC	Supreme Court
SCM	Agreement on Subsidies and Countervailing Measures (1994)
SOFA	Status of Forces Agreement
TIEA	Tax Information Exchange Agreement
UK	United Kingdom
UN	United Nations
UN Charter	Charter of the United Nations (1945)
UNCTAD	United Nations Conference on Trade and Development

UN MC	United Nations Model Double Taxation Convention between Developed and Developing Countries (2017)
USD	United States Dollars
VAT	Value added taxes
VCDR	Vienna Convention on Diplomatic Relations (1961)
VCLT	Vienna Convention on the Law of Treaties (1969)
VN	Vietnam
WTO	World Trade Organization

Part I

Introduction and Methodology

Chapter 1

Introduction

1.1. International tax law at a crossroads

The starting point of modern international tax cooperation lies in the early 20th century and late 19th century. The double tax treaty[1] between Prussia and Austria and Hungary is generally known as the first double tax treaty ever signed.[2] The aims of international tax cooperation have, since the beginning of such international (and in the meantime, not only bilateral) cooperation, changed significantly. The work of the League of Nations in the early 20th century and the later work of the UN and the OECD in the second half of the 20th century had a focus on the avoidance of juridical double taxation. In particular, the consecutive publications of the OECD Model Convention (OECD MC) and the UN Model Convention (UN MC) have been of major importance when it comes to the allocation of taxing rights between two or more states and, therefore, the avoidance of international juridical double taxation. Hundreds – even thousands – of double tax conventions have been signed mainly based on these model agreements.[3]

Aggressive tax planning of multinational enterprises and cross-border tax evasion by individuals have led to intensified international tax cooperation. However, countering aggressive international tax planning is a quite recent phenomenon, as international tax planning, per se, is still a young discipline.[4] Only since the publication of the Report on Harmful Tax Competition by the OECD in 1998[5] has there been increasing cooperation among member countries of the OECD and other states in order to counter harmful tax practices and aggressive international tax planning. Such cooperation has been led by the OECD and the G20 and has found its (temporary) end in the Base Erosion and Profit Shifting (BEPS) Project and the foundation of the

1. In the following we will use the terms "double tax conventions", "double tax treaties" and "double tax agreements" simultaneously, even though the term "convention" often indicates that an international agreement is a multilateral agreement and not only a bilateral agreement. Nevertheless, in international tax law the term "double tax conventions" is commonly used to describe bilateral agreements as well.
2. For further details about the development of the current network of double tax treaties, *see* Braun & Zagler, p. 243 et seq.
3. Currently, more than 3,000 treaties have been signed. For further details *see* sec. 4.2.3.1.
4. *See*, with further references, Happé, p. 538.
5. OECD, Report on Harmful Tax Competition (OECD 1998).

Inclusive Framework.[6] Moreover, in order to prohibit cross-border tax evasion, many double tax conventions providing for an exchange of information provision and a number of other tax-related bilateral agreements, such as Rubik agreements, TIEAs and FATCA IGAs, with the same or similar aims have been signed.

Not only have the goals of international tax law changed, but also the legal instruments. Most of the aforementioned tax coordination has been and still is rendered by signing double tax agreements and other bilateral tax agreements. Recently, multilateral conventions have more often been employed. Moreover, compared to the early work of the OECD and the League of Nations, the most recent BEPS Project by the OECD and the work of the Inclusive Framework not only suggests model provisions for double tax conventions, but recommendations on the design of domestic tax rules have also been published.

The OECD BEPS Project has indeed shifted international tax coordination to another level. States are generally still sovereign regarding the levy and enforcement of taxes; however, the BEPS Project seems to lead to a certain degree of harmonization with regard to domestic rules, and not only with regard to the allocation of taxing rights according to double tax treaties. Therefore, international tax policy is at a crossroads, as international tax cooperation has reached a new stage and, depending on the success,[7] policymakers might further follow such a path toward (partial or full) tax harmonization or refrain from further cooperation projects. Enhanced tax cooperation, however, requires that international tax policy considers the interests of all involved and affected individuals and states. In this respect, terms such as "justice" and "fairness" must be at the forefront of an international debate.[8]

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6. There is much literature about the BEPS Project, but it is best to refer to the website of the OECD, which provides all necessary documents for an in-depth understanding of the content of the BEPS Project (*see* http://www.oecd.org/ctp/beps.htm, last visited 29 Nov. 2018). For further details about such recent developments, *see also* sec. 4.2.3.2. For an intermediate analysis of the impact of the BEPS Project, *see* Christians & Shay, p. 17 et seq.

7. The term "success" here should not indicate that harmonization is, per se, a wishful result from a normative perspective. The latter question will be addressed in Part IV of the present study.

8. The present study, as indicated in the title, mainly refers to the term "justice", but the terms "fairness" and "justice" are intertwined as, for instance, according to the Oxford Dictionary (https://en.oxforddictionaries.com/, last visited 11 Feb. 2019), fairness means "impartial and just treatment or behaviour", whereas justice means "the quality of being fair". There is an intense debate among philosophers on the difference between the two terms. An important discussion was, for instance, triggered by the fact that Rawls in his

The present study should be understood as a jigsaw piece of this very complex debate about justice in international tax law at a crucial moment in the potential crystallization[9] of a more integrated international tax regime.

1.2. Justice – Terminology and origin

The term "justice" is on the one hand society-related, as justice considerations are needed to allocate (limited) goods in a specific society, but on the other hand, justice is demanded in all human relations.[10] From a legal perspective, justice has been an important anchor in order to achieve a legal system that is considered valid and legitimate among its members.[11] Some scholars, however, have questioned the normative value of the term "justice" as, for instance, Kelsen highlights that many different understandings of the term "justice" have been developed, which might be a sign of the unsubstantial content of the term "justice".[12]

Although the term "justice" might not directly provide for very concrete guidance on how a certain policy should be drafted, a debate about justice is essential, particularly one that considers the various (contemporary) philosophical studies about justice within a global world order and their fascinating findings. Moreover, such debate is vital, considering the lack of reference to demands of justice within (international tax) law in general.[13] As

masterpiece *A Theory of Justice* (Rawls, 1999a, p. 1 et seq.) uses the subtitle "justice as fairness". In sec. 6.2.1. we will briefly outline the reasons why Rawls uses the term "justice as fairness" in his theory of justice. For more details on the different aspects to be considered when rendering a comprehensive distinction between the two terms, *see also* Sen, 2009, p. 72 et seq. One reason for using the term "justice" instead of "fairness" in the title of this work is that fairness in international law is sometimes used in a broad manner with reference to procedural fairness. However, as the focus of the present study is on the substantive content of fairness (*see* sec. 2.1.6.), the term "justice" better suits our needs (*see*, for example, Franck, 1997, p. 7, who distinguishes between two aspects of fairness – i.e. the substantive [distributive justice] and procedural [right process]).

9. This term is owed to Brauner, 2003, p. 259 et seq., who of course used it for other purposes at a different development stage of the international tax regime. However, it seems that the term is more useful than ever to describe the stage of the current international tax regime, which is about to become more integrated and even harmonized. For a more recent perspective, *see* Brauner, 2016, p. 1 et seq.

10. *See generally* Höffe, p. 26 et seq.; Finnis, p. 161.

11. *See*, for example, Radbruch, 1945. The interaction between legitimacy and justice has triggered an entire debate in international law and will not be fully explored in the present study (*see generally* Buchanan, 2004, p. 1 et seq.).

12. Kelsen, 1957, p. 1 et seq. and p. 43. *See also* Kelsen, 1960, p. 57 et seq.

13. *See also* advocating for an enhanced use of justice considerations within legal studies and legal education Thürer, 2015, p. 357.

we will demonstrate, notwithstanding the presumed deficiencies, it is still possible to draw certain very precise lines on what "just" means and what is considered to be "unjust".[14] Even with this possibility for classification, there is indeed no "algorithm" that might help us to resolve the different questions of justice in international tax law.[15] However, history has shown that the understanding of what "just" means deviates among societies and different times and, therefore, the results of the present study must also be understood in the context of the current international tax world.[16]

It is indeed true that the available theories on defining a just global (tax) order are manifold and can also be misused by policymakers in order to achieve (unjust) results under the protection of justice. While justice may not have a universal appearance, it is still essential to try to understand its content and impact on tax policy. Tipke, with reference to Kant, has rightly stated that if justice should not play any role in tax law, we should give up our profession as tax lawyers or academics, respectively.[17] The same must be true for international tax law. The present study is not the beginning of such a debate,[18] but should provide new ways of thinking about justice within the international tax regime.

Many law-related studies on justice or specific accounts of justice as a starting point refer to the distinction between commutative and distributive justice (*iustitia commutativa* and *iustitia distributiva*), as used by Aristotle in his Nichomachean Ethics.[19] Often cited is the following quotation by Aristotle:[20]

> Of particular justice and that which is just in the corresponding sense, (A) one kind is that which is manifested in distributions of honour or money or the other things that fall to be divided among those who have a share in the constitution (for in these, it is possible for one man to have a share either unequal or equal to that of another), and (B) one is that which plays a rectifying part in transactions between man and man.[21]

14. Mahlmann, p. 202 et seq.
15. Singer, 2009, p. 910.
16. *See generally* Koller, 2014, p. 11 et seq.
17. Tipke, 1981, p. 4.
18. *See* the authors mentioned in sec. 1.4.
19. *See*, for example, Oesch, p. 31 et seq. Aristotle seems not to be the actual origin of the distinction between *iustitia commutativa* and *iustitia distributiva* (*see*, with further references, Arnold, p. 26 et seq.). Cf. Finnis, p. 161, who argues that Aristotle first treated justice as an "academic topic".
20. The English translation might deviate depending on the editor.
21. Aristotle, 1130b para. 30 et seq.

The distinction between *iustitia commutativa* and *iustitia distributiva* is still of major relevance and usefulness,[22] although these two accounts of justice have been understood in various manners and have developed over time.[23] A certain amount of reluctance is necessary to translate the Aristotelian understandings into modern times without any reflections of more recent theories of justice that consider the specifics of our societies and the globalizing or globalized world.

First of all, it is crucial to understand that Aristotle drafted his ideas of justice with reference to various areas of relations.[24] Commutative justice in the Aristotelian understanding is often understood as justice between equal parties,[25] whereas distributive justice refers to subordination and, therefore, justice among unequals.[26] Commutative justice could, for instance, mean a "victim of wrongdoing to be compensated equally, regardless of merits."[27] Nowadays, however, it is often referred to in order to claim justice or injustice in an exchange process, such as a contract or a physical barter.[28] In this respect (i.e., in a situation of exchange), the "just is intermediate between a sort of gain and a sort of loss."[29] Therefore, commutative justice "ignores the differences in rank and worthiness [footnote omitted] of the persons involved [footnote omitted]."[30]

It is sometimes argued that *iustitia commutativa* is of interest in order to achieve *iustitia distributiva* as *iustitia commutativa* is concerned "with preserving each citizen's share."[31] Therefore, *iustitia commutativa* should apply if the distribution among citizens is not just and in line with *iustitia distributiva*. However, this does not mean that *iustitia commutativa* has only

22. *See*, inter alia, Mahlmann, p. 204 et seq.; Radbruch, 2006, p. 36; Senn, p. 54 et seq. From a tax perspective, *see*, with further references, Tipke, 2000, p. 260 et seq. *See also* Koller, 2014, p. 14, who outlines in detail the core elements of the term "justice", which have not changed over time and seem to be valid in very different societies.
23. For more details about the historical development of the term "distributive justice", *see* Fleischacker, p. 1 et seq.; Koller, 2014, p. 11 et seq. On the different varieties in terminology, *see* Arnold, p. 32 et seq.
24. *See generally* Böckenförde, p. 113 et seq.
25. *See*, for example, Radbruch, 2006, p. 36. On these two terms, *see* Koller, 2014, p. 17 et seq.
26. *See*, with further references to the work of Aristotle, Chroust, p. 140.
27. Fleischacker, p. 19.
28. *See*, for example, Senn, p. 55; Wiederkehr, 2008, p. 394. *See also* Gordley, p. 1590, with further details on the application of commutative justice on both tort and contract in the understanding of Aristotle.
29. Aristotle, 1132b para. 18 et seq.
30. Chroust, pp. 120 and 136.
31. Gordley, p. 1589.

a secondary relevance. The latter has been intensively discussed in contract law.[32] From a domestic tax law perspective, in particular, the term "distributive justice" has been of interest as it seems to relate to the interaction between the state and its citizens or the members of the community or a society.[33] In this sense, for instance, the Swiss Federal Supreme Court held that justice in tax law is mainly a question of distributive justice (and not commutative justice) in the sense of the Aristotelian *iustitia distributiva*:

> *Gerechtigkeit im Steuerrecht ist vor allem eine Frage der Verteilungsgerechtigkeit im Sinne der aristotelischen iustitia distributiva.*[34]

However, such distributive justice should not be misunderstood as a just distribution in a basic structure, such as a society, or, in more general terms, as justice in a society.[35] Aristotle's analysis in his Nichomachean Ethics is not concerned with the question of distribution in a coercive framework, as it was in the focus of Rawls' work. Or, as held by Torrione:

> *Cette notion aristotélicienne de justice distributive à laquelle renvoie le TF* [i.e. the Supreme Court] *ne correspond pas non plus au sens qu'elle a quand l'expression est utilisée par un philosophe politique comme John Rawls.*[36]

Distributive justice in an Aristotelian understanding means, in more general terms, what is just between too much and too little in respect to a specific regulatory or interpretive question. Or, as held by Aristotle: "for in any kind of action in which there is a more and a less, there is also what is equal."[37] To review whether a certain action is just, such action must be tested against the existing options and be justified in an individual case. The just is, according to Aristotle, a "species of the proportionate".[38] Therefore, it is regularly argued that equals should be treated equally and unequals should be treated differently as it would be disproportionate if different situations were treated equally and vice versa.

The understanding of justice applied in the present study is not in opposition to Aristotle's definition, but it rather deals specifically with the particularities attached to the term "justice" in a societal framework (i.e., a basic

32. *See*, with further references, Arnold, p. 1 et seq.
33. *See*, for example, from a tax perspective Matteotti, 2007, p. 16; Tipke, 1981, p. 10 et seq.; Tipke, 2000, p. 260 et seq. With a focus on non-discrimination from a tax perspective, *see*, for example, Bammens, p. 1 et seq.
34. CH: SC, BGE 133 I 206, 1 June 2007, cons. 7.4.
35. Torrione, p. 142 et seq.
36. Id., p. 142.
37. Aristotle, 1131a para. 10.
38. Id., 1130a para. 29.

structure).[39] In other words, we will not refer in detail to Aristotle's understanding of justice as a virtue, as the focus of this study is on specific justice considerations in an institutional framework, such as the international world order.[40] This also means that we will not review what justice requires from individuals and corporate representatives in relation to specific actions. However, we are concerned with what justice requires from the international tax regime.[41] We will not discuss whether tax planning is morally wrong from the perspective of the taxpayer or his advisors. We will also not test whether existing value-based guidelines for corporations, such as the OECD Guidelines for Multinational Enterprises[42] or the UN Global Compact,[43] are in line with normative thinking or whether justice would require different obligations from corporate representatives.

In the following two introductory sections, we will provide an overview on different discussion points concerning both justice in domestic tax law and justice in international tax law in order to frame the content of and the idea behind the present study before we further discuss the structure and the methodology.[44]

1.3. Justice as a domestic tax policy guideline

Studies about tax justice generally aim at answering the question of what the appropriate allocation of tax burdens within a society is or how much each member of a society should contribute. Different views have been developed that have been based on different philosophical and political concepts, such as libertarian approaches, including the proposal of Nozick,[45] liberal ideas, such as the idea of justice as fairness according to Rawls,[46] more egalitarian views, such as the theory of Marx or socialism in general, or utilitarian

39. This is influenced by the introduction of Rawls on the subject of justice. He argues that his understanding of justice is related to the basic structure in a society, whereas Aristotle did not deal with the specific requirements, but this means that there is not a conflict between their understanding of the term, as they applied it to different accounts (Rawls, 1999a, p. 9 et seq.).
40. *See*, with further references on the understanding of justice as a virtue, Arnold, p. 27 et seq. We will also not deal with the interaction of justice with interpretation.
41. *See also* the persuasive introduction of Rawls, 1999a, p. 6 et seq.
42. OECD, OECD Guidelines for Multinational Enterprises, 2011 Edition (OECD 2011), p. 1 et seq.
43. For more information about the ten principles of the UN Global Compact, *see* https://www.unglobalcompact.org/what-is-gc/mission/principles, last visited 19 Jan. 2019.
44. *See* chapter 2.
45. Nozick, p. 1 et seq.
46. For more detail *see* sec. 6.2.

undertakings, as proposed by Mill[47] or Bentham.[48,49] As an example and in simplified terms, a socialist[50] might be in favor of a strong welfare state with a significant distributive tax system, whereas a libertarian might support a state with very limited competences and few taxes in general.[51] Aristotle argued that there is not a single principle that would lead to the ideal distribution according to *iustitia distributiva* but that it would depend on the political regime of a certain society. Or, as summarized by Gordley:

> Aristotle noted that there is no one correct principle for determining the share each person should receive. Rather, a particular society will adopt a principle consistent with its political regime.[52]

Depending on the underlying political or philosophical concept, the design of the domestic tax system deviates. In other words, the ideal structure of a political order, such as a state or a community, depends on the underlying understanding of justice of each member of the society, which might deviate depending on the political ideal. The idea of what a just domestic tax system should look like might also change over time, as the underlying idea of political institutions, such as the state, might change.[53] Therefore, the design of the domestic tax system and its justice conception highly depends on the underlying political or normative viewpoint, although some general considerations are acknowledged as being valid nowadays in nearly all societies or states. For the purpose of the present introductory section, and before referring to justice in international tax law, it is important to

47. Mill, 2004, p. 85 et seq.; Mill, 2016, p. 1 et seq. Even though a consequent utilitarian understanding is difficult to align with justice considerations as the final aim of maximizing the utility of all, as intended by utilitarian ideas, does not answer the question of how to allocate the utility among all members of a society (Höffe, p. 39). In sec. 11.4.3.2. we will deal with some of the critics of utilitarian views.
48. Bentham, p. 14 et seq.
49. For an overview on the different normative underpinnings of the domestic tax system, *see* Leviner, p. 95 et seq.
50. The term "socialist" is intentionally used instead of the term "Marxist" because it is unclear whether Marx was indeed a defender of distributive duties or whether he believed an abolishment of capitalism would automatically lead to an abundance of goods and the needs of distribution. For further details of the different understandings of Marx in terms of distributive justice, *see* Fleischacker, p. 96. Of course, there is no clear definition of what socialism means, but for the limited purpose of the present comparison, using the term without further defining its content seems justified.
51. *See*, for example, Nozick, p. 1 et seq.
52. Gordley, p. 1589.
53. *See* Tipke, 2000, p. 241, who states that the understanding of tax justice is neither absolute nor definitive. On fairness and tax law and the variations depending on the underlying philosophical understanding, *see* Holmes, 2000, p. 14 et seq. For a historical overview *see* Koller, 2014, p. 11 et seq.

highlight two elements of justice in domestic tax systems that are currently agreed on by persons in most states.

First of all, there is wide agreement that in domestic situations, i.e. in a certain basic structure,[54] taxation should follow equality considerations.[55] This means that members of a society should be treated equally to one another. To be more precise, this means that if two citizens have the same income and if they are in the same social situation (i.e., marriage, children, etc.) there seems to be wide agreement that they should be treated identically from a tax perspective. The latter understanding is often based on constitutional principles of (horizontal) equality or equal taxation,[56] but it seems at first glance also valid from a normative perspective, following the idea that human beings are to be treated equally by state institutions. In Part IV we will deal further with this equality principle from a normative perspective and its scope of application at an international level.[57]

Second, in a domestic situation, most people would agree that certain distributive measures are required as the market, following a libertarian approach, would lead and has led to unjust inequalities.[58] Currently, many countries have implemented progressive income tax rates in order to achieve a certain distributive effect. However, the extent of the need for redistribution highly depends on the underlying political concept. Furthermore, as highlighted by Matteotti with reference to Murphy & Nagel, even progressive taxation does not guarantee a distributive effect, as the distributive effect highly depends on the spending policy of a state.[59] The work of Murphy & Nagel is indeed a seminal example of how justice considerations and tax policy interact. Their approach follows the idea that ownership or pre-tax income is a myth in the sense that pre-tax income or ownership is not generated and secured without any help from the government. Therefore, discussions about justice and tax law should focus on the question of the distribution of

54. The term "basic structure" will often be used in the following. Our understanding of what a basic structure means will be defined in sec. 8.3.
55. *See*, for example, with further references Matteotti, 2007, pp. 14 and 38. *See also* the many citations in Tipke, 2000, pp. 284 and 290 et seq. The equality principle is sometimes referred to as the prototype of justice (Wiederkehr, 2006, p. 40, with further references to Kaufmann, Richli and Tschentscher).
56. *See*, for instance, article 14 of the Spanish Constitution or specifically regarding taxation article 127(2) of the Swiss Federal Constitution.
57. *See* sec. 11.2.
58. *See*, with references to the theories of Nozick and von Hayek, Matteotti, 2007, p. 41 et seq.
59. Matteotti, 2007, p. 43 et seq. *See*, on the interaction between the distribution of income and equal taxation based on the ability-to-pay principle, Kaufman, 1998, p. 159 et seq.

the after-tax income within a society, i.e., about the outcomes and not the burdens.[60] Or in other words, according to Murphy & Nagel, the distribution of welfare by the market is not per se just, and, therefore, "we can no longer offer principles of tax fairness apart from broader principles of justice in government".[61] This means that tax justice cannot be separated from the more general discussion about the distribution of governmental benefits.[62]

As we will see, the remarks on justice in the international tax regime are not limited by these two demands, as the term "justice" might also contain further components or elements that are crucial when rendering a normative review of the international tax regime.[63]

1.4. Justice and the international tax regime – Some preliminary remarks

Besides the mentioned debates about justice and domestic tax law, a further component of complexity is added at an international level, since the inter-state relation needs to be taken into consideration, not simply the relation between the state and its citizens or between the citizens themselves.[64] It is crucial that an analysis of justice in a certain legal regime considers the specific societal features that are regulated by such a regime.[65] Societal differences trigger different justice-related questions. In other words, the international realm requires specific analysis on the question of whether its regulative framework (such as the international tax regime) is just for its purpose.

We have already referred to the question of distribution and its importance for domestic tax policy, but at an international level, a focus should also be

60. Murphy & Nagel, p. 98 et seq.
61. Id., p. 30.
62. With a more detailed argument in this respect Kordana & Tabachnick, p. 652 et seq. Triggered, inter alia, by the work of Murphy & Nagel, an interesting discussion about the normative value of the principle of (horizontal) equality has evolved in the United States (*see*, with further reference, Repetti & Ring, p. 135 et seq.; *see*, already before the publication of Murphy & Nagel, Kaplow, 1989, p. 139 et seq.).
63. This is a general limitation of the present study that it is impossible to cover all the different theories of justice or different understandings of the term. For instance, we will not deal further with Kant's moral philosophy or with religious views on what justice means (for instance, from a legal philosophy perspective, *see* Kelsen, 1960, p. 357 et seq., regarding a bouquet of different concepts).
64. *See* Graetz, p. 306 et seq.; Kaufman, 1998, p. 167. On the demands of justice at an international level, *see* Koller, 2009, p. 188 et seq.
65. Koller, 2014, p. 35.

on considerations on commutative justice. The latter is an important aspect of justice in international law, as we should also be able to judge whether the relationship between states – which often are in contractual relation – is just, and not only whether the distribution of the tax burden or the outcome of the levy of taxes in a society or globally is just. Commutative justice or similar demands[66] are also critical, as these refer to a relation among equal parties such as states.

Therefore, in an individual case, it might be necessary to further develop which demands of justice are discussed. From an international tax law perspective, the great German tax law scholar Klaus Tipke stated in 1981 – i.e. only 38 years ago – that the term "justice" has rarely been mentioned in writings on international tax law:

> *In der Literatur zum internationalen Steuerrecht stösst man kaum je auf das Wort „Gerechtigkeit."*[67]

However, later in his book on tax justice, Tipke states that international tax law should also be based on consequent and appropriate rules in order to qualify as law.[68] Yet, Tipke does not further develop how such rules would look and whether the international tax regime in place in the early 1980s actually followed these principles. Things have changed significantly in the last 38 years, as states are not the only entities to claim just treatment with respect to cross-border tax issues, but international organizations, such as the OECD, also render projects based on fairness and justice considerations.[69] Furthermore, NGOs have played an important role by running awareness campaigns on injustices within the international tax regime.[70] However, the term "justice", as we will develop it in the present study and

66. *See* Koller, 2009, p. 188, who uses the terms "transactional justice" and "corrective justice", which are both linked to the term "commutative justice", depending on the understanding. The term "corrective justice" is sometimes used as a synonym – especially in the Anglo-American discussion – but there is no common understanding of the term (*see*, for example, Arnold, p. 32 et seq.).
67. Tipke, 1981, p. 120.
68. Id., p. 186.
69. *See* the introduction to the BEPS Action Plan, OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), p. 7 et seq.
70. *See*, inter alia, Christian Aid, The Shirts off Their Backs, How tax policies fleece the poor, September 2005, available at http://www.christianaid.org.uk/images/the_shirts_off_their_backs.pdf, last visited 12 Jan. 2019; Oxfam, Tax Havens, Releasing the Hidden Billions for Poverty Eradication, 2000, available at http://www.taxjustice.net/cms/upload/pdf/oxfam_paper_-_final_version__06_00.pdf, last visited 19 Dec. 2018; Tax Justice Network, tax us if you can, 2nd ed., 2012, available at http://www.taxjustice.net/cms/upload/pdf/TUIYC _2012_FINAL.pdf, last visited 14 Sept. 2017.

as we have already indicated above, must be understood in a much broader manner and must include all different demands of justice.[71]

A bevy of questions is, therefore, related to the term "justice" in international tax law.[72] These questions are not limited to tax burden considerations within state and market justice, but concern whether justice should also refer to justice among states as the core agents in international tax law (i.e., inter-state justice). Reference should moreover also be made to global justice[73] or international distributive justice, i.e. whether the international tax regime is just to the poorest on the planet.[74] Therefore, various demands of justice have to be considered.

We will further deal with these different demands of justice in Parts III and IV, and we will try to align these different demands of justice with the existing philosophical theories and ideas of justice.

1.5. Why is the international tax regime considered to be unjust?

Before we focus further on the structure and methodology of the present study, it is vital to first outline some actual claims on why the international tax regime is perceived to be unjust. This is necessary in order to justify the method and the necessity of the present study, per se. If the international tax regime was considered to be just, one could question the need for a normative review of the international tax regime. In this case, there would not be an obvious scientific problem that would require a detailed scientific analysis.[75]

We first need a perception of why the international tax regime is considered to be unjust in order to suggest, in a second step, some potential amendments

71. Koller, 2009, p. 192.
72. *See* Matteotti, 2015/2016, p. 57, who speaks of a bouquet of questions of fairness in (mainly domestic) tax policy.
73. Global justice in this sense focuses more on the moral importance of states and the inter-state relation, and not simply how justice can be achieved among individuals (*see*, with further references, Ratner, 2015, p. 45).
74. *See*, with further references, id.
75. But even if the international tax regime would be considered to be just, it could still be questioned by research, or the next generation could perceive it as an unjust system. Therefore, even if a legal regime is considered to be just, research about the normative validity of such a regime seems justified.

through a normative review of the international tax regime, as intended in Part IV of the present study.

As the following remarks will show, the international tax regime is considered to be unjust in various ways.[76] No single reason is available to support the popular opinion that the international tax regime is unjust. Different elements have led scholars, NGOs, business representatives and politicians to the conclusion that the international tax regime is unjust.

In the following paragraphs, we will try to group the different arguments by reference to statements of different stakeholders. Some of these statements might not directly use the terms "justice" or "fairness", but all of the statements at least imply that it is the understanding of the authors that something is unjust.[77]

There are hundreds or even thousands of statements available, but an emphasis is on statements by public authorities or NGOs in order to better outline the public opinion, while a second focus is on recent statements in order to allow a comprehensive understanding of the contemporary deficiencies of the international tax regime. The categorization of the statements does not follow a clear-cut line, but it still seems a necessary categorization for the purpose of the present study in order to focus our normative review on some of the most vital topics in the area of international taxation. The order of the different groups of arguments in the following should not indicate any assessment of the quality of the injustice.

An initial group of arguments on why the international tax regime is perceived to be unjust relates to the fair share paid or actually not paid by multinational enterprises and rich individuals. Most famously, the OECD claims that USD 100-240 billion in tax revenue is lost every single year due to base erosion and profit shifting, which seems to be enhanced or at least not prohibited by the international tax regime.[78] At another instance, the OECD argues:

76. Of course, the claim that the international tax regime is unjust should ideally be supported by an empiric study, but the mere fact that we did not find a single statement that the international tax regime is considered to be just shows that it contains justice deficiencies.
77. *See*, with further remarks on why the international tax regime is considered to be *unfair*, Burgers & Mosquera Valderrama, p. 767 et seq.
78. OECD/G20, Measuring and Monitoring BEPS, Action 11: 2015 Final Report (OECD 2015), p. 102.

> These developments have opened up opportunities for MNEs to greatly minimise their tax burden. This has led to a tense situation in which citizens have become more sensitive to tax fairness issues.[79]

The claim that multinationals do not pay their fair share due to the international tax regime is not only made with respect to the global tax situation, but also with respect to a specific country's perspective. For instance, Rachael Le Mesurier, a representative of Oxfam, with respect to New Zealand, argued the following:

> When there is so much inequality and poverty, it is utterly unacceptable that large corporations like Apple don't pay their fair share of taxes. The company is making hundreds of millions of dollars here in New Zealand, but appears to be paying a tax rate of just over one percent. That can't be right, and must be fixed.[80]

Secondly, it is moreover argued that the international tax regime (which is not fully transparent) has been a catalyzer for immoral activities. Or, as held by Stiglitz & Pieth:

> [S]ecrecy-havens, which provide ample opportunity not just for facilitating tax avoidance and evasion, but also money laundering – thus facilitating all manner of corruption and socially destructive and morally repugnant activities.[81]

A third justice deficiency that was both discussed in public and highlighted by scholars is that certain rules of the international tax regime seem to have been implemented without the consent of states, which is perceived to be unjust. Therefore, the sovereignty of states is infringed upon by forcing certain states to follow certain international guidelines.[82] For instance, a Member of the Swiss Parliament has, in a debate on the corporate tax reform III in Switzerland, held that tax legislation is a major element of state sovereignty, and she implicitly concluded that the fact that states are forced to change their laws due to international pressure is not driven by justice considerations, but by the self-interest of other states:

> *„Wir befinden uns ja in einem bedeutenden Souveränitätsbereich des Nationalstaates, nämlich der Steuerhoheit. Dass bei den internationalen Vorgaben und*

79. OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), p. 8.
80. *See* Apple New Zealand must pay fair share of tax, says Oxfam, following European ruling, published online at https://www.oxfam.org.nz/news/apple-new-zealand-must-pay-fair-share-tax-says-oxfam-following-european-ruling, last visited 20 Apr. 2019.
81. Stiglitz & Pieth, p. 22. *See also* Henry, p. 43, who speaks of a "rise of a vast new gray zone of quasi-legal economic activity".
82. *See* Ring, 2008, p. 190 et seq., with many (official) statements with respect to the OECD work on harmful tax competition.

> *Harmonisierungsbestrebungen nicht immer nur die Steuergerechtigkeit im Vordergrund steht, sondern dass es eben auch um Standortwettbewerb geht, dürfte ja wohl auch klar sein.* "[83]

Or, in a similar manner, it is held by Essers that the mentioned inter-state pressure could be (unjust) "Machiavelism":

> Another example is the development of black lists of third countries that do not apply minimum standards of good tax governance; countries on these black lists are offered assistance by way of the renegotiating, suspending and cancelling of tax treaties concluded with them by compliant countries. Also Machiavellian is the naming and shaming of companies, the call for boycotting these companies, the requirement that taxpayers have to disclose their tax planning arrangements, the threat of ending enforcement covenants in case of unethical tax behaviour and the lack of legal protection of taxpayers with respect to exchange of information.[84]

Linked to such justice deficiency is the argument that not all states are indeed on "equal footing", as stated multiple times by the OECD.[85] As a result, there is currently no equality of states in international tax law, as some strong economies have dominated the design of the international taxation realm.[86]

A fourth justice deficiency is that the current international tax regime undermines the sovereignty of states, as it triggers under-funding and must, therefore, be considered unjust:

> Moreover, Base Erosion and Profit Shifting (BEPS) undermines the integrity of the tax system, as the public, the media and some taxpayers deem reported low corporate taxes to be unfair. In developing countries, the lack of tax revenue leads to critical under-funding of public investment that could help promote economic growth. Overall resource allocation, affected by tax-motivated behaviour, is not optimal.[87]

Or, "We are taking actions to ensure the fairness of the international tax system and to secure countries' revenue bases."[88]

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83. Keller-Sutter Karin, Swiss Parliament, State Council, Amtliches Bulletin (2015), p. 1258 et seq.
84. Essers, p. 65.
85. In just the brief explanatory statement, the term "equal footing" is used 10 times (OECD/G20, Explanatory Statement, 2015 Final Reports, p. 1 et seq.).
86. *See*, for example, Mosquera, 2015, p. 372 et seq. This is not an international tax law-specific claim, but it has found reception in international law in general (*see* the references in Altwicker & Diggelmann, p. 81 et seq.).
87. OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), p. 8.
88. G20, G20 Leaders' Communiqué Brisbane Summit, 15 -16 November 2014, para. 13.

A fifth group specifically argues that the international tax regime harms the developing world, certain specific states or certain people:

> Developing countries lose around US$100bn in tax revenues each year as a result of corporate tax avoidance schemes that route investments through tax havens. This does not include the full set of tax avoidance schemes used by multinational companies nor the billions of dollars that corporations gain because of overly generous tax incentives.[89]

It is even argued – at least implicitly – that the international tax regime enhances poverty:

> Our research shows that developing countries could be losing more than US $100 billion every year because of corporate tax dodging and tax breaks for corporations [footnote omitted]. This would be almost enough to get every child into school four times over [footnote omitted].[90]

These injustices are part of a broader claim that the current world is highly unjust as poverty and hunger still exist and inequalities are significant. It is also argued that human rights deficits are caused by the international tax regime, as argued by Pogge & Mehta:

> Clearly, massive reductions in existing human rights deficits could be achieved by allowing poor countries to collect reasonable taxes from MNCs and from their own most affluent nationals, assuming the resulting revenues were appropriately spent [footnote omitted].[91]

In more general terms, it is argued that the current international tax regime, which (still) tolerates tax havens, fuels inequalities at a global level:

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89. Blog Post, SwissLeaks: Why Corporate Tax Scandals Won't go Away, Oxfam, 8 February 2016, written by Claire Godfrey and available at https://blogs.oxfam.org/en/blogs/16-02-08-swissleaks-why-corporate-tax-scandals-wont-go-away, last visited 14 Sept. 2017, or *see*, for instance, AllianceSud, Global Volume 63 (2016), p. 4. Many similar studies are mentioned by Pogge & Mehta, p. 4. *See also* Brock & Pogge, p. 2, who claim that "tax abuse [footnote omitted] causes especially grave harm to development and democracy in poorer countries". Cf. Grinberg, 2016a, p. 15. The presumed detrimental impact on developing countries is also mentioned by Henry, p. 32, and he combines his arguments with a more general globalization and/or capitalism critic (*see* p. 34 et seq.). *See also* Magalhães, p. 499 et seq.

90. Oxfam Media Briefing, Turn the Tide: The G20 must act on rising inequality, starting with fairer global tax reform, 14 November 2014, p. 2.

91. Pogge & Mehta, p. 4. *See also* Christians, 2009a, p. 211 et seq.; International Bar Association, p. 1 et seq. Similar concerns are raised in the following study UN, Human Rights Council, Interim study by the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, 10 February 2015, A/HRC/28/60.

> Inequality rises when tax rules are unfair. When corporations pay less tax, profits increase, and these profits accrue overwhelmingly to the top 10% and 1% richest people especially. In the US, for example, about 80% of corporate income is held by households in the top fifth of the income scale, and about 50% is held by the top 1% [footnote omitted].
>
> Governments make up shortfalls by levying higher taxes on other, less wealthy sections of society. This is particularly unjust because corporations depend on "public goods" that have been paid for by taxes, like educated and healthy workforces and infrastructure like roads and ports.[92]

Or, as held by a researcher of the Tax Justice Network:

> For example, we already know that the "black hole" represented by offshore financial wealth is much larger than anyone has previously determined. We already know that it has grown large enough to have a powerful impact on inequality, the distribution of the tax burden, public finances, and political influence across the globe.[93]

A sixth group of arguments implies that the international tax regime has led to unfair competition. For instance, the OECD states the following:

> Fair competition is harmed by the distortions induced by BEPS.[94]

Lastly, and likely the origin of injustices in the international realm, is the claim for double or over-taxation in cross-border situations. Double taxation has not vanished and is still considered to be unfair in both the public and academic debate.[95] Regarding the potential double taxation of multinationals, a representative of a business association held, for instance, the following:

> As a result, European companies already subject to tax in their home country are now being asked to write a second cheque to American states. This double tax is not only inconsistent with US tax treaties and international norms, but also a violation of basic fairness.[96]

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92. Oxfam Media Briefing, Turn the Tide: The G20 must act on rising inequality, starting with fairer global tax reform, 14 November 2014, p. 5 et seq.
93. Tax Justice Network, Henry James S., The Price of Offshore Revisited, July 2012, p. 45.
94. OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), p. 8. Again, the OECD does not argue that the legal regime harms competition, but the statement implies that the international regime enables BEPS and therefore leads to unfair competition.
95. However, very few authors discuss why double taxation is unfair. One could, for instance, claim that it is unfair because it would lead to "over-taxation" (Matteotti, 2015/2016, p. 55), but what "over-taxation" means and whether there is a moral difference between the situation in which income is taxed twice at a rate of 10% or twice at a rate of 30% is unclear. We will further discuss the application of the single taxation principle at an international level in sec. 11.2.3.4.
96. McLernon Nancy, America's unfair double taxation, Financial Times, 15 April 2010.

These statements relate to various demands of justice. All statements were made in the last few years and should highlight some contemporary claims of injustice. We will throughout this entire study highlight further statements to demonstrate the presumed justice deficiencies of the international tax regime.

Chapter 2

Structure and Methodology

2.1. Why refer to political philosophy?

The scientific problem to be solved relates to the fact that the current international tax regime is considered to be unjust for several reasons.[97] However, before hastily running into a discussion about how to enhance justice in the international tax regime, it is essential to define the methodology and outline the structure in order to allow the reader a more stringent understanding of the achieved results.

2.1.1. Interdisciplinary research and legal studies

Writing an interdisciplinary legal study, such as the present one, which combines law and political philosophy, requires an understanding of precisely what it means to research in the field of law or what is required by a legal study per se. Inter alia, we would distinguish two kinds of research in the area of law, which are relevant for the present study, but which must be distinguished.

Some legal studies focus on the application of a specific positive legal rule or several legal rules. These dogmatic studies deal, for instance, with the question of how a certain fact pattern ought to be treated under an existing legal regime. Such area of legal research is dedicated to the question of the interpretation and application of legal norms *de lege artis*. In order to apply and interpret a legal regime or a legal rule, lawyers around the world know different, but often similar, methodologies that are habitually highly influenced by the case law of a supreme court or which are – as is the case in international law – influenced by contractual or customary guidelines, such as the VCLT. Such dogmatic legal scholarship is part of the present study. As we will outline in more detail, most legal rules of the international tax regime derive their validity from the consent of states and, therefore, international dogmatic law studies need to apply rules that are based on interstate interaction. However, even in such traditional dogmatic methodology, moral theory cannot be ignored.[98]

97. *See* sec. 1.5.
98. *See* Ratner, 2015, p. 21.

A second part of legal research focuses on the question of what law ought to be and not how it ought to be applied. An important task of legal science is indeed to question an existing legal regime or specific rules in order to review whether the positive legal system is indeed just and whether it serves the purpose of justice or other moral claims.[99] Justice, therefore, should also play a major role in legal science.[100] However, in order to answer the mentioned "ought to be" question, reference to other disciplines than law might be necessary, as traditional legal methods seem insufficient to cope with the need for a substantive and value-based analysis. Lawyers must consider the limits of their expertise and methodology.[101] In other words, by using dogmatic methods, we might not be able to answer the question of whether a certain rule or legal regime is just. This is – and we will demonstrate this in the following section – particularly true with respect to international law.

As mentioned, in the present study, reference is made to political philosophy and moral theory in order to render a normative review of the international tax regime. Reference to political philosophy is particularly attractive if a study deals with an abstract question.[102]

However, besides the chosen interdisciplinary approach or methodology, the present study remains a legal study and the focus is not on an abstract definition of justice, but on the question of how to enhance justice in a specific legal regime, i.e. the international tax regime.[103]

Nevertheless, this requires an in-depth understanding of the existing positive legal regime and, in particular, of the existing legal limitations in which positive legal rules may operate within such a regime. In other words, we aim to analyze the current international tax regime as a (mainly)[104] positive legal regime and to review its main principles and rules based on justice considerations. In the case of a study about the theoretical fundaments of a law discipline, such as international law, it, therefore, seems indispensable to refer to philosophy in general or political philosophy in particular.[105] One

99. Wissenschaftsrat, p. 27; from an international law perspective *see* Peters, 2013, p. 548. Such a task is often linked to the discipline of "legislation" or "*Gesetzgebungslehre*" bzw. "*Rechtssetzungslehre*". *See* the seminal and comprehensive work of Noll, p. 1 et seq.
100. On the tasks of legal science arguing in a similar manner, *see* Thürer, 2015, p. 357.
101. Noll, p. 68.
102. For a detailed analysis on when reference to philosophy might be justified in a legal analysis, *see* von der Pfordten, p. 128 et seq. *See also* Wissenschaftsrat, p. 27.
103. *See* Grundmann, p. 696; Peters, 2016, p. 26.
104. This will be reviewed in Part II of the present study.
105. Regarding international law in general, *see* Peters, 2007, p. 754.

of the core theses of the present study is indeed that the current international tax regime lacks an underlying theory of justice and an in-depth understanding of its main design principles.

2.1.2. Interdisciplinary research and international law

Reference to political philosophy is indeed necessary if lawyers explore problems "that are not confined to a single discipline",[106] and this is particularly true with respect to international tax law, as many principles have been used in order to steer the international tax regime in a certain direction. We will refer to ideas of political philosophy in order to review some of the most fundamental principles and rules within the international tax regime. From an international law perspective, reference to political philosophy and an interdisciplinary approach in general is furthermore justified by the following specific reasons.[107]

First, as we will demonstrate in detail, the international tax regime only provides for primitive evaluation guidelines in order to decide whether or not a positive rule ought to be.[108] Therefore, it is even more necessary to refer to a moral debate in the international realm, rather than in a domestic analysis, as domestic constitutions might provide for more detailed guidelines on what moral values are agreed upon by a society.[109] Or, as argued by Peters in her seminal article on the future of the discipline of international law, international law only knows rudimentary assessment standards and, therefore, should refer to an ethical dimension to a greater extent than domestic law:

106. National Academy of Sciences, p. 40.
107. The question of the suitability of a normative theory in international law could also be answered from the opposite direction, i.e. by focusing on its skepticisms (*see* Besson & Tasioulas, p. 13 et seq., on normative skepticism about the morality of international law). Parts of these arguments were already published in Hongler, 2018, p. 756 et seq.
108. The term "primitive" will be specifically addressed in sec. 3.4.
109. *See*, on the purpose of a domestic constitution, sec. 4.4.2. There is furthermore no central legislator at an international level, as we will outline in sec. 4.4.3.1.1. This is one reason why academics should be assigned with law-creating functions (Peters, 2013, p. 537; Bluntschli, p. VII). And international law is also not underpinned with a democratic process of creation, which could increase its legitimacy (Peters, 2013, p. 548). Of course, justice is only one standard that should guide the development of international law. Others would be legitimacy, peace, prosperity or the preservation of nature (*see generally* Tasioulas, 2010, p. 97). Peace and prosperity will also be discussed in the following as potential accounts of global justice.

> *Verfassungsähnliche positivierte Grundsätze des Völkerrechts, die Bewertungsmaßstäbe liefern würden, sind nur rudimentär vorhanden. Deshalb darf und muss die Völkerrechtswissenschaft in stärkerem Maß als die auf das nationale Recht bezogene Jurisprudenz die ethische Dimension mit einbeziehen.*[110]

Or, as stated by Peters in another article:

> I submit that, because of specific qualities of international law, doctrinal analysis in this field is not useless, but indeed of limited value. First, the stuff of international law is less dense than in the main field of application for doctrinal research: domestic contracts, tort and property law. There are, in total, fewer rules and judicial decisions. So a logical-semantic analysis of this "thin" legal subject matter yields less.[111]

Second, a specific need for interdisciplinary research exists in international law, as there is no common dogmatic approach at an international level and it is more difficult to distinguish between dogmatic claims and claims from other disciplines. Of course, the VCLT is to be understood as a partial dogmatic consensus on how treaties as one source of international law should be interpreted, but the VCLT does not demonstrate in detail how and what kind of values should influence the application of international law. However, even in a mere domestic (and traditional dogmatic) circumstance, many scholars have claimed the usefulness of interdisciplinary research in the area of legislation and law making.[112]

Third, interdisciplinary research on the fundamentals of a legal discipline is particularly needed in disciplines undergoing rapid regulative change, such as international (tax) law.[113] We would therefore argue as others have, that in reaction to rapid changes, legal studies should use a higher level of abstraction.[114] For instance, as a preliminary insight from an international tax law perspective, legal science should not only try to interpret the arm's

110. Peters, 2007, p. 754. *See also* Ratner, 2011, p. 159, who argues that "international lawyers are engaging in debates about world order that parallel those among philosophers concerned with global justice".
111. Peters, 2013, p. 545 et seq.; Peters, 2016, p. 24.
112. *See*, for example, from a Swiss perspective, Richli, p. 123 et seq. *See also*, with respect to legal philosophy, Seelmann, p. 59.
113. We will outline in detail the most recent and rapid changes in international tax law in sec. 4.2.3.2.5. At the same time, as others have argued, interdisciplinarity has not been replaced by other disciplines, but other disciplines have made legal studies richer and more exciting (Balkin, p. 970). This means that by rendering an interdisciplinary study, we will not question "our" legal discipline.
114. Peters, 2007, p. 743. *See also* Peters, 2013, p. 546. *See also* Besson & Tasioulas, p. 4, who argue that, "the most pressing questions that arise concerning international law today are arguably primarily normative in character".

length principle in a very technical and dogmatic manner, if any, but legal science should also review the justifications for an international tax regime that is highly dependent on the arm's length principle.[115] In order to do so, reference to other disciplines, such as political philosophy, is essential. Therefore, the complexity of a legal order such as the international tax regime does not necessarily increase the complexity of defining justice for such an order but requires a higher level of abstractness.[116]

Fourth, when international rules are negotiated, very different legal systems collide with each other and very different cultures must interact. This triggers the question of what is the lowest common denominator when it comes to morality or ethical principles.[117] In this respect, political philosophy has already developed a more substantive understanding of what morality requires in an international realm in order to be appreciated by very different legal systems and cultures. This might justify a detailed reference to political philosophy, as it helps us to better frame such a lowest common denominator of values and morality at an international level.

Fifth, a pure analysis of positive international law risks being biased or might engender "a false security".[118] This means by only focusing on the application of the current international law regime, scholars might recommend the application of highly unjust or unfair rules, simply because these rules are part of the positive international law regime. Reference to another discipline helps us to overcome such potentially biased positive legal regimes in order to challenge their normative base.

Lastly, even if legal scholarship is followed in a more dogmatic manner, ethical values and moral claims are relevant as interpretative means and general considerations. As a consequence, reference to moral theory is necessary, even in a positive (and not a normative) analysis.[119] Therefore, there is also in a traditional dogmatic approach the need for a review of ethical views and moral values. Or, as developed in detail by Smits, at the core of all legal studies is always the question of what law ought to be.[120] Moreover, sources such as general principles of law or customary international law might be influenced by moral thoughts as we will outline in detail later in

115. *See* for more details sec. 4.2.3.3.4.
116. But *see* Vogel, 1988c, p. 394.
117. Kadelbach, 2004, p. 15. Or in other words, international legal discourse is not a "self-contained legal discourse [footnote omitted]" (Altwicker & Diggelmann, p. 86).
118. Peters, 2013, p. 551.
119. *See*, from an international law perspective with reference to Koskenniemi, Ratner, 2015, p. 432. *See generally* Seelmann, p. 68 et seq.
120. Smits, p. 75 et seq.

this study.[121] From our perspective, it seems unavoidable that at least parts of legal research refer to moral theory, such as political philosophy, in order to assess whether a legal regime indeed leads to justice. Political philosophy as philosophy generally helps, moreover, lawyers to approach the truth in a circumstance with no or not sufficiently worded positive rules.[122]

2.1.3. Interdisciplinary research and international tax law

International tax law has long been interdisciplinary, in the sense that it has combined legal scholarship and economics or public finance since its inception. Some of the most important founders or designers of the current international tax regime have been economists (inter alia, von Schanz[123] and, in particular, the drafters of the first report on double taxation, i.e. Bruins, Einaudi, Seligman and Stamp).[124] Yet, in recent years, the interaction between law, economics and public finance has also played an important role.[125] In a domestic circumstance, taxation as part of public finance is an even older discipline than tax law.[126] However, economic analysis has severe weaknesses as a policy guideline, as it often does not deal with fundamental values and the question of why policy should aim at a certain goal.[127] In particular, if the law does not require efficiency per se, an economic analysis cannot be the alternative to a more value-based approach.[128] Moreover, the international tax regime has never followed a single economic principle. As we will see below, with reference to capital export neutrality (CEN), capital import neutrality (CIN) and capital ownership neutrality (CON), the allocation of income within the current international tax regime is not in accordance with a single economic principle.[129]

International tax law has also been interdisciplinary in the sense that scholars argue that it is essential to outline the international law background or framework before discussing new concepts within international tax law.

121. *See* sec. 4.3.2.2.4. and sec. 4.3.3.2.
122. *See* Seelmann, p. 59 et seq., who uses the German term "*Richtigkeit*" for "truth".
123. Von Schanz, p. 365 et seq.
124. *See*, with further details, sec. 4.2.3.2.2.
125. *See*, for instance, the contributions in: Tax Treaties: Building Bridges between Law and Economics (Lang Michael et al. [eds.], IBFD 2010), Books IBFD. As an example, *see also* Tavares, p. 243 et seq.
126. Tipke, 2000, p. 18.
127. Singer, 2009, p. 935.
128. *See*, on the difficulties of efficiency as a normative goal in international law in general, Paulus, 2007, p. 713. For further details *see* sec. 11.4.
129. *See* sec. 11.4.2. *See also* Ault, 1992, p. 571.

Therefore, international law or international public law[130] limits, on one hand, the development of international tax law, but on the other hand, it provides for a framework in which international tax law may operate. There have been, for instance, many studies – and we will refer to these in the following[131] – about tax jurisdiction and its link to international law. However, as far as it can be observed, no comprehensive study exists regarding the international law framework of the international tax regime. This is the goal of Part II of the present study.

Besides international law and economics (or public finance), other disciplines such as sociology, international relations, anthropology, political theory, moral theory and political philosophy have played minor roles in recent decades and for the overall development of the international tax regime.[132] However, in recent years, these studies have gained some momentum among lawyers through authors like Benshalom,[133] Christians,[134] Dagan,[135] Peters,[136] Ring[137] and Valta.[138,139] This triggers the question of why international tax law scholars should focus on moral theory or political philosophy.

The idea of focusing on political philosophy and tax law as one of the aforementioned disciplines was triggered by the BEPS Project itself. Indeed, the BEPS Project has generated an impressive number of publications from (mainly) tax lawyers or economists arguing what would be necessary in order to achieve a just, fair, and/or legitimate global tax system. The discussion about fairness and justice in these documents, however, is often arbitrary, because the underlying concepts used are arbitrary. The latter does not, as we will describe later in this study, mean that these publications are not of importance for the discussion about justice in international tax law. They are indeed valuable, but we are of the opinion that international tax lawyers, policy advisors and academics should extend their horizon by at least partly focusing on political philosophy, as international tax policy

130. In the following, we will use the term "international law", as "international public law" seems to be outdated (Besson, 2010, p. 168).
131. *See* sec. 4.1.2.
132. But *see* Richman (Musgrave), 1963, p. 22 et seq. Or, partly, Vogel, 1988c, p. 393 et seq.
133. Benshalom, p. 1 et seq.
134. Christians, 2009b, p. 99 et seq.
135. Dagan, 2017, p. 1 et seq.; Dagan, 2018, p. 1 et seq.
136. Peters, 2014, p. 1 et seq.
137. Ring, 2008, p. 156 et seq.
138. Valta, p. 1 et seq.
139. In alphabetical order. There are further contributions that should be mentioned. *See*, for example, Essers, p. 34 et seq.; Gutmann, p. 27 et seq.

requires an in-depth understanding of normative ideas. Or, as Rawls puts it in a general manner:

> By showing how the social world may realize the features of a realistic utopia, political philosophy provides a long-term goal of political endeavor, and in working toward it gives meaning to what we can do today.[140]

Moreover, not referring directly to political philosophy, Singer has made the following persuasive remark:

> There is no alternative but to make arguments that elaborate fundamental human values and that express our considered commitments to judgments about morality and justice. As budding lawyers, this is something law students must understand. Judges partially base decisions on such considerations, and the ability to make sophisticated arguments about justice and morality is a skill all lawyers need.[141]

Additionally, another reason why a focus of the present study is on justice relates to the fact that the current world tax order, as mainly developed by the OECD and the UN, seems to have failed to provide for an effective system that states will regularly comply with.[142] Compliance and efficiency are somehow linked to the questions of justice, which means that by improving justice within the international world order, compliance and effectiveness can also be enhanced. Therefore, the goal is to question the current international tax regime consisting of soft and hard law instruments, to analyze whether it should be improved, and to determine how such improvements can be reached. In order to do so, it is crucial to elaborate further on the question of what states ought to do in order to achieve a more just international tax regime based on substantive values. The answer to such questions, however, requires reference to philosophical argumentation, as the science of law by itself cannot guide us to answer the normative goals of the international tax regime. Or, as mentioned by Sen: "[P]hilosophy can also play a part in bringing more discipline and greater reach to reflections on values and priorities as well as on the denials, subjugations and humiliations from which human beings suffer across the world."[143]

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140. Rawls, 1999b, p. 128. *See also* Kleinbard, 2015, p. 27, who argues that "[a]ny coherent fiscal policy ultimately is an exercise of moral philosophy".
141. Singer, 2009, p. 904.
142. There is wide discussion in international law as to why states obey international law obligations, even though there is no central body of enforcement. An interesting discussion has occurred on whether the institutional improvements or improvements in the quality of international law will improve compliance (*see generally* Koh, p. 2599 et seq.).
143. Sen, 2009, p. 413. *See also* Seelmann, p. 61, or Ratner, 2011, p. 171, who highlights the "analytic rigour" of philosophers, which might help lawyers better understand or question some basic assumptions.

This means that only if we reach a consensus as to how an international tax regime should be designed, i.e. how it ought to be, can we draft recommendations to improve the existing tax regime. Otherwise, the stated arguments could be misleading as they are either contradictory or not based on any normative theory. Such methodology should allow for the development of rather concrete guidelines on what policy advisors should seek in the current and upcoming international tax debates. As stated by Ring in 2010:

> Law is ultimately most relevant and successful as the field within which we grapple with the normative questions for which our work as a whole seeks to offer prescriptive guidance.[144]

Benshalom even uses the term "*alarming*" to describe the gap among economists, policymakers and normative philosophers.[145] It seems that philosophers dealing with justice and legitimacy mainly focus on other fields, such as international environmental law, trade law or in a more general way on human rights. However, tax law itself is one of the core reasons for inequality among societies or within a society, while also being one of the key instruments to resolve such inequalities. Philosophers are themselves aware of their importance also from a practical perspective. Tax scholars (and economists),[146] on the other hand, are very reluctant to use normative theory in order to justify a certain provision of international tax law.[147] In this respect, we do, as a concluding remark, agree with Cohen & Sabel that the current changing tax world order requires particular reference to political philosophy:

> In times of transformation of fundamental human relations, political philosophy can tell us where, in the space ranging from humanitarian obligation to egalitarian justice, to look for answers, and can suggest what we might find.[148]

2.1.4. Can lawyers influence political philosophy?

It has been argued above that political philosophy contains a normative theory that helps tax lawyers when reviewing long-existing positions and arguments. Political philosophy should indeed allow us to enhance justice

144. Ring, 2010a, p. 21.
145. Benshalom, p. 72. *See also* Cappelen, p. 101. See Thürer, 2009a, p. 14, who highlights the limited reference to justice in our (i.e. lawyers') everyday life.
146. One example is the work of Zucman on the hidden wealth of nations, who does not refer to political philosophy and philosophy in general, although he develops a rather detailed understanding of how a fair or just international system should be designed (Zucman, 2015, p. 1 et seq.). Such a methodology does not, however, always lead to persuasive and well-founded results.
147. Benshalom, p. 73.
148. Cohen & Sabel, p. 175.

within the international tax regime. However, potentially, it might also be a task of tax lawyers or lawyers in general to provide political philosophers with an outline of how to implement their ideas of justice into the existing legal framework.[149]

We are, of course, not of the opinion that tax lawyers should attempt to develop their own theories of justice, because our legal methodology is not able to cope with the need for a philosophical theory of justice. Moreover, scholars should be careful not to generalize both disciplines and merge them into one non-defined realm, as this would weaken both disciplines.[150]

The importance of tax law from a philosophical perspective is that tax law can have an enormous distributive impact both in a domestic and international setting if one claims – as certain philosophers do[151] – that there are distributive duties among individuals living in different jurisdictions. Tax law might even be the most suitable instrument to achieve such a goal at an international level. However, we would be reluctant to propose new worldwide taxes, such as Piketty,[152] Pogge[153] or Nussbaum[154] in order to achieve such distributive effects.[155] The reason is that we already have a global tax regime, so before introducing a new tax, it should be analyzed whether and how the current international tax regime could be amended in order to achieve distributive justice.[156] In this respect, it might be our task as tax lawyers to develop new ideas for amending the current tax system, rather than simply asking for new worldwide taxes, such as the Pikettian wealth tax or the Poggian worldwide dividend (i.e. tax) on resources. Or, as held in more general terms by Ratner:

> [L]awyers offer the base of knowledge of the process of international law-making, the substance of current norms, and the role of international institutions in formulating and implementing norms.[157]

149. Singer, 2009, pp. 906 and 936 et seq.
150. *See* Ratner, 2015, p. 19.
151. For further details *see* sec. 7.5.
152. Piketty, p. 515 et seq.
153. Pogge, 1999, p. 501 et seq. For further options *see* Brock, 2008, p. 161 et seq.
154. Nussbaum, 2004, p. 16 et seq.
155. With further examples of proposed "global taxes", *see* Schulzke, p. 108. *See also* the proposal of Henry, p. 32 et seq.
156. Further reasons would also oppose the introduction of global taxes and we will partly refer to these in the following sections. We do not see how global taxes would enhance justice in international tax law if no international body with distributive power exists (on this topic *see generally* Schulzke, p. 105 et seq.). Global redistribution would require that there is indeed a cross-border distributive duty, which we will analyze in detail in chapter 8.
157. Ratner, 2011, p. 171.

Crucially, some philosophers have already dealt with international tax law and its normative concepts.[158] These authors have already referred to the international tax regime as a legal regime and, therefore, there is already an exchange between lawyers and philosophers. The present study should further enhance such an interdisciplinary way of thinking and must be understood as an attempt to lower the fences between the two disciplines, without minimizing either discipline.

Other authors mention that an influence of lawyers on philosophy could be that lawyers should highlight whether philosophers understand the law incorrectly, but this is not of particular interest for the present study.[159]

2.1.5. Realizing a realistic utopia

> [P]olitical philosophy is realistically utopian when it extends what are ordinarily thought to be the limits of practicable political possibility and, in so doing, reconciles us to our political and social condition.[160]

In his book *The Law of the Peoples*, Rawls refers to a realistic utopia in which he develops a system of principles of justice. There are not just – from his perspective ideal – liberal democracies in the world, but that same world also consists (and will likely in the long term consist) of so-called decent, but not liberal, societies, outlaw states and burdened societies. The distinction between these different societies is essential in order to understand Rawls' *The Law of Peoples*.[161] From Rawls' perspective, only liberal and decent societies are well ordered.[162] Decent peoples might also be non-liberal societies that meet some "specified conditions of political right and justice" and, therefore, their citizens obey some sort of just law for the society of peoples.[163] On the contrary, an outlaw state is, according to Rawls, created when a "state's policies threaten [the other non-outlaw states']

158. *See* Brock, p. 161 et seq.; Cappelen, p. 97 et seq.; Dietsch, 2015, p. 1 et seq.; Dietsch & Rixen, p. 150 et seq.; Ronzoni, 2009, p. 229 et seq.; Ronzoni, 2014, p. 1 et seq.; Van Apeldoorn, p. 1 et seq. Or *see* the contributions in the special issue 2014/1 of the journal Moral Philosophy and Politics, or *see* the contributions in Pogge & Methaen, Global Tax Fairness.

159. *See*, with some examples, Ratner, 2015, p. 32 et seq.

160. Rawls, 1999b, p. 11. *See* regarding the term "realistic utopia" as understood by Rawls, Tasioulas, 2002, p. 368.

161. In his theory, there is even a fifth category of societies, i.e. societies that follow benevolent absolutism. These are, however, not of interest for the present study (for further details *see* Rawls, 1999b, p. 4).

162. Id.

163. Id., p. 3 (n. 2).

security and safety, since they must defend the freedom and independence of their liberal culture and oppose states that strive to subject and dominate them."[164] Burdened societies as a last category are, according to Rawls, societies that are burdened by unfavorable conditions.[165] These societies are not aggressive, but they lack crucial elements, such as resources, know-how and human capital to become well-ordered peoples. Therefore, Rawls seeks principles of justice at an international level that apply, notwithstanding the fact that some states might domestically not follow a just state's system according to his liberal understanding within *A Theory of Justice*.[166]

This is also the goal of the present study, since we aim to challenge rules and principles of the international tax regime by attempting to achieve a just international tax regime that could be applied and considered as just, even though one might argue that certain states being a part of such an international tax regime do not domestically apply principles of justice in a sufficient manner.[167] This is already reflected in the current international tax regime, as some states forming part of the international tax regime are oppressing people and are generally considered to have an unjust domestic political system in place.[168] Therefore the results of the present study could influence the design of the international tax regime, even though the domestic political structure of the involved states that are part of an international tax regime are manifold, i.e. some states might know a larger distributive structure than others, some might be dictatorships, and others might be democracies. We believe it is crucial to develop ideas "which may have the power of transforming international relations, and which therefore contribute to 'realizing utopia' [footnote omitted]".[169]

Reference to a realistic utopia has a second component relating to the issue of practical constraints. It is important for the purpose of the present study to limit the results to feasible options and realistic considerations, and not solely to base the results on an ideal system of international tax law. Such a

164. Id. p. 48.
165. Id., p. 106.
166. For further details, *see* sec. 6.3.
167. *See*, on the topic of international tax law as a framework regulation being capable of considering the interest of very different states, Dietsch, 2015, p. 12 et seq.
168. For instance, Saudi Arabia, Eritrea and China are part of the Inclusive Framework of the BEPS Project (*see* http://www.oecd.org/tax/beps/beps-about.htm, last visited 14 Sept. 2017), even though these states are qualified as "authoritarian" by the Democracy Index 2015, as published by The Economist, Intelligence Unit (*see* www.eiu.com, last visited 14 Sept. 2017). Moreover, the Democratic People's Republic of Korea has signed several double tax treaties, for instance, with Bulgaria, the Czech Republic and Indonesia (for further details *see* IBFD Treaties & Models database).
169. Peters, 2017, p. 159.

methodology was also proposed by Benshalom, as he argues that a theory on the reshaping of reality needs to consider the actual boundaries of political feasibility.[170]

Therefore, the present study does not develop a just institutional system as a world order based on ideal principles. We prefer to leave such incredibly difficult work to philosophers. The most prominent limitation relates to the fact that the current world order, with several sovereign states, will not change into a one-single state or one-single institution order, i.e., as mentioned by Rawls "reasonable plurism limits what is practicably possible here and now."[171] This means, however, that if the facts change, it might have an impact on the normative claim. For instance, if we did not have a multistate order in the Westphalian sense, but rather a single-state world, the normative ideas of justice would change. Normative reasoning requires, therefore, a precise analysis of the "apparent constraints", as a normative concept would otherwise be chosen due to the wrongful assumption of infeasibility.[172] The existing constraints might change over time. This is true from an international tax law perspective. Reddy defines these constraints in the following persuasive manner:

> A constraint faced by an agent is a feature of the world that can reasonably be judged to have the property that the agent cannot change it without substantial cost or difficulty, if at all.[173]

2.1.6. Limits of the reference to political philosophy

Within the present study, the focus from a political philosophy perspective is on the time after 1975, or more precisely, the time after Beitz's work on political theory and international relations.[174] This time can be seen as the latest important wave of philosophical studies about cosmopolitanism and global justice, or of "ethics and international relations".[175] One may even think of shifting the starting point to Rawl's publication of *A Theory of Justice* in 1972, as his book actually triggered the debate about global justice, which was also within the work of Beitz and later contributors,

170. Benshalom, p. 22, with reference to Reddy. This is also brought forward in the writing of Dagan, 2017, p. 15 et seq., who emphasizes the focus on the feasibility of policy considerations. *See also* Rawls, 1999b, p. 83.
171. Rawls, id., p. 12.
172. Reddy, p. 119.
173. Id., p. 121.
174. Beitz, 1975, p. 1 et seq.
175. *See*, with further references, Cheneval, p. 24.

although *A Theory of Justice* focuses on principles of domestic or intra-society justice.[176]

The reason why reference is made in the present study to modern contemporary theories of political philosophy is their accessibility for "outsiders" and their rather concrete proposals, which can conveniently be aligned with the existing international tax regime, as will be described in Part II of the present work. Nevertheless, in some instances, reference will also be made to more classical philosophical studies, such as the work of Hobbes, Locke, Mill or Kant. In particular, the work of Mill on utilitarianism and Kant's work on perpetual peace are also essential within the current debate about the international tax regime, in general, and the allocation of income among jurisdictions, in particular.

It is by no means the aim of the present study to develop a new normative theory of global justice from a philosophical perspective built on a stringent line of argumentation, but it is the aim to demonstrate the various existing opinions and to use these theories in order to visualize whether the current international tax regime, and its latest amendments through the BEPS Project, are in line with one, some or none of the existing normative claims among political philosophers. One constraint of the present methodology, which tries to refer to several existing theories and philosophers, is that the present study is not able to always reflect the actual depth and extent of some of the theories.

Another limitation relates to the institutional aspect of international policy. This means that the focus is more on the output of the international tax regime and not on the input side. The latter, in particular, means the potential improvements of the decision-making bodies, such as international organizations or the international institutional structure in general.[177] The present study will, therefore, not particularly deal with the discourse ethics

176. *See* sec. 6.2. For a more precise discussion of the development of the theory of global or international distributive justice, *see* Beitz, 2005, p. 12 et seq.

177. Such a distinction relates to the debate about input and output legitimacy, as discussed and developed by Scharpf, p. 1 et seq.; *see also* Franck, 1997, p. 7 et seq. *See*, from a tax perspective, Mosquera, 2015, p. 351 et seq. On the question of (tax) justice within the legislative procedure at an international level, *see* Brauner, 2016, p. 6 et seq.; Essers, p. 54 et seq.; Magalhães, p. 499 et seq.; Peters, 2014, p. 1 et seq. *See generally* Thürer, 2009a, p. 21, who uses the term "democratic justice". *See also* Marti, p. 103 et seq., who argues that distributive justice also requires an analysis of how, for instance, power is distributed internationally. The question of legitimacy is more closely linked to legal sociology than to legal philosophy or philosophy in general. On legitimacy as one task of legal philosophy *see*, for instance, Rehbinder, p. 23 et seq.

of Habermas and others.[178] That being said, the question of deliberation and institution building at an international level in order to enhance morality and justice is a highly interesting and very relevant topic in international law, in general,[179] and international tax law, in particular.[180]

Lastly, and not reflecting an actual limitation, but more a methodological disclaimer, it should be considered that interdisciplinary communication requires that the core discipline of a study, i.e. legal science in the present work, is sufficiently followed. The goal is therefore not to influence political philosophy from a normative perspective, but to breach "the barriers of inquiry of two major disciplines",[181] which is a complex and challenging task.

2.2. Structure

2.2.1. Part I

As different disciplines render research projects on the same topics, it is the methodology that distinguishes between the disciplines and consequently, in a study which follows an interdisciplinary approach such as the present one, it is crucial that the applied methodology is transparent and well justified. This has been the purpose of the present Part I, which has aimed at developing a framework for this research project on justice in international tax law. As seen above, it is essential to determine what the existing legal regime is, how it should be interpreted, and what legal regime we ought to have, following justice considerations, in order to define the normative policy guidelines.

A legal analysis of a certain rule or principle will help us to better understand the current legal framework, but in order to develop a logical and more consequent understanding of how the international tax regime should be designed, we need reference to political philosophy, as there is no existing international legal framework, such as a comprehensive international constitution,[182] from which we as lawyers acting within our legal methodology could derive certain principles and rules.[183]

178. Habermas, 2009a, p. 1 et seq. *See generally* Tschentscher, p. 1 et seq.
179. *See generally* Kadelbach, 2004, p. 15 et seq.
180. *See* Mosquera, 2015, p. 344 et seq.
181. Ratner, 2015, p. 433.
182. *See*, however, the remarks on constitutionalism in sec. 4.4.
183. *See* Peters, 2007, p. 754 et seq.

In other words, juridical methods are facing constraints and limitations, as these are not able to demonstrate whether Rule A or B or Principle A or B will better align with justice considerations in an individual case, if such considerations do not occur within a certain domestic legal framework. However, even if there is a legal framework within which we as lawyers are used to operating, it is still necessary to deal with the question of whether Rule A or B or Principle A or B is more just or which rule or principle leads to just results. Lawyers tend to use justice as a reason to favor either of the principles or rules, but lawyers are reluctant to deal with the underlying theories of justice.[184] However, an analysis of the foundations and the demands of justice is a key topic within philosophy and consequently it is essential to deal with philosophy in detail if one wants to render an in-depth analysis on whether Rule A or B or Principle A or B is just or leads to just results.

This means that when a study, such as the present one, aims at analyzing whether a certain rule or principle within a legal regime, such as the international tax regime, is just or not and how to advance justice, we must use strategies outside traditional legal methods, which has already been highlighted above in the present Part I.

2.2.2. Part II

Part II aims to render a detailed legal analysis of the current international tax regime. This has several purposes.

First, instruments such as customary international law, general principles of law, and soft law as part of international tax law have not yet been given the necessary attention by tax law scholars. However, in order to discuss justice as a normative guideline for the international tax regime, it is absolutely essential to first demonstrate the international law framework in which international tax rules operate. This is crucial and useful as international tax lawyers have often been rather limited in their reference to international law. In the past, the focus was on the interpretation of tax treaties[185] or on other aspects of treaty law, such as the application of an abuse of law doctrine in international law,[186] timing and conflict issues in the case of several existing treaties containing tax rules, or the question of jurisdiction-to-tax.[187] Yet

184. From a methodological perspective *see* Singer, 2009, p. 903 et seq.
185. *See*, for example, Engelen, 2004, p. 127 et seq.
186. *See*, for example, De Broe, 2008, p. 1 et seq.
187. *See*, for example, Gadžo, p. 1 et seq.; Martha, p. 1 et seq.

international law studies are also rather reluctant to consider international tax law as a specific discipline of international law.[188] There seems to be a certain tension between international law studies and tax law. However, if policymakers wish to enhance justice, they must understand how justice as a normative goal influences the different sources of international law.

Second, it will be important to demonstrate the underlying reasons for the validity of the different sources of the international tax regime, and we will demonstrate whether and to what extent moral reasons are crucial for the validity of a certain rule within international law in general. In particular, with regard to customary international law and general principles of law, different positions exist that are derived from the underlying antagonism between naturalism and positivism. For a study on normative guidelines within a legal regime, it is indeed crucial to understand whether a legal system follows a strict positive understanding or whether values may also influence the validity of a rule within a specific regime.[189] Therefore, an in-depth understanding of the current international legal framework is essential in order to discuss realistic improvements of the international tax regime based on justice considerations. This is also the justification for why a study about justice in international law must use an in-depth understanding of the legal sources of international tax law and their authority. For instance, a debate about sovereignty and its potential importance for the demands of justice at an international level must consider not only the philosophical understanding of the term "sovereignty" but also the legal content and its validity reasons as otherwise there is a risk that the understandings of the two disciplines will be mixed, which could lead to contradictions and inaccurate results. A clear separation of a positive and normative analysis is also required by scholarly standards[190] as it is

188. *See*, e.g., Franck, 1997, p. 3 et seq. In his seminal work on fairness in international law, he deals with environmental law, development and trade law, and investment law but not tax law. Or *see* the treatise, *International Law* (Oxford University 2014), edited by Evans, which has several chapters on the application of international law (i.e., the law of the sea, international environmental law, international investment law, international criminal law, international human rights law, the law of armed conflict), but tax law is not referred to. *See also* the book on international law (Völkerrecht, C.H. Beck 2014) as edited by Ipsen, which has a specific chapter on international economic law, but international tax law is not mentioned. Although some topical analyses in the field of international law already refer to the specifics of international tax law (*see*, for example, Lepard, p. 285 et seq.; Meng, p. 441 et seq.). In particular, studies on jurisdiction in international law often deal with international tax law (*see*, for example, Mann, 1964, p. 1 et seq. and Mann, 1984, p. 1 et seq.).

189. For a first overview on the relation between moral considerations and international law, *see* Ratner, 2011, p. 155 et seq.

190. The term is used by Peters, 2013, p. 552. *See also* Altwicker & Diggelmann, p. 74 et seq.

important to separate positive and normative arguments. In particular, in international tax law, moral, legal, and political claims have been mixed. However, as we will develop further in Part II, separation is not possible in all cases, as certain rules or principles of international law might contain or might even be justified by normative claims. Part II will not only discuss the interaction between moral and legal claims but also outline the current content of the international tax regime. This includes an overview of the existing treaties, examples of customary international tax law and general principles of international law.

Third, it is crucial to have an in-depth understanding of the current international tax regime in order to render a normative study about how the international tax regime ought to be designed. Considering and understanding the existing international tax regime allows us to draw a link to the question of whether these design principles have been used or misused in order to steer the design of the current international tax regime. It will, therefore, be important to understand how these design principles have influenced the international tax regime in the past.

Fourth, as we will outline in Part III, political philosophy attaches specific moral importance to societal features, such as coercion, association, and cooperation. Therefore, it will be important to detect the level of coercion, association, and cooperation within the existing international tax regime as this seems to influence the reach and intensity of the term "justice". This sounds rather abstract as part of an introductory section, but it will become clear once we have outlined our position with respect to global justice theory.

Fifth, a detailed analysis of the international tax regime helps in understanding the difference between domestic and international tax policy. By doing so, it also shows the differences in applying the term "justice" at both the domestic and international levels. One important element of such a debate will be the analysis of whether an international fiscal constitution exists. If so, an enhancement of justice in the international tax regime should also consider constitutional values as this would be the approach taken unilaterally when improving the domestic tax system. Such constitutional analysis will also help to better frame the current international legislative framework. This means that we will also deal with the question of whether there has been a shift of legislation competences in tax matters to the international realm and what the reasons and justifications are for such a potential shift.

The aforementioned reasons have shown the importance of a detailed reference to the existing international tax regime as part of international law while rendering a normative review of such an international tax regime.

2.2.3. Part III

Part III discussed some of the recent and most relevant ideas and theories of global justice or distributive justice in an international circumstance. Among political philosophers, the terms "global justice" or "international distributive justice" have been used, inter alia, to describe the potential moral duties among individuals worldwide. As the present study aims to demonstrate whether international tax policy is indeed bound by certain duties, and whether these duties have an impact on a potentially just international tax regime, it is essential to better understand the underlying philosophical concepts or normative theories.

Part III will start with Rawls' *A Theory of Justice* and his later work *The Law of the Peoples*, in which he develops principles of a just international order.[191] We will refer in detail to his principles of justice applicable at an international level and, furthermore, we will demonstrate some of the weaknesses of the approach taken by Rawls. The latter task requires a detailed analysis of left institutional and pure egalitarian ideas, such as those proposed by Pogge, Beitz and Caney, but we will also refer to (other) right institutional approaches, as developed by Nagel, Risse and Blake. Referring to Rawls' ideas as a starting point seems justified, inter alia, because his *A Theory of Justice* was the decisive trigger for the current contemporary debate about global justice or international distributive justice. Furthermore, Rawls' writings are of particular interest, as he develops principles of justice in a domestic framework, as well as at an international level, which might help tax lawyers to better frame the different demands of tax justice in a domestic and international setting, if any.

Besides these what we will hereinafter call "transcendental theories of justice", which in general aim to demonstrate how an ideal international institutional structure should look, we will refer in detail to *The Idea of Justice* of Sen, whose theory might help to better answer the question of whether

191. *See* sec. 2.1.6. We mentioned that the starting point of the contemporary debate about global justice was Beitz with his 1975 publication, but as it was also argued, his work was highly influenced by Rawls' domestic theory of justice. This is why we will start with *A Theory of Justice* published by Rawls in 1972, even though the focus is on contemporary theories published since 1975.

a certain principle or rule is just and not how an ideal system should be designed. The idea of justice of Sen might be more attractive and of particular interest for the present study, as Part IV is dedicated to an analysis of whether some of the most fundamental principles and rules of the international tax regime should be considered just. The present study does not aim to develop the perfect or ideal international tax structure, but it should help to better understand – by referring to political philosophy – whether a certain policy principle or rule indeed has a normative value, in the sense that it increases justice at a global level.

Therefore, the goal of Part III is to develop guidelines that can help lawyers to decide whether a certain policy, and derived from that whether a certain rule or a certain principle, is just or whether justice requires to change or amend a certain policy, principle or rule. This does, however, also mean that we cannot ignore the transcendental theories of justice, as these theories might also provide us with some guidance, for instance, to better frame our argumentation as an analytical tool to decide whether a certain rule or principle is indeed just.[192]

2.2.4. Part IV

In Part IV, we will first analyze if and how the different ideas or theories of justice have been received within international tax law. We will demonstrate how and why tax scholars have referred to one or several of the existing theories of justice. Based on these remarks, some of the most fundamental principles of international tax law will be outlined and it will be reviewed whether these principles indeed have a normative value. Inter alia, the principles of inter-nation equity, the ability-to-pay principle, the source principle, the benefit principle and the principle of neutrality will be reviewed.

Furthermore, after a review of the most important principles that guide international tax policy, we will refer to some central rules within the international tax regime, as outlined in Part II, and analyze whether these rules indeed lead to a just tax system, or whether they do not have a normative value. A selection was made based on their recent importance within the discussion about improving the international tax regime.[193]

192. *See* sec. 7.7.2.2., which deals with the question of whether transcendental ideas of justice are still relevant, even though one follows the idea of justice according to Sen.
193. For further details about the selection of the rules, *see* sec. 11.1.2.

As will be justified in detail, the present study will mainly rely on *The Idea of Justice* according to Sen. The instruments of "normative reasoning" and the "impartial spectator viewpoint" will be used to demonstrate whether a certain principle or rule is indeed required to achieve a just international tax regime or not. Such analysis will also contain remarks on how these principles and rules ought to be understood in case they can indeed be seen as a guideline for achieving a just international tax regime. As mentioned, the methodology, in order to achieve appropriate results, is to use normative reasoning and the various ideas and theories of global justice and international distributive justice developed in Part III. Normative reasoning means, as stated by Michels, to ask the deep questions about "justice, fairness, and value that underlie our ordering of society", or for the purpose of the present study, that underlie the international tax structure.[194] Normative reasoning as a method to analyze what justice indeed requires often boils down to the question of "why?" Why should we apply a certain principle? Why should a certain principle be based on a reason and why is such a reason being considered to be normative? We will refer to questions such as: Why should the international tax regime be neutral? Why should we only treat persons resident in the same jurisdiction equally from a tax perspective and not also persons in different jurisdictions? Why should there be equality of states and what does it mean? Why is taxation where value creation occurs considered just? And is it just to have a distributive tax system domestically, but not internationally?

When discussing the most fundamental principles of international tax law, lawyers are often unable to justify why a certain principle should indeed be considered valid. At a certain point, after several "whys" we might run out of reasons.[195] The present study should, however, allow a more fundamental and in-depth discussion about justice in international tax law. The goal, in other words, is to possibly push the debate within international tax law one "because" further.

Therefore, the methodology of the present study is to review rather concrete principles and rules of the international tax regime. A study about justice in international tax law could, however, also remain at a high level of abstraction. Yet, the goal of the present study is to provide guidelines, particularly for policymakers, on how to design the international tax regime and how to improve justice in international tax law. Some of these guidelines might have a high level of abstraction, but others are rather concrete and precise.

194. *See generally* Michels, p. 4.
195. *See generally* Singer, 2009, p. 903 et seq., who was highly influential for the present methodology.

If one uses normative reasoning and if one aims to develop rather definite results, there is a considerable risk of not being impartial.[196] However, as we will demonstrate with reference to Sen, impartiality and determinacy are not mutually exclusive. Lastly, the present study is not sufficient to develop a detailed understanding of how a principle should be interpreted or how a certain rule should be drafted, but the present study should at least provide the foundation for further work in this respect.

196. Id., p. 908.

Part II

The International Tax Regime

The International Tax Regime – Scope of Research

A regime is only a regime if it is regulated by rules and principles.[197] Or to use the famous definition by Krasner: "International regimes are defined as principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area".[198] The term "regime" could also be replaced by the term "system",[199] although the term "system" (related to the term "systematic") would be misleading, as the international tax regime contains loopholes and contradictions and might, therefore, not be very systematic.[200] Yet, even though the international tax regime has loopholes and contradictions, it is still a regime that is part of the international law regime or the international legal order. However, by using the term "regime", we do not intend to give a negative connotation, as the term "regime" in politics is often used to describe unjust groups, such as totalitarian regimes.

In the following, we will outline the legal content of the international tax regime. This means that we will mainly refer to rules stemming from the sources of international law mentioned in article 38 of the ICJ Statute. Reference to article 38 of the ICJ Statute has the advantage of a categorization of the existing sources of international law, but it also has the disadvantage of not being comprehensive enough. As we will develop below, we will therefore use a broader understanding of the sources of international law that regulate the international tax regime.[201] The international tax regime, in this respect, consists of binding and non-binding rules, which are the outcome of international deliberations, and not simply the outcome of domestic legislative procedures. Therefore, the distinction between national and international law for the purpose of the present study relates to the law-making process, which is either a mere domestic or an inter-state process.[202] For the present study, transnational law such as domestic tax provisions covering cross-border fact patterns are not part of the international tax regime.[203] Therefore, for instance, the (worldwide) well-known *Aussensteuergesetz* in

197. *See* Tipke, 1981, p. 44, even though he uses the term "order" instead of "regime".
198. Krasner, 1982, p. 185.
199. From an international law perspective, *see* Crawford, p. 15 et seq.
200. With respect to the term "systematic" from a tax perspective, *see* Tipke, 1981, p. 47 et seq. From an international law perspective, there have also been certain ambiguities with respect to the use of the term "international law system" (*see*, for example, Kohen, p. 139 et seq.).
201. *See* sec. 3.2.
202. Besson, 2010, p. 167.
203. However, there will be a specific chapter on CFC rules (*see* sec. 12.3.) which are technically speaking not part of the international tax regime.

Germany is not part of the international tax regime and is not part of the analysis.[204] A broader understanding of the international tax regime, however, would also require the inclusion of domestic tax rules with a reference to cross-border or foreign fact patterns.[205]

The international tax regime consists of rules that regulate the taxation of cross-border income, such as corporate income or individual income. We will not specifically deal with other rules of the international tax regime dealing with other taxes, such as VAT, inheritance or gift taxes, or any other taxes or levies. The reason is that the international income tax regime is the most diverse with respect to the rules regulating it, and secondly, the international income tax regime seems to require more intense cooperation than the other parts of the international tax regime. However, many results of the present study might also be useful when reviewing the international VAT regime or other international tax regimes, such as the international inheritance tax regime.

The international tax regime, as it is understood in the present study, consists of rules not only of international, but also of supranational law. However, the focus in the following is on international law. In particular, supranational tax provisions stemming from EU law are not part of the following analysis. If one distinguishes between supranational and international law based on whether a rule has developed out of unanimity or as a majority rule, there is also an increasing overlap of these two categories within the international tax regime, as more rules are based on multilateral or (de facto) majority-based law making.[206] On several occasions, we will discuss the current status of the international tax law-making process as both multilateral and de facto majority-based and we will, therefore, also refer to supranational law created through de facto majority-based law-making processes.

The following analysis is, as far as it can be observed, the first comprehensive outline of the international law framework of the international tax regime.

204. DE: Aussensteuergesetz, 8 Sept. 1972.
205. Schaumburg, para. 1.4. On the distinction between a narrow and a broad understanding with further references, *see* Matteotti & Horn, para. 2. On the term "international tax law" *see generally* Vogel, 1997, p. 269.
206. *See* Besson, 2010, p. 167.

Chapter 3

The Theories and Development of International Law

3.1. Overview

Part II of the present study looks at the legal content of the international tax regime. This means that this part of the study will analyze the actual sources of international tax law and rules derived from these sources in more detail. The international tax regime is not limited to double tax treaty law, i.e. the allocation of taxing rights between two states by using a contractual and consensual instrument, but it also consists, inter alia, of human rights provisions, tax rules in non-tax agreements, customary international (tax) law provisions, general principles of law and rules of soft law, as published by international organizations. The aim of these rules and principles is to regulate the international tax regime. The need for rules of international tax law has obviously increased in recent years due to globalization, as international trade has consistently and significantly increased since World War II. If there were no cross-border business, there would basically be no need for international tax law.

The core part of the following analysis relates to the discipline of international law. International law is understood as the law covering the relationship between states, but also other bodies of international law (i.e. *ius inter potestates* and not *ius gentium*).[207] Nowadays, international law, however, is regulating not only the inter-state relation but also, for instance, the functioning of international organizations, areas beyond territorial sovereignty (e.g. space law), or the duties and rights of individuals.[208]

In the following introductory section, it is necessary to refer to the concepts of the actual validity or the legal origin of the different sources of international law. Legal theorists have long and intensively discussed the various concepts of law and also applied them at the international level. In this respect, it was even argued that international law is either no law or primitive law, as it has no central enforcement body, lacks reliability, and has no rule of recognition. In particular, the argument that international law is no law, as there is no enforcement mechanism, has been overcome historically,

207. *See*, with further details about historical development of the term "international law" (*Völkerrecht*), Verdross & Simma, § 1 et seq.
208. Kälin et al., p. 6.

as the need for a regulatory framework at the international level exists even without a centralized power.[209] We will render a concluding section on the question of whether the international tax regime is indeed primitive.[210]

Moreover, and this goes beyond the present study, the question of whether "something" is indeed law depends, of course, on the definition of what law is; various positions have been brought forward, some with a particular focus on international law.[211] For the purpose of the present study, we indeed agree with the statement of Franck that international law has reached a point at which its existence as law can no longer be questioned.[212] However, this does not help in answering the question of why certain rules of international law are valid. The validity of international law is traditionally derived from two main justifications, i.e. naturalism and positivism. These two concepts, which might overlap, will be described below.[213] Before doing so, we will discuss what the term "sources" means for the purpose of the following analysis.

3.2. The term "sources"

3.2.1. General remarks

Many legal theorists and scholars of international law have analyzed in detail the term "sources of law" or the term "sources of international law".[214] Savigny famously held that legal sources ("*Rechtsquellen*") are the causes for the validity ("*Entstehungsgrund*") of a rule.[215] This means that if a rule is based on a source of law, it is a valid norm.

The term "legal source" (without specifically referring to international law) is often split into a formal source and a material source of law, at least in civil law countries. The formal sources of law are understood as positive sources, i.e. sources of law that were created by a formal law-creation process. The material sources are fundamental values that are not necessarily

209. With further reference, *see* Ipsen, in: Ipsen, § 1 para. 18 et seq.
210. *See* sec. 5.
211. *See*, for example, Hart, p. 213 et seq.
212. Franck, 1997, p. 6.
213. *See* sec. 3.3.
214. From an international law perspective *see* Boas, p. 45; Kolb, 2006, p. 1 et seq.; Degan, p. 1 et seq. On the notion of "source of international law" *see* Besson, 2010, p. 169 et seq.
215. Von Savigny, p. 11: "*Wir nennen Rechtsquellen die Entstehungsgründe des allgemeinen Rechts*."

created through a formal law-creating process. Often mentioned as material sources of law are equity or fairness;[216] however, there is no consistent worldwide understanding in this respect.[217] The distinction between material and formal sources of law is also made for the purposes of international law,[218] but certain ambiguities exist regarding the precise distinction between material and formal sources of international law. For instance, some authors[219] argue that the distinction between material sources and formal sources might be misleading within international law, as there is no (constitutionally fixed) law-creating process within international law that is comparable to a domestic framework. It is true that international law does not provide for a fixed law-creating process regulated by a constitution in the sense of a parliamentary legislative process.[220] However, article 38 of the ICJ Statute might provide us with some further insight on the existing sources of international law.

3.2.2. Article 38(1) ICJ Statute

Studies about sources of international law generally refer to the formal sources mentioned in article 38(1) of the ICJ Statute. Accordingly, the following sources of international law are recognized:[221]

– treaties and conventions;
– international custom; and
– general principles of law.

Article 38(1) of the ICJ Statute is indeed "[h]istorically the most important attempt to specify the source of international law"[222] and the mentioned sources are also called traditional sources of international law.[223] Even though some theoretical concerns exist, the ICJ nevertheless applies these sources "without evident difficulty".[224] The categorization according to the sources mentioned in article 38(1) of the ICJ Statute is not a clear-cut decision; in particular, with regard to the distinction between customary international law and general principles of international law, certain ambiguities

216. Heintschel von Heinegg, in: Ipsen, § 3, Introduction, para. 1.
217. Thirlway, 2014, p. 3 et seq. *See also* D'Amato, p. 264 et seq.
218. *See*, for example, Besson, 2010, p. 170.
219. *See*, for example, Crawford, p. 20.
220. Besson, 2010, p. 164 et seq.
221. Boas, p. 45 et seq.
222. Crawford, p. 21.
223. Thürer, 2009b, p. 111.
224. Thirlway, 2005, p. 77.

exist.[225] Furthermore, some norms might fulfill the requirements of more than one source of international law. This should always be considered and it will be highlighted in several instances in the following sections.

In order to render a deeper analysis of the international tax regime along these traditional sources, it is necessary to deal with the question of why these sources are mentioned in article 38 of the ICJ Statute as a procedural act, and whether the list contained in article 38 of the ICJ Statute is exhaustive. In other words, the question is whether the aforementioned list provides for the sources of international law because these instruments are contained in article 38 of the ICJ Statute or because tacit consent exists that these rules shall be obeyed in an international framework. It is important to note that article 38 of the ICJ Statute is not formally constitutive, in the sense that the mentioned sources would not be valid if not mentioned therein.[226] Otherwise, all sources of international law would be valid simply because these have been stated in a treaty, i.e. the ICJ Statute.

3.2.3. Article 38(2) ICJ Statute and beyond

Moreover, the present study also analyzes further sources of international tax law understood in a substantive manner.[227] A separate chapter will be dedicated to soft law as a key legislative instrument in contemporary international tax law.[228] Soft law is, inter alia, used by the OECD, the UN, the G20 and the EU in order to harmonize or at least coordinate various domestic tax systems. Prima facie, soft law indeed seems to be a source of international tax law, as rules qualifying as soft law evidently have an impact on the behavior of states, and the latter is indeed an important criterion for the definition of international law.[229] As will be shown below, soft law, such as a resolution of an international organization, may directly affect the domestic legislation process in some states, in the sense that certain laws are domestically approved or changed solely due to the development of soft law at the level of an international organization.

225. *See*, for example, regarding the good faith principle in international law, Müller, p. 263 et seq.
226. *See* Boas, p. 45. For further details on this topic *see* Verdross, 1973, p. 98.
227. *See*, with further references, Peters, 2014, p. 70.
228. *See* sec. 4.3.3.
229. *But see* Thürer, 2009c, p. 171: "It seems to be more appropriate to consider soft law acts as indications of the meaning behind, or the stages in, the development of international law, rather than as international law itself."

Furthermore, the existing international peremptory rules, which are valid even without being derived from a formal source of law, as mentioned in article 38 of the ICJ Statute, are understood as a source of international law for the purpose of the present work. Moreover, article 38(2) of the ICJ Statute states in paragraph 1 "shall not prejudice the power of the Court to decide a case ex aequo et bono, if the parties agree thereto". Notably, the courts shall also refer to judicial decision and legal teaching. We will, however, not discuss these elements – sometimes referred to as ancillary or auxiliary sources of international law – in detail.

Such a broad understanding of the term "sources of international law" is also justified by the fact that not only in tax law, but in many other areas of international law,[230] the traditional sources have been proven to be inefficient as a regulatory means in order to deal with the global economy as a highly integrated area. A legal theorist might conclude that such an understanding of the term "source" is rather artificial or even arbitrary, but nevertheless, for the purposes of the present study it is necessary to follow such a broad understanding of the term "source". In order to question some of the main rules and principles of the international tax regime, the international tax regime must be understood in a comprehensive manner, and so should the term "source".

The discussion on the sources of international law reveals that there is no underlying constitutional framework at an international level that would frame the legal content of international law.[231] It is, furthermore, highly disputed whether and what the source of source is in international law and whether there is indeed something like a basic rule or "*Grundnorm*" in international law, as suggested by Kelsen.[232] The existence of a "*Grundnorm*" within international law would clearly help to indicate or derive what the sources are of international law and how these are defined. However, it seems that no such unambiguous concept is available in international law.

3.3. Naturalism and positivism

An important origin of the concept of naturalism for the purpose of international law relates to the work of the Spanish school of Luis Molina

230. *See generally* Thürer, 2009b, p. 110 et seq.
231. We will refer to constitutionalism and international tax law in sec. 4.4.
232. *See generally* Hart, p. 233 et seq., who develops an in-depth criticism of the need for and the existence of a "*Grundnorm*" within international law. Cf. Kelsen, 1967, p. 446. *See*, in more general terms on the need for a "*Grundnorm*" Kelsen, 1953, p. 442.

and Francisco Suarez, but also later to the work of Grotius and Pufendorf. Naturalism, as a general (domestic) legal theory, has a much longer history than it has in international law.[233]

In simplified terms, naturalism defines the idea of having certain rules as a given by nature, i.e. not created by the interaction of human beings. In fact, the beginning of naturalism in international law was driven by religious understandings of certain rules as having been given by God. Other (later) schools of naturalism did not refer to a divine God-given natural law, but rather to reason as the underlying natural justification for a certain rule.[234] Naturalism in international law means that certain rules are determined by nature, meaning that no positive law making is required in order to regulate, for instance, the interaction among states. Naturalism, therefore, assumes that certain international rules are set even without direct cooperation or consent by states.

Following an exclusive understanding of naturalism would mean that there is no law among states other than natural law. The latter position was explicitly taken by Pufendorf, who argued that a legal order indeed governs the relation between states; however, the latter is derived not from treaties or custom, but from natural reasons.[235] Others theorists such as Grotius also followed the idea of naturalism, but also simultaneously proposed that states might voluntarily agree on certain rules of (positive) law.[236] Overlapping positions do exist.

Grotius was, as indicated, not a representative of absolute positivism. Nevertheless, Grotius made an important distinction between *ius natural* and *ius gentium*; by doing so, he accepted that the will of states creates law within the international legal order. However, Grotius was also of the opinion that certain rules are given by nature and consequently did not follow positivism as an absolute paradigm. Secondly, de Vattel, who was highly influenced by von Wolff, further developed the idea of the will of states as the underlying law-creating factor.[237] De Vattel is still recognized within international law as the originator of the idea of international society, or as he called it, "*la société des nations*". This will be discussed further

233. Boas, p. 12.
234. Ipsen, in: Ipsen, § 1 para. 18, mentions Grotius, Hobbes, Pufendorf, Wolff and Kant. *See*, with further reference on the school of "Enlightenment Naturalism", Hall, p. 273 et seq.
235. Such interpretation is provided by Grewe, p. 354. *See also* Hall, id., p. 274 et seq.
236. Damrosch & Murphy, p. xxii. *See*, with further reference, Koh, p. 2606.
237. For more details *see* Neff, p. 194 et seq.

in the section on sovereignty.[238] Besides de Vattel, Hall mentions Bentham and Austin as the most prominent founders of positivism.[239] Notably, Hegel argued that absolute power on earth lies with the people of a certain state; therefore, a state is not bound by any kind of natural law but has to accept the sovereignty of other states.[240] Based thereon, Jellinek stated in a similar manner that the will of states is not subject to limitations of international law.[241] It was a gradual development of positivism in international law[242] and later authors followed that positivism in a strict sense and rejected the validity of natural law entirely.[243] In particular, scholars in the 19th and 20th centuries further strengthened a positive understanding of international law.[244]

For instance, Kelsen further outlined the idea of positivism in his book on the pure theory of law. However, as demonstrated by others,[245] Kelsen, being a positivist,[246] also refers to a "*Grundnorm*" as a hypothetical foundation of all positive rules, i.e. a rule beyond a positive rule. This does not mean that Kelsen refers to natural law, but it does show that the fundaments of law are logically not based on a positive provision, as this would lead to a circular argument.[247] Obviously, the question of the source of source is delicate and linked to inevitable logical problems in a positive judgment. For instance, Onuf raised the question of the source of custom and concluded that there is currently no answer available.[248]

Positivism within international law means that a certain source of international law is applicable (and existent) because two or more states or other bodies of international law have (explicitly) agreed on a certain rule.[249] In a more general manner, following a positive approach, a rule is valid if it is created through a legislative process. In other words, for the purpose of international law, there must be a will of legal subjects to enact a certain

238. *See* sec. 4.1.
239. Hall, p. 279.
240. *See* Hegel, § 331; Fischer-Lescano, p. 726.
241. Jellinek, p. 377.
242. Damrosch & Murphy, p. xxii.
243. Koh, p. 2608, mentions Hobbes, Zouche and Rachel as representatives of the early positive school.
244. *See*, with further reference, Scheuner, p. 569 et seq.
245. E.g. id., p. 590 et seq.
246. Some use the terms "analytical positivism", "critical positivism" and "neo positivism" in order to describe the Vienna School of Kelsen et al. (*see*, with further references, Neff, p. 367 et seq.).
247. For more details *see* Neff, id.
248. Onuf, p. 77 et seq. Regarding positivism and the referral to the Grundnorm *see also* Ipsen, in: Ipsen, § 1 para. 26 et seq.
249. Ipsen, id., § 1 para. 20. For further details *see* Thirlway, 2014, p. 10 et seq.

legal act. Agreeing on a certain rule of international law could mean that a state needs to consent to a specific rule in order to be bound by that law.[250] Therefore, in order to implement a binding international law provision, states must consent to such rules.[251] However, consent as the basis for international law also has a weakness, as there might not be genuine consent due to economic pressures.[252]

Positivism in its raw form denies the validity of peremptory rules, such as *ius cogens*. Therefore, positivism denies the possibility that international law can be created without the power of sovereign forces.[253] In other words, positivism *stricto senso* denies any metaphysical justification of law.[254] Following an extreme position, this would mean that states could agree on a valid treaty, even though such a treaty would infringe on the dignity of mankind. One could also derive from positivism that morality and law are clearly separated. Therefore, it might be the case that a rule was created through a proper process and is consequently applicable, yet still immoral. Does the international law regime therefore follow naturalism or positivism?

Naturalism as the theoretical rationale of international law has lost its foundation in the last two centuries and is no longer accepted by scholars and courts as the main underlying theory or concept of international law. However, after the brutal experience of World War II (and the years before World War II), it was argued that states do not have full consensual discretion to implement whatever legal rule they wish.[255] States must be bound by certain underlying principles. Such an understanding leads to the consequence that state sovereignty is not absolute or unlimited. For instance, the principle of sovereignty and the development of certain rules of *ius cogens* have been signs that states cannot legally deviate from certain rules. It is sometimes argued that this is a sign of a shift from positivism back to at least a partial naturalism.[256] The latter is particularly true with regard to

250. However, for further details on consent and legal positivism in international law *see* Besson, 2016, p. 289 et seq.
251. Friedrich, p. 381.
252. *See* sec. 4.2.1.5.2. *See* Tasioulas, 2007, p. 313, who outlines the shortcomings of positivism as a concept to enhance the legitimacy of international law.
253. Crawford, p. 8.
254. Scheuner, p. 569. From a tax perspective *see* Tipke, 1981, p. 29.
255. Scheuner, p. 556 et seq. *See also* the reference to Justice Jackson's Opening at the Nuremberg trials mentioned by Boas, p. 13. *See also* the references in Marro, p. 331. A second wave of what is called a "turn to ethics" was triggered by the Kosovo intervention in 1999 (*see*, with further details, Peters, 2013, p. 548).
256. Friedmann, p. 75 et seq. *See also* Scheuner, p. 556 et seq.; for further details *see also* Neff, p. 158 et seq.

the development of *ius cogens* according to article 53 of the VCLT, as it is generally accepted that states cannot (even by consent) deviate from these rules by signing a treaty. World War I and World War II have indeed shown that positivism can endanger the world order, as it justifies that a state treats its citizens with full discretion and liberty, but international law would not provide for any guidance on whether the use of force is right or wrong.[257]

As a tax lawyer, I would never dare to take a fundamental position on legal philosophy and whether positivism or naturalism is the Holy Grail to our understanding of international law. Furthermore, the variety of issues at stake is far more complex than a binary distinction between naturalism and positivism. However, for the purposes of the following analysis, we fully agree with Simma:

> I consider that none of them can give an all-embracing, definite explanation of, or justification for, the phenomenon of law, but I am also convinced that they do not exclude each other, that, on the contrary, each of them can unveil and illuminate aspects of international law which remain inaccessible or off-limits to the other(s). Within this spectrum of functions, natural law arguments fulfil the task of setting limits to the validity of legal norms, of depriving them of their claim to authority, whenever they evidently and grossly contradict the postulates of justice [footnote omitted].[258]

It seems that the dispute between positivism and naturalism as two different legal philosophical accounts is less "diametrical than it is alleged to be".[259] Moreover, neither positivism nor naturalism is a single justification for the validity of the current system of sources of international law. On the one hand, for instance, the usability of treaty law is clearly a sign of voluntarism or positivism within international law, while on the other hand, the general principles of law[260] according to article 38(1)(c) of the ICJ Statute or *ius cogens* seem to be a sign of natural law in international law.[261] It seems, further, that naturalism has recently gained some relevance as radical positivism has been replaced.[262] Natural law, however, is not formulated in the sense of a God-given law system, but in the sense that the current world order as a system of equal and sovereign states requires that certain rules are

257. *See*, with further details, Scheuner, p. 581 et seq.
258. Simma, 1995, p. 34. *See also* Ratner, 2011, p. 155, with reference to Simma, holds that positivism remains the dominant methodology in international law.
259. Besson, 2010, p. 166.
260. This is, however, disputed. *See* sec. 4.3.3.2.
261. *See* sec. 4.3.3.2. However, the wording of both article 38(1)(c) of the ICJ Statute ("recognized") and article 58 of the VCLT ("accepted and recognized") indicates that a consensus of the states is required.
262. *See*, for example, ICJ, Advisory Opinion, 8 July 1996.

obeyed, even though these rules are not codified.[263] As we will show, inter alia, with respect to the term "fiscal sovereignty", naturalism as a foundation for legal rules is also relevant from a tax perspective.[264] However, both naturalism and positivism require that policymakers and academics refer to normative reasoning either to demonstrate the validity of a rule within naturalism or to use normative understanding in order to shape positive rules.[265] The latter, in particular, is the task within the present study, i.e. to use normative reasoning in order to define how principles and rules within the international tax regime should be designed. Therefore, normative reasoning might have other purposes in naturalism and positivism.

To conclude, international law has developed over recent centuries and has passed through several schools of legal philosophy. These have significantly influenced the current understanding of the sources of international law, but they have also led to a system of sources with some unsolved theoretical ambiguities. From an international tax law perspective, as a relatively young subdiscipline of international law, these issues have not yet been given the necessary attention.

3.4. The historical development of the current world order

The main features of the current international order have developed over time and there was no "big bang"[266] as the starting point of the international order. It is of the utmost importance to understand the historical path of development in order to comprehend the current international law regime. The world order as it is presently designed will not be everlasting. There will always be boundary conflicts,[267] merging states,[268] states disappearing[269] or states that are newly established.[270] Some historians of international law, when analyzing the development of the current world order following a Eurocentric approach, split the history of international law into the following ages: the Middle Age (1300-1500), the Spanish Age (1500-1648),

263. Thirlway, 2014, p. 103 et seq., with reference to Domenicé.
264. *See* sec. 4.1.1.2.
265. *See* Michels, p. 5 (n. 8), with reference to Bentham and West.
266. Tomuschat, 1993, p. 221.
267. *See* the recent conflict between Russia and Ukraine since 2013.
268. *See*, for instance, the reunification between the German Democratic Republic (DDR) and the Federal Republic of Germany in 1989.
269. *See*, for instance, the transformation of the Soviet Union into several independent states after the fall of the Iron Curtain in the early 1990s.
270. *See* the independence of the Republic of South Sudan in 2011.

the French Age (1648-1815), the English/British Age (1815-1919), the Age between World War I and World War II (1919-1945) and the Age of the UN (1945-).[271]

For the present study, the focus should be on the development of states as sovereign bodies of international law.[272] Through the Spanish Age until 1648, the European continent was marked by a fight over the secular authority of the Emperor and the Pope, and the world was far from territorial stability. Therefore, the principle of sovereignty over a certain territory was a rather weak concept that changed after the Peace of Westphalia in 1648, as accordingly, each state shall have the single power to govern its territory.[273] Yet, others argue that the Peace Treaties of Münster and Osnabrück, as the main content of the Peace of Westphalia, did not yet provide for the principles of the modern law of nations, but at least they helped in creating the necessary conditions for development of the new world order.[274] Despite the dispute about the actual importance of the Peace of Westphalia for the development of the current world order, composed of approximately 200 sovereign states, there seems to be a variety of arguments showing that the Peace of Westphalia must at least partly be seen as the starting point of the modern international law order.[275] The Peace of Westphalia is even considered one of the main origins of the current world order. However, this is sometimes also referred to as an aetiological myth.[276]

It would not, however, be accurate to claim that the Peace of Westphalia of 1648 was the only triggering event that led to a system of equal states, as is the case in the current international community.[277] Rather, the entire French

271. Grewe, p. 1 et seq. *See*, with a different outline, Neff, p. 1 et seq. On the periodization of the history of international law *see generally* Diggelmann, p. 997 et seq., who reviews Grewe's periodization on p. 1004.
272. For further details on the term "state's sovereignty and fiscal sovereignty" *see* sec. 4.1.
273. Lewicki, p. 43 et seq.; Tomuschat, 1993, p. 220 et seq.; Verdross & Simma, § 76. Regarding the development of peremptory norms after the Peace of Westphalia *see* Hannikainen, p. 25 et seq. For an overview of the content of the Peace of Westphalia *see* Schrijver, p. 66 et seq.
274. Lesaffer, p. 129 et seq. On this topic, *see also* Koh, p. 2607 et seq.
275. *See* Boas, p. 8.
276. Beaulac, 2004, p. 181 et seq.
277. The term "international community" has already been used and analyzed by many scholars, also with respect to its relation to the term "constitutionalism" (*see* Tomuschat, 1993, p. 222, or for a more recent overview *see* Villalpando, p. 381 et seq.). Some even use the term "international community school" (Fassbender, 2009, p. 54) to describe the approach of Tomuschat and others who outline that there are certain constitutional rules at an international level that regulate the "international community". We will deal with community interests and constitutionalism in particular in sec. 4.4.3.2.3.

Age between 1648 and 1815 was of great importance in this respect, particularly the use of peace treaties among states in Europe in the post-Westphalian world, is a sign that somehow a balance of power among states – at least – in Europe had emerged.[278] The decades after the Peace of Westphalia further enhanced the development of law among states. One sign of such development is that states have begun to sign international treaties among themselves not in the name of an emperor, but on behalf of a state.

The Peace of Westphalia did not directly lead to an international world order providing for non-state bodies of international law. Such development started later in the 18th and 19th centuries,[279] and the first important step – and also relevant from a tax perspective[280] – was the foundation of the League of Nations in Geneva in 1919. The main aim of the Contract of Versailles as the underlying incorporation document was to safeguard international peace and enhance international cooperation.[281] Therefore equal sovereignty of states has long been a tradition within international law and is now presently provided for in article 2(1) of the UN Charter. Obviously, this does not mean that since then, the sovereignty over a jurisdiction has been with the people, as this was a development of the Enlightenment period in the 17th and 19th centuries.[282] The latter, however, means that states are not only sovereign regarding their territory, but also that states are equally sovereign, and that no state should have a leading position in the world. Defining the scope and practical consequences of state or fiscal sovereignty and the legal equality of states will be dealt with below.[283] A further important step in the development of a world order or international community was the implementation of the UN Charter.[284] This includes the agreement that the UN Charter prevails in the event of a conflict "between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement".[285] The UN Charter also includes a general prohibition of the use of force against the territorial integrity of other states.[286] These are two important pillars of modern

278. Grewe, p. 332 et seq., with a detailed analysis of the historical development. *See also* Lesaffer, p. 129 et seq. For a more global approach toward the history of international law *see* the regional contributions in Fassbender Bardo & Peters Anne (eds.), The Oxford Handbook of the History of International Law (Oxford 2012).
279. Verdross & Simma, § 77 et seq.
280. *See* sec. 4.2.3.2.2.
281. Verdross & Simma, § 85.
282. From an international law perspective *see* Ipsen, in: Ipsen, § 2 para. 17. et seq.
283. *See* sec. 4.1.
284. De Wet, 2006, p. 54 et seq.; Tomuschat, 1993, p. 221.
285. Art. 103 UN Charter.
286. *See* art. 2(4) UN Charter.

international law. Moreover, during the time since World Word II several international conventions to protect human rights have been implemented. We will further deal with more recent developments in section 4.4.3. while discussing the potential constitutional framework at an international level.

As a conclusive remark, it seems important to note that enhanced globalization in recent decades has not led to a dilution of the international regime with several equal states. However, as we will demonstrate a number of times in the following, globalization, at least from a tax perspective, has led to a transfer of certain competences from the state level to international law bodies, and certain global community interests have emerged. We will also demonstrate that the international tax law does not contain strong central institutions, but at an international level, coercive measures are not unknown.

Chapter 4

The International Tax Regime

4.1. Sovereignty and jurisdiction – Key elements of the international tax regime

4.1.1. State sovereignty

4.1.1.1. Overview

Sovereignty is an important element of statehood and, therefore, discussions about (fiscal) sovereignty often refer to the question of what a state is and what its main elements are in order to outline the content of the term "sovereignty".[287] In the following, however, we will not particularly focus on the constitutive elements of a state, such as the three-elements approach, as developed by Jellinek, but we will more closely focus on the origin and the legal source of the term "sovereignty".[288]

As mentioned above,[289] and as will be demonstrated in detail, according to article 38 of the ICJ Statute, the following sources of international law must be distinguished: treaty law, customary law and general principles of law. However, the principle of (fiscal) sovereignty, which is a core principle or rule[290] of the international tax regime, does not fit into only one of the sources and, prima facie, it could even fall under all three. However, it is the author's understanding, and we will further outline and justify our position in the following, that some norms of the international (tax) law regime are legally valid not because they derive from one of the mentioned sources, but because they are logical preconditions of the current world order derived

287. From a fiscal perspective *see* Cavelti, 2016, para. 251 et seq.; Simonek, 2010, p. 552.
288. We do not see any disadvantage of not specifically focusing on what a state is in order to further discuss the principle of fiscal sovereignty. Cavelti, 2016, para. 251, raises the concern that a discussion about the relationship between the state and sovereignty might end in a chicken-or-egg puzzle. The latter would mean that there is a causality dilemma regarding the question of what was first – state or sovereignty. However, state and sovereignty are logically not causally related. Both have developed in parallel, as compared to the chicken and the egg dilemma. From our perspective, reference to statehood is therefore not crucial for a discussion of sovereignty.
289. *See* sec. 3.2.
290. For more details about the distinction between rules and principles, *see* sec. 11.1.1.

from the historical development of the modern international legal system, or derived from the fact that a legal regime has developed at an international level and some rules and principles are inherent in all legal regimes. One of the most important of these peremptory rules or principles from a tax perspective is indeed the principle of fiscal sovereignty, which derives its validity from the principle of state sovereignty as a legal precondition of the international law regime.[291]

4.1.1.2. The term "sovereignty" – Origin as a legal concept

In order to define whether there are any rules or principles of general international law[292] derived from peremptory norms, such as the principle of sovereignty, it is first of all essential to discuss the development of the term "sovereignty" within political philosophy and political science.

The term "sovereignty" has descended from a history of monarchical and popular sovereignty,[293] but an important theoretical origin source lies within the work of Bodin in the late 15th century. Bodin argued that sovereignty meant that the final decision authority shall be with the king. Sovereignty in his understanding relates to the absolute power to govern even above positive rules.[294] Sovereignty as a concept of political philosophy gained further momentum through the work of Locke and Hobbes. Hobbes, in his *Leviathan*,[295] famously argued that state sovereignty is based on a contract among citizens in order to overcome the natural state of war. In a Hobbesian understanding, this means that individuals transfer their sovereignty to a governmental body with absolute power. The latter also leads to the conclusion that there is no positive law among states. In other words, it is argued that by following the position of Hobbes in a consequent manner,

291. Instead of legal precondition, one could also argue that sovereignty is an "a priori consequence of … statehood" (Mills, 2014, p. 192). *See*, however, on the interaction between statehood and sovereignty, *supra* n. 288.
292. In the following we will use the term "general international law" to describe the non-treaty-based residual international law regime. For an in-depth analysis of the terms "general" and "particular international law", *see* Gourgourinis, p. 993 et seq.
293. *See*, with further details about the origins of the term "sovereignty", Wildhaber, p. 425 et seq. Wildhaber (p. 427) states that Bodin's definition of sovereignty "still dominates the discussions in present-day public international law". On the historical development, *see also* Mann, 1964, p. 24 et seq.
294. Bodin, in particular, livres I, chapter 10.
295. Hobbes, in particular, part IV. On the differences between the three authors *see* Wildhaber, p. 428 et seq. Of course, there are many further authors that should be added. In particular, Rousseau's work on sovereignty has been of great importance for the development of a modern understanding of sovereignty.

no positive international law exists and the relation between states reflects mere co-existence based on a naturalist understanding of international law.[296]

Sovereignty, as developed by Bodin, Hobbes, Locke and Rousseau,[297] is referred to as domestic sovereignty, which attempts to define which authority has the legitimacy to govern a state.[298] History has shown that states can be organized in many different manners and sovereignty in a domestic understanding might lie with various authorities. In particular, the French Revolution brought a drastic change from absolutism to democracy as two rather different domestic sovereignty concepts.

In the following sections, the focus is on the international legal understanding of the term "sovereignty" and a persuasive starting point for such a purpose is the writing of de Vattel.[299] Compared to Bodin and Hobbes, de Vattel developed the idea that states are part of an international regime that relies on the principle of sovereignty and equality of states. Or, as mentioned by Krasner,[300] he transposed sovereignty from an internal understanding to an international level.[301] De Vattel argued that by applying natural law, there is perfect legal equality between independent states:

> *Nous avons déja observé (Prélim. § 18.) que la Nature a établi une parfaite égalité de Droits entre les Nations indépendentes*.[302]

To define the actual source of state sovereignty and fiscal sovereignty is a rather difficult and abstract request. First, as the excursus on the development of the current state or world order has shown,[303] it seems accepted among states that sovereignty is essential in order to uphold the current international legal regime. Sovereignty as a fundamental principle seems to be accepted among all states.[304] On the one hand, one could therefore argue that state sovereignty is part of customary international law, as there seems

296. *See*, with further details and references, Grewe, p. 350.
297. *See generally* Noone, p. 696 et seq.
298. *See generally* Krasner, 1999, p. 11.
299. With further reference to the various understandings of the term "sovereignty", both in law and political science, *see also* Cavelti, 2016, para. 235 et seq.
300. Krasner, 1999, p. 14.
301. *See generally* Beaulac, 2003, p. 247. *See*, with reference to other authors who were important for such transposition of the term "sovereignty" to the international realm, Mann, 1964, p. 25 et seq.
302. De Vattel, livre II, § 36.
303. *See* sec. 3.4.
304. Obviously, some states might question the sovereignty of another state for political reasons, but this does not mean that sovereignty itself is questioned.

to be a sufficient state practice and an *opinio iuris*.[305,306] However, on the other hand, one could also claim that sovereignty derives from treaty law, as states have signed thousands of treaties based on the principle of sovereignty and, therefore, have implicitly accepted the sovereignty of the other states.[307] It could even be an option to argue that sovereignty forms part of a general principle of law according to article 38(1)(c) of the ICJ Statute, as it is accepted as a principle recognized by civilized countries.[308]

Therefore it seems that the sovereignty principle fulfills the requirements of all three sources of international law according to article 38 of the ICJ Statute. However, as was already argued earlier, it is our understanding that sovereignty is a peremptory norm that is essential to uphold the current world order. In a similar way, other authors understand state sovereignty as an idea without which the current world order or international regime would not work,[309] i.e. a legal precondition. Therefore one might call state sovereignty an unwritten rule, idea, fundamental principle or a peremptory norm (or even *ius cogens*)[310] of the international legal regime.

4.1.1.3. Legal content

Many methods are feasible to approach and outline the content of the term "sovereignty" from a legal perspective. In the following sections, we will focus on internal and external sovereignty[311] in order to better frame the different elements of state sovereignty as a legal rule, even though these terms (internal and external sovereignty) are interconnected and even overlap one another. Therefore, the purpose of splitting up the chapter on the content of the sovereignty principle is to avoid a too-narrow analysis of the subject and the aim is not to derive specific legal results from the distinction between internal and external sovereignty.

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305. Regarding fiscal sovereignty or the term "jurisdiction-to-tax" *see* Englisch & Krüger, p. 519; Kaufman, 1998, p. 167 et seq.; Valta, p. 47 et seq. *See also* with further details Gadžo, sec. 2.1.4.
306. On the requirements of customary international law *see* sec. 4.3.2.
307. From a tax perspective, it is self-evident to argue that fiscal sovereignty is an accepted principle, as there are more than 3,000 double taxation conventions.
308. For further details about the general principles of law as a source of international law, *see* sec. 4.3.3. From a tax perspective concerning the principle of territoriality *see* Opel, p. 15 et seq.
309. *See*, for example, the opinion of the PCIJ (PCIJ, *Lotus*, p. 18 et seq.).
310. With further reference on the *ius cogens* character of the principle of sovereign equality *see* Efraim, p. 88, or sec. 4.4.3.
311. The terms are used by Epping, in: Ipsen, § 5 para. 138; Wildhaber, p. 435 et seq. With further references *see also* Cavelti, 2016, para. 264 et seq.

4.1.1.3.1. *Internal sovereignty*

Internal sovereignty means the authority to implement a domestic state order. In particular, a state (or the people of a state to be more precise) is free to decide which political system is best for governing its territory.[312] Therefore a state can also choose whether and under what circumstances coercive measures should be used against its population.[313] Internal sovereignty, in other words, means that a state has a "plenary power over territory",[314] but this does not mean that a state cannot refrain from its sovereignty through a merger with another state. A state's sovereignty also does not limit the right of a state to transfer certain competences to another body of international law. Or, as stated by Huber in the Palmas decision: "Territorial sovereignty, …, involves the exclusive right to display the activities of a State."[315] Obviously, not all states are independent for various reasons. For instance, a state might be dependent due to its accession to a supranational organization, such as an EU membership. As mentioned, a state can transfer certain competences to another body of international law; as long as the transferring state still has the ability to reclaim its competences, such a state shall still be seen as sovereign.[316] This is also of importance from a tax perspective, as we will, for instance, demonstrate with regard to the Rubik agreements, which led to a transfer of certain taxation competences.[317]

An important element or ingredient of internal sovereignty is the jurisdictional power of a state.[318] Therefore, internal sovereignty also relates to the question of whether a state has the jurisdiction to act. A distinction is made between prescriptive jurisdiction and enforcement jurisdiction.[319] The for-

312. Epping, in: Ipsen, § 5 para. 258. *See also* on the content of internal sovereignty Wildhaber, p. 435 et seq. However, in recent decades the so-called "*domaine réservé*" has been narrowed and restricted due to manifold developments such as human rights treaties or environmental law. These developments cannot be fully outlined in the present study. For further details *see* Ziegler, para. 1 et seq.
313. The term "citizens" is purposely not used, as we will further discuss in sec. 8.3.2. who should be part of a coercive state system.
314. Crawford, p. 245.
315. Reports of International Arbitral Awards II (1928).
316. Epping, in: Ipsen, § 5 para. 138.
317. *See* sec. 4.2.2.
318. For a more profound distinction between the terms "sovereignty" and "jurisdiction," see Mann, 1964, p. 16. However, for the purpose of the present study, jurisdiction is understood as an ingredient of sovereignty (Mann, 1984, p. 20).
319. Crawford, p. 456; Müller & Wildhaber, p. 373; Staker, p. 312 et seq. From a tax perspective, inter alia, Picciotto, 1992, p. 308. The term "jurisdiction" is often used to define the limitations of sovereign powers in international law (Mills, 2014, p. 194). Therefore, these two terms (i.e. "sovereignty" and "jurisdiction") are intertwined.

mer means, inter alia, the power to legislate, while the latter refers to the power to take executive action.[320]

There are many cases and opinions on internal sovereignty or jurisdiction in general, but the most important, most influential and most disputed court decision regarding internal sovereignty is the *Lotus* case of the PCIJ. The *Lotus* case has been the object of intense discussion within international law and international tax law,[321] and scholars generally refer to this decision when discussing the legal nature and content of the legal term of (internal) sovereignty or jurisdiction-to-tax.[322] The PCIJ had to deal with the question of whether Turkey was infringing on general international law by starting criminal proceedings against a French captain (Mr Demons) of the Lotus SS, who was presumably responsible for the deaths of eight Turkish sailors due to a crash with a ship (the *Boz-Kourt*), sailing under the Turkish flag, but on the high seas.

In the *Lotus* case, the PCIJ had to decide whether the flag state had the exclusive criminal jurisdiction regarding criminal offenses on the high seas. Turkey argued that such a rule had not become part of customary international law at that point. The PCIJ held, inter alia, the following:

> [T]he first and foremost restriction imposed by international law upon a state is that – failing the existence of a permissive rule to the contrary – it may not exercise its power in any form in the territory of another state. In this sense jurisdiction is certainly territorial; it cannot be exercised by a state outside its territory except by virtue of a permissive rule derived from international custom or from a convention.[323]

This means that the extraterritorial enforcement is certainly prohibited under general international law. Therefore, states are, unless explicitly permitted, not allowed to physically enforce their legislation on the territory of another state (i.e. territorial integrity). However, this does not yet answer the question of whether prescriptive jurisdiction is also limited.

320. It would be possible to make a further distinction between prescriptive, adjudicative and enforcement jurisdiction. *See*, for example, Kamminga, para. 1 et seq.
321. *See*, inter alia, from an international tax law perspective Monsenego, p. 36 et seq. As an example from an international law perspective, Keller, 2008, p. 256; Meng, p. 482; Mills, 2014, p. 190 et seq. With respect to customary international law Boas, p. 78. Of course, the *Lotus* case is also of interest from the perspective of external sovereignty, as it has an impact on the relation between states, i.e. with respect to the question of when a state infringes the sovereignty of another state.
322. *See*, for example, Martha, p. 38 et seq.; Picciotto, 1992, p. 308.
323. PCIJ, *Lotus*, p. 18 et seq.

The PCIJ in the *Lotus* case held that states are allowed to exercise

> jurisdiction in its own territory, in respect of any case which relates to acts which have taken place abroad, and in which it cannot rely on some permissive rule of international law. Such a view could only be tenable if international law contained a general prohibition to States to extend the application of their laws and the jurisdiction of their courts to persons, property and acts outside their territory, and if, as an exception to this general prohibition, it allowed States to do so in certain specific cases. But this is certainly not the case under international law as it stands at present.[324]

Therefore, regarding prescriptive jurisdiction states have "a wide measure of discretion which is only limited in certain cases by prohibitive rules; as regards other cases, every State remains free to adopt the principles which it regards as best and most suitable".[325]

In the *Lotus* case, the PCIJ reviewed whether there is any international rule which would explicitly limit the jurisdiction of Turkey. It argued, inter alia, that the rule according to which the criminal jurisdiction lies only with the flag state is not part of customary international law. The outcome was mainly based on the non-existence of the *opinio iuris*. Or, in the words of the PCIJ:

> Even if the rarity of the judicial decisions to be found among the reported cases were sufficient to prove in point of fact the circumstance alleged by the Agent for the French Government, it would merely show that States had often, in practice, abstained from instituting criminal proceedings, and not that they recognized themselves as being obliged to do so.[326]

Compared to the rather traditional understanding in the Lotus decision, sovereignty is nowadays not unlimited in the aforementioned sense, as it is, inter alia, restricted by *ius cogens* and human rights obligations. Non-compliance with some essential human rights might trigger coordinated consequences by an organized group of states.[327] Moreover, as mentioned, the UN Charter contains a use of force prohibition also limiting the more traditional legal understanding of sovereignty.[328] A further well-known limitation concerning prescriptive jurisdiction is that a state without explicit consent of another state has no jurisdiction over people that have no link to its territory, i.e.

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324. Id., p. 19.
325. Id.
326. PCIJ, *Lotus*, p. 28.
327. *See generally* Ring, 2008, p. 162 et seq. *See* on *ius cogens* in sec. 4.4.3.2.
328. *See* art. 2(4) UN Charter; *see* sec. 3.4.

either a territorial or personal link.[329] This is traditionally true in terms of criminal jurisdiction,[330] but this point will be highlighted below with respect to fiscal jurisdiction.[331] The PCIJ was not yet clear regarding such general limitations of prescriptive jurisdiction in the *Lotus* decision. In other words, the Lotus case did not yet provide for the explicit requirement of a "genuine connection" as a requirement for prescriptive jurisdiction.[332] It was later decisions such as the *Nottebohm* case[333] and the *Barcelona Traction* case[334] but also the *Diallo* case[335] in which the ICJ developed a more detailed understanding of what we hereinafter call the "genuine link doctrine".[336]

4.1.1.3.2. *External sovereignty*

External sovereignty is defined as the ability to represent a state toward other states.[337] It also contends that a state may act independently from any other state.[338]

In the *Palmas* decisions in 1928, Max Huber as the sole arbitrator famously held the following:

> Sovereignty in the relations between States signifies independence. Independence in regard to a portion of the globe is the right to exercise therein, to the exclusion of any other State, the functions of a State. The development of the national organisation of States during the last few centuries and, as a corollary, the development of international law, have established this principle

329. Mills, 2014, p. 194.
330. *See generally* Boas, p. 244.
331. *See* sec. 4.1.2.2.
332. Some scholars argue, however, that the PCIJ already in the *Lotus* case argued (at least in an ambiguous manner) that a sufficient connection is required (*see* Kamminga, *supra* n. 320, at para. 9 [last visited 14 June 2017]).
333. ICJ, *Nottebohm* Case, p. 23 et seq.
334. ICJ, Case concerning the Barcelona Traction, Light and Power Company, Limited, p. 42 et seq.
335. ICJ, Case concerning Ahmadou Sadio Diallo.
336. The genuine link doctrine will be further described in sec. 4.1.2.2. with a particular focus on tax law.
337. Epping, in: Ipsen, § 5 para. 137. Crawford, p. 448, speaks of a "catch-all" understanding assuming a broad understanding of the term "sovereignty". The latter means that sovereignty is, on one hand, the entitlement to exercise control over a territory, and, on the other hand, to act on an international level as a state (i.e. on behalf of a certain territory and its people). For further details *see also* Ring, 2008, p. 159 et seq.
338. *See*, for example, Wildhaber, p. 436 et seq.: "Like the notion of internal, that of external sovereignty is used in various connotations: (1) It signifies independence, that is, the power of a state to determine its tasks, means and structures independently from any foreign subject only to international law; (2) …". *See also* Epping, in: Ipsen, § 5 para. 254.

> of the exclusive competence of the State in regard to its own territory in such a way as to make it the point of departure in settling most questions that concern international relations.[339]

With regard to the term "external sovereignty", reference is often also made to the individual opinion of Judge Anzilotti in the *Austro-German Customs* case:

> Independence as thus understood is really no more than the normal condition of States according to international law; it may also be described as sovereignty (suprema potestas), or external sovereignty, by which is meant that the State has over it no other authority than that of international law.
>
> The conception of independence, regarded as the normal characteristic of States as subjects of international law, cannot be better defined than by comparing it which the exceptional and, to some extent, abnormal class of States known as "dependent States". These are States subject to the authority of one or more other States. The idea of dependence therefore necessarily implies a relation between a superior State (suzerain, protector, etc.) and an inferior or subject State (vassal, protege, etc.); the relation between the State which can legally impose its will and the State which is legally compelled to submit to that will. Where there is no such relation of superiority and subordination, it is impossible to speak of dependence within the meaning of international law.[340]

Building upon these ideas, it has been shown above[341] that since the Peace of Westphalia, the world order has developed into an international regime containing various sovereign and independent actors (i.e. states). It has also been demonstrated that the current international regime follows certain unwritten, although peremptory, norms that guarantee the long-standing existence of the regime itself, or norms that are a logical precondition of the current world order. Therefore it is a crucial part of such an international framework that sovereignty and fiscal sovereignty are indispensable,[342] and that the state's sovereignty will still be essential with respect to the future of international law.[343]

One part of external sovereignty is that all states are equal from a legal perspective. In this respect, reference is also made to Goebel,[344] who stated in 1923 that "[n]ot only from the point of view of historical development

339. Reports of International Arbitral Awards II (1928), p. 838.
340. PCIJ, Customs Régime between Germany and Austria.
341. *See* sec. 3.4. *See also* Epping, in: Ipsen, 2014, § 5 para. 254.
342. From an international law perspective *see* Verdross & Simma, § 37. *See also* Martha, p. 36 et seq., who uses the term "a priorism".
343. *See* Crawford, p. 13.
344. Goebel, p. 89, with a historical analysis.

but also from that of analytical jurisprudence the principle of the equality of states stands forth as a useful and indispensable principle of international law." Or, as already mentioned by de Vattel: "*Un nain est aussi bien un homme, qu'un Géant: Une petite République n'est pas moin un Etat souverain que le plus puissant Roïaume*."[345] Furthermore, de Vattel makes valid remarks on the basis of international law, which will also be relevant in terms of the current status of international tax law and coercion measures among states. He argues that states might be forced to accept certain unjust and objectionable outcomes, given that they are obliged to obey each state's liability, as states would otherwise endanger the natural international community:

> *Il est donc nécessaire, en beaucoup d'occasions, que les Nations souffrent certaines choses, bien qu'injustes & condamnables en elles-mêmes, parce qu'elles ne pourroient s'y opposer par la force, sans violer la liberté de quelqu'une & sans détruire les fondements de leur Société naturelle*.[346]

However, one does not need to render a detailed historical analysis to demonstrate that factual equality among states has never been achieved in an absolute manner.[347] There have always been stronger and weaker states that have less power to steer the development of international law, and this has already been an important topic of international relations theory.[348] From a normative perspective, we will again refer to the principle of equality of states when discussing the principle of "inter-nation equity".[349]

Lastly, sovereignty does not mean that a state must not conform to general international law and its peremptory norms. This finds support in Kelsen's opinion, who states that a subject's freedom within a legal order is limited by the equality of the subjects within the same order: "*[E]ine Rechtsgemeinschaft, in der die Freiheit der Subjekte (Staaten) durch ihre grundsätzliche rechtliche Gleichheit beschränkt wird* [footnote omitted]."[350] In other words, the legal sovereignty of one state is somehow limited by its participation within the international community or the world, as such. Therefore, the current world order with equal states requires that each state respects the other states' sovereignty, and each shall be in principle

345. De Vattel, Préliminaires, § 18.
346. Id., § 21. Some argue that de Vattel introduced the concept of equality of states (Krasner, p. 14).
347. *See* Von Bredow, p. 159 et seq.
348. *See*, for example, the seminal article of Ring, 2008, p. 155 et seq., who already refers to some of the most important international relation theories from a tax perspective.
349. *See* sec. 11.3.
350. Kelsen, 1928, p. 252.

independent and equal.[351] On one hand, this means that a state shall not interfere in another state's territory, while on the other hand, states shall respect the jurisdiction of other states.[352] The former, i.e. the prohibition of intervention, is also referred to as the "key element" or the "*Grundnorm*" of the sovereignty principle.[353] We will, moreover, dedicate a particular chapter to the question of whether an international constitutional framework has developed which would systematically limit the traditional understanding of sovereignty.[354]

4.1.2. Fiscal sovereignty

4.1.2.1. Setting the framework

As stated by Graetz: "No function is more at the core of government than its system of taxation."[355] Fiscal sovereignty is indeed an essential element of state sovereignty. A state relies on fiscal income, meaning that a state could not render its essential functions, such as the protection of its citizens, without levying taxes and without being fiscally sovereign.

Fiscal sovereignty is generally understood as the authority to tax certain persons or activities with a link to a specific territory.[356] More specifically, the right to tax must be understood as an element of internal sovereignty in the above-mentioned terminology, and we will demonstrate what "link" means in this respect. Therefore, connected to the question of fiscal sovereignty is the question of jurisdiction-to-tax.[357] However, fiscal sovereignty

351. Mann, 1964, p. 15, with reference to the limitations of jurisdiction in the international realm. *See also* the UN, Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations, A/RES/25/2625. *See also* Cohen, p. 269 et seq.

352. Crawford, p. 447; Wildhaber, p. 438. On the former point *see* Epping, in: Ipsen, § 5 para. 261. *See also* Mann, 1964, p. 28, with reference to a statement of the US Supreme Court Justice Story in 1824: "The laws of no nation can justly extend beyond its own territories, except so far as regards to its own citizens."

353. Krasner, 1999, p. 20, with reference to Jackson.

354. *See* sec. 4.4.

355. Graetz, p. 277. For further details about the terms "tax sovereignty" or "fiscal sovereignty" *see also* Postma & Schwarz, p. 786 et seq.; Ring, 2008, p. 156 et seq. *See*, at least with respect to direct tax competences of a state, Steichen, p. 43.

356. *See*, for example, Oberson, 2014, p. 1. Some authors also distinguish between a principle of territoriality ("*Territorialitätsprinzip*") and a principle of personality ("*Personalitätsprinzip*"), *see* Englisch & Krüger, p. 515.

357. *See* Albrecht, p. 145, who states that the right to tax (i.e. jurisdiction-to-tax) is an "aspect of sovereignty". Or later in his seminal article he states that the "right to tax aliens is a prerogative of the sovereign state" (p. 185). *See* Griziotti, p. 18 ("*Le droit de*

also has a negative component, as it contains a duty not to tax persons or activities if such taxation would infringe on the fiscal sovereignty of another state. Therefore fiscal sovereignty is also affected by external sovereignty, as fiscal sovereignty regulates the interaction and behavior between states.

In the following, a focus is placed on the question of jurisdiction-to-tax as a key part of fiscal sovereignty. Jurisdiction-to-tax is understood as the legal right to impose taxes by creating tax rules and, therefore, we refer to legislative jurisdiction,[358] prescriptive jurisdiction[359] or substantive jurisdiction.[360] We will not specifically address enforcement jurisdiction in the following. Although, enforcement jurisdiction triggers several debatable questions from a general international law perspective.[361]

As outlined in detail by Martha, with reference to Albrecht, four theories as potential justifications for the jurisdiction-to-tax can be distinguished: (i) realistic or empirical theory; (ii) ethical or retributive theory; (iii) contractual theory and (iv) the sovereignty theory.[362] According to the realistic theory, a state's (physical) power to tax is the basis for taxation and not any juridical reference. The ethical or retributive theory mainly relates to questions of fairness within an international setting.[363] The latter jurisdiction could, for instance, be based on the benefit principle. This would mean that taxation is justified if it is a return for certain benefits obtained.[364] The contractual theory relates to the idea that taxes are due based on a contractual relation between the taxpayer and the state.[365] These three theories, however, have no sufficient legal base and are of secondary importance when rendering a legal analysis within international law. Therefore, these theories might be

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lever l'impôt a nécessairement son origine et son fondement ou titre juridique dans la souveraineté de l'État, laquelle s'exerce sur quiconque appartient à l'État"). *See also* Martha, p. 15; Monsenego, p. 46; Schoueri, p. 691.

358. Martha, p. 64. *See also* McLure, 2001, p. 328 et seq.

359. *See* sec. 4.1.1.3.1.

360. Hellerstein, 2014, p. 346 et seq. On this terminology *see* Mann, 1964, p. 13.

361. *See* sec. 4.1.1.3.1. From a tax perspective *see*, for instance, on the question of whether the embassy of Bosnia and Herzegovina was allowed to levy taxes from the diaspora resident in Switzerland, with further references *see* Kälin et al., p. 200.

362. Martha, p. 18 et seq. *See also* Albrecht, p. 145 et seq., who does not mention the realistic or empirical theory as its own category. Reference to these studies is also made by Peters, 2014, p. 72 et seq. Furthermore, the work of Griziotti, p. 5 et seq., and Allix, 1937, p. 35 et seq., are ground-breaking studies in this respect. The distinction between the four categories is not crystal clear as, for instance, the contractual theory could also be understood as an ethical theory.

363. *See* Albrecht, p. 148, with reference to Griziotti.

364. *See* for further details sec. 11.6.

365. With reference to further variances on the contractual understanding *see also* Albrecht, p. 146 et seq. *See also* Griziotti, p. 31, with reference to the work of Saredo.

relevant for Part IV, when discussing the normative validity of some of the most important design principles of international tax law, such as the benefit principle and the source principle. However, as stated by Albrecht, the right to tax (aliens) "is justified in international law essentially as an attribute to statehood or sovereignty"[366] (i.e. the sovereignty theory). Therefore the legal claim to tax someone's income is, as already indicated, indeed a legal claim derived from the sovereignty principle.

Several authors have then further made a distinction between fiscal sovereignty based on personal, territorial or functional elements in order to describe the extent of fiscal sovereignty, i.e. the right to tax, in a more comprehensive manner.[367] In simplified terms,[368] personal sovereignty relates to nationality or residency as a potential justification for tax jurisdiction of a state on its people. Territorial sovereignty means that a state has the right to levy taxes on foreigners if they are present in a certain territory or if part of their income was created in a certain jurisdiction; functional sovereignty is relevant if there is stateless income or an international organization with no territory, but government-like competences. In principle, we share the view that fiscal sovereignty can legally be based on different elements, but the third element of sovereignty, i.e. functional sovereignty, is not a persuasive category in our perspective. As will be developed below, the "genuine link doctrine" better suits the need to comprehensively outline the scope of fiscal sovereignty as a legal rule, and we do not see a specific need to make the mentioned categorization. From our viewpoint, the genuine link doctrine is better aligned with other understandings of jurisdiction in other fields of international law. However, the practical difference in the results of a threefold approach, as suggested by Martha,[369] or following the genuine link doctrine might be minimal or even nonexistent.

In conclusion, we understand that the jurisdiction-to-tax, as derived from the sovereignty principle, is indeed limited by general international law and that states do not have an unlimited jurisdiction in tax matters. This seems to be in line with the current prevailing opinion, although some authors in the second half of the 20th century have held a different opinion.[370] It is

366. Albrecht, p. 148. *See also* Martha, p. 23.
367. Martha, p. 43 et seq., although he understands personal, territorial and functional sovereignty not as "phenomena sui generis" but as "three modalities of one genus" (i.e., sovereignty). *See also* Allix, 1937, p. 550 et seq., who uses the terms "political" and "economic allegiance" to further circumscribe the reach of jurisdiction-to-tax.
368. For a more comprehensive outline *see* Martha, p. 43 et seq.
369. Id.
370. *See* the various references in Englisch & Krüger, nn. 42 and 43. *See also* the references stated by Martha, p. 27 et seq.

also in line with the case law of the ICJ, inter alia, in the mentioned *Diallo*, *Nottebohm* and *Barcelona Traction* cases.[371]

4.1.2.2. Genuine link doctrine

4.1.2.2.1. *Preliminary remarks*

Many tax law scholars have argued that fiscal sovereignty means that a state has the right to tax a certain income or person, so long as there is a genuine link to its territory.[372] Or, as also stated by Lang in a negative manner, "[i]t is only when neither the person nor the transaction has any connection with the taxing state that tax cannot be levied."[373] This means – and this has also been confirmed by several courts – that a person, be it an individual or a corporation, shall not be taxed if it does not have any link to a certain country.[374] In other words, as mentioned by Rivier, fiscal sovereignty is actually limited by the fact that it is linked to a certain territory: "*La souveraineté fiscale est limitée par le fait qu'elle est rattachée à un territoire*."[375]

The following section focuses on the content of the genuine link doctrine from an international law perspective, followed by a discussion of its application in international tax law.[376] Afterwards, we will focus on two important examples for which the genuine link doctrine might also be of relevance and which help to understand its current application in the international realm: (i) taxation of an individual based on citizenship[377] and (ii) taxation of con-

371. The *Nottebohm* case seems to be the leading decision (ICJ, Nottebohm Case, p. 23 et seq.).
372. Douma, 2006, p. 523 et seq.; Englisch & Krüger, p. 512 et seq.; Locher, 2005, p. 56 (n. 15) and with further references Lehner, in: Vogel & Lehner, 2015, Grundlagen para. 11, who uses, with reference to a German Supreme Court decision, the German term "*sachgerechte Anknüfungsmomente*". *See also* Oberson, 2014, p. 1 et seq., who refers to the French term "*lien suffisant*". Furthermore, Simonek, 2010, p. 556, with further references, speaks of a meaningful and actual link ("*sinnvolle und tatsächliche Anknüpfung*"). *See also* Dahm & Hamacher, p. 126; Martha, p. 46 et seq.; Schoueri, p. 690 et seq.; Valta, p. 45 et seq.
373. Lang, 2013, para. 2.
374. *See*, for example, IN: Income Tax Appellate Tribunal (India), *Metro & Metro v. ACIT*, I.T.A. No.: 393/Agra/2012, 1 Nov. 2013, § 15. *See also* Van Raad, p. 19, or with further references, also Peters, 2014, p. 72 et seq. *See also* the various references in Englisch & Krüger, nn. 36 and 37.
375. Rivier, p. 31.
376. *See* sec. 4.1.2.2.3.
377. *See* sec. 4.1.2.2.4.

trolled foreign companies (CFCs).[378] These two examples are of essential relevance when determining the normative foundations of the international tax regime, as intended in Part IV of the present study.

4.1.2.2.2. *The meaning of "genuine link" from an international law perspective*

It is nowadays generally accepted that "a State must be able to identify a sufficient nexus between itself and the object of its assertion of jurisdiction".[379] Each area of law has developed specific connecting factors or genuine links. In particular, criminal law has played a pioneering role with regard to the question of the prohibition of extraterritorial prosecution.[380] However, from an international criminal law perspective, jurisdiction might in some cases be universally justified without a specific link to a territory in the case of crimes against humanity.[381] The latter, however, seems, prima facie, of no importance from a tax law perspective.

As in international tax law, international lawyers generally use different connecting factors to justify jurisdiction, just as tax lawyers use territorial, personal, functional or other elements to describe jurisdiction.[382] But again, and this is crucial, the definition of what a genuine or sufficient link means must be defined with respect to a specific area of law and be justified with respect to its purpose.[383] It must be proven that a certain link is sufficiently reasonable to justify jurisdiction of a specific state in a specific area and to a specific extent.[384] For instance, if we aim to define a genuine link from a bankruptcy law perspective, we must consider the purpose of such potential regulation and we must review whether such a link indeed justifies regulatory power of a state in such an area. Therefore, it would be wrong, for

378. *See* sec. 4.1.2.2.5.
379. Oxman Bernard H., Jurisdiction of States, Max Planck Encyclopedia of Public International Law, para. 10 (available online at http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1436?rskey=zMzRdd&result=2&prd=OPIL, last visited 14 Sept. 2017). *See also* Scott, p. 89 et seq.
380. Ipsen, in: Ipsen, § 31 para. 5 et seq., with further references.
381. Boas, p. 258 et seq., with further references.
382. *See* id., p. 251, who mentions territoriality, nationality, protective, passive personality and the university principle.
383. Mann, 1964, p. 50. As a consequence, this means that there are no general "jurisdiction principles" in international law, as each area of international law must be distinguished.
384. Mann, 1984, p. 29. For an overview on different links *see* Kamminga, *supra* n. 320, at para. 10 et seq.

instance, to claim that a state has per se jurisdiction over its nationals in all areas of law. In certain areas, it would infringe general international law obligations if a state claimed jurisdiction based on nationality.[385]

A particularly interesting example is jurisdiction in antitrust law in order to better understand the relativity of the genuine link doctrine.[386] Antitrust law has led to important discussions about the relation between jurisdiction and the infringement of the principle of sovereignty. Reference is often made to the so-called "effects doctrine", which should briefly be discussed, as it is also of interest for the present study. The effects doctrine, as understood in the United States since the Alcoa decision in 1945,[387] means in simplified terms that a country shall have the right to apply its antitrust law if an activity of a foreign enterprise has an economic effect (even if it is minimal) within its territory.[388] This means that the jurisdiction should not be limited to persons with a direct link to a jurisdiction, such as personal or territorial connecting factors in a traditional physical understanding. This far-reaching approach was challenged by other states[389] and its compliance with general international law still seems disputed.[390] The ECJ in its case law, however, uses similar (but not identical) instruments in order to justify jurisdiction in antitrust law matters.[391] The development of the effects doctrine, however, shows that there is no rule of general international law according to which jurisdiction shall be based on a very specific link or well-defined connecting factor. The ICJ has also not yet developed clear factors that would suit the need to define the genuine link for all areas of law, or even within a single area of international law. For instance, in the *Barcelona Traction* case, the Court held the following:

> However, in the particular field of the diplomatic protection of corporate entities, no absolute test of the "genuine connection" has found general acceptance.[392]

385. *See* Mann, 1984, p. 24 et seq., who, for instance, argues that it would be too far-reaching if Britain would oblige all its nationals to sell whiskey at a certain minimum price, even beyond its borders.
386. Relativity in two senses: (i) the connecting factors might deviate, depending on the area of international law, and (ii) the connecting factors might change over time.
387. *See* US: Court of Appeals for the Second Circuit, *United States v. Aluminum Co. of America et al.*, 148 F.2d 416, 12 Mar. 1945. For an overview, *see* Staker, p. 318 et seq.
388. With reference to further cases with a less strict application of the effects doctrine *see* Crawford, p. 479. *See* for further details Alford, p. 1 et seq.; Scott, p. 92 et seq.
389. For further details with respect to opposing positions *see* Crawford, p. 480.
390. *See*, for example, with further references Schultz, p. 811 et seq.
391. For a detailed study *see* Alford, p. 27 et seq.; Scott, p. 87 et seq.
392. ICJ, *Barcelona Traction, Light and Power Company, Limited*, p. 42.

Moreover, the genuine link doctrine might be refined from time to time due to technological progress. For instance, the digitalization of the economy has triggered the need for new connecting factors, such as digital presence.

To conclude, even though there is no consent about the quality of the genuine link, it is generally accepted among international law scholars that a certain link (i.e. personal, territorial or any other) is required.[393] As general international law needs to regulate very different areas, it makes sense, however, that there is no single definition of what a genuine link is.[394] Therefore, general international law does not provide for clear guidance on the question of jurisdiction, except in a few cases which have been decided by the ICJ, such as the mentioned *Nottebohm*, *Barcelona Traction* or *Diallo* cases.

4.1.2.2.3. *The meaning of "genuine link" from an international tax law perspective*

It should again be highlighted that the genuine link doctrine is, according to our understanding, based on a peremptory rule derived from state sovereignty and not based on customary international law or a general principle of law.[395] In other words, the genuine link doctrine is a legal precondition of the current world order. Infringing on such a principle would question the entire legal system, which is based on the equality of states.

As there are different areas of tax law, the question of whether there is a genuine link might require a subject-related analysis in order to justify jurisdiction. Each area of tax law might require different links. In particular, regarding criminal tax law, specific guidance might exist.[396] Another example would be financial transfer taxes (or non-personal taxes, in general), as the context in which such taxes operate might trigger different genuine links.[397] However, for the purpose of the present study, the focus is on

393. *See*, for example, Boas, p. 246, who speaks of a "real link".
394. *See* id., who mentions the following example: "[T]he mere presence of tourists within the state's territory for a few days might represent a sufficient connection to support a requirement to register with police, but not to allow them to be conscripted for military service [footnote omitted]."
395. From a tax perspective *see* Schön, 2015, p. 280. *See also* Martha, p. 43, who argues in a similar manner: "Still one basic rule remains – which for some is a customary rule [footnote omitted] but should rather be envisaged as an a priori presupposition stemming from the very concept of international law – that must serve as the most fundamental and basic test in matters of international taxation: A state may only fiscally attach those facts that are subject to its supremacy (sovereignty)."
396. For further details *see* Crawford, p. 457 et seq.; Müller & Wildhaber, p. 386 et seq.
397. Englisch & Krüger, p. 513 et seq. *See also* Dahm & Hamacher, p. 123 et seq.

the genuine link as a justification for income taxation, i.e. either personal income or corporate income taxation. In this respect, it is decisive to consider the result and the purpose of a presumed genuine link. For instance, a certain link might only justify limited tax liability, whereas another link might justify unlimited tax liability (i.e. taxation of worldwide income). As mentioned above, a link must always be justified in relation to its purpose: the purpose of creating unlimited tax liability might require a different link quality than for the justification of only limited tax liability.

Many authors have explicitly dealt with the question of genuine link and fiscal sovereignty. For instance, it is the opinion of Hinnekens that the link of a person that justifies taxation can be manifold if it is sufficiently close.[398] However, he does not further discuss what "sufficiently close" means. Monsenego even states that, "[c]onsequently, although one may instinctively support the view that some connection should be required by international law, the impossibility to objectively define it impedes this view."[399] Other authors have used categories in order to visualize the various issues at stake. For instance, Martha, as previously mentioned, distinguishes between personal sovereignty, territorial sovereignty and functional sovereignty when discussing the question of jurisdiction-to-tax. However, he also admits that these categories are "three modalities of one genus".[400] From our perspective, such a distinction might indeed help to better understand the entire scope of application of the genuine link doctrine. However, as mentioned, the categories used by Martha as such have no legal value.[401] From an international law perspective, the link itself might indeed be a personal, territorial or functional link, or even another link that is not covered by the categories of Martha.

To be more concrete, genuine link from a tax perspective means, for instance, that a person resides in that territory or that such a person receives income sourced in a specific territory or that a person owns assets situated in a certain jurisdiction. Furthermore, it seems to be in line with general international law that a state has the right to tax its nationals – whether based on citizenship (individuals) or on incorporation (corporation) (i.e. personal link). However, again, these different links might only justify income taxation to a certain extent.

398. Hinnekens, p. 282 et seq.
399. Monsenego, p. 41.
400. Martha, p. 43.
401. The categories, as such, would require an interpretation of their content, which again could lead to ambiguities.

In the case of uncertainty whether a link to a certain state is sufficient, it might be helpful to refer to the case law of international courts, as already done by some authors.[402] In the following, we will highlight one more recent court decision of the Indian Supreme Court that perfectly outlines the different legal (and moral) arguments related to the genuine link doctrine from an international tax perspective. In the *GVK Industries Ltd. & Anr. v. ITO* case, the Supreme Court of India held the following:[403]

> Within international law, the principles of strict territorial jurisdiction have been relaxed, in light of greater interdependencies, and acknowledgement of the necessity of taking cognizance and acting upon extra-territorial aspects or causes, by principles such as subjective territorial principle, objective territorial principle, the effects doctrine that the United States uses, active personality principle, protective principle etc. However, one singular aspect of territoriality remains, and it was best stated by Justice H.V. Evatt: "The extent of extra-territorial jurisdiction permitted, or rather not forbidden, by international law cannot always be stated with precision. But certainly no State attempts to exercise jurisdiction over matters, persons, or things with which it has absolutely no concern." (See Trustees Executors & Agency Co Ltd v. Federal Commissioner of Taxation (1933) 49 CLR. 220 at 239). The reasons are not too far to grasp. To claim the power to legislate with respect to extraterritorial aspects or causes, that have no nexus with the territory for which the national legislature is responsible for, would be to claim dominion over such a foreign territory, and negation of the principle of self-determination of the people who are nationals of such foreign territory, peaceful co-existence of nations, and coequal sovereignty of nation-states. Such claims have, and invariably lead to, shattering of international peace, and consequently detrimental to the interests, welfare and security of the very nation-state, and its people, that the national legislature is charged with the responsibility for.

These judicial considerations are of interest in many respects. First, according to the Court, there is no general principle of law or customary international law provision limiting the taxation rights of a state to people with a strict territorial link, such as physical presence, or a personal link, such as citizenship or incorporation. Second, however, the Court also argues that general international law requires at least that a certain link to a state exists. Third, and this will be of importance in Part IV of the present study, an extensive interpretation of the genuine link doctrine, although legal, might be considered unjust. However, this requires a clear distinction of what is in line with general international law and what is required by normative

402. Avi-Yonah, 2004, p. 489; Monsenego, p. 36 et seq. *See*, with many references, Martha, p. 1 et seq.
403. IN: SC, *GVK Industries Ltd. & Anr. v. ITO*, Civil Appeal No. 7796, 1 Mar. 2011, para. 40.

considerations. We will review in Part IV whether there is any normative answer to the question of how the "link" should be defined from an international tax law perspective.[404] Or, as mentioned by Schön:

> International law does not require a certain "threshold" to be passed: again, it has to be accepted that it depends on good policy whether to introduce a de minimis test for the assertion of tax jurisdiction on a sales-only basis.[405]

This means from a general international law perspective that a state has, for instance, the right to tax part of the income of a sportsman if such a sportsman only spends a few hours in a jurisdiction due to a competition.[406] Or, as we have argued at another instance,[407] the requirement of a fixed place of business in order to create a permanent establishment (PE), according to article 5 of the OECD MC, does not form part of general international law; therefore, it would be compatible with general international law if a state taxes business income based on a virtual or digital presence, i.e. if an enterprise generates income in a state without being physically present.[408] As a consequence, a state could tax an enterprise that has no physical presence in its state. However, it once again remains a question whether states ought to have a taxing right in these circumstances from a normative perspective.

In conclusion, from an international law perspective, legally prohibited extraterritorial taxation is given if there is no link to a certain jurisdiction and such jurisdiction nevertheless levies income taxes. Such a line of argumentation is based on the present understanding of the principle of sovereignty as a legal precondition of the current world order. In the following, we will analyze two important aspects of jurisdiction-to-tax; one relates to taxation based on citizenship and the other relates to control of a foreign company as a justification for taxation within CFC legislation. Both of these cases might be borderline cases that help to unfold the actual legal limitations of the genuine link doctrine from a general international law perspective. Also, reference to two specific cases seems necessary, as it is impossible to define the genuine link doctrine detached from specific cases.[409]

404. *See* secs. 11.5. and 11.6. *See* Staker, p. 329, who questions whether there is indeed a clear theoretical answer to the problem of defining the link that justifies jurisdiction in general.
405. Schön, 2009, p. 92.
406. In this sense, *see* UK: House of Lords, *Agassi v. Robinson* [2006] UKHL 23, 17 May 2006. I owe this reference to Monsenego, p. 57.
407. For more details *see* Hongler & Pistone, p. 16.
408. For more details *see* id., p. 19 et seq.
409. *See* the seminal work of Mann, 1964 and 1984, p. 1 et seq., who aims at finding a general description of the threshold for jurisdiction.

4.1.2.2.4. *Individuals: Citizenship as a sufficient genuine link*

Individuals are generally taxed in the current international tax regime if, inter alia, a person has his domicile in or is a resident of a jurisdiction, a person owns immovable property in a certain jurisdiction, or if the income of a person stems from a source in a jurisdiction. In all these cases, there seems to be consent that general international law does not prohibit taxation, as that represents a sufficient link to the territory of a certain state.[410] However, bearing in mind that only the United States refers to citizenship as the triggering criteria for taxation,[411] it is worth briefly discussing whether citizenship reflects a sufficient genuine link from a general international law perspective in order to justify taxation. Many scholars have argued that citizenship indeed justifies taxation and no limitation exists from a general international law perspective.[412] The underlying reason why citizenship seems to justify taxation relates to the benefit principle, at least as argued by the US Supreme Court in *Cook v. Tait* in 1924:[413]

> 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 dependent upon the situs of the property in all cases, it being in or out of the United States, nor was not and cannot be made dependent upon the domicile of the citizen, that being in or out of the United States, but upon his relation as citizen to the United States and the relation of the latter to him as citizen. The consequence of the relations is that the native citizen who is taxed may have domicile, and the property from which his income is derived may have situs, in a foreign country, and the tax be legal, the government having power to impose the tax.

Even though one can question whether a citizen living abroad indeed has access to enough benefits to justify taxation,[414] it is still, legally speaking, allowed from a general international law perspective to implement a tax

410. For further details *see* Monsenego, p. 47 et seq.
411. For further details *see* Mason, p. 178. According to Tanasoca, p. 150, Eritrea also levies income taxes based on citizenship. The latter has not been verified.
412. E.g. Kirsch, p. 443 et seq. *See also* Schön, 2009, p. 91; Richman (Musgrave), 1963, p. 23, with reference to Kelsen. This does not, however, mean that these authors support citizenship as a justification to tax (*see*, for instance, with further references, Kemmeren, 2001, p. 27 et seq.).
413. US: SC, *Cook v. Tait, Collector of International Revenue*, 265 U.S. 47, 2 May 1924; in this respect *see also* the case *United States v. Lucienne D'Hotelle*, as mentioned by Martha, p. 71 et seq. *See also* Kirsch, p. 470.
414. *See* Avi-Yonah, 2004, p. 484 et seq. Contra, however, Tanasoca, p. 147 et seq., who favors the argument that citizens indeed benefit from a state's services, even while residing abroad.

system based on citizenship, as long it aligns with existing treaty obligations. Or, in the more general words of Boas, a state "may legitimately impose obligations on their subjects."[415] No rule of general international law limits taxation based on citizenship.[416] Furthermore, there is no opposing case law at the level of the ICJ. Citizenship, as such, seems to be a "genuine" or "sufficient" link to justify unlimited tax liability from a general international law perspective. For a detailed analysis, it would, however, be required that the reasons for acquiring citizenship are reviewed.[417]

Interestingly, in the above-mentioned *Cook v. Tait* case, the US Supreme Court referred to the benefit principle. One could therefore claim that the benefits obtained are the link justifying taxation and not citizenship, per se. This sounds like a mere theoretical question or it might reflect a chicken-and-egg problem, but in Part IV, we will demonstrate whether the benefit principle is indeed valid and, therefore, whether a justification-to-tax theory in line with the benefit principle might not only be legal because it aligns with the sovereignty theory, but because it also aligns with normative considerations.[418]

Again, it is important to distinguish the question of what kind of taxation is in line with general international law and what kind of taxation is just and valid from a normative perspective. There might be cases in which a certain income can be taxed in a jurisdiction from a general international law perspective, but such income should not be taxed, as it leads to an unjust result. However, it would be wrong to argue that unjust taxation, e.g. because there is a very minimal link, is per se infringing general international law obligations. The same seems true regarding citizenship taxation, which is, according to our understanding, in line with general international law, but this does not mean that it is a just solution. In other words, following the aforementioned sovereignty theory, citizenship taxation is legal, but following the ethical or retributive theory, taxation solely based on citizenship might lead to unfair results, as it is not justified by normative considerations. The latter will be discussed in Part IV of the present study.[419] Such analysis shows again the importance of why a normative review of the international tax regime requires an in-depth understanding of the international tax regime as a legal regime.

415. Boas, p. 255.
416. *See generally* Martha, p. 66 et seq. *See also* Kemmeren, 2010, p. 254 et seq.; Mann, 1984, p. 24.
417. For further details *see* Spiro, p. 101 et seq.
418. *See* sec. 11.6.
419. *See*, inter alia, sec. 11.2.

4.1.2.2.5. *Corporations: Control of a foreign company as a sufficient link*

Concerning corporations, states claim that the seat of a company or its place of incorporation justifies taxation. In international law, it is generally assumed that a corporate entity obtains the nationality of the state of incorporation.[420] Therefore, if a company was incorporated in a certain state, (worldwide) taxation based on nationality seems in line with general international law, even if there is no significant economic allegiance to a certain state.[421] Again, general international law does not provide for a well-defined framework within which taxation should occur, but general international law provides states with significant leeway to tax corporations. The present section discusses one specific aspect of corporate income taxation and jurisdiction-to-tax concerning CFC rules. One reason is that (i) CFC rules trigger complex (but interesting) questions from a general international law perspective and (ii) CFC rules are part of our normative review, as we will demonstrate in Part IV of the present study.[422]

Many countries have in recent decades followed the example of the US and implemented CFC rules according to which, in simplified terms, a state can tax the income of a low-taxed foreign company if it is controlled by a domestic taxpayer. Currently, approximately a fourth of all states have implemented CFC rules.[423] The US enacted the so-called Subpart F rules in 1962 to challenge the accumulation of profits in foreign-controlled companies.[424] It was not a coincidence that the CFC safari started in the US, as (i) it is the largest economy, and (ii) it decides based on the place of incorporation (and not, for example, on the place of effective management) whether a company qualifies as a foreign company.[425] As we will see in Part IV of the present study, there seems to be a correlation between the size of an economy and the likelihood of knowing CFC rules.

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420. For a more detailed and comprehensive discussion on the jurisdiction-to-tax corporations and with further references *see* Marian, p. 1613 et seq. From an international law perspective *see*, with further details, Muchlinski Peter T., Corporations in International Law, Max Planck Encyclopedia of Public International Law, para. 1 et seq. (available online at http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1513, last visited 20 Apr. 2019).
421. *See* Schön, 2009, p. 91.
422. *See* sec. 12.3.
423. For some number crunching *see* sec. 12.3.3.3.
424. For further details *see* Picciotto, 1992, p. 111 et seq.
425. *See also* Avi-Yonah, 2007, p. 24 et seq. *See*, on the spread of CFC rules worldwide, Picciotto, 1992, p. 144 et seq. However, case law of the ECJ has led to a trend toward weaker CFC rules, at least within the EU, and there is even pressure on the United States to refrain from its current Subpart F rules (*see*, with further details, Picciotto, 2013, p. 1107).

The OECD within the BEPS Project asked for a strengthening of these rules in order to avoid base erosion and profit shifting.[426] It also outlined the different design options for CFC rules. In general, in order for the domestic CFC rules to apply, and consequently, for income to be (partly) allocated to the parent company, it is required that:[427]

– The CFC is resident in a low-tax jurisdiction.[428]

– The CFC is controlled by a domestic taxpayer.[429]

– The CFC receives passive (and potentially also active) income.[430]

– No *de minimis* threshold is applicable and/or an anti-avoidance structure is at hand.[431]

If CFC rules apply, it means that the (passive and/or active) income of the foreign company is (partly or entirely) taxable at the level of the foreign parent company, even if no distribution occurs between these two entities.[432] The question of whether such taxation is in line with general international law has often been limited to the question of whether CFC rules are in line with double tax treaty law or whether such rules are compliant with EU law.[433] Considering the above-mentioned prohibition of extraterritorial taxation and the genuine link doctrine, the only way by which CFC rules would be in line with general international law is for a genuine link to exist between the income of the CFC and the country of taxation.

At first glance, such an overexpansion of the genuine link doctrine or an "excessive tax jurisdiction"[434] simply because a subsidiary is controlled by

426. OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report (OECD 2015), p. 1 et seq.
427. For an overview on the Chinese CFC rules *see*, for instance, Li, 2014, p. 536 et seq.; on the Polish CFC rules *see* van Doorn-Olejnicka, p. 395 et seq., or on the UK CFC rules *see* Smith, 2013, p. 127 et seq.
428. *See*, for example, art. 7(1)(b) ATAD.
429. For more details on the existing options in this respect *see* OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report (OECD 2015), p. 23 et seq.
430. For more details on the existing options in this respect *see* id., p. 43 et seq.
431. For more details *see* id., p. 33 et seq.
432. *See*, for instance, the options according to art. 8 ATAD.
433. With respect to the compatibility of the German CFC legislation and double tax treaties, *see* Schaumburg, § 10.19 et seq., with further references. With respect to the compatibility of CFC rules and EU law, *see* Smit, 2014, p. 259 et seq.
434. With reference to Park, *see* Picciotto, 1992, p. 145.

another company seems rather unreasonable. This is particularly true, considering that in other areas of international law, ownership does not suffice for jurisdiction. For example, even the effects doctrine within antitrust law would not allow the application of domestic antitrust laws solely due to ownership.[435] Such a line of argumentation is not entirely new among tax scholars, as Avi-Yonah stated in 2000:

> Even more striking is the fact that many of the countries adopting the CFC rule abandoned the deemed dividend idea, which can lead to significant difficulties in practice, in favour of direct taxation of the CFC's shareholders on its earnings on a pass-through basis [footnote omitted] … Claiming that nationality jurisdiction applies to foreign corporations just because they are controlled by nationals is a striking departure from ordinary international law.[436]

In order to support his doubts that CFC rules are indeed in line with general international law, he referred to cases with respect to the application of international sanctions in an extraterritorial manner.[437] However, Avi-Yonah then seems to conclude that CFC legislation might still be legal, as these rules developed into customary international law.[438] One of his main arguments is that CFC states would have the right to tax the income of the CFC and, therefore, CFC rules do not harm the right to tax the income of the source country ("first bite at the apple rule").

We oppose the latter understanding as there is no sufficient state practice[439] to justify the existence of customary international law and, moreover, there is also no law requiring CFC rules in the sense of an *opinio iuris*.[440] We, however, consider CFC rules to be a rather extreme example of the wide scope of the genuine link doctrine. This requires some further remarks.

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435. On the effects doctrine *see* sec. 4.1.2.2.2. Or *see also* the opinion of the ICJ in the *Barcelona Traction* case in which it was held that control is not sufficient for diplomatic protection (ICJ, *Barcelona Traction Light and Power Company, Limited*, p. 42). But again, as mentioned above in sec. 4.1.2.2.2., each area of law has different genuine links. *See also* Kaufmann et al., p. 1 et seq., who in detail review whether violations of human rights by a company can trigger legal consequences in the parent state (e.g. p. 63). However, the latter requires a detailed study of the different existing human rights conventions and domestic regulations.

436. Avi-Yonah, 2004, p. 488 et seq. For more details about the effect of control from an international law perspective, *see* Mann, 1984, p. 56 et seq.

437. Avi-Yonah, 2004, p. 489.

438. Id., p. 489 et seq.; Avi-Yonah, 2007, p. 26.

439. *See* sec. 12.3.3.3.

440. *See* on our understanding of the requirements of state practice and *opinio iuris* sec. 4.3.2.

We would certainly agree that in abusive circumstances, i.e. when abusing a foreign letter box company or in the wording of the ECJ, when implementing a "wholly artificial" structure,[441] there are persuasive reasons to argue that CFC rules are legal, as the actual genuine link of the income is from a substance-over-form perspective with the parent state. However, if there is substance in the state of the CFC and if the income is actually linked to that activity, it is rather difficult to prove that there is a sufficient link to the parent state. Nevertheless, from a strict legal perspective, taxation of CFCs still seems in line with general international law, even in these cases, although it is a rather extreme example of how the jurisdiction-to-tax of a state can be extended. There is no opposing case law available at an international level[442] and at least there is a link (i.e. ownership or control)[443] to the parent state.

However, the problem is not only that the link to the parent state is rather limited, but that the influence on the sovereignty of the other state is considerable, as such a state might be forced to raise its tax rate in order to avoid the application of the foreign CFC rules. Bearing in mind the argument that sovereignty also means independence, it would not be far-fetched for courts to come to a different conclusion and argue that CFC rules are indeed an infringement of general international law.

As we will outline in Part IV, there are persuasive reasons to argue that the tax rate in the other state should, from a normative perspective, not influence the decision of whether a country attributes the income of a foreign subsidiary to the parent company, i.e. whether CFC rules should apply. However, again, it is important to distinguish between the questions of what is in line with general international law and how a justification-to-tax rule should be drafted from a normative perspective. In other words, the level of taxation should, from a normative perspective, basically not influence the decision of whether a country attributes the income of a foreign subsidiary to the parent company, i.e. whether CFC rules should apply. However, from a general international law perspective, there might still be a sufficient link to the parent state justifying taxation and a distinction based on the tax rate in the CFC state seems in line with general international law.

441. EU: ECJ, Case C-196/04, *Cadbury Schweppes*, 12 Sept. 2006, para. 55.
442. The ICJ has decided two leading cases on whether the control and/or ownership should have an influence on the nationality of a corporation. But both cases dealt with (diplomatic) protection of shareholder rights and not with the question of whether international law allows a state to tax the income of a foreign controlled company. *See* ICJ, *Barcelona Traction Light and Power Company, Limited*, p. 3 et seq. and ICJ, *Ahmadou Sadio Diallo*, p. 639 et seq.
443. Another link could be that the subsidiary is financed by the parent company through debt.

4.1.2.3. Worldwide and territorial taxation or source vs residence

4.1.2.3.1. *Preliminary remarks*

After having discussed the question of when states have jurisdiction over persons, in the present section we will analyze whether general international law contains a limitation with respect to the extent of jurisdiction-to-tax. Such a question is vital for the present study, as we will in Part IV review whether, following a normative analysis, tax systems should be designed as worldwide or territorial systems.[444] Related to such a question is, obviously, the never-ending discussion of source versus residence.

As outlined above, each field of international law has different "genuine links" justifying jurisdiction. It is also important to again highlight that each link might, however, only justify jurisdiction to a certain extent.[445] This is of significance from a tax perspective, since depending on the quality of the link, tax jurisdiction might be limited or unlimited in the current general international law framework. A look at the existing debate might shed some further light on how international tax law has justified the extent of jurisdiction.

4.1.2.3.2. *Taxation of residents and citizens*

It is the common understanding among scholars that general international law does not provide for a broad and general norm according to which taxation is limited in the sense of a territorial system.[446] A territorial system, for the purpose of the present section, is understood as a tax system according to which only income sourced in a certain country is taxed in that country. Prima facie, moreover, it seems that general international law allows a state to at least tax its residents on their worldwide income. This means from a general international law perspective, "residency" and, as it was shown, "citizenship" as a link seem to grant the resident state unlimited tax jurisdiction.[447] This seems evident, as most states have at least partial worldwide tax systems in the event that a corporation or an individual is resident.[448] General international law seems not to limit worldwide tax sys-

444. *See* secs. 11.5. and 11.6.
445. We highlighted this, in particular, with reference to the seminal articles of Mann (*see* sec. 4.1.1.3.).
446. Albrecht, p. 158 et seq.; Mann, 1964, p. 113 et seq. For a deviating opinion with respect to impersonal taxes *see* Martha, p. 54 et seq.
447. On citizenship taxation, *see* sec. 4.1.2.2.4.
448. According to the IBFD Country Survey, less than 20% of states know territorial systems concerning corporate income taxes. Such a number does not include states that

tems if a person, whether a corporation or an individual, is a resident in a state or if a person is a citizen of a state. Moreover, no general principle of international law according to article 38(1)(c) of the ICJ Statute or rule of customary international law according to article 38(1)(b) of the ICJ Statute exists stating that taxation should be limited to a territorial understanding in the sense that only income sourced in one jurisdiction shall be taxed in said jurisdiction.[449] Of course, bilateral and multilateral double tax conventions limit the extent of jurisdiction.[450]

Thus, this means that general international law allows the taxation of extraterritorial income if a person is a resident in a state. We are not suggesting that the taxation of residents and citizens ought to be structured in such a manner, but we are arguing that general international law sets no limits regarding the taxation of residents. Again, it is important to distinguish the question of legality (i.e. what is in line with general international law) from the question of how jurisdiction should be understood based on, inter alia, justice considerations.

As a result of the legality of worldwide tax systems, international tax law plays a particular role within international economic law, as it seems to be one of the only areas of international economic law in which domestic rules lead to factual extraterritorial jurisdiction due to the taxation of foreign income.[451] Another consequence of the application of worldwide taxation is that the risk of double taxation is obvious and that there seems to be a need for allocation rules in order to reduce the tax burden triggered by such double taxation.[452] Therefore, a taxing right is often not "exclusive but conjunctive".[453]

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know a partial territorial system (i.e. for active income only). *See*, with further references to case law, in particular, in the United States, Monsenego, p. 47 et seq.

449. *See* Hinnekens, p. 284 et seq. *See also* Lehner, in: Vogel & Lehner, 2014, Grundlagen para. 13; Schön, 2009, p. 91; Monsenego, p. 47 et seq. With further details, *see also* Martha, p. 48 et seq.

450. On the functioning of international tax treaties *see* sec. 4.2.3.3.

451. Meng, p. 450: "*Die Erörterung ausgewählter Konfliktfälle und Regelungsmaterien aus der Praxis hat gezeigt, dass eine reine Auslandsanknüpfung, soweit sie nach der vorgegebenen Definition extraterritoriale Jursdiktion darstellt, von Einzelfällen im Aussenwirtschaftsrecht abgesehen, überwiegend nur im Steuerrecht vorkommt*."

452. This is of course, again, a normative claim that there "ought to be" an allocation of income in order to avoid double taxation. We will specifically deal with such a claim in sec. 11.2.3.4.

453. Christians, 2009b, p. 108. *See also* Monsenego, p. 42 et seq. From an international law perspective, *see* Mann, 1964, p. 10. Overlapping jurisdictions, however, is not particularly related to tax law, as it also exists in other areas of law (*see* Staker, p. 329).

4.1.2.3.3. *Taxation of non-residents*

So far, the focus has been on the question of to what extent a state can tax its residents and citizens according to general international law. We have seen that general international law does not provide for a limitation that a state shall only tax domestic-sourced income. However, the missing legal limitations of worldwide taxation in general international law (i.e. besides the genuine link doctrine as a justification for taxation)[454] could also mean that there is no limitation of source taxation and source states could legally also tax foreign income, i.e. income that is not sourced in the source state.[455] This would mean that a state could, for instance, tax the entire income of a foreigner, even if such a person only owns real estate in a state and has not been physically present in that jurisdiction. It also means that the state of the PE could also tax the income of the foreign headquarters. This question has not yet attracted the necessary attention among tax scholars, as it is sometimes thoughtlessly concluded that general international law limits the rights of source states to tax domestic (i.e. source) income.[456] Monsenego is an exception in this respect and he concludes after detailed analysis that, "international law does not prohibit the taxation of non-residents on foreign income."[457] Yet, his conclusion, which we generally share, needs some further specifications.

From a legal perspective, it seems at first glance that the genuine links triggering source taxation are generally not sufficient to create a worldwide tax liability. Mann claims that this reflects a "sensible doctrine of international jurisdiction."[458] For instance, Mann holds that the state of the PE "does not thereby become so closely connected with the enterprise as a whole as to justify it in assuming jurisdiction over the foreign enterprise's conduct abroad."[459] This indeed seems to be a rule of general international law followed by all states. At least, as far as it can be observed, there is no state taxing the worldwide income of an enterprise due solely to the fact that such an enterprise has a PE or, as far as it can be observed, there is no state actually taxing the worldwide income of an individual resident in another state only because that person owns immovable property in another state, or based on another mere source connection, such as the fact that a person receives income from a source in a state.

454. *See* sec. 4.1.2.2.3.
455. *See also* Monsenego, p. 52 et seq. Contra, Martha, p. 54.
456. *See*, for example, Cavelti, 2016, para. 557.
457. Monsenego, p. 54.
458. Mann, 1964, p. 115.
459. Id.

However, we would agree with Monsenego that this does not mean the source states are not allowed to tax any foreign income, although source taxation in practice often means a territorial tax base.[460] The OECD MC itself indicates that a source state might be allowed under general international law to tax foreign income just as, for instance, the state of the PE might tax foreign-sourced dividends according to article 21(2) of the OECD MC if these dividends are effectively connected to the PE.[461] In other words, the taxing rights of the source state do not seem to be limited to income sourced in the same territory, and general international law does not oblige states, in the case of a source-connecting factor, only to tax a territorial tax base. This leads us to the following initial observations.

According to general international law, residency and citizenship seem to be sufficient to create taxation on a worldwide tax base, but source as a genuine link is not. However, general international law seems not to limit the taxing rights of the source state to income sourced in the source state (i.e. territorial base). Source as a link might still allow states to tax foreign income, but as far as it can be observed, no state taxes a worldwide tax base merely because a source of income is in a state. However, it must be admitted that no international case law (e.g. of the ICJ) exists that supports these observations, nor is any international case law available that would deny such observations from a general international law perspective. The question then is how to distinguish between source and residence from a general international law perspective.

4.1.2.3.4. *Source vs residence from a general international law perspective*

We have not yet answered the question of how to define source and residence. However, the latter is a necessary condition for our conclusion. In other words, it would not be sufficient to argue that general international law allows taxation to a different extent depending on whether a source or residence link is given, if it is not defined what source and/or residence mean. It seems that the source and residence concepts are blurred, as they trigger different legal limitations from a general international law perspective (i.e. worldwide vs [more or less] territorial systems), but they are not at all well-defined concepts. The main issue is that these concepts are domestic concepts and states are generally free to define what source and residence is, considering potential treaty obligations, of course. A treaty might further

460. *See* Cavelti, 2016, para. 554, who reviewed six countries.
461. Monsenego, p. 53 et seq.

limit the taxing right of a state and further narrow the terms "source" and "residence", but if no treaty exists, a state seems – from a general international law perspective – free to define what source and what residence mean. In fact, these concepts might even overlap, as the following example will show:

If a state has a very low residence threshold, the question is whether this could be seen as an infringement of general international law, as de facto, such a residence is only a source connection and, therefore, taxes should not be levied on a worldwide tax base following the considerations above. To be more concrete, according to Swiss domestic law, residence taxation is already triggered if a person spends more than 30 days in Switzerland and has employment in Switzerland.[462] No one has questioned the compatibility of such a rule with general international law, but it demonstrates the blurred concept of jurisdiction-to-tax and, in particular, the blurred distinction between residence and source from a general international law perspective. Would it, for instance, still be in line with general international law if a state sets the residency threshold at the level of 10 days spent in such a jurisdiction? Or would a physical presence of only 10 days not justify residency?

These questions are often answered with normative arguments, for instance, with reference to the ability-to-pay principle or the benefit principle.[463] It could, for instance, be argued that in this case (i.e. a 10-day rule), the benefits obtained by a person are not sufficient to justify worldwide taxation, but if a person stays 30 days in a country, unlimited taxation is justified. Yet, this is a normative analysis and again shows the weak international law framework, as general international law does not provide us with any guidance on how fiscal jurisdiction should be drafted in order to be considered just, nor how we should distinguish between source and residence. Moreover, while rendering such a normative analysis, we would even suggest refraining from using the terms "residence" and "source" in order to justify certain taxation, be it either worldwide or territorial. In a normative review, it is crucial that the underlying normative reasons are disclosed for such purposes and it needs, therefore, to be disclosed why a link should trigger worldwide or only territorial taxation, and reference to these blurred concepts is not sufficient.

462. Art. 3(3)(a) Federal Tax Act, 14 Dec. 1990.
463. *See*, for example, Monsenego, p. 48 et seq., who uses the ability-to-pay principle and the benefit principle in order to justify worldwide taxation of residents as a concept in line with international law. *See also* Cavelti, 2016, para. 129 et seq., who uses several normative arguments (including efficiency considerations) for his presumably legal analysis.

It is often argued (presumably from a legal perspective)[464] that a personal link (or personal allegiance) might justify worldwide taxation compared to a mere economic link (or economic allegiance), because if a personal link is given, a person is under the sovereignty of a state. However, we do not see any grounds for such a conclusion, at least from a general international law perspective. In other words, the distinction between personal and economic genuine links is not persuasive to justify worldwide or only territorial taxation, and it has no legal content. General international law does not provide any clear guideline on how to distinguish between personal and territorial links.

These remarks show that the concepts of source and residence are arbitrary from a general international law perspective, as source might actually be residence, depending on the domestic definition of residence. Moreover, these concepts do not combine the quality of the genuine link and the tax consequences. The source and the residence approach provide for an overly simplified binary answer to the complex question of jurisdiction-to-tax from an international law perspective. General international law does not suggest such a binary categorization between personal and economic links, and general international law, in particular, does not provide a defined line between personal and economic links or between source and residence, respectively. The concepts of source and residence have no common legal understanding around the globe, as each state applies different definitions of source and residence.[465]

These ambiguities again disclose the diffuse guidelines that can be derived from general international law, revealing the need to refer to an outside discipline in order to review how jurisdiction ought to be defined in order to be considered just. Therefore, we are not (yet) suggesting that the distinction between source and residence corresponding to the distinction between worldwide and territorial taxation is causing justice deficiencies, but we argue that general international law, per se, does not help us in solving the source vs residence dilemma, as general international law does not address these concepts, and does not provide us with detailed guidelines in which circumstance territorial or worldwide taxation is justified.

464. *See*, for example, Blumenstein & Locher, 2016, p. 71.
465. *See* Vogel, 1988, p. 229, at least regarding the term "source" and not specifically focusing on international law.

4.1.2.4. Income allocation and fiscal jurisdiction

Some authors rightly argue that with respect to international income allocation for tax purposes, the genuine link doctrine does not provide for a solution.[466] There is no legal basis to claim that income taxation should be limited to territorial income. General international law, besides the few mentioned limitations, indeed does not provide for detailed rules on how income relating to cross-border activities should be allocated among different countries.[467]

Income allocation among various states is a political task and the result of such allocation negotiations is very open and unsure.[468] However, we will show below that justice considerations or a normative analysis might at least suggest certain allocation principles.[469] The latter would also influence the question of how residency and source should be defined.[470] Therefore, the current allocation system (mainly the arm's length principle)[471] is not based on any principles or rules of general international law, but is instead the result of inter-state negotiations. In other words, if the world would again be required to negotiate the applicability and the design of the allocation rules within the UN MC and the OECD MC, the outcome might be different than the current state of the art. Such a conclusion is undermined by two strong statements.

The first one relates to von Schanz, who developed a system of cross-border income allocation before the League of Nations started its work in this respect, i.e. in a "pre-double-tax-treaty-world". According to him, the source state should receive three quarters of the total income of an enterprise.[472] Although we will not discuss the details of his idea, his normative claim seems not at all to be reflected in the current international tax regime[473] and, therefore, is a clear sign that income allocation rules – as they are currently drafted – are a matter of political strength and negotiation skills, rather than the result of a crystal-clear legal analysis. The second statement

466. Schön, 2009, p. 93.
467. We have only seen that when a foreigner receives income sourced in a certain state, the latter state is not allowed to tax the worldwide income of such a person.
468. Schön, 2009, p. 93.
469. *See* sec. 11.5.2.
470. Regarding the normative definition of residency of corporate taxpayers *see* Marian, p. 1613 et seq.
471. For more details *see* sec. 12.2.2.1.
472. Von Schanz, p. 365 et seq.
473. On the current allocation according to double tax treaties, *see* sec. 4.2.3.3.

relates to the CARICOM agreement, which is a multilateral convention between various Caribbean countries dealing, inter alia, with the avoidance of double taxation.[474] It provides, for instance, for exclusive source taxation in the respective interest and royalties article, which seems to be more or less the opposite of the current system following articles 11 and 12 of the OECD MC and the UN MC, or at least the states' practice based on these models, which tends to minimize source taxation. It also shows how artificial income allocation is and proves that there is not a rule of general international law besides rules contained in double tax treaties, which would actually require income allocation in line with the arm's length principle.

In conclusion, general international law does not specifically regulate income allocation if no double tax treaty applies. In other words, different allocation keys would be in line with general international law. In order to distinguish which allocation key, if any (e.g. the arm's length principle or a specific formula), would enhance justice in the international tax regime, reference to an outside discipline might be necessary, as general international law does not provide any useful guidance on how a just allocation key ought to be drafted.

4.1.2.5. Transfer of fiscal competences

In general, it is at the discretion of a state to shift parts of its (fiscal) competence to another state. This does not mean that such a state is no longer sovereign. This is true if there is a possibility of reclaiming some of the transferred competences. Shifting certain fiscal competences is not a mere theoretical issue, as recent years have shown that under certain circumstances, a state might actually seek to cooperate intensively with another state, and due to such collaboration, might lose parts of its fiscal sovereignty.

The issue was, for instance, already relevant more than 90 years ago, when Switzerland and Liechtenstein signed a (terminable) agreement on a customs union in 1923.[475] By doing this, Switzerland and Liechtenstein have not refrained from their sovereignty, but they did shift certain competences to another state.[476] Another example is the EU, which has also led to a shift

474. For more details *see* sec. 4.2.4.2.
475. CH/LI: Vertrag zwischen der Schweiz und Liechtenstein über den Anschluss des Fürstentums Liechtenstein an das schweizerische Zollgebiet [Treaty between Switzerland and Liechtenstein concerning the connection of the Principality of Liechtenstein to the Swiss customs territory] [author's translation], 29 Mar. 1923.
476. *See* Guggenheim, p. 166.

of certain parts of fiscal competence to central authorities, be it the ECJ or the European Commission.[477]

Two more recent examples should further illustrate the shift of fiscal competences. The first one relates to Rubik agreements, which introduce an extraterritorial levy of taxes. According to Rubik agreements, banks resident in one participating state will levy income taxes on behalf of the other state regarding non-disclosed bank accounts.[478] This means that the actual levy of taxes occurs abroad and part of the competence to levy income taxes is shifted to foreign banks. The second example is more theoretical and relates to the option to implement an in-depth cooperation regarding the taxation of the digital economy. In this respect, it has been proposed that when one agrees that enterprises of the digital economy should pay income taxes in a state, even though they do not have a physical presence there, the state of residence should levy income taxes on behalf of other states, and should then distribute the collected taxes among the involved countries.[479] Such a shift of fiscal competence would be in line with general international law.

4.1.3. Justice and the principle of sovereignty – Some concluding remarks

The principle of fiscal sovereignty – understood as a peremptory norm of international law – provides for very few limitations. We showed that if a person, be it an individual or a corporation, has no genuine link to a jurisdiction, then such state is legally not allowed to levy any income taxes from such a person, according to general international law. However, what a genuine link means is not clear. Moreover, it has been shown that states can tax the worldwide income of a person if such a person is resident in a jurisdiction, but international law does not state any guidance on how residency must be defined.

Moreover, if the jurisdiction-to-tax is with a specific state, it has also been demonstrated that it is – if no treaty obligations exist – in the full discretion of the state to decide whether it wants to levy taxes at all and what kinds of taxes. This means that there is no prohibition in international law that generally requires a state to levy income and/or corporate income taxes at all. Furthermore, there are no legal constraints with respect to the allocation

477. E.g. regarding direct taxation Isenbaert, p. 1 et seq.
478. *See* sec. 4.2.2.
479. *See* Hongler & Pistone, p. 36 et seq.

rules used to allocate income in a cross-border circumstance. Therefore, in international tax law, jurisdiction is concurrent and not at all exclusive.

Importantly, these remarks reflect the outcome of a legal analysis and not a normative one. This means we reviewed the legal framework of international law in which a domestic tax system may operate. As was already indicated, we would not support all of the genuine links currently sufficient for triggering worldwide taxation following a normative review. In particular, CFC rules seem to be an extreme example of fiscal jurisdiction, as the link to the parent state might be very limited in order to potentially create unlimited tax liability. The legal principle of fiscal sovereignty does not, moreover, provide for sufficient guidance on the inter-state allocation of income. Or, as stated by Bird and Wilkie in an extreme manner: "There are no rules of international taxation."[480]

We will demonstrate in Part IV of the present study whether such legal conclusions find support from a normative perspective. Therefore, we will also review whether it is desirable to have an international system of exclusive jurisdiction,[481] as compared to the current system of largely concurrent jurisdiction.

4.2. Treaty-based rules of the international tax regime

4.2.1. What is an international treaty?

4.2.1.1. Preliminary remarks

The present chapter intends to shed further light on the international law understanding of treaties, with a special focus on tax treaties and their specific characteristics. The exact definition of a treaty depends on its context. For instance, the definition of a treaty in article 2(1)(a) of the VCLT relates to the scope of the VCLT, but states might domestically apply a different definition of what an international treaty is.[482]

In international law, an international treaty or convention according to the VCLT is generally defined as (i) a binding obligation based on implicit

480. Bird & Wilkie, p. 79.
481. Such claim is, for instance, made by Mann, 1964, p. 50 et seq.
482. For more details about defining treaties in context, *see* Hollis, p. 13 et seq.

or explicit consent, (ii) between subjects of the international legal order,[483] (iii) governed by international law.[484] These prerequisites will be further examined in the following with a special focus on international tax law. Another requirement is that the treaty is not invalid by a number of reasons, including (but not exhaustively) threat and error. The latter will be dealt with below through a special focus on coercion and its potential impact on the validity of tax treaties.[485] We will then further focus on tax treaties, both bilateral and multilateral, and we will conclude the present chapter on treaty-based rules with a section on justice and treaties.[486]

4.2.1.2. Binding obligation

4.2.1.2.1. *In general*

In order to demonstrate whether a document is indeed an international treaty in the aforementioned sense, it is crucial to determine whether the parties had the intention to create a legal obligation under international law. For instance, a mere letter of intent does not create a legal obligation for the participating states.[487] However, the distinction is not always simple.[488] The denomination is, as a preliminary remark, not decisive in order to decide whether an international treaty obligation is created.[489] For instance, the ICJ had to deal with the question of whether minutes of a meeting can be seen as an agreement. The Court concluded that:

> The two Ministers signed a text recording commitments accepted by their Governments, some of which were to be given immediate application. Having signed such a text, the Foreign Minister of Bahrain is not in a position subsequently to say that he intended to subscribe only to a "statement recording a political understanding", and not to an international agreement.[490]

483. For the purpose of the present study, such subjects are states, but also international organizations (such as the OECD and the UN).
484. E.g. Degan, p. 357. *See*, with further details, Heintschel von Heinegg, in: Ipsen, § 10 para. 1; Verdross, 1973, p. 40, et seq.; Verdross & Simma, § 534. *See also* the definition in art. 2(1)(a) VCLT.
485. *See* sec. 4.2.1.5.2.
486. *See* sec. 4.2.5.
487. Heintschel von Heinegg, in: Ipsen, § 10 para. 3. For further details, *see* Verdross & Simma, § 545.
488. *See*, inter alia, with further references to international case law, Chinkin, p. 230 et seq. For a detailed analysis of the demarcation line between soft law and international treaties, *see* Giersch, p. 73 et seq.
489. For further details *see* Crawford, p. 371. *See also* Boas, p. 54; Verdross, 1973, p. 42; Verdross & Simma, § 536.
490. ICJ, Maritime Delimitation and Territorial Questions (*Qatar v. Bahrain*), p. 122.

In order to determine whether a certain document actually creates a legal obligation, the wording of the agreement is crucial,[491] but subsequent practice of the state can also be helpful for a final determination.[492] Furthermore, according to the ICJ, it is not relevant what the intentions of the specific signing ministers were.[493] A separate but related central distinction for the purpose of the present study and for international tax law, in general, is the distinction between a binding resolution of an international organization (i.e. a treaty obligation) and a mere recommendation. Such a distinction is also made based on the question of whether a binding obligation exists. It seems clear that if an international organization adopts a mere recommendation, the involved state representatives were of the clear opinion that their state was not bound by such a document.[494] Often, decisions of international organizations do not create binding obligations among the member states and in very few cases does a resolution of an international organization have the character of an international binding treaty.[495]

4.2.1.2.2. *Some examples from a tax perspective*

As an example, the UK and German governments published a joint statement as "Proposals for New Rules for Preferential IP Regimes".[496] The joint declaration provides a statement of both states, i.e. the UK and Germany, according to which preferential IP regimes shall require substantial economic activities to be undertaken in the jurisdiction in which a preferential regime exists. Such IP regimes are generally referred to as "nexus" or "modified nexus" regimes. By publishing such a joint declaration, the UK and Germany made several proposals under which IP box regimes should still be allowed. Furthermore, the joint declaration provides for some proposals on the legislative grandfathering of existing regimes, which would not be compliant with the BEPS Project.

However, the proposal of the UK and Germany, at least according to the author's understanding, does not create a legal obligation in the sense of a treaty obligation, as it is merely a declaration of intention by these two

491. E.g. Giersch, p. 80.
492. Chinkin, p. 239 et seq.
493. *See* ICJ, Maritime Delimitation and Territorial Questions (*Qatar v. Bahrain*), p. 121 et seq.
494. Giersch, p. 81; Van Hoof, p. 179 et seq.
495. For further details, *see* Giersch, p. 206 et seq.
496. DE/UK, Proposals for New Rules for Preferential IP Regimes. The joint declaration is available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/373135/GERMANY_UK_STATEMENT.pdf (last visited 14 Sept. 2017).

countries. The wording[497] of the joint declaration does not oblige the UK in a way that it would be required to amend its existing (domestic) IP regime within a certain time frame. It seems more to be a mere commitment by the UK and Germany to follow the mentioned path and to abolish domestic regimes, if any, which are not in line with the stated joint declaration. One could also use the term "pledge" in order to describe the quality of the joint declaration and to distinguish it from a binding contract.[498] Therefore, contracts create a legal obligation, while pledges only establish a moral or political obligation.[499] Furthermore, no other statements of the parties would lead to a different conclusion that the proposal qualifies as a binding treaty.[500] Therefore the joint declaration does not have the same legal force as a treaty.[501]

The OECD/G20, in the aftermath of the aforementioned joint declaration, published an agreement on a modified nexus approach for IP regimes.[502] The document seems, from a formal perspective, to qualify as an international treaty, as it is even called an "agreement".[503] Furthermore, some parts of the wording support such an opinion:

"This consensus achieved by the FHTP …."[504]

"General acceptance of the Modified Nexus …."[505]

"The FHTP further agrees that any legislative process necessary to make this change must commence in 2015."[506]

497. For further details on the importance of the wording of a document for the question of whether the parties are legally bound, *see* Giersch, p. 208 et seq.
498. *See* Raustiala, p. 581 et seq., who refers to the terms "contract" and "pledges" in order to describe the different quality between binding and non-binding.
499. Id., p. 586. The article of Raustiala and the discussion among international lawyers has much more depth than the remarks within the present study. However, it would go beyond the present study to provide for a comprehensive distinction between binding and non-binding treaties. *See*, e.g., Klabbers, 1996, p. 1 et seq.
500. For further references on the behavior of the parties for the creation of a legal obligation, *see* Giersch, p. 209 et seq.
501. *See also* Hollis, p. 33 et seq.
502. OECD/G20, Action 5: Agreement on Modified Nexus Approach for IP Regimes (OECD 2015).
503. However, the nomenclature is not a decisive element in order to qualify a document as an international treaty (Chinkin, p. 229 et seq.).
504. OECD/G20, Action 5: Agreement on Modified Nexus Approach for IP Regimes (OECD 2015), p. 3.
505. Id.
506. Id., p. 4.

Therefore, the participating states within the FHTP clearly indicate that there is an agreement and that the states "must" act. The wording seems to suggest that the states are of the opinion that they are bound by such agreement. This would mean that states would have the (international law) obligation to change their domestic IP regimes in order to align with the agreed (modified) nexus approach. It must not necessarily be a bilateral or multilateral contractual document outside an international organization.[507]

However, according to the document, the consensus was reached within the FHTP, which is not competent to influence domestic tax law in such a considerable manner. The scope of the agreement goes beyond the competence of the FHTP. Furthermore, the document does not even contain references to the persons who actually "signed" the agreement. Therefore it is not sufficient to create a treaty obligation if a group of representatives of tax administrations, such as the members of the FHTP, agree on a certain legislative framework.[508] This also seems to be the understanding of the member jurisdictions, as none (at least as far as can be observed) have initiated a domestic ratification process of such an "agreement", which would likely be required in several states if the "agreement" indeed qualifies as an international treaty. Nevertheless, the "agreement" creates a significant degree of obligation, even if it does not yet qualify as an international treaty.[509] Therefore, if we draft a spectrum between no law and hard law, such an "agreement" qualifies as soft law, which is certainly closer to hard law than to no law.[510]

Other important instruments of current international (tax) policy are MoUs – memorandums of understandings. For instance, the United States and India have signed an MoU as an attachment to their double tax convention. In an exchange of notes on 12 September 1989, the following is held:

507. *See also* Giersch, p. 83, who, however, follows a narrow understanding of what kinds of resolutions might qualify as a treaty.
508. It is a common understanding within international law that only the Head of State, the Head of Government and the Minister of Foreign Affairs are deemed to represent a state (without any explicit authority). None of these were part of the FHTP and the representatives therein also did not have a specific authority to bind their states. *See* for further details, for instance, International Law Commission, Guiding Principles, applicable to unilateral declarations of States capable of creating legal obligations, with commentaries thereto, 2006, p. 372 et seq.
509. *See*, with respect to the OECD Report on Harmful Tax Competition, Christians, 2007, p. 331. *See also*, as an example of the influence in Switzerland, Hongler, 2016, p. 103 et seq.
510. For the definition of soft law for the purpose of the present study, *see* sec. 4.3.4.1.

> During the course of the negotiations leading to conclusion of the Convention signed today, the negotiators developed and agreed upon a memorandum of understanding intended to give guidance both to the taxpayers and the tax authorities of our two countries in interpreting aspects of Article 12 Royalties and Fees for Included Services relating to the scope of included services.[511]

Accordingly, one could conclude that the parties are actually bound by the interpretation within the memorandum of understanding, i.e. that they have created a legal obligation to interpret article 12 of the double tax convention in a certain manner. However, as will be shown by the following quotation, which is part of the MoU, it seems that the memorandum of understanding is more a letter of intent than an international treaty, creating a binding obligation in the sense of the aforementioned definition:

> It is also my Government's view that as our Governments gain experience in administering the Convention, and particularly Article 12, the competent authorities may develop and publish amendments to the memorandum of understanding and further understandings and interpretations of the Convention.[512]

Another example is the joint statement of Switzerland and the EU on the future validity of certain tax regimes in Switzerland. The latter could also be called a memorandum of understanding, although it is officially named a "joint statement". The joint statement intends to resolve the long-lasting tax dispute between Switzerland and the EU. Before digging deeper into an analysis of the joint statement between Switzerland and the EU, it should again be highlighted that the nomenclature or the form does not itself qualify a document as either an international or non-binding letter of intention.[513]

The joint statement states, inter alia, the following:

> The parties concur that tax avoidance and tax evasion need to be countered appropriately.
>
> Anti-abuse provisions or countermeasures contained in tax laws and in double tax conventions play a fundamental role in counteracting tax avoidance and evasion.

511. US/IN: Convention between the Government of the United States of America and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, 12 Sept. 1989, Notes of Exchange III, 12 Sept. 1989.
512. Id.
513. *See* Aust, 2012, p. 46 et seq. For more details about MoUs *see* Aust, 2013, p. 28 et seq. *See also* Hollis, p. 28 et seq.

> The parties agree that the application of anti-abuse rules or countermeasures needs to be justified and transparent and to correspond to generally accepted international standards.[514]

Furthermore, it is held that:

> The Swiss Federal Council therefore intends to adopt draft legislation and open the compulsory consultation process with the cantons, political parties and other interested groups as soon as possible.[515]

Therefore, it is persuasive, given the wording of the latter sentence, that the Swiss Federal Council only intends, i.e. pledges, to do something, but is by no means obliged in the sense of a contractual obligation to do something. The joint statement is not an international treaty.

Thus, as a concluding remark, the recent enhanced international cooperation in tax matters has also been accompanied by different instruments of international policy at the border between soft and hard law, be it joint statements, MoUs or joint declarations. Therefore it is more than ever of crucial importance to understand the legal framework in which international tax law operates and, in particular, the distinction between binding and non-binding rules.

4.2.1.2.3. *Unilateral statements*

Another issue that could be of relevance from a tax perspective is whether unilateral statements create a legal obligation based on the good faith principle or based on another justification.[516] In international law literature, reference is often made to the *Nuclear Tests* case of the ICJ when dealing with the potential binding effect of unilateral statements.[517] In this case, the French government announced that it would not render any further atmospheric atomic tests. One of the questions within the proceedings was whether France, through its concession, unilaterally entered into a binding legal obligation. In its judgment, the ICJ held the following:

514. CH/EU: Joint Statement between the Representatives of the Governments of the Member States of the EU and The Swiss Federal Council, 14 Oct. 2014, sec. 2(II).
515. Id., sec. 3.
516. *See* Cedeño Victor Rodriquez & Torres Cazorla Maria Isabel, Unilateral Acts of States in International Law, Max Planck Encyclopedia of Public International Law (available at http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1496?rskey=Wl5QQI&result=1&prd=EPIL, last visited 14 Sept. 2017).
517. E.g. Chinkin, 242 et seq.; Thirlway, 2014, p. 45.

> When it is the intention of the State making the declaration that it should become bound according to its terms, that intention confers on the declaration the character of a legal undertaking, the State being thenceforth legally required to follow a course of conduct consistent with the declaration.[518]

Besides the case law of the ICJ, the International Law Commission published in 1996 "Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations", which addresses the legal nature and potential impact of unilateral statements. According to article 1 of these guidelines, the following needs to be considered:

> Declarations publicly made and manifesting the will to be bound may have the effect of creating legal obligations. When the conditions for this are met, the binding character of such declarations is based on good faith; States concerned may then take them into consideration and rely on them; such States are entitled to require that such obligations be respected.[519]

Unilateral declarations are only binding to the extent that they were made by a competent authority.[520] This means that a representative of a state's tax authority cannot bind a state by his declarations, as long as he is not competent to do so. Another aspect to be considered is the circumstance in which a unilateral statement occurred.[521] Therefore an analysis of whether a certain unilateral statement creates a binding obligation requires a review of the moment and location or premises in which a certain statement was made. For instance, regarding the BEPS Project, several states have published unilateral statements in order to, inter alia, demonstrate their commitment to the BEPS Project. For instance, on 6 February 2015 the Swiss State Secretariat for International Financial Matters ("SIF") published a unilateral declaration with the following wording:

> As all other 43 BEPS participating states, Switzerland endeavors to follow the transfer pricing documentation recommendations of the OECD. Switzerland

518. ICJ, Nuclear Tests Case (*New Zealand v. France*), p. 472.
519. For more details *see* International Law Commission, Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations, with commentaries thereto, 2016.
520. Art. 4 of the Guiding Principles, applicable to unilateral declarations of states capable of creating legal obligations.
521. *See* ICJ, Case concerning the Frontier Dispute (*Burkina Faso v. Republic of Mali*), p. 573 et seq. For further details, *see* Chinkin, p. 242 et seq. *See also* art. 3 of the mentioned Guiding Principles: "To determine the legal effects of such declarations, it is necessary to take account of their content, of all the factual circumstances in which they were made, and of the reactions to which they gave rise."

> is going to develop a legal base according to which the relevant enterprises are obliged to draft the relevant documents and to transfer them to the tax authorities.[522]

Of particular interest is the second sentence, according to which Switzerland is going to develop a legal base for the new transfer pricing documentation recommendations of the OECD. The wording suggests that Switzerland shows the will to be bound by such a commitment and is indeed obliged to develop such a legal base. However, the author understands that due to the lack of preciseness of the statement, it is difficult for another state to argue that Switzerland should be bound by such a unilateral statement. Moreover, it was not the intention of Switzerland to create any legal obligation by publishing it. The latter seems particularly true, as in February 2015, it was by no means clear what the outcome of BEPS Action 13 would be. Therefore, it is also important to develop the context in which a statement was made and not only to rely on the wording in order to decide whether an international treaty has been established.

4.2.1.3. Between bodies of international law

From a tax perspective, it is most common that tax agreements or non-tax agreements containing tax rules are signed between states as the bodies of international law. However, there are examples in which international agreements in the sense of the aforementioned definition are also signed between a state and an international organization that also qualifies as a body of international law.[523] For instance, the headquarters agreement between the UN and Switzerland as the host state is also a treaty governed by international law that contains tax rules.[524]

In order to qualify as an international treaty, it is crucial that both parties are bodies of international law.[525] This means that, for instance, a treaty in

522. Own translation. "*Wie alle anderen 43 Länder, die sich am BEPS- Projekt beteiligen, ist die Schweiz bestrebt, die Empfehlungen der OECD bezüglich der Verrechnungspreisdokumentation zu befolgen. Die Schweiz wird eine Rechtsgrundlage schaffen, die die betroffenen Unternehmen verpflichtet, die erforderlichen Unterlagen zu erstellen und den Steuerbehörden einzureichen.*" (Stellungnahme SIF zu den Publikationen der OECD im Rahmen des Projekts zur Gewinnverkürzung und Gewinnverlagerung [Base Erosion and Profit Shifting, BEPS], 6 Feb. 2015).

523. Webb, p. 567, mentions, for instance, that the UN is party to at least 1,500 international treaties. *See also* Hollis, p. 22 et seq.

524. For more details *see* Hongler, 2012b, p. 778 et seq.

525. However, a body of international law and another private contractual party may opt (explicitly or implicitly) for the application of international law to a specific contract (Kälin et al., p. 17).

the sense of a binding tax ruling between a state and a taxpayer is not an international law treaty. Another example from a tax perspective would be an agreement between the FIFA and a host state of an international competition, such as the World Championships.[526] Such an agreement is an agreement between a private association, according to Swiss law (i.e. FIFA), and a state; therefore, it is not governed by international law.

It is not required that a direct representative must sign an international agreement; in principle, a state is free to authorize a private institution or state-like institution to sign an international agreement. For example, from a tax perspective, in 1998 the Air Macao Company Limited and the Taipei Airlines Association signed an agreement on the exemption of airline taxes. However, both parties have signed a side agreement with their home states, authorizing them to sign on behalf of the government.[527] Another special case relates to the Holy See, which is part of the VCLT and has signed certain tax-related treaties, such as an exchange of information agreement with Italy.[528] The Holy See qualifies as body of international law and, therefore, can sign international treaties. Such a signature can be rendered either independently from the Vatican City State or together with the Vatican City State.[529]

Moreover, in the case of a federal state granting competence to some member states of the federation to sign treaties with another state, such an agreement is also an international treaty in the sense of the present definition.[530] However, a contract between members of that federation is not an international treaty.[531] For instance, there are certain reciprocal agreements between Swiss cantons regarding exemptions from inheritance and gift taxes for certain payments to non-profit organizations.[532]

526. *See* Von Heinegg, in: Ipsen, § 11 para. 12. *See generally* Verdross & Simma, § 374 et seq. Albrecht, p. 147, mentions another (older) agreement between the Imperial Government of Persia and the Anglo-Persian Oil Company Ltd., which would likely fall in the same category.
527. Sussman & Lu, p. 164 et seq.
528. IT/HS: Agreement between the Holy See (Vatican City State) and Italy for the Exchange of Information on Tax Matters, 1 Apr. 2015.
529. Epping, in: Ipsen, § 9 para. 1 et seq.
530. Degan, p. 364.
531. Verdross & Simma, § 541.
532. E.g. CH: Gegenrechtsvereinbarung zwischen den Kantonen Wallis und Zürich betreffend die Befreiung von der Erbschafts- und Schenkungssteuer für Zuwendungen an gemeinnützige oder kirchliche Zwecke [Mutual agreement between the cantons of Valais and Zurich concerning the exemption from inheritance and gift tax for donations to charitable or religious purposes] [author's translation], 30 Aug./5 Oct. 1978.

4.2.1.4. Governed by international law

The last requirement according to which an international treaty must be governed by international law refers to the distinction between international treaties and treaties between bodies of international law concerning civil law aspects. Some consider this the most important feature of an international treaty.[533] It is common among states that a transaction which occurs in a similar way among private individuals and/or corporations, such as a rental or purchase contract, is governed by domestic civil law and not by international law.[534]

4.2.1.5. The validity of treaties

4.2.1.5.1. *Overview*

If a treaty fulfills the above-mentioned requirements, it is valid and creates a legal obligation between the signing parties, as long as no grounds for invalidity occur or already existed at the time of the signature. A treaty is, for instance, invalid if it infringes *ius cogens*. This will be dealt with below.[535] Other reasons are stated in article 46 et seq. of the VCLT. However, in practice, very few international treaties have been declared invalid.[536] As mentioned by Klabbers, three categories must be distinguished: (i) improper procedure or authorization; (ii) result of something misleading or (iii) the result of coercion.

In the following, the focus is on (iii), the relation between coercion and invalidity. The reasons that coercion attracts special attention are that coercion is of particular importance from a global justice perspective, as philosophical theories might attach particular significance to coercion,[537] and one of the presumed injustices is that the recent development of an international tax regime seems to be led by strong economies, and other weaker states are likely to accept or have already accepted rules proposed by other states due to international pressure or coercion, respectively.[538]

533. E.g. Hollis, p. 25.
534. *See* Von Heinegg, in: Ipsen, § 10 n. 5; Degan, p. 393 et seq.; Verdross & Simma, § 541.
535. *See* sec. 4.4.3.2.
536. Klabbers, 2012, p. 555 et seq.; Verdross, 1973, p. 60 et seq.
537. *See*, for instance, sec. 4.4.1.
538. *See* the statements in sec. 1.5.

Injustice is not per se a reason for invalidity. Even a highly unjust treaty is valid from an international law perspective.[539] International law does not provide for a detailed framework according to which treaties must be well balanced. We will further deal with this aspect in section 4.2.5.

4.2.1.5.2. *Coercion and invalidity*

Invalidity because of coercion can be derived from two aspects that are dealt with in articles 51 and 52 of the VCLT. Article 51 of the VCLT refers to coercion against a state's representative while negotiating or signing an agreement. This is, however, not of great relevance for the present work. Instead, we focus on the question of invalidity in relation to coercion of the state itself, according to article 52, which is part of customary international law:[540]

> A treaty is void if its conclusion has been procured by the threat or use of force in violation of the principles of international law embodied in the Charter of the United Nations.[541]

The *ratio legis* of article 52 of the VCLT is rather obvious: A state shall not be bound if there is no consent on a certain agreement, as one of the states did not sign an agreement voluntarily, but rather based on coercion.[542] The wording of article 52 of the VCLT is quite specific in the sense that only military coercion leads to invalidity, not economic or political pressure.[543] To be more precise, this means a treaty is void in the case of the use or threat of force in an illegal manner. It contains a direct link to the UN Charter and article 2(4) of the UN Charter, respectively.[544] Furthermore, a military threat, as such, must be concrete and not only vague, as stated in the Fisheries Jurisdiction Case of the ICJ:

> There can be little doubt, as is implied in the Charter of the United Nations and recognized in Article 52 of the Vienna Convention on the Law of Treaties, that under contemporary international law an agreement concluded under the threat or use of force is void. It is equally clear that a court cannot consider an accusation of this serous nature on the basis of a vague general charge unfortified by evidence in its support.[545]

539. *See*, however, the application of an unwritten anti-abuse principle as a general principle of law in sec. 4.3.3.3.2.
540. Villiger, 2009, Article 52 para. 20, with further references.
541. Art. 52 VCLT.
542. Klabbers, 2012, p. 568.
543. *See* Villiger, 2009, Article 52 para. 7.
544. Schmalenbach, Article 52 para. 33 et seq.; Verdross & Simma, § 748 et seq.
545. ICJ, Fisheries Jurisdiction Case (*United Kingdom of Great Britain and Northern Ireland v. Iceland*), p. 14. *See also* Boas, p. 67.

Therefore, the metaphorical use of military language is not sufficient. As an odd example from a tax perspective, the threat of the former German Finance Minister Peer Steinbrück to make use of the "cavalry" in 2009 in order to force Switzerland to comply with the OECD standard of article 26 of the OECD MC[546] cannot be seen as a reason for the invalidity of the double tax treaty between Switzerland and Germany implementing the OECD standard that was signed later.

During the Vienna Congress, certain states were of the opinion that article 52 should be extended and not only cover military coercion.[547] There was, however, no consent in this respect and the participating states agreed on a declaration condemning the use of political and economic pressure in a treaty-negotiating scenario.[548] According to such a declaration, the participating states condemned:

> [T]he threat or use of pressure in any form, whether military, political, or economic, by any State, in order to coerce another State to perform any act relating to the conclusion of a treaty in violation of the principles of the sovereign equality of States and freedom of consent.[549]

Even though the declaration is clear in its wording and was adopted by 102 votes to none, it does not create a binding obligation on states, which means that a state cannot claim the invalidity of a treaty based on economic or political pressure. This means from a tax perspective that even though a state faces significant economic pressure, such as the risk of being blacklisted if it does not consent to a treaty, it does not lead to the invalidity of an international agreement that a state signed only to mitigate or abolish existing economic pressure.

For instance, Switzerland was essentially forced to sign the agreement with the United States on the request of information regarding UBS accounts in 2009,[550] as it would have otherwise risked a collapse or at least a signifi-

546. *See* http://www.nzz.ch/die-kavallerie-wird-nicht-ausgemustert-1.17888615 (last visited 14 Sept. 2017).
547. Villiger, 2009, Article 52 para. 2 et seq., with further references. *See also* Von Heinegg, in: Ipsen, § 16 para. 30.
548. For further details *see* Klabbers, 2012, p. 569, or with further reference on the Declaration on the Prohibition of Military, Political or Economic Coercion in the Conclusion of Treaties Schmalenbach, Article 52 para. 55 et seq.
549. Declaration on the Prohibition of Military, Political or Economic Coercion in the Conclusion of Treaties as part of the Annex to the Final Act of the United Nations Conference on the Law of Treaties, A/CONF.39/26.
550. CH/US: Agreement between the Swiss Confederation and the United States of America on the request for Information from the Internal Revenue Service of the United States of America regarding UBS AG, a corporation established under the laws of the

cant financial crisis of its domestic economy due to political and economic pressure. Another example is the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. The political pressure to sign the agreement is enormous and, even if a state (at least a member country of the OECD) does not sign such an agreement, it will likely face detrimental economic impacts, it is still a valid agreement. Political and economic pressure is not covered by article 52 of the VCLT.

Besides, there is also no type of prohibition of unequal treaties or non-reciprocal treaties in international law. This means that even though an agreement might be beneficial only to one party, it does not affect its validity. From a tax perspective, this is true, for instance, regarding TIEAs, but also for some double tax conventions, if such a double tax convention is only or mainly beneficial for one of the involved parties.[551] However, such a conclusion reflects a legal analysis and, of course, non-reciprocal agreements might potentially be considered unjust from a normative perspective.[552]

4.2.2. Tax rules in international treaties – A "*tour d'horizon*"

Not only in international tax law, but also in international law, in general,[553] treaties have become the main source of international law. Globalization, particularly cross-border trade, has further enhanced the development of a significant international treaty network. Currently, there are more than 3,000 double taxation conventions in force.[554] We will dedicate a specific section to the development and content of such a network of international double tax agreements.[555] However, this is not the end of the story as, inter alia, the following treaties have been signed in the past, which are themselves tax treaties or contain tax rules:

Swiss Confederation, SR 0.672.933.612, 19 Aug. 2009. There are many examples of evidence that Switzerland has signed the agreement due to political and economic pressure by the United States. For instance, *see* the debate within the Swiss Parliament (*see* National Council, 15 June 2010 – Amtliches Bulletin [2010], p. 971 et seq.; State Council, 9 June 2010 – Amtliches Bulletin [2010], p. 545 et seq.).

551. *See*, however, the deviating opinions among some states, as mentioned by Heintschel von Heinegg, in: Ipsen, § 16 para. 34.

552. *See*, for instance, sec. 11.3.

553. Degan, p. 355; Thirlway, 2014, p. 31. Or *see* Verdross, 1973, p. 38; Verdross & Simma, § 533.

554. OECD/G20, Action 15, Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15: 2015 Final Report (OECD 2015), p. 15.

555. *See* sec. 4.2.3.

First, in recent years, various (former) offshore jurisdictions or tax havens have signed TIEAs with other states. According to the published list of the OECD, there are currently over 500 TIEAs in place.[556] These agreements mainly follow the OECD model convention for a TIEA.[557] As shown by Moore & Sawyer,[558] the ratification of TIEAs has increased significantly since the G20 Washington Summit in November 2008. It is a very recent development within the international tax regime that states sign TIEAs. Through TIEAs the international tax regime has faced a significant expansion to offshore jurisdictions in the last decade.

Second, FATCA as a US regulation has led to new international agreements: in order to provide for a more efficient and more practical solution for FATCA FFIs, the US, in collaboration with other states, has developed two model agreements, i.e. the so-called inter-governmental agreements (IGAs). These agreements allow FFIs to comply with FATCA due to domestic legal impediments. Another reason why these IGAs have been necessary was the potential impact of reporting FFIs to the IRS and privacy rules in the state of residence of the FFI.[559] Without having an IGA in place, FATCA forces FFIs without any presence in the US to report to the IRS. This means that the extraterritoriality is not an expansion of the jurisdiction-to-tax by the US, but rather an expansion of the jurisdiction to report. The US has so far signed over 100 IGA agreements.[560]

Third, Rubik agreements have been signed by a few states. The term "Rubik" is not an official denomination, but initially, even governmental bodies in Switzerland, Germany and Austria used the term. Officially, these specific agreements are called "Agreements on the Cooperation in the Area of Taxation".[561] In the German speaking area, the term "*Quellensteuerabkommen*", i.e. "Source Tax Agreements" or "Withholding Tax Agreements", has also been used. As far as can be observed, only Switzerland (with the UK and Austria) and Liechtenstein (with Austria) have signed Rubik agreements as source states with other countries. Originally, Switzerland intended to implement a further agreement with Germany, but

556. The list is published online at http://www.oecd.org/tax/exchange-of-tax-information/taxinformationexchangeagreementstieas.htm (last visited 14 Sept. 2017).
557. The model agreement is available online at http://www.oecd.org/tax/exchange-of-tax-information/taxinformationexchangeagreementstieas.htm (last visited 14 Sept. 2017).
558. Moore & Sawyer, p. 76.
559. *See* Oberson, 2015b, p. 95.
560. The list is published online at https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx (last visited 20 Apr. 2019).
561. E.g. UK/CH: Agreement between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Cooperation in the Area of Taxation, 6 Oct. 2011.

the German parliament did not approve the already signed agreement.[562] The application of the Rubik agreements is not only governed by the agreements themselves, but Switzerland and Liechtenstein have also implemented specific domestic laws on the implementation of these agreements.[563] In simplified terms, Rubik agreements implement a system in which one of the contracting states and financial institutions collects taxes on behalf of the other contracting state with respect to taxpayers resident in the latter state owning bank accounts in the former state. As a consequence, these agreements also prevent international tax evasion, not necessarily by improving fiscal transparency, but rather by ensuring taxation. The purpose of these agreements is indeed to ensure effective taxation in one of the contracting states[564] by levying a one-time tax payment on existing accounts and a final withholding tax on future income on such accounts in the other contracting state. These agreements will likely be terminated or have already been terminated through the introduction of an automatic exchange of information.[565]

Fourth, several trade agreements contain provisions that are relevant from a tax perspective. It is not only the agreements within the WTO umbrella, such as GATT, GATS, SCM and ITA that have an impact on the international tax regime, but also bilateral or multilateral trade agreements. These agreements generally do not have a direct effect on taxpayers, in the sense that a taxpayer could claim a remedy under a WTO agreement in order to avoid or mitigate taxation.[566] Nevertheless, even though only states have access to the dispute resolution mechanism, the impact of the WTO on tax law is still significant. The case law of the bodies of WTO law has so far been focused on the trade of goods, even though GATS would also provide for certain measures to affect the taxation of services. The three most important tax features within trade agreements are most-favored-nation (MFN) rules,[567] the national treatment provisions[568] and the prohibition of subsidies.[569] The aim of these provisions is to lower trade barriers in order to raise standards of

562. Oberson, 2013, p. 375; Oberson, 2014, p. 355.
563. E.g. CH: Bundesgesetz über die internationale Quellenbesteuerung (IQG), 15 June 2012.
564. E.g. art. 1 of the CH/UK: Agreement between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Cooperation in the area of Taxation, 6 Oct. 2011.
565. E.g. the agreement between Switzerland and Austria was terminated as of 1 January 2017 (*see* https://www.admin.ch/gov/de/start/dokumentation/medienmitteilungen.msg-id-64470.html, last visited 26 Apr. 2019). However, the agreement between Liechtenstein and Austria is still in force.
566. *See* Farrell, p. 30.
567. E.g. art. II GATS.
568. E.g. art. XVII GATS.
569. E.g. art. XVI GATT.

living to ensure "full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services".[570] The procedures within the WTO framework led to the abolition of certain domestic tax regulations that were not in line with trade law agreements, such as GATT, GATS, SCM or the ITA.

The trade agreements have major income tax carve-outs, such as the rule that potential infringement of the MFN or the national treatment provision due to the application of double tax treaties is not covered by trade agreements. Article XIV(d) GATS also states that discrimination of foreign suppliers is justified if it is necessary to ensure equitable taxation.[571] From a conceptual point of view, both trade law and international tax law intend to enhance international trade in order to increase global growth, but as an important difference, tax law also needs to ensure that sufficient financing of public goods occurs. Trade barriers could be lowered to zero at a global level, but taxation cannot be reduced to 0% without jeopardizing the current world order based on sufficiently financed sovereign states. These differing goals might be one reason why tax law and trade law have taken different paths in the past.[572] Such a conceptual difference is also one reason why states are reluctant to agree on more fundamental cooperation within international tax law, such as through the implementation of global mandatory arbitration. Although some cases of the Panel and the Appellate Body of the WTO have had a significant impact on national legislation,[573] it is generally agreed that fiscal sovereignty is not endangered by WTO rules, even though it provides certain limitations, particularly with respect to indirect taxes.[574] Trade law has had the greatest impact on tax competition through (tax) subsidies and, therefore, some authors conclude that the WTO law framework would be the better place to deal with tax competition.[575] We conclude with Farrell that, "WTO should be recognized as an integral element of the multi-governance of international tax law, and that its impact should not be underestimated."[576]

Fifth, many further non-tax agreements contain tax rules. A non-tax agreement in the sense of the present section is an agreement between two bodies

570. Preamble of the Agreement Establishing the World Trade Organization, 15 Apr. 1994.
571. For more details *see* Cockfield & Arnold, p. 142 et seq.
572. With further references, *see* id., p. 144. *See also* the interesting remarks of McLure, 2001, p. 328 et seq., on the potential development of a GATT for taxes.
573. *See* the most comprehensive study by Farrell, p. 29 et seq.
574. *See* Farrell, p. 224.
575. Avi-Yonah, 2005, p. 129.
576. Farrell, p. 247.

of international law (be it two states or a state and an international organization) and taxation is only a minor or side aspect of such an agreement. Therefore, a double tax agreement is a tax agreement, as the main purpose relates to tax issues. In 2011, the Institute of Austrian and International Law hosted a conference about the various tax rules in non-tax agreements.[577] For this purpose, the national reporters were asked to develop a country report on the following examples (not exhaustive):

– Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations

– Convention on the Privileges and Immunities of the UN and of other international agreements

– Headquarters agreements between international organizations and their host state

– Status of forces agreements

– Cultural exchange agreements

– Development aid agreements and other agreements on technical and financial cooperation

Most of these agreements contain provisions according to which one of the signing parties should refrain from taxing certain citizens (or other specified persons) resident or domiciled in its territory.[578] For instance, some status of force agreements provide for tax exemptions for certain military forces serving abroad in other jurisdictions.[579] Non-tax agreements might therefore contain allocation rules, but often not in a reciprocal manner, such as is provided for in double tax conventions. For instance, in an aid and development agreement, only persons sent to work in the receiving state are exempt from income tax.

This makes sense, as few people are generally sent to the sending state, as the intention of an aid and development agreement is to support the

577. *See* the contributions in Lang et al. (eds.). *See also* with respect to tax rules in non-tax treaties, Norr, p. 443 et seq.
578. *See* Knechtle, p. 144.
579. Allie & Brauner, p. 891 et seq., with an overview on US status of forces agreements.

poor country through, inter alia, human resources and know-how.[580,581] Nevertheless, the mentioned aid and development agreements have a direct reciprocal impact as, for instance, the tax exemptions are granted because the state granting the tax exemptions receives a direct benefit due to these agreements, such as developmental aid or the relocation of an international organization to its territory.

The mentioned agreements are generally international treaties in the sense of VCLT even though it should be noted that both parties of these agreements are not necessarily states.

4.2.3. A closer look at double tax conventions

4.2.3.1. Preliminary remarks

In the following, after some preliminary remarks, we will first focus on the historical development of the current double tax treaty network,[582] and then we will outline the content of double tax treaties in an overview section.[583] These two sections are essential in order to understand and analyze the current international tax regime from a normative perspective as intended in Part IV of the present work. Double tax conventions have been the main element of the international tax regime not only in recent decades, but for as long as international tax cooperation has existed.[584] As already mentioned, more than 3,000 double tax conventions have been signed between states. The main driver behind such an impressive development has been globalization and the aim of abolishing cross-border trade obstacles, such as international juridical double taxation.

In the following, we will highlight a few empirical facts about the international treaty network, which we mainly owe to Braun & Zagler, and which are of particular interest for the present study. First of all, a shared colonial past has a positive impact on the likelihood of a double tax convention

580. E.g. CH/VN: Agreement between the Government of the Swiss Confederation and the Government of the Socialist Republic of Vietnam Concerning Development Cooperation, 7 June 2002.
581. Exceptions are the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations, as these agreements grant tax exemptions in a reciprocal manner.
582. *See* sec. 4.2.3.2.
583. *See* sec. 4.2.3.3.
584. *See* Knechtle, p. 143.

between two jurisdictions.[585] This means that if there were a colonial relationship, for instance, between the UK and India, it is more likely that a treaty exists than in a situation with no colonial past, e.g. between Sweden and the Philippines. Second, the same language being spoken in two states has a positive impact on the likelihood of a double tax convention. This means that it is more likely for Spain to have treaties with South American countries than with Asian countries. Third, the distance between two countries has an impact on the likelihood of a treaty between them. Fourth, Zagler & Braun demonstrate that the amount of official development assistance from an OECD country to a developing country has a positive impact on the likelihood of a double tax convention between these two jurisdictions.[586]

It goes without saying that a double tax convention qualifies as an international treaty and remains in the scope of the VCLT for the following reasons:

– It creates a contractual obligation:[587] This can be derived from the fact that the treaty obliges states, inter alia, not to tax certain income or capital.

– It is governed by international law:[588] The object of the tax treaty is taxation and taxation is a public competence; therefore, a double tax treaty is governed by international law and not by private law.

– It is signed by two bodies of international law:[589] In general, it is already stated in the title of a double tax convention that the agreement is between two states. For instance: "Convention between the Republic of Albania and The Kingdom of Belgium".[590]

The procedure of implementation of a double tax convention depends on the domestic legislative and constitutional framework of the contracting states. Also, whether a contracting state of a double tax convention is, according to domestic law, allowed to infringe a double tax convention obligation

585. Braun & Zagler, p. 256 et seq.
586. Id., p. 257.
587. *See* sec. 4.2.1.2.
588. *See* sec. 4.2.1.3.
589. *See* sec. 4.2.1.4.
590. AL/BE: Convention between the Republic of Albania and the Kingdom of Belgium for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and for the Prevention of Fiscal Evasion, 14 Nov. 2002.

by approving domestic provisions (i.e. treaty override) depends on the domestic constitutional and legal framework. For the sake of completeness, it is worth mentioning that double tax conventions generally do not regulate the allocation or attribution of taxing rights regarding specific taxpayers, but they do provide for rules that can be applied by all individuals and corporations if certain requirements are met. However, states might also sign treaties regarding specific taxpayers.[591]

4.2.3.2. Historical background

There are many ways of exploring the history of tax treaties. We chose to focus on the different institutional players who have influenced the current international and mainly treaty-based regime. After an overview of their development before 1920, we will separately discuss the work of the League of Nations between 1920-1945, the work of the UN after 1945, the work of the OECD/OEEC between 1956-2012 and the latest work of the OECD and the G20 since 2012.

4.2.3.2.1. *International tax law until 1920*

Leaving aside potential rules of international tax law in ancient Greece, the Roman Empire or in medieval times,[592] the starting point of the modern international tax regime is generally seen as the agreement between Austria-Hungary and Prussia signed in 1899/1900 that deals with different tax issues.[593] That agreement has since been a model for later double tax conventions or model tax conventions.[594] Not surprising is that the first

591. *See*, for example, at least regarding exchange of information, the agreement regarding UBS accounts between Switzerland and the United States, CH/US: Agreement between the Swiss Confederation and the United States of America on the request for Information from the Internal Revenue Service of the United States of America regarding UBS AG, a corporation established under the laws of the Swiss Confederation, SR 0.672.933.612, 19 Aug. 2009.
592. Lehner, p. 1149 et seq., with references to the roots of international tax law, in general, within Biblical law and Talmudic law.
593. Earlier treaties existed with respect to inheritance taxes. *See*, with reference to an agreement between the Swiss Federal Council on behalf of the canton of Vaud and the UK signed in 1872, as mentioned by Knechtle, p. 202 et seq. Or *see* the references of Bühler, p. 50, to the agreement regarding cross-border assistance between the Netherlands, France, Belgium and Luxembourg. On this topic *see also* Holmes, 2014, p. 60. *See also* Musgrave & Musgrave, p. 64 et seq.
594. Von Roenne, p. 24.

double tax agreements were signed among states with a very close relationship or even those within the same federation.[595]

The agreement between Austria-Hungary and Prussia provided for nine articles allocating taxing rights, for instance, regarding interest and pensions among the signing parties.[596] Subsequent agreements signed in the following years by Bavaria, Saxony and Austria-Hungary contained similar regulations.[597] These agreements were vital for the later development at the level of the League of Nations, which will be discussed in the following section. Furthermore, due to their federal system, some states had to deal with double taxation domestically. This is particularly interesting when considering that the very recent developments at the level of the OECD tend to partly harmonize domestic tax rules comparable to federal states, which also tried (and succeeded) to harmonize their tax systems. The question of allocating income is not limited (and also does not originate) within inter-national law, but has instead already been triggered by the overlapping jurisdiction-to-tax in federal states such as the US[598] or Switzerland.[599]

4.2.3.2.2. *The work of the League of Nations (1920-1945)*

After World War I, the steady growth of the economy, along with the need for fiscal revenue in order to recover the war costs-triggered deficits, led to an increasing amount of cross-border double taxation and further enhanced the development of an international double tax treaty network.[600] The approaches for how to tackle cross-border double taxation deviated significantly in the beginning among many countries. Some (even capital-exporting) states were reluctant to sign double tax treaties at all, as they believed that their state would not actually benefit from such agreements.[601] Other states quite actively started to sign tax treaties.

In the early 1920s, the League of Nations appointed four economists to elaborate the issue of double taxation. The group – consisting of Bruins

595. Lehner, in: Vogel & Lehner, Grundlagen para. 32. *See also* Vogel & Rust, in: Reimer & Rust, Introduction para. 20; Vogel, 1997, p. 278.
596. *See* Von Roenne, p. 24 et seq. *See also* Hemetsberger-Koller, p. 13 et seq.
597. Oeser & Bräunig, p. 2 et seq.
598. *See*, for instance, the seminal work of Harding, p. 1 et seq. Or from a later perspective *see* Hellerstein, 2012, p. 245 et seq.
599. For an overview of the development of intercantonal tax law in Switzerland, *see* Simonek, 2012, p. 221 et seq.
600. Lenz, p. 9; Vogel & Rust in: Reimer & Rust, Introduction para. 20 et seq.
601. *See*, for example, the reference to the treaty practice of the UK in Graetz, p. 293. *See also* Vogel, 1997, p. 278.

(Rotterdam), Einaudi (Turin), Seligman (New York) and Stamp (London) – outlined, among others, the (right) place of taxation for various types of income and wealth.[602] The report was submitted in 1923 and was presented in Geneva to the Financial Committee of the League of Nations.[603] It was later the starting point for drafting the first model tax convention in 1928.[604] A significant part of the report was dedicated to critical issues, such as the economic consequences of double taxation, but also to the consequences on the free flow of cash.[605]

Picciotto describes the report as a "compromise", as the expert group on one hand favored residence taxation in order to align with the ability-to-pay principle, but on the other hand, according to Picciotto, the four economists "acknowledged that considerations of pure theory might have to yield to the practical needs of national budgets"[606] and "[t]he report therefore accepted that agreement on the allocation of jurisdiction to tax could not be reached on the basis of any simple general principle."[607] Picciotto's remarks are of pronounced importance, as he shows that already in the early international debate in the 1920s and early 1930s, which was the basis for the later development of the international tax regime, jurisdiction-to-tax could not be allocated based on a single principle, such as the ability-to-pay principle or the neutrality principle.[608] Further authors have also analyzed the importance of the report for the discussion on the design of international tax law. However, there is no common understanding of the impact of the report.[609] What is remarkable for the purpose of the present work is indeed the intense reference to the ability-to-pay principle and the principle of economic allegiance.[610]

Inter alia, following the study of the four economists, a model convention was published in 1933 that contained 13 articles and was sent to the involved states for comment. Among others, the draft contained article VI,

602. For further details, *see* Ault, 1992, p. 567 et seq.
603. Von Roenne, 2011, p. 30; Vogel & Rust in: Reimer & Rust, Introduction para. 21. *See also* Picciotto, 1992, p. 20, who further demonstrates the other developments – besides the mentioned report – at the level of the League of Nations.
604. Holmes, p. 61.
605. In particular, the first part of the report (*see* Bruins et al., p. 5 et seq.). *See also* Jogarajan, p. 388 et seq.
606. Picciotto, 1992, p. 19.
607. Id.
608. *See*, with further details, Picciotto, 1992, p. 247.
609. *See* the different opinions as demonstrated by Cavelti, 2016, para. 151 et seq. *See also* Ault, 1992, p. 567 et seq.; Jogarajan, p. 368 et seq.
610. *See*, with further details, Bruins et al., p. 18 et seq.

which introduced the arm's length principle as the leading transfer pricing principle still in use today.[611] An important driver of the introduction of the arm's length principle into the model was a study by Carrol, who compared the allocation rules in 27 countries, particularly the legal framework of the United States at that time.[612] The 1933 draft was never approved by a higher authority. It contained significant deviations from the current international tax regime, as it was, for instance, suggested that non-residents should be exempt and taxation should remain solely with the resident state.[613] Remarkably, the draft focused on a bilateral tax treaty, but the League of Nations at that time also dealt with a potential multilateral tax treaty. However, the idea was not pursued further in the following years.

The Fiscal Committee continued its work and held regional conferences, inter alia, in Mexico in the early 1940s. Compared to the first draft published by the Fiscal Committee in 1933, the so-called Mexico Draft, which was published in 1943, was beneficial for developing countries, as the taxing rights were shifted to the source state.[614] The Mexico Draft was again revisited in 1946 and the taxing rights were again shifted back to the residence state in the so-called London Draft in 1946.[615] The League of Nations was replaced after World War II by the UN in 1946. The tax work of the UN will be outlined in the following section.

4.2.3.2.3. *The work of the UN (1946-)*

After World War II, several states signed double tax treaties based on the Mexico and/or London Draft, and the newly formed Fiscal Commission of the UN, the predecessor of the Fiscal Committee of the League of Nations, further worked on drafting a model convention. However, compared to other areas of international law, such as international trade law, the development of a more integrated tax world order has stopped in these years, even though the interaction with the work of the UN on international trade law has never been as close as it was within the first ten years following World War II.[616]

611. For further details *see* sec. 4.2.3.3.4.
612. Carrol, p. 1 et seq. With further details on the work of Carrol *see* Li, 2002, p. 857 et seq.
613. Bruins et al., p. 51. *See* Vogel, 1988a, p. 220. *See also* Lehner, in: Vogel & Lehner, Grundlagen para. 33.
614. Holmes, 2014, p. 61.
615. Id.; Lehner, in: Vogel & Lehner, para. 33. *See also* Vogel & Rust, in: Reimer & Rust, Introduction para. 21.
616. For more details *see* Farrell, p. 15 et seq. *See also* sec. 4.2.2.

As states started to sign a large number of tax treaties based on the draft model convention of the OECD in 1963, which will be discussed in the following section, developing states launched an initiative within the UN, according to which a model convention should be developed that also suits the needs of the developing world.[617] The reason for this was that the 1963 draft of the OECD was mainly driven by the interests of developed states.

As a consequence, an Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries was created based on a resolution of the ECOSOC in 1968.[618] The Ad Hoc Group published an initial draft of a UN model convention in 1980 that, in comparison to the OECD model convention, was more favorable for capital-importing countries. In simplified terms, it was concluded that the place of origin of income should be decisive. Or, as stated by the OECD in 2014 and, therefore, considering BEPS, the "greatest importance was attached to the nexus between business income and the various physical places contributing to the production of the income".[619]

The Ad Hoc Group was renamed in 2004 as the Committee of Experts on International Cooperation in Tax Matters.

4.2.3.2.4. *The work of the OECD/OEEC (1956-2012)*

The Organisation for European Economic Co-operation (OEEC) formed the Fiscal Committee in 1956. The purpose of the Fiscal Committee was to render a study on questions related to cross-border double taxation and to renew the work of the League of Nations.[620] In the years before the foundation of the OEEC, a significant number of tax treaties were signed, but not as extensively as in recent decades.[621] The Fiscal Committee prepared four interim reports between 1956 and 1961 until – after the creation of the OECD in 1961 – the first draft of the OECD model convention was published in 1963.[622] Unsurprisingly, the first draft was the outcome of the consent of the OECD member countries (i.e. developed states). As a consequence, taxing rights were, compared to the Mexico Draft, shifted to the

617. Holmes, 2014, p. 63 et seq.
618. UN, ECOSOC Resolution 1273 (XLIII), 4 Aug. 1967.
619. OECD/G20, Addressing the Tax Challenges of the Digital Economy, Action 1: 2014 Deliverable (OECD 2014), p. 37.
620. *See generally* Knechtle, p. 203.
621. *See* Holmes, 2014, p. 61, who states that 70 double tax agreements were signed between 1946 and 1955.
622. Vogel & Rust, in: Reimer & Rust, Introduction para. 22; Vogel, 1997, p. 278.

resident state and contained both a credit and an exemption method article.[623] Another important feature of the first model was that it also contained a commentary in order to provide further guidance. Since then, member countries have been able make reservations and observations if they do not agree with part of the content of the OECD MC or the OECD Comm., respectively.[624]

After the publication of the first draft in 1963, it took another 14 years until the first final version of the OECD model convention was adopted in 1977.[625] In the following years, the OECD has published several new (updated) model conventions and commentaries, namely in 1992, 1994, 1995, 1997, 2000, 2003, 2005, 2008, 2010, 2014 and 2017, and with respect to the exchange of information, also in 2012.[626] One of the most influential changes was made in 2005, as the new article 26 on the exchange of information was introduced as an answer to the work of the OECD on harmful tax practices.[627] Another standout amendment that is of particular interest for the present work was made in 2008, as a new paragraph on arbitration was introduced in article 25 of the OECD MC.[628] Moreover, the 2017 version contains in article 29 an anti-abuse provision.

From a transfer pricing perspective, the years from 1972 to the present are essential, as they reflect the age of globalization and, therefore, the increasing relevance of transfer pricing within the international tax regime. Not surprisingly, the first OECD transfer pricing guidelines were published in 1979. The guidelines were highly influenced by transfer pricing regulation in the US.[629] Besides that, and of interest for the present study, the OECD introduced the authorized OECD approach in 2010, which meant that for the purposes of allocating income and capital to a PE, the PE must be treated as a separate entity, also regarding internal dealings.[630]

Furthermore, the OECD published a report in 1998 on harmful tax competition, which was the starting point of a more intense discussion about

623. *See* on the latter topic Bühler, 1964, p. 53, with further details.
624. Lehner, in: Vogel & Lehner, Grundlagen para. 35.
625. Holmes, 2014, p. 62. Vogel & Rust, in: Reimer & Rust, Introduction para. 34.
626. A draft of the 2017 update was published in July 2017 (http://www.oecd.org/ctp/treaties/oecd-releases-draft-contents-2017-update-model-tax-convention.htm, last visited 23 July 2017).
627. *See* Lehner, in: Vogel & Lehner, Grundlagen para. 35a.
628. Art. 25(5) OECD MC.
629. For more details, *see* Li, 2002, p. 859 et seq.
630. OECD, 2010 Report on the Attribution of Profits to Permanent Establishments (OECD 2010).

harmful tax competition, base erosion, profit shifting and the potential partial harmonization of domestic tax laws.[631] The Harmful Tax Competition Report marked a cornerstone, as since then the work of the OECD has also influenced domestic tax legislation, and not only double tax treaties. Such influence mainly occurred by using soft law instruments. Below, we will dedicate a specific section to the importance of soft law instruments within the international tax regime.[632]

Another important milestone was the creation of the Global Forum on Transparency and Exchange of Information for Tax Purposes in 2000,[633] as well as its restructuring in 2009. It was the starting point of an effective implementation of fiscal transparency through monitoring and peer reviewing of the participating states.[634] Its work is obviously not limited to fiscal transparency based on double tax treaties, but also those formulated on other treaty bases. The Global Forum has also been responsible for the development of international standards, both for an exchange upon request and an automatic exchange. It currently has 154 member countries; therefore, it indeed has a global reach that goes far beyond the OECD member countries. At the core of the development was the G20's famously introduced white, black and gray lists in 2009.[635] Also, the G20 agreed on coordinated sanctions against non-cooperative jurisdictions.[636] This has led to the abolishment of secrecy laws in various countries.[637]

4.2.3.2.5. *The work of the OECD/G20 in the years 2012 and afterwards*

In June 2012, the leaders of the G20 stated in their declaration that they "reiterate the need to prevent base erosion and profit shifting and [the G20] will follow with attention the ongoing work of the OECD in this area."[638] Thereupon, the G20 mandated the OECD to draft a report about the problem of base erosion and profit shifting. In early 2013, the OECD published its report on addressing base erosion and profit shifting.[639] The launch of the

631. OECD, Tax Competition, An Emerging Global Issue (OECD 1998).
632. *See* sec. 4.3.4.
633. For more details about the circumstances of its creation *see* Oberson, 2015a, p. 6.
634. *See* OECD, Summary of Outcomes of the Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes Held in Mexico on 1-2 September 2009, p. 1 et seq. (available at https://www.oecd.org/tax/transparency/abouttheglobalforum.htm, last visited 14 Sept. 2017).
635. *See* Oberson, 2015a, p. 8.
636. G20, London Summit – Leaders' Statements, 2 Apr. 2009, para. 15.
637. For more details *see* Oberson, 2015a, p. 8 et seq.
638. G20, Leaders Declaration Los Cabos 2012, para. 48.
639. OECD, Addressing Base Erosion and Profit Shifting (OECD 2013).

BEPS Project aligned with what Brauner refers to as a "dramatic geopolitical shift", as some BRICS states have demanded more influence on international tax policy due to their increased economic power.[640]

Following on from this, the OECD issued the Action Plan on Base Erosion and Profit Shifting in July 2013 at the G20 Meeting in Moscow.[641] The final reports were approved by the CFA on 21-22 September 2015.[642] These reports were submitted to the OECD Council on 1 October 2015 and were published on 5 October 2015.[643] The reports were endorsed by the G20 finance ministers at a meeting on 8 October 2015.[644] As this brief introduction shows, a major difference between the former work of the OECD and the new age is the intense interaction between the G20 and the OECD. Moreover, the fact that international tax policy has risen from a topic discussed among technicians, as representatives of the fiscal authorities, to the top of the policy agenda is also of significance. These developments must be seen as a considerable change in the institutional framework of the international tax regime.[645]

From a material perspective, the principal difference between the pre-BEPS work and the post-BEPS work is that the BEPS Project has focused on stateless income or, as stated by Picciotto in 2013: "For decades it [the OECD] has prioritized the prevention of double taxation, but only recently has it begun to talk about the problem of double nontaxation."[646] The aim of the BEPS Project was no longer just to coordinate in order to avoid double taxation, but also to coordinate in order to increase tax revenue. The OECD even uses numbers in order to underpin its claim for increasing tax revenue:

> New OECD empirical analyses estimate, while acknowledging the complexity of BEPS, as well as methodological and data limitations, that the scale of global corporate income tax revenue losses could be between USD 100 to 240 billion annually.[647]

640. With further details, *see* Brauner, 2016, p. 16 et seq.
641. OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013).
642. CH: Federal Department of Finance, Documentation, OECD BEPS Project Final Reports, 5 Oct. 2015.
643. The reports are available at http://www.oecd.org/ctp/beps-2015-final-reports.htm (last visited 14 Sept. 2017).
644. *See* http://www.oecd.org/tax/g20-finance-ministers-endorse-reforms-to-the-international-tax-system-for-curbing-avoidance-by-multinational-enterprises.htm (last visited 14 Sept. 2017).
645. On this topic *see also* Christians, 2010, p. 19 et seq.
646. Picciotto, 2013, p. 1114.
647. OECD/G20, Explanatory Statement, Final Reports 2015 (OECD 2015), p. 16.

Another important difference between the most recent work of the OECD regarding the design of double taxation is the increased attention given to non-OECD states, such as – but not exclusively – BRICS states.[648] Furthermore, the BEPS Project of the OECD/G20 intended to revamp the work rendered in the years before 1998 and following the publication of the Report on Harmful Tax Practices in 1998. Within the BEPS Project, the fight against harmful tax practices is unsurprisingly also a major aim; in particular, Action 5 covers the issue.[649] The term "harmful tax practices" mainly relates to preferential regimes that lead to ring-fencing or other distortions leading to double non-taxation or very low taxation. Or, in the words of the OECD, the "current concerns may be less about traditional ring-fencing, but instead relate to across the board corporate tax rate reductions on particular types of income."[650] Furthermore, the OECD states that "(t)he work on harmful tax practise is not intended to promote the harmonisation of income taxes or tax structures generally within our outside the OECD."[651] Therefore, the OECD intends to define a certain level playing field, as domestic measures are limited when combating harmful tax practices.

In the months after the publications of the final BEPS reports, the OECD member countries and the G20 states have developed the so-called "Inclusive Framework".[652] It aims at reviewing and monitoring the implementation of the results of the BEPS project. Prima facie, the Inclusive Framework has similar goals with respect to anti-BEPS measures as the Global Forum has with respect to cross-border transparency. As the Inclusive Framework has more than 100 participating states, its impact goes far beyond the OECD member countries.[653] The same is true for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, which was signed by more than 100 states.[654]

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648. Brauner, 2014, p. 13.
649. OECD/G20, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report, p. 1 et seq.
650. OECD/G20, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2014 Deliverable, p. 12.
651. OECD/G20, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report, p. 11.
652. For more information, *see* http://www.oecd.org/tax/beps/beps-about.htm (last visited 15 Sept. 2017).
653. A list of all members is available at http://www.oecd.org/tax/beps/beps-about.htm#membership (last visited 20 Apr. 2019). For further details *see* Christians & Shay, p. 41 et seq.
654. For further details *see* http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm (last visited 20 Apr. 2019).

4.2.3.2.6. *Implications for a normative review?*

The current model tax conventions of the OECD and UN have many similarities. This is not surprising, as both of their roots lie within the work of the League of Nations in the 1920s and 1930s.[655] The latter is also vital to consider when rendering a normative review of the international tax regime, as all the existing double tax treaties have been highly influenced by the work of the League of Nations. For instance, the arm's length principle, which is the most influential allocation principle, has its roots in this age. However, we have also seen that drafters of the first model convention did not follow a single design principle, and this is still reflected in the current models. In particular, the arm's length principle seems to be the result of compromise, and not derived from mere theoretical consideration. It is somehow a "product of history".[656]

Moreover, as argued, the current international tax regime was mainly developed in the 1920s and 1930s. At that time, the world was very different; in particular, the relation between developing and developed countries has changed and global trade was by no means existent as it is on today's scale. The publications of the annual World Trade Report by the WTO[657] and the publication of the World Investment Reports of the UNCTAD[658] show the impressive evolution of global trade and cross-border investments at least within recent years. This is material for a normative review. As was already demonstrated in the introduction, the structure of the global society might have an impact on the applicable justice principles; consequently, a normative review of the international tax regime must always be understood in its context. The context for the present study is a highly integrated and globalized society.

Lastly, a more integrated tax world through the creation of the Inclusive Framework and the Global Forum might have repercussions for the applicable justice principles. In particular, the fact that coercive measures have been used to achieve a certain harmonization or level playing field will be relevant in Part IV of the present study. Coercion, per se, is an element in a legal regime that might trigger specific moral considerations.

655. *See generally* de Wilde, 2015, p. 438. *See also* Graetz, p. 262.
656. The term is used by Sadiq, p. 276, with reference to Langbein.
657. The reports are available at https://www.wto.org/english/res_e/reser_e/wtr_e.htm (last visited 15 Sept. 2017).
658. The reports are available at http://unctad.org/en/pages/DIAE/World%20Investment%20Report/WIR-Series.aspx (last visited 15 Apr. 2019).

4.2.3.3. Content of double tax conventions

4.2.3.3.1. *Some preliminary methodological remarks*

It would go beyond the scope and purpose of the present study to discuss the content of double tax conventions in detail. Many commentaries have been published in recent years focusing on the application and interpretation of double tax conventions. Nevertheless, in order to understand the impact of the current international tax regime on the allocation of taxing rights and in order to render a normative review of the international tax regime in Part IV of the present study, it is important to understand at least the main rules provided for in a double tax convention.

In the following, reference is made to the OECD MC and not to the UN MC. The wording of the OECD MC and the UN MC is – besides certain specific rules in favor of developing countries[659] – very similar. Such methodology, i.e. not referring to actual double tax conventions, also seems justified, as the clear majority of rules contained in double tax conventions follow these models. Avi-Yonah, Sartori and Marian[660] concluded that 80% of the wording of the existing double tax treaties is identical, which demonstrates that states rely highly on these two models. Although the OECD only has 34 member countries, the OECD MC has not only influenced double tax treaties among OECD member countries, but also between a member country and a non-member country, and even between two non-member countries.

In the following section, we will mainly make reference to the OECD MC and – if necessary – to the UN MC. Some special provisions in the double tax treaty practice that are not contained in the OECD MC and the UN MC will also be highlighted.

4.2.3.3.2. *General rules (scope of convention and definitions)*

After the general provisions of articles 1 and 2 of the OECD MC on the scope of the application of double tax conventions, article 3 of the OECD MC provides for various treaty definitions and further interpretation guidance.[661] Article 4 of the OECD MC contains the definition of resident for

659. For further details about the differences between the OECD MC and the UN MC *see* Daurer, p. 53 et seq.; Lennard, 2009, p. 4 et seq.
660. Avi-Yonah, Sartori & Marian, p. 150. *See also* Brauner, 2016, p. 4, who states with further references that the OECD Model "dominates the current tax treaty law".
661. *See* art. 3(2) OECD MC.

the purpose of the application of a double tax convention and must be understood in connection with article 1 of the OECD MC, as the definition of the personal scope of the application of tax treaties relies on residency of a taxpayer in one of the two contracting states.

The definition of the term "permanent establishment" is found in article 5 of the OECD MC. The PE concept is important, as it provides for a certain threshold that must be met in order to justify the taxation of an enterprise in the state of the business activity. The PE criteria must be seen as the counterparty of the residence criteria, as it justifies source taxation and not full residence taxation.

At this stage, it should be highlighted that double tax conventions are reciprocal. This means that the protection of the double tax convention applies at least from a legal perspective to residents in both jurisdictions. However, from a factual perspective, depending on the economic interdependence of two states, the income flow that receives treaty protection might mainly be in one direction.[662]

4.2.3.3.3. *Allocation rules and method articles*

The so-called "allocation rules" according to articles 6-22 of the OECD MC allocate specific income or capital to the resident and/or the source state, whereby articles 6-21 of the OECD MC relate to the allocation of income and article 22 of the OECD MC concerns the allocation of capital. If a double tax treaty only deals with income, it will not contain a respective article 22 of the OECD MC.

The allocation rules generally reduce the tax rate applicable in the source state or even oblige the source state to not tax certain income. It is essential to note at this stage that double tax treaties do not only have the purpose of avoiding or mitigating double taxation, but these agreements also aim at reducing source taxation, as the income taxation is shifted to the resident country.[663] This is an important fact of the current international tax regime. Generally speaking, the OECD MC follows the approach that active business income should be taxed in the source country and passive income in the resident country.[664] However, the taxing rights of the source country are

662. For further details on this topic *see* sec. 4.2.5.
663. *See also* Avi-Yonah, 2007, p. 169, who even argues that double taxation as such is not addressed in double tax treaties. On this topic *see also* Dagan, 2000, p. 2 et seq.; Dagan, 2015, p. 15 et seq.
664. E.g. Graetz, p. 262.

also reduced with respect to active income, as the taxing right of the source country is limited to cases in which an enterprise meets the PE threshold in the source country.

The most important allocation rules for the purpose of the present study include article 7 of the OECD MC, which limits the taxation of the source country with respect to active business income to cases in which the foreign enterprise meets the PE threshold. Furthermore, article 9 of the OECD MC is crucial, which requires the application of the arm's length principle in an intra-group situation.[665] Articles 10-13 of the OECD MC reflect, besides articles 7 and 9 of the OECD MC, the core allocation rules with respect to the income of corporations. Following these, the OECD MC articles 10-13 aim at lowering the taxing right of the source country with respect to dividends (article 10), interests (article 11), royalties (article 12) and capital gains (article 13). Articles 15-20 of the OECD MC relate to the taxation of the income of individuals, such as ordinary employment income (article 15), directors' fees (article 16), artists and sportsmen (article 17), pensions (article 18), government service (article 19, and students (article 20). Article 21 of the OECD MC covers any other income that does not qualify for one of the aforementioned income allocation rules.

Juridical double taxation will be avoided by applying one of the method articles in article 23A or 23B (i.e. exemption method or credit method). Interestingly, the credit method has significantly gained importance within the international treaty network since World War II, when the US, Canada and the UK began signing more double tax treaties.[666] Furthermore, since the first agreement between the US and France, it is common that tax treaties contain a combination of both method articles.[667]

4.2.3.3.4. *Transfer pricing*

Transfer pricing is the core issue of the international tax regime[668] and, as already mentioned, article 7(2) and article 9(1) of the OECD MC, almost identical provisions, are its legal base. The arm's length principle has two important functions; it determines that (i) the income of a PE should be calculated according to the arm's length principle following the authorized

665. For more details *see* sec. 4.3.3.3.4.
666. Bühler, p. 50 et seq.
667. Id., p. 59.
668. Avi-Yonah, 2007, p. 102.

OECD approach (article 7(2) OECD MC)[669] and, that (ii) the remuneration for the sale of a good or a service among related parties should follow the arm's length principle (article 9(1) OECD MC).[670]

With respect to the allocation of income to a PE following the authorized OECD approach, it is essential to treat the PE as a functionally separate entity, i.e. functions, risks and assets need to be attributed to the PE.[671] With respect to intra-group transactions, the arm's length principle presupposes that a transaction between related parties has a comparable transaction among third parties, which can act as a benchmark for the calculation of the appropriated price of an intra-group sale of goods or services. This requires that the situations are sufficiently comparable.[672] The OECD has developed different transfer pricing methods and distinguishes between traditional transaction methods[673] and transactional profit methods.[674] The aim according to the OECD is to allocate income depending on the value creation of each of the involved parties. This means that taxation should theoretically occur where value is created.[675]

The arm's length principle is by far the most widely applied income allocation mechanism worldwide; it is fair to say that nearly all countries follow the arm's length principle to allocate income between treaty jurisdictions. One of the only states that significantly deviates in this respect is Brazil.[676] Other states do apply the arm's length principle internationally, but they follow a formulary system domestically in order to allocate the income to various states in a federation.[677] Below, we will further analyze whether the arm's length principle has become part of customary international law.[678]

669. For more details *see* OECD, 2010 Report on the Attribution of Profits to Permanent Establishments (OECD 2010), p. 13 et seq.
670. E.g. Lang, 2013, para. 472 et seq. For more details *see* OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017), para. 1.1 et seq.
671. E.g. Lang, 2013, para. 266 et seq.
672. OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017), para. 1.33.
673. The OECD distinguishes between the comparable uncontrolled price method, the resale price method, and the cost-plus method (OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations [OECD 2017], para. 2.12 et seq.).
674. The OECD distinguishes between the transactional net margin method and the transactional profit split method (OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations [OECD 2017], para. 2.62 et seq.).
675. For more details on the so-called source principle, *see* sec. 11.5.
676. For further details on the methodology in Brazil *see* De Sá, 2015, p. 22 et seq.
677. *See*, for instance, the system in the US (Mayer, p. 65 et seq.) or the system in Switzerland (id., p. 124 et seq.). For further details, *see also* sec. 12.2.
678. *See* sec. 4.3.2.8.5.

4.2.3.3.5. *Special provisions*

The OECD MC and the UN MC contain further provisions – so-called special provisions[679] – such as a non-discrimination provision (article 24 OECD MC), an exchange of information provision (article 26 OECD MC), and a provision on the assistance in the collection of taxes (article 27 OECD MC). The provision on the collection of taxes is required, as international law does not allow enforcing taxation on a foreign territory.[680] Article 27 of the OECD MC is not always included in double tax treaties, as states are reluctant to transfer part of their enforcement competence or sovereignty to another state.

Furthermore, the OECD MC and UN MC provide for a specific provision on mutual agreement procedures, which itself contains an optional arbitration rule (article 25 OECD MC), a rule on the interaction between a double tax convention and the exemption of diplomatic and consular personnel in other international agreements (article 28 OECD MC), an anti-abuse rule (article 29 OECD MC) and a rule on the territorial extension of the treaty (article 30 OECD MC).

These special provisions are critical for the purpose of a normative analysis, as these rules not only reveal crucial limitations of international cooperation due to international law restrictions, but they also cover important features of the current international tax regime. Below, we will analyze whether the implementation of such a provision is required to enhance justice in the international tax regime.[681]

4.2.3.3.6. *Final provisions*

The OECD MC contains, as the final provisions, rules on the entry into force of the treaty[682] and a termination clause.[683] The termination clause is not just of theoretical importance, but within international tax practice, some double tax treaties have been cancelled.[684] For the purpose of the present study, it is vital to note that tax agreements are not signed for an indefinite period of time. This means that having a double tax convention is not self-evident,

679. *See* the title of Chapter VI of the OECD MC.
680. *See* sec. 4.1.1.3.
681. *See* sec. 12.2.
682. Art. 31 OECD MC.
683. Art. 32 OECD MC.
684. For an overview from a tax perspective *see* Nasdala, in: Vogel & Lehner, Artikel 30/31 para. 39.

but rather, it relies on real consent and many states have not yet reached an agreement.

4.2.4. Enhanced multilateralism?

4.2.4.1. Preliminary remarks

In international law, a distinction is made between multilateral and bilateral treaties.[685] The distinction between a bilateral and a multilateral treaty depends – quite obviously – on the number of parties of a concrete treaty. If a treaty has more than two signing bodies, it qualifies as a multilateral treaty; if not, it is a bilateral treaty.[686] However, if a group of states appears as one party to an agreement, such an agreement can still qualify as a bilateral agreement.[687] This means that, for instance, the savings agreement between Switzerland and the EU is a bilateral treaty, as only two subjects of international law are part of the treaty (i.e. the EU and Switzerland).[688]

The usability of a multilateral convention depends on the area to be regulated, and if the advantages prevail, states might indeed prefer a multilateral framework, compared to mere bilateral treaties. A benefit of a multilateral approach is, for instance, that it saves costs, as the negotiation of a multilateral instrument seems more time- and cost-efficient.[689] Furthermore, from a tax perspective, a multilateral double tax convention would be less manipulative and complex than the current international tax regime, consisting of more than 3,000 (non-identical) bilateral treaties, and would therefore lead to less distortion.[690] However, of course, a multilateral approach will only be successful if the members of a multilateral negotiation process receive a surplus from the participation in a later multilateral treaty.[691] From a substantive perspective, which will be further outlined below when we refer to constitutionalism, multilateral treaties might be the ideal instrument to serve so-called community interests.[692]

685. For further details *see* Verdross & Simma, § 538.
686. Von Heinegg, in: Ipsen, § 10 n. 7. *See* Guggenheim, p. 59.
687. Doehring, para. 328.
688. CH/EU: Agreement between the Swiss Confederation and the European Community providing for measures equivalent to those laid down in Council Directive 2003/48/EC on the taxation of savings income in the form of interest payments, 26 Oct. 2004.
689. Pross & Russo, p. 365. *See*, on the transaction cost aspect of a multilateral agreement from an international tax law perspective, García Antón, p. 187 et seq.
690. *See* Graetz & O'Hear, p. 1105, with reference to Adams.
691. García Antón, p. 185 et seq., with reference to Thompson and Verdier.
692. *See* Simma, 1994, p. 323. *See also* secs. 4.4.3.2.3. and 4.4.4.2.2.

Regarding their legal nature, multilateral treaties might not only create an obligation between states, but multilateral conventions could also have a law-making effect. For instance, a multilateral convention may provide for the creation of an international organization, such as the OECD. Consequently, the contracting states agree that the newly established international body shall have the rights to render decisions or even publish guidelines or regulatory documents, i.e., to act as a "quasi-legislator". Depending on the actual underlying multilateral convention, such resolutions can have a binding or non-binding effect. The actual legal basis for such binding or non-binding resolutions remains the multilateral convention and, therefore, as mentioned by Thirlway, the concept of international legislation relates to an underlying multilateral agreement.[693]

In international law, multilateral conventions have gained importance since the late 19th century.[694] From a tax perspective, the discussion about multilateral tax conventions has very recently gained (again) some momentum due to Action 15 of the BEPS Project[695] and the Multilateral Convention to Implement Tax-Related Measures to Prevent BEPS (MLI), even though the League of Nations already considered the use of a multilateral tax convention, rather than a bilateral tax convention.[696] Moreover, as shown in detail by García Antón,[697] multilateralism has always been part of the international tax regime, but it might have been a form of "fuzzy multilateralism" due to the importance of the OECD MC, the UN MC and their respective commentaries.[698] Therefore, the fact that double tax treaties to a very large extent follow either the UN MC or the OECD MC is a sign that multilateral negotiations, which form the base for the OECD MC and the UN MC, have already impacted the international tax regime, even though from a formal perspective, the international tax regime is still a regime primarily based on bilateral agreements. Therefore, the term "fuzzy" is suitable to describe the status of multilateralism from an international tax law perspective. However, as will be developed in the following section, some formal multilateral tax agreements already exist and, therefore, multilateralism is not exclusively "fuzzy" in the international tax regime.

693. Thirlway, 2014, p. 33.
694. For further details *see* Boas, p. 71 et seq. *See also* García Antón, p. 147 et seq.
695. *See* OECD/G20, Action 15, Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15: 2015 Final Report (OECD 2015).
696. *See* sec. 4.2.3.2.2.
697. García Antón, p. 161 et seq.
698. He namely mentions the "multilateral" effect of the OECD MC, its Commentary and the most-favored-nation principle in Indian double tax conventions (*see* García Antón, p. 165).

4.2.4.2. Some existing multilateral tax agreements

From an international tax perspective, at least three types of multilateral conventions can be distinguished:[699]
– special purpose multilateral tax convention;
– multilateral double tax convention; and
– multilateral harmonization tax convention.

If a multilateral tax convention has one particular purpose and if that purpose is not the avoidance of double taxation, it would be qualified as a special purpose multilateral tax convention. If a multilateral convention aims at harmonizing domestic tax systems, it would be qualified as a multilateral harmonization tax convention, compared to a multilateral double tax convention, which aims at mitigating the risk of double taxation in cross-border circumstances. A potential fourth category would be the aforementioned conventions incorporating an international organization, such as the UN Charter and the OECD Convention.

An example of the first category of special purpose multilateral tax conventions is the Convention on Mutual Administrative Assistance in Tax Matters (CMAATM), which should be seen as a special purpose convention, as it aims to ensure and enhance administrative assistance among the parties and not, for instance, to generally mitigate double taxation. The CMAATM has been open for signature since 1988 and was amended by a Protocol in 2010.[700] The CMAATM does not have any other major aims and is therefore limited and dedicated to a special purpose. Another special purpose multilateral agreement is the Multilateral Competent Authority Agreement (MCAA). In simple terms, the purpose of the MCAA is to enhance fiscal transparency or, as stated in the preamble, it is the intent of the parties "to improve international tax compliance by further building on their relationship with respect to mutual assistance in tax matters".

With respect to the second category, it would be possible that the taxing rights, compared to the existing predominant instrument of bilateral double tax convention, are allocated through a single multilateral convention signed by dozens of countries. There have been several attempts to partially replace the existing system of hundreds or even thousands of double tax treaties. However, even within the EU, as a highly integrated market, attempts to implement a multilateral double tax convention have not proven to be

699. Even though the qualification has no legal consequences, it allows for a better understanding of the scope of multilateral conventions within the international tax regime.
700. For more detail *see* Pross & Russo, p. 361.

successful.[701] The MLI is at least partly a multilateral double tax convention, as it tries to harmonize several clauses in hundreds of existing double tax purposes in order to "ensure swift, co-ordinated and consistent implementation of the treaty-related BEPS measures in a multilateral context".[702] However, some states in a "well-defined region"[703] have already signed full-fledged multilateral double tax conventions with other states. Others have been replaced by a bilateral treaty network.[704] In particular, the Nordic Tax Convention and the CARICOM Multilateral Double Taxation Agreement should be mentioned, even though further multilateral double tax conventions exist, such as the multilateral tax agreement between the Andean countries.[705] In general, these agreements use a significant part of the wording of the OECD MC and UN MC, but they contain some other interesting features. For example, one feature of the CARICOM should be mentioned.

It allocates the income differently than the OECD MC and the UN MC, as the taxing right is with the source state. For instance, according to article 12(1) of the CARICOM, "[i]nterest arising in a Member State and paid to a resident of another Member State shall be taxed only by the first-mentioned State", whereas the tax rate in the source state shall not exceed 15%.[706] This means the taxing right of the resident state is not even residual. Further differences exist compared to the OECD MC and UN MC, which might not only trigger difficult interpretation issues, but might also lead to complexities when signing a double tax treaty with a non-participating state.[707] The exclusive source taxation concept seems to have the advantage that it is easier to administer, as a taxpayer does not need to apply a complicated credit or exemption method,[708] and it also seems to consider the potential benefit of source taxation for developing countries.[709] Reference to such an agreement is necessary, as it demonstrates that residual residence taxation is not carved in stone as the only available allocation mechanism.

Compared to the other two categories of multilateral tax conventions, international tax harmonization conventions have not yet played a significant

701. *See* Lang & Schuch, p. 39 et seq.
702. Preamble of the MLI.
703. Brauner, 2003, p. 318.
704. *See* the convention between Austria, Hungary, Poland, Italy, Romania and the Kingdom of Serbs, Croats and Slovenes from the early 20th century, as mentioned by Lang & Schuch, p. 39 et seq.
705. For more details *see* Brooks, 2010, p. 227 et seq.
706. Art. 12(1) CARICOM.
707. For more details *see* Bierlaagh, p. 99 et seq.
708. Brooks, 2010, p. 234 et seq.
709. Id., p. 229 et seq.

role. Obviously, the development of tax law within the EU and its project on the CCCTB has shown that, at least in an internal market, there seems to be a need for a partial harmonization through multilateral instruments.[710] However, the legislative background within the EU is different than at the international level. At that international level, formal harmonization agreements have not yet been signed, but the use of model conventions at an international level (i.e. fuzzy multilateralism) might have already led to a de facto harmonization of part of domestic tax law. In other words, by providing standard clauses in international tax treaties, states might have transformed certain concepts from treaty law into domestic law. For instance, states might align their domestic PE definition to the treaty definition.

4.2.5. Justice and international treaties – Some concluding remarks

Following a positive understanding of international law and considering the consent of states as the main basis for international law, international treaties are without a doubt[711] a source of international law.[712] There is no comparable dispute with regard to the underlying reason for the binding character of treaties, as compared to customary law or general principles of law.[713] In other words, justice or morality generally does not influence the validity of international treaties. Consequently, international agreements might be valid, even though they contain highly unjust rights and obligations of the involved parties.[714]

As part of the present concluding remarks on the contractual part of the international tax regime, a few specific aspects relating to justice and international treaties should nevertheless be highlighted.

An important factor in judging if a treaty is unjust is whether it contains reciprocal provisions or whether one party is only losing by signing an agreement. As highlighted by Graetz, fairness at an international level indeed seems to require reciprocity among states, as this allows a fair and

710. For further details, *see* https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_de (last visited 14 Apr. 2019).
711. *See* Fitzmaurice, p. 153 et seq.
712. Hollis, p. 14; Thirlway, 2014, p. 31.
713. *See*, with further details about the dispute regarding customary law, sec. 4.3.2.2., and with respect to general principles of international law, sec. 4.3.3.2.
714. *See*, however, the application of an unwritten anti-abuse clause as a general principle of law as outlined in sec. 4.3.3.3.2.

just system.[715] Certain treaties, however, are not reciprocal but can still be considered just.[716] Therefore, depending on the agreement, fairness does not necessarily require reciprocity, but reciprocity of duties and rights is often key to achieving a fair and just agreement.

Rules of international tax law are, in particular, obeyed in situations in which reciprocity occurs. This is theoretically the case regarding double tax conventions, as these are formally reciprocal conventions, similar to bilateral extradition treaties. For instance, if State A exempts an individual resident in State B based on article 15(2) of the OECD MC, then State A expects that State B will also apply article 15(2) of the OECD MC in a vice versa situation.

Reciprocity with regard to the application of double tax conventions not only means that the contracting states expect that both parties apply the same article in a vice versa situation, but also that they expect the contracting states to apply the entire double tax convention, as certain rules might not be in the interest of one of the contracting states. This means, for instance, that a developing state might sign a double tax convention only because the parties agree on a 10% residual withholding tax on royalties or because of the implementation of a special article on technical services, whereas a developed state might only sign the same double tax convention because it provides for a 0% residual withholding tax on intra-group dividends. A lack of reciprocity in tax treaties is also a major reason why some developing countries in the past have been reluctant to sign tax treaties without a tax sparing provision. As shown by Avi-Yonah, a double tax treaty that reduces source taxation, but simultaneously applies to an inter-state relationship in which the income only flows in one direction, creates detrimental impacts for the source country.[717] The question of reciprocity is, therefore, not only crucial for determining whether a treaty is just, but also an important evaluative factor in deciding whether signing a double tax convention is in the interest of a state. The question of whether a state should sign a double tax treaty should therefore follow a cost-benefit analysis; if

715. *See* Graetz, p. 300.
716. This is, for instance, the case for human rights conventions as these agreements conceptually do not contain reciprocal rights and duties for intra-state relations.
717. Avi-Yonah, 2007, p. 170. On the impact of signing double tax treaties *see also* Dagan, 2000, p. 2 et seq., or from a policy perspective, International Monetary Fund, Spillovers in International Corporate Taxation, 9 May 2014, p. 15 et seq. *See also* the remarks of the International Monetary Fund on what the presumed costs are of treaties between developed and developing states (p. 26 et seq.).

a treaty is not sufficiently reciprocal in this respect, signing a double tax treaty might have harmful consequences, particularly for developing states.[718]

These remarks on reciprocity as an important element of a just contract are not comprehensive and generally do not relate to "distributive justice", but solely to "commutative justice" in the Aristotelian understanding, as it relates to justice within the exchange occurring between states.[719] Koller uses the term "transaction justice" to describe such a demand.[720] The latter is indeed a suitable term to describe the justice concerns attached to the balancing of contractual rights and duties and, in particular, to the question of whether an agreement is indeed reciprocal.

A striking question, however, is whether contracts can also be evaluated based on distributive justice. In German civil law, a refreshing debate has emerged on how both *iustitia communtativa* and *iustitia distributiva* are of relevance in order to conclude whether a (civil law) contractual relation is considered to be just.[721] In Part IV, we will further review the question of distributive justice at an international level; certain conclusions on how double tax treaties ought be designed can be derived from these chapters.[722] However, the question of whether the duties and rights of a contract are indeed just and lead to distributive justice is an interesting area of research that we cannot fully explore within the present study. Future research in this area that might refer to civil law research results should consider that the circumstances leading to an international tax treaty are, to a certain extent, not comparable to a traditional contract among private individuals in full liberty. One aspect that should be considered is that at an international level, some contracts are not signed at full liberty, as economic pressure (by the other contractual parties) might be considerable. Therefore, it would be wrong to argue that all international treaties are considered just simply because states are free to sign and negotiate.[723]

718. A striking example is Mongolia, which recently terminated several double tax treaties (i.e. with Luxembourg, Kuwait, the Netherlands and the UAE). This has led to an intense debate in the Dutch parliament regarding the question of what kind of tax treaties should be signed with developing states (*see* for an overview Schrievers & Vogel, p. 202). On this topic *see also* Meyer-Nandi, p. 36 et seq.
719. *See* sec. 1.2.
720. Koller, 2009, p. 192.
721. *See*, in particular, Canaris, p. 1 et seq.; Arnold, p. 1 et seq.
722. *See*, for example, sec. 11.3.2.
723. Arnold, p. 16, with reference to Von Hayek and Flume. *See also*, on the question of justice in international treaties, the remarks of Nagel as outlined in sec. 7.4.1.

Another topic of interest in relation to contractual obligations and justice relates to the question of whether justice would require that multilateralism play a more important role in international law. There are indeed several advantages of multilateral approaches in order to regulate international taxation; however, it is an under-developed question whether justice would require that the international tax regime be regulated by more multilateral frameworks, instead of by mere bilateral relations between countries. An important aspect of justice and multilateralism relates to the procedure for how multilateral instruments are created at an international level. It boils down to questions of procedural justice, such as whether the OECD is the right institution to steer multilateral frameworks. Or, as held by García Antón:

> Finally, assuming the difficulties in relaunching a new form of multilateralism based on tax justice, the paper acknowledges the fact that regional integration processes defined as "thick multilateralism" already encapsulate harmonization mechanisms and an idea of justice among the members states that strengthen the struggle against the existing inequalities and asymmetries. Therefore, there is no need to ask for a specific EU multilateral treaty when EU legislation can effectively achieve the same goals. Restoring the faith in the European project and the value of solidarity become crucial in stamping out the current inequalities and asymmetries, at least in Europe.[724]

Another aspect to consider is whether multilateral instruments are better balanced than bilateral agreements and, therefore, are better aligned to considerations of commutative justice in the Aristotelian form. Multilateral conventions might generally employ rights and obligations that are acceptable by a large group of states, and an extreme imbalance for the disadvantage of some participants seems less possible than it would in a mere bilateral situation. However, at the same time, the procedure that leads to a multilateral convention sometimes does not allow states to actually consent, as they are forced to participate (by external or internal pressure) in such multilateral agreements.[725]

In conclusion, the contractual-based part of the international tax regime does not guarantee that the international tax regime is just, as it is a consent-based and not necessarily a moral- or value-based regime. In more general terms, international agreements are not necessarily a device to enhance justice in the international realm, as content-wise they might contain unjust or unfair provisions. Of course, the processes of how treaties are negotiated can potentially have a positive influence following procedural theories of justice (multilateral vs bilateral treaties). Nevertheless, it would be erroneous to

724. García Antón, p. 192.
725. Payandeh, p. 196.

claim that rules in an international treaty are just simply because it was in the free will of the states to consent to such an agreement.

4.3. Non-treaty-based rules and principles

4.3.1. Preliminary remark

The main rules of the international tax regime stem from written treaties between states. However, in order to render a normative review of the international regime, it is vital to prove the existence or non-existence of non-contractual rules within the international tax regime.[726] In the following, we will focus, in particular, on customary international law and general principles of law according to article 38 of the ICJ Statute in order to develop a comprehensive understanding of the legal content of the international tax regime.

4.3.2. Customary law

4.3.2.1. Preliminary remarks

Customary international law is explicitly mentioned in article 38(1)(b) of the ICJ Statute as a source of international law. Accordingly, the ICJ shall apply: "b. international custom, as evidence of a general practice accepted as law; …."

Following a traditional understanding, customary international law derives from a consistent (and widespread) international state practice (objective or quantitative criteria) and the *opinio iuris* (subjective or qualitative criteria)[727] "as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it."[728,729] Such a twofold definition has its fundaments within the above stated article 38(1)(b) of the ICJ Statute

726. As we will show in sec. 4.3.2.2.2., customary law is sometimes derived from a "tacit agreement" and therefore if customary law is indeed understood as a tacit agreement, these rules could also be understood as "contractual". As we support a different position, however, the qualification of customary law as a non-contractual source still seems justified.
727. The terms *"quantitative"* and *"qualitative"* are used by D'Amato, pp. 66 and 74.
728. ICJ, North Sea Continental Shelf Cases (*Federal Republic of Germany v. Denmark and Netherlands*), p. 44. For further details *see* D'Amato, p. 73 et seq.; Guggenheim, p. 46 et seq.; Lepard, p. 6 et seq.
729. For further details *see* Damrosch & Murphy, p. 60 et seq.; Giersch, p. 117 et seq.; Heintschel von Heinegg, in: Ipsen, § 17 para. 2; Payandeh, p. 245 et seq.

as the terms "general practice" (i.e. "state practice") and "accepted as law" (i.e. "*opinio iuris*") indicate.[730]

It is argued that customary international law was first mentioned or developed in an international framework by Grotius in the 17th century. In the following centuries, customary international law has been an important legal source to regulate inter-state relations, for instance, with regard to the treatment of diplomats.[731] For several decades, however, there has been a significant shift from customary international law to international treaty law.[732] Customary international law has lost some of its importance and international treaties have clearly become the most important source of international law. This is also true with regard to areas in which customary international law was traditionally of great relevance, but particularly with regard to areas in which no (international) regulation had been in place in the past. Tax law is an example of the latter, as until the early 20th century, no (or very few)[733] customary international tax rules existed and the international tax regime has been regulated by treaty law from the beginning. Notwithstanding such a decreased importance of customary international law, it is still relevant in various instances.[734]

However, in legal literature, it is rarely discussed which taxation principles and rules belong to customary international law and, therefore, are applicable even if no treaty exists. In order to elaborate whether rules of customary international tax law do indeed exist as part of the international tax regime, it is necessary to discuss in detail (i) whether one should follow a traditional understanding regarding the prerequisites of customary international law and, if yes, (ii) under what kind of circumstances the two requirements (i.e. consistent practice and *opinio iuris*) are met.

The interaction between the two requirements is highly complex. Thirlway described the interaction between the *opinio iuris* and the state practice requirement by arguing that these "are thus so intertwined as concepts that they need to be studied together, or in a tandem."[735] That being said, we will discuss in detail the two traditional requirements of customary international

730. E.g. Degan, p. 143 et seq.; Von Heinegg, in: Ipsen, § 17 para. 2.
731. *See generally* Boas, p. 73, who states with reference to Jennings & Watts that customary international law is the oldest source of international law. *See*, with a brief overview on the origin of customary international law, Trachtman, p. 172 et seq.
732. This was already stated by Verdross & Simma, § 533.
733. *See*, for instance, the remarks on the tax exemption of diplomatic agents in sec. 4.3.2.8.4.
734. E.g. Lepard, p. 3 et seq.
735. Thirlway, 2014, p. 62. And courts often seem not even to apply the twofold definition (for more details *see* Choi & Gulati, p. 117 et seq.).

law before discussing the limits of customary international law, particularly with respect to international tax law.[736] In section 4.3.2.2., we will first outline the different conceptual views on customary law. Finally, in section 4.3.2.8., we will develop concrete examples of potential customary international (tax) law rules.

4.3.2.2. The concept of customary international law

4.3.2.2.1. *Some preliminary remarks*

Due to the lack of consistent opinions among states (judges and scholars), the concept of customary international law has also been under scrutiny.[737] D'Amato, for instance, speaks of a "tremendous amount of disagreement".[738]

For the purpose of rendering a normative review of the international tax regime, it is essential to discuss what the actual basis or justifications of customary international law are in order to better define the role of customary international law within the international tax regime. Reference to different conceptional opinions is also of interest, as the aim of the present study is not only to discuss the various traditional sources of international tax law, but also to refer to the importance of justice or other moral values as part of an international legal regime. Justice or other moral values might potentially play a role for the creation of customary international tax law.

In the following, therefore, it is necessary to discuss the underlying rationale of the (assumed) binding character of customary international law according to article 38(1)(b) of the ICJ Statute.

We will discuss three potential concepts of the validity of customary international law. We begin with a more positive understanding[739] and then focus on an approach based on good faith.[740] We will then further discuss more morality-based understandings of customary international law.[741] The separation of these chapters cannot be seen as a clear-cut categorization of the various opinions that exist, as some of the concepts are related and similar in certain aspects. Some authors might propose theories that contain elements from two of the following theories. Furthermore, there are various

736. *See* secs. 4.3.2.3. and 4.3.2.4.
737. D'Amato, p. 5 et seq.; Lepard, p. 3 et seq.; Guggenheim, p. 45 et seq.
738. D'Amato, p. 5. *See also* Heintschel von Heinegg, in: Ipsen, § 17 para. 3.
739. *See* sec. 4.3.2.2.2.
740. *See* sec. 4.3.2.2.3.
741. *See* sec. 4.3.2.2.4.

other opinions or intermediate positions on the requirements of customary international law.[742]

4.3.2.2.2. *Voluntarism or positivism*[743]

Following a voluntarist, consent or positive approach, customary international law is created based on the consent of states, similar to the consent in an international treaty.[744] Therefore the free will of states to create a legal obligation is the actual reason for the existence or the creation of customary international law.[745] The consent requirement was also emphasized by Kelsen: "Indeed, it is redundant to stress the importance of consent in the development of custom since it is obviously implicit in the constituent elements of custom."[746] In a similar way, it is also argued by Wolfke, who states that countries are bound by customary law due to their either direct or indirect consent.[747] Or previously, de Vattel stated that customary law is the outcome of a state's will: "*Car ils procèdent tous de la Volonté des Nations … le Droit Coûtumier d'un consentement tacite*."[748]

Other international law scholars also referred to consent as the underlying reason for the validity of customary international law.[749] Often used in this respect is the term "tacit agreement".[750] The ICJ in the North Sea Continental Shelf Cases outlined, with reference to the *Lotus* decision, a similar understanding:

> Applying this dictum to the present case, the position is simply that in certain cases - not a great number - the States concerned agreed to draw or did draw

742. For an overview on other opinions *see* Degan, p. 144 et seq.; Verdross, 1969, p. 635 et seq.
743. It goes beyond the present study to provide a full and sophisticated distinction between voluntarism and positivism in the area of customary international law. *See* on this topic, for instance, Besson, 2016, p. 289 et seq.
744. This seems to be the oldest theory to justify the validity of customary international law (Verdross, 1969, p. 636).
745. *See generally* Lauterpacht, p. 360. Further references are also mentioned by D'Amato, p. 187 et seq. or with reference to the opinions of some of the fathers of international law (Grotius, de Vattel, Wolff) *see* Verdross, 1969, p. 636; *see* concerning such theory Müller, p. 78 et seq.; Verdross, 1973, p. 96.
746. Kelsen, 1967, p. 453 et seq. With further remarks to the position of Kelsen, which is not a consensual theory in a strict sense, *see* Verdross, 1969, p. 639 et seq.
747. Wolfke, p. 160 et seq. *See also* Thirlway, 2014, p. 12 et seq.
748. De Vattel, Préliminaires, § 27.
749. Verdross, 1969, p. 636 et seq., with further references.
750. Thirlway, 2014, p. 54. However, the term "tacit agreement" already indicates that it is a strict consensual theory, as consent is only "tacit". On the latter point, with reference to the opinion of Anzilotti, *see* Verdross, 1969, p. 638.

> the boundaries concerned according to the principle of equidistance. There is no evidence that they so acted because they felt legally compelled to draw them in this way by reason of a rule of customary law obliging them to do so - especially considering that they might have been motivated by other obvious factors.[751]

Also, in the *Lotus* decision itself, the ICJ refers to the will of states as the underlying justification for international law in general:

> The rules of law binding upon States therefore emanate from their own free will as expressed in conventions or by usages generally accepted as expressing principles of law and established in order to regulate the relations between these co-existing independent communities or with a view to the achievement of common aims.[752]

As many authors have highlighted, the problem with voluntarism or positivism as a concept of customary law is that it can only bind states that indeed have demonstrated their will to be bound to a certain rule of customary international law.[753] However, this significantly limits the scope of application and the necessity of rules of customary international law. Moreover, the "ethical attractiveness" of a rule is basically ignored if one follows a strict positive approach.[754] Another practical difficulty is to prove that a state has indeed consented on the application of a certain rule. This issue might be mitigated if one uses silence or acquiesces as an alternative for consent.[755] Such an approach will be discussed in the following section. Inter alia, due to these shortcomings, the ICJ has not in all cases analyzed whether the involved parties indeed followed a certain practice, but discussed whether sufficient state practice exists in general terms.[756]

4.3.2.2.3. *Good faith, reasonable expectations or trust in a certain behavior*

Another approach is to argue that states are bound by customary international law due to legitimate expectations of the behavior of other states. Following such an opinion, it is not the vague term of *opinio iuris*, per

751. ICJ, North Sea Continental Shelf Cases (*Federal Republic of Germany v. Denmark and Netherlands*), p. 44 et seq.
752. PCIJ, Lotus, Permanent Court of International Justice, The Case of the Lotus S.S., *France v. Turkey*, p. 18.
753. Lepard, p. 17; Verdross, 1969, p. 637; Verdross, 1973, p. 96. For further details about the consent theory *see* Kammerhofer, p. 533 et seq.
754. Tasioulas, 2007, p. 313.
755. Kammerhofer, p. 533, with reference to Byers.
756. With reference to the *Lotus* and *Nottebohm* decisions, *see* Verdross & Simma, § 555. *See*, with an empirical analysis, Choi & Gulati, p. 117 et seq.

se, but rather the justified trust in certain actions of another state that creates a legal obligation.[757] The consistent state practice could therefore be understood as a sign of certain expectations among states that other states will also behave in a certain way in the future. Such an approach can be understood as being supplementary to cases in which it is obvious that state consent on a certain rule is binding by customary international law.[758] If one follows such rationale, it is essential to elaborate when and due to what reasons trust in a certain behavior of a state should be protected. Two aspects are of preeminent importance.

First of all, within international law, due to a lack of a centralized legislative authority to issue binding obligations, the historical reality is to be considered if opposing interests of states exist.[759] Otherwise, certain expectations and stability within an international framework could not be achieved. To be more precise, this means that it is essential to further analyze the historical development of a certain behavior of a state and whether such behavior has created a legal obligation vis-à-vis other states or, for instance, such behavior appeared in a very specific circumstance with no intention to create an international legal obligation.

Secondly, the past and consistent behavior of states regarding the allocation of state interest, for instance, with regard to natural resources, shall not become void by a one-sided refusal of one state.[760] This means that it should not be in the discretion of a single state to object to a long-standing international consistent practice. Or, in more general terms, a state cannot undermine the legal validity of a customary rule by persistently objecting to it. The latter might only lead to a denial of the application of the presumed customary rule in relation to such a state, but not question the validity of the customary rule, per se.[761]

Such an understanding could overlap with the aforementioned approach of a tacit agreement among states. A state might, by behaving in a certain

757. Müller, p. 85: "*Es ist nicht das spekulative Moment einer nicht weiter erklärbaren opinio iuris, sondern das gerechtfertigte Vertrauen in die die Konstanz fremden Verhaltens in rechtlich relevanten Handlungsbereichen, das die Verbindlichkeit einer Übung begründen kann*."
758. Id., p. 80: "*Die Lehre vom Vertrauensschutz vermag nun insbesondere jenen Bereich der Gewohnheitsrechtsbildung zu erhellen, in dem es sich nicht um ausdrückliche, sondern stillschweigende, aus den Umständen zu schliessende Anerkennung einer Übung als Recht handelt*."
759. Id., p. 91.
760. Id., p. 90.
761. *See also* Besson, 2016, p. 315.

manner, indeed tacitly agree to a certain rule and, simultaneously, a state might create a reasonable expectation. Such an approach also overlaps with the following, which at least partly justifies the validity of customary international law through moral or ethical arguments, as the protection of legitimate expectation is per se a value-based argument in order to justify the existence of customary international law.

4.3.2.2.4. *Morality or ethical values*

Related to a theory based on good faith is the claim that morality and ethics are relevant for justifying the validity of a rule of customary international law. This would mean that morality or ethical values could be the basis for the recognition of customary international law. Therefore, both prerequisites (i.e. state practice and *opinio iuris*) of the traditional understanding of customary international law would not be required.

Some authors argue that there are moral reasons for recognizing customary international law as a potential source of international law.[762] Some authors and, according to Lepard, also the ICJ,[763] do not base a rule of customary international law on moral or ethical principles, but rather argue that ethical values might "tip the balance" in favor of customary law.[764]

Lepard[765] further states that a desirable rule must be believed by states as an authoritative rule. This means that it would not be sufficient to become part of customary international law that states believe that a certain rule should exist. Moreover, he argues that a rule must be obligatory in the sense of a legal authoritative norm, and not only as a social or moral authoritative norm. As a last prerequisite, Lepard argues that it is crucial that states believe that a certain rule binds all nations (or at least a group). Therefore, there should be a belief that even those states that have not committed to a certain rule should be bound by such a rule. In short, he proposes the following definition of customary international law:

> A customary international law norm arises when states generally believe that it is desirable now or in the near future to have an authoritative legal principle or rule prescribing, permitting, or prohibiting certain conduct. This belief

762. *See* the references stated by Akehurst, p. 34 et seq. *See also* the references mentioned by Petersen, p. 264 et seq. *See* as an example, Tasioulas, 2016, p. 95 et seq., and his "moral judgment-based account (MJA) of customary international law".
763. Lepard, p. 142 et seq.
764. Id., p. 143.
765. Id., p. 114.

> constitutes opinio juris and it is sufficient to create a customary law norm. It is not necessary in every case to satisfy a separate "consistent state practice" requirement. Rather, state practice can serve as one source of evidence that states believe that a particular authoritative legal principle or rule is desirable now or in the near future.[766]

Besides, it is important to note that Lepard understands an *opinio iuris* to exist "[i]f the norm objectively has a direct and significant impact on fundamental ethical principles, either positive or negative, this impact is a reason to presume that states either favor or disfavor implementation of the norm as a legal rule."[767]

To sum up, Lepard at least partly refers to ethical values in order to justify the validity of rules of customary international law. A distinct approach is taken by Tasioulas, who uses the term "interpretive conception" for his account of customary international law. In simplified terms, he detaches *opinio iuris* from the state practice and, in principle, he does not require that both elements are fulfilled in order to create customary international law.[768] Moreover, he takes into account the *opinio iuris* of non-state actors in order to achieve more legitimacy in international law and to achieve enhanced global justice. The core of his concept, however, is that both state practice and *opinio iuris* are "raw data", as he calls it, and it "will be a matter for the interpreter's independent ethical judgment"[769] to determine how morally attractive a rule as a customary rule is.

Following such an understanding, one could in simplified terms argue that value-driven rules are more likely to become customary international law. From a tax perspective, one could, for instance, argue that fiscal cross-border transparency is feasible from a moral perspective, as it leads presumably to less tax evasion and tax avoidance and, therefore, this might be a justification for the creation of a customary international rule aiming at fiscal transparency.[770] Such an approach – if it would find its way into international

766. Id., p. 8.
767. Id., p. 140.
768. *See*, on the latter point, Tasioulas, 2007, p. 330 et seq. However, he argues on one hand that, "a customary norm may be found on the basis of widespread state practice and no independent showing of opinio iuris" (p. 331). Therefore, the *opinio iuris* can be derived from state practices. He also argues that there might indeed be cases in which an *opinio iuris* develops without existing state practice.
769. Tasioulas, 2007, p. 331.
770. *See* sec. 4.3.2.8.8. on the question of whether such a rule has indeed become customary international law. Moreover, *see* sec. 12.6. on the question of whether fiscal transparency indeed reflects a normative claim.

legal practice – also has some major disadvantages. For instance, as highlighted by Tasioulas,

> The danger in accepting this idea is that custom becomes, not a source of legal norms the existence and content of which is robustly independent of anyone's viewpoint on contestable ethical and political issues, but either a political battlefield in which indeterminancy is rampant or else the puppet of some arbitrarily privileged ideological standpoint.[771]

However, for the purpose of the present study, it is our understanding that moral reasons cannot by themselves create customary international law, as the two traditional requirements, "state practice" and "*opinio iuris*" must be evident. However, of course, the question of whether an *opinio iuris* is at hand is influenced by moral considerations, but customary international law cannot be given if there is no state practice in which such a rule is reflected. This means that many moral or ethical principles and rules will not fulfill the requirements of customary international law.[772] In the following, we will discuss in more detail these two traditional requirements for the creation of customary international law.

4.3.2.3. State practice

4.3.2.3.1. *What is state practice?*

What "consistent international practice" means exactly has triggered many intense discussions among international law scholars.[773] For the purpose of the present thesis, some aspects will be highlighted.

Practice generally means the action or inaction of a state in relation to other subjects of international law. Or, in the words of Heintschel von Heinegg, state practice encompasses all actions ("*Verhaltensweisen*") that can be attributed to the state and which refer to an international circumstance.[774] With regard to taxation, this could mean, in a very simplified manner, that a certain income is taxed or not taxed in a jurisdiction.

771. Tasioulas, 2007, p. 311. *See also* Petersen, p. 265.
772. *See also* Akehurst, p. 34 et seq.; Lepard, p. 142.
773. *See* on this topic, for instance, Akehurst, p. 1 et seq.; D'Amato, p. 56 et seq., Crawford, p. 24 et seq.; Doehring, para. 290 et seq.; Giersch, p. 120 et seq.; Kammerhofer, p. 525 et seq.; Thirlway, 2014, p. 63 et seq. *See also* Villiger, 1997, p. 16 et seq. The ICJ also used the term "usage constant et uniform" (*see* ICJ, Asylum Case (*Colombia v. Peru*), p. 276).
774. Von Heinegg, in: Ipsen, § 17 para. 6. *See also* Boas, p. 77, who states that omissions as evidence of state practice are more difficult to characterize. *See also* Verdross & Simma, § 560.

One disputed issue is whether a claim of a state without an actual act of such a state qualifies as practice in the sense of the customary law definition.[775] It is, for instance, unclear whether a claim within a legal procedure can also be seen as state practice.[776] However, the distinction between a mere claim and an actual state action seems, from a tax perspective, not of great importance, as the existence of mere claims is rare, as states tend to indeed tax (or explicitly not tax) an income and not just claim that a certain income should (or should not) be taxed. Or, in other words, from a tax perspective, a claim generally aligns with an actual action of a state, i.e. the taxation of an item of income.

Another issue relates to the question of the spread and duration[777] of a certain state practice. Regarding the necessary duration for the creation of customary international law, Villiger[778] mentions that most authors agree that customary international law can also be created within a short time frame and, therefore, the duration of a certain practice is a relative requirement. Concerning the required spread of state practice, under certain circumstances, even local or regional customary international law can emerge.[779] According to some authors,[780] the disputed practice does not need to be applied by all countries. However, it needs to be analyzed in each individual case whether a certain practice is applied (and supported) by a sufficient number of countries.[781] Often, reference is also made in this respect to the North Continental Shelf Cases, in which the ICJ held the following:

> Although the passage of only a short period of time is not necessarily, or of itself, a bar to the formation of a new rule of customary international law on the basis of what was originally a purely conventional rule, an indispensable requirement would be that within the period in question, short though it might be, State practice, including that of States whose interests are specially affected, should have been both extensive and virtually uniform in the sense of the provision invoked.[782]

775. *See* Crawford, p. 25.
776. Akehurst, p. 1 et seq., with reference to D'Amato; Giersch, p. 122 et seq. For further details *see* Kammerhofer, p. 525 et seq.
777. *See* on this specific topic Boas, p. 74; Crawford, p. 24; Heintschel von Heinegg, in: Ipsen, § 17 para. 8 et seq.; Kammerhofer, p. 530 et seq.
778. Villiger, 1997, p. 45. *See also* Verdross & Simma, § 571.
779. E.g. Heintschel von Heinegg, in: Ipsen, § 17 para. 44 et seq.
780. Crawford, p. 25; Heintschel von Heinegg, in: Ipsen, § 17 para. 10. Lepard, p. 7, with further references.
781. Von Heinegg, id., para. 11; Thirlway, 2014, p. 64.
782. ICJ, North Sea Continental Shelf Cases (*Federal Republic of Germany v. Denmark and Netherlands*), p. 43.

The ICJ sometimes even seems to approve the existence of customary law without proving that there is indeed sufficient state practice.[783] The practice must not be uniform and infringements of a certain rule might not necessarily be a sign of the non-existence of a rule.

Therefore, from a tax perspective, it is essential to analyze which states are specifically affected by a certain practice. Prima facie, and considering that most states have income and corporate income taxes, it could be argued that all states are specifically affected by certain income and corporate income tax practices of other states. For instance, if a state implements a PE definition solely based on digital presence, such a redefinition will affect enterprises resident in various jurisdictions.[784] This is indeed true, but it seems that there are also areas in international tax law by which only a few countries are affected.[785] For example, the opinion or the hypothetical practice of Austria with regard to the question of the taxation of enterprises extracting oil on the seabed might be of limited importance, as Austria does not have a seabed.

With regard to the requirement of sufficient state practice, some further conceptual ambiguities exist, such as whether state practice is relevant in order to prove that there is consent among states or whether state practice is only a sign of an existing *opinio iuris*.[786]

4.3.2.3.2. *Resolutions of international organizations*

Among scholars of international law, it is disputed whether and under what circumstances a decision of an international organization can be a sign of state practice as a constituting element of customary international law.[787]

From a tax perspective, it is worth analyzing in more detail whether and under what circumstances a resolution of an international organization, such as the OECD or the UN, can be a sign or even evidence of state practice. This is particularly true, considering the importance of the work of the

783. Thirlway, 2014, p. 221 (n. 102) with further references. *See also* Choi & Gulati, p. 117 et seq.
784. OECD/G20, Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report (OECD 2015), para. 277 et seq. *See also* the proposal brought forward by Hongler & Pistone, p. 1 et seq.
785. *See* Boas, p. 76, with reference to the *Asylum* case.
786. *See* the references mentioned by Lepard, p. 23 et seq.
787. *See generally* Giersch, p. 120 et seq., or with further references Payandeh, p. 258 et seq. Or *see* the contribution of Van Hoof, p. 182 et seq.

OECD as the leading authority in international tax law. At first glance, it seems reasonable to conclude that resolutions of international organizations can be a sign of customary international law, as state representatives are generally involved in the decision-making process and, therefore, the decision of an international organization might reflect the practice of states.[788] However, from a tax perspective, the resolutions of international organizations will regularly find their reception in domestic tax law or treaty law, and then customary international law might be justified by direct state practice. This is true regarding new provisions in model conventions, which will be transferred into actual tax conventions, as well as regarding the recommendation for the design of domestic rules, as these rules will also need to be implemented domestically. Therefore, certain reluctance is necessary before a resolution of an international organization is considered to be a sign for state practice.[789] Resolutions of international organizations are generally not yet a sign of state practice for tax purposes.

Resolutions of an international organization might even be misleading if a state's representatives have, on one hand, agreed to a certain regulation, but on the other hand, these rules have (purposely) not been given an obligatory character and have not been transferred to the actual state practices of the involved parties. For example, the OECD published the Partnership Report in 1999 and only very few states have made explicit reservations,[790] but the BEPS Project, i.e., Action 2, has shown that the impact of the Partnership Report has still been rather limited. Otherwise, the proposal of a new article 1(2) of the OECD MC would not have been necessary within BEPS Action 2.[791] Therefore it would have been wrong to conclude that recommendations within the Partnership Report reflect a sufficient state practice in order to form customary international law, simply because it was agreed by the members of an international organization.

Furthermore, if a decision is rendered by a body of an international organization that does not consist of state representatives, such a decision can in general not be considered a sign of state practice, based on the definition of customary international law.[792] Some further limitations on the validity

788. Thirlway, 2014, p. 79. *See also* Boas, 2012, p. 88 et seq.; Giersch, p. 120 et seq.
789. *See generally* Giersch, p. 122 et seq.
790. OECD, The Application of the OECD Model Tax Convention to Partnerships (OECD 1999), p. 63 et seq.
791. OECD/G20, Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2014 Deliverable (OECD 2014), p. 139 et seq. *See also* art. 3 MIL.
792. *See*, however, for a more distinct analysis Akehurst, p. 11. On the question of the importance of a resolution of an international organization for the creation of state practice *see also* Doehring, para. 308.

of a decision of an international organization as the basis for customary international law will be mentioned in section 4.3.2.4.2. with respect to the *opinio iuris* requirement.

4.3.2.3.3. *Treaty provisions*

State practice as a requirement to create customary international law might also be derived from treaty provisions.[793] For example, signing a treaty can actually be a sign of the practice of such a state,[794] or signing a treaty as a governmental action is *per definitionem* a state practice. Therefore, if a state, in its double tax treaty, for instance, uses the PE definition according to article 5 of the OECD MC, this could be a sign of the practice of such a state. As we will outline below,[795] the existence of rules in international treaties might also have an influence on the existence of customary international law with respect to the question of whether a rule is supported by an *opinio iuris*. As shown by Choi and Gulati, treaties are indeed the most important material source of evidence for judges dealing with customary international law.[796]

4.3.2.4. *Opinio iuris*

4.3.2.4.1. *Some general remarks*

The *opinio iuris* as the subjective requirement means that, according to the case law of the ICJ, the relevant rule reflects a "belief that this practice is rendered obligatory by the existence of a rule or law requiring it."[797]

This definition, as provided for in the North Continental Shelf Cases, is generally referred to as the key wording in order to understand the *opinio*

793. Verdross & Simma, § 580. *See also* Allott, p. 44.
794. However, there is a dispute among international law scholars under what circumstance a treaty can and cannot be seen as reflecting a state's practice (Akehurst, p. 1 et seq.). *See*, with further references on the question of whether and under what condition an *opinio iuris* can be derived from international treaties, sec. 4.3.2.4.3. In particular the remarks on the North Continental Shelf Cases might also be relevant for the present section.
795. *See* sec. 4.3.2.4.3.
796. Choi & Gulati, p. 117 et seq. However, they argue that courts often do not refer to the two requirements (i.e. state practice and *opinio iuris*) to prove customary international law. Therefore, it is difficult to draw a clear line of how important treaty provisions are to prove state practice and/or an *opinio iuris*, as courts seem to rarely or not at all refer to the two-part definition.
797. ICJ, North Sea Continental Shelf Cases (*Federal Republic of Germany v. Denmark and Netherlands*), p. 44.

iuris requirement following the case law of the ICJ.[798] Furthermore, the ICJ held within the same judgment that:

> The frequency or even habitual character of the acts is not in itself enough. There are many international acts, e.g., in the field of ceremonial and protocol, which are performed almost invariably, but which are motivated only by considerations of courtesy, convenience or tradition, and not by any sense of legal duty.[799]

The opinion was further confirmed, inter alia, in the case concerning military and paramilitary activities in and against Nicaragua.[800]

Even though scholars generally agree that the *opinio iuris* is essential in order to create customary international law, there is still an intense debate on how to prove that there is indeed an *opinio iuris*. According to Kammerhofer, the *opinio iuris* requirement is actually "the most disputed, least comprehended component of the workings of customary international law".[801] However, it is inherent that the subjective element of an *opinio iuris* is challenging – if not impossible – to demonstrate.[802]

Such an existing dispute among scholars is often related to the underlying justification of customary international law in general. On one hand, one could argue that the *opinio iuris* is relevant in order to demonstrate that there is consent among states that a certain rule should be followed.[803] Second of all, one could argue that the *opinio iuris* element is necessary in order to demonstrate that the behavior of a state has created reasonable expectations.[804] Other authors actually argued that the *opinio iuris* element is not at all necessary and that it is sufficient that a certain state practice exists in order to justify that a certain rule belongs to customary international law.[805] Indeed, the *opinio iuris* requirement has an inherent circularity, if one understands it as a sign that there is a law requiring it and at the same

798. Boas, p. 80; Crawford, p. 27; Heintschel von Heinegg, in: Ipsen, § 17 para. 12; Thirlway, 2014, p. 57; Verdross, 1973, p. 104.
799. ICJ, North Sea Continental Shelf Cases *(Federal Republic of Germany v. Denmark and Netherlands*), p. 44.
800. ICJ, Case concerning military and paramilitary activities in and against Nicaragua (*Nicaragua vs. the United States of America*), p. 98.
801. Kammerhofer, p. 533.
802. *See* Müller, p. 82 et seq. On this topic previously, Verdross & Simma, § 563; Verdross, 1973, p. 104 et seq.
803. *See* sec. 4.3.2.2.2.
804. *See* sec. 4.3.2.2.3.
805. This is, in simplified terms, the opinion of Mendelsohn, p. 206 et seq. He also mentions further authors, such as Kelsen, Guggenheim and Kopelmanas.

time, as a requirement in order to prove that there is a pre-existing law. In this respect, Kammerhofer uses the term the "opinio iuris paradox".[806]

As mentioned, the *opinio iuris* is necessary in order to demonstrate that a certain state is indeed of the opinion that there is a specific legally binding rule and, as a consequence, that a certain practice is not just followed due to courtesy.[807] This means that there is actually a necessity for a certain rule. Furthermore, it seems that the *opinio iuris* has a negative impact, as it is necessary to distinguish between a state practice that might reflect only a courtesy and a state practice that actually reflects a binding, but unwritten law.[808] It is also not necessary to prove that a certain position is the opinion of all involved states, as it is sufficient to demonstrate that a certain rule reflects a general position.[809]

For the purpose of the present study, it is important to note that justice and fairness are not key factors in order to decide whether an *opinio iuris* exists according to the case law of the ICJ. It is essential to demonstrate that there is a necessity for a certain rule ("*opinio iuris sive necessitatis*"), and not whether a specific rule is fair from the perspective of the taxpayer. For instance, one could argue that it is unfair if the profit of an enterprise is taxed twice in two jurisdictions (i.e. juridical double taxation). However, we are not of the opinion that there is an *opinio iuris* among states that juridical double taxation should be avoided.[810] Therefore, customary international law is not about figuring out whether a rule ought to exist, but whether a rule does indeed exist.[811] Or, vice versa, it is possible that an *opinio iuris* exists and that a certain rule is required, even though this leads to an unfair or unjust result.

In the following, two specific aspects of the evidence of an *opinio iuris* will be discussed. These are also of particular interest from a tax perspective. First of all, we will deal with the question of how and whether recommendations, resolutions or other decisions of an international organization can be seen as a sign of an *opinio iuris*; secondly, we will demonstrate how

806. Kammerhofer, p. 533. *See also* with reference to Oppenheim, Finnis, p. 238 et seq.; Tasioulas 2009, p. 320 et seq. *See* Lefkowitz, p. 201, on dissolving such a chronological paradox in customary international law foundation.
807. Such an opinion is brought forward in a persuasive manner by D'Amato, p. 74 et seq.
808. Villiger, 1997, p. 47 et seq.
809. Heintschel von Heinegg, in: Ipsen, § 17 para. 15.
810. For further details *see* sec. 4.3.2.8.3.3.
811. Thirlway, 2014, p. 78.

treaties and customary law interact and whether a treaty can be a sign of an existing *opinio iuris*.

4.3.2.4.2. *Resolutions of international organizations as a sign of an* opinio iuris

With respect to the state practice requirement, it has already been shown[812] that a resolution of an international organization, such as the OECD, can indeed be a sign of an existing state practice, but reluctance is required. The present section aims to further discuss the validity of resolutions of an international organization in order to create customary international law with respect to the *opinio iuris* requirement.

The debate on whether resolutions of international organizations are a sign of customary international law is often limited to the impact of decisions of the bodies of the UN – in particular, of decisions of the General Assembly.[813] For instance, the Universal Declaration of Human Rights[814] and its relation to customary international law have attracted some attention.[815] In order to shed further light on the interaction between decisions of an international organization and the *opinio iuris* requirement, reference is first made to the case law of the ICJ.

As an example, the ICJ stated in an advisory opinion about the legality of the threat of use of nuclear weapons that:

> The focus of these resolutions has sometimes shifted to diverse related matters; however, several of the resolutions under consideration in the present case have been adopted with substantial numbers of negative votes and abstentions; thus, although those resolutions are a clear sign of deep concern regarding the problem of nuclear weapons, they still fall short of establishing the existence of an opinio juris on the illegality of the use of such weapons.[816]

From a tax perspective, one could derive from such case law that a resolution of an international organization, such as the UN or the OECD, could be a sign of an existing *opinio iuris,* although the ICJ is reluctant to accept such an *opinio iuris* if negative votes and abstentions exist regarding a concrete decision of an international organization. Also of interest is the *Nicaragua*

812. *See* sec. 4.3.2.3.2.
813. Boas, p. 86 et seq.; Heintschel von Heinegg, in: Ipsen, § 17 para. 23; Lepard, pp. 33 et seq. and 318 et seq.
814. UN, The Universal Declaration of Human Rights, A/RES/217, 10 Dec. 1948.
815. Lepard, pp. 180 et seq. and 318 et seq., with further references.
816. ICJ, Advisory Opinion, Legality of the Threat or Use of Nuclear Weapons, p. 225.

case of the ICJ. In this case, decided in 1986, Nicaragua claimed that the US infringed on the obligation to refrain from the threat or use of force as part of customary international law. It is of particular interest that article 2 of the UN Charter provides for an explicit prohibition of the threat or use of force. However, due to procedural reasons, the Court could only rely on customary international law (and not treaty law) as a potential legal base. With respect to the validity of the claim of Nicaragua, the Court stated the following:

> The Court has however to be satisfied that there exists in customary international law an opinio juris as to the binding character of such abstention. This opinio juris may, though with all due caution, be deduced from, inter alia, the attitude of the Parties and the attitude of States towards certain General Assembly resolutions, …. The effect of consent to the text of such resolutions cannot be understood as merely that of a "reiteration or elucidation" of the treaty commitment undertaken in the Charter. On the contrary, it may be understood as an acceptance of the validity of the rule or set of rules declared by the resolution by themselves.[817]

Prima facie, it seems, therefore, not sufficient in order to qualify as customary international law that a state acquiesces a certain recommendation or resolution published by an international organization. The reason is that the lack of protest of a certain state can originate from various reasons and does not necessarily need to reflect its *opinio iuris*. As a consequence, it is essential to consider why states have actually voted in favor of or against a certain resolution of an international organization.[818] For example, a decision of an international organization might not be the outcome of real consent, but might be achieved through direct or indirect coercion.

Furthermore, with reference to the aforementioned case law of the ICJ, it is important to consider that certain states will agree on a decision of an international organization, even though they might not be supportive. The reason is that their position might be too weak to disagree. Furthermore, the BEPS Project has shown that states might not even have the chance to state their objections, at least at the level of the international organization, before a certain report is adopted. The time schedule of the BEPS Project has been so tight that even large states have not been able to review all the adopted reports in detail, not to mention small states participating in the BEPS Project.

817. ICJ, Case concerning military and paramilitary activities in and against Nicaragua (*Nicaragua v. the United States of America*), para. 188.
818. *See*, with further details on the reasons for a non-protest, Lepard, p. 188. *See also* Boas, p. 88.

Although it is proven that certain resolutions of international organizations might reflect customary law, it is decisive that a court crystallizes which parts of a resolution are actually parts of customary international law and which are not. This means that if the resolution of an international organization contains various rights and duties, it is essential to determine which rules form part of customary international law.[819]

In conclusion, it seems persuasive to argue that resolutions of an international organization, such as the UN or the OECD, in tax matters could be a sign of an existing *opinio iuris.* But we need to consider that the ICJ is reluctant to accept such an *opinio iuris* if negative votes and abstentions exist. Furthermore, an *opinio iuris* might hardly exist if states were factually coerced to consent or were unable to state their opinion at the level of the international organization.

4.3.2.4.3. *The importance of treaty provisions*

Rules provided for in conventions and international treaties could also be a sign for the existence of an *opinio iuris* and, therefore, of customary international law. Or, as stated by the ICJ, "the rules laid down in that Convention might be considered as a codification of existing customary law."[820] This is only one side of the coin, i.e. that a treaty can be a sign of existing customary international law. On the other side, treaties can also create new rules of customary international law.[821] These two interactions of treaty law and customary law are both relevant from a tax perspective, and have already triggered an intense debate among scholars of international law.[822]

First of all, as will be shown below,[823] some tax exemptions of diplomatic agents have formed part of customary international law for decades and have also been codified in two conventions. If a rule of customary international

819. Lepard, 2010, p. 319, with reference to Simma & Alston.
820. ICJ, Case concerning the Gabčíkovo-Nagymaros Project (Hungary vs. Slovakia), p. 38.
821. Boas, 2012, p. 84; Heintschel von Heinegg, in: Ipsen, 2014, § 17 para. 22; Lepard, 2010, p. 30. Christians, 2007, p. 330, from a tax perspective, highlights that signing an international treaty could be a sign that no customary international law exists, as states would otherwise not be expected to sign such a treaty, as they would already be bound by customary law. However, the latter position seems not persuasive, as states might sign treaties even though they are of the opinion that a certain rule reflects customary international law. One reason might be that signing an international treaty would increase legal certainty.
822. E.g. Crawford, 2012, p. 33 et seq. *See also* Thirlway, 2014, p. 69 et seq.
823. *See* sec. 4.3.2.8.4.

law is indeed codified in an international treaty, this does not, therefore, mean that the underlying rule of customary rules vanishes. It is still valid with regard to other countries and it might also slightly deviate from the rule contained in the treaty.[824] Yet, furthermore, it is important to note that states might conclude a bilateral treaty because they are of the opinion that a certain rule does not form customary international law, meaning that there is a need for legal action. Consequently, signing a treaty might even lead to the conclusion that a certain rule has now become part of customary international law.[825] With respect to such a codification of existing rules of customary law, the ICJ held in the *Gabčíkovo-Nagymaros* case that, "the rules laid down in that Convention might be considered as a codification of existing customary law".[826] Also, within the VCLT, article 38 states that:

> Nothing in articles 34 to 37 precludes a rule set forth in a treaty from becoming binding upon a third State as a customary rule of international law, recognized as such.

The second example of interaction between treaty law and customary law has also triggered the attention of courts and several authors. The ICJ confirmed in North Sea Continental Shelf Cases that it is indeed possible that rules within a treaty or an international convention might become customary international law and, therefore, bind parties that have not been parties of such a convention.[827] It seems indeed persuasive to argue that rules provided for in a treaty can be a statement of customary international law.[828] However, it is important to consider that a provision in a bilateral treaty might be less of a sign of an existing customary rule of international law, as compared to a rule provided in a multilateral convention signed by dozens of jurisdictions.[829] The amount of participating states might generally influence the validity of the argument that a treaty provision creates customary international law.[830] In the case of several dozen or even hundreds of bilateral agreements containing the exact same provisions, this might indeed reflect the existence of a rule of customary international law.[831] However, it is also important to

824. *See*, on the relation between treaties and custom, Crawford, p. 33; Thirlway, 2014, p. 139.
825. Doehring, para. 314 et seq.
826. ICJ, Case concerning Gabčíkovo-Nagymaros Project (*Hungary v. Slovakia*), p. 38.
827. ICJ, North Sea Continental Shelf Cases (*Federal Republic of Germany v. Denmark and Netherlands*), p. 41.
828. *See generally* D'Amato, p. 160 et seq. Further opinions are mentioned by Lepard, p. 32.
829. E.g. ICJ, Case concerning the Continental Shelf (*Lybian Arab Jamahiriya v. Malta*), p. 29 et seq.
830. Baxter, p. 275 et seq.
831. *See generally* about the interaction between multilateral treaties and custom, id.

consider that a treaty itself does not play a constitutive role, in the sense that a treaty practice, which is reflected in dozens or even hundreds of treaties, is automatically a sign of an existing *opinio iuris*.[832] However, there is a lack of clear guidance about such an interaction of treaty law and customary law and it needs to be decided in an individual case whether a certain treaty network has led to the creation of customary international law.[833]

From a tax perspective, the question could be whether the signing of thousands of double tax conventions containing mainly identical provisions has led to the creation of customary international law within international tax law. To be more precise, one could, for instance, argue that the 183-day rule according to article 15(2) of the OECD MC or article 15(2) of the UN MC is part of customary international law, as it seems to be the practice of most states in a cross-border situation to exempt the income of a person in simplified terms if such individual is resident in a treaty country and works less than 183 days in the other country for an employer that is not resident in the latter country. Therefore, a taxpayer could claim non-taxation in a certain state, as he could apply the 183-day rule as part of customary international law, even in concrete circumstances where no double tax treaty is in place. However, we would disagree with such a position for the following two (non-exhaustive) reasons.

First of all, double tax treaties do not cover or, at least in the past, have not covered offshore states. This means that there is an impressive network of existing provisions that are very similar in every double taxation convention, but certain states have not yet signed one of these treaties. The latter is not a sign that these states do not agree on these provisions in a double tax treaty, but that the other (onshore) jurisdictions have or had no interest in signing these agreements with offshore havens. Or, as stated by Villiger:

> Yet even a series of such [identical bilateral] treaties cannot per se offer conclusive evidence of a customary rule, or the opinion, since States may be ratifying such treaties precisely because they believe that no customary rules exist, or will exist, on the matter.[834]

This is indeed true with regard to the 183-day rule, as states are not of the opinion that the income of such a cross-border worker should not be taxed in the recipient state, per se, but rather that if they agree on a double tax convention, that the 183-day rule seems a rather practical solution in application.

832. Villiger, 1997, p. 187.
833. *See* Boas, p. 86.
834. Villiger, 1997, p. 189.

Second, Doehring[835] mentions the example of MFN clauses in international trade agreements, arguing that even though most agreements contain such an MFN provision, these provisions have not become customary law, as it is not the intention of states that such a customary rule develops, given that states want to keep the liberty to decide whether it shall grant a certain state a benefit, and it is not a presumption of a common interest of having these rules. Transferred to the tax world, it is convincing to argue that the rules on the allocation of income and capital, such as article 15(2) of the OECD MC, as contained in the OECD MC and the UN MC, have not become part of customary law, because it is not in the common interest of states to have these rules implemented worldwide. It would otherwise be difficult to explain, for instance, why Brazil and the US have not yet signed a double tax convention or why India and Indonesia have terminated their double tax agreements with Mauritius, at least for a certain period of time.

4.3.2.5. Persistent objector

If a certain rule indeed belongs to customary international law, it is compared to soft law, generally binding for (all) states, and compared to international treaties, not only for the contracting states.[836] An important exception is made if a state is a "persistent objector", meaning that the state consistently refuses the application of such a rule.[837] There is no agreement among scholars and a clear opinion can also not be found in the case law of the ICJ, under what circumstance a state indeed qualifies as persistent objector.[838] Some of these uncertainties relate to the dispute with respect to the underlying justification of customary international law.[839] For instance, a strict positivist (or voluntarist) would even argue that a state needs to consent to a certain rule of customary international law and, therefore, the persistent objector doctrine must be applied in a broad sense. On the other hand, following, for instance, the understanding of Lepard, as outlined above, it might be more difficult for a state to object to the development of a rule of customary international law.[840]

835. Doehring, para. 319.
836. Besson, 2016, p. 313 et seq.
837. *See* for further details Boas, p. 93 et seq.; Crawford, p. 28; Heintschel von Heinegg, in: Ipsen, § 17 para. 25 et seq.; Thirlway, 2014, p. 86 et seq.
838. *See* Boas, p. 93 et seq.
839. *See* for further details sec. 4.3.2.2.
840. *See* for further details sec. 4.3.2.2.4.

4.3.2.6. Limitation of customary international tax law

As we will outline in the following, several reasons limit the importance of customary international law as a source of international tax law. Some of these reasons are not specifically tax law-related, but might reflect more general concerns about the functionality of customary international law.[841]

A first limitation relates to the importance of the legality principle, as implemented in most countries' constitutions, case law or domestic tax laws.[842] Therefore, certain reluctance is required before a tax liability (or a tax exemption) is created (or granted) through customary international law. In this sense, Bühler already stated in 1964 that the likelihood of the existence of customary international law within international tax law is less than in other areas due to the strict application of the legality principle within tax law:

> *Auf dem Gebiet des IStR ist wegen der hier besonders streng durchgeführten Bindung der Verwaltung an gesetzlich formulierte Tatbestände für Gewohnheitsrecht weniger Raum als in anderen Zweigen des i.n. Rechts* [footnote omitted].[843]

The ICJ has also used the argument of coordination as a reason for establishing a rule of customary international law. It has stated in the Gulf of Maine Case:

> A body of detailed rules is not to be looked for in customary international law which in fact comprises a limited set of norms for ensuring the co-existence and vital co-operation of the members of the international community, together with a set of customary rules whose presence in the opinion juris of States can be tested by induction based on the analysis of a sufficiently extensive and convincing practice, and not by deduction from preconceived ideas.[844]

It might also even be the case that constitutional principles and/or domestic case law explicitly prohibits the creation of a tax liability based on (international) customary law,[845] or one could argue that the principle of "*nullum*

841. For some contemporary views on the suitability of customary law as a source of international law in the current global environment, *see* the contributions in Bradly (ed.).
842. E.g. Bill of Rights, 1698: "That levying money for or to the use of the Crown by pretence of prerogative, without grant of Parliament, for longer time, or in other manner than the same is or shall be granted, is illegal; …."
843. Bühler, p. 36. *See also* Knechtle, p. 156.
844. ICJ, Case concerning Delimitation of the Maritime Boundary in the Gulf of Main Area (*Canada vs. United States of America*), p. 299.
845. *See*, for example, the case of the Swiss Federal Supreme Court, CH: BGE 94 I 305, 15 May 1968, cons. 3.

tributum sine lege" in a strict sense could even be part of customary international law and, in this way, a conflict could arise. Therefore, depending on the relation between customary international law and domestic (constitutional) law, it might not even be possible that a tax liability (or a tax exemption) can be based (or granted) on customary international law. The fact that customary international law is often not dependent on a domestic ratification process not only limits the usability of customary international law as a law-making source, but is also a concern of democratic legitimacy.[846] Although, from an international law perspective constitutional law cannot prohibit the creation of customary international law, but it can prohibit its application domestically.

Another important limitation of the application of customary international law relates to the grade of detail of tax rules. Tax rules are generally very detailed and technical, and the more technical a provision is, the less likely is its creation through customary law. The latter is also an important reason why customary international law has generally lost some of its importance in recent decades, as the technicalities within international regulation have significantly increased. As an example, one could argue that the exemption of the income of a diplomatic agent has been developed as a rule of customary law,[847] but more technical rules, such as the 183-day rule in article 15(2) of the OECD MC can, practically speaking, only be defined by treaty provisions due to their grade of detail and cannot be developed as a customary international rule. However, this does not preclude that the creation of customary international tax law is possible regarding general cooperation aspects which are "vital"[848] for the international community.[849]

Further limitations can be derived from the work of Trachtman[850] who, inter alia, showed, based on an empirical analysis, that (i) most rules of customary international law are already codified, (ii) the pedigree of treaties and the likelihood of compliance are better than for customary international law and (iii) in general, customary international law is obsolete in the current international legal framework. He mentioned the following disadvantages of customary international law, which we will also refer to from a tax per-

846. Trachtman, p. 186 et seq.
847. *See* sec. 4.3.2.8.4.
848. The term is used by the ICJ in the aforementioned case, ICJ, Case concerning Delimitation of the Maritime Boundary in the Gulf of Main Area (*Canada v. United States of America*), p. 299.
849. We will discuss, for instance, whether the prohibition of international double taxation is such a rule of customary international law which is vital for the cooperation of the international community. *See* sec. 4.3.2.8.3.
850. Trachtman, p. 173.

spective, in order to better outline the disadvantages of customary law as a source of international tax law:

(i) it cannot be made in a coordinated manner in advance of events;
(ii) it cannot be made with sufficient detail;
(iii) it cannot be made with sufficiently heterogeneous reciprocity between states;
(iv) it cannot be made with specifically designed organizational support;
(v) it is generally not subject to national parliamentary control;
(vi) it purports to bind states that did not consent, but failed to object to its formation; and
(vii) it provides excessive space for auto-interpretation by states, or for (sometimes) insufficiently disciplined interpretation by judges.

These disadvantages are also of particular interest for the present work. The following should be highlighted from a tax perspective:

– International tax law requires a very detailed level of coordination and, therefore, customary international law might not suit the area of international tax law. In particular, tax law requires very technical rules that can only derive from intensive coordination.[851] For instance, theoretically, it could have been possible that the PE threshold requiring a fixed place of business according to article 5(1) of the OECD MC could have been developed as a rule of customary international law, as the definition of a threshold itself seems at first glance not as complicated, as it requires a written rule. However, also with regard to such a fundamental question of tax liability, it is well known that it has triggered manifold interpretation issues. Considering the very recent development regarding the BEPS Project at the level of the OECD, it seems evident that the PE concept could not have been developed through customary international law, as it requires a detailed negotiation process among the involved parties, for instance, with regard to the applicable exemptions according to article 5(4)of the OECD MC.[852] One could even argue that customary tax law is not successful because there is no need for coordination, which is not the case in other fields, such as border conflicts. In order words, it is essential to know what the territory is of

851. Trachtman, p. 180, mentions further areas, such as international trade law or international food safety law, which contain complexities that are difficult to be covered by customary international law.
852. *See* OECD/G20, Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: Final Report (OECD 2015).

a state, but it is not as essential to solve overlapping taxation.[853] Similar arguments can be raised regarding point (ii) above. Customary international law is not able to cover very detailed rules, as the process of creation takes decades and customary international law is not able to react in a sufficiently timely manner to certain developments or new structures. In particular, within international tax law and its current complexity, customary international law seems not to be an efficient instrument in order to a find a more coordinated international tax law.[854]

– Regarding point (iii) above, it is also true that heterogeneous reciprocity is also of great importance within the field of international tax law. This is one of the main obstacles making it unlikely that a single multilateral tax convention will replace all existing international double tax conventions any time soon, as double tax conventions are a sign of reciprocal rights and duties. One state might require a 0% withholding tax on intra-group dividends, while another state might ask for a broad PE definition and reducing the threshold to six months in article 5(2) of the OECD MC. Therefore, rules provided for in double tax conventions are primarily the result of long-lasting and reciprocal bilateral negotiations, and not a sign of an international *opinio iuris*. It is not as simple as in other cases, for instance, with respect to the protection of diplomats.[855]

– As mentioned by Trachtman under (iv) above, it seems indeed true from a tax perspective that a certain research center at the level of the OECD or the level of the UN is necessary in order to develop international tax law. This means that, in order to develop an international allocation of income system, expertise is essential and it seems necessary that a centralized body develops the ideas and principles, which will then be agreed upon by state representatives. Customary international law is not able to fulfill these prerequisites.

– Due to the importance of the legality principle within tax law, it is indeed a major disadvantage that, as mentioned under (v) and (vi) above, the legislative process according to domestic law is not required for the

853. *See* Finnis, p. 244, who argues that custom is authoritative, as it indeed enables the solving of coordination problems, but tax law might be too technical for an area of coordination compared to, for instance, border conflicts.
854. On the issues of change in international law and the disadvantages of customary international law, *see* Tasioulas, 2007, p. 308 et seq.
855. *See* Trachman, 2016, p. 184, who mentions one of the most symmetric rules that developed as customary international law: "[Y]ou protect my diplomats, and I will protect yours."

creation of customary international law.[856] Therefore, the levy of taxes or the granting of tax exemptions would not follow the ordinary path of a (democratic) legislative procedure. This limitation of customary international tax law has already been highlighted above.

– As already mentioned, tax law requires detailed rules, as otherwise the risk of the too extensive use of a judge's discretion could lead to excessive results, thus leading to unequal treatment, as indicated in (vii) above.

4.3.2.7. Intermediate observations from a tax perspective

Others have dedicated in-depth studies on customary international law in general and it would clearly be dogmatism to argue that the correct definition of customary international law can be conceived and a distinct position on the concept of customary law can be outlined in an interdisciplinary work on the international tax regime and justice. Nevertheless, in order to further demonstrate whether certain tax rules indeed form part of customary law and what its interaction with justice considerations and morality is, some intermediate conclusions from a tax perspective are necessary.

– First, the present study follows a traditional understanding, according to which the existence of customary law requires that a sufficient state practice exist and that the *opinio iuris* can be proven. This reflects the case law of the ICJ, even though the conclusions out of such a twofold definition vary significantly and the ICJ might also not follow a clear-cut understanding of how the requirements ought to be understood.[857] The author is fully aware of the ambiguities, which are a direct consequence of the different conceptual understandings of customary international law. Moreover, the legal understanding of customary international law might also change over time, as its recognition is based on what could be called "custom" among states.[858]

– Secondly, it seems unpersuasive to assume that the justification for the bindingness of customary international law follows strict voluntarism, in the sense that states need to consent to the development of a certain rule of customary international law. This would mean that only if a state has participated in the development of a certain rule can the state be

856. *See* Tasioulas, 2007, p. 309.
857. E.g. Tasioulas, 2007, p. 334. With empiric evidence, *see* Choi & Gulati, p. 117 et seq.
858. Finnis, p. 244.

bound by it. Custom must not in all cases be based on explicit consent, as states might also be bound if they have not explicitly shown their consent to a certain rule. Therefore, customary international law does not require an explicit agreement, as compared to treaty law.[859]

– Third, state practice is essential for the creation of customary law. This means that customary law cannot exist solely based on an *opinio iuris*. The main argument for such a position is that the term "custom" itself requires practice, habit, usage, etc. The term "dialectic of practice", as used by Allott, is a suitable description.[860]

– Fourth, the *opinio iuris* has an important limiting function that should be highlighted by referring to the case law of the ICJ. First of all, the *opinio iuris* is decisive to distinguish between rules of customary law and mere rules of courtesy. Or, in the words of Akehurst: "[O]pinio juris is also needed in order to distinguish legal obligations from non-legal obligations, such as obligations derived from considerations of morality, courtesy or comity [footnote omitted]."[861] Second of all, the *opinio iuris* requirement is necessary to distinguish between situations in which a certain act of a state does not create a legal obligation and a situation in which states can actually create trust in the behavior of a state in the sense of a binding obligation. Therefore, the *opinio iuris* might also be understood as a negative requirement to exclude certain state practices from customary international law.

– The observations of Trachtman have been very fruitful in demonstrating that customary international law is not an efficient source of law making for the international tax regime. Various reasons have proven that the development of customary international tax law might be limited due to its complexity, technicality, and the fact that the legality principle is often crucial for tax purposes.

4.3.2.8. Examples from a tax perspective

4.3.2.8.1. *Preliminary remarks*

What rules exactly belong to customary international tax law is difficult to assess, as there is basically no international case law available. However,

859. Besson, 2016, p. 315.
860. Allott, p. 38.
861. Akehurst, p. 33.

the ICJ has stated that certain privileges of diplomatic and consular relations belong to customary international law.[862] As will be shown below,[863] this also has an impact on the international tax law regime. The following sections will refer to specific examples of potential rules of customary international tax law that have been mentioned in the literature. Reference, in particular, is made to the work of Avi-Yonah[864] and Lepard[865] in this respect, but also to older German or Swiss literature, such as Knechtle[866] or Bühler.[867] There are also other authors who referred to customary international tax law in their writing.[868]

From a methodological perspective, we refer to the traditional requirements of state practice and *opinio iuris* in order to demonstrate whether or not a certain rule indeed forms part of the international tax regime. Moreover, in some instances, we will refer to some of the existing deviating underlying conceptions of customary international law, as shown above,[869] and their impact on the result of the evaluation. We will render a more detailed analysis regarding the prohibition of international double taxation, the non-taxation of diplomatic personnel and the arm's length principle. Our remarks will be shorter regarding the potential customary qualification of the treaty interpretation methodology and fiscal transparency. Before discussing some examples, in the following introductory remark, we will review the principles of the prohibition of extraterritorial taxation, its relation to the source of customary international law, and its interaction with CFC rules. The focus is on prescriptive jurisdiction and not enforcement jurisdiction.[870]

4.3.2.8.2. *Excursus: Prohibition of extraterritorial taxation and CFC legislation*

According to Schaumburg,[871] it is part of customary international law that states shall not extend their tax systems to persons not having a personal or local link to a certain jurisdiction. Schaumburg does, however, not provide

862. ICJ, Case concerning the Arrest Warrant of 11 April 2000 (*Democratic Republic of Congo v. Belgium*), p. 21.
863. *See* sec. 4.3.2.8.4.
864. Avi-Yonah, 2004, p. 483 et seq.; Avi-Yonah, 2007, p. 1 et seq. *See also* Christians, p. 326 et seq.
865. Lepard, p. 285 et seq.
866. Knechtle, p. 142 et seq.
867. Bühler, p. 34 et seq.
868. E.g. Albrecht, p. 169 et seq.
869. *See* sec. 4.3.2.2.
870. On the distinction *see* sec. 4.1.1.
871. Schaumburg, para. 3.13, with further references. *See also* Avi-Yonah, 2004, p. 498.

for further details about the question of whether there is indeed a sufficient state practice and an *opinio iuris* that would justify the existence of customary international law. Prima facie, it seems persuasive to argue that a sufficient state practice is given and that taxation indeed requires a genuine or sufficient link, and that such a rule is undermined with an *opinio iuris* that there is a law requiring it. The *opinio iuris* could, for instance, be supported by the benefit theory, which actually states that a person should only be subject to taxes in a specific jurisdiction if that person benefits from the services or the infrastructure of that state. As demonstrated, this was also the approach taken in the *Cook v. Tait* decision of the US Supreme Court.[872]

However, as was developed in detail above,[873] it is our understanding that the prohibition of extraterritorial taxation (i.e. prescriptive jurisdiction) derived from the principle of sovereignty is a peremptory norm in international law that reflects a legal precondition of the current order in the post-Westphalian world. Therefore, there is no necessity to claim that the prohibition of extraterritorial taxation receives its legal validity from custom, as its legal validity is derived directly from the current world order as a legal regime. The main difference of these two positions is that the consequence of a qualification of customary law would be that a persistent objector could, by persistently infringing the genuine link doctrine, avoid legal obligations according to international law.[874] The latter is not possible if one follows our understanding that the sovereignty principle and as a consequence the prohibition of extraterritorial taxation are legal preconditions of the current world order.

Such a rather abstract deviation is not only of theoretical importance, but could also have an impact, for instance, with respect to CFC legislation. As mentioned above,[875] many countries apply CFC rules in order to extend their jurisdiction to tax the income of foreign resident companies. It has also been argued above that such expansion is an extreme extension of the genuine link doctrine, as the link depending on the legislation might be very limited. Avi-Yonah states that the potential infringement of international law is potentially carved out, as CFC rules have become customary law.[876] This means that CFC rules are not to be seen as infringing on the prohibition of extraterritorial taxation, as they form a valid rule based on a customary character. If CFC rules are indeed an infringement of the prohibition of

872. *See* sec. 4.1.2.2.4.
873. *See* sec. 4.1.
874. *See* sec. 4.3.2.5.
875. *See* sec. 4.1.2.2.5.
876. *See* id. *See also* Avi-Yonah, 2004, p. 488 et seq.

extraterritorial taxation, we would disagree with the position taken by Avi-Yonah based on the following reasons.

First of all, it is by no means clear that the traditional requirements of customary international law are fulfilled, as only some of the largest economies have implemented CFC rules and many (smaller) economies do not have this kind of regulation.[877] Of course, one could argue that the other states tacitly agree on the need for CFC legislation. However, with regard to CFC rules, it is obvious that many states have intentionally not implemented CFC rules, as they are either of the opinion that it would be against international law or they refrain from doing it to eliminate the risk of losing competitiveness. Second of all, we have shown in detail above[878] that the principle of fiscal sovereignty and consequently the prohibition of extraterritorial taxation is a legal precondition and a peremptory norm within the current international tax regime and, therefore, unilateral deviations from such rules are not valid from an international law perspective if the affected state (i.e. the CFC state) does not consent. Therefore, we cannot support the argument that there is indeed a law requiring CFC legislation in line with the *opinio iuris* requirement.

In conclusion, and in opposition to the introductory statement of Schaumburg, the prohibition of extraterritorial taxation indeed has a legal value, but its source is not customary international law; rather, it is a norm with a peremptory character as a legal precondition of the current world order. Furthermore, it was shown that the opinion that CFC rules have become part of customary international law cannot be supported.

4.3.2.8.3. *Prohibition of juridical double taxation*

4.3.2.8.3.1. Preliminary remarks – Description of the rule

The present section will analyze whether cross-border juridical double taxation is prohibited based on a rule of customary international law. Prima facie, there is an agreement among many authors that such a rule does not form part of customary international law.[879] However, some authors argue that in the case of double taxation, states are at least required to consider

877. *See* sec. 12.3.3.3.
878. *See* sec. 4.1.
879. E.g. Peters, 2014, p. 72 et seq., with further references. *See*, with reference to older legal writing, Knechtle, p. 41 et seq. *See also* Norr, p. 431; Eastmond, p. 357; Vogel & Rust, in: Reimer & Rust, 2015, Introduction para. 11. Cf. Albrecht, p. 172, who at least

the interests of other states as part of customary international law.[880] This would mean that the prohibition of juridical double taxation itself is not part of customary international law, but merely the obligation of states to consider the other states' interest in the case of cross-border juridical double taxation. In the following, we will review both potential rules of customary international law. The analysis follows the two traditional requirements of customary international law, i.e., state practice and *opinio iuris,* and will also refer to deviating conceptual opinions as demonstrated above.[881]

4.3.2.8.3.2. State practice

From our perspective, there is not sufficient state practice according to which double taxation should be prohibited. This seems to be true for, inter alia, the following three reasons.

First, many states do not grant full relief from foreign taxes if no double tax treaty is in place. For instance, if a person residing in State A works in State B for 20 days, the salary might be taxable in states A and B, and both states might not grant a relief mechanism if no treaty is signed between them. This is the case, for instance, in Switzerland, as it does not provide comprehensive unilateral relief if a resident person works abroad for a short period and is taxed on the resultant income. However, in such a situation, some states do allow at least a deduction of foreign taxes, but will not grant a full tax credit, but as consequence, juridical double taxation is not avoided.

Secondly, another example in which states do not avoid juridical double taxation is the case in which a domestic credit system is limited to the amount of taxes paid in the country of residence. This means that if the tax rate on the income source abroad is higher than the domestic taxes, the taxpayer might in this case face a juridical double taxation, as the two countries will tax the same income item.[882] Even the OECD MC does not allow full relief from juridical double taxation if the credit method applies, as article 23B also contains a proviso safeguarding progression.[883]

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claims that the prohibition of confiscatory taxation forms part of customary international law. The latter could be the case if double taxation occurs (e.g. if two states tax an income at a rate of 40% each).

880. Meng, p. 450 et seq., with further references.

881. *See* sec. 4.3.2.2.

882. *See*, for instance, the complicated limitation rules within the former US foreign tax credit system (for more details *see* Kochman & Rosenbloom, p. 221 et seq.).

883. Art. 23 B(1) OECD MC.

Thirdly, states do not generally provide for specific domestic measures in order to mitigate juridical double taxation if a treaty applies and if double taxation still occurs through a qualification conflict. Interestingly, this might be different in some federal states, as double taxation might legally be prohibited.[884] Even if all treaties contain measures to abolish juridical double taxation in all cases, the international tax regime would still be very far from providing an international regime with double tax treaties between all states. As mentioned above, there are currently around 3,000 double tax treaties in place, which is far from a comprehensive worldwide treaty network.

In conclusion, there is insufficient state practice according to which states are forced to mitigate or avoid double taxation.

4.3.2.8.3.3. *Opinio iuris*

As just shown, there is no sufficient state tax practice according to which double taxation should be prohibited. Furthermore, even if there were a sufficient state practice, states are far from an *opinio iuris* that there is a law requiring the mitigation of double taxation. The latter can particularly be demonstrated with reference to the current MAP procedure, as there is not even a mandatory MAP procedure within the OECD MC. Or, in the words of the OECD MC:

> The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.[885]

Based on these brief remarks, we would also deny the validity of a rule according to which states are obliged to consider the interest of other states when taxing a certain income. If this had been the case, the MAP procedure would require that states act not on the request of taxpayers, but independently, if it appears that the taxation of an income might infringe on the interests of another state. Therefore it does not seem to reflect the opinion of the states to consider the interest of the other state in the case of a double tax convention and, therefore, such potential obligation is also not part of customary international law.

884. E.g. art. 127(3) of the Swiss Federal Constitution.
885. Art. 25(2) OECD MC.

4.3.2.8.3.4. Conclusion

In conclusion, the avoidance of double taxation is not part of customary international law, as both the *opinio iuris* and the state practice requirement are not fulfilled. Neither is there a legal duty of states to consider the interests of another state in the case of juridical double taxation. As a consequence, the so-called single taxation principle is also not a principle deriving legal validity from customary law. It is neither reflected in the current state practice, nor is there a related *opinio iuris* among states.[886] Therefore, Mann's prediction in 1964 that signing multiple double tax treaties could perhaps lead to the creation of customary international law has not yet been verified.[887]

4.3.2.8.4. *Non-taxation of diplomatic and consular personnel in the residence state*

4.3.2.8.4.1. Preliminary remarks – Description of the rule

A conference held by the Institute for Austrian and International Tax Law in 2011, on tax rules in non-tax agreements, explicitly dealt with the non-taxation of diplomatic and consular personnel, as provided for in the conventions on diplomatic relations and consular relations.[888] The convention on diplomatic relations, which is the focus of the present section, widely reflects customary international law.[889]

However, whether the tax privileges, such as the income tax exemption of a diplomatic agent according to article 34 of the VCDR, are part of customary international law is disputed.[890] Some argue that these privileges were granted as a matter of courtesy, but others state that these fiscal privileges indeed belong to customary international law.[891] In the following, it is demonstrated whether (i) state practice and (ii) *opinio iuris,* as the requirements for customary international law, are fulfilled.

886. *See*, on the single tax principle with further references, de Wilde, 2011, p. 64.
887. Mann, 1964, p. 10: "In the field of taxation numerous … treaties have been concluded and in due course they will perhaps lead to the acceptance of a rule of customary international law establishing exclusivity of tax jurisdiction."
888. The results are published in Lang et al. (eds.).
889. *See*, with further details also on the development of the VCDR, Denza, p. 1 et seq.
890. Denza, p. 292 et seq. *See also* Smit, 2012b, p. 3 et seq.
891. *See* the references stated by Denza, p. 292 nn. 1 and 2. *See also* Lyons, p. 307 et seq.; Pijl, 2012, p. 6.

4.3.2.8.4.2. State practice

Without having rendered an empirical study, it seems clear that there is a widespread – if not unanimous – practice according to which the salary of the head of a diplomatic mission is exempt from income tax. This is in line with article 34 et seq. of the VCDR, which has been signed by approximately 190 states. Article 34 of the VCDR has the following wording:

> A diplomatic agent shall be exempt from all dues and taxes, personal or real, national, regional or municipal, except:
>
> a) indirect taxes of a kind which are normally incorporated in the price of goods or services;
>
> b) dues and taxes on private immovable property situated in the territory of the receiving State, unless he holds it on behalf of the sending State for the purposes of the mission;
>
> c) estate, succession or inheritance duties levied by the receiving State, subject to the provisions of paragraph 4 of Article 39;
>
> d) dues and taxes on private income having its source in the receiving State and capital taxes on investments made in commercial undertakings in the receiving State;
>
> e) charges levied for specific services rendered;
>
> f) registration, court or record fees, mortgage dues and stamp duty, with respect to immovable property, subject to the provisions of Article 23.

Furthermore, article 37 of the VCDR states the following:

> The members of the family of a diplomatic agent forming part of his household shall, if they are not nationals of the receiving State, enjoy the privileges and immunities specified in articles 29 to 36.

Regarding the application of such provisions, there are some ambiguities and uncertainties, as states seem to apply them differently,[892] but at least the income of the head of the diplomatic mission (not having citizenship of and not being permanently resident in the other state)[893] is exempt from income taxes. For instance, one ambiguity relates to the extension of the tax exemption to the family members according to article 37 of the VCDR. It is, for instance, unclear how the term "family members" must be interpreted, as it is not defined in the VCDR. For instance, one state might qualify a fiancé

892. For further details *see* Smit, 2012b, p. 4 et seq.
893. *See* art. 38(1) VCDR.

as a family member, whereas another state would argue that a fiancé is not yet part of the family.

Therefore, following the above-mentioned criteria, in order to define customary international law, it seems clear that a sufficient number of states follow such a practice in order to create customary international law, even though there are some differences in the application of the exemption. The implementation of the VCDR has certainly enhanced an alignment of the scope of the fiscal privileges, i.e. the VCDR is not only a convention codifying existing customary law, but also an instrument that has accelerated the development of customary international law, or at least the development of a more consistent and widespread state practice.

4.3.2.8.4.3. *Opinio iuris*

For the purpose of the present chapter, which aims to analyze whether the fiscal privileges of diplomatic agents have become part of customary international law, it is vital to understand why these privileges were granted to diplomatic and consular personnel.

According to an older understanding, it was argued that the mission in a foreign jurisdiction is exterritorial in the sense that the embassy forms part of the territory of the sending state. This would mean that taxing an ambassador would be seen as an infringement of the fiscal sovereignty of the sending state. However, such understanding is no longer the legal justification for the application of the privileges. Nowadays, scholars argue that the privileges are necessary in order to allow diplomatic missions to render their functions in an efficient manner.[894] Lyons stated already in 1954 that, "the cardinal principle on which immunity from taxation or from any other burden should be based is the avoidance of coactio, that is, of hindering the agent from carrying out fully and freely the functions of his office."[895] In a similar manner, for instance, the ICJ also held in the Arrest Warrant Case:

> A certain number of treaty instruments were cited by the Parties in this regard. These included, first, the Vienna Convention on Diplomatic Relations of 18 April 1961, which states in its preamble that the purpose of diplomatic privileges and immunities is "to ensure the efficient performance of the functions of diplomatic missions as representing States." It provides in Article 32 that only the sending State may waive such immunity. On these points, the

894. Crawford, p. 397 et seq.
895. Lyons, p. 307.

> Vienna Convention on Diplomatic Relations, to which both the Congo and Belgium are parties, reflects customary international law. The same applies to the corresponding provisions of the Vienna Convention on Consular Relations of 24 April 1963. To which the Congo and Belgium are also parties.[896]

And later in the judgment, the court confirmed the understanding that the immunities are granted in order to allow the effective performance of the functions:

> In customary international law, the immunities accorded to Ministers for Foreign Affairs are not granted for their personal benefit, but to ensure the effective performance of their functions on behalf of their respective States.[897]

Therefore, concerning the exemption of the salary of the head of the mission, it is not persuasive to argue that such a privilege is only a matter of courtesy. The reason is that it is not granted solely to be polite or to demonstrate generosity, but because there also, based on the aforementioned court decision of the ICJ, seems to be a rule requiring such treatment of diplomatic agents (i.e. *opinio iuris sive necessitates*). Such a rule is required to ensure effective functioning of the diplomatic system.[898] The latter is particularly true due to two reasons. First, it would be difficult to tax diplomatic personnel in their state of residence, considering the fact that such persons change their host state on a regular basis. Second, and more importantly, the tax could potentially not be enforced at the level of the employer, as the employer is another state and, therefore, the host state would clearly infringe on the principle of sovereignty by enforcing such taxes.[899]

4.3.2.8.4.4. Conclusion

In conclusion, the tax exemption of the income of diplomatic personnel that are not citizens and permanent residents of the host state is part of customary international law. Even though it has been brought forward that the income tax exemption of diplomatic agents forms part of customary international law, there are certain ambiguities in this respect. For instance, it is unclear that article 34 et seq. of the VCDR is entirely part of customary international law or whether it is only the income tax exemption for the

896. ICJ, Case Concerning the Arrest Warrant of 11 April 2000 (*Democratic Republic of the Congo v. Belgium*), p. 21.
897. ICJ, Case Concerning the Arrest Warrant of 11 April 2000 (*Democratic Republic of the Congo v. Belgium*), p. 22.
898. *See* Villalpando, 2010, p. 395, who speaks of collective interest.
899. *See* sec. 4.1.2.2.

head of the diplomatic mission. From our perspective, the exemption of diplomatic agents is a good example of why customary international law faces problems in very technical areas of law, such as tax law.[900] It seems impossible, and reference is made to Trachtman,[901] that the variety of existing taxes and duties and the exemption granted to the head of a diplomatic mission, and even to a certain extent his family and household, could be governed in an effective manner by customary international law.

4.3.2.8.5. *Arm's length principle*

4.3.2.8.5.1. Preliminary remarks – Description of the rule

Lepard[902] in his book on customary international law renders a detailed case study about the question of whether the arm's length principle forms part of customary international law; however, compared to other authors,[903] he does not conclude that the arm's length principle indeed forms part of customary international law. In the following, we will refer to the traditional requirements of customary international law, i.e. state practice and *opinio iuris*, in order to challenge the contrary position as outlined by Avi-Yonah.[904]

Before doing so, it is vital to define the actual scope of application of such a potential unwritten customary law provision. One option would be to argue that such a rule applies both for the allocation of income between an enterprise and its foreign PE, as provided for in article 7 of the OECD MC. Or one could argue that the arm's length principle has become part of customary law for the determination of transfer prices between two companies within the same group. This would basically mean that either both or one of the following rules has become part of customary international law:

> *Article 7(2) OECD MC*
>
> For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent

900. *See*, on the limitations of customary international law in the field of tax law, sec. 4.3.2.7.
901. *See* sec. 4.3.2.3.
902. Lepard, p. 285 et seq.
903. Avi-Yonah, 2004, p. 500. Further references are stated by Lepard, p. 268 et seq. Contra, Schön, 2015, p. 275, who states that customary international law does not contain an allocation of income rule.
904. Avi-Yonah, 2004, p. 500.

enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

Article 9(1) OECD MC

Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

4.3.2.8.5.2. State practice

Prima facie, it seems indeed true that the arm's length principle reflects a worldwide state practice, as it is contained in most international double taxation treaties. This has been shown by others in a persuasive manner.[905] To be more precise, this means that most double tax treaties contain a provision similar[906] to article 7(2) of the OECD MC and article 9(1) of the OECD MC or the respective articles in the UN MC.[907]

However, even though the vast majority of tax treaties follow the arm's length principle, there are still some doubts on whether sufficient state practice exists in order to create customary law, particularly with respect to the application of the arm's length principle to allocate income between the headquarters and the PE (i.e. article 7(2) of the OECD MC). The following facts do not support the thesis that sufficient state practice exists:

905. Thomas, p. 123 et seq. Lepard, p. 298 et seq., with further references.
906. Due to significant changes to art. 7 of the OECD MC in 2010, many treaties still follow the old wording of the OECD MC. This, however, does not change the argument that most treaties follow the arm's length principle.
907. Arts. 7(2) and 9(1) UN MC.

– Some treaties[908] contain different provisions following article 7(4) of the old, i.e. the 1963 OECD MC, which provides that the contracting states have some leeway to apply a different method of income allocation, if this is common. Therefore, according to these agreements, the states are not obliged to follow the arm's length principle when allocating income between headquarters and the PEs. States could also apply formulary systems.

– Furthermore, some treaties provide for special allocation rules, such as for business operations in certain – further specified – cross-border areas.[909] In these cases, the arm's length principle does not apply and the allocation of income follows different rules.

– Lastly, and most importantly, some states follow a (consequent) worldwide tax system and tax the profits of a foreign PE if no double tax treaty exists. This means that it does not reflect a worldwide practice to avoid juridical double taxation by applying the arm's length principle in a non-treaty situation.

However, also with respect to the rule in article 9(1) of the OECD MC, there are reasons why the state practice is not sufficient:

– Various states apply a domestic CFC provision, even in a treaty situation that leads to an allocation of income, which might not be in line with the arm's length principle.[910] This means that an income item is allocated to the parent company only because its CFC is taxed at a low level and not because it is not in line with the arm's length principle.

908. E.g. art. 7(4) of the CH/AT: Convention between the Swiss Confederation and the Republic of Austria for the Avoidance of Double Taxation with respect to Taxes on Income and Capital, 30 Jan. 1974: "Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total income of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment, as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles of this Article."

909. E.g. art. 7(4) of the NL/DE: Convention between the Federal Republic of Germany and the Kingdom for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed 12 April 2012: "Where an enterprise of one of the Contracting States has a fixed place of business in the part of a cross-border economic area belonging to the territory of the other Contracting State, the place of business shall not, for the taxation of the profits of the enterprise, be deemed to be a permanent establishment. Article 14 shall remain unaffected."

910. This, however, depends on the exact design of the CFC rule. For further details *see* sec. 12.3.1.

– Some states have specific legislative measures to deny the tax-efficient deductibility if the expense was paid to a tax haven, even though the payment would have met the arm's length standard.[911]

To sum up, at first glance, there are reasons to agree that the arm's length principle is reflected in a sufficient state practice, which could justify the existence of customary international law. However, we have also seen that, in practice, many important exceptions exist that lead to a different conclusion. In particular, because states do not domestically exempt the income of foreign permanent establishments in non-treaty situations and many states have CFC rules, we tend to support the position that no sufficient state practice exists with regard to both elements of the arm's length principle (i.e. articles 7(2) and 9(1) of the OECD MC). However, even if the first requirement of a customary international law did exist, it would still be required to prove that the *opinio iuris* is given.

4.3.2.8.5.3. *Opinio iuris*

Within the present study, the *opinio iuris* requirement, as shown above,[912] is understood in line with the case law of the ICJ as being necessary to distinguish between rules of courtesy and rules that are actually required in the sense of customary international law. We see various arguments demonstrating that there is no law actually requiring a taxation following the arm's length principle. For the purpose of stringency, it would again be required to distinguish between the arm's length principle as a principle to allocate income between the headquarters and a PE (i.e. article 7(2) of the OECD MC) and the arm's length principle as a rule to determine the applicable transfer price for transactions among related (but legally separate) parties (article 9(1) of the OECD MC).

However, as the following reasons will demonstrate, there are valid arguments denying both the *opinio iuris* regarding the arm's length principle, according to article 7(2) and with regard to article 9(1) of the OECD MC. We would argue that there is no *opinio iuris* that the income between a headquarter and a foreign PE should be allocated following the arm's length principle. The same is true for the arm's length principle as a determinant for intra-group transfer prices, due to the following reasons:

911. *See*, for instance, the legislative measures in Italy (Banfi & Brambilla, p. 67 et seq.).
912. *See* sec. 4.3.2.4.

– Some states unilaterally apply a formulary system when allocating income and capital between federal states. For instance, Switzerland and the United States are famous for applying such a transfer pricing methodology within their jurisdictions.[913] Therefore, it seems to be their opinion that the allocation of income among different territories does not necessarily need to follow the arm's length principle.

– The BEPS Project has also shown that with regard to certain enterprises, it might be more appropriate to use formulary apportionment in an international framework. In other words, the discussion concerning a redefinition of the PE threshold within Action 7 of the BEPS Project was essentially triggered by the authorized OECD approach, intending to follow the arm's length principle.

– Furthermore, the negotiations concerning the implementation of a multilateral convention at the level of the League of Nations in the 1920s and the following years[914] showed that states are of the opinion that income allocation should mainly be a matter of bilateral negotiations.[915] In other words, the drafters of the current international tax regime seem to have been of the opinion that there is no customary law requiring an allocation in line with the arm's length principle.[916]

– Lepard argues based on his concept of customary international law[917] that the arm's length principle is a coordination rule among states and there must be, following his understanding of customary international law, especially strong arguments in order to justify a rule of customary international law. He concludes that such a high threshold is not met with regard to the arm's length principle.[918]

There are, furthermore, no moral or fundamental ethical principles that would justify the arm's length principle.[919] As will be shown below,[920] global

913. *See*, on the distinction between a formulary system and the arm's length principle with further references, sec. 12.2. Of course, the allocation system both in the US and in Switzerland are not identical and, in particular, Switzerland does not follow a pure formulary system (*see* for more details about the existing domestic systems Mayer, p. 63 et seq.).
914. *See* sec. 4.2.3.2.2.
915. *See* Lepard, p. 302.
916. Id., p. 303.
917. For more details *see* sec. 4.3.2.2.4.
918. Lepard, p. 301.
919. Id., p. 300.
920. *See* sec. 12.2.

justice does not require a single allocation key aligning to the arm's length principle.

4.3.2.8.5.4. Conclusion

Therefore, there are no reasons to conclude that there is indeed an (unwritten) law requiring the application of the arm's length principle. Authors arguing the opposite[921] mainly rely on the treaty practice in this respect, which is – as shown also above – due to various reasons, not sufficient to create customary international law.

Thomas stated in 1998: "There seems to be substantial evidence that the separate accounting method [i.e. arm's length principle] is in fact a rule of customary international law."[922] The aforementioned arguments have, however, shown that the arm's length principle does not reflect a coordination rule that seems to be part of customary international law. In particular, there is no *opinio iuris* saying that the arm's length principle is applicable even in a non-treaty situation. Furthermore, it has also been shown that the arm's length principle is contained in most double tax treaties, but it is nevertheless unlikely that sufficient state practice exists, as there are many exceptions. This can also be underpinned by scholarly opinions, which clearly argue that the arm's length principle is not carved in stone. For instance, Owens states the following:

> The arm's length principle is neither rigid nor immoveable. Since the OECD published the 1979 Transfer Pricing Guidelines, these have been continuously adapted to reflect new business models and the emergence of new players.[923]

Such a conclusion is true regarding the arm's length principle in both article 7(2) and article 9(1) of the OECD MC. The impact of such a result is manifold. Firstly, it should still be up to the states within their bilateral negotiations to decide whether they want to follow the arm's length principle.[924] This means that states are free to conclude, for instance, a double tax convention that allocates the income of a PE in the other state based on a formula and not based on the arm's length principle and the authorized OECD approach. Second, in a domestic situation in which no treaty is applicable, a state is free to tax the income of a foreign PE, even though this leads to double taxation. Third, even in an intra-group circumstance, a state is not

921. Thomas, p. 130 et seq.
922. Id., p. 135.
923. Owens, p. 443. *See also*, on the question of whether the commentaries on the OECD MC have become customary international law, Avery Jones, sec. 5.2.4.
924. Lepard, p. 300.

obliged to apply the arm's length principle in order to define the appropriate transfer price between domestic and foreign corporations.

4.3.2.8.6. *The "no harm" principle*

4.3.2.8.6.1. Preliminary remarks

In simplified terms, the "no harm" principle in international law means that no state shall harm another state or individuals living in another state. In the following, we will outline whether and to what extent such a principle has the quality of customary international law and whether it is relevant for the international tax regime. We will not deal with the question of whether the "no harm" principle could also qualify as a general principle of international law.[925]

4.3.2.8.6.2. From an international law perspective

When discussing the "no harm" principle in international law, reference is regularly made to two cases: the *Corfu Channel* case[926] and the *Trail Smelter* case.[927]

The *Trail Smelter* case was decided in 1938 and 1941 by an arbitration tribunal. The facts were as follows: Trail Smelter was a smelter in British Columbia, Canada. Fumes from the smelter caused damage in the territory of the United States.[928] The question was whether Canada was liable for such damages (i.e. the damages caused by a private corporation). It was proven that the damages in the United States were caused by the fumes. The court applied a "no harm" principle in the following manner:

> [U]nder the principles of international law, as well as of the law of the United States, no State has the right to use or permit the use of its territory in such a manner as to cause injury by fumes in or to the territory of another or the properties or persons therein, when the case is of serious consequence and the injury is established by clear and convincing evidence.[929]

The court, inter alia, made reference to the following statement of Eagleton: "A state owes at all times a duty to protect other States against injurious

925. *See*, for example, Bäumler, p. 29 et seq. Of course, if the "no harm" principle is part of an international treaty, it becomes treaty law (*see*, for example, art. 5 SCM).
926. ICJ, *The Corfu Channel Case*, p. 4 et seq.
927. Reports of International Arbitral Awards III (1941), p. 1905 et seq.
928. For further details, *see also* Bäumler, p. 75 et seq.
929. Reports of International Arbitral Awards III (1941), p. 1965.

acts by individuals from within its jurisdiction."[930] This meant that Canada was obliged to refrain "from causing any damage through the fumes in the State of Washington."[931] One of the main justifications was that states must respect the territory of other states (i.e. territorial sovereignty shall be protected).[932] The decision contains two important limitations:[933] (i) evidence for the harm is necessary and (ii) the damages must be serious.

In the *Corfu Channel* case, it was proven that a minefield in the Corfu Channel was laid by the Albanian government or at least that the minefield was laid with the connivance of the Albanian government. The United Kingdom lost two Navy ships after striking two of these mines.[934] The question arose as to whether or not Albania should compensate the United Kingdom for the losses suffered. The ICJ held that there is an "obligation not to allow knowingly its territory to be used for acts contrary to the rights of other states."[935] In other words, the application of the "no harm" principle is a sign of mutual respect of sovereignty in international law.[936] Therefore, the "no harm" principle was upheld by the court. However, the court is not clear in its remarks about the legal justification of such a legal duty[937] (i.e. whether it is indeed based on customary grounds, whether it is derived from the sovereignty principle, or whether it is a general principle of law). There are more decisions in which the court confirmed that there is a "no harm" principle in international law, mainly in relation to environmental protection.[938]

The "no harm" principle – and this seems true notwithstanding whether it is derived from the sovereignty principle, whether it is a general principle of international law, or whether it has customary validity – is a principle that is very much influenced by moral considerations. It seems wrong per se that a state would harm the territory of another state. Traditionally, cases referring to the "no harm" principle deal either with harm caused to the territory or assets of another state. Another issue is whether there is a "no harm" principle toward common goods or common areas (e.g. concerning

930. Id., p. 1963.
931. Id., p. 1966.
932. *See also* Bäumler, p. 79.
933. Id., p. 82.
934. ICJ, *The Corfu Channel Case*, p. 16.
935. Id., p. 22.
936. Wise & Jensen, p. 282.
937. Bäumler, p. 61. This is a general concern with respect to the "no harm" principle in international environmental law as the courts often seem silent regarding the actual source of the "no harm" principle (*see* Heintschel von Heinegg, in: Ipsen, § 50 para. 16).
938. With further references, *see* Bäumler, p. 83 et seq.

the pollution of the high seas). The argument is that it is justified to extend the "no harm" principle to such common goods because all states should have the same right to use these common goods (i.e. resources).[939] It indeed seems to reflect the current understanding that the "no harm" principle also applies to international territories, such as international waters or airspace.[940] However, taxes are not a common good of the global community, as they belong to the people of separate states. Therefore, the latter discussion is not of relevance for the present study.

4.3.2.8.6.3. From an international tax law perspective

The question to be reviewed in the present chapter is whether a state can cause harm to another state with a certain tax policy and whether this would be covered by the "no harm" principle as a customary rule of international law. Some authors have already dealt with the question of whether states owe duties to each other when it comes to designing domestic tax systems, but these studies often focus on whether there is a normative claim for such duties and not whether an actual legal claim exists.[941] Later in the present study, we will also deal with these normative claims according to which states ought to refrain from harming other states.[942]

For the present legal analysis, we will focus on harmful tax competition as this is the area where other authors have already discussed the potential application of the "no harm" principle. We will assume that the "no harm" principle has customary quality. Therefore, we do not need to prove whether there is sufficient state practice or an *opinio iuris*, but we do need to prove whether the "no harm" principle as an existing customary rule prohibits states from implementing harmful tax practices.

It is important to note that the "no harm" principle, like other customary rules, has no precise contours. The few existing international cases do not provide for detailed guidance and are highly controversial.[943] Nevertheless, some conclusions seem possible.

First, both in the *Trail Smelter* case and the *Corfu Channel* case, courts dealt with the liability of a state for actual damages. Therefore, a certain damage must be at hand. It is clear that damages to the environment of another state

939. With reference to Wins, *see* id., p. 102.
940. *See* Heintschel von Heinegg, in: Ipsen, § 50 para. 17.
941. *See* Christians, 2009b, p. 99 et seq.
942. *See* sec. 8.4.
943. *See*, for instance, with respect to the *Trail Smelter* case, the contributions in Bratspies.

or damage to ships or other assets of a state are covered by the "no harm" principle.[944] Concerning tax competition, there is no actual damage, but the damage consists of a future loss in tax revenues. There is no evidence in the case law of international courts that the no harm principle would also apply to such future losses.[945] If it were to apply, it would have the consequence that other competitive measures of states could also be affected by the "no harm" principle. For instance, if a state lowers employee protection laws in order to be more attractive to businesses, this could harm the other state as certain functions might be relocated to the former state. This would not be persuasive, however. It is our understanding that the "no harm" principle should not apply to these situations, as it has traditionally developed as a principle protecting territorial integrity, such as in the *Trail Smelter* case or the *Corfu Channel* case. It would be too far reaching and would also not reflect current international practice if it were to prohibit competitive measures in general.

Second, it is again important to consider that the justification of the application of the "no harm" principle is that the territorial integrity of a state is protected and sovereignty is per se limited by the territorial integrity of other states.[946] In other words, sovereignty is not absolute, and the "no harm" principle is a direct consequence of such limited sovereignty. This is also why the "no harm" principle does not only have customary quality but could also be derived from the principle of sovereignty as a legal precondition of the international law system.[947] Harmful tax competition does not, however, cause territorial harm in this sense but might lead to a situation in which states lose tax revenue due to competitive disadvantages. Therefore, the justification of the "no harm" principle indicates that it is not applicable to the tax policy decisions of a state, as such decisions do not infringe the territorial integrity of other states.

Third, particularly in the *Trail Smelter* case, causation was "far more attenuated"[948] as in the case of tax competition. It would be impossible to draw precise causation between a change in tax policy and the amount of revenue lost in another state due to such a tax policy change. This is true

944. Bäumler, p. 274.
945. *See e contrario* the very clear statement of the ICJ in: ICJ, Advisory Opinion, Legality of the Threat or Use of Nuclear Weapons, p. 241 et seq. The ICJ states that the "no harm" principle is part of the corpus of international law relating to the environment (and not relating to other areas, such as future losses in tax revenue).
946. *See* Heintschel von Heinegg, in: Ipsen, § 50 para. 8.
947. At least this is our understanding of the sovereignty principle. *See* sec. 7.1.
948. This is used as an argument by Wise & Jensen, p. 294, against the application of the "no harm" principle as a legal instrument against drug trafficking.

since taxes are only one element considered by individuals or corporations when relocating to another state and, therefore, potentially causing losses in tax revenue in the state of origin.

Why do authors suggest the application of the "no harm" principle in relation to harmful tax practices?

Bäumler had already dealt with the question of whether a certain tax policy of a state might collide with the "no harm" principle as it is understood in international law. She states that if a state is no longer able to decide upon the level of its taxes because of the policy of another state, it must be understood as a blatant infringement on the sovereignty of the former state. Or, in her words:

> *Diese Überlegung ebnet den Weg für die Anwendung des Schädigungsverbots im Steuerrecht: wenn ein Staat aufgrund der Steuerpolitik eines anderen Staates faktisch nicht mehr in der Lage ist, selbst über die Höhe seiner Steuern zu entscheiden, dann berührt das Handeln des anderen Staates in eklatanter Weise die effektive Souveränität des betroffenen Staates.*[949]

Bäumler is, however, reluctant to then actually apply the "no harm" principle to tax matters. In other words, it cannot be derived from her study to what extent a certain tax policy would infringe upon the "no harm" principle and, therefore, international law. That being said, she at least states that it is not absurd to think about a "no harm" principle applying in international tax law.[950] The argument of Bäumler seems to be that the harm is caused because states are no longer able to define the tax rates as there is competitive pressure, and, therefore, their sovereignty is infringed. Implicitly, it also means that the "no harm" principle is infringed as states are not able to decide what level of distribution they want to achieve as tax competition might de facto limit their legislative leeway. Therefore, the political will of the people is limited.

If the latter is indeed the argument in favor of the legal prohibition of harmful tax practices, it would also mean that there is a legal duty to support poor states. This is true as these states – even through higher taxes – would certainly not have the same amount of revenue available as rich states and would not be able to decide upon their level of distribution. The legislative leeway of poor states is far more limited than the legislative leeway of rich states facing competitive pressure. This is a strong argument that we will

949. Bäumler, p. 276.
950. Bäumler, p. 262 et seq.

also use while discussing the normative value of the "no harm" principle, but it also proves to be relevant for the legal question of whether the "no harm" principle in international law is relevant for tax law.[951]

In conclusion, we do not see a case for the application of the "no harm" principle prohibiting harmful tax competition or harmful tax practices, as there are strong arguments against it that are derived from the existing case law; while the existing arguments in favor of its application in tax matters are not persuasive.

4.3.2.8.7. *Interpretation principles according to article 31 VCLT*

As stated by many tax scholars[952] and with reference to the jurisprudence of the ICJ or other courts,[953] the interpretation principles according to article 31 of the VCLT have become a part of customary international law. The ICJ has also held this in some recent decisions:

> As regards the interpretation of that Treaty, the Court notes that neither Botswana nor Namibia are parties to the Vienna Convention on the Law of Treaties of 23 May 1969, but that both of them consider that Article 31 of the Vienna Convention is applicable inasmuch as it reflects customary international law. The Court itself has already had occasion in the past to hold that customary international law found expression in Article 31 of the Vienna Convention …. Article 4 of the Convention, which provides that it "applies only to treaties which are concluded by States after the entry into force of the Convention with regard to such States" does not, therefore, prevent the Court from interpreting the 1890 Treaty in accordance with the rules reflected in Article 31 of the Convention.[954]

This means that these principles are also relevant for interpreting double tax conventions between states that have not ratified the VCLT, such as the US. Furthermore, it means that these principles are also applicable with regard to treaties already existing at the time the VCLT was ratified in a specific state.[955] The interpretation methods are a good example of a rule of customary international law that are not affected by the conceptual limitations of customary international law, as mentioned above in section 4.3.2.6. In particular,

951. *See* sec. 8.4.
952. E.g. Engelen, 2004, p. 57; Höhn, p. 73. With further references *see* Hongler, 2012a, p. 194.
953. E.g. CH: Federal Administrative Court, A-4911/2010, 30 Nov. 2010, cons. 4.1; CH: SC, BGE 122 II 234, 27 June 1996, cons 4c. With further references *see* Avery Jones, sec. 3.1.
954. ICJ, Case concerning Kasikili/Sedudu Island (*Botswana v. Namibia*), p. 1059.
955. For further details *see* Engelen, 2004, p. 54 et seq.

it seems that interpretation methodology, according to article 31 et seq. of the VCLT – at least as long as it does not lead to arbitrary results – does not require a domestic ratification process.

4.3.2.8.8. *Fiscal transparency*

As argued by Pistone, and considering the worldwide developments in the years before and including 2013, an effective global fiscal transparency reflects "almost … the substance of an opinio iuris ac necessitates."[956] Consequently, if the world proceeds with implementing an international (automatic) exchange of information and refrains from systems such as the Rubik system,[957] one could, according to Pistone, conclude that global fiscal transparency has become part of customary international law. Fiscal transparency, even in its basic form, i.e. the exchange of information on request, is, according to our understanding, however, not a rule of customary international law and it is difficult to imagine that it will become a part of customary international law in the coming years.[958] Such a result is mainly based on two arguments.

First of all, an analysis of the state practice requirement shows that fiscal transparency reflects the treaty practice of most states, but if there is no treaty, even the most progressive states do not exchange information with other states. In other words, with regard to fiscal transparency, it is not the case that the increase of treaty provisions with respect to the exchange of information reflects a codification of an existing customary law provision, but it is merely the result of negotiations among the various jurisdictions. Second of all, the *opinio iuris* cannot (at least currently) be demonstrated, as the current system of a rather transparent tax world has been achieved through coercive measures, which should not lead to the conclusion that there is a law requiring a transparent global tax world. Otherwise, it would not have been necessary to use coercive instruments, such as blacklisting or threatening the termination of double tax treaties, in order to achieve a transparent tax world. Former offshore tax havens, as well as other states like Austria, Switzerland or Luxembourg,[959] were basically forced to implement a transparent cross-border system. The latter would not have been

956. Pistone, 2013, p. 216.
957. On Rubik agreements *see* sec. 4.2.2.
958. The question of whether cross-border transparency is generally required by customary international law is actually a broader question that cannot be covered by the present study (e.g. Turina, 2016, p. 385 et seq.).
959. Depending on the definition some authors would also qualify these states as tax havens. At least regarding Switzerland and Luxembourg this is the opinion of Oxfam,

necessary if there were indeed a belief that there is a need for a rule requiring fiscal transparency – at least within these jurisdictions. Furthermore, moral considerations are, according to our view, not of crucial importance in order to create customary international law.[960]

As has been shown above, a new rule of customary international law is created in a long-lasting process and, compared to treaty law, is not a source of law that is able to react quickly to international developments. The result might be different if one follows another understanding of the concept of customary international law, for instance, one in line with the theory developed by Lepard, i.e. focusing more on the moral reasons for a certain rule.[961]

4.3.2.9. Justice and customary international tax law – Some concluding remarks

Besides the important works of Avi-Yonah,[962] Bühler,[963] Knechtle[964] and Lepard[965] in this field, customary law seems to still be in a 100-year sleep from an international tax perspective. The present section, however, has shown that following the traditional requirements of state practice and *opinio iuris*, there are very few rules of customary international tax law. The main reasons are the technical details of tax law and the importance of the legality principle. Therefore, the international tax regime seems to be an area that is not very accessible for customary international law. This is not necessarily a negative result, but it shows an important feature of the international tax regime, i.e. the fact that the legal content of the international tax regime is mainly based on the results of explicit international negotiations[966] and not based on the customary behavior of states.

Moreover, we have also demonstrated that morality and justice are, from our perspective, not of decisive importance for the validity of a rule as customary international law. Therefore, compared to others, we would deny

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Tax Battles, The dangerous global Race to the Bottom on Corporate Tax, 12 Dec. 2016, available at https://www.oxfam.org/en/research/tax-battles-dangerous-global-race-bottom-corporate-tax (last visited 15 Sept. 2017).

960. *See* sec. 4.3.2.7.
961. *See* sec. 4.3.2.2.4.
962. Avi-Yonah, 2007, p. 1 et seq.
963. Bühler, p. 1 et seq.
964. Knechtle, p. 1 et seq.
965. Lepard, p. 285 et seq.
966. The result of such negotiations can be treaties as well as soft law, which is also highly relevant and effective from an international tax perspective (*see* sec. 4.3.4.).

a moral judgment-based account of customary international law.[967] The example of fiscal transparency[968] is persuasive to demonstrate the weaknesses of a value-based concept of customary international law. There is a significant risk of falling into the trap of parochialism and even paternalism, as the claim for transparency is not supported by all people, given that there is significant disagreement among various political parties. Transparency is, inter alia, a political and value-based claim. This does not mean that we do not support transparency as a normative claim,[969] but the argument is that we should be careful to argue in favor of the existence of a customary rule primarily based on values. We would deny in the current international law framework and, based on the case law of the ICJ, that a rule is valid as customary international law if the twofold requirements of state practice and *opinio iuris* are not met. In other words, normative claims and claims for the validity of a rule as customary law should not be mixed or, as stated by Trachtman:

> Instead of endlessly arguing about whether a particular CIL [customary international law] rule exists, or still exists, or what it is – trying to establish responsibilities for others without exchange – we should focus on transactions that are desirable for both sides.[970]

4.3.3. General principles of international law

4.3.3.1. General remarks

General principles of law are a third source of law mentioned in article 38(1) of the ICJ Statute, even though there is some debate within international law whether these principles are indeed a separate source of law.[971] In particular, an older doctrine denied the source character.[972] General principles of law, as mentioned in article 38(1)(c) of the ICJ Statute, are domestic law principles or general law principles that are applicable in an international setup, yet only to the extent that these principles are, from a conceptual perspective,

967. Cf. Tasioulas, 2007, p. 307 et seq.
968. *See* sec. 4.3.2.8.8.
969. *See* sec. 12.6.
970. Trachtman, p. 204.
971. Boas, pp. 105 et seq. and 109 et seq.; Heintschel von Heinegg, in: Ipsen, § 18 para. 5; Marro, p. 263 et seq. For further details and with further references *see* Rentsch, p. 110 et seq.; Verdross, 1973, p. 126.
972. *See* the references mentioned by Marro, p. 263 et seq. *See* sec. 3.2. on the definition of sources of international law.

applicable with regard to the relation of states.[973] These principles might be a sign of a general and long-standing legal culture.[974] They are required since positive rules (treaties and customary international law) cannot cover every single fact pattern and deliver an appropriate, just resolution.[975] It was also famously argued during the drafting process of the ICJ Statute that these general principles are required in order to avoid *non liquet* situations.[976] And furthermore, as claimed by Jennings:

> It is clear, however, that the intention of Root's formulation of para. (c) was to limit discretion of Judges, lest they be tempted to impose subjective notion of justice.[977]

Following these remarks, it seems that article 38(1)(c) of the ICJ Statute has, on one hand, a limiting effect in the sense that judges should consider whether there are indeed general principles of law influencing a decision, instead of deciding based on their own discretion, and on the other hand, judges can refer to these general principles when developing their results, in particular, in *non liquet* situations. However, certain general principles of law might not be considered as simple rules, but these principles can by themselves qualify as a law-creating source. Or, as Kolb states, they have "some element of source-power".[978] This means that certain general principles might create norms that are not based on a treaty or customary law. Another topic often discussed is the distinction between general principles of law and customary international law.

The categories "general principles of law" and "customary law" are not exclusive. This means that a qualification as customary law does not lead to a denial of the qualification of a rule as a general principle of law. As the categorization does itself not create a legal order, it seems inappropriate to strictly qualify each unwritten rule or principle as either a customary law or a general principle of international law. In some cases, the term "general international law" might indicate that a rule fulfills the requirements of both

973. Crawford, p. 34 et seq., with reference to Oppenheim. *See*, with respect to the historical development of these general principles of law in international law, Verdross & Simma, § 599 et seq.
974. Thürer, 2000, p. 600.
975. Marro, p. 40 et seq.
976. Boas, p. 105; Heintschel von Heinegg, in: Ipsen, § 18 para. 6; Thirlway, 2014, p. 93 et seq. However, certain authors believe the risk of a *non liquet* situation is not evident (Guggenheim, p. 140, or in a similar manner Verdross & Simma, p. 607). *See* the many references brought forward by Kolb, 2000a, p. 46 et seq.
977. Jennings, p. 71.
978. Kolb, 2006, p. 9.

sources.[979] The case law of the ICJ has shown that the line between a general principle of international law and customary international law is vague.[980] It is, for instance, argued that the ICJ might qualify a rule more frequently as customary international law, as it is generally reluctant to apply general principles of international law.[981]

These general remarks have already outlined some essential elements of this third source of international law. Before going into more detail about the actual content of the general principles of international (tax) law, it is crucial to discuss what justifies the legal validity of these principles. This is once again important in order to comprehensively describe the international tax regime, but also to better understand the delimitation between legal claims and mere moral or normative claims at an international level, since this is required in order to demonstrate whether the international tax regime provides for any justice guidelines.

4.3.3.2. Concepts of international law and general principles of law

It is disputed whether the general principles of law are valid due to a widespread application in the domestic laws (*in foro domestic*)[982] of several states (i.e. a more positive approach[983]) or whether these are principles that apply to legal relations in general. The latter would mean that certain principles are self-evident for all legal relations and are somehow given by nature.[984] The latter more natural law approach would also mean that a court is not required to render a detailed comparative study, but it could instead rely on equity and justice in order to prove the validity of a certain general principle of law. Both lines of argument find their support and a clear underlying

979. For more details *see* Lepard, p. 163. *See* for our understanding of the term "general international law" *supra* n. 292.
980. Lepard, p. 28 et seq.; Rentsch, p. 113; Thirlway, 2014, p. 100 et seq.
981. Thirlway, 2014, p. 101 et seq.
982. Tomuschat, 1993, p. 312, with reference to the drafting history of art. 38(1)(c) ICJ Statute.
983. However, this more positive approach does not mean that there is consent among the states regarding the application of a certain principle, since states have only applied these principles in a domestic circumstance, but not yet necessarily at an international level (Payandeh, 2010, p. 301).
984. *See* the various opinions demonstrated by Degan, 1997, p. 14 et seq., or for further references *see also* Cheng, 1987, p. 2 et seq.; Marro, p. 165 et seq.

justification concept is hardly to be construed, as many intermediate positions exist.[985]

One of the reasons for these ambiguities concerning the legal nature of the general principles of law is related to the fundamental distinction between naturalism and positivism as two underlying and potentially intertwined concepts of international law.[986] A strict voluntarist would argue that the validity of a rule depends only on the will (or consent) of the states, which is demonstrated by the application of a certain principle within the municipal law of various states.[987] In order to elaborate whether a certain rule or principle indeed forms part of these general principles of international law, one would therefore need to develop an international comparative study in order to elaborate whether a principle is indeed inherent in most municipal systems.[988] Moreover, such general principles of international law would need to be part of the domestic system that follows a certain rule of law. This seems well-argued, as in article 38(1)(c) of the ICJ Statute reference is only made to general principles "recognized by civilized nations." Nowadays, it is generally accepted that "civilized nations" means all Member States of the ICJ Statute or all UN Member States, respectively.[989]

However, a more naturalist position would not require such codification or application in domestic law in order to achieve validity but would, inter alia, require that the international legal system as such requires certain general principles, as otherwise the system would not work properly. One could even state it in a more abstract manner that general principles are inherent in

985. Marro, p. 162 et seq., with further references. *See also* the references to authors following a more naturalistic approach in Marro, p. 326 et seq. For a positive understanding, *see* Doehring, 2004, para. 412.
986. *See* Ellis, 2011, p. 953 et seq.; Ratner, 2011, p. 157; Simma, 1995, p. 47 et seq.; Thirlway, 2014, p. 96 et seq.
987. For more details about a potential positive justification of the validity of general principles of law, *see* Ellis, 2011, p. 953. Concerning international tax law, this seems to be the position of Matteotti, 2005, p. 342, with reference to Lauterpacht: "The qualification of a maxim of jurisprudence as a general principle of international law is the result of an enquiry comparing the way in which the law of states representing the main systems of jurisprudence regulates the problem in the situation in question"; Matteotti, 2003, p. 295.
988. Rentsch, p. 112, with further references. Even though, according to Boas, courts tend to cite only a few large Western legal systems (Boas, p. 108). Boas (p. 106) furthermore uses the term "deduction" in order to visualize the interaction between domestic principles and art. 38(1)(c) of the ICJ Statute.
989. Crawford, p. 34, n. 88; Heintschel von Heinegg, in: Ipsen, § 18 para. 2; Verdross & Simma, § 602. On the unsatisfactory wording of art. 38 of the ICJ Statute, *see* Rentsch, p. 108. For further details about the term "recognized by civilized countries" *see* Degan, p. 68 et seq.

the concept of law.[990] Of course, following positivism as a general concept does not exclude such an understanding of the general principles of law, as one could argue that "positive international law never figured as a closed consent-based system but from the very outset drew from and referred to principles whose legal validity was not established but pre-supposed by positive law."[991] The international legal system would consequently consist of positive rules created through consent of countries, but also of general principles that are applicable, as these are inherent in all legal regimes.

From our perspective, and this reflects the approach taken in the following analysis, it seems indeed persuasive, as suggested in the latter position, that some principles are indeed valid in every legal relation based on equity or justice considerations. This means that, from a procedural perspective, it is not in any case necessary to actually render an empiric, comparative study on the application of a certain principle within dozens of jurisdictions in order to prove their validity as a general principle of law according to article 38(1)(c) of the ICJ Statute.[992] We would agree with Ellis that, "the validity of a general principle would have to be grounded in the soundness and persuasiveness of a legal argumentation rather than in claims about the objective nature of law or implicit state consent".[993] The reference to domestic law, however, could still be necessary as a guide to develop or frame an applicable principle in a concrete proceeding.[994] Some rules might even be self-evident, such as certain collision rules,[995] as a legal regime without collision rules would not work.

However, this does not mean that any moral values can justify the existence of the general principles of law. For instance, some claim that protecting fairness or justice requires that double taxation be prohibited in cross-border circumstances, but such a claim is obviously not sufficient for its validity as a general principle of law.[996] This means that there is no general principle of law prohibiting cross-border double taxation. Otherwise, the general

990. Ellis, p. 954.
991. This is the position of Verdross, as described by Simma (Simma, 1995, p. 48).
992. Thirlway, 2014, p. 96. Therefore, the validity of a general principle of international law is often based on a value-based assessment (Payandeh, p. 301).
993. Ellis, p. 971.
994. Thirlway, 2014, p. 99. *See also* Boas, p. 106 et seq., who distinguishes between two forms of general principles, i.e. one deducted from domestic law and one directly derived from legal relations as such. *See*, in general, on fairness and general principles in domestic law, Wiederkehr, 2006, p. 133 et seq.
995. Boas, p. 107; Thirlway, 2014, p. 96. On the collision rules *see* sec. 4.3.3.3.4.
996. It might not even be persuasive to claim that fairness or justice requires the prohibition of double taxation. For more details *see* sec. 11.2.3.4.

principles of law could be misused in order to steer the development of international law by politics.[997] The latter is an important deficiency of all moral-based validity claims in international law, as at a global level, many different moral understandings exist and there is a significant risk of parochialism or even value imperialism.[998] This has already been highlighted above regarding fiscal transparency as a potential rule of customary international law and it will further be discussed in Part IV of the present study.[999]

Therefore, in order to be valid as a general principle of law, it is crucial that the principle reflects not only a political value-based claim, but that it is indeed evaluated that a certain principle ought to be part as a valid general principle of a legal system, such as the international law regime.[1000] The effect of such general principles can be manifold; for instance, they can be corrective in the sense that they could have a derogatory impact on an international obligation, which goes beyond the interpretation of the rule of international law[1001] or these principles can serve as a "necessary complement to a series of legal rules".[1002]

4.3.3.3. Examples from a tax perspective

4.3.3.3.1. *Preliminary remarks*

According to Thirlway,[1003] so far neither the ICJ nor its predecessor court has based a ruling entirely and directly on general principles of international law. Nevertheless, in a changing world in which justice seems to play a more vital role in the international realm, some authors claim that general principles of law should play a greater law-forming role.[1004] In the following, reference is made to certain examples that could form a part of the general principles of international law according to article 38(1)(c) of the ICJ Statute and which could have or have already had an impact on international tax law, i.e. which are part of the international tax regime.

997. *See* Tomuschat, 1993, p. 311.
998. The term "value imperialism" is used in several instances in the present study. For further details *see* sec. 11.4.3.
999. *See*, for example, sec. 11.2.
1000. *See* Kolb, 2006, p. 29.
1001. Kolb, 2006, p. 31 et seq., with further references.
1002. Id., p. 34.
1003. Thirlway, 2014, p. 93. Nevertheless, Thirlway mentions several decisions in which the ICJ made reference to general principles as such (*see* id., p. 102 et seq.).
1004. Thürer, 2000, p. 600.

Not surprisingly, there is no consensus on the actual content of article 38(1)(c) of the ICJ Statute. Often mentioned are procedural rules,[1005] some coordination rules, and the good faith principle.[1006] Certain general principles of international law, which are usually mentioned by scholars and mainly relate to procedural rules, could also be relevant from a tax law perspective. These are, however, not in the scope of the present section. For instance, the ICJ has already referred to, inter alia, the procedural principles of *res iudicata*, *lis pendens*, and to the rule according to which no one can be judge in his own suit.[1007]

Furthermore, other general principles of law are mentioned in the literature and within the case law of arbitral courts or the ICJ, such as the principle of unjust enrichment and indemnity.[1008] These principles have only a very limited reference to international tax law and, therefore, will not be specifically addressed in the following. For more details, reference is made to the work of Cheng, who elaborated the various potential general principles of law according to article 38(1)(c) of the ICJ Statute.[1009] In the following, we will highlight some of the most important general principles from a tax perspective.

4.3.3.3.2. *Abuse of law*

4.3.3.3.2.1. From an international law perspective

The following section should analyze whether the abuse of law principle (or rule) is indeed a general principle of law according to article 38(1)(c) of the ICJ Statute. At first glance, it is true that the abuse of law principle is applied in various jurisdictions, but the exact scope of application and the nomenclature differ significantly. For instance, according to article 2(2) of the Swiss Civil Law Code, the abuse of a right under a contract is prohibited. Some states seem to have similar but not identical doctrines domestically.[1010] For a further review, three questions are essential.

1005. Onuf, p. 73; Verdross, 1973, p. 130 et seq., with references to several cases.
1006. Kolb, 2000a, p. 1 et seq.; Kolb, 2006, p. 1 et seq. *See*, for example from a tax perspective, Schaumburg, para. 3.14.
1007. *See* Crawford, p. 36. *See also* Heintschel von Heinegg, in: Ipsen, § 18 para. 4.
1008. Doehring, para. 410; Heintschel von Heinegg, id.
1009. Cheng, p. 1 et seq. *See generally* Marro, pp. 221 et seq. and 434 et seq.; Guggenheim, p. 144 et seq.
1010. Ipsen, in: Ipsen, § 28 para. 46, mentions, for instance, Italian and English law.

First of all, is the abuse of law principle indeed valid in international law? Second, does it receive its validity from being a general principle of law according to article 38(1)(c) of the ICJ Statute? And third, and this goes beyond the present study, if one agrees that the abuse of law principle is valid from an international law perspective, what is its exact content?

With respect to the first question, it is not necessary to reinvent the wheel, as others have impressively analyzed the application and the validity of the abuse of law principle within international case law and referred to by international law scholars: Kolb mentions more than 70 scholars who are of the opinion that a prohibition of abusive acts exists within international law.[1011] Furthermore, he adds dozens of judgments of the ICJ and other international courts, along with separate opinions arguing in favor of the applicability of the abuse of law principle within international law as a principle derived from the good faith principle.[1012] After having also referred to the (few) deviating opinions, Kolb concludes that even the principle of sovereignty as the anchor of international law is more questioned than the principle of abuse of law:

> *Paradoxalement, si l'on met les choses en proportion, probablement la notion de souveraineté, cette pierre angulaire du droit international* [footnote omitted]*, est plus contestée que le principe de l'abus de droit* [footnote omitted].[1013]

Therefore, following the persuasive remarks of Kolb, it seems more than reasonable to conclude that the abuse of law principle is a valid principle in international law. This does not yet answer, however, the question of whether the abuse of law principle is a general principle of law according to article 38(1)(c) of the ICJ Statute. Some authors are against such a conclusion,[1014] while others support it.[1015] The cause for the dispute about the source of the abuse of law principle lies in the underlying concept of article 38(1)(c) of the ICJ Statute.

First of all, the abuse of law principle as a general principle of law is not based on a treaty, even though some treaties might contain explicit anti-abuse provisions.[1016] Second, it is unlikely that the abuse of law principle

1011. Kolb, 2000a, p. 442 et seq. *See also* Cheng, p. 121 et seq.
1012. Kolb, id., p. 445 et seq.
1013. Kolb, 2000a, p. 450.
1014. E.g. Crawford, p. 562, who opposes the qualification of the abuse of law principle as a general principle of law. *See also*, from a tax perspective, sec. 4.3.3.3.2.
1015. E.g. Cheng, p. 26.
1016. *See* the many existing anti-abuse provisions in tax treaties. For more details *see* OECD/G20, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report (OECD 2015).

has become part of customary international law, particularly because it is not a precise rule that can be framed by state practice, as it is more a principle-based rule applicable in various situations with various characteristics. Therefore, if one agrees that the abuse of law principle should also apply in international law, the last resort – at least following the listing of the sources in article 38 of the ICJ Statute – would be to argue that it qualifies as a general principle of law according to article 38(1)(c) of the ICJ Statute. However, if one follows a more positive understanding of the definition of the general principle of law according to article 38(1)(c),[1017] it is very difficult, if not impossible, to prove that the abuse of law principle is indeed inherent in all or most domestic laws and what its exact content is. The reason is that not all states have such an explicit principle or rule and its actual content differs from jurisdiction to jurisdiction.

If one understands, however, the general principles of international law according to article 38(1)(c) of the ICJ Statute in a more value-based manner as principles that are necessary, inter alia, to avoid highly unequitable decisions or *non liquet* situations, it seems persuasive to argue that the abuse of law principle should also be applicable in an international law framework as a general principle of law. Its content could be derived from the good faith principle.

Yet, this does not help in defining the abuse of law principle, as there seems to be some uncertainty with respect to the actual content. However, reference is again made to Kolb, who in his seminal work outlines a broad variety of application cases in international law.[1018] Therefore, it is not detrimental that there is no single definition of what abuse of law is in international law and it seems that the vagueness is a strength of the abuse of law principle, as it is able to avoid very different highly unequitable or *non liquet* situations.

4.3.3.3.2.2. From an international tax law perspective

The abuse of law principle has gained significant importance in international tax law, as international tax planning has increased over the last decades and abuse doctrines of every kind have been used by authorities and courts in order to challenge some of the most aggressive planning structures.[1019] International tax planning – or as an example treaty shopping –

1017. *See* sec. 4.3.3.2.
1018. Kolb, 2000a, p. 476 et seq. And it seems that certain key elements are commonly agreed upon (for further details *see* Cheng, p. 132 et seq.; Marro, p. 231 et seq.).
1019. This has also led to the development of different GAARs, which are often linked to or derived from a domestic abuse of law doctrine (*see* Krever, p. 1 et seq.).

structures have been used in order to mitigate withholding tax liability in the source state. The abuse of law principle has played an important role in international tax law as a law-correcting measure, as most double tax treaties traditionally did not contain anti-abuse provisions, as both the OECD MC and the UN MC did not do so. BEPS Action 6, of course, has fundamentally changed this.[1020]

It was therefore basically in line with the wording of a treaty to interpose a holding company for the sole purpose of treaty shopping.[1021] However, a few authorities have attacked such structures by referring to an (unwritten or inherent) abuse of law doctrine. Most prominently, the Swiss Federal Supreme Court in 2005 stated that the abuse of law principle is recognized in Switzerland, but also at the European level, even though the double tax treaty in question did not contain a specific anti-abuse provision:

> *Dementsprechend wird das Rechtsmissbrauchsverbot in Bezug auf Abkommen nicht nur auf schweizerischer Seite, sondern ebenso auf europäischer Ebene als allgemeiner Rechtsgrundsatz anerkannt, ohne dass es diesbezüglich jeweils einer expliziten Regelung im jeweiligen Abkommen bedarf.*[1022]

The Swiss Federal Supreme Court did not refer to article 38(1)(c) of the ICJ Statute, but the use of the term "general principle of law" ("*allgemeiner Rechtsgrundsatz*") could lead to the conclusion that the Court understands the abuse of law principle as applied in this case, as a general principle of law according to article 38(1)(c) of the ICJ Statute. It seems clear that the Court derives such a principle from international law and not from a domestic legal source, as the Court also mentions the application of such a principle at the European level. Also, its remark that the abuse of law principle is derived from the good faith principle as an internationally valid principle suggests that the Court referred to a principle that was understood as a general principle of law.[1023] Another argument in favor of such an understanding is that the Swiss Federal Supreme Court refers to Vogel's article in

1020. OECD/G20, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report (OECD 2015). *See also* art. 29 OECD MC.
1021. It would already be an option to challenge such a structure through interpretative measures (*see* Matteotti as mentioned *infra* n. 1029). In the present study, we will not further review the interaction between a potential abuse of law principle and interpretative measures *ex lege*.
1022. CH: BGer 2A.239/2005, 28 Nov. 2005, cons. 3.4.3.
1023. Id., cons. 3.4.3. When stating that the abuse of law principle is derived from the good faith principle, the Swiss Federal Supreme Court relied on the OECD Comm. and on the opinion of Prokisch, i.e. not on domestic cases or scholars. Therefore, the Court seems indeed to refer to international law and not domestic law when demonstrating the validity of the abuse of law principle.

which Vogel clearly argues in such a manner.[1024] However, the decision of the Court is capable of being misunderstood, as it also refers to article 26 of the VCLT and the good faith principle stated therein in order to justify the application of an unwritten anti-abuse reservation in every double tax treaty. The latter could be interpreted in a way that the anti-abuse doctrine as applied by the Court is based on treaty law, as part of the interpretation methodology according to the VCLT.[1025]

The discourse on whether an abuse of law principle would allow the non-application of a double tax treaty, even though the formal requirements for the application of the treaty are met, has intensified in recent decades. Some authors, such as Vogel,[1026] argue that the abuse of law principle forms a general principle of law and, as a consequence, such general principle of law should also be applicable to tax treaties, notwithstanding the parties of a specific treaty. Other authors are also of the opinion that a double tax treaty contains an unwritten anti-abuse rule, but without further discussing the actual international law base and/or constitutional base.[1027] Some other tax scholars argue that the abuse of law principle does not form a general principle of international law according to article 38(1)(c) of the ICJ Statute: De Broe[1028] states that there is no unanimity and no case law "that characterizes the concept of abuse of rights" as a general principle of international law. Matteotti denies the validity of the abuse of (tax) law principle as a general principle of law, as he seems to follow a positive understanding of article 38(1)(c) of the ICJ Statute by arguing that states should only be bound by a general principle of international law if the relevant rule or the relevant principle is applied in most or all states in the world:

> *Da somit selbst hochentwickelte Rechtsordnungen von OECD-Mitgliedstaaten kein allgemeines steuerliches Rechtsmissbrauchsverbot kennen, das im Einzelfall eine Rechtsfindung contra legem zulassen würde, muss bereits die Existenz eines allgemeinen völkerrechtlichen steuerlichen Rechtsmissbrauchsverbot innerhalb der OECD verneint werden.*[1029]

1024. Vogel, 1995, p. 472; Vogel, 1997, p. 275.
1025. This seems, for instance, to reflect the understanding of Oesterhelt & Winzap, p. 777. *See also* Jung, p. 242.
1026. Vogel, 1995, p. 472. Cf. Matteotti, 2003, p. 296, who is of a different opinion, mentions Merthan and Paschen. *See* with no clear opinion De Broe et al., 2011, p. 386.
1027. E.g. Oberson, 2014, p. 245, who seems to derive such understanding from the principle of good faith, however, without further discussing the legal source of the principle of good faith at an international level.
1028. De Broe, 2008, p. 306.
1029. Matteotti, 2003, p. 297. *But see* Matteotti, 2005, p. 344, where he does not follow such a strict approach and suggests that the maxim of "*contra venire factum proprium*" as derived from the principle of abuse of rights should apply at an international level. However, it is unclear whether the claim for an application of the mentioned maxim is part

Furthermore, he argues that only the common minimal standard in different jurisdictions should be recognized as a general principle of international law according to article 38 of the ICJ Statute.[1030] In a similar manner, De Broe states that the anti-abuse principle is only recognized in the case law of one out of the ten states that he reviewed and, therefore, such general principle of international law cannot be derived from domestic law (following a comparative law analysis). Due to the uncertainty concerning the content of such abuse of law principle, it should not apply, or as stated by De Broe:

> Serious hurdles of principle and practical nature must be taken before one can conclude that there exists a universally accepted anti-abuse rule applicable to abuses of tax treaties under Art. 38(1)(c) of the Statute to the ICJ. The most important difficulty stems from the fact that the practices in the various States are still too inhomogeneous to formulate a universally accepted standard.[1031]

The latter seems to be persuasive at first glance. However, uncertainty itself does not question the validity of a certain general principle. It is by all means conceivable to argue in favor of the validity of the abuse of law principle, even though it is admitted that the requirements for application are by no means clear and need to be developed by case law. Moreover, a consequence of the application of general principles is that a court has certain discretion, otherwise there would be no principles existing within international law.[1032] As already indicated, we would also disagree with De Broe that a rule (i.e. a general principle of international law) "must be construed on the basis of the domestic provisions and doctrines as applied by the Courts in the various jurisdictions in relation to abuse of treaties".[1033] Bearing in mind that the abuse of law principle is widely applied in international law, we do not see any reason why it should not be valid from a tax perspective. This does not mean that we agree with the aforementioned case of the Swiss Federal Supreme Court and its interpretation of the abuse of law principle. The present study only aims at analyzing whether the abuse of law principle forms a general principle of international law according to article 38(1)(c)

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of an interpretation methodology or can indeed be considered as a general principle of law according to art. 38(1)(c) of the ICJ Statute. *See also* Matteotti, 2006/2007, p. 788 et seq. In this respect, it is important to note that the maxim of "*contra venire factum proprium*" might be related or even identical to the principle of estoppel, which is considered to be a general principle of law (for more details *see* Kolb, 2000a, p. 357 et seq.). On the estoppel principle *see* sec. 4.3.3.3.3.

1030. Matteotti, 2003, p. 296.

1031. De Broe, 2008, p. 315. It is indeed an empiric fact that there is no homogeneous practice in the different states. *See*, for example, Zimmer, p. 38.

1032. *See* Kolb, 2000a, p. 459 et seq.

1033. De Broe, 2008, p. 315. *See* sec. 4.3.3.2.

of the ICJ Statute and not in what circumstances a tax planning structure indeed is abusive.

We have previously stated that an important cause for the existing dispute about the actual content of the general principle of international law according to article 38(1)(c) of the ICJ Statute and its validity relates to the underlying concept of international law as being either caused by positivism or naturalism. This is also reflected (though not explicitly) in the position taken by the aforementioned tax scholars (i.e. De Broe and Matteotti). It was shown that the general principles according to article 38(1)(c) of the ICJ Statute should not be understood by following a strict voluntarist approach. We must instead consider that certain principles are necessary in order to achieve a fair judgment if an interpretation according to article 31 et seq. of the VCLT would lead to a highly inequitable situation or if these principles are necessary in order to avoid *non liquet* situations. The abuse of law principle, as such, does qualify as a general principle of law according to article 38(1)(c) of the ICJ Statute, derived from the good faith principle, and we do not foresee any reason why this should not be true from an international tax practice perspective. This is also in line with the ICJ case law, as the ICJ, for instance, with respect to the estoppel principle, has also not rendered a comparative study on the validity of the estoppel doctrine in civilized nations, which would be required by a more positive methodology.[1034]

Obviously, we have not developed a clear understanding of what impact this has on tax-planning structures nor under which circumstances a structure must qualify as abusive. Yet, the abuse of law principle can be used in order to mitigate the detrimental consequences of an existing consent among states; the reference to the abuse of law principle was necessary to find a solution that is outside the written consent of two treaty parties. Or, in the words of Kolb:

> Its [i.e. the good faith principles and derived from that the abuse of law principle] aim is to blunt the excessively sharp consequences sovereignty and its surrogates (e.g., the principle of consent, no obligation without consent) may have in the international society, in ever increasing need of cooperation.[1035]

1034. *See* sec. 4.3.3.2.
1035. Kolb, 2006, p. 18.

4.3.3.3.3. *Estoppel*

4.3.3.3.3.1. From an international law perspective

In general, estoppel prohibits a party from claiming a certain right if this was in contrast to the past behavior of such party. However, estoppel does not prohibit contradictory behavior in general.[1036] The ICJ has only, in one case, clearly based its decision on estoppel (and acquiescence).[1037] However, in many other decisions, the ICJ referred to estoppel in a material manner, as it either denied or affirmed the estoppel doctrine even without an explicit denomination.[1038] In the well-known Temple of Preah Vihear Case, which relates to a boundary dispute between Cambodia and Thailand, the ICJ held that Thailand was bound by a map that was drafted by experts from French Indochina (i.e. Cambodia) and sent to Thailand – or Siam, the predecessor of Thailand. The authorities in Thailand/Siam did not object to the boundary line, which was not in accordance with the existing treaty between the states, and as a consequence, the ICJ concluded that Thailand was bound by its behavior. This meant that Cambodia had jurisdiction over the Temple of Preah Vihear, even if it was proven that Thailand did not recognize it explicitly:

> The Court however considers that Thailand in 1908-1909 did accept the Annex 1 map as representing the outcome of the work of delimitation, and hence recognized the line on that map as being the frontier line, the effect of which is to situate Preah Vihear in Cambodian territory. The Court considers further that, looked at as a whole, Thailand's subsequent conduct confirms and bears out her original acceptance, and that Thailand's acts on the ground do not suffice to negative this. Both Parties, by their conduct, recognized the line and thereby in effect agreed to regard it as being the frontier line.[1039]

Furthermore, in the Fisheries Case, the ICJ implicitly applied the estoppel principle. The question brought to the ICJ related to the delimitation of the coastline of Norway. The ICJ held that the delimitation mechanism by Norway was consistently applied and the United Kingdom (as the appealing party) had not contested it for more than 60 years.[1040] Consequently, Norway could rely on its delimitation system. The Court did not explicitly refer to

1036. Müller, p. 10 et seq. *See also* Verdross & Simma, § 615.
1037. Thirlway, 2008, p. 29 et seq.
1038. *See generally* Ovchar, p. 1 et seq. *See also* Müller, p. 13 et seq. For instance, regarding the *Legal Status of Eastern Greenland* case, *see* Degan, p. 57.
1039. ICJ, Case concerning the Temple of Preah Vihear (*Cambodia v. Thailand*), p. 32 et seq.
1040. ICJ, Fisheries Case (*United Kingdom of Great Britain and Northern Ireland v. Norway*), p. 116 et seq.

the principle of estoppel, but the line of argument used by the ICJ resulted in an application of an estoppel doctrine:

> The notoriety of the facts, the general toleration of the international community, Great Britain's position in the North Sea, her own interest in the question, and her prolonged abstention would in any case warrant Norway's enforcement of her system against the United Kingdom.
>
> The Court is thus led to conclude that the method of straight lines, established in the Norwegian system, was imposed by the peculiar geography of the Norwegian coast; that even before the dispute arose, this method had been consolidated by a constant and sufficiently long practice, in the face of which the attitude of governments bears witness to the fact that they did not consider it to be contrary to international law.[1041]

Many scholars assume that the principle of estoppel[1042] as understood by the ICJ is part of the general principles of law according to article 38(1)(c) of the ICJ Statute.[1043] The content of the estoppel principle, however, is by no means clear and needs to adapt to individual cases. In this respect, it is also important that a court adapts the domestic principle of estoppel for an international setting.[1044] Some authors argue instead that estoppel, or at least some parts of estoppel, could be part of customary international law.[1045] The distinction between customary law and general principles of international law is not straightforward; however, based on the case law of the ICJ, it seems persuasive to qualify estoppel as a general principle of law according to article 38(1)(c) of the ICJ Statute. Even though the estoppel principle itself mainly derives from common law jurisdictions, it can nevertheless be argued that estoppel or similar principles, such as good faith, are general principles among civilized states. As we have seen above, it is not necessary for a court to prove that all states apply a general principle in order to qualify as a general principle of law.[1046]

Obviously, these remarks do not provide for a precise frame of the estoppel principle. There is nothing particularly weak about the estoppel principle; however, vagueness is an overall concern with respect to general principles of law. It is exactly the purpose of these general principles to provide judges

1041. Id. p. 139.
1042. *See* Verdross, 1973, p. 133, who also uses the terms "forclusion" or "preclusion".
1043. Giesch, p. 166; Heintschel von Heinegg, in: Ipsen, § 18 para. 4; Marro, p. 432; Müller, p. 5; Verdross, 1973, p. 133 et seq. *But see* the dissenting opinion of Judge Pirzada in the Case concerning the Aerial Incident (*Pakistan v. India*), p. 78.
1044. *See* Marro, p. 432.
1045. MacGibbon, p. 513.
1046. *See* sec. 4.3.3.2.

with an instrument in order to find a solution in many different and, inter alia, *non liquet*, circumstances.[1047]

4.3.3.3.3.2. From an international tax law perspective

The principle of estoppel has recently gained some momentum within international tax law, as Engelen argued that the OECD Comm. must be seen as a binding instrument for interpretation, at least for OECD member countries, due to the principle of estoppel.[1048] Furthermore, Engelen claimed that by not issuing any observations on the Commentary, an OECD member country is actually bound by estoppel. He draws an analogy to the *Temple of Preah Vihear* case:

> Insofar as the OECD Member countries have not made an observation on the interpretation of the provisions of the OECD Model as set out in the Commentaries thereon and, when concluding or revising their bilateral tax treaties, conformed to those provisions, as recommended by the Council in accordance with Art. 5(b) of the OECD Convention, it is clear that the circumstances of the negotiations were such as called for some reaction if the parties wished to disagree with or had any serious question to raise regarding that interpretation.[1049]

As shown in another instance[1050] and as demonstrated by many other authors,[1051] we would disagree with such an opinion based on various reasons, but particularly because the estoppel principle requires that a certain act of another state is *estopped*; however, with respect to the OECD Comm., there is no act of the other state to be estopped. It would, for instance, require that after signing a double tax convention, a state would in all circumstances follow the interpretation within the Commentary in a strict sense. However, the latter seems implausible, as every state has in some areas its own practices and does not follow the commentary in a comprehensive manner. Likely, if one would conduct an empiric study, one might be able to demonstrate that the practice in many jurisdictions deviates significantly from the interpretative solutions within the OECD Comm. Furthermore, the conclusion of Engelen is not persuasive simply by the fact that the OECD would have the opportunity to issue a binding measure instead of a non-binding measure.[1052] The states could therefore also agree

1047. For further details *see* sec. 4.3.3.1.
1048. Engelen, 2006, p. 105 et seq. For further details *see* Engelen, 2004, p. 458 et seq.
1049. Engelen 2006, p. 109.
1050. Hongler, 2012a, p. 212 et seq.
1051. E.g. Avery Jones, sec. 5.2.3.; Pijl, 2008, p. 95 et seq.
1052. For further details, *see* sec. 4.3.4.4.

as parties to a double tax treaty that the interpretation according to the Commentary should be determinant. However, by not doing so, it implies that the member countries also do not want to be bound by the Commentary indirectly via general principles of law.

However, if one considers that the estoppel principle has in the past been of particular importance with respect to territorial sovereignty in general, or in particular with respect to boundary conflicts, it could be of relevance from a tax perspective in similar circumstances.[1053] The following example could, for instance, require reference to the estoppel principle in order to resolve a potential tax dispute at the level of a domestic or an international court.

Example

A famous restaurant for tourists is located at the top of a mountain pass, which is at the same time the border between A and B. In the past both states were of the opinion that the restaurant as such was still on the territory of State A and, therefore, State A levied corporate income tax on the income of the restaurant. However, due to a necessary reconstruction of the street that connects the two states, an engineer of State B found older maps actually demonstrating that the restaurant is in the territory of State B; therefore, State B retroactively taxed the income of the restaurant.[1054] In this case, a court would need to review in detail whether State B has not lost its right to tax the restaurant based on the principle of estoppel, as it was aware that State A taxed the income of the restaurant and assumed that it was in its territory.

In conclusion, the principle of estoppel as a general principle of international law can be understood in line with the case law of the ICJ and with many legal scholars as a general principle of international law. It has thus far been of minor importance from an international tax perspective, but it could be of relevance for cases in which the tax dispute is actually a border dispute. We mentioned the case of a restaurant at the border of two states, but one could, for instance, also refer to the taxation of offshore oil platforms or of oil pipelines, as these are areas in which border conflicts might arise.[1055]

1053. We already mentioned above the *Temple of Preah Vihear* case (*see supra* n. 1039) and the *Fisheries* case (*see supra* n. 1040). Further border disputes also refer to the principle of estoppel (*see* for instance ICJ, Delimitation of the Maritime Boundary in the Gulf of Main Area, p. 246 et seq.).
1054. The fact pattern is loosely based on a case decided by the Swiss Federal Supreme Court (with no reference to tax issues). *See* CH: SC, BGE 106 Ib 154, 2 July 1980.
1055. For more details on the taxation of oil pipelines also in a cross-border scenario, *see* Olsen, p. 1 et seq.

4.3.3.3.4. *Collision rules*

4.3.3.3.4.1. From an international law perspective

In a legal system or a legal regime with overlapping provisions and non-exclusive legislation, many conflicts of rules occur, thus requiring collision rules. The two most important collision rules are "*lex posterior derogate lex inferior*" and "*lex specialis derogat lex generalis*". In the following sections, we will discuss whether these rules qualify as general principles of law according to article 38(1)(c) of the ICJ Statute.

Not only in international law, but also within domestic law, these principles are categorized in various ways. In an overview, Vranes[1056] referred to at least ten different options, such as, inter alia, (i) general principles of law, (ii) methods of interpretation, (iii) presumption rules, (iv) subjective rules or (v) customary law. One might even wonder whether these principles do not have peremptory character or whether these collision rules are not an imminent part of international law. A detailed analysis would require a separate study, but, prima facie, some persuasive arguments tend to favor the result that these collision rules are to be understood as a general principle of law according to article 38(1)(c) of the ICJ Statute.

First of all, collision rules such as *lex specialis* and *lex posterior* are logically necessary, as otherwise *non liquet* situations might arise. As shown above, the aim of the general principles of law according to article 38(1)(c) of the ICJ Statute are, inter alia, to avoid any situation in which the judge cannot find any precise solution based on the customary international law or treaty law. Secondly, these collision rules are found in many domestic laws and also, following a more voluntarist or positive understanding of general principles of law,[1057] their validity seems indeed justified. Thirdly, and closely linked to the first argument, it seems that collision rules are inherent in all legal systems, at least in legal systems with non-exclusive rules.

Although these three arguments seem to suggest a qualification of the collision rules as general principles of law according to article 38(1)(c) of the ICJ Statute, there would be many more aspects to be discussed. Nevertheless, collision rules are part of the international law regime and valid grounds exist to conclude that they are valid, as they are considered to be general principles of law.

1056. Vranes, p. 391 et seq. *See also* Simma & Pulkowski, n. 10, with further references.
1057. On the dispute between a positive and a more ethical understanding of the general principles of law, *see* sec. 4.3.3.2.

4.3.3.3.4.2. From an international tax law perspective

From a tax perspective, Bühler already stated in 1964 that the *lex specialis* and the *lex posterior* rules qualify as general principles of (tax) law.[1058] The *lex specialis* and *lex posterior* rules, due to the variety of existing treaty provisions within the international tax regime, have an important role. It might, for instance, be that a non-tax agreement[1059] is in conflict with a double tax convention[1060] or that a provision in a multilateral tax convention is not in line with a provision in a bilateral tax convention. Furthermore, there might be a conflict between a domestic tax rule and a treaty provision, which would also require the application of collision rules. However, the latter question is or might be governed by domestic (constitutional) law and not (only) by international law.[1061] It might even be that two rules within the same treaty are in conflict.

The *lex specialis* rule, for instance, is relevant from a tax perspective, as one could argue that article 3(2) of the OECD MC is a *lex specialis* interpretation method compared to the VCLT, as it requires a court to follow the methodological approach of article 3(2) of the OECD MC.[1062] The *lex posterior* rule could apply, for instance, when there is a conflict between a status of forces agreement (SOFA)[1063] and a double tax treaty that was signed after the conclusion of the SOFA.[1064] For instance, the conflict could occur if, according to the SOFA, the sending state could tax the salary of a soldier and the receiving state could claim taxing right under the double tax convention between the two jurisdictions. Another example of a potential application of the *lex posterior* rule is if states have signed both a double tax convention and a multilateral convention with deviating rules on the exchange of information. In this case, *lex posterior* would suggest that the rules in the later agreement should prevail. Many other examples demonstrate the importance of collision rules in the field of international tax law.

1058. Bühler, p. 39.
1059. For more details on the term "non-tax treaty" *see* sec. 4.2.2.
1060. *See* the example in Hongler, 2012b, 792 et seq.
1061. In the present study, we will evade the discussion about the interaction between domestic (constitutional) and international collision rules.
1062. *See* Engelen, 2004, p. 477 et seq., with further references.
1063. *See* sec. 4.2.2.
1064. *See* Smit, 2012c, p. 585 et seq.

4.3.3.3.5. *Statute of limitation or extinctive prescription*

4.3.3.3.5.1. From an international law perspective

Many scholars are of the opinion that the statute of limitation is a general principle of international law.[1065] The statute of limitation is – as far as other studies have shown[1066] – inherent in all or most legal systems.[1067] Apparently, there is no consent with regard to the exact length of a statute of limitation worldwide.[1068] As an example, it is not even clear (and there is a lot of confusion) how long the duration of an unwritten statute of limitation provision is within Swiss domestic tax law.[1069] Therefore, it also seems difficult to develop a defined statutory limitation period within international law, as there is a lack of institutionalization at an international level.[1070] Based on natural law and not based on the instrument of general principles of law in article 38(1)(c) of the ICJ Statute, de Vattel already stated that there is no exact prescription duration:

> *Il est impossible de déterminer en Droit Naturel, le nombre d'années requis pour fonder la Prescription. Cela dépend de la nature de la chose, dont la propriété est disputée, & des circonstances*.[1071]

International courts have also dealt with the question of extinctive prescription. Often mentioned in respect of a statute of limitation within international law is the *Gentini* case,[1072] in which the Mixed Claims Commission explicitly stated that the principle of prescription is a general principle of international law:

> On examining the general subject, we find that by all nations and from the earliest period, it has it been considered that as between individuals an end to disputes should be brought about by the efflux of time. Early in the history of the Roman law, this feeling received fixity by legislative sanction. In every country have periods been limited beyond which actions could not be brought. In the

1065. With further details, also on the historical development, *see* Marro, p. 222 et seq.; Dahm, Wolfrum & Delbrück, p. 64.
1066. Müller, p. 74 et seq. (n. 270).
1067. As was shown above, we do not, however, necessarily require that the application in all or most states is proven in order to qualify as a general principle of law (*see* sec. 4.3.3.2.).
1068. *See* Marro, p. 226 et seq.
1069. *See* Oesterhelt, p. 821 et seq.
1070. Müller, p. 67.
1071. De Vattel, livre II, § 142.
1072. Italy/Venezuela Mixed Claims Commission, Gentini Case, *Italy v. Venezuela*, p. 551 et seq. *See*, with further references on older cases that deviate from the *Gentini* case, Jackson, p. 133 et seq. *See also* Verdross & Simma, § 614, who refer to an arbitration procedure based on the French–Hungarian Peace Treaty of 1919.

> opinion of the writer, these laws of universal application were not the arbitrary acts of power, but instituted because of the necessities of mankind, and were the outgrowth of a general feeling that equity demanded their enactment; for very early it was perceived that with the lapse of time, the defendant, through death of witnesses and destruction of vouchers, became less able to meet demands against him, and the danger of consequent injustice increased, while no hardship was imposed upon the claimant in requiring him within a reasonable time to institute his suit. In addition, another view found its expression with relation to the matter in the maxim "Interest republica ut sitfinis litium."
>
> The universal opinion of publicists and lawgivers has been that the statutes of prescription or "limitation", as they have come to be called, were equitable and the outgrowth of a general desire for the attainment of justice.[1073]

This means that if a state asks for the payment of a claim based on an international treaty, the other party of such treaty may revoke a statute of limitation, even if the relevant treaty does not contain such a provision. However, as already mentioned, international law does not provide for precise prescription duration.[1074] Or, as stated in the aforementioned *Gentini* case of the Mixed Claims Commission:

> The umpire, while disallowing the claim, expresses no opinion as to the number of years constituting sufficient prescription to defeat claims against governments in an international court. Each must be decided according to its especial conditions. He calls attention to the fact that under varying circumstances the civil-law period is ten, twenty, and thirty years; in England, for many years - for contracts, six years; in the United States, on contracts with the Government, six years, and in the several States, on personal actions, from three to ten years.
>
> It is sufficient to say that in the present case the claimant has so long neglected his supposed rights as to justify a belief in their nonexistence.[1075]

One could argue that the statute of limitation does not form a particular principle of international law, but is instead derived from the principle of estoppel or acquiescence. Indeed, if one agrees that the statute of limitation itself is a general principle of international law, but no specific statute of limitation can be derived from international law, meaning that one would need to determine and decide in an individual case what the statute of limitation is, there seems no difference between claiming the limitation based

1073. Italy/Venezuela Mixed Claims Commission, Gentini Case, *Italy v. Venezuela*, p. 557.
1074. For further details *see* Cheng, p. 373 et seq.; Marro, p. 226 et seq. *See also* Guggenheim, p. 146.
1075. Italy/Venezuela Mixed Claims Commission, Gentini Case, *Italy v. Venezuela*, p. 561.

on a general principle of international law or indirectly by referring to the principle of estoppel or acquiescence.[1076]

4.3.3.3.5.2. From an international tax law perspective

As far as can be observed, the statute of limitation as a general principle of international law has not been of any importance regarding international tax law, according to article 38(1)(c) of the ICJ Statute. Obviously, statutes of limitation as a domestic rule based on either a domestic legal provision or a constitutional rule have also been of great relevance from an international tax law perspective. Furthermore, another question is whether an individual is protected by the principle of prescription if a state claims a tax liability after several years, even though the individual relocated to another state. Apparently, it is again likely that the individual does not need to rely on a general principle of law according to article 38 of the ICJ Statute, as it is likely that he can find legal remedies and prescription rule within domestic law.

However, we assume that due to the consistent growth of international coordination, additional international disputes among states might require further analysis of the statute of limitation as a general principle of international law. Moreover, new tax coordination measures might raise new questions of prescription, not only between individuals and the state, but also between states. For instance, a state could refer to the principle of prescription if another state claims the payment of a certain amount of taxes collected by another state due to the application of a Rubik agreement.[1077] In this case, if the Rubik agreement does not provide for an explicit prescription provision, prescription as a general principle of international law applies, as in the *Gentini* case,[1078] and a court might conclude that a payment of the claim is time-barred.

4.3.3.3.6. *Excursus:* Pacta sunt servanda

Kelsen famously mentioned "*pacta sunt servanda*" as the potential "*Grundnorm*" of international law.[1079] There would indeed be no rationale for signing an agreement if such an agreement would not be binding for the contracting states. In this sense, *pacta sunt servanda* is somehow

1076. *See* Marro, p. 228.
1077. *See* for further details about Rubik agreements, sec. 4.2.2.
1078. *See* sec. 4.3.3.3.5.1.
1079. *See* sec. 3.3. *See* for further details Kammerhofer, p. 548.

axiomatic,[1080] or a precondition for the existence of the current world order.[1081] This is even true considering the fact that, from a tax perspective, several states have infringed double taxation conventions through treaty overrides.[1082] A famous, albeit disputed, example is the implementation of domestic CFC provisions.[1083] However, the fact that certain agreements are infringed in practice does not mean that *pacta sunt servanda* is itself questioned.[1084]

There has been a long-lasting dispute among scholars regarding the legal base or the foundation of *pacta sunt servanda*.[1085] In the present section, it should be briefly analyzed whether it can be derived from an international treaty, from customary international law, or whether it reflects a general principle of international law.

Pacta sunt servanda is stated in article 26 of the VCLT. Accordingly: "Every treaty in force is binding upon the parties to it and must be performed by them in good faith." Therefore it could be argued that the legal base of the *pacta sunt servanta* principle is actually the explicit consent of states within the VCLT, i.e. a treaty-based rule. However, it would be illogical to argue that the *pacta sunt servanda* principle should only be based on treaty provision itself, which would again be subject to the *pacta sunt servanta* principle.[1086] One could also argue that *pacta sunt servanda* forms part of customary international law[1087] due to widespread practice and the belief that there is an unwritten rule requiring that treaty obligations be fulfilled.[1088] Besides, a qualification of *pacta sunt servanda* as a general principle of law might be true, and it would even be advantageous compared to the qualification as customary international law, as no consensus is required.[1089] All lines

1080. Crawford, p. 450. *See also* Thirlway, 2014, p. 7, and with more details p. 31 et seq.
1081. On the topic of *pacta sunt servanda* from an international tax law perspective, *see* Matteotti & Krenger, paras. 57 et seq. and 108.
1082. *See generally* Schoueri, p. 682 et seq.
1083. The question of the compatibility of CFC rules and double tax treaties is disputed and many different opinions among scholars and courts exist. For an overview, *see*, for instance, the contributions in Lang et al. [eds.] (2004).
1084. *See* Villiger, 2009, Article 26 para. 4.
1085. *See* Binder, p. 17 et seq.; Degan, pp. 72 et seq. and 394 et seq.; Fischer-Lescano, p. 726; Thirlway, 2014, p. 31 et seq.
1086. Binder, p. 21, with reference to Verdross; Schmalenbach, Article 26 para. 1. *See also* Tomuschat, 1993, p. 211.
1087. Verdross, 1969, p. 642, para. 38, with further references. *See also* Boas, p. 58; Degan, p. 396. With reference to Kelsen, *see* Kammerhofer, p. 584 et seq., who highlights that such opinion would lead to the conclusion that customary international law and treaty law are not two distinguished sources of international law.
1088. Villiger, 2009, Article 26 para. 10. *See also* the references stated by Binder, p. 24 et seq.
1089. Schmalenbach, Article 26 para. 21 et seq.

of argument are valid and again demonstrate that a clear-cut categorization within the existing sources of international law is difficult, if not impossible. Even a qualification as *ius cogens* seems feasible.[1090]

From our perspective, *pacta sunt servanda* is a logical precondition for the world order since the Peace of Westphalia, as a system with equal sovereignty, requires that the treaty obligations be obeyed.[1091] Actually, the word "treaty" itself requires the "*sunt servanda*" obligation. One could call this a natural law, a peremptory norm of the current world order, or a fundamental principle of international law.[1092] The term "legal precondition" indeed seems suitable to describe its relevance in international law. Yet, it is persuasive to argue that aligned to the development of the current world order, the *pacta sunt servanda* principle developed simultaneously.[1093] In a similar way, it was already stated by de Vattel that the tranquility, joy and security of humans requires that the obligations to other parties be obeyed:

> *Toute la tranquillité, le bonheur & la sûreté du Genre-humain reposent sur la Justice, sur l'obligation de respecter les droits d'autrui.*[1094]

Furthermore, de Vattel even concluded that *pacta sunt servanda* is a holy duty, as it protects welfare.[1095]

The acceptance of the current world order requires that certain rules be obeyed as legal preconditions, and one of these few rules is *pacta sunt servanda*. The latter has also been stated by Lesaffer in a very persuasive way:

> What then were the features opposing sovereignty, which allow for an assessment of the modern States system as a dualistic system? First, the European order could only function if two basic rules were commonly accepted: pacta sunt servanda as a basis for the validity of treaties and the right to defend one's own legitimate claims, if necessary with violent means.[1096]

4.3.3.4. Justice and general principles of law – Some concluding remarks

The present chapter has shown that the general principles of international law according to article 38(1)(c) of the ICJ Statute also form a piece of

1090. *See* Thirlway, 2014, p. 32.
1091. *See* Binder, p. 17.
1092. Id., p. 22. *See also* Fischer-Lescano, p. 726.
1093. *See* Verdross, 1969, p. 643.
1094. De Vattel, Livre II, § 163.
1095. Id., § 220.
1096. Lesaffer, p. 131.

the international tax regime. In particular, the question of whether there is an unwritten anti-abuse principle in international tax law has also been of practical importance in recent decades. We demonstrated that much of the underlying dispute about the validity of an abuse of law principle relates to the theoretical concept of the general principles of law, as one could either follow a more ethical (naturalist) or a more positive approach.

We opined for the validity of certain general principles of law following moral concerns, as certain principles are necessary in all legal regimes in order, inter alia, (i) to resolve highly unjust situations, (ii) to assist judges in *non liquet* circumstances, and (iii) to provide complementary instruments to legal rules. Therefore, it is not required to render a comparative study of domestic laws in order to demonstrate the validity of a certain principle as a general principle of law. Such understanding is a further sign that the international tax regime as part of the international law regime is partly based on non-consensual rules and principles. This means that the international legal regime is at least partly value-based and not a strict voluntary system, which would, for the validity of certain rules or principles, always require an explicit or tacit agreement of states.

However, general principles of law have not been of major importance in international tax law in terms of enhancing justice of the international tax regime and, in particular, they are not of particular relevance for the development of new rules, as they mainly help judges resolve individual cases of injustice.[1097] Therefore, in order to mitigate the perceived justice deficiencies of the international tax regime as shown,[1098] these general principles of law are only partly helpful. They might help to resolve instances of injustice in individual cases, but they do not, for example, answer the general question of where multinationals should pay their fair share and what "fair share" means at an international level. However, also with regard to the other presumed justice deficiencies, general principles of law do not provide for guidance on how to resolve these deficiencies or how to enhance justice within the international tax regime.

For the purpose of the present study, this means that the general principles of law as a source of international law are by no means sufficient to mitigate

1097. Cf. Kolb, 2006, p. 2 et seq., with some evidence that general principles of law can indeed create new rules. He moreover states that: "They [i.e. the general principles of law] then serve to free the legal actor from the constraints of positive law and to seek in more lofty and general areas a satisfactory solution for the single case submitted to him" (p. 34).
1098. *See* sec. 1.5.

the justice deficiencies perceived in the international tax regime. They are not a sufficient reference point as an orientation tool to render a normative review of some of the most important principles and rules of the international tax regime. Therefore, an analysis of the general principles of law has not overthrown our initial thesis that, for a normative review of the international tax regime, reference to a non-legal discipline, such as political philosophy, is necessary.[1099]

4.3.4. Soft law

4.3.4.1. Definition of international soft (tax) law

There is no unanimity on what soft law means and whether the term "soft law" is indeed appropriate to suit its purpose.[1100] Prima facie, the terms "soft" and "hard law" indicate that the effect of both categories is different: a rule might either have a hard or soft effect. In other words, for the purpose of categorization, it is decisive whether a rule is binding or non-binding.[1101] Binding could mean that a rule is enforceable, although a rule of hard law might have a binding character, yet might not be enforceable. This is particularly true in the international realm, where (cross-border) enforceability is generally rather weak.[1102] For instance, no one would question the hard law value of a double tax treaty provision, although not in every jurisdiction may a taxpayer, in any case, refer to the benefits granted by a treaty due to a treaty override.[1103] Therefore, the treaty benefit might not be enforceable. Binding means rather that the breach of a binding provision leads to legal responsibility.[1104] One could also argue that soft law has less of an impact on states than treaties, as treaty obligations are more likely to influence the behavior of states.[1105]

On the other end of the spectrum, it derives from the term "soft law" that an act or a publication should at least have a certain effect and not only be considered as "no law". The distinction between no law and soft law is

1099. *See* secs. 2.1.2. and 2.1.3.
1100. For a detailed overview on the different opinions *see* Giersch, p. 37 et seq. *See also* Thürer, 2009c, p. 169 et seq.
1101. *See*, for example, Heintschel von Heinegg, in: Ipsen, § 20 para. 20; Thirlway, 2014, p. 164. *See also* Guzman, p. 583, with further references.
1102. *See generally* id., p. 588 et seq.
1103. *See*, for example, Lang, 2013, para. 55.
1104. *See generally* Goldstein et al., p. 25. *See*, with respect to the definition of treaties for the purpose of international law, Hollis, p. 13 et seq.
1105. *See* Guzmann, p. 583 et seq., with further references.

vague, however, and is not linked to any legal consequences, at least at an international level and in the author's country of residence, Switzerland. The effect of soft law could either be the application by courts of the respective rules or, particularly true with regard to the present study, the implementation of a certain rule by the legislator or any other constitutional body in line with international soft law provisions.

Soft law, therefore, is understood as an instrument that influences (or may influence)[1106] the behavior of various state actors.[1107] Yet, soft law itself is not part of the traditional sources of international law as provided for in article 38 of the ICJ Statute.[1108] As the term "soft law" does not, as far as can be observed, trigger specific legal consequences, it is not detrimental to understand it in a broad sense. Within European law, it is generally accepted that recommendations of the European Commission regarding a specific directive are considered to be soft law. The ECJ stated in the *Grimaldi* case[1109] that states are bound to consider such recommendations.[1110] However, there is a dispute whether this should mean there is indeed a duty for a consistent interpretation in accordance with certain recommendations, whether recommendations should be understood as a mandatory interpretation aid, or whether recommendations can also be ignored by Member States.[1111]

From an international tax law perspective, in order to qualify a certain principle or rule as soft law, it is not required that a court or legislator in a specific state actually be bound to consider such rules. Therefore, soft law is given if a publication, be it, for example, a recommendation or a code of conduct published by an international law body, is likely to have an impact on the behavior of certain actors, such as states or courts.[1112] It is not necessary that the effect has already occurred. In a similar manner, it is argued that soft law consists of norms that are non-binding, but habitually obeyed,[1113] or in other words, as rules that are "considered as something more than mere political gestures, so that there is an expectation of compliance even

1106. *See* Gribnau, p. 74, with further references.
1107. *See* Pistone, 2010, p. 102.
1108. *See*, with further details about the question of whether soft law could lead to an extension of international law in general, Thürer, 1985, p. 443 et seq.
1109. BE: ECJ, C-322/88, *Grimaldi*, para. 18.
1110. For further details about soft law in the EU *see* Sarmiento, p. 53 et seq.
1111. *See generally* Senden, p. 387 et seq. *See also* Dubut, p. 2 et seq.
1112. *See* Pistone, 2010, p. 106 et seq.
1113. Johnstone, p. 89. Or as held by Thürer: "[S]oft law as a phenomenon in international relations covers all those social rules generated by States or other subjects of international law which are not legally binding but which are nevertheless of special legal relevance" (Thürer, 2009c, p. 163).

if there is no legal duty [footnote omitted]".[1114] As a consequence, the possibility of having an impact on a court decision or on a binding regulation by a governmental body defines the outline of soft law compared to no law.

Very stimulating, and demonstrating the complexity of a definition of soft law, is the contribution of Goldstein et al.[1115] The authors conclude that there is a spectrum between no law and hard law or, as they also refer to, between anarchy and hard law. On the right side[1116] of such a spectrum is hard law with (i) an obligatory effect, (ii) a precise wording, and (iii) a proper delegation to a third party (i.e. a court) with authority. On the other side is "no law", with no binding effect, with a very generic meaning, and with no delegation to a third party with authority. In between, there are a variety of rules that could be soft law in the sense of the present definition.[1117]

4.3.4.2. International organizations as quasi-legislative bodies

The publications of international organizations can broadly be split into two categories.

First of all, certain publications only affect organizational aspects of the international organization as such. For instance, the Rules of Procedure of the OECD primarily affect the organization, and not the legislation within the member countries.[1118] Secondly, the member states of an international organization might also agree on certain rules that have an external effect. Such rules can, but do not necessarily, have a binding effect. The publication of binding rules requires that it be explicitly stated in the incorporation documents of the international organization that the organization may create legal obligations among the member states. However, even without a formal binding character, certain publications of international organizations, such as technical recommendations or standards, might have a de facto binding effect to a certain extent, as states might follow such guidelines even without a legal obligation, or a state committing to a specific soft law might be

1114. Thirlway, 2014, p. 166.
1115. Goldstein et al., p. 1 et seq. *See also*, from a tax perspective, Christians, 2007, p. 331.
1116. It would also be possible to demonstrate this in a top-down spectrum and not a right-left one, as in the article of Goldstein et al., id.
1117. *See* Dean, p. 554, who writes with reference to Abbott that "[h]ard and soft law can be distinguished across three dimensions: precision, obligation and delegation." For a critical review of such understanding of soft law *see* Raustiala, p. 586 et seq.
1118. OECD, Rules of Procedure of the Organisation, Oct. 2013.

bound by good faith.[1119] From a tax perspective, resolutions of international organizations have, in general, no binding effect as, for instance, resolutions of the Security Council. Therefore, the debate in international tax law on the legal quality of the resolutions of international organizations is less intense than in other areas of international law.[1120]

Another distinction could be drawn between publications of an international organization that have an impact on the design of international treaties, as well as other publications that have an impact on the design of domestic legislation of a country. As will be shown below,[1121] this is currently particularly relevant with regard to publications of the OECD within the BEPS Project, as it is the intention of the OECD to not only change international treaty law, but also to impact the domestic tax legislation of its member countries (and even non-member countries).

We will further deal with these varieties of soft law, but before going into more detail, it is vital to understand the functioning of the UN and the OECD as the two most important bodies of international tax policy.[1122] In this respect, we will also focus on the impact of these two organizations on tax policy as such (including domestic tax policy). We have already highlighted the importance of these two organizations regarding hard law, i.e. double tax conventions.[1123] We will not specifically focus on the G20 and its position within international tax policy.[1124]

Following a broad understanding of the term "soft law",[1125] the creation of it does not require that a legislative or quasi-legislative process be obeyed. A rule can even have a soft law character regarding a certain state, even if such state was not at all involved in the deliberative process. For instance, the publications of the OECD/G20 within the BEPS Project might also affect state actors of countries that did not participate in the BEPS Project. It is

1119. *See* the remarks on estoppel and application of the OECD Comm. in sec. 4.3.3.3.3.
1120. *See*, for example, ICJ, Advisory Opinion, Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution 276, p. 26 et seq. *See also* Thürer, 2009c, p. 164 et seq. However, there is an extensive discussion on the exact value of publications of international organizations for interpretation purposes. Regarding the publications of the OECD, *see* sec. 4.3.4.4.3.
1121. *See* sec. 4.3.4.4.
1122. We will not discuss the question of whether, from an institutional perspective, a WTO should be incorporated (*see*, for example, Cockfield, p. 178 et seq.; Tanzi, p. 256 et seq.).
1123. *See* sec. 4.2.3.2.
1124. For more details *see* Christians, 2010, p. 19 et seq.
1125. *See* sec. 4.3.4.1.

not even required to qualify as soft law that a certain rule is recommended by an international organization. It is sufficient if a few states consider that a certain rule should be obeyed. For instance, the Germany-UK joint statement on new rules for preferential IP regimes published in December 2014 has a soft law character, as other legislators might follow such guidance when designing their domestic IP box.[1126]

To qualify as soft law, according to our understanding, it is not even required that a certain formal decision, for instance, by an international organization be rendered. Even a published draft of a certain regulation by an international organization could have a soft law character if it is likely that such a draft has an impact on the behavior of a state. However, considering the spectrum between no law and hard law, the higher the level of an approval is, the closer a certain rule is to hard law.

In order to better understand the interaction between soft law and the international tax regime, per se, it is necessary to outline the current work of the UN and the OECD as the two most important soft law-issuing bodies of international tax law. It was already shown above that recent developments have also brought forward new bodies of international law, such as the Global Forum or the Inclusive Framework, which have issued or will issue soft law provisions. Moreover, of course, the G20 might also publish soft law, which could be of relevance from a tax perspective.[1127]

4.3.4.3. The UN as a body of international tax law legislation

4.3.4.3.1. *In general*

The UN is an international organization that was incorporated by the UN Charter signed in 1945 in San Francisco. Its aim is, inter alia, to maintain international peace and "[t]o achieve international co-operation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights and for fundamental freedoms for all without distinction as to race, sex, language, or religion".[1128] The UN Charter provides for the use of (military) coercive measures if it is "necessary to maintain or restore international peace and

1126. *See* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/373135/GERMANY_UK_STATEMENT.pdf (last visited 26 Apr. 2019).
1127. E.g., all final BEPS reports were joint publications of the OECD and the G20.
1128. Art. 1 UN Charter.

security."[1129] The latter requires a resolution from the UN Security Council. Such coercive power – even though it is limited to very few circumstances – is an important feature of the UN.

The tax-related work of the UN is mainly assigned to the Committee of Experts in International Cooperation in Tax Matters as part of the Economic and Social Council of the UN (ECOSOC). The ECOSOC is regulated mainly by Chapter X of the UN Charter and it "may make or initiate studies and reports with respect to international economic, social, cultural, educational, health, and related matters and may make recommendations with respect to any such matters to the General Assembly to the Members of the United Nations, and to the specialized agencies concerned."[1130] It cannot make use of coercive measures, as the Security Council can. In 2013, the ECOSOC decided to hold an annual special meeting to consider international cooperation in tax matters.[1131] Besides these annual meetings of the ECOSOC, the work of the Committee of Experts on International Cooperation – as will be shown in the following section – has been crucial with respect to the UN work in general on tax matters.

Moreover, other bodies of the UN have published soft law concerning international tax law. We will focus in particular on the results of the conferences on financing for development in Monterrey, Doha, and Addis Ababa. Moreover, tax policy was also of relevance in the recent debate about strengthening the protection and enhancement of human rights. In particular, the work of the Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of all human rights – particularly economic, social, and cultural rights – must be highlighted.[1132] Of particular importance are the recently amended Guiding Principles on human rights impact assessments of economic reforms.[1133] Therein, the importance of tax policy in general and domestic revenue mobilization is stressed as it enables states "to overcome the disadvantaged situation of the population in situations of social vulnerability (the poor, minorities and women, among others) and other priority

1129. Art. 42 UN Charter.
1130. Art. 62(1) UN Charter.
1131. *See* UN, ECOSOC, Resolution adopted by the Economic and Social Council, E/RES/2013/24, 24 July 2013.
1132. The various UN reports and documents cited herein are available online at https://www.ohchr.org/EN/PublicationsResources/Pages/Publications.aspx (last visited 15 Feb. 2019).
1133. UN, Human Rights Council, Guiding principles on human rights impact assessments of economic reforms, A/HRC/40/57.

care groups, notably older adults, children and persons with disabilities."[1134] Therefore tax policy is understood as a means to protect human rights, particularly economic, social, and cultural rights. As will be shown, this is very much in line with the results of the conferences on financing for development. We will not address the work of the Independent Expert and UN Human Rights Council in a separate chapter, but we will refer to his reports at several instances in the following sections.

4.3.4.3.2. *The Committee of Experts on International Cooperation in Tax Matters*

The Committee was incorporated in 2005, as the prior so-called Ad Hoc Group of Experts was uplifted within the UN structure and is now directly reporting to the ECOSOC.[1135] Any attempts to further uplift the Committee into an inter-governmental commission or body, which would have increased the importance of the Committee, have failed.[1136] A particular aim of the work of the Committee relates to supporting developing states regarding both capacity building and technical assistance.[1137] The Committee consists of 25 Members[1138] nominated by Member States, each elected for a term of four years. These members, and this is an important difference compared to the OECD, do not represent specific national interests, but act in their personal capacity.[1139] In general, the Committee meets once a year for a five-day session. The Committee consists of several subcommittees and one advisory group.[1140] Inter alia, the UN incorporated a Subcommittee on Base Erosion and Profit Shifting, which was created in 2013.[1141] Moreover, the Committee has also implemented an Advisory Group on Capacity Development, which

1134. Id., Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of human rights, particularly economic, social, and cultural rights, 19 Dec. 2018, A/HRC/40/57, para. 11.4.
1135. Lennard, 2008, p. 24. *See also* UN, ECOSOC Resolution 2004/69 on the Committee of Experts on International Cooperation in Tax Matters, 11 Nov. 2004.
1136. Lennard, 2009, p. 11. A reason was that most developed states rejected the proposal in order to defend the leading role of the OECD in tax matters (*see* Mosquera Valderrama, Lesage & Lips, p. 11).
1137. *See* UN, ECOSOC Resolution 2004/69 on the Committee of Experts on International Cooperation in Tax Matters, 11 Nov. 2004, decision (d) (iv).
1138. A list of the current members is accessible at http://www.un.org/esa/ffd/tax-committee/tc-members.html (last visited 15 Sept. 2017).
1139. Lennard, 2008, p. 24.
1140. For an overview, *see* UN, ECOSOC, Further strengthening the work of the Committee of Experts on International Cooperation in Tax Matters, E/2015/51, 22 Apr. 2015, p. 6.
1141. For more information about the subcommittee *see* http://www.un.org/esa/ffd/tax-committee/tc-subcommitte-beps.html (last visited 15 Sept. 2017).

aims at strengthening the technical assistance to developing states in tax matters.[1142]

4.3.4.3.3. *The publications of the Committee of Experts on International Cooperation in Tax Matters and their impact*

The Committee publishes at least two important documents in the field of tax law: the UN MC and the UN Transfer Pricing Guidelines. Both documents are not binding for the Member States. This means that in their treaties, states can deviate if they conceive that the solution in the UN MC is not feasible.

The UN MC and the OECD MC consist of many identical provisions, but important differences also exist. Generally speaking, the UN MC leaves more taxing rights to the state where the investment occurs and where the economic activity is. Therefore, the balance between the source and the residence country tends to favor the source country.[1143] The reason for this is that the focus of the work of the UN in tax matters considers – as already highlighted above – the needs of developing countries more strongly.[1144] The different results between the OECD MC and the UN MC obviously also relate to the different members of the two organizations and the purpose of the two respective Committees.[1145] Another focus of the UN is to develop simpler rules (e.g. transfer pricing) in order to allow developing states to apply these principles in a cost-efficient manner.[1146] Or, in other words, the Committee shall "[m]ake recommendations on capacity-building and the provision of technical assistance to developing countries and countries with economies in transition."[1147]

There have been two (or possibly three) important studies of the IBFD about the UN MC in practice, i.e. its impact on the treaty policy of UN and OECD

1142. For further details *see* http://www.un.org/esa/ffd/tax/documents/bgrd_cb.htm (last visited 15 June 2017).
1143. *See* Lennard, 2008, p. 25. For further details about the differences between the two Models *see* Lennard, 2009, p. 4 et seq.; Yaffar & Lennard, p. 624 et seq.
1144. *See* secs. 4.2.3.2.2. and 4.2.3.2.3. *See also* UN, ECOSOC, Resolution 2004/69, Committee of Experts on International Cooperation in Tax Matters, 11 Nov. 2004, sec. (d)(iv).
1145. *See*, for example, UN, ECOSOC, Role and work of the Committee of Experts on International Cooperation in Tax Matters, E/2012/8, 29 Feb. 2012, p. 5.
1146. *See* id., p. 6.
1147. UN, ECOSOC, Resolution 2004/69, Committee of Experts on International Cooperation in Tax Matters, 11 Nov. 2004, sec. (d)(iv).

states.[1148] Among others, the authors of the study demonstrate that it takes a number of years before a new provision in the model finds its way into treaty practice. This is not only true with regard to the UN MC, but also with regard to the OECD MC. However, the studies also show that there is a significant impact of the UN MC on the treaty practice between developing and developed states. However, Wijnen & de Goede, the authors of the study, even argue that the UN MC has gained importance as a standard among OECD countries. This means that OECD countries, even when signing a treaty with another OECD member country, more frequently refer to the UN MC than in the past. One reason might be that some provisions of the UN MC have also been introduced into the OECD MC.[1149]

As will be shown below,[1150] the OECD has emphasized the design of domestic rules, not only within the harmful tax competition project, but also recently in the BEPS Project. The UN has not rendered similar visible projects on the design of domestic tax rules compared to the OECD.[1151] This does not mean that the UN has had no impact on the design of domestic rules, since (i) the UN MC also affects the design of domestic rules, as states might, for example, try to align their domestic PE to the UN MC in order to avoid disparities, and (ii) that the Committee with its project on capacity building might also influence domestic regulation, particularly in developing countries.[1152]

4.3.4.3.4. *UN Conferences on Financing for Development*

4.3.4.3.4.1. Introduction

As we will see in the following sections, tax policy has become an important pillar of the debate on how to achieve sustainable development in the world. The goal of the following sections is to demonstrate what the reasons are for such an inclusion of tax policy into the financing for development debate and to explore the current status of such a debate. We will not, however, specifically focus on the techniques to achieve development goals through tax

1148. Wijnen & de Goede, p. 118 et seq.; Wijnen & Magenta, p. 524 et seq. *See also* Wijnen, de Goede & Alessi, p. 27 et seq.
1149. *See* Wijnen & de Goede, p. 144.
1150. *See* sec. 4.3.4.4.
1151. *See*, however, UN Handbook on Selected Issues in Protecting the Tax Base of Developing Countries (UN 2015).
1152. For more details *see* http://www.un.org/esa/ffd/topics/capacity-development-tax-cooperation.html (last visited 10 Jan. 2019).

policy decisions.[1153] This would be the task of a separate study. Moreover, the present study does not consider private initiatives steering tax policy as a means for development.[1154]

4.3.4.3.4.2. Monterrey Consensus

The conferences on financing for development were the outcome of a strong need by the global south for a new deal in development finance.[1155] It started with the Monterrey Consensus in 2002. The Monterrey Consensus was the result of a UN conference on financing for development held in 2002 in Monterrey, Mexico. In particular, it addresses ways and means to achieve the UN Millennium Goals, which were approved by the UN General Assembly in the so-called Millennium Declaration.[1156] The leading actions of the Monterrey Consensus were the following:[1157]

- mobilizing domestic financial resources for development;
- mobilizing international resources for development; foreign direct investment and other private flows;
- international trade as an engine for development;
- increasing international financial and technical cooperation for development;
- external debt; and
- addressing systemic issues.

Of particular importance for the present study is the action on mobilizing domestic financial resources for development as the link to domestic tax policy is obvious considering that a successful tax policy helps to mobilize domestic resources. However, some of the other actions might also require tax policy decisions. For instance, enhancing international trade as a separate action might require a reduction in cross-border distortions through avoiding double taxation.

1153. An intense debate exists over how developing states should design their tax systems in order to spur development (i.e. whether it is most effective to implement a broad-based VAT and a low-rate corporate income tax). Such debate has mainly been led by economists (e.g. Bird & Zolt, p. 73 et seq.; Keen & Mansour, p. 1 et seq.; Tanzi & Zee, p. 1 et seq.). *See* for a broader perspective Stewart, 2003, p. 160 et seq.

1154. Many academics have advised other countries on how to improve their domestic tax system to spur development. This was already the case in the post-World War II and the post-Colonial phase (*see*, for example, the work of Prof. Shoup, a U.S. academic who advised Japan on their tax system after World War II). For a more comprehensive overview on the existing cross-border advice toward developing countries, *see* Stewart, 2003, p. 151 et seq.

1155. Fomerand & Dijkzeul, p. 665.

1156. UN, Resolution adopted by the General Assembly, 8 Sept. 2000, A/55/L.2.

1157. UN, Report of the International Conference on Financing for Development, 18-22 Mar. 2002, A/CONF.198/11, para. 10 et seq.

With respect to the goal of mobilizing or increasing domestic financial resources, the UN report holds that such action requires an equitable and efficient tax system.[1158] Moreover, capacity building is key for developing countries in order to increase and protect domestic resources.[1159] However, the report is silent with respect to the question of what an "equitable and efficient tax system" means and how cooperation in tax matters could indeed mobilize domestic financial resources. In other words, the Monterrey Consensus is not yet suggesting any detailed scheme of tax policy recommendations that would enhance development across the globe.

4.3.4.3.4.3. The Doha Declaration

The Doha Declaration, endorsed by the General Assembly in 2008, reaffirmed the Monterrey Consensus in its entirety.[1160] The leading actions remained very similar as well.

For our purpose, reference should again be made to the action on mobilizing domestic financial resources as using tax policy to enhance development is part of such a measure. Here, the Doha Declaration states that signatory states "will continue to undertake fiscal reform, including tax reform, which is key to enhancing macroeconomic policies and mobilizing domestic public resources."[1161] Moreover, tax systems should be made more pro-poor.[1162] Also, importantly, the tax base should be broadened, and tax evasion should be combatted.[1163]

However, it is also held that each country is responsible for its tax system, but international cooperation should be supported.[1164] The suggestions for tax policy changes were not the core of the Doha Declaration but rather an integral part of the chapter on increasing domestic resources, and the reference to tax policy is slightly more detailed than in the Monterrey Consensus.

1158. UN, Report of the International Conference on Financing for Development, A/CONF.198/11, 18-22 Mar. 2002, para. 15.
1159. For more details, *see* id., para. 19.
1160. UN, Doha Declaration on Financing for Development: outcome document of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus as endorsed by the General Assembly, A/RES/63/239, 12 Dec. 2008, para. 2.
1161. Id., para. 16.
1162. Id.
1163. Id.
1164. Id.

4.3.4.3.4.4. Addis Ababa Action Agenda

A next step was the Addis Ababa Action Agenda, which was the outcome of the third conference on financing for development and was held in Addis Ababa in 2015. The final text was also endorsed by the UN General Assembly.[1165] The Addis Ababa Action Agenda refers to the 17 Sustainable Development Goals aimed at ending poverty and hunger by 2030. These Sustainable Development Goals were finally approved a few months after the conference by the UN General Assembly on 25 September 2015.[1166] They must be understood as the post-2015 goals replacing the Millennium Development Goals,[1167] and they should guide the work of the UN in the area of development in the years 2015-2030.[1168] Importantly, the Sustainable Development Goals are more comprehensive than the Millennium Development Goals, and they understand development as a "universal rather than a North-South project".[1169]

In Addis Ababa, the heads of state, government leaders, and high representatives reaffirmed the results of the Monterrey Consensus and the Doha Declaration.[1170] The Addis Ababa Action Agenda outlines action areas to achieve the Sustainable Development Goals. These actions, in a broad sense, do not deviate from the previous ones in the Doha Declaration.

1165. UN, Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda), Resolution adopted by the General Assembly, 27 July 2015, A/RES/69/313.

1166. For the precise content of the Sustainable Development Goals *see* the Annex to the Resolution A/RES/69/315. The Sustainable Development Goals were also included in the Resolution "Transforming Our World: The 2030 Agenda for Sustainable Development", A/RES/70/1, 25 Sept. 2015. The Conference in Addis Ababa happened at the final state of the broader negotiations on the Sustainable Development Goals (*see* the comprehensive overview of Dodds, Donoghue & Roesch, p. 1 et seq.).

1167. For some historical background, *see* Fukuda-Parr, p. 764 et seq.

1168. UN, Transforming Our World: the 2030 Agenda for Sustainable Development, Resolution by the General Assembly, A/RES/70/1, 25 Sept. 2015, para. 21. It has also been argued that the consensus on Sustainable Development Goals has also led to "greater alignment" between the work of the UN in the area of financing for development and the Bretton Woods Institutions, such as the World Bank or the IMF (*see* Murphy, p. 366). The present study does not specifically deal with the tax work of the IMF and the World Bank. Their recommendations toward developing countries have been of great importance for development policies in general (*see* Stewart, 2003, p. 156 et seq.). For evidence on how the Bretton Woods Institutions cooperate with the other UN bodies in tax matters, *see* Grau Ruíz, p. 83 et seq.

1169. Fukuda-Parr, p. 777.

1170. UN, Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda), 13-15 July 2015, endorsed by the General Assembly in its resolution A/RES/69/313 on 27 July 2015, para. 1.

However, from a tax perspective the Addis Ababa Action Agenda contains more detailed recommendations.

For instance, it is stated that the countries "will work to improve the fairness, transparency, efficiency and effectiveness of [their] tax systems."[1171] Moreover, nationally defined domestic targets and timelines for enhancing domestic revenues are welcomed.[1172] The countries also agreed to redouble their efforts in order to reduce illicit financial flows in the coming years. This includes combating tax evasion through international cooperation.[1173] Countries should work together to strengthen transparency. This specifically includes country-by-country reporting for multinational enterprises.[1174] Moreover, states should advance toward the automatic exchange of information to assist developing states, particularly the least developed states.

States agreed that in order to end harmful tax practices, they can engage in voluntary discussions concerning tax incentives.[1175] Such international tax cooperation "should be universal in approach and scope and should fully take into account the different needs and capacities of all countries."[1176] This is according to the Addis Ababa Action Agenda particularly true for the least developed countries, landlocked developing countries, small island developing states, and African countries.[1177] The signing countries, moreover, welcomed the efforts of the Global Forum and also took into account the work of the OECD and the G20 on base erosion and profit shifting.[1178]

The Addis Ababa Action Agenda shows that developed states are willing to improve the fiscal capacity of the least developed states.[1179] However, the Addis Ababa Action Agenda does not contain any suggestions for significantly reallocating taxing powers between source and residence countries.

In order to further highlight the importance of tax policy for domestic resource mobilization as a means to achieve sustainable development, some

1171. Id., para. 22.
1172. Id.
1173. Id., para. 23.
1174. Id., para. 27.
1175. Id.
1176. Id., para. 28.
1177. Id.
1178. It goes beyond the present study to review which actions and measures of the BEPS Project indeed consider the interests of developing states (*see* with further references Mosquera Valderrama, Lesage & Lips, p. 1 et seq.).
1179. *See* Meyer-Nandi, p. 10.

states agreed on the so-called Addis Tax Initiative, which will be briefly outlined in the following section.

4.3.4.3.4.5. The Addis Tax Initiative

The Addis Tax Initiative was signed by 41 states during the Financing for Development conference in Addis Ababa. Moreover, several organizations have also supported the initiative. By signing the Addis Tax Initiative, the participants "declare their commitment to implement the Addis Ababa Accord in the leading action of raising domestic public revenue, to improve fairness, transparency, efficiency and effectiveness of their tax systems."[1180] In particular, they agreed to the following three commitments:

– collectively doubling technical cooperation in domestic revenue mobilization;
– enhancing domestic revenue mobilization so as to spur development; and
– ensuring policy coherence.

The Addis Tax Initiative is not a binding international treaty but a soft law (i.e. a political commitment by the participating states). In order to join the initiative, countries must sign a letter of intent.[1181]

The Addis Tax Initiative has been joined by development partners, partner countries (i.e. developing states), and supporting organizations. Whereas partner countries have a strong interest in receiving technical assistance, development partners and supporting organizations, inter alia, share good practices and past experiences with these partner countries.[1182] Such integrated cooperation reflects the general working scheme of the Addis Tax Initiative. This brings us to the content of the three (partly overlapping) commitments.

The first commitment aims at more coordination between the partner countries and the development partners. The participating providers of support commit to collectively double their support for technical cooperation by

1180. Addis Tax Initiative, Financing for Development Conference, The Addis Tax Initiative – Declaration, p. 2.
1181. The letter is available online at https://www.addistaxinitiative.net/documents/ATI_Letter-of-Intent_EN.docx (last visited 18 Feb. 2019).
1182. Addis Tax Initiative, Fact Sheet, p. 3 et seq.

2020.[1183] The support will particularly focus on cross-border tax issues.[1184] This includes that partner countries are enabled to use the results of the international tax agenda, such as the BEPS Project and the standard with respect to the automatic exchange of information, but also that partner countries are integrated in the continuing global tax debate.[1185] However, the initiative further highlights specific challenges for partner countries in designing their domestic tax system.[1186] Inter alia, these challenges include decreasing tariffs due to trade liberalization, low taxpayer morale and poor governance due to corruption.[1187]

Support is generally needed to increase revenue mobilization. It is explicitly stated that states should undertake a "diagnostic assessment" of their tax system in order to define key areas of reform and reform measures but also in order to define areas of capacity building.[1188] The participating countries will share information about their support with the OECD Development Assistance Committee as well as the International Tax Compact.[1189]

The second commitment is very much linked to the outcome of the Monterrey Consensus and the Doha Declaration. The goal of enhancing domestic revenue mobilization is in line with the broader goal of attaining sustainable development and protecting and enhancing human rights.[1190] An important figure to measure the level of domestic revenue mobilizations is the tax-to-GDP ratio, which is also used as the guideline in the publications

1183. Addis Tax Initiative, Financing for Development Conference, The Addis Tax Initiative – Declaration, p. 2. *See* for further details about how the support of the development partners is calculated Addis Tax Initiative, ATI Monitoring Report 2015, p. 28 et seq.
1184. Addis Tax Initiative, Financing for Development Conference, id.
1185. Id., p. 3.
1186. *See* with reference to the report "From Billions to Trillions" of the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Reals Resources to Developing Countries, DC2015-002.
1187. *See* for further details Addis Tax Initiative, Financing for Development Conference, The Addis Tax Initiative – Declaration, p. 2.
1188. Id., p. 3.
1189. Id., p. 2.
1190. In sec. 4.3.4.3.1. we highlighted the work of the Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of all human rights – particularly economic, social, and cultural rights. There are obviously mutual goals between the work of the Independent Expert in relation to protecting and enhancing human rights and attaining the Sustainable Development Goals, as intended by the Addis Tax Initiative. One reason is that the Sustainable Development Goals were approved in order to realize human rights. This is indicated in the Preamble to the 2030 Agenda (UN, Transforming Our World: the 2030 Agenda for Sustainable Development, Resolution by the General Assembly, A/RES/70/1, 25 Sept. 2015). For a seminal analysis concerning the interaction of development goals and the protection of human rights, *see* Darrow, p. 55 et seq.

of the Addis Tax Initiative.[1191] It is specifically highlighted in the Addis Tax Initiative that a holistic approach is necessary (i.e. not only focusing on tax revenues but also "encompassing mobilization and management of public budgets and private resources and development of an inclusive domestic financial sector").[1192] Moreover, the partners agreed to certain key principles, which are outlined in the Annex of the Addis Tax Initiative. These principles include that the partners "enhance cooperation to combat tax evasion, fight corruption, tackle illicit finance, and promote good financial governance, transparency and accountability."[1193]

Lastly, the third commitment aims at achieving policy coherence. It is highlighted that the private sector must also respect the legal framework[1194] (i.e. the public efforts taken could be undermined if the private sector does not respect "the spirit as well as the letter of tax laws").[1195] The initiative explicitly refers to Chapter XI of the OECD Guidelines for Multinational Enterprises in order to further define what this means. The OECD Guidelines, inter alia, state that this does not require that excessive tax payments be made but that enterprises provide the tax authorities with relevant information for the determination of the (appropriate) tax burden.[1196] Moreover, the commentary to the OECD Guidelines states that "[a]n enterprise complies with the spirit of the tax laws and regulations if it takes reasonable steps to determine the intention of the legislature and interprets those tax rules consistent with that intention in light of the statutory language and relevant, contemporaneous legislative history."[1197] Enterprises should therefore refrain from transactions with tax consequences that do not reflect the underlying economic rationale of such a transaction.[1198] Besides these statements, the Addis Tax Initiative recommends that a chapter similar to Chapter XI on Taxation in

1191. *See*, for example, Addis Tax Initiative, ATI Monitoring Report 2015, p. 48. However, it is disputed whether the tax-to-GDP ratio is indeed an appropriate measure for the level of development (*see* Stewart, 2003, p. 175 et seq.).
1192. Addis Tax Initiative, Financing for Development Conference, The Addis Tax Initiative – Declaration, p. 4.
1193. Id., p. 5.
1194. *See* id., p. 4. It is therefore not so much aiming at policy coherence between several state bodies, but more between the private sector and the state.
1195. Id. *See also* Meyer-Nandi, p. 12.
1196. OECD, OECD Guidelines for Multinational Enterprises, 2011 Edition (OECD 2011), Chapter XI. Taxation, para. 1.
1197. Commentary to the OECD Guidelines for Multinational Enterprises, 2011 Edition (OECD 2011), para. 100.
1198. Id. As mentioned in sec. 1.2., the present study does not deal specifically with the question of what the normative obligations are of corporate representatives. Sec. 12.5. specifically reviews the question of whether anti-abuse measures have a normative validity. Such measures would partly prohibit these transactions.

the OECD Guidelines for Multinational Enterprises be included in the UN Global Compact.[1199]

These rather general remarks do not yet answer the question of how the partner countries should fulfill their commitments most effectively. However, it would go beyond the present study to develop detailed guidelines. Issues such as taxpayer registration, taxing strategic sectors and risk management are some of the most relevant topics.[1200] Moreover, we will not discuss how development partners may adapt their tax treaty policy (including their policy regarding exchange of information) in order to fulfill their commitments under the Addis Tax Initiative.[1201]

4.3.4.3.4.6. Intermediate conclusions

The importance of the conferences on financing for development cannot be overestimated. The Monterrey Consensus, the Doha Declaration and the Addis Ababa Action Agenda are key documents of the UN in the debate on improving welfare in the world and in developing states in particular. Interestingly, tax policy has gained importance since the Monterrey Consensus, as has the goal of enhancing domestic resources, although the Monterrey Consensus in 2002 already highlighted the importance of domestic resource mobilization through effective and equitable tax systems. A particular feature of the recent debate is that the recommendations have become more detailed and more comprehensive.[1202]

It is obvious that the debate on fiscal transparency at the level of the Global Forum and on base erosion and profit shifting at the level of the OECD/G20 in the years after the financial crises has had a significant influence on the debate of enhancing sustainable development. In parallel, in the introduction, we highlighted the work of the Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of all human rights – particularly economic, social and cultural rights.[1203] In his work, a similar development can be moni-

1199. The UN Global Compact is a voluntary code of conduct for multinational enterprises committing to act with universal principles on human rights, labor, environment and anti-corruption. More information is available at https://www.unglobalcompact.org (last visited 19 Jan. 2019).
1200. For further details, *see* Addis Tax Initiative, ATI Monitoring Report 2015, p. 8.
1201. *See*, for instance, from a Swiss perspective, Matteotti, 2017/2018, p. 680 et seq.
1202. Even before these conferences, tax policy was considered to be an important piece of development policy at the level of the UN. Stewart traces these approaches back to the 1950s (Stewart, 2003, p. 155 et seq.).
1203. *See* sec. 4.3.4.3.1.

tored since tax policy suggestions, such as an increase in fiscal transparency and anti-BEPS measures, have become more imperative. The latter is not surprising, as the means to protect human rights (particularly economic and social rights) and attain the Sustainable Development Goals overlap. It seems that tax policy and domestic resource mobilization are key elements of both debates. Interestingly, the Independent Expert is even more detailed in his recommendations on how domestic tax systems should address inequalities, suggesting, for instance, a higher taxation of the richest and the use of progressive tax systems.[1204] However, neither the Addis Ababa Action Agenda nor other publications of the UN suggest any major amendment of the existing allocation rules of the current international tax regime.

4.3.4.4. The OECD as a body of international tax law legislation

4.3.4.4.1. *In general*

The OECD was created in 1961 and is an intergovernmental organization. From a legal perspective, all 34 member countries of the OECD are equal and the EU is a quasi-member of the OECD.[1205] The articles of the OECD Convention and the Rules of Procedure of the organization are the key sources of organizational rules of the OECD as a body of international law. The aim of the OECD is:

> (a) to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
>
> (b) to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
>
> (c) to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.[1206]

The main bodies of the OECD are the Council, the Secretary-General, the Secretariat and many committees and working groups.[1207] The Council consists of the representatives of all member countries (including a

1204. *See* UN, Guiding principles on human rights impact assessments of economic reforms, Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of human rights, particularly economic, social, and cultural rights, 19 Dec. 2018, A/HRC/40/57, para. 9.3.
1205. *See*, with further details about the development of the membership of the OECD, Woodward, p. 1 et seq.
1206. Art. 1 OECD Convention.
1207. *See generally* Woodward, p. 43.

representative of the European Commission).[1208] The Secretary-General, as the head of the Council, is the "external face"[1209] of the OECD for all intents and purposes. The Secretariat, on the other hand, exercises all management functions and is divided into various departments and directorates. Furthermore, semi-autonomous bodies and the OECD committees are also part of the Secretariat. Non-member countries of the OECD are not part of the Council, although they might take part in the work of several of the committees and other bodies. These non-member countries and international organizations observe the work of the various (sub-)bodies of the OECD. Regarding the BEPS Project, these non-member countries were even part of the OECD working parties.

From a tax perspective, the Centre for Tax Policy and Administration is a department of particular interest. It currently consists, inter alia, of the Committee on Fiscal Affairs (CFA) and several sub-groups. The Committees issue various policy advisories and other instruments that could have the character of soft law.[1210] These Committees are created by the Council based on article 9 of the OECD Convention. Non-member countries of the OECD are not part of the Council, but they might take part in the work of several of the committees and other bodies. The focus of the following section is on the CFA, one of the most important designers of the international tax regime.[1211]

4.3.4.4.2. *The CFA*

As mentioned above, the CFA consists of many working and advisory groups. Some of these are highly important with respect to international tax policy. For instance, Working Party 1 on tax conventions and related questions was created in 1971 in order "to act as a forum for the discussion of issues related to the negotiation, application and interpretation of tax conventions, to examine proposals for the modification of the OECD Model Tax Convention and to draft appropriate recommendations for dealing with the issues it has examined and for periodic updates to the Model Tax Convention."[1212]

In order to describe the objective and methods of the CFA, as the most important committee within the OECD, it is vital to refer to the underlying

1208. Art. 7 OECD Convention.
1209. I owe this term to Woodward, p. 49.
1210. *See* id., p. 52.
1211. *See* Picciotto, 2013, p. 1105.
1212. Extract from document DAFFE/CFA 998, § 61, which is published in OECD, Directory of Bodies of the OECD (OECD 2012), p. 260.

legal documents. The CFA draws its competence from a delegation decision (i.e. a mandate) of the Council, which has the following wording:[1213]

> a) The overarching objective of the Committee on Fiscal Affairs (hereinafter called "The Committee") is to contribute to the shaping of globalisation for the benefit of all through the promotion and development of effective and sound tax policies and guidance that will foster growth and allow governments to provide better services to their citizens. Its work is intended to enable OECD and non-OECD governments to improve the design and operation of their national tax systems, to promote co-operation and co-ordination among them in the area of taxation and to reduce tax barriers to international trade and investment.
>
> b) In light of this objective, the Committee shall:
>
> 1. facilitate the negotiation of bilateral tax treaties and the design and administration of related domestic legislation;
>
> 2. promote communication between countries and the adoption of appropriate policies to prevent international double taxation and to counteract tax avoidance and evasion;
>
> 3. encourage the elimination of tax measures which distort international trade and investment flows;
>
> 4. promote a climate that encourages mutual assistance between countries and establish procedures whereby potentially conflicting tax policies and administrative practices can be discussed and resolved;
>
> 5. support domestic tax policy design through the development of high quality economic analysis of tax policy issues, comparative statistics and comparisons of country experiences in the design of tax systems;
>
> 6. improve the efficiency and effectiveness of tax administrations, both in terms of taxpayer services and enforcement. Support the integration of Partners into the international economy by strengthening policy dialogue with them to increase their awareness of and contribution to the Committee's standards, guidelines and best practices.[1214]

As we will demonstrate in the second and third parts of the present work, many of these objectives seem to be valid also from a normative perspective. For instance, the most interesting is probably objective 1 above, i.e. "support the development of efficient and equitable tax systems." The CFA, according to such regulation, should therefore enhance equitable tax systems. We need to discuss what this means in more detail below.[1215] Regarding

1213. OECD, Resolution of the Council C(2008)147 and C/M(2008)20, item 285. The resolution is also published in OECD, Directory of Bodies of the OECD, id., p. 253 et seq.
1214. OECD, Resolution of the Council C(2008)147 and C/M(2008)20, item 285. The resolution is also published in OECD, Directory of Bodies of the OECD, id.
1215. *See* chapter 11.

the methods to be used in order to achieve these objectives, the relevant mandate states the following:

> In order to achieve these objectives, the Committee will focus its work on delivering outputs of high quality and with high policy impacts and shall regularly assess whether these targets are being met. In particular, the Committee shall:
>
> a) develop standards, guidelines and best practices in areas where international coordination is desirable and monitor the practical implementation of them and other recommendations;
>
> b) provide a forum for discussions by senior policymakers and tax administrators, and where appropriate the business community and other parts of civil society, of international and domestic tax policy and administration issues and emerging issues in a global economy which require a response from senior tax policy makers;
>
> c) supply OECD countries with internationally comparable tax statistics and comparisons of the major taxes used throughout the OECD area, and provide strategic analysis of important tax policy and administration issues for use in publications, briefs, and the like.[1216]

It is important to note that the CFA created a subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries in 2013. Inter alia, the subcommittee published a questionnaire on how developing countries deal with the issues of base erosion and profit shifting.[1217]

4.3.4.4.3. *The publications of the OECD in tax matters and their impact*

It is important to note that the purpose of the OECD is to advise and consult, and not to issue directives or similar documents.[1218] According to article 3(b) of the OECD Convention, member countries are obliged to consult each other on a continuing basis. This system of consultations, surveillance and peer review, as mentioned by Woodward, does "not lead to overnight resolutions but over a long period of time the values, ideas, and principles agreed at the OECD become norms which percolate the national and international policymaking circuitry."[1219] Besides, if the member countries are

1216. OECD, Resolution of the Council C(2008)147 and C/M(2008)20, item 285. The resolution is also published in OECD, Directory of Bodies of the OECD (OECD 2012), p. 255.
1217. *See* Peters, 2015, p. 375 et seq.
1218. *See* Woodward, 2009, p. 62.
1219. Woodward, 2009, p. 81.

of the opinion that certain areas should be regulated formally, they have the opportunity to sign a binding agreement.

From a legal perspective and deviating from other international organizations, decisions of the OECD can have either a binding or non-binding character.[1220] This is relevant from a tax perspective, as the OECD, for instance, could theoretically not only publish a non-binding commentary, but could also publish a binding commentary to the OECD MC. This needs to be considered, as it has an influence on the value of the OECD Comm. as an interpretation instrument.[1221]

Moreover, the OECD publishes several hundred reports a year, but it does not have any reward and sanction system to enforce any of its suggestions. Nevertheless, the OECD has had a significant influence as an international tax policy institution. The most important publications, from a tax perspective, are the OECD MC and OECD Comm. These documents have been updated regularly and, as we have shown already,[1222] these publications have a great influence on actual double tax treaties and their interpretation. In fact, they are the backbone[1223] of most double tax treaties. Furthermore, the OECD Transfer Pricing Guidelines are widely applied in many jurisdictions worldwide.[1224]

From a tax perspective, the OECD has also launched specific projects with an influence on domestic tax policy, and not only with the aim of affecting the existing double tax treaty network. The most important initial projects in this respect were the publication of the Report on Harmful Tax Competition[1225] and the publication of the Partnership Report.[1226] Both reports intended to align domestic tax policies in order to avoid harmful tax competition and to align practices with respect to the treatment of partnership in order to avoid qualification conflicts. These reports and, in particular, the entire project on

1220. *See* art. 5a) of the Convention on the Organisation for Economic Co-operation and Development, 14 Dec. 1960.
1221. We will not specifically deal with interpretation methodology. Our opinion with respect to the importance of the OECD Comm. as an interpretative means was already outlined in another instance (*see* Hongler, 2012a, p. 212 et seq.).
1222. *See* sec. 4.2.4.
1223. Brauner, 2003, p. 317. *See also* Christians, 2010, p. 20. *See*, for example, regarding the impact of the first OECD MC of 1963 and its impact on the Swiss tax policy, Locher, 2005, p. 68.
1224. *See* sec. 4.2.3.3.4. *See* for a recent overview Rocha, p. 28 et seq.
1225. OECD, Tax Competition, An Emerging Global Issue (OECD 1998).
1226. OECD, The Application of the OECD Model Tax Convention to Partnerships (OECD 1999).

harmful tax competition, had a significant impact on domestic legislation and administrative practices.[1227]

The latest and thus far most important tax project is the BEPS Project. In order to demonstrate its impact on domestic tax measures, some empirical studies would be necessary to determine how the domestic legislation process is influenced by soft law published by the OECD. This would go beyond the present study, although the OECD/G20 has had a considerable influence on domestic tax policies in various countries.[1228] With respect to this author's home country, the impact of the BEPS Project was significant, as the entire corporate tax reform III project, in particular, was aligned to the publications within the BEPS Project, and further legislative projects were launched based on the BEPS outcome.[1229] Of course, the influence in some countries might be minimal, as these countries are the actual policy drivers or "norm makers" at the level of the OECD and not "norm takers". Therefore, these countries might already have certain BEPS-related regulation and might not be forced to further change their domestic tax code.[1230]

We have shown the importance of the publications of the OECD on both the tax policy of member countries and non-member countries, as well as on the design of domestic tax policy. As we have seen, there would be the opportunity to publish binding regulation, but the OECD in general uses non-binding instruments to steer tax policy. Therefore, the significant influence of the OECD – not only in the field of taxation – is due to the publications of soft law.

4.3.4.5. What are the reasons for an enhanced use of soft law?

One important reason for implementing soft law and not binding hard law is that the implementation of a rule through a non-binding instrument is significantly faster, so the long-lasting process of deliberating, signing and ratifying of, for instance, a multilateral convention can be avoided.[1231]

1227. E.g. Switzerland abolished the administrative practice with respect to service companies and has since then basically followed the OECD Transfer Pricing Guidelines (Locher, 2005, p. 82, with further references).
1228. *See*, for example, most famously, the publication and implementation of the ATAD within the EU. *See* http://europa.eu/rapid/press-release_IP-16-159_en.htm (last visited 10 Feb. 2019).
1229. E.g. for a detailed overview on the impact of the BEPS Project in Switzerland *see* Hongler, 2016, p. 100 et seq.
1230. For further details from a Chinese perspective *see* Li, 2015, p. 355.
1231. Blokker, p. 17 et seq., or regarding soft law within the EU *see* Gribnau, p. 76. These questions are obviously not limited to tax law. E.g. regarding international environmental

However, regarding the timing, it should not be underestimated that the implementation process of non-binding provisions into binding domestic law or international treaties might also demand a certain time frame and the timing argument might, as a consequence, not always be persuasive.

Soft law might also allow more experiments and creative solutions than binding instruments,[1232] and soft law is used if the international organization lacks the competence to issue binding instruments. From a mere pecuniary perspective, the costs to implement (and negotiate) hard law might also be higher than the costs of agreeing on soft law.[1233] Moreover, from a sovereignty perspective, soft law has the major advantage that states do, in principle, not lose their authority.[1234] Therefore, states might choose soft law instead of hard law in order to avoid a domestic ratification process. Soft law might also be used as a matter of "compromise between groups seeking a treaty and those seeking to avoid any commitment."[1235]

From a practical perspective, soft law might be used if there is no authority with enforcement power at an international level. Therefore, the increased use of soft law instruments within international tax law is triggered by the missing institutional framework to achieve binding rules on some of the most challenging issues of international tax law.[1236] This aspect, i.e. the increased use of soft law due to a missing institutional order, is discussed in international relations theory.[1237] From a tax perspective, the recent trend toward the use of soft law within international tax law has also been triggered by new governance mechanisms, according to which the OECD and the G20 try to harmonize or at least coordinate the tax systems in various jurisdictions.[1238]

Therefore when it is not feasible to achieve such a harmonization or coordination through binding instruments, soft law steps in.[1239] It seems obvious, however, that soft law (at least as published by the OECD/G20) is mainly

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law *see* Friedrich, p. 135, or with regard to the work of the WIPO *see* Kwakwa, p. 179 et seq. On the flexibility argument *see* Guzman, 591 et seq.

1232. Thirlway, 2014, p. 164, with further references. *See also* Guzman, p. 591 et seq.
1233. Abbott & Snidal, p. 50 et seq. *See also* Christians, 2007, p. 332.
1234. *See generally* Abbott & Snidal, p. 52 et seq. *See also* Guzman, p. 592.
1235. Guzman, p. 593.
1236. *See* Cockfield, p. 181.
1237. For further details from a tax perspective *see* Dean, p. 537 et seq.; Ring, 2010b, p. 649 et seq. *See also* Grinberg, 2016a, p. 19 et seq.
1238. *See*, with regard to soft law within the EU, Gribnau, p. 71.
1239. *See* Brodzka & Garufi, p. 400.

used to achieve new rules instead of preserving the existing ones.[1240] Or, according to Pistone,[1241] soft law has actually become the "main conveyor of international tax coordination around the world."

4.3.4.6. Soft law and its effectiveness

At first glance, soft law is by no means as effective as hard law due to the lack of obligation toward the involved parties and the lack of credibility. Nevertheless, if soft law is used in a way that it requires not de jure, but de facto certain behavior of state actors, it might have the same impact as hard law. This can be true for various reasons.

First of all, soft law can be combined with direct coercive measures taken by other bodies of international law if a state does not implement the recommended rule, i.e. is not compliant.[1242] For instance, assuming that several states agree that cross-border fiscal transparency is necessary, and these states publish a recommendation on the design of domestic and treaty law to achieve such a goal, such recommendations to implement measures to achieve fiscal transparency would qualify as soft law and could be combined with the threat of blacklisting countries that are not compliant. The non-compliant states might be forced to follow such a soft law rule due to the detrimental effect of the blacklisting on its economy. This has been the case regarding the implementation of cross-border exchange of information, as the G20 agreed to take measures against non-cooperative tax havens, or in the words of the G20:

> We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information.[1243]

1240. *See* Friedrich, p. 134, with further references to Fatouros.
1241. Pistone, 2010, p. 101.
1242. *See* Verdross & Simma, § 656, regarding the "Declaration on the granting of Independence to colonial countries and peoples". These measures would generally require a monitoring process in order to demonstrate which states are compatible (*see* on soft law and monitoring processes from a tax perspective Grinberg, 2016a, p. 20). *See also* Grinberg, 2016b, p. 1178 et seq.
1243. G20, London Summit – Leader's Statement, 2 Apr. 2009, para. 15. For more details about the involvement of the Global Forum on Fiscal Transparency *see also* Mosquera, p. 365 et seq.

A global peer-review process or a similar monitoring mechanism could provide the necessary information on which states are compliant and which states are not.[1244]

Secondly, compliance with soft law is also achieved through other factors, such as the pressure of public opinion or, positively speaking, soft law can be effective due to participation incentives.[1245] Therefore, a state might be forced to follow, for instance, a recommendation of the UN in the field of humanitarian law due to the pressure by its citizens or public opinion, respectively. Therefore soft law may not create a legal, but rather a moral obligation.

Thirdly, another possibility would be that soft law is structured in a way that states are forced to implement the recommendations, as they would otherwise not face direct disadvantages, but rather indirect negative consequences. The latter means that coercion is not a direct coercion by other states, but the pressure on compliancy is achieved through indirect means, for instance, a systematic element. For example, the OECD/G20 suggested the introduction of so-called linking rules to eliminate or significantly reduce hybrid financing structures.[1246] By proposing two different and lexical linking rules, states might be obliged to introduce at least the first linking rule (denial of deduction) in order not to lose tax revenue through the application of the second linking rule (inclusion) in the recipient state.

Fourth, soft law might be more effective if the affected persons or states are participating within the negotiation process of new rules of international soft law, such as an international standard.[1247] This might create a moral obligation to implement a certain recommendation, as a state was part of the development of such a recommendation. In this case, there might be a commitment among states or other bodies of international law that a certain rule should be implemented. States are not legally bound through their commitment, but they are somehow indebted to the other states, as these could at least have certain expectations regarding the behavior of the committing

1244. *See*, e.g., Christians, 2016, p. 1618 et seq.
1245. On participation incentives, see Grinberg, 2016a, p. 21 et seq.
1246. OECD/G20, Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2015 Final Report (OECD 2014), p. 23 et seq.
1247. *See* Dourado, p. 184 et seq. The tension between legitimacy and soft law is obvious and it requires a detailed analysis of institutional procedures of how soft law is created. As already mentioned in the introduction (*see* sec. 2.1.6.), however, this goes beyond the present study. For instance, a question would be which parties are to what extent involved in the drafting process. *See* in this respect on multistakeholderism Kaufmann, p. 375 et seq.

state.[1248] Of course, soft law is also more effective if the "preferences align and distributive problems are largely absent".[1249] In other words, if the involved states have the same interests, soft law might be more effective.

To sum up, soft law seems to have several advantages, but compared to hard law, it is presumably less effective due to the lack of a legal obligation. If soft law is combined with either direct or indirect coercive measures, however, it can nevertheless have a similar impact as hard law. The latter finds further support if soft law is worded precisely and published by the competent and legitimate authority.

4.3.4.7. Justice and soft law – Some concluding remarks

As was shown earlier, soft law is not a binding source of international law and, therefore, we do not see any specific validity reasons, such as the consent of states or morality. Consent among states is not required to create international soft law, as even drafts of recommendations of international organizations can qualify as soft law.[1250] Moreover, moral or ethical values are not of constituting importance for the validity of soft law, as even highly unjust soft law would still qualify as soft law based on our understanding of the term "soft law".[1251] However, of course, this has no direct legal impact, as soft law is not binding and states are generally not obliged to follow such presumably unjust provisions. Nevertheless, as was shown, soft law that follows ethical values and moral principles might be more effective in terms of state obedience.[1252]

From a tax perspective, it was shown that the OECD and the UN, together with a few related bodies, such as the Global Forum or the Inclusive Framework, are the main issuing bodies of international soft tax law. We have also shown that both the OECD and the UN's constituting conventions suggest that the organizations have normative goals, such as the protection of peace as the main goal of the UN and, inter alia, "to achieve the highest sustainable economic growth … and rising standard of living" in the case of the OECD.[1253] Moreover, the specific committees might have further goals,

1248. *See* Thürer, 1985, p. 445 et seq.
1249. Grinberg, 2016b, p. 1163.
1250. *See* sec. 4.3.4.1.
1251. *See* id.
1252. *See* sec. 4.3.4.6.
1253. Art. 1(a) of the Convention on the Organisation for Economic Co-operation and Development, 14 Dec. 1960.

such as supporting developing countries as an important aim of the UN Tax Committee. However, notwithstanding the fact that both organizations seem to follow moral or value-based goals, it is not guaranteed that the publications of these organizations lead to more justice within the international tax regime and that they can be considered as guidance on how to enhance justice in international tax law. This is mainly due to three reasons.

First of all, the underlying goals of both the OECD and the UN are not sufficiently outlined in order to render a final judgment of whether and how justice is enhanced within the international tax regime by these goals. For instance, the protection of peace as the main goal of the UN might not provide for detailed guidance on how the international tax regime should be drafted in order to protect international peace. Moreover, the support of developing countries as intended by the work of the UN Tax Committee but also as intended by the conferences on financing for development might not necessarily lead to more justice in the international realm, unless it is further outlined why this is indeed the case. Prima facie, it seems obvious that developed states should support developing states, however, we will in Part IV further deal with the question of whether there is (and to what extent) indeed a moral duty to support developing states in the quest for justice or whether global justice does not, per se, require a general support of developing states by developed states.[1254]

Secondly, the recent soft law projects, particularly those of the OECD, lack a reference to the ultimate and value-based goals of the organizations. This means that it is not clear, for instance, whether the recommendations of the OECD within the BEPS Project will indeed lead to a higher standard of living and whether they will at the same time help "to achieve the highest sustainable economic growth", as the goals of the OECD would require. In other words, it is not guaranteed that the soft law recommendations of the UN and the OECD indeed fulfill one of their value-based goals, as the publications of these organizations are often silent in this respect. However, the publications of the UN might sometimes be more detailed on the question of how they are indeed in line with the value-based aims of the UN, such as, in particular, the support of developing states as a major aim of the tax work of the UN is often outlined in detail before a certain recommendation is made.[1255] However, the OECD publications are often silent when it comes

1254. *See*, for instance, secs. 11.5.2.2. or 12.2.2.3.1.
1255. For instance, the benefits and costs of tax treaties are outlined in detail in the UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (UN 2016), p. 13 et seq.

to their conformity to the underlying goals of the OECD.[1256] Moreover, it seems that both the UN and the OECD, as the two most important soft tax law-issuing bodies, do not have an internal review process to decide whether a certain recommendation indeed follows their underlying goals.

And thirdly, the recommendations of the UN and OECD, despite being formally in line with the goals of the organizations, might be biased, as the OECD tax agenda, in particular, is driven by representatives of the tax authorities. In other words, even though the OECD may claim that a certain recommendation is justified, as it increases the standard of living in line with the goals of the OECD, it might be biased, as it would reflect the opinion of tax authorities on how the standard of living should be increased. UN work is more driven by non-biased experts, but it can still not be assumed that their result might not also be biased in a certain direction. However, if the recommendation derives from a procedure that follows an ideal of procedural justice, it could be claimed that the outcome of such procedure is just. However, an important limitation of the present study is, as mentioned,[1257] that procedural theories of justice are not the main focus.

Additionally, we have shown that the use of soft law combined with direct or indirect coercive elements might even be a cause for the presumed perception that the international tax regime is unjust, i.e. it reflects one of the outlined justice deficiencies.[1258] Moreover, soft law does not necessarily help to resolve the mentioned justice deficiencies of international law.

4.3.5. Judicial decisions and legal writing

Neither judicial decisions nor legal writings are formal sources of international law, but they can be evidence of law or material sources of law.[1259] Judicial decisions are mentioned as one potential source of international law in article 38(1)(d) of the ICJ Statute. Accordingly, the ICJ shall apply "subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law."

1256. *See*, for example, the BEPS Action Plan as the core steering document in the last decade, which in its introductory remarks is more or less silent regarding the question of whether the suggested BEPS actions will indeed achieve the goals of the OECD, for instance, to increase the general well-being (*see* OECD, Action Plan on Base Erosion and Profit Shifting [OECD 2013], p. 7 et seq.).
1257. *See* sec. 2.1.6.
1258. *See* sec. 1.5.
1259. With respect to judicial decision, *see* Boas, p. 110; Crawford, p. 37.

Article 59 of the ICJ Statute mentions, however, that the decisions of the ICJ are not binding beyond the parties of a specific case. Furthermore, the ICJ itself acknowledges that depending on the reason, it can deviate from earlier decisions.[1260] Another question relates to the kinds of decisions that qualify as court decisions according to article 38(1)(d) of the ICJ Statute. Decisions of the ICJ, as the highest authority within international law, are covered.[1261] Furthermore, national decisions can also be a (material) source of law according to article 38 of the ICJ Statute.[1262]

From a tax perspective, and thinking beyond the scope of the ICJ Statute, decisions of foreign courts have and will continue to play an important role with respect to the interpretation of double tax treaties and beyond. This is true if, inter alia, courts face the issue of interpreting a term within a double tax treaty that should be understood autonomously, i.e. independent from domestic law.[1263] In this case, the court must develop an interpretation detached from a domestic understanding. However, the goal of the present study is to determine how to enhance justice within the international tax regime and not how to enhance justice in a judicial process. However, in Part IV we will also approach the question of whether justice would require the implementation of a mandatory arbitration system within the international tax regime.[1264]

4.3.6. Equity

According to article 38(2) of the ICJ Statute, paragraph 1 of the same article "shall not prejudice the power of the Court to decide a case *ex aequo et bono*, if the parties agree thereto". This means that if there is consent among parties, the interpretation of a provision can also go beyond the wording (*contra verba legis*). In such cases, equity can be an actual source of international tax law. This is only valid, however, if the law (e.g. a treaty) allows for such an *ex aequo et bono* decision. According to Thirlway, the ICJ has never referred to article 38(2) of the ICJ Statute.[1265] Furthermore, if the law does not provide for a solution at all, a judge might refer to equity

1260. ICJ, Case concerning the Land and Maritime Boundary between Cameroon and Nigeria, p. 21.
1261. Thirlway, 2014, p. 120.
1262. Boas, p. 110 et seq.; Crawford, p. 41.
1263. In German-speaking countries, the term "*Entscheidungsharmonie*" is sometimes used (*see generally* Hongler, 2012a, p. 201 et seq.).
1264. *See* sec. 12.4.
1265. Thirlway, 2014, p. 104. However, *see* ICJ, Case concerning the Frontier Dispute (*Burkina Faso v. Republic of Mali*), p. 17 et seq.

praeter legem. If a situation indeed occurs in which the law does not provide for a solution, equity *praeter legem* might not be a specific source of law, but rather a general principle of international law, as provided for in article 38(1)(c) of the ICJ Statute.[1266]

Equity itself is a widespread principle applied within domestic law as an interpretation method. Obviously, equity is also relevant as an interpretation element at an international level, in the sense that if two (or more) interpretation possibilities exist, a court might apply an interpretation result that is fair and equitable. In this scenario, the law itself requires the application of equity as an interpretation element *infra legem*.[1267] For instance, if a tax treaty provides for an arbitration clause in the sense of article 25(5) of the OECD MC, the competent court shall not go beyond the wording of a treaty solely based on equity if the treaty itself does not provide for such a reservation. However, equity could be relevant for an arbitration court as an element of interpretation *intra verba legis*.[1268]

4.4. The international tax regime and its constitutional content

4.4.1. Some preliminary methodological remarks

As has been shown above,[1269] the modern system of sovereign states has developed since and before the Westphalian Peace without a formal international constitution-like document, even though some authors refer to the UN Charter and highlight its constitutional features.[1270]

In the previous sections, we outlined the content and validity of the different sources of the international tax regime, per se. However, this still seems insufficient to render a normative review and conclude that the international

1266. Thirlway, 2014, p. 110.
1267. The different kinds of equity are also outlined by the ICJ in ICJ, Case concerning the Frontier Dispute *(Burkina Faso v. Republic of Mali*), p. 17 et seq.
1268. *See* Züger, p. 45. *See also* Knechtle, p. 147, with respect to equity within the mutual agreement procedure.
1269. For further details *see* sec. 3.4.
1270. *See generally* Fassbender, 2009, p. 1 et seq.; Kleinlein, p. 29 et seq. German-speaking scholars often distinguish between a potential formal source of constitutional rules and principles, such as potentially the UN Charter ("*formeller Verfassungsbegriff*") and material or substantive content of an international constitution ("*materieller Verfassungsbegriff*") (e.g. Scheyli, p. 98 et seq.).

tax regime as a legal regime does not provide for sufficient guidance on how to enhance justice and how to mitigate the presumed justice deficiencies. More legal guidance could be derived from an analysis of whether the international tax regime consists of constitutional elements that have not been captured in the previous sections. With particular reference to the historical analysis of international law in general,[1271] and considering the potential transformation of the world into a more integrated international legal community,[1272] the following sections focus on the content of such a potentially constitutional international framework. Particular reference is made to the so-called international tax or fiscal constitution. The thesis for the following section is that the international tax regime has shifted from a mere coordinative system into a more constitutive regime considering, inter alia, certain individual rights and community interests.

However, the outcome of a chapter or study on constitutionalism highly depends on its purpose or underlying thesis.[1273] For instance, there have been studies about constitutionalism and realism at an international level. These studies review the question of whether international law must not only be seen as a mere reflection of the power and interest of different states, but whether there is indeed a potential value-based constitution-like framework at an international level above any consent-based rules. Another approach would be to analyze whether constitutionalism at an international level is in line with the democratic needs of the domestic society, i.e. whether it is right to claim that certain value-based rules exist at an international level, even though these were not agreed through a formal domestic democratic process.[1274] Or, from the perspective of legal theory, it could be reviewed whether there is indeed something like constitutional law at an international level, i.e. whether such international constitutional law is effective, as constitutional law ought to be. Another topic would be to outline the legal interaction between a domestic constitution and a potential (at

1271. *See* sec. 3.4.

1272. The term is used by many scholars. It is, however, neither an empirical nor a sociological claim, but rather reflects the fact that legal science has become more global in recent years. Many scholars have dealt with the question of the impact of the development of the international community on international law. *See*, for example, Fassbender, 2009, p. 52 et seq., with further references.

1273. *See* for a "*tour d'horizon*" on the different approaches chosen by scholars and discussed in the following section, Fassbender, 2005, p. 837 et seq.; Fassbender, 2009, p. 27 et seq.; Kühne, p. 10 et seq.; Paulus, 2007, p. 695 et seq., or for a comprehensive overview see the seminal work of Kleinlein, p. 1 et seq.

1274. These questions are also of central importance in the work of Habermas on constitutionalism at an international level (Habermas, 2009b, p. 313 et seq.).

least partial) international constitution, and as a prominent task, one could review whether the world is getting more integrated and whether international constitutionalism aligns to the development of such an international community. Or, lastly, constitutionalism could be understood as a tool to redesign international affairs and international law, per se.[1275]

For the purpose of the present study, the terms "constitutionalism" or "international constitution" are used for descriptive and analytical purposes in order to develop an in-depth understanding of whether the outlined international tax regime contains constitutional elements that could guide our normative review of the international tax regime, aiming at achieving a just system. Furthermore, it will be vital to discuss whether the economic and social developments in recent decades have led to a new international legal regime implying certain constitutional elements.[1276] At least three reasons justify such methodology.

The first reason is that a constitutional analysis of the international tax regime could influence (tax) lawmaking at an international level, as it would demonstrate the limits of domestic legislative measures, i.e. the limits of sovereignty,[1277] and these legislative constraints are of vital interest for a normative review of the international regime, as intended in Part IV of the present study. To be more precise, we will review whether there are any rules or principles as part of the international tax regime that are of higher (or constitution-like) rank, and which must be considered when discussing an amendment to the international tax regime toward more justice.[1278] This is essential for all studies on a potential amendment to the international tax regime.

Secondly, for the purpose of the present study, it is crucial to understand in what constitutional framework, if any, the international tax regime operates and what values and moral principles can be derived from such potential constitutional framework. The goal at this stage of the study is not to argue in favor of or against a more integrated international constitutional-like system (or even a federal or world state), but rather to outline the potential constitutional features of the international tax regime. An exclusive analysis

1275. For an innovative approach *see* Diggelmann & Altwicker, p. 623 et seq.
1276. For a similar justification for the usage of constitutionalism in international law *see* Payandeh, p. 51. *See also* Kälin, p. 43 et seq.
1277. *See* Peters, 2005, p. 549; Simma, 1994, p. 217 et seq.; Werner, p. 349.
1278. *See*, with a similar definition, Peters, 2010, p. 12, with reference to Kadelbach & Kleinlein.

of treaty-based and non-treaty-based rules of the international tax regime, as rendered in section 4.2. to section 4.3., is not sufficient to cover the international tax regime in a comprehensive manner. Furthermore, in several instances in this study we have already highlighted the importance of a clear understanding of what is indeed a legal claim, what is a moral claim, and what might be a moral claim with a legal base. A constitutional analysis should help to better draw such vital demarcation lines.

Thirdly, as we have already outlined above,[1279] one thesis of the present interdisciplinary approach is that the international law framework does not provide states with sufficient guidelines in order to judge whether the most important principles and rules of the international tax regime indeed enhance justice internationally. In a domestic circumstance, the legislator is well advised to refer to the constitutional limits when proposing new rules,[1280] so the question is whether an international legislator can refer to similar guidelines in tax matters. The reason for referring to the concept of constitutionalism is, therefore, to develop a potential reference-concept[1281] in order to decide whether international law does indeed not provide international tax legislators with similar guidance as domestic constitutions when drafting new rules within the international tax regime, in order to approve or disapprove of the aforementioned thesis. If this is not the case, enhanced international legislation outside the framework of a domestic constitution would therefore lead to an enhanced erosion of the importance of domestic constitutional values.[1282] If it is indeed the case that there is nothing like a domestic constitutional value-based framework at an international level, it would further justify the present approach with a focus on political

1279. *See* sec. 2.1.2.
1280. This is, for instance, the case in Switzerland, as the legislator, when proposing new rules, generally reviews whether these rules are constitutional (*see*, for example, Botschaft zum Unternehmenssteuerreformgesetz III, 5 June 2015, 15.049, Bundesblatt (2015), p. 5183 et seq.).
1281. The term is used by Diggelmann & Altwicker, p. 637. They also speak of a "correspondence strategy". Diggelmann & Altwicker, p. 623 et seq., render a critical analysis on whether such a correspondence strategy is indeed justified. They argue that these approaches "suffer from an inherent inclination to turn blind eye on disintegrating trends in the international legal order or they employ reference-concepts, the choice of which is subjective and contestable" (p. 650). The first "blind eye argument" is important to consider, but does not exclude the usability of a correspondence strategy per se. The second "biased argument" is inherent in every research study on international law, as we tend to use our domestic principles, but since we will not take a position on whether the world should contain more elements of a domestic constitution, such potential bias is not detrimental for the present analysis.
1282. *See* de Wet, 2007, p. 797.

philosophy, which could provide researchers and policymakers at least with certain guidance on how to draft international tax legislation in order to enhance justice.

In the following, we will also not use or misuse the term "constitutionalism" in order to suggest the development of a more integrated international law system.[1283] By contrast and as mentioned, reference to potential constitutional rules and principles is necessary, as it is not sufficient to outline the existence of treaty-based or non-treaty-based rules as part of the international tax regime. In other words, it helps us to better understand whether international tax negotiations are only a mere power play between different states with no legal constraints or whether states when redesigning the international tax regime need to operate within an international constitutional framework. Therefore in the present section we will suggest neither more integration nor fragmentation of the international tax regime.

The methodology to be taken in order to elaborate whether there is indeed an international tax constitution follows a "constitution by analogy approach". This means that we will discuss whether rules contained in domestic constitutions, such as, inter alia, the Swiss, German or US constitutions, are also accessible at an international level in order to regulate the international realm.[1284] The following sections, therefore, intend to visualize the current world tax order or the international tax regime with reference to (i) organizational aspects, but (ii) also regarding substantial values.[1285] Reference to these two aspects is necessary in order to better understand the standing of the current international constitutional framework, as compared to a domestic constitutional framework. Furthermore, these two aspects might also be the main components of a domestic constitution.[1286]

1283. *See*, with some critical thoughts on the use of the term "constitutionalism" in the international law realm, Biaggini, 2000, p. 459 et seq. *See also* Altwicker & Diggelmann, p. 91; Kälin, p. 43 et seq. This would be a normative task, i.e. how the world ought to be regulated, which is dealt with in Part IV of the present study (*see also*, on the analytical and normative component of studies about constitutionalism, Thürer & Zobl, p. 194).
1284. Of course, such analysis cannot be comprehensive. However, the following sections should be understood as a first approach to discuss the topic of international fiscal constitutionalism. We will therefore need to "cherry-pick" some rules in a few constitutions, as it is impossible to render a comprehensive comparative constitutional study within the present project on justice in international tax law.
1285. This seems, for instance, the method taken by Kühne, p. 1 et seq. *See also* Paulus, 2009, p. 90 et seq., on whether domestic constitutional principles can be fulfilled by the international legal order.
1286. *See generally* Kühne, p. 23 et seq.

From a mere tax perspective, there is, as far as can be observed, no detailed study about international constitutionalism or about an international fiscal constitution ("*Finanzverfassung*"). Very few authors have used the term "constitutionalism" in studies on international tax law.[1287] The discussion is generally limited to the content of the domestic fiscal constitution or the domestic rule of law and its impact for international tax purposes. Yet, there has been an intense discussion about constitutionalism in international law, and we will utilize these studies in the following sections.[1288] Moreover, international tax law has not been of major importance for international law scholars dealing with constitutionalism.[1289]

4.4.2. What is the purpose of a constitution?

In order to judge whether the international tax regime contains rules or principles that are constitution-like, it is important to first briefly review what the functions and the purpose of a constitution are. A constitution, for the purpose of the present section, is understood as a collection of fundamental rules and principles according to which a legal system (such as a state or, in the present case, the world order) is governed.[1290] Therefore, the validity of an entire legal order or regime is derived from a constitution.[1291] Both the legislator and courts shall act within a constitution. The purpose of a constitution is furthermore to outline the main organizational rules of states, such as checks and balances between the different state powers. A further goal of a constitution is to structure the competences within a state, such as between Member States and the federation, and not only between the judicial, legislative and executive bodies. Therefore, the constitution as such

1287. *See*, as one of a few, Reimer, p. 2. *See also*, at least on constitutional pluralism, Kofler & Pistone, p. 14 et seq.; Vanistendael, 2011, p. 185 et seq.
1288. *See* De Wet, 2006, p. 51 et seq.; Diggelmann & Altwicker, p. 623 et seq.; Fassbender, 2003, p. 115 et seq.; Fassbender, 2005, p. 837 et seq.; Fassbender, 2009, p. 1 et seq.; Kleinlein, p. 1 et seq.; Kühne, p. 1 et seq.; Thürer, 2009b, p. 113 et seq.; Peters, 2005, p. 537 et seq.
1289. We already argued above that international tax law has mainly been neglected in international law studies. Regarding constitutionalism, *see generally* Kühne, p. 1 et seq., who deals with international human rights protection, international law of peace, international humanitarian law and international environmental law, but not international tax law.
1290. For more details about the term "constitution" *see* Fassbender, 2007, p. 22 et seq.; Kühne, p. 13 et seq.; Peters, 2005, p. 338 et seq.
1291. For a broader overview on the functions of a constitution, *see* Biaggini, 2015, § 7 para. 7 et seq.

is also a sign of the level of integration and centralization of a state. In the following, we will refer to these rules by using the term "organizational rules".

There are further goals of constitutions besides regulating the organization of the state, per se. A constitution is considered to be the document that states the values agreed upon by the members of a particular society.[1292] This implies, in simplified terms, that if a law is in line with constitutional limitations, it is considered to be in line with the values and ethics of a particular state or society. In other words, if the legislator acts in line with the constitution when implementing or proposing new laws, its decision seems justified by a legitimate value system.[1293] The preamble of the US Constitution states, for instance, the following:

> We the people of the United States, in order to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity, do ordain and establish this Constitution for the United States of America.

According to such wording, the purpose of a constitution is to not only outline certain values of a society, but also to increase, establish or promote justice. This is also true from a tax perspective, as constitutions may outline the main tax justice principles of a state, either through specific tax-related principles and rules,[1294] or other constitutions that might provide for general justice principles from which tax justice principles can be derived.[1295] In the following, we will use the term "substantive rules" in order to cover these more value-based provisions.

We will approach the potential content of the international fiscal constitution by outlining both potential organizational and substantive rules of the international constitution, in general, before specifically referring to international tax law in section 4.4.4.

1292. E.g. from a Swiss perspective, Belser, para. 43, with reference to Tschannen.
1293. *See* Belser, id.
1294. *See*, for example, the tax justice principles ("*Steuergerechtigkeitsprinzipien*") in art. 127 et seq. of the Swiss Federal Constitution (*see generally* Matteotti, 2007, p. 14 et seq.; Matteotti & Aebi, p. 106 et seq.).
1295. For instance, the German Constitution contains the equality principle in art. 3 *Grundgesetz*, from which scholars and courts derive several specific tax justice principles (e.g. Hey, § 3 para. 110 et seq.).

4.4.3. Constitutionalism in international law

4.4.3.1. Organizational rules

4.4.3.1.1. *Legislative, judicial and executive bodies*

Although no written constitution in the sense of a domestic constitution exists at an international level, it is argued that certain rules belong to the international public order or reflect the "minimum world order".[1296] An important part of such a minimum world order relates to the basic functions of global governance; in particular, this means creating international law and applying or executing international law.[1297] A domestic constitution generally provides for checks and balances among the various state bodies and provides for rules on which body shall have which legislative, executive and judicial power.[1298] From an international law perspective, one must admit that such comprehensive organizational rules do not exist at an international level.[1299] However, certain organizational constitutional features can be identified.

First of all, at an international level, there is no legislative body with absolute power to issue binding rules on non-consenting states. Some organizations might still have a significant impact on domestic legislators through the publication of soft law, even though no organizational, constitutional-like legislative framework exists.[1300] However, there seems to be a trend to implement majority systems on an international level, compared to a consent system based on unanimity, as traditionally seen in international law.[1301] Moreover, the UN Security Council has some legislative powers and its veto system might be understood as a "constitutional device of 'checks and balances'".[1302] In more general terms, the UN is highlighted as a "powerful norm-setter".[1303] Moreover, there is an intense debate among international law scholars about the quasi-legislative competence of international organizations, which are somehow independent from the state level and the

1296. The term is used by Thürer, 1996, para. 17. *See also* Thürer, 2000, p. 597 et seq.
1297. *See generally* Fassbender, 2009, p. 94 et seq. He also mentioned the adjudication of legal claims as a third element of global governance (i.e., the judicial element).
1298. *See generally* Kühne, p. 25 et seq.
1299. *See* Thürer, 2000, p. 601 et seq.
1300. *See* Kühne, p. 27 et seq., with further references.
1301. *See* Peters, 2004, p. 23.
1302. Fassbender, 2009, p. 131.
1303. *See* Fassbender, 2009, p. 95, with reference to Tomuschat.

consent of states.[1304] We also referred to such debate when reviewing the source of soft law.[1305]

Secondly, there is no sophisticated judicial system at an international level compared to a domestic judicial system with a supreme instance. Nevertheless, at an international level, several more or less global judicial instances have been incorporated in recent decades. First of all, the ICJ is the main judicial body of the UN.[1306] It is competent in several areas of international law.[1307] However, the main limitation of the competence of the ICJ is that it shall only act if a procedure is initiated by a state and not if an individual files a lawsuit.[1308] Furthermore, all participating states need to consent to a specific procedure at the level of the ICJ, i.e. there is no obligatory procedure.[1309] Other courts have also played important roles, such as the European Court of Human Rights, the Panel and the Appellate Body of the WTO,[1310] which is competent in many trade law areas, or the International Criminal Court in The Hague. Furthermore, there is also a trend to make use of arbitrational courts or other judicial bodies with respect to intrastate relations. Therefore the judicial element partly exists, even though it is fragmented and split among several bodies and not as comprehensive as a domestic judicial constitution-based system.

Thirdly, there is also no executive body at an international level that is capable of acting even if no consent exists and that is competent to apply the existing rules of international law.[1311] The executive body is generally known as the body executing the laws enacted by the legislator. In domestic circumstances, this means the government and the administration.[1312] Again, the Security Council of the UN shows certain features of a domestic executive body, such as the possibility to agree on binding resolutions that can lead to executive measures around the world. However, its current veto system limits its capabilities to situations of unambiguity. As far as can be observed, the decisions of the Security Council, however, have not yet affected tax

1304. *See*, for example, Klabbers, 2011, p. 81 et seq.
1305. *See* sec. 4.3.4.2.
1306. *See*, with further details on the judicial system within the UN, Fassbender, 2009, p. 99.
1307. *See* art. 34 et seq. ICJ Statute.
1308. *See* art. 34(1) ICJ Statute.
1309. For further references *see* Egli, p. 84 et seq.
1310. *See*, on constitutionalism and the WTO dispute settlement mechanism, Peters, 2005, p. 544 et seq.
1311. *See generally* Kühne, p. 30 et seq.; Paulus, 2009, p. 100; Simma, 1994, p. 275 et seq.
1312. *See generally* Kühne, id.

law. Moreover, other bodies of the UN might have executive competences such as the WHO, WIPO or the UNHCR.

In conclusion, such a brief analysis – which is by no means exhaustive – has at least indicated that the institutional framework is rather fragmentary and there are no governance institutions at a global level which are comparable to a domestic constitutional framework.[1313]

4.4.3.1.2. *Other organizational rules and principles*

Although the current world order does not have a single executive, legislative and judicial body, as compared to domestic constitutional order, some organizational rules and principles have a constitutional or peremptory character. These rules and principles can be derived from different sources, such as treaties, customary law or general principles of law.[1314] However, as already outlined with reference to the principle of sovereignty,[1315] some rules might be valid, as they are legal preconditions, such as the principle of sovereignty or the right of peoples to self-determination.[1316] One could also call these peremptory norms juristic inevitabilities of a world order with several equal states, as developed since (and before) the Peace of Westphalia.[1317] Or, as stated by Hannikainen: "The absence of peremptory norms would constitute at least a potential threat to the international legal order."[1318] In this respect, the ICJ held in the *North Sea Continental Shelf* cases the following:

> In its fundamentalist aspect, the view put forward derives from what might be called the natural law of the continental shelf, in the sense that the equidistance principle is seen as a necessary expression in the field of delimitation of the accepted doctrine of the exclusive appurtenance of the continental shelf to the nearby coastal State, and therefore as having an a priori character of so to speak juristic inevitability.[1319]

1313. For a more comprehensive analysis *see* Payandeh, p. 131 et seq.
1314. Kühne, p. 33. The term "derived" is not precise, as these rules might have been unwritten rules that were at a later stage transferred into a legal source, such as one of those mentioned above.
1315. *See* secs. 4.1.1.2. and 4.1.1.3.
1316. *See*, with regard to self-determination as a constitutional principle, Paulus, 2009, p. 89.
1317. *See*, from a tax perspective, Martha, p. 37. *See also* Hinnekens, p. 282 et seq. The terms "fundamental principles" or "fundamental rules of international law" could also be used (*see* Kohen, p. 139 et seq., who reviews the right of peoples to self-determination, the prohibition of the threat or use of force, respect for territorial integrity, respect for human rights, the peaceful settlement of international disputes and good faith).
1318. Hannikainen, p. 16.
1319. ICJ, North Sea Continental Shelf Cases (*Federal Republic of Germany v. Denmark and Netherlands*), p. 28 et seq.

The current world order,[1320] i.e. a world order based on sovereign (and equal) states, requires that some fundamental structural or organizational rules are obeyed. These rules are legal preconditions for the international system or the international regime that is currently in place. This also means that if a state infringes these fundamental rules, it questions the current world order. Such preliminary remarks might sound rather abstract, but if one considers the following concrete rules, the importance of these peremptory (organizational) rules becomes obvious.

The first and most basic rule is the principle of sovereignty, as mentioned earlier. The current international legal system requires that states obey the sovereignty of other states, since otherwise, the entire system is questioned and the world would fall back to its state before the Peace of Westphalia.[1321] Secondly, and derived from the sovereignty principle, is the principle of equality among states.[1322] This means that all states have the same rights and duties in the current world order and no state shall be dominated by another state. Yet, this does not mean that economic inequalities between states are illegal. Thirdly, it is persuasive that the co-existence of states without having one state as the leading state requires that the principle of good faith (i.e. bona fides) be followed. If states cannot trust in good faith in the behavior of another state, the entire world order would be questioned.[1323] The bona fides principle is also mentioned by many international lawyers as a general principle of international law in the sense of article 38(1)(c) of the ICJ Statute, as was discussed above.[1324] Fourth, and related to the good faith principle and the sovereignty principle, the *pacta sunt servanda* principle is also of a constitutional character and was also discussed in more detail above.[1325] The *pacta sunt servanda* principle is indeed valid in order to maintain the current world order. Or, in other words, the development of the current world order was linked to the development of the *pacta sunt servanda* principle. The *pacta sunt servanda* principle is a rule that is necessary to regulate international lawmaking and, therefore, these rules are necessary, as they are necessary for any sort of governance, or as Tomuschat calls them "meta-rules".[1326]

1320. On the historical development of the current legal world order, *see* sec. 3.4.
1321. *See* id.
1322. *See* Epping, in: Ipsen, § 5 para. 248 et seq.; Tomuschat, 1993, p. 220 et seq. *See also* sec. 4.1.1.3.2.
1323. Verdross & Simma, § 60. *See also* Kohen, p. 148, who refers to the jurisprudence of the ICJ and states that good faith (together with equity) should guarantee stability and foreseeability as "two of the main objectives of any legal system."
1324. *See* sec. 4.3.3.3.2.
1325. *See* sec. 4.3.3.3.6.
1326. Tomuschat, 1993, p. 216.

These organizational rules can be seen as being part of an unwritten international constitution regulating the core aspects of the international world order consisting of several sovereign states.[1327] Depending on the definition, some of these rules could also qualify as substantive rules, as for instance, the equal treatment of states contains a moral component, but also abides by the *pacta sunt servanda* principle, as it might reflect a moral claim that states should follow their contractual commitments. The distinction between substantive and organizational rules has no legal consequences.

4.4.3.2. Substantive rules and principles

4.4.3.2.1. *Some general remarks*

The substantive rules of an unwritten international constitutional framework compared to the aforementioned organizational norms govern not only the relation between states, but also between states and individuals, such as certain fundamental human rights.[1328] At an international level, constitutionalism concerning substantive rules is a steady development and the relevant rules might change from time to time.[1329] Yet, some are "mere" moral principles, which are not (yet) legally enforceable at an international level. However, the debate demonstrates how intertwined international constitutional claims and moral claims are, as there is no written international constitution that would clearly qualify certain principles as legal claims, and not just as being derived from normative considerations. Therefore, a discussion about the potential existence of international substantive rules should also analyze whether these indeed qualify as legal rules, or whether they are mere moral claims.[1330]

Furthermore, each area of law has its own substantive rules that could form part of an unwritten international constitution. Also, a domestic constitution is often split into different parts governing different areas of law such as, for instance, environmental law, education policy, military or, as important for the present study, the fiscal order of a state. Each part may contain specific

1327. The present opinion is mainly based on the writings of Verdross (*see* Verdross, 1969, p. 649).
1328. *See* Keller, 2007, p. 633, who argues that the most important merit of a constitutional approach at an international level is the recognition of the universal validity of human rights. *See also* Paulus, 2009, p. 88 et seq.
1329. Kühne, p. 33.
1330. German literature uses the term "*Verrechtlichung*", i.e. "juridification", in order to show that certain ethical or moral rules have developed into legal claims at an international level (*see* Kühne, p. 33).

constitutional rules. As an example, there is an intense discussion whether within international environmental law, a certain principle of shared responsibilities exists and whether such principle forms part of an unwritten international constitution.[1331] In order to frame the issues properly, in the following, we will distinguish rules and principles protecting individual rights,[1332] as well as rules and principles to protect community interests.[1333] This allows us to develop a rather comprehensive understanding of the concept of substantive rules as part of an international constitution, which is necessary for the later tax law analysis.

4.4.3.2.2. *Protection of individual rights*

One important international law development is that individuals have gained (direct) rights in international law in recent decades and along with such development, the sovereignty of states has been limited through these internationally valid rights.[1334] One reason is that global agreements on human rights have been signed and implemented in nearly every corner of the world, and some of these agreements even contain the right for individuals to appeal beyond national borders.[1335] Some of these human rights even have the quality of *ius cogens,* such as the prohibition of slavery or torture. These *ius cogens* rules are a core part of an international constitutional framework. *Ius cogens* compared to *ius dispositivium* is understood as a rule from which states cannot deviate, even if they consent to do so.[1336] Such rules cannot be abolished or amended at the free discretion of states. These rules are superior to other rules of international law.[1337] One of the reasons for *ius cogens* is that certain rules are necessary to uphold human co-existence on the basis of dignity, and because these rules are essential for the survival of the human race.[1338] However, there is intense debate about some of the aforementioned reasons for the unconditional validity of some *ius cogens*

1331. *See*, with further details on the discussion of the content of the unwritten international constitution with respect to environmental law, Kühne, p. 243 et seq.
1332. *See* sec. 4.4.3.2.2.
1333. *See* sec. 4.4.3.2.3.
1334. *See* Peters, 2010, p. 13.
1335. *See*, in particular, the UN Agreements on Human Rights, such as the Universal Declaration of Human Rights, 10 Dec. 1948, but also the European Convention on Human Rights, 21 Sept. 1970.
1336. E.g. Boas, p. 95; Thirlway, 2014, p. 35 et seq. Or for further details, *see* Heintschel von Heinegg, in: Ipsen, § 16 para. 37 et seq.
1337. E.g. Tomuschat, 2006, p. 425.
1338. *See*, on the argument that certain rules are necessary in order to protect the survival of the human race, Thürer & Zobl, p. 195.

provisions.[1339] These rules are valid due to their content, as these provisions are superior, since they are necessary for "upholding peace and justice in the world."[1340] This means that they are not necessarily based on one of the sources of international law outlined above.[1341]

Importantly, the development of such peremptory rules reflecting an international value system has been obvious since World War II and even increased after the fall of the Iron Curtain. According to Kadelbach,[1342] the Charter of the Nuremberg Military Tribunal and the UN Charter must be seen as the start of a new era in this regard. Hannikainen[1343] assumes that there was "a notable advancement in the doctrinal writings on *jus cogens*" in the years 1945-1969. The ILC, when drafting the VCLT, did not include a certain list of the existing rules of *ius cogens*. But it is generally accepted[1344] that the prohibition of slavery, torture, and genocide forms part of *ius cogens*. Furthermore, the prohibition of aggressive war also forms part of *ius cogens*. Various authors have suggested a broader scope of application.[1345] These rules form part of an unwritten international constitution, but it is not required that a rule qualifies as *ius cogens* in order to qualify as an (unwritten) constitutional rule. Nevertheless, the qualification of a rule as *ius cogens* is a very strong sign that a certain rule belongs to the most essential constitutional rules at an international level.[1346]

4.4.3.2.3. *Protection of community interest*

The remarks on *ius cogens* and the global protection of individual rights have shown that certain fundamental individual rights have become part of an international constitution-like framework in which international and domestic law must operate. These rights are indeed limiting state sovereignty and they have led to a transformation of international law from a system of co-existence to a more integrated and coordinated value-based regime. Another (but connected[1347]) limitation of sovereignty is that the pro-

1339. *See*, for example, Conklin, p. 837 et seq. *See also* Boas, p. 100.
1340. Tomuschat, 1993, p. 223, with further references. *See also* Werner, p. 335 et seq.
1341. However, this is disputed in international law. *See*, for example, Kolb, 1998, p. 69 et seq., with further references.
1342. Kadelbach, 2006, p. 22.
1343. Hannikainen, p. 155.
1344. *See*, for example, Paulus, 2009, p. 88. He also mentions further potential candidates to be qualified as *ius cogens*.
1345. *See*, for example, Hannikainen, p. 716 et seq.
1346. Kühne, p. 36, with reference to Raffainer.
1347. The distinction between "individual rights" and "community interests" at an international level is not beyond reproach as, for instance, the protection of some fundamental

tection of certain interests of the international community might disallow a state to legislate in full discretion. Indeed, certain obligations are considered as commitments toward the international community as a whole.[1348]

These community interests are interests that can only be protected by international coordination and such interests are concerns of basically all states.[1349] The international community might have an interest in a coordinated solution if, for instance, a threat is not only affecting a specific state's territory, but mankind at large.[1350]

A challenging question is how these community interests can be detected. One important indication seems to be the current and past international political agenda, but already existing agreements might also be sources for a sign of community interest.[1351] Simma held, for instance, that a community interest is "a consensus according to which respect for certain fundamental values is not to be left to the free disposition of States individually or inter se, but is recognized and sanctioned by international law as a matter of concern to all States [footnote omitted]."[1352] Community elements are even abolishing traditional bilateral structures to a certain extent.[1353] Also, these community interests limit the de facto sovereignty of states. There might be an international system of direct or implicit coercive threat to act and legislate in consideration of these community interests. For the sake of clarification, the ICJ also held in the *Barcelona Traction* case that there are indeed obligations of a state not only toward another state, but also toward the international community (so-called *erga omnes* obligations).[1354] However, *erga omnes* obligations are not predominantly protecting community interest, as they might also protect individual rights, such as human rights. For instance, the prohibition of genocide is an *erga omnes* rule that does not primarily protect community interest, but rather the lives of individuals.

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human rights (such as the prohibition of slavery) is also in the interest of the international community (*see* Simma, 1994, p. 242). *See also* on this topic Fassbender, 2002, p. 242 et seq. The same is true for the prohibition of genocide (*see* on the protection of such community interests ICJ, Case concerning the Barcelona Traction Light and Power Company, Limited (*Belgium v. Spain*), p. 32).

1348. *See*, with reference to the *Barcelona Traction* case, Simma & Paulus, p. 267. The usage of the term "community" already implies that there are certain interests common to the members of the international world order (id., p. 268).

1349. Scheyli, p. 204, with further references.

1350. Payendeh, p. 91.

1351. *See* id., p. 99.

1352. Simma, 1994, p. 233.

1353. This was already outlined in detail by id., p. 217 et seq.

1354. ICJ, Case concerning the Barcelona Traction, Light and Power Company, Limited (*Belgium v. Spain*), p. 32.

Although more and more international legislative projects are rendered based on community interests and not mere state interests, it would nevertheless be wrong to argue that a paradigm shift has occurred and that the international law order based on state consent has been overcome.[1355] One of the main reasons for the (still) limited effect of these community interests is, as with other value-based rules and principles at an international level, that enforcement mechanisms are missing to a large extent. Nevertheless, some authors claim that community interests should be allocated a greater legal position in international law.[1356] It seems indeed evident that states must consider more and more the international community interest as a whole when rendering international or domestic legislative or quasi-legislative projects. The enhanced consideration of community interest does not mean that the world has shifted to a monist or cosmopolitan global society of individuals.[1357] The world is still based on the interests of states, but in certain areas, international law has begun to consider the interest of a global community.[1358] We will see in section 4.4.4.2.2. whether this has also been a driver of the international tax legislator.

In the framework of the present section, it is impossible to outline all existing and potential community interests, but we will use an example list in order to allow a better understanding and to prepare the analysis from a tax perspective. Besides the protection of human rights as a community interest,[1359] scholars generally mention the following elements.[1360]

The first item on the list of community interests is (global) environmental protection. Such a community interest has been essential in the international debate about global warming, and international community interests in this respect have been mentioned in several international environmental agreements.[1361] Therefore, there seems to be an international agreement that environmental protection is necessary to align with the interests of the international community, per se, and not just the interest of states, as the

1355. *See*, for example, Fassbender, 2002, p. 268 et seq.
1356. *See*, for example, Scheyli, p. 205.
1357. *See*, on cosmopolitanism, sec. 7.5.
1358. *See*, in a similar manner, Cohen, p. 270 et seq., who uses the term "constitutional pluralism" in order to distinguish the current world order from a "multileveled cosmopolitan world order".
1359. The protection of human rights was already outlined above when discussing the protection of individual rights at an international level. As outlined *supra* in n. 1347, however, the protection of human rights could indeed also be seen as a protection of community interest and not just a protection of individual rights.
1360. *See generally* Payandeh, p. 100 et seq.
1361. Kühne, p. 270 et seq. *See also* Simma, 1994, p. 238 et seq. On the question of whether certain duties with respect to the protection of the global environment have

environment is something that must be protected in a coordinated manner. Therefore this goes beyond the "no harm" principle. As a second example, some argue that there is a principle of solidarity at an international level, similar to solidarity principles that are sometimes contained in a domestic constitution in order to achieve cohesion in a state, i.e. solidarity among federal states, for example.[1362] In older legal literature, such a claim was also labeled as "North-South solidarity".[1363] However, international lawyers are generally reluctant to argue that there is indeed a genuine community interest of solidarity between developing and developed states.[1364] A third example would be the legal prohibition of weapons of mass destruction, particularly nuclear weapons.[1365] The use of nuclear weapons could indeed endanger mankind. Or in a similar matter, it is argued that the resolution of inter-state conflicts is no longer a matter of mere bilateralism, but the protection of international peace and security is actually a community interest of the world.[1366] As a fourth and final example, it is argued that there is a common interest in the protection of the common heritage of mankind.[1367] This means that certain geographical areas are protected by a common global regime and not just by national jurisdiction.[1368]

4.4.4. Constitutionalism in international tax law

4.4.4.1. Organizational rules and principles

4.4.4.1.1. *Legislative, judicial and executive bodies*

It seems clear that due to the importance of treaties as the main source of international tax law,[1369] states are still the main force and legislative power within the international tax regime.[1370] However, considering the impact of

become part of *ius cogens, see* Kadelbach, 2004, p. 12, with further references. On the protection of the environment as a community interest, *see also* Payandeh, p. 115 et seq.; Scheyli, p. 215 et seq.

1362. *See* Paulus, 2009, pp. 93 and 105 et seq., who refers, inter alia, to the German constitution. He concludes that: "[t]hus, international solidarity as a right has not quite entered the operational phase" (id., p. 106).
1363. *See*, for instance, Simma, 1994, p. 235, who speaks of "an equitable solution to North-South economic problems" and of North-South solidarity (p. 237).
1364. Payandeh, p. 121.
1365. Thürer & Zobl, p. 196.
1366. *See* Payandeh, p. 100 et seq.; Simma, 1994, p. 236.
1367. For an overview on the content of these interests *see* Payandeh, id. p. 122 et seq.
1368. *See* id., p. 122.
1369. For further details *see* sec. 4.2.
1370. Kühne, p. 29; Tomuschat, 1995, p. 9.

the BEPS Project, as well as the work of the Global Forum, it seems that quasi-legislative international bodies have indeed emerged to limit state sovereignty – at least de facto and not de jure.

In a domestic circumstance, constitutions often regulate which bodies are competent to levy what kinds of taxes and, therefore, which bodies are competent to legislate in which areas of taxation.[1371] It is obvious that there is no global rule defining who is competent to levy taxes and who is not. There is also no global tax legislator that would have the formal competence to levy taxes beyond the sovereign will of states. In fact, there are also no global taxes (as demanded by certain philosophers and economists).[1372] Nevertheless, it is of the utmost importance from a tax law perspective to consider that tax legislation competence has partly shifted, albeit not formally but de facto, from a domestic to an international sphere. An obvious trend exists toward the globalization of tax legislation.

It goes beyond the present study to render an empiric study on the impact of the BEPS Project in domestic law, but the widespread implementation of country-by-country reporting[1373] or the creation of domestic provisions allowing for a spontaneous exchange of tax rulings[1374] are just two of the many clear signs of the actual impact of the BEPS Project on domestic legislation.[1375] The use of minimum standards has narrowed the domestic legislative leeway. Another example is the developments with respect to international fiscal transparency, particularly the mechanism of black or gray-listing of certain jurisdictions, which has been an important driver of shifting the tax-related legislative power and its surveillance to an international body. However, there is no underlying constitution or similar framework that would provide for certain legislative or quasi-legislative powers for global institutions. Besides, it is important to note that peer-review processes at an international level have increasingly been used to achieve an alignment of domestic provisions or practice with international recommendations. The most important example are the peer-review processes of the Global Forum and the Inclusive Framework, which aims at analyzing

1371. *See*, for example, art. 104a et seq. of the German Constitution. *See also* art. 13(1) of the Austrian Constitution and the Fiscal Constitutional Act (*Finanzverfassungsgesetz*).
1372. *See* sec. 2.1.4. with reference to Piketty and Pogge.
1373. *See* OECD/G20, Transfer Pricing Documentation and Country-by-Country Reporting, Action 13: 2015 Final Report (OECD 2015), p. 11 et seq.
1374. *See* OECD/G20, Countering Harmful Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report (OECD 2015), p. 45 et seq.
1375. *See* for an intermediate analysis of the global impact of the BEPS Project Christians & Shay, p. 17 et seq.

the compliance of a jurisdiction's domestic tax practice and legislation with the international standard of transparency.

Interestingly, the outlined developments of international tax legislation were triggered by the publication of formally non-binding soft law, such as the BEPS final reports or the recommendations of the Global Forum. However, if soft law is combined with coercive measures, its effect might be similar to hard law[1376] and might indeed reflect an increase of de facto global tax legislation.[1377] In conclusion, even though tax legislation remains a core part of national competence, the recent trends at an international level, i.e. inter alia, the work of the Global Forum and the BEPS Project, have shown that the competence to legislate has shifted partly to one or several international quasi-legislative bodies.[1378]

Not only with international tax law, but also, as already shown above,[1379] in other areas of international law, no central executive body exists in order to execute existing international tax rules.[1380] Moreover, no global limitations regarding the spending of taxpayer money exist, as compared to domestic constitutions, which sometimes state the purposes for which governments may use taxes. This is important as, for instance, there are no rules at an international level regarding whether states should use funds for global distributive purposes or whether states should only spend their tax revenue domestically. International tax rules are executed by domestic bodies, such as the tax administration or other governmental bodies. The executive element of an international (unwritten) tax constitution is rather weak or even nonexistent, although the mentioned peer-review processes could also be understood as an executive measure to supervise the implementation of the (quasi-) legislative proposals. Furthermore, the collection of taxes remains a central domestic competence, even if states might agree on cross-border cooperation with respect to the collection of taxes (i.e. article 27 of the OECD MC).[1381] Therefore, tax rules are executed almost entirely by domestic bodies.

1376. *See* sec. 4.3.4.6.
1377. *See* Peters, 2005, p. 546, who outlines the potential anti-constitutional effect of soft law.
1378. The present study should not further review whether the current quasi-legislative setup is justified and the right manner to move forward or whether the UN, instead of the OECD, "is capable of paving the way for true Habermasian deliberation that leads to a legitimate global law on tax." (García Anton, p. 179).
1379. *See* sec. 4.4.3.1.
1380. *See* Tomuschat, 1993, p. 13. *See also* Kühne, p. 31, with further references.
1381. *See* sec. 4.2.3.3.5.

This leaves us with the judicial power at an international level. As mentioned, several international courts have international judicial power, such as the European Court of Human Rights or the International Criminal Court. These courts have mainly not dealt with tax law, but several tax-related questions have been decided by these courts. In particular, the case law of the European Court of Human Rights has had an influence on the domestic tax law in many states, particularly regarding procedural tax rules.[1382] Moreover, the case law of the WTO judicial bodies has had an impact on domestic tax law. Furthermore, the debate with respect to Action 14 of the BEPS Project has shown that from the perspective of many countries, there seems to be a need for a mandatory international arbitration system in the event of a dispute concerning the application of a double tax convention.[1383]

In the future, we expect that the importance of statutory international courts or ad-hoc arbitration courts will also significantly increase from a tax perspective. However, there is little evidence for the development or existence of an international fiscal judicial system that could be compared to a complex and comprehensive judicial system in a domestic constitution.[1384] To sum up, although a shift from domestic to international judicial bodies seems to be occurring, the international tax regime is far from having a central judicial body, as compared to domestic systems.

4.4.4.1.2. *Other organizational rules and principles*

The mentioned organizational rules, such as the *pacta sunt servant* principle or the equality of states and the good faith principles, are also relevant from an international tax law perspective.[1385] We have already dealt with their importance in the international tax regime[1386] and will further refer to these rules and principles when rendering a normative review of the international tax regime in Part IV.

1382. *See*, for example, Baker, p. 211 et seq. *See also* Kofler & Pistone, p. 3 et seq.
1383. *See* OECD/G20, Making Dispute Resolution Mechanisms More Effective, Action 14: 2015 Final Report (OECD 2015), p. 1 et seq.
1384. *See*, for example, on constitutionalism, judicial protection and trade law, Cottier, p. 54.
1385. *See* sec. 4.4.3.1.2.
1386. *See*, inter alia, secs. 4.1.1.3.2. and 4.3.3.3.6.

4.4.4.2. Substantive rules and principles

4.4.4.2.1. *Protection of individual rights*

Prima facie, it seems obsolete from a tax perspective to deal with substantive rules and the protection of the rights of individuals as part of an international constitution. This seems particularly true with respect to *ius cogens*, such as the prohibition of torture, slavery or genocide. These are not important from an international tax perspective, although cynics (and libertarians) would claim that a high-tax burden might be seen as torture and taxation is slavery, per se. Yet certain (very few) rules can be considered to be part of an unwritten international fiscal constitutional framework from which states cannot deviate. From a tax perspective, in particular, certain procedural rules that are part of multilateral human rights declarations could be seen as part of an international constitution and might limit the sovereignty of states. For instance, the right to a fair trial also affects domestic tax law procedures.[1387]

Furthermore, as we will demonstrate in Part IV, certain principles presumably protecting individual rights have been referred to as being valid at an international level, such as the ability-to-pay principle. However, as we will show in detail, we are of the opinion that the ability-to-pay principle has no normative validity as an international policy guideline and there is also no evidence that these rules are part of an international constitutional-like framework.[1388] The same is true for the single taxation principle, as there is no rule of international law that would prohibit double taxation per se. Remarkably, for instance, the Swiss Federal Constitution states that intercantonal double taxation is prohibited.[1389] Therefore, by referring to such a rule, the Swiss Federal Supreme Court has played a particular role in harmonizing tax laws among the different cantons. The Court has, for instance, as compared to the ECJ, the right to decide which canton should tax and not only to rule that a certain tax treatment is discriminatory. At an international level, however, no legal claim for single taxation or the prohibition of double taxation exists.[1390]

However, what is important to consider is that the international tax policy has, particularly in the early 20th century, focused on the avoidance of double taxation, and only in recent years has the focus been more on community interests. This will be outlined in the following section.

1387. *See*, with further details, the references mentioned *supra* in n. 1382.
1388. *See*, for example, from a legal perspective, Monsenego, p. 61 et seq.
1389. *See* art. 127(3) Swiss Federal Constitution.
1390. *See also* for further details sec. 11.2.3.4.

4.4.4.2.2. *Protection of community interests*

As mentioned, the international political agenda and existing treaties might be indications of existing community interests.[1391] A look at the G20 communiqués in recent years indeed demonstrates that taxes have been at the forefront of the international political agenda. For instance, in the 2016 Leaders' Communiqué of the Hangzhou Summit, the following was stated:

> We will continue our support for international tax cooperation to achieve a globally fair and modern international tax system and to foster growth, including advancing on-going cooperation on base erosion and profits shifting (BEPS), exchange of tax information, tax capacity-building of developing countries and tax policies to promote growth and tax certainty.[1392]

Derived from such a statement and following the entire development of international tax law in recent decades, we see at least three major streams of the international tax agenda that were triggered by (presumably) community interests.

First of all, the work of the Global Forum focusing on a global extinction of tax evasion seems to align with the interests of the international community. Or, as held by Kosie Louw, the former Chair of the Global Forum:

> Given the change that AEOI will bring, implementing this standard is *undoubtedly a big challenge for all of our members*. Nonetheless, I am confident that given the progress we have made this year, it will be implemented on schedule. It is critical that we meet the timelines we have *mutually committed* to so that the message goes out loud and clear that there will soon be nowhere left for tax evaders to hide [emphasis added].[1393]

In a similar manner, it is stated in the preamble of the MCAA:

> Considering that the development of international movement of persons, capital, goods and services – although highly beneficial in itself – has increased the possibilities of tax avoidance and evasion *and therefore require increasing co-operation among tax authorities* [emphasis added].

1391. *See* sec. 4.4.3.2.3.
1392. G20, Leaders' Communiqué Hangzhou Summit, 4-5 Sept. 2006, para. 19. Similar statements can be found in the Communiqués of the previous summits (*see* www.g20.org, last visited 10 Feb. 2019).
1393. Global Forum on Transparency and Exchange of Information for Tax Purposes, Tax Transparency, 2015, Report on Progress, p. 5.

And, in the same document, it is held that:

> Considering that *a co-ordinated effort between States is necessary* in order to foster all forms of administrative assistance in matters concerning taxes of any kind whilst at the same time ensuring adequate protection of the rights of taxpayers [emphasis added].[1394]

Or, as held by Stiglitz & Pieth: "Secrecy has to be attacked globally—offshore and onshore. There can be no places to hide."[1395]

Or: "The collection and exchange of information related to taxation, ownership, and illicit activities is a shared global responsibility."[1396]

Or: "Transparency is a global public good, requiring global efforts."[1397]

So there seems to be a community interest of prohibiting tax evasion globally. As mentioned above, community interests are interests that can only be fulfilled by coordinated international measures. The same seems to be true according to the aforementioned preamble regarding the fight against cross-border tax evasion, as the argument is that only by consolidated global action can tax evasion be extinguished. The fight against cross-border tax evasion indeed seems difficult, if not impossible, without global coordination, as some states by applying strong secrecy laws might indeed attract non-taxed money and severely hinder a global fight against cross-border tax evasion. Even if only a single state has strong secrecy laws, it might prevent the extinguishment of cross-border tax evasion. Or, as held by Stiglitz & Pieth:

> A major lesson emerges: in our global economy, transparency is only as strong as the weakest link – as the least transparent member of the global community. There are two major implications: Secrecy has to be tackled globally and there has to be zero tolerance for any deviation from the established global norms.[1398]

Now, this does not mean that any measures are justified in order to enforce global transparency, but it indicates that there indeed seems to be a community interest to achieve fiscal transparency. In Part IV, we will further deal with the question of whether global transparency is indeed a normative goal that can and should be enforced by coercive measures.[1399]

1394. *See* the Preamble of the Convention on Mutual Administrative Assistance in Tax Matters, 1 June 2011.
1395. Stiglitz & Pieth, p. 15.
1396. Id.
1397. Id.
1398. Id., p. 22.
1399. *See* sec. 12.6.

A second example of community interests, which was mentioned in the aforementioned communiqué of the G20, relates to tax avoidance, base erosion and profit shifting.[1400] The BEPS Project was deemed to be launched based on interests of the international community, as the OECD/G20 held that there would be global tax chaos if no coordinated measures were taken. Or, in their words:

> Inaction in this area would likely result in some governments losing corporate tax revenue, the emergence of competing sets of international standards, and the replacement of the current consensus-based framework by unilateral measures, which could lead to global tax chaos marked by the massive re-emergence of double taxation.[1401]

Therefore, the OECD/G20 assumes that there is a community interest at a global level to protect the tax base and fight tax avoidance and that such community interest can only be fulfilled by coordinated international action. These coordinated measures seem necessary, as states would otherwise lose large parts of their revenue and single-country action would not be successful. Or, as stated by Vanistendael:

> These new measures [i.e. for example to raise revenue at a global level] make only sense when all important economic powers will strive for the same goal and agree to march into the same direction, because the tax measures envisaged have worldwide repercussions on the competitive position of each party.[1402]

One other important argument of why the fight against tax avoidance is indeed a community interest in the current debate is the argument that mere unilateral measures would lead to chaos, and this is an important criterion when evaluating community interest in international law. As an example, the OECD/G20, particularly with regard to countering harmful tax practices, is of the opinion that a coordinated approach is necessary to stop the assumed "race to the bottom":

> Countries have long recognised that a "race to the bottom" would ultimately drive applicable tax rates on certain sources of income to zero for all countries, whether or not this is the tax policy a country wishes to pursue, and combating

1400. We will not try to answer the extremely difficult and fuzzy question of how the terms "tax avoidance" and "base erosion and profit shifting" interact, i.e. whether every measure to erode the tax base or to shift profits to a low tax jurisdiction is tax avoidance. In the following, we will use the term "tax avoidance" in order to circumscribe the behavior of somehow aggressive tax planning, which has triggered some recent international legislative projects, such as the BEPS Project.

1401. OECD, Action Plan on Base Erosion and Profit Shifting, p. 10 et seq.

1402. Vanistendael, 2011, p. 193. *See*, on the issues of partial coordination and its negative impact, with reference to several studies of economists, International Monetary Fund, Policy Paper, Spillovers in International Corporate Taxation, 9 May 2014, p. 44.

> harmful tax practices is an interest common to OECD and non-OECD countries alike. There are obvious limitations to the effectiveness of unilateral actions against such practices.[1403]

Therefore, there seems not only a community interest to fight tax avoidance, but also to regulate tax competition.[1404]

A third example would be to claim that the avoidance of double taxation is a community interest. However, as an empiric fact, we would disagree that such community interest is already reflected in the international political agenda, as first of all, there is no international legislative project or policy agenda that aims at prohibiting double taxation in a coordinated and multilateral manner. Also, as it was already shown, there is no international rule prohibiting double taxation.[1405]

A daring claim and a fourth example is that global trade is a community interest.[1406] However, from a tax perspective, the BEPS debate has shown that the main goal of such policy is not to protect global free trade without cross-border obstacles, such as double taxation, but rather to protect tax revenue. Therefore, at least from a tax perspective and considering the recent developments of international tax policy, there is not a very coordinated approach to allow and protect free trade at an international level.

To sum up, we have indicated at least two community interests in international tax law (fight against cross-border tax evasion and fight against tax avoidance). However, the new orientation of international tax policy to enhance community interests does have a price, as there has been an "erosion of the consent requirement"[1407] in international tax law, as international organizations have steered domestic tax policies through blacklisting and/or peer-review processes, even without the consent of states, in order to protect the mentioned community interests.[1408] Lacking international consent also means that international legislative measures might also not be covered

1403. OECD/G20, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report (OECD 2015), p. 12.
1404. *See* Brauner, 2016, p. 6, who argues that the international tax regime "evolved with the apparent sole aim of perfecting such competition [i.e., following market theory], rather than curbing it."
1405. *See* sec. 4.3.2.8.3.
1406. *See generally* Payandeh, p. 120.
1407. Peters, 2005, p. 542 (not focusing on tax law). And for the sake of completeness, we are not necessarily claiming that considering community interests must be understood as progress (for more details about the progress debate in international law *see* Altwicker & Diggelmann, p. 87 et seq., with further references).
1408. For further details from a tax perspective *see* Essers, p. 54 et seq.

by a domestic democratic decision. The latter, however, is essential for a legitimate tax law ("no taxation without representation").[1409] We will further deal with such a normative claim in Part IV.[1410]

The discussion on the international tax regime has also shown that recent international quasi-legislative projects have focused on community interests, e.g. that multinationals pay their fair share and it is of less interest in which states the taxes are paid. Aligned with such development, the international tax world has recently seen an initial wave of what Peters calls "World Order Treaties".[1411] These treaties, such as the MCAA, have a "quasi-universal membership" and regularly contain something like "public interest norms".[1412] These treaties consider the community interest, and not only the interest of every individual state. Surprisingly, the community interests are also realized and considered through rules between states, so it therefore seems that from a legal perspective, it is still an international community of states and not of individuals.[1413] It is not a surprise that the increased relevance of assumed community interest aligns with the increased use of multilateral treaties in international tax law. Multilateralism is indeed an effective to tool to foster community interest.[1414]

4.4.5. Conclusion

We have shown that certain peremptory rules as part of the international constitution limit domestic legislative leeway. For instance, the sovereignty principle and the principle of *pacta sunt servanda* are important pillars of the international tax regime as a legal regime.

However, no three-pillar international organizational setup for tax purposes exists that is comparable to a domestic framework consisting of a legislative, executive and juridical body. Regarding the legislative component of a constitution, it was shown that there is indeed a shift of tax legislation from a domestic to an international level, even though legislative powers have not been formally transferred to an international level. The judicial and executive powers are, from a tax perspective, rather weak – if not nonexistent – at

1409. *See*, with further references on democratic legitimacy and tax law, Ring, 2008, p. 172 et seq.
1410. *See*, for example, sec. 12.6.2.1.
1411. Peters, 2005, p. 542.
1412. Id., p. 542 et seq., with further references.
1413. *See generally* Ratner, 2011, p. 162 et seq., who draws the link to cosmopolitanism in political philosophy (*see* for more details sec. 7.5.).
1414. Simma, 1994, p. 324.

an international level. Looking forward and also considering the further internationalization and consolidation of tax legislation, the lack of judicial and executive checks and balances with regard to the international realm might trigger severe institutional issues and might require further institutional reconsiderations.

Of particular interest were substantive rules as part of an international fiscal constitution. As we have shown in this regard, individual interests have played minor roles in the most recent international tax law developments. The focus of the recent international (quasi-)legislative projects was clearly not on the protection of individual rights.[1415] However, the first wave[1416] of international tax coordination, i.e. the work of the League of Nations and the OECD, was directed more at individual rights, as the prohibition of double taxation was the major goal, as compared to the most recent wave of international tax coordination, which seems more focused on the international community as a whole.

In general, very few international value-based rules exist as part of an international constitution. For instance, there is no international ability-to-pay principle or a global prohibition of double taxation. However, community interests, such as the prohibition of cross-border tax evasion or the fight against tax avoidance, have created at least a certain framework of international limitations through the use of peer-review processes and a coercion-based system in the case of non-compliance. Nevertheless, it is fair to state that very few value-based guidelines can be derived from an international law perspective or from an international constitutional framework, and one can hardly speak of a constitution in a value-based sense.[1417] In other words, when discussing a redesign of the international tax regime in order to enhance justice and fairness, scholars might find very little guidance from an international constitution. This further supports our methodology, according to which tax lawyers should refer to other disciplines in order to demonstrate more substance within a discussion about justice in international tax law.

1415. *See*, for example, on the (missing) protection of human rights in the international debate on fiscal transparency, Pistone & Baker, p. 17 et seq.
1416. The "first wave" is not a technical term, but might entail the work of the League of Nations before World War II (for more details *see* sec. 4.2.3.2.2.).
1417. *See* Peters, 2005, p. 540, from an international law perspective: "I have some doubts as to whether we can find a constitution in this value-loaded sense on the international plane. [footnote omitted]."

Chapter 5

Conclusions: The International Tax Regime – A Primitive Legal Regime

5.1. General remarks on primitiveness

The preceding concluding sections should be understood on one hand as a summary of the achieved results of Part II, but also as the starting point for the normative review of the international tax regime, as intended through Parts III and IV. In several instances, we will in the following refer to the presumed justice deficiencies, as outlined in the introduction,[1418] and we will evaluate whether the international tax regime, as it was developed in Part II, provides guidance on whether these presumed justice deficiencies are indeed deficiencies and, if yes, how they can be mitigated. Moreover, we will refer to some particular and presumably primitive elements of the international tax regime in order to justify our reference to political philosophy in Parts III and IV.

Other authors have already used the terms "primitive" or "primitiveness" to describe the entire or parts of the international law regime.[1419] It is vital to refer to the term "primitive" in relation to something, as only this provides the term with context. A domestic legal regime is often the comparable for an analysis of whether the international legal regime is indeed considered primitive. Primitive in this sense does not necessarily have a judgmental element, but should instead be understood as a mere comparative evaluation scale. In other words, in the following, we are not suggesting that the international tax regime should develop into a regime that is comparable to a domestic tax regime, but we will use the term "primitive" to describe the current status quo of the international tax regime, as compared to a domestic tax regime. Therefore, the term "primitive" is understood in a neutral manner.

In the introduction of this study, we fully outlined the thesis, particularly with reference to the writings of Peters and others, arguing that international law does not provide very concrete guidelines on how the international tax regime or any international legal regime ought to be designed in order to be

1418. *See* sec. 1.5.
1419. *See* the many references stated by Kolb, 2000b, n. 1. But *see* for a critical view on the terminology Verdross & Simma, § 40.

just.[1420] This would be the first overall conclusion of why the international tax regime is primitive compared to a domestic comprehensive legal regime. In a domestic circumstance, a legislator can derive certain guidelines on what is considered just by a society from, for instance, substantive rules in a constitution or from the rule of law. In the following, to summarize the present Part II, we will highlight four further specific aspects of why the international tax regime is primitive:

– blurred jurisdiction-to-tax and its detrimental impact;
– bilateralism, "fuzzy multilateralism" and primitive international tax legislation;
– the (biased) protection of community interests and individual rights; and
– the primitiveness of the traditional sources of international tax law.

5.2. Blurred jurisdiction-to-tax and its detrimental impact

As was shown earlier, general international law and, as far as can be observed, the decisions of the ICJ in the area of prescriptive jurisdiction, do not provide for very concrete limitations on the quality of the genuine link as a justification for tax criteria. The leeway of states in this regard is considerable, which has caused many overlapping jurisdictional claims that have again triggered cross-border double taxation. This has, inter alia, been shown with reference to three well-known examples.

First of all, the taxation of the worldwide income of residents is in line with international law and has been applied by many countries, as residence seems to be a sufficient link to tax the entire income of a corporation or an individual from an international law perspective. This means that general international law does not limit taxing rights of states to income that was created within the territory of a certain state in cases of residence as a link.[1421]

Second, it has been shown that CFC rules, i.e. taxing the income of a foreign-controlled company due solely to the fact that such company is taxed at a low rate and controlled by a company in another state, seems to be in line with international law, or at least there is no opposing case law available. This is true, although the link to the parent state might be very minimal, or

1420. *See* sec. 2.1.2.
1421. *See* sec. 4.1.2.2.

even incidental, in some cases, particularly if CFC rules do not solely apply in abusive situations in which no substance is at hand in the CFC state.[1422]

Third, the remarks regarding citizenship taxation have shown that US courts assumed that taxation based on citizenship is in line with international law, even though a certain citizen might not live or stay in its citizenship state. Considering the *Cook v. Tait* case, we argued that the benefit principle might be an important anchor to justify citizenship taxation from a normative perspective. However, the latter is a mere moral argument. The legal argument behind the genuine link doctrine is the principle of sovereignty as a peremptory norm of the current world order, which seems to allow states to tax their citizens.[1423]

Therefore, the link to justify taxation can be very limited. However, the actual cause for overlapping jurisdictions is not necessarily the limited link itself, but the fact that a link can trigger broad jurisdiction through the application of worldwide tax systems. This means that the international tax regime is primitive, as it (i) does not only not define what a genuine link is, but worse, it does not (ii) limit the extent of taxation if certain connecting factors, such as residence and/or citizenship, are given. As a consequence, compared to a domestic system, exclusive jurisdiction is not defined at all in international law. In a domestic scenario, a constitution might regulate, for instance, which state body is competent in which area of tax jurisdiction. Therefore, the primitiveness of the international tax regime can be highlighted by the following statement from Martha:

> However, note that general international law – paradoxically – "causes" double taxation, which leads to situations prompting the creation of particular international fiscal law (tax treaties) through international law creating processes.[1424]

In other words, these missing limitations of jurisdiction have triggered one important presumed justice deficiency, i.e. double taxation through overlapping jurisdictions.[1425] Therefore, compared to a domestic federal state setup, international law does not regulate who should be competent to tax what kind of income – if no treaties exist. The blurred jurisdiction-to-tax is also the most important reason why recent international tax law projects deal with the question of how to share the income pie of multinationals or individuals. Initiatives like the BEPS Project would not be necessary if general international law would limit the jurisdiction in a much stricter manner,

1422. *See* sec. 4.1.2.2.5.
1423. *See* sec. 4.1.2.2.1.
1424. Martha, p. 32.
1425. *See*, on the presumed justice deficiencies, sec. 1.5.

for instance, prohibiting double taxation per se. Again, we are neither suggesting that there ought to be a legal prohibition of double taxation at an international level, nor arguing in the opposite manner. The goal of Part II, however, is to demonstrate the weak or primitive legal framework in which the international tax regime operates.

5.3. Bilateralism, "fuzzy multilateralism" and primitive international tax legislation

Besides these missing limitations concerning jurisdiction-to-tax, the international tax regime is primitive in the sense that it has no central legislative body and international tax legislation is not systematically regulated. Moreover, the international tax regime does not have a judicial or executive body with appropriate competences. This is another reason why the international tax regime might be considered unjust, in comparison to a domestic tax regime, as strong states might be able to enforce whatever rule they like on weak states. This was previously mentioned as one of the presumed justice deficiencies.[1426]

We have highlighted in several instances that the international tax regime is mainly based on rules and principles derived from a state's consent through signing international tax and non-tax treaties. The development of the international tax regime mainly based on treaties, however, has occurred in a rather primitive regulatory framework. As an example, it is possible for states to infringe their treaty obligations through treaty overrides and the other parties might not have any access to a judicial body in order to protect their taxpayers. Or, as stated by Lefkowitz in a more general manner, with respect to the missing compulsory jurisdiction of the ICJ:

> Conversely, however, international law's current primitiveness may make it a less effective vehicle for the achievement of justice than it would be were it less primitive in various respects; for instance, were the ICJ to enjoy compulsory jurisdiction.[1427]

Moreover, general international law does not contain any effective measures to disallow unbalanced or even unjust treaties. In a sense, this is also primitive, but as a comparison, reference would need to be made to civil law and the protection of parties to a civil law contract. Prima facie, the available remedies of the parties of an international treaty seem to be fewer than the

1426. *See* id.
1427. Lefkowitz, p. 198.

parties of civil law contracts, but a final judgment would require a separate study.[1428]

From a justice perspective, it seems difficult to understand why states sign some agreements that do not contain factual reciprocal rights and duties. The most obvious examples were the mentioned IGAs signed with the US, some TIEAs signed between developing and developed countries, and double tax conventions providing for a consequent reduction of source taxation, even though the income only flows in one direction between the countries. International agreements do not necessarily contain reciprocal elements in the sense that both parties have (de facto) the same rights and duties. There is, moreover, no legal remedy in international law to challenge unjust international treaties.[1429]

Additionally, we discussed the importance of multilateral treaties in international tax law and their potential justice-enhancing effect. It has been shown that a few multilateral treaties are part of the international tax regime and that the core tax provisions are still provided for in bilateral double tax treaties. It was also shown that international tax law has always had multilateral elements ("fuzzy multilateralism") due to the importance of the OECD MC and the UN MC for the development of the international treaty network. As mentioned above,[1430] with reference to Avi-Yonah, Sartori & Marian, 80% of the wording of the existing treaty network is based on either the OECD MC or the UN MC, i.e. soft law. However, such fuzzy multilateralism steered or led mainly by the OECD might have caused severe disadvantages to developing states. It is argued that international tax legislation through the importance of model conventions might have been done for the benefit of a few rich states. In other words, the international tax regime is primitive, as it has not (presumably), in the past, been able to provide for an institutional setup for multilateralism, which is considered to be just by all affected states. This was also highlighted as one presumed justice deficiency in the introduction.[1431]

Furthermore, in recent years, international tax legislation consisted not only of bilateral and multilateral tax or model tax conventions, but also of

1428. For instance, in international law, there is nothing like unconscionability, which is common in civil or contract law and would, for instance, protect a party in the case of an exploitation of weaknesses by the other contractual party (*see*, for example, art. 21 of the Swiss Code of Obligations, 30 Mar. 1911).
1429. *See*, on the validity of international treaties, sec. 4.2.1.5.
1430. *See* sec. 4.2.3.3.1.
1431. *See* sec. 1.5.

resolutions and recommendations of international organizations having a significant impact on domestic tax legislation. In particular, international soft law has played an important role in the development of domestic tax provisions. The BEPS Project has shifted international cooperation to a new level and the decisions of international organizations have had domestic legislative effects and significant importance.[1432] It can be expected that the influence and importance of soft law will further increase in the upcoming years. An important reason why the use of soft law was so effective is that some of the resolutions of international organizations were combined with direct or indirect coercive measures and supervision mechanisms. The international tax system has traditionally developed without coercive measures, in the sense that states were basically free and not forced to agree on certain international tax rules. Therefore, states have (theoretically) signed tax treaties only if they found an agreement with another state based on a cost-benefit analysis, not forced by any international pressure, besides the economic need to sign double tax treaties in order to increase cross-border trade or investments. However, inter alia, development in the area of fiscal transparency has shown that strong states might also enforce specific rules by threatening other states with severe economic disadvantages, such as exclusion from the international tax regime through blacklisting or other measures.[1433] Importantly, we have not argued that coercion at an international level is illegal in the sense that coercion, as such, would lead to invalidity of treaties, but we instead showed that the presumed justice deficiency of what could be called "Machiavellianism"[1434] is caused by the missing regulation of the use of coercive measures and the primitiveness of the international law regime, as it is not at all regulated – for instance, compared to a domestic constitutional regime – who is competent to legislate and who is allowed to enforce legislation through coercive measures. In a domestic circumstance, if a legislator acts within the constitutional limitations, the law will in general be considered just by its people. At an international level, we showed in detail that there is nothing comparable to a domestic constitution that could provide for guidance on what kind of rules have to be considered just. Therefore, the international tax regime does seem primitive, as it does not provide for specific value-based limitations.

In summary, the international tax regime is not able to judge on whether the mentioned presumed justice deficiencies are indeed deficiencies and, if yes, how these deficiencies, such as the use of coercive power in order to implement certain rules or the lacking solidarity between the developing and

1432. *See generally* Brauner, 2016, p. 47 et seq.
1433. *See* sec. 4.3.4.6.
1434. *See* sec. 1.5.

developed worlds through unjust treaties, could be resolved.[1435] Again, this is not yet a judgment, but this is a descriptive statement that international law as a legal regime does not provide an answer to whether these presumed justice deficiencies must indeed be considered deficiencies and, if yes, how such presumed injustices can be mitigated. Reference to other disciplines is necessary.

5.4. The (biased) protection of community interests and individual rights

The international tax regime is still a regime driven mainly by coordination purposes and not harmonization intentions. The coordination started with the work of the League of Nations, which focused on the allocation of taxing rights among jurisdictions and the mitigation of double taxation.[1436] It was demonstrated that there has been increased cooperation among states from a tax perspective in the past two decades, particularly since the publication of the Report on Harmful Tax Competition in 1998. International cooperation has since reached its peak with the BEPS Project and the formation of the Inclusive Framework. Alignment with such enhanced coordination and, as was shown above,[1437] with community interests is more frequently considered when designing the international tax regime. This means that the international tax regime has overcome parts of its primitiveness compared to a domestic legal system, as it seems to consider the interests of all people and not just of a few single states. One might call this the evolution of a more substantive understanding of international tax law. What are the reasons for such development?

As in other areas (particularly with respect to environmental protection), facts have proven that bilateralism finds its limitations when it comes to the protection of certain public goods. Some global problems can only be resolved by more coordinated work of the different bodies of international law, mainly states. In this respect, increased cooperation at an international level in tax matters is indeed partly justified by the argument that a public good (being tax revenue) cannot be protected in a nationalized and fragmented way. In particular, the fight against cross-border tax evasion and the more recent fight against tax avoidance has led to increased cooperation and consideration of community interests through global tax governance.

1435. *See*, on these deficiencies, id.
1436. *See* sec. 4.2.3.2.2.
1437. *See* secs. 4.2.3.2.4. and 4.2.3.2.5.

The argument is that cross-border tax evasion and tax avoidance can only be resolved by global and coordinated measures. Therefore, it seems that the international tax regime has, at least in this respect, lost its status as a mere coordinative and primitive system that is only steered by the strongest players.

Certain reluctance is required, as notwithstanding the fact that community interests are considered more frequently, the international law framework does not provide us with guidelines on which community interests should be paramount and how to judge whether the taken measures are indeed protecting these community interests. There is a considerable risk that the presumed community interests are biased, as there is no objective reference point in international law for an evaluation. For instance, the current protection of community interests seems mainly or almost exclusively in a state's – or to be more precise, in revenue services' – interests, such as the protection of tax revenue by limiting cross-border tax evasion or by limiting tax avoidance opportunities. The recent international measures are not necessarily in the direct interests of individuals. This will be an important fact to consider when reviewing some of the most important rules and principles of the international tax regime.[1438] For instance, the mere fact that tax revenue increases in a certain state through global measures to fight base erosion and profit shifting does not necessarily mean that the well-being of citizens in the very same state increases. Of course, it is argued that the protection of the tax base through international fiscal transparency or the mitigation of base erosion and profit shifting might increase the well-being of individuals, but international tax projects, such as the BEPS Project or the work of the Global Forum, do not deal with the question of how to increase the well-being of which individuals and what well-being means. These projects imply that raising tax revenue from a multinational perspective increases "general well-being" according to, for instance, the Preamble of the OECD Convention.

Therefore, it seems that the increased protection of community interests within the international tax regime is somehow biased, as mainly community interests have been followed, which are in the interests of the revenue services. Community interests that might be more in the interest of taxpayers, such as the actual distribution of income globally or the protection of taxpayers' rights, have not yet received sufficient attention by

1438. *See*, from an international law perspective, Ratner, 2011, p. 168. *See also* Steichen, p. 48 et seq., who argues that direct tax harmonization would not necessarily lead to individual justice. The same must be true with respect to a partial harmonization, such as the one intended by the BEPS Project.

global tax legislation. However, this should not be understood as a negative perception of the fight for fiscal transparency and against base erosion and profit shifting, but should again disclose the limited guidelines that can be derived from international law with respect to which, if any, community interests should be protected.

Therefore it seems fair to say that the international tax regime is primitive, as it does not provide us with any guidance on which individual rights and community interests should be protected by global tax legislation. For instance, in a domestic situation, a constitution might at least provide certain guidance. Yet, it is crucial to consider that these remarks are still based on a legal analysis of the international tax regime, and we have not yet made any normative claim, such as, for instance, that there should be a distributive element in the international tax regime. We have not yet developed our normative understanding of how the international tax regime ought to be designed in order to be considered just. This will be one of the decisive tasks for Parts III and IV of the present study. The normative question of whether, for instance, the international tax regime should contain cosmopolitan distributive elements to support the poorest on the planet, or whether we should "share the pie" at a global level, cannot be answered by referring to rules or principles contained in the international tax regime as an international law regime.

5.5. The primitiveness of the traditional sources of international law

In the following, we will argue that the traditional sources of the international tax regime are primitive. As mentioned, however, it is crucial to draw a comparison before qualifying something as primitive, and we have thus far mainly used a domestic legal regime for such comparisons. The same is true for the present section.

Compared to a domestic legal regime, several arguments support such a position. In very general terms, the international law regime has shown to be primitive, as no clear hierarchy of the existing sources is available. As mentioned by Kolb, only punctual collision norms exist such as *lex posterior* or *lex specialis*.[1439] In other words, the hierarchy of the different sources of international law is highly disputed. When reviewing the specific sources of international law, more elements of primitiveness have been identified.

1439. Kolb, 2000b, p. 107.

Treaties are by far the main source of international tax law. As many others have shown, a system of thousands of double tax treaties with a non-harmonized national tax system leaves room for tax planning that might – as famously claimed by the OECD – lead to presumably unjust base erosion and profit shifting.[1440] It has also been demonstrated that the net of double tax treaties is far from comprehensive, as only approximately 3,000 have been signed. With respect to treaties, we have further shown that even a highly unjust treaty is valid from an international law perspective and that there is basically no legal requirement to sign non-reciprocal or highly unfair and unbalanced treaties. As a logical consequence, this also means that treaties can cause unjust results within the international tax regime. Compared to a domestic tax act, which must generally be in line with constitutional values, an international treaty must not generally[1441] conform to any value-based framework. This brings us to the other sources of the international tax regime.

We have seen that the development of customary international tax law faces practical and legal constraints, because on one hand, customary international law is a rather weak source concerning very technical disciplines, such as international tax law, and on the other hand, customary international tax law, due to the application of the legality principle in tax law, might not be able to function as an important legal source in the area of international taxation.[1442] Furthermore, we opined that customary international law must be understood as a positive legal concept and morality or justice considerations should not play a crucial role when reviewing the question of whether a rule or principle has become customary international law. Therefore, with respect to the validity of a rule as customary international law, justice or other moral arguments do not play a crucial role, which on the other hand would also mean that unjust customary international law could theoretically emerge, even though the requirement of both state practice and *opinio iuris* might make it a less fragile source of international law regarding justice, as unjust rules of customary law are less likely to be developed than unjust treaty rules.[1443]

Moreover, we analyzed whether there are any general principles of (tax) law according to article 38(1)(c) of the ICJ Statute. It was highlighted that when rendering an analysis of the existence of general principles of law, it is essential that one also considers the underlying reasons for the validity

1440. *See*, for example, Brauner, 2016, p. 4 et seq.
1441. *See*, however, the remarks on *ius cogens* in sec. 4.4.3.2.
1442. *See* sec. 4.3.2.6.
1443. *See* sec. 4.3.2.9.

and the development of these general principles of law. We dismissed the argument that in order to demonstrate the validity of a general principle of law, one actually needs to render a comparative legal analysis following a more positive understanding of such a legal source. A value-based assessment might be sufficient to justify the validity of a general principle of law. Therefore, moral arguments are important for the evaluation of whether a principle qualifies as general principle of law.[1444] Therefore it seems persuasive to argue that the international tax regime is not without value-based principles. However, we have also seen that the scope for the application of the general principles of law is rather limited, as these apply with respect to specific cases and might be unable to influence international (quasi-) legislative projects.

In conclusion, the sources of international law are not exclusively grounded in the consent of states and do not follow an exclusive positive path. But it was shown that the international law regime does not provide a concrete guideline for assessing whether a system is indeed just. Compared to domestic law, international law only provides for very few value-based rules. The sources of international law are generally not steered by moral arguments. Therefore, international tax law needs other reference points in order to analyze whether the international tax regime is considered just and under what circumstances, as the sources of international law are rather limited in this respect. The sources are not in a value-based corset, which means that these sources do not prohibit the emergence of unjust rules to the same extent that sources of domestic law would do. This is one of the main reasons why, in the following, we will refer to moral theory and political philosophy, which were also suggested by other international scholars.[1445] Reference to an outside discipline is necessary in order to provide policy-makers with more concrete guidelines on how the international tax regime should be designed in order to be considered just. Such findings are in line with the aim of Part II, which was, inter alia, to justify why we refer to political philosophy in Parts III and IV of the study.

1444. *See* sec. 4.3.3.2.
1445. *See* the mentioned statements of Peters in sec. 2.1.2.

Part III

Political Philosophy as a Normative Reference Point

Introduction

The present part will lay the groundwork for the later normative assessment of some of the most important principles and rules of the international tax regime. It will be vital to develop an in-depth understanding of the philosophical debate over global justice. The global justice debate was mainly triggered by the enhanced globalization following World War II and from an academic perspective by the publication of Rawls' *A Theory of Justice* in 1972. As we will see in various instances, however, some of the more classical works about justice are still of great importance for the contemporary discussion.[1446] The following chapter will start with references to Rawls' ground-breaking work. We will then refer to his reception among other philosophers before we finish Part III with some concluding remarks.

There are many more ways to structure the part about the different theories of global justice to develop a reference point for our later normative review. One could follow the historical development, but one could also try to group the existing theories. As mentioned, we will refer to Rawls as a starting point and we will outline the reception of his work in a separate chapter. Such a structure allows us to focus on Rawls' work, but simultaneously develop a rather comprehensive overview, as many later authors refer to him. We will dedicate the following section 6.1. to outline in detail why we chose Rawls as a starting point.

As argued above,[1447] the term "justice" in international tax law has long been neglected and the specifics of a justice debate in international tax law have been ignored. In this respect, even among philosophers, the aspect of global justice has been omitted or neglected when theories of justice were discussed.[1448] Yet, in recent decades – since the publication of Rawls' *A Theory of Justice* – ideas of global justice have gained importance. The more recent writings of authors like Beitz, Pogge, Sen and Nussbaum, as well as those of Blake, Caney, Nagel and Risse, should be used as reference points when designing the international tax regime.

To better understand the normative claim of different philosophical ideas, it is crucial to understand that such claims are based on several very complex

1446. *See* Kant's (Kant, p. 1 et seq.) work on perpetual peace as a key for the understanding of the later theories on global justice. And, of course, Kant's work in general was highly influential on all contemporary theories of justice.
1447. *See* sec. 1.4.
1448. *See* Höffe, p. 96, who mentions Kant's work on perpetual peace (i.e. Kant, p. 1 et seq.), however, as an exception among the classics of philosophy.

and intertwined arguments. Even though, as a tax lawyer, I am reluctant to develop my own normative idea of global justice, I think it is essential to understand why the different theories are applied, as this seems the only way to derive principles of international taxation and, more importantly, to demonstrate why these principles are valid. This is the goal of the following overview of the different existing theories.

Chapter 6

John Rawls' Ideal Theory of Inter-State Justice

6.1. Why John Rawls as a starting point?

In several instances in the present Part III and in the following Part IV, we will justify our reference to Rawls for rendering a normative review of the international tax regime. Rawls seems to be the perfect starting point. This is based on several reasons, some of which will be highlighted in the present introductory section.

Rawls' principles of justice should help tax lawyers in the current framework of discussing a redefinition of the international tax regime to reconsider their arguments. For instance, the original position construct, which will be discussed in detail below[1449] and which is a core element of Rawls' theory, could serve as an instrument to measure whether the current rules are indeed just. This has already been highlighted by Christians:

> The contractarian approach [of Rawls] thus provides a structure for thinking about duty in tax system design that is already implicitly at play in the attempts of OECD officials to create an international consciousness regarding tax policy.[1450]

Therefore, even though, and this will be discussed in detail in the following sections, one might not agree with Rawls on his principles of justice among states (i.e. *The Law of Peoples*),[1451] his method of using a veil of ignorance and the original position seems to be a very strong procedure to decide between several claims, which is not uncommon among lawyers.[1452] In this respect, we will further discuss the impact of a plurality of reasons as part of a debate about justice with reference to Sen's *Idea of Justice,* who again was also highly influenced by the writings of Rawls.[1453]

Furthermore, reference to Rawls is required, as his writings in *A Theory of Justice* triggered the discussion about international distributive justice or

1449. *See* sec. 6.2.2.
1450. Christians, 2009b, p. 130.
1451. *See* sec. 6.3.3.
1452. *See* Singer, 2009, p. 975.
1453. *See* sec. 7.7.

global justice in recent decades.[1454] Also, if one uses normative reasoning, it is essential to frame the universe of existing theories,[1455] which can best be done by starting with one of the most important and influential authors in this respect. Rawls is one of the most important political philosophers in the 20th century because, inter alia, he made, as stated by Fleischacker, moral philosophy respectable again. He was basically the starting point for an important wave of discussions about several moral concepts besides utilitarianism.[1456] Therefore it makes sense to also use him as a starting point for our study.

Finally, Rawls matters because he is a persuasive example of why domestic and international considerations about justice might need to be distinguished, even though one might tend to apply the same principles at both a national and international level. This is also true from a tax perspective: Principles developed in order to achieve a just domestic tax system are not, per se, principles that are useful to achieve a just international regime.[1457] This will, for instance, be outlined with reference to the ability-to-pay principle.[1458]

6.2. A theory of justice as fairness

6.2.1. Some conceptual remarks

Rawls' work on justice and international law or the global order, as such, which will be one of the most important points of reference in the following, is strongly related to his masterpiece *A Theory of Justice*, which was published in a first version in 1972 and in a revised version in 1999. To understand his later work on the law of peoples, it is essential to first outline his theory of justice as fairness.

One of the main tasks of *A Theory of Justice* was to question utilitarianism as a normative theory of justice and to develop an alternative to utilitarianism.[1459] Moreover, Rawls challenges intuitionism by arguing that

1454. *See* the Stanford Encyclopaedia of Philosophy, International Distributive Justice (available at http://plato.stanford.edu/entries/international-justice/, last visited 20 Jan. 2019).
1455. *See* Singer, 2009, p. 951.
1456. Fleischacker, p. 110.
1457. *See* the remarks in the introductory secs. 1.3. and 1.4.
1458. *See* sec. 11.2.
1459. Rawls, 1999a, p. 20.

intuitive capacities are generally "unguided by constructive and recognizably ethical criteria".[1460] He aims at developing a theory of justice that reduces intuition by focusing on the development of a more "systematic account of our considered judgments of the just and the unjust."[1461] Therefore his theory should allow for a more structured way of dealing with different claims about justice in a societal framework. We will again deal with such criticism of intuitionism when reviewing *The Idea of Justice* by Sen.

Importantly, in *A Theory of Justice*, Rawls already argues that his general principles of justice that he uses to enhance justice within a society should be applicable to a specific system, such as the current state's system:

> The scope of our inquiry is limited in two ways. First of all, I am concerned with a special case of the problem of justice. … The conditions for the law of nations may require different principles arrived at in a somewhat different way. I shall be satisfied if it is possible to formulate a reasonable conception of justice for the basic structure of society conceived for the time being as a closed system isolated from other societies.[1462]

In *A Theory of Justice*, Rawls therefore focuses on the basic structure of a society as the main subject of justice, i.e. social justice.[1463] Therefore, in his theory of justice as fairness, he did not yet provide a solution to resolve the injustices among various societies and states, respectively.[1464] Or, as stated by Rawls: "The conditions for the law of nations may require different principles arrived at in a somewhat different way."[1465]

He had not yet developed principles of justice for structuring the world order, but the latter was discussed by Rawls in *The Law of Peoples*, which will be discussed in section 6.3. Some authors, however, have used his *A Theory of Justice* to discuss the idea of global justice or the concept of a just global structure. As we will see below, this has led to others, such as Beitz[1466] or Pogge,[1467] coming to a very different outcome than the one provided later by Rawls in *The Law of Peoples*.

1460. Id., p. 34.
1461. *See* on this topic id., p. 36 et seq.
1462. Id., p. 7.
1463. *See* id., p. 6 et seq. *See also* Ronzoni, 2009, p. 232 et seq.
1464. Other authors, however, have extended the basic structure argument to the international framework and therefore applied Rawls' principles of just society globally (*see* sec. 7.5.).
1465. Rawls, 1999a, p. 7.
1466. *See* sec. 7.5.1.
1467. *See* sec. 7.5.2.

6.2.2. Rawls' original position and the veil of ignorance

The starting point of Rawls as a contractualist[1468] is the idea of a social contract among the members of a certain society. He therefore puts forward a social contract methodology already used by Thomas Hobbes, Immanuel Kant, John Locke and Jean-Jacques Rousseau.[1469] However, Rawls aims at developing a conception of justice based on social contract theory with a higher level of abstraction.[1470] Rawls' *A Theory of Justice* is therefore based on a theoretical, or better, on a hypothetical situation of a world or society without any rules or, as he calls it, in an "original position". In such an original position of equal liberty for all, people would choose certain principles of justice.[1471] Or, in the words of Rawls: "These principles are those which rational persons concerned to advance their interests would accept in this position of equality to settle the basic term of their association."[1472]

This means that in such an original position, the parties try to reach the basic terms of justice in their society if there is freedom and equality of all persons.[1473] Importantly, according to Rawls, the parties are under a veil of ignorance, which means that the parties do not know what their position will be within the society. The veil of ignorance allows Rawls to demonstrate that the agreed upon principles are considered to be just[1474] and it "ensures that no one is advantaged or disadvantaged in the choice of principles by the outcome of natural chance or the contingency of social circumstances."[1475] It has similar features as an impartial spectator approach, which we will discuss further below with reference to Sen.[1476] Due to the veil of ignorance,

1468. As rightly pointed out by Nussbaum, 2004, p. 4, Rawls is not a strict contractualist, as he combines moral elements (of Kant) and the idea of a social contract. However, for further details on Rawls' own understanding of what social contract theory means, *see* Rawls, 1999a, p. 14 et seq.
1469. *See*, on contractualism as an approach for contemporary theories of justice, Sen, 2012, p. 101 et seq.
1470. *See* Rawls, 1999a, p. 10.
1471. Id., p. 11. Such procedural considerations on how to achieve principles of justice in a society might lead to the conclusion that Rawls aims at developing procedural fairness (*see*, for example, Senn, p. 182) as he aims at demonstrating how members of a society could agree on certain principles of justice. However, as Rawls in a rather precise manner demonstrates how these principles should be designed, his theory is of great interest for the present study focusing on results-oriented justice considerations.
1472. Rawls, 1999a, p. 102.
1473. *See* Pogge, 2004b, p. 1739.
1474. *See* Rawls, 1999a, p. 118.
1475. Id., p. 11.
1476. *See*, on the difference between an impartial spectator approach and the original position of Rawls, Sen, 2009, p. 134 et seq.

the parties of the original position do not know whether they are going to be rich, poor, strong or weak members of the society.[1477] Therefore, they would agree on principles that suit all members of the society, as they run the risk of being any member – even the worst off – of the society.

According to Rawls, justice is what free and equal people would agree to as basic principles of cooperation within a society under conditions that are fair for this purpose. The use of an original position helps us develop principles that are based on unanimous decisions, as such results are only feasible to the extent that the parties do not know which parties they are representing.[1478] Therefore, "the original position is the appropriate initial status quo which insures that the fundamental agreements reached in it are fair."[1479] Moreover, this explains why Rawls calls his theory "justice as fairness", as he dedicates significant importance to the (fair) circumstances in which the members of a society would agree on certain principles of justice.[1480] As a consequence, Rawls' principles of justice are closely linked to questions of social choice, as the people within the original position render their decision on which principles should be agreed upon based on rational choice.[1481] Or, as stated by Rawls: "The theory of justice is a part, perhaps the most significant part, of the theory of rational choice."[1482]

Following such methodology, he develops his idea of (liberal) principles that would be chosen by the parties in such hypothetical circumstances, as we will visualize in the following section. As mentioned, Rawls calls such an approach "justice as fairness", as the principles of justice are those that people would agree upon in an initial situation that is fair.[1483]

6.2.3. The two principles of justice

Following such a methodology, Rawls develops two principles of justice throughout the book that are the core elements of his theory of justice:

1477. Rawls, 1999a, p. 118.
1478. Id., p. 122.
1479. Id., p. 15.
1480. For a more detailed analysis in this respect *see* Sen, 2009, p. 53 et seq.
1481. *See* Rawls, 1999a, p. 16. For more details on his understanding of rationality, *see* id., p. 123 et seq.
1482. Id., p. 15. We will further deal with social choice theory as part of a theory of justice when reviewing *The Idea of Justice* by Sen in sec. 7.7.
1483. Rawls, 1999a, p. 11.

> First Principle
>
> Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all.
>
> Second Principle
>
> Social and economic inequalities are to be arranged so that they are both: (a) to the greatest benefit of the least advantaged, consistent with the just savings principle, and (b) attached to offices and positions open to all under conditions of fair equality of opportunity.[1484]

The principles are chosen by the parties within the original position, as these "protect their basic rights and they insure themselves against the worst eventualities."[1485] These principles are lexically ordered (some authors also use the term "serially"), in the sense that the first principle (i.e. basic liberties) shall not be infringed as a result of obeying the second principle. This means that the first principle "can be restricted only for the sake of liberty".[1486] Additionally, none of the principles may be infringed to achieve higher aggregated goods. This means, as mentioned already, that Rawls clearly opposes utilitarian ideas according to which – in simplified terms – a system is just if there is an overall tendency to promote the highest amount of happiness.[1487] He, therefore, also denies the suitability of a single principle of justice, as suggested by utilitarianism. According to Rawls, members of a society would not agree on a utilitarian concept, as everyone would run the risk of being oppressed and not treated with human dignity.[1488] Or, as stated in the very beginning of *A Theory of Justice*, he argues that each member of a society has "an inviolability founded on justice that even the welfare of society as a whole cannot override."[1489]

Within the first principle, Rawls would claim the following rights: freedom of thought and liberty of conscience; the political liberties and freedom of association, as well as the freedoms specified by the liberty and integrity of the person; and finally, the rights and liberties covered by the rule of law. As a liberal, he does not argue that further social economic rights are essential in his theory of justice. There is a tremendous amount of literature concerning such a principle and its justification, but this principle is not in the scope of the present study, since the question of justice in the international tax

1484. Id., p. 266.
1485. Id., p. 154.
1486. Id., p. 266.
1487. For further details about Rawls' criticism of utilitarian ideas *see* id., p. 19 et seq.
1488. For further details *see* Fleischacker, p. 109 et seq.
1489. Rawls, 1999a, p. 3.

regime is more related to questions of distribution of income and/or wealth, as covered by the second principle of justice.

The second principle consists of two parts. The second part requires equal opportunities within a society, while the first part refers to the famous "difference principle", which we will refer to in many instances in the following. The difference principle means that inequalities within a society are permitted to the extent that they are for the benefit of the worst off within a society. It is a modern definition of what distributive justice means or could mean. As we have seen above, Aristotle's use of the term "distributive justice" was not as precise and also differs from the use of the principle of distributive justice or the difference principle by Rawls.[1490]

The difference principle is of preeminent importance in the present work, as it relates, inter alia, to the distribution of wealth in a society and the question of whether existing inequalities are to the benefit of the worst off. The level of distribution is an essential part of a national tax policy and, potentially, as we will discuss in detail in Part IV of the present study, of international tax policy. The difference principle is required from Rawls' perspective because the natural endowments, such as talents, are not deserved.

The difference principle, however, does not lead to a mandatory redistribution of assets from rich members of the society to poor members, as it is acknowledged that certain conventions within a society require that some people be more powerful than others. This is under the condition that the project will make the worst off within a society receive a better life and the condition that there is no arbitrary discrimination or discrimination based on irrelevant criteria, such as religion, race or gender.[1491] In other words, redistribution of wealth is necessary to conform to the difference principle and not achieve equality per se.

However, the gifted members of the society should use their talents, as long as the less endowed also benefit from these abilities. This leads to a certain balance of the existing talents within a society, which reduces the inequality within a society and, therefore, also enhances the cohesion of a society. According to Rawls, the difference principle should allow a long persistence of society, or else great disparities among the members of the society would be created and threaten the stability of a society.[1492]

1490. *See* sec. 1.2.
1491. Rawls, 1999a, p. 84 et seq.
1492. Id., p. 137. Rawls, however, does not discuss in detail how a tax regime should be designed in order to align with his principles of justice (*see*, however, p. 245 et seq.).

The principles of justice within *A Theory of Justice* have, as already mentioned, triggered criticism from different angles. The most famous critique stems from Nozick in his libertarian *Anarchy, State and Utopia*.[1493] However, as we will see in the following section, the focus of the present study is on the concept of justice at an international level within *The Law of Peoples* and its reception among philosophers.

6.3. *The Law of Peoples*

6.3.1. Some introductory remarks

In simplified terms, in *The Law of Peoples* Rawls developed some principles of justice for the international realm. Therefore he argues that there is justice beyond the state, but as we will see in the following he denies that distributive justice is part of justice in the international realm. To better understand these principles and their later reception, some preliminary remarks are essential.

First, it is crucial to highlight that by publishing his book on the law of peoples, Rawls admits that justice is applicable at an international level. This seems to be self-evident, but if one follows a strict understanding of Hobbes as another contractualist, one could argue that, as there are no shared interests at an international level and no central coercive power, there are no or very minimal considerations of justice at an international level.[1494]

Secondly, it shall briefly be discussed why Rawls uses the title *The Law of Peoples* and not *Law of the States*. He dedicates a separate chapter on this question[1495] and seems, therefore, to assign great importance to this differentiation. Rawls understands peoples as a group of persons with their own state.[1496] Nevertheless, the terms "peoples" and "states" are not identical, as Rawls emphasizes two major differences between states and peoples.[1497] First, peoples do not have an unlimited sovereignty as states would have in the current world order. Secondly, a difference between states and peoples, according to Rawls, lies in the fact that a state does not have the autonomy

1493. Nozick, p. 1 et seq.
1494. *See* Tasioulas, 2002, p. 369. For further details about Hobbes and international law and his reception from a cosmopolitan perspective, *see* Cheneval, p. 225 et seq.
1495. Rawls, 1999b, § 2.
1496. *See* Buchanan, 2000, p. 698.
1497. Rawls, 1999b, p. 26 et seq.; Nussbaum, 2007, p. 238 et seq., questions the utility of the term "peoples" in this context.

to deal with its own citizens in its own full discretion or, in other words, to have an "unrestricted internal autonomy".[1498] Many arguments question the usefulness of the term *The Law of Peoples* instead of *Law of the States* or *Interstate Law*, as pointed out by several authors.[1499] For instance, as Pogge rightly highlights,[1500] it is not persuasive to use the term "Peoples", as it does not reflect the reality that borders are drawn identically to where peoples are factually separated. Or, considering the flow of migrants in recent decades, it is obvious that the term "Peoples" has nearly no reference in the current world order.[1501] For the purposes of the present study, however, it seems appropriate to utilize the terms "law of peoples" and "law of states" simultaneously, or to conclude with Buchanan:

> So it is appropriate to describe the principles of Rawls's Law of Peoples as interstate principles, so long as we keep in mind Rawls's distinction between peoples (as politically organized into states with limited sovereignty) and states as traditionally conceived (where these limitations on sovereignty were lacking).[1502]

A third preliminary remark relates to the fact that Rawls did not have the intention to develop a just international system in an ideal world, but he instead focused on developing the most important principles in the framework of the existing world order, i.e. a realistic utopia.[1503] Furthermore, his principles among different peoples do not primarily aim at developing a just system, but these principles are important to ensure peace among different states.

Fourth, it should be highlighted that Rawls argues that there is no need for cooperation by states as a natural or conceptual duty. This means – compared to a situation among persons in a society – Rawls argues that states will only cooperate if they receive a benefit from it. However, it is obvious that most peoples will cooperate.[1504] International tax law is a persuasive example to demonstrate that a presupposed duty for cooperation among states does not exist. Many of the so-called tax havens had not signed a single tax treaty until very recently, as these states have been of the opinion that they are better off by not having any cooperation with other states when it comes to tax matters.

1498. Rawls, id., p. 27.
1499. E.g. Tasioulas, 2002, p. 372 et seq.
1500. Pogge, 1994, p. 197.
1501. *See* Pogge, 2004b, p. 1743, demonstrating further inconsistencies.
1502. Buchanan, 2000, p. 699.
1503. *See* sec. 2.1.5.
1504. *See* Reidy, p. 299.

Fifth, Rawls' intention in *The Law of Peoples* was not to develop principles for a (liberal) foreign policy, but indeed to apply his theory of justice at an international level[1505] or, in other words, *The Law of Peoples* "is an extension of a liberal conception of justice for a democratic regime to a Society of Peoples".[1506]

6.3.2. The second original position

As already mentioned, Rawls further extended parts of his methodology used in his book *A Theory of Justice* into an international framework and argued that the so-called second social contract will provide for the independence of states limited by a few essential rights for all peoples. Or, as mentioned by Rawls, the second original position "is a model of representation, since it models what we would regard – you and I, here and now [footnote omitted] – as fair conditions under which the parties, this time the rational representatives of liberal peoples, are to specify the Law of Peoples, guided by appropriate reasons."[1507]

This means that Rawls assumes that the necessary basic fairness in international law is secured, as the peoples or states are represented equally in their original position, i.e. the veil of ignorance.[1508] Therefore he used a second original position at an international level, in the sense that in the second original position, citizens are the representatives of their societies being equal and rational.[1509] These representatives would choose principles for the law of peoples. Importantly, the representatives of the peoples act in the interest of their clients,[1510] i.e. their people and not in their own interest. Their aim is "to preserve the equality and independence of their own society".[1511] Therefore, it is their goal "to guarantee their security, territory, and the well-being of their citizens".[1512] The latter is essential for the understanding of Rawls' theory from a tax perspective.[1513]

Rawls' application of the social contract methodology at an international level consists – to be more precise – of a twofold approach. First, he

1505. *See* Nussbaum, 2007, p. 229.
1506. Rawls, 1999b, p. 9.
1507. Id., p. 32.
1508. *See* id., p. 115.
1509. *See* id., p. 32 et seq.
1510. Pogge, 2004b, p. 1740.
1511. Rawls, 1999b, p. 41. *See also* id., p. 115.
1512. Id., p. 34.
1513. *See* the remarks on the position of Valta in sec. 10.3.

develops the principles that would be agreed upon by liberal peoples and demonstrates that in a second step, decent but non-liberal peoples would agree on the same principles. Therefore, he ensures that the developed principles are also reasonable from the perspective of decent non-liberal states.[1514] Consequently, Rawls implies that liberal states ought to tolerate non-liberal but decent states as equal members of the society of states.[1515]

The representatives or agents of a specific people also find themselves under a veil of ignorance, in the sense that they do not know which people they are representing. Accordingly, the representatives in the second original position do not know whether they represent a large country, a rich country, or a developing country.[1516] The adjusted veil of ignorance at an international level means, as mentioned, that the parties "do not know, for example, the size of the territory, or the population, or the relative strength of the people whose fundamental interests they represent."[1517] They also do not know the extent of natural resources in their territory or their economic development.

In other words, Rawls modifies the contract methodology at an international level. By the way, this is also one of the main critiques about *The Law of Peoples*, that he did not consequently apply the same participants to justify principles of justice at an international level. The principles of justice would be different if individuals were directly (i.e. without boundary constraints) participating in the second negotiation round. This important critique will be dealt with below.[1518] Furthermore, the parties within the second original position have the task to agree on certain rules of conduct among them and not to develop a worldwide institutional order.[1519]

For the moment, it is important to highlight that in *The Law of Peoples* Rawls refrains from using all available theories and options for a just international system, as his thoughts were limited by the existing principles of international law and the existing world order consisting, inter alia, of liberal and decent states. This is an important difference compared to *A Theory of Justice*, in which he dealt with the various existing ideas, such as utilitarianism, in order to develop his theory of justice.[1520]

1514. Rawls, 1999b, p. 10. *See also* Tasioulas, 2002, p. 371 et seq.
1515. *See* Nussbaum, 2004, p. 9.
1516. *See* id., p. 5 et seq.
1517. Rawls, 1999b, p. 32.
1518. *See* sec. 7.2. *See also* Sadurski, p. 6.
1519. Pogge, 2004b, p. 1740. *See* in support of Rawls, Risse, p. 113 et seq.
1520. For further details about the difference in methodology *see* Sadurski, p. 13 et seq.

For the present analysis concerning justice in international tax law, the second original position is an extremely important instrument to potentially judge whether the current rules of international tax law are just. However, it is crucial to understand why the original position, as such, is used as a mechanism to justify interstate cooperation. First, within a society and within a group of states, different doctrines exist to decide on whether rules are just or not: "The society in question, however, is one in which there is a diversity of comprehensive doctrines, all perfectly reasonable."[1521] The original position helps to find common principles for the interaction of states, even though justice consideration domestically might deviate significantly among the participating states. Furthermore, the veil of ignorance or the original positions are methodological models. Such models can be used to demonstrate whether a system, such as the current international tax regime, is more or less just. It is essential, as mentioned, to decide on "what we would regard – you and I, here and now [footnote omitted] – as fair conditions under which the parties, this time the rational representatives of liberal peoples, are to specify the Law of Peoples, guided by appropriate reasons."[1522] Therefore, following Rawls' understanding of reasonable and rational states (respectively, peoples), they can offer "fair terms of political and social cooperation".[1523]

6.3.3. The principles of justice

6.3.3.1. Some preliminary remarks

In his book, Rawls develops eight traditional principles of the law of peoples. These eight principles are the moral law binding all peoples.[1524] Importantly, these principles are valid even though non-democratic peoples are involved in the international order – as long as these peoples are decent. This means that Rawls is of the opinion that the representatives of decent hierarchical (i.e. non-liberal) peoples would choose the same eight principles that the representatives of liberal peoples would adopt.[1525] These eight traditional principles of justice among free and democratic peoples are the following:[1526]

1521. Rawls, 1999b, p. 31.
1522. Id., p. 32.
1523. Id., p. 35.
1524. Reidy, p. 302.
1525. Rawls, 1999b, p. 69.
1526. Id., p. 37.

(1) Peoples are free and independent, and their freedom and independence are to be respected by other peoples.

(2) Peoples are to observe treaties and undertakings.

(3) Peoples are equal and are parties to the agreements that bind them.

(4) Peoples are to observe a duty of non-intervention.

(5) Peoples have the right of self-defense, but no right to instigate war for reasons other than self-defense.

(6) Peoples are to honor human rights.

(7) Peoples are to observe certain specified restrictions in the conduct of war.

(8) Peoples have a duty to assist other peoples living under unfavorable conditions that prevent their having a just or decent political and social regime.

Many authors have argued that these principles reflect most of the familiar principles of the current international law framework.[1527] However, as pointed out by Macedo,[1528] in the real world, the duties owed by a state to another state might go beyond the mentioned principles, for instance, due to their historical relationship (e.g. between the Netherlands and Indonesia as its former colony).[1529] However, Rawls discusses an ideal theory of justice without considering existing wrongdoings between states and, therefore, his theory does not specifically deal with what could be called restorative justice.

From a tax perspective, the following sections aim to develop more concrete guidelines from a normative perspective following Rawls' principles. However, and as also highlighted by Rawls, these principles trigger difficult questions of interpretation, and he also agrees that these principles are up for debate.[1530] Therefore the following sections should be understood as a personal interpretation to further make use of these principles as normative

1527. E.g. Nussbaum, 2004, p. 6; Reidy, p. 302.
1528. Macedo, p. 1732.
1529. *See also* the work of Benshalom, as outlined in sec. 10.2.
1530. Rawls, 1999b, p. 42.

guidelines from an international tax law perspective. We will not discuss all the principles in detail, but we will focus on the most important ones for the purposes of the present study.

6.3.3.2. Principle of freedom, independence and *pacta sunt servanda*

The first principle, according to which states shall be free and independent ("Peoples are free and independent, and their freedom and independence are to be respected by other people.")[1531] could be understood in an extreme manner. For instance, Franck argues (but only with references to *A Theory of Justice* and not to *The Law of Peoples*) that this would mean in a strict sense that even if a genocide were to occur, that other states could not invade another state. Or in other words:

> Thus rational governmental representatives would agree upon an absolute principle of non-intervention; and they would agree because the negotiators would have the shared moral perspective of governments. It is the special self-interest of governments – all governments – to protect their authority against external intervention, and to prefer order above other virtues.[1532]

Yet, Rawls does not understand the principle of independence in an absolute form and he argues that the "right to independence and self-determination is no shield from that condemnation, nor even from coercive intervention by other peoples in grave cases."[1533] This means that in a grave case, for instance, in a genocide situation, the independence of a state must not be obeyed. Moreover, Rawls[1534] admits that no people should have the self-determination to oppress another people. Rawls does not provide for any justification for non-obedience. However, he argues that only if a state qualifies as an outlaw state, other states might be allowed to interfere and to bring such a state out of its natural position.

A further principle of *The Law of Peoples* that is linked to the first principle is the principle of *pacta sunt servanda*. According to Rawls – notwithstanding the fact of whether a state is liberal or decent but non-liberal – *pacta sunt servanda* must be followed, which means that peoples are to observe treaties and undertakings. According to my understanding, this is linked

1531. Id., p. 37.
1532. Franck, 1990, p. 222.
1533. Rawls, 1999b, p. 38.
1534. Id.

to the general need that the principles of *The Law of Peoples* must satisfy reciprocity. This is most obviously true regarding the principle of *pacta sunt servanda*.[1535]

6.3.3.3. Peoples are to honor human rights

According to Rawls, the representatives of peoples would in the second original position agree to honor the most basic human rights. This would include "freedom of slavery and serfdom, liberty (but not equal liberty) of conscience, and security of ethnic groups from mass murder and genocide."[1536]

Some claim that the list is rather thin, as it "explicitly omits more than half the rights enumerated in the Universal Declaration."[1537] According to Rawls, this consent is found even though some hierarchical (non-democratic) societies might be part of such a negotiation round.[1538] Others oppose such an outcome as being unrealistic. Pogge is of the opinion that human rights are not essential to hierarchical societies as they are for liberal societies,[1539] which means that it is doubtful that the representatives of hierarchical societies would choose to commit to obey human rights regulations at an international level.

Besides, Pogge argues that liberal states, on the other hand, would likely ask for more than the most essential human rights,[1540] as suggested by Rawls. Moreover, Tasioulas rightly points out that the reason for such a rather limited human rights collection in Rawls' writing is that Rawls understands human rights as being linked to the morality of intervention.[1541] This means that an intervention by another state is not permissible if these basic human rights are honored. Again, this shows how much importance Rawls attributes to toleration of both liberal, but also decent but hierarchical states. According to Rawls, human rights within the law of peoples "restrict the justifying reasons for war and its conduct, and they specify limits to a regime's internal autonomy."[1542]

1535. *See*, on reciprocity, id., pp. 41 and 57.
1536. Id., p. 79.
1537. Nussbaum, 2004, p. 8. *See also* Macedo, p. 1725, who uses the expression "most urgent rights contained in the Universal Declaration".
1538. *See* sec. 2.1.5.
1539. Pogge, 1994, p. 215.
1540. Id.
1541. Tasioulas, 2002, p. 384.
1542. Rawls, 1999b, p. 79.

As mentioned, the present study does not aim to develop a comprehensive understanding of which human rights ought to be followed at both an international and a national level. However, the application of human rights in international tax law has gained significant momentum due to the recent developments within the field of cross-border exchanging of information to counter tax evasion,[1543] and we will at least partly refer to the protection of human rights in our discussion on how to achieve global justice.[1544]

6.3.3.4. Duty of assistance

According to principle eight, "[p]eoples have a duty to assist other peoples living under unfavourable conditions that prevent their having a just or decent political and social regime."[1545]

The duty of assistance requires that well-ordered peoples (i.e. liberal peoples or decent peoples)[1546] should assist burdened societies until these states reach a certain level at which they are capable of running their state affairs.[1547] Burdened societies, according to Rawls, and as already mentioned, are societies that "lack the political and cultural tradition, the human capital and know-how, and, often, the material and technological resources needed to be well-ordered."[1548] However, the duty does not exist with respect to what Rawls calls outlaw states, as these states do not have the intention to indeed ensure a just international structure.

The aim of the duty of assistance, according to Rawls, is explicitly not to reach an egalitarian level of wealth.[1549] It is also not a duty for distributive justice, as the duty of assistance ends when a stable order has been established.[1550] Or, in a negative manner, it is not the duty of a state to support another state just because it has a (significantly) lower GDP. As Risse points out, Rawls understands the duty of assistance as being limited to a "transitory assistance in institution building."[1551] This means that the assist-

1543. *See*, for example, Baker & Pistone, p. 21 et seq. *See also* International Bar Association, p. 1 et seq.
1544. *See*, for example, sec. 8.4.
1545. Rawls, 1999b, p. 37.
1546. *See* sec. 2.1.5.
1547. Rawls, 1999b, p. 106 et seq. *See also* Macedo, p. 1726.
1548. Rawls, id., p. 106.
1549. Id.
1550. *See* Kreide, p. 108.
1551. Risse, p. 95.

ance should support the burdened societies to install just and functioning institutions.

6.3.4. Rawls on international institutions and international cooperation

As international organizations play a crucial role within international tax law and within the international tax regime, it is essential to consider Rawls' thoughts in this respect.

Prima facie, following the mentioned principles of the law of peoples, Rawls does not argue in favor of the need for intensive international cooperation, nor does he state that states should avoid any cooperation, as he argues, for instance, that regulation on free trade could be to everyone's advantage.[1552] Yet, he follows Kant, and clearly rejects the idea of a world state.[1553]

If states indeed agree on an international organization, for instance, to regulate trade laws, these organizations need to not necessarily be organized along democratic lines.[1554] Or, as Reidy states: "Global and regional institutions are, then, something like the international analogue of the voluntary associations constitutive of civil society in a liberal democracy. They exist as such, however, apart from and unconstrained by any sort of world state."[1555]

Furthermore, and this might also be of importance from a tax perspective, Rawls assumes that there could be international organizations that may have an authority to initiate economic sanctions, but only in grave cases of unjust domestic institutions and clear infringements of human rights.[1556] He repeats his understanding by saying that the people's independence is not protected from coercive measures in grave cases.[1557] Nevertheless, Rawls argues that justice does not require that international organizations be founded in order to promote egalitarian ideas at a global level.[1558]

Besides, Rawls highlights the importance of fair terms if states do indeed cooperate. Fair terms mean that states should follow their treaty obligations

1552. *See* Rawls, 1999b, p. 42 et seq.
1553. Id., p. 36.
1554. *See* id., p. 42 et seq.
1555. Reidy, p. 293.
1556. Rawls, 1999b, p. 36.
1557. Id., p. 38.
1558. *See* Caney, 2006, p. 755.

and that severe market distortions should be discouraged. Or, in Rawls' words:

> Consider fair trade: suppose that liberal peoples assume that, when suitably regulated by a fair background framework,[footnote omitted] a free competitive-market trading scheme is to everyone's mutual advantage, at least in the longer run. A further assumption here is that the larger nations with the wealthier economies will not attempt to monopolize the market, or to conspire to form a cartel, or to act as an oligopoly.[1559]

However, it is brought forward that Rawls' theory is weak on the role of international institutions with respect to justice on a global scale, as he does not develop detailed ideas of international trade or the structures of international organizations.[1560]

6.3.5. No distributive duties at an international level

Rawls is of the opinion that there is no type of (egalitarian) distributive duty at an international level.[1561] Therefore he does not apply the aforementioned difference principle[1562] – which is one of the fundamental aspects of his *A Theory of Justice* within a society – at an international level. This means that he clearly denies liberal cosmopolitanism.[1563]

As a consequence, he concludes that inequalities among individuals living in different nations are not unjust per se.[1564] Inter alia, one of the main reasons why there is no need for the application of a distributive duty at an international level is that the aforementioned second principle of justice within domestic law, i.e. the argument of reciprocity, is not necessary at an international level, as the gap between poor and rich people is already sufficiently narrowed by the second principle of justice in a domestic framework.

Rawls argues that the economic wealth of two states is different because one state has spent its entire (or a significant part of its) savings in the past and the other has not.[1565] Rawls argues that in this case, it is unacceptable

1559. Rawls, 1999b, p. 42 et seq.
1560. *See* Caney, 2006, p. 755. *See also* Beitz, 2005, p. 19 et seq.
1561. For details *see* Rawls, 1999b, p. 113 et seq. *See also* Kesselring, p. 47; Pogge, 1994, p. 196 et seq.; Tasioulas, 2002, p. 370; Wenar, p. 82.
1562. *See* sec. 6.2.3.
1563. Macedo, p. 1724. For more details on cosmopolitanism *see* sec. 7.5.
1564. Rawls, 1999b, p. 113.
1565. Id., p. 114.

that the saving state would be required to transfer parts of its wealth to the other state. This means that Rawls is of the opinion that inequalities among states are generally homegrown.[1566] Or, as Macedo puts it: "the substance of justice is held hostage to the brute facts of global diversity."[1567]

From the perspective of Rawls, the duty of assistance is sufficient in order to achieve a just international distribution of goods. The duty of assistance means that states are obliged to "assist burdened societies to become full members of the Society of Peoples and to be able to determine the path of their own future by themselves."[1568] Therefore, the position of Rawls deviates from a traditional global egalitarian approach, even though Rawls argues that his understanding actually reflects an "egalitarian principle with target."[1569] According to Nagel, he therefore developed principles that should be decisive for foreign policy and he did not have the intention to develop an idea of a just world; in other words, a just world from a Rawlsian perspective consists of internally just states.[1570] Furthermore, this means that "moral units"[1571] at an international level are states (or peoples) and not individuals. As argued by Macedo, and as will also be further developed below,[1572] Rawls' approach shows the moral significance of political communities:

> A self-governing political society is a hugely significant joint venture, and we understand it as such. Cosmopolitan distributive justice (as opposed to a duty to assist other peoples to become self-governing) makes no sense absent a cosmopolitan state and a cosmopolitan political community, for which hardly anyone seriously argues [and which Rawls, following Kant, rightly rejects].[1573]

Rawls is aware of the argument that depending on the definition of the duty for assistance, the outcome of a more cosmopolitan understanding of global justice and his approach would be nearly the same, besides practical matters such as taxation and administration.[1574] What Rawls tries to emphasize, however, is that even in the case of an extensive duty of assistance, his law of peoples would still require strong sovereign states and he would, inter alia, disagree with the need for a centralized world state or very strong global institutions with coercive power.

1566. Pogge, 1994, p. 213 et seq.
1567. Macedo, p. 1723.
1568. Rawls, 1999b, p. 118. *See* sec. 2.1.5.
1569. Rawls, 1999b, p. 119.
1570. *See* Nagel, p. 134.
1571. The term is used by Nagel, p. 124.
1572. *See* sec. 8.3.1.
1573. Macedo, p. 1731.
1574. *See* Rawls, 1999b, p. 118 et seq. *See*, on cosmopolitanism, sec. 7.5.

The latter seems to be of no interest in the framework of the current discussion about improving the world (tax) system by using a normative realistic theory, as the development of a world state is an apparent constraint.[1575] Nevertheless, it is vital to realize that the need for a more integrated international tax regime questions the validity of moral significance of the sovereignty of states within Rawls' theory on the law of peoples. It is also important to understand why Rawls denies the need for a world state. By referring to Kant, he argues that a world state would either be a despotic system or "a fragile empire torn by frequent civil strife as various regions and peoples tried to gain their political freedom and autonomy [footnote omitted]."[1576] This furthermore justifies Rawls' understanding of arbitrary boundaries as historical considerations. If one agrees that a world state is not a normative claim due to its detrimental effects, then it is essential to agree on certain agents who protect a certain territory and, therefore, boundaries are necessary even though they might appear arbitrary from a historical perspective.[1577]

1575. For further details *see* secs. 2.1.6. and 8.3.1.
1576. Rawls, 1999b, p. 36. From a tax perspective in a similar manner *see* Graetz, p. 278 et seq.
1577. *See generally* Rawls, 1999b, p. 38 et seq.

Chapter 7

Reception of Rawls among Political Philosophers

7.1. Preliminary remarks

Importantly, the word "reception" in the title of this chapter might be misleading, as *The Law of Peoples* was published after some of the writings that we will refer to in the following. Nevertheless, even Beitz, who published his article on international distributive justice in 1975,[1578] can be seen as a reception of Rawls in this area, as Beitz transferred Rawls' *A Theory of Justice* into a global setup even before the final version of *The Law of Peoples* was published. It is also important to note that Rawls also published an earlier version of *The Law of Peoples* in 1993.[1579]

The Law of Peoples has not received much approval among contemporary philosophers[1580] of the various disciplines; already, the first publication of a shorter version of *The Law of Peoples* has triggered many critical reviews.[1581] A considerable disagreement already exists with regard to the title used, *The Law of Peoples* instead of *The Law of the States*.[1582] Additionally, many scholars have discussed the potential incoherence between *A Theory of Justice* published in 1972 and *The Law of Peoples* published several years later. In the following, the focus is firstly on two specific aspects of the criticism. On one hand is the argument that *The Law of Peoples* lacks reference to the rights and duties of individuals, while on the other hand is the non-inclusion of a kind of difference principle at an international level. In particular, the latter discussion might help to develop a different view on the international tax regime – one that has not been given the necessary attention in recent decades.

After a discussion of these two weaknesses, some other theories both supporting, but also opposing the understanding of Rawls in *The Law of Peoples* will be outlined. For purposes of clarity, we will distinguish

1578. Beitz, 1975, p. 360 et seq.
1579. Rawls, 1993, p. 36 et seq.
1580. However, for a positive reception *see* Wenar, p. 95 et seq.
1581. Rawls, 1993, p. 37 et seq. *See*, with further references to critical reviews, Garcia, 2001, p. 659 et seq., or Reidy, p. 291 et seq. *See also* Nussbaum, 2004, p. 3 et seq.; Pogge, 2004b, p. 1739 et seq. From a legal philosophy perspective, *see*, for example, Mahlmann, p. 189.
1582. *See* sec. 6.3.1.

between left institutionalists and right institutionalists.[1583] Left institutionalists oppose the idea of Rawls that there is no distributive duty at an international level. Right institutionalists, however, favor the two-tier approach of Rawls, i.e. that when discussing distributive duties, one needs to clearly distinguish between the domestic and the international spheres. Basically, both left and right institutionalists would agree that principles of distributive justice only apply in a certain institutional framework or basic structure; however, there is a disagreement on which institutions actually trigger distributive duties.[1584]

In order to visualize the difficulties at stake, the following example should guide us through the next sections.

According to the Swiss inter-cantonal equalization scheme ("*Finanzausgleich*"), the so-called "giver cantons" are paying millions of Swiss francs each year, inter alia, to reduce the difference in the ability to pay among cantons in Switzerland. Let us assume for the sake of ease that the Canton of Zurich, as a paying canton, contributed CHF 100 million in 2016 as an equalization payment. The Canton of Jura received CHF 20 million in 2016 as a receiving canton. What is the normative difference between the payment of the Canton of Zurich to the other cantons in Switzerland, such as the Canton of Jura, and a potential payment from the Canton of Zurich to Haiti? Do the inhabitants of Zurich have a moral duty to support individuals in other cantons, but not in Haiti, even though poverty in Haiti is outrageous compared to the Canton of Jura?

7.2. Missing out on individualism

Some authors argued that *The Law of Peoples* falsely ignores the importance of international principles of justice that apply to individuals.[1585] The latter means that Rawls limits his principles of justice only to the law among states, and does not consider that certain principles of justice should apply to individuals at a global level. The individual has somehow "disappeared"[1586] in the second original position following Rawls' *The Law of Peoples*. It is

1583. The same categorization is made by Blake & Smith, International Distributive Justice, Stanford Encyclopaedia of Philosophy (available at http://plato.stanford.edu/entries/international-justice/, last visited 20 Jan. 2019).
1584. *See* id., sec. 3.
1585. *See*, for example, Nussbaum, 2004, pp. 6 and 11; Pogge, 2004b, p. 1752 et seq.; Wenar, p. 86 et seq. *But see* Macedo, p. 1724.
1586. Kreide, p. 96. *See also* Pogge, 2004b, p. 1756.

obvious that an individual who is not a representative of a state and who would directly take part in a negotiation of a worldwide valid social contract would find different principles of justice compared to a situation in which the agreement is reached by representatives of peoples. For instance, as mentioned by Sadurski,[1587] the risk of being part of an undemocratic and non-egalitarian state would be too high that such an agreement would be found. Or, as mentioned by Pogge:

> It has also been frequently noted that Rawls endorses normative individualism domestically, but rejects it internationally. (Normative individualism is the view that, in settling moral questions, only the interests of individual human beings should count.)[1588]

Or in other (more positive) words:

> Internationally, Rawls finds the main expression of moral constraints not in a relation among individuals, but in a limited requirement of mutual respect and equality of status among peoples.[1589]

In a similar manner, some authors argue that Rawls only refers to a very limited set of human rights within his principles of *The Law of Peoples*, even if individuals being part of a global negotiation would require a comprehensive catalog of human rights to be applicable at an international level.[1590] The question of the application of principles of justice to an inter-state relation or following a more human-centered approach is closely linked to the difference between left and right institutionalism.

7.3. Missing out on international distributive justice

Closely linked to the question of why Rawls did not apply an original position at a worldwide level in which individuals participated directly, without using a second layer of state's representatives, is the question of whether an international distributive duty indeed exists. From a political philosophy perspective, the question of validity of a distributive duty at an international level is one of the most disputed questions in recent decades. We will not mention any empirical numbers in the present study related to wealth and income distribution among individuals worldwide, as it is obvious that the

1587. Sadurski, p. 6.
1588. Pogge, 2004b, p. 1744. *See also* Singer, 2002, p. 179.
1589. Nagel, p. 124.
1590. *See,* for example, Tasioulas, 2002, p. 380 et seq.

poverty in various parts of the world is outrageous.[1591] Prima facie, therefore, it would not be more than reasonable to say that rich states should morally be obliged to end poverty, as there seems to be sufficient funds to do so. However, as the following sections will show, there is a considerable disagreement among philosophers as to whether there is indeed an obligation for international distributive justice to counter such "moral discomfort".[1592] The moral discomfort is, for instance, related to the question of why the Canton of Zurich seems to have a moral duty to support the Canton of Jura, but not Haiti, as mentioned in the introductory example.[1593]

As Rawls followed more traditional principles of inter-state justice and did not apply a more progressive global approach to justice, his principles of justice, as developed in *The Law of Peoples*, are being referred to as static or statism.[1594] Some also use the term "dualistic theory", as he distinguishes between principles of justice at a domestic and international level. One consequence of Rawls' method is that he does not agree on a system of international distributive duties, as argued by cosmopolitans.[1595] In this respect, for instance, Brown argues in the following manner: "What emerges from this second contract is, in effect, the traditional practices of international law and diplomacy – self-determination, nonintervention, nonaggression, and so on – but no conception of international distributive justice."[1596]

7.4. Right institutionalists

7.4.1. Nagel

Nagel is one of the most extreme or one of the most consequent[1597] (right) institutionalists who in principle denies claims for distributive justice in an international framework outside the state setting. He presented his opinion in an article on global justice in 2005.[1598] To understand his approach, it is

1591. *See*, for example, Pogge & Mehta, p. 1 et seq.; Thürer, 2009a, p. 18. *See also* the insightful statistics published online at https://ourworldindata.org/ (last visited 20 Jan. 2019).
1592. This term is used by Benshalom, p. 12.
1593. *See* sec. 7.1.
1594. Garcia, 2001, p. 664, with further references.
1595. Or at least a very minor redistribution from the rich to the poor countries.
1596. Brown, p. 127.
1597. The term "extreme" might trigger a negative connotation, which is not the intention. This is why the term "consequent" is also used in order to appropriately describe Nagel's positions.
1598. Nagel, p. 113 et seq.

essential to distinguish between a principle of humanity and a principle of justice in his concept of global justice:

> Humanitarian duties hold in virtue of the absolute rather than the relative level of need of the people we are in a position to help. Justice, by contrast, is concerned with the relations between the conditions of different classes of people, and the causes of inequality between them.[1599]

After such clarification, Nagel continues to discuss the meaning of the term "justice" and applies a so-called associative obligation in the sense that we owe justice through shared institutions.[1600] This means that only within the boundaries of states do individuals owe (full) justice to each other, even though the boundaries might indeed seem arbitrary.[1601] Therefore the state as such is normatively significant.[1602] However, he also highlights that "some conditions of justice do not depend on associative obligations."[1603] In principle, he agrees that certain human rights are valid even without any special form of association. Basic human rights are not protected due to social interaction, but we owe these to everyone in the world, independent of an institutional membership, i.e. even in a pre-political[1604] condition.[1605] However, socioeconomic justice, to which Nagel refers, requires a certain political society, as we owe such duties only to other members of the same society or state.[1606]

It seems that the position – at least the result – is rather similar to Rawls' concept argued in *The Law of Peoples*. However, Nagel disagrees with Rawls and is against a strong personification of peoples, as argued by Rawls in the second original position.[1607] Therefore he is against the understanding of states (or peoples) as moral units, but instead emphasizes that "[p]eople engaged in a legitimate collective enterprise deserve respect and noninterference, especially if it is an obligatory enterprise like the provision of security, law, and social peace."[1608] Or, as he states at another instance:

1599. Id., p. 119. One could also speak of natural duties in this respect (Klosko, pp. 247 and 250).
1600. Nagel, p. 121.
1601. Id. p. 121 et seq.
1602. *See* Cohen & Sabel, p. 150.
1603. Nagel, p. 126.
1604. The term is used by id., p. 127.
1605. Id., p. 131.
1606. Id., p. 127.
1607. For further details *see* sec. 6.3.2.
1608. Nagel, p. 135.

> Justice applies, in other words, only to a form of organization that claims political legitimacy and the right to impose decisions by force, and not to a voluntary association or contract among independent parties concerned to advance their common interests.[1609]

His idea of an associative obligation triggers, for the purposes of the present study, the question of whether the current highly integrated world economy is not a sufficient associative order so that Nagel's idea of intra-society justice would not apply globally. Nagel includes this question in his article, however, denies such a line of argumentation. According to him, international institutions have not yet reached the same level of statehood as is found in a domestic setting, mainly referring to the absence of sovereign authority at the international level.[1610] He furthermore argues that "[m]ere economic interaction does not trigger the heightened standards of socioeconomic justice".[1611] One important argument within Nagel's article is that international rules are not enacted by coercive means, but are instead developed through a bargaining process between "mutually self-interested sovereign parties".[1612] Therefore, the current international order does not create socioeconomic justice among citizens of different states. Moreover, Nagel mentions that there is a relevant distinction between voluntary association at an international level (i.e. a more integrated system) and coercive authority at a domestic level.[1613]

We have not yet answered, however, the question of why an associative obligation might trigger broader justice considerations according to the understanding of Nagel. He is not of the opinion that bending someone's will through coercive measures is wrong, as argued by Blake,[1614] who argues that an organization having the right to impose sanctions through coercive measures has a special obligation to the person within such an organization, as such an organization is the authorized fiduciary of the persons forming part of such an organization.[1615]

Not in the main focus of the present study is the manner of how to achieve global justice according to Nagel. As he requires a central body with coer-

1609. Id., p. 140. For further details on whether institutions may indeed help to resolve coordination problems and whether this triggers specific duties, *see* Follesdal, p. 49 et seq.
1610. Nagel, p. 137 et seq. *See also* Cohen & Sabel, p. 155 et seq.; Sangiovanni, 2007, p. 14 et seq.
1611. Nagel, p. 138.
1612. Id.
1613. Id., p. 140.
1614. For further details on Blake *see* sec. 7.4.2.
1615. For more details about the justification *see* Sangiovanni, 2012, p. 88. He also develops a critical analysis of such a line of argumentation (p. 103 et seq.).

cive competence in order to create justice considerations, he assumes that the only way of creating global justice considerations in a cosmopolitan manner is to create a central global power, even if at first instance it might create unjust results. Or in his (speculative) words:

> For this reason, I believe the most likely path toward some version of global justice is through the creation of patently unjust and illegitimate global structures of power that are tolerable to the interests of the most powerful current nation-states. Only in that way will institutions come into being that are worth taking over in the service of more democratic purposes, and only in that way will there be something concrete for the demand for legitimacy to go to work on.[1616]

In conclusion, Nagel – at least this is the understanding of Sabel & Cohen – argues that international organizations are "morally unencumbered".[1617]

Nagel's work is not only very fruitful for the discussion about the relevance of global justice, but also regarding justice and international treaties. He is of the opinion that international agreements are of a different moral content than agreements among individuals within a sovereign state. It is his thought that international treaties are treaties with no reference to justice.[1618] One of the reasons of such moral difference between international treaties and a treaty among a self-interested people within a state is that the people in the latter case might be part of a system in which, inter alia, property and tax law is collectively embedded.[1619] In other words, an "embedded tax law" in a society is one important aspect triggering specific moral duties among the involved parties. According to Nagel, however, international treaties have the following moral content:

> They are "pure" contracts, and nothing guarantees the justice of their results. They are like the contracts favored by libertarians, but unless one accepts the libertarian conception of legitimacy, the obligations they create are not and need not be underwritten by any kind of socioeconomic justice. They are more primitive than that.[1620]

7.4.2. Blake

Blake deals explicitly with the question of whether the current world order with different – and in principle sovereign – states triggers distributive duties

1616. Nagel, p. 146.
1617. Cohen & Sabel, p. 171.
1618. Nagel, p. 140 et seq.
1619. *See* id., p. 141.
1620. Id.

among different states and under what circumstances. His approach, inter alia, relates to the moral significance of coercion in a system. To be more precise, according to Blake, a system of distributive justice only applies in a system of coercion, i.e. a "coercion theory of distributive justice."[1621] However, he also states that other justice considerations (besides distributive justice) apply at an international level.[1622]

His understanding of Rawls' idea of coercion is that a state might coerce its citizens, but this is justified, as the state follows principles that cannot be rejected by its citizens.[1623] The coercive power of the state, therefore, derives from the consent of the people, which actually leads to the legitimation of a state. In general terms, Blake links the term "coercion" with autonomy by arguing that coercion as such limits (or violates) the autonomy of an individual (following a liberal theory) to choose different options.[1624] This is based on the understanding that coercion infringes on the autonomy of each person and is therefore wrong, as long as it is not justified by the aforementioned reason.[1625]

Importantly, Blake concludes that distributive duties only apply within a state and that state boundaries are thus morally significant. He demonstrates that with an example that the denial of a US citizen to vote in a US election is morally problematic, but not the denial of a French citizen to vote in a US election.[1626] From a tax perspective, this could mean that the unequal treatment of two citizens of two different states with no link to the other state is morally acceptable, because only equal treatment of citizens of the same state is necessary to protect the autonomy of states, which, on the other hand, is required by justice.

With references to Buchanan, Blake makes an example of two autarkic states that are and have always been separated by mountains, i.e. the fictional states of Burduria and Syldavia.[1627] We could potentially also use a

1621. Blake, 2011, p. 555. *See also* Nagel, p. 121.
1622. Blake, id., p. 556. *See*, on the topic of coercion and its potential relevance providing for a critical view, Sangiovanni, 2012, p. 79 et seq. For a critical view on whether the domestic level and the international level indeed trigger different considerations concerning the importance of a coercive system, *see* Follesdal, p. 61 et seq.
1623. Blake, 2001, p. 287.
1624. Id., p. 272.
1625. *See*, with respect to Blake, Sangiovanni, 2012, p. 86 et seq. *See also* Sangiovanni, 2007, p. 8 et seq.
1626. Blake, 2001, p. 294 et seq.
1627. For more details about this example *see* id., p. 289 et seq.

more real example, i.e. the US and Iran, which have, at least trade-wise, been without any link in recent years. Burduria has developed much better due to more sophisticated techniques, but also due to better soil. Syldavia is poorer than Burduria, but it is also expected to provide its citizens with a decent life with sufficient food production. At one point in time, the representatives of Syldavia reached the country of Burduria and realized the economic differences. As a matter of fact, they asked the government of Burduria to transfer payments to Syldavia in order to mitigate the economic inequalities. Blake is of the opinion that Burdurians do not have to honor such a request from a moral perspective.[1628]

Blake then proceeds with hypothecating that the two countries begin intensive (trade) cooperation. As result of such cooperation, the poorer country of Syldavia is slightly better off than in its state of autarky, but Burduria benefits significantly more from the inter-state trade. The question then posed by Blake is whether such inter-state trade changes the moral judgment of potential cross-border distributive payments. Does the trade create distributive justice between the two states? Blake denies that intense trade should influence the moral judgment, arguing that the start of trade was not triggered by coercive measures, but was at the full discretion of both states. As there is no coercion in the trade relation afterwards, the relationship between a citizen of Burduria and Syldavia is not comparable to the relationship between two persons within the same (coercive) society.[1629]

The ongoing coercion that is present in a state does not, according to Blake, exist at an international level between two states.[1630] However, of particular interest for the present thesis is the moral importance that Blake allocates to the fact that strong states might indeed force weak states to implement certain rules. His understanding is that such a coercive system at an international level does not itself trigger the same distributive duties as in a domestic situation, but "global circumstances ought to be altered so as to prevent its possibility."[1631] His approach is either to justify coercion or to eliminate it entirely.[1632] In an international setting, he seeks for an elimination of coercion, as there is no justification for coercion compared to in a domestic situation:

1628. Id., p. 290.
1629. Id., p. 292.
1630. Id., p. 293.
1631. Id., p. 557.
1632. Id.

> The coercion of marginal states by stronger states is not a necessary part of the institutional makeup of our world; the ideal would be not a particular vision of this coercion, but the absence of that coercion itself.[1633]

He does not, furthermore, ignore the fact that the current international order, such as the WTO umbrella, forces states to participate by coercion as "[f]ull autarky tends to lead to exceptional difficulties."[1634] However, he assumes that there is a difference between a vertical coercion system, such as within a state, and a horizontal coercive system, such as at an international level.[1635] In a domestic situation, coercion is justified, as most of us would agree that certain institutions, such as states with coercive power, are necessary.

7.4.3. Risse

Risse, who also argues in favor of a right institutional approach, i.e. not advocating for a cosmopolitan understanding of distributive duties, refers to coercion within a society as the crucial reason why distributive duties should generally not apply between states. His line of argumentation is similar, although not identical, to the one demonstrated by Blake.[1636]

In order to better understand Risse's approach, it is crucial to consider that according to Risse, institution building is essential in order to improve the welfare situation in a poor country. He argues that the quality of institutions is the most important criterion for the development of a society, i.e. not the integration of a society into the global trade system and not the geography of a state.[1637] Based on these considerations, Risse continues analyzing whether, at an international level, a distributive duty from rich to poor countries exists. He denies cross-border distributive duties by highlighting the link between redistributive measures and property regimes. As ownership is regulated by domestic law, according to Risse, it is justified that redistributive elements are included in a domestic setup, but not at an international level.[1638] Compared to domestic law, international law regulates transnational questions and might indeed contain coercive elements, but not coercive elements that would create distributive duties.[1639] Therefore, he

1633. Id., p. 567.
1634. Id., p. 565.
1635. Id., p. 556 et seq. *See also* id., p. 265.
1636. *See* sec. 7.4.2.
1637. For more details *see* Risse, p. 84 et seq. *See also* the remarks in sec. 11.4.3.2. with references to Deaton.
1638. Risse, p. 105.
1639. *See* id., p. 105 et seq.

does not argue that coercion as such creates distributive duties, but coercion with respect to property rights does.

In other words, he suggests that if a state can coercively dispose of assets held by individuals, such power triggers distributive duties. From a moral perspective, states are, according to Risse, protected in their sovereignty, as they "provide for their members by maintaining a morally defensible legal framework and social system."[1640] Or, drawing a link to each individual's ownership right:

> It is, in terms of its moral justifiability not much different from coercion in a domestic context that keeps people from randomly seizing each other's property. Just as individuals within states should be allowed to have property in their lives for them to pursue meaningful projects, so states (i.e., organized groups of individuals) should be as well.[1641]

Risse further elaborates on whether there is a normative claim for duties to burdened societies, as proposed by Rawls.[1642] In this respect, he supports the approach of Rawls. One of his reasons for such a duty is that it is necessary to support the building of institutions and, secondly, burdened societies are "a global liability".[1643] Therefore, it is in the self-interest of the representatives within the second original position in Rawls' approach to mitigate the risk of the existence of burdened societies. Burdened societies might, for instance, spread refugees, but also enhance drug trafficking.[1644] Furthermore, Risse argues that considering the actual options, states are required as agents at an international level, and other ideas, such as a world state or other models, face practical constraints and, therefore, do not provide guidance on how to act.[1645]

7.5. Left institutionalists

7.5.1. Beitz

Beitz is one of the most important representatives of cosmopolitism,[1646] monism and the idea of global justice, as he understands humans (and not

1640. Id., p. 107.
1641. Id.
1642. *See* on this topic sec. 6.3.3.4.
1643. Risse, p. 109.
1644. *See*, with further reasons, id.
1645. Id., p. 115. He also refers to the vertically dispersed sovereignty according to Pogge.
1646. *See also* Brock, p. 1 et seq.

states) as the only units for moral concern. His book, *Political Theory and International Relations*, was published in 1979,[1647] i.e. between the publication of the two books of Rawls, i.e. *A Theory of Justice* and *The Law of Peoples*. The book has three chapters; Part Two on the autonomy of states and Part Three on international distributive justice are of particular importance for the present study. Beitz dedicates his first part to skepticism in international relations, which is not the focus of the present study.

One of the main innovations of the early writings of Beitz is that he applied the first original position of Rawls, according to the theory of justice, to the entire world.[1648] Or in the words of Beitz:

> My claim is that, if one finds Rawls' theory plausible, then the facts of contemporary international relations require that the theory be reinterpreted in the ways suggested here.[1649]

Or, as supported by Nussbaum:

> The global veil of ignorance is an insightful way of capturing the idea that a just global order will not be based on existing hierarchies of power, but will be fair to all human beings.[1650]

Following such an understanding, Beitz, compared to Rawls, favors the application of a so-called conditional difference principle at an international level. He argues that in a case where a certain threshold of cooperation or interdependence (i.e. a conditional requirement) is met, a difference principle as proposed in *A Theory of Justice* shall apply internationally.[1651] However, he does not conclude that this would a priori mean a transfer of money from rich to poor countries. The difference principle would, according to Beitz, mean that there would be transfer payments within the same country in order to help the globally worst off, and states would still be the "primary 'subjects' of international distributive responsibilities."[1652] States, according to Beitz, might be self-sufficient corporate schemes, but the recent decades of enhanced cooperation have made it obvious that this is no longer true.[1653] This means that he justifies the cost of the application of an international

1647. *See*, Beitz, 1999, p. 1 et seq. with a new afterword by the author.
1648. Nussbaum, 2004, p. 10 et seq. *See also* Wenar, p. 82. *See* on the first original position sec. 6.2.2.
1649. Beitz, 1999, p. 129.
1650. Nussbaum, 2004, p. 11.
1651. *See also*, on the difference between Rawls and Beitz, Klosko, p. 246 et seq.
1652. Beitz, 1999, p. 153.
1653. Beitz, 1975, p. 373.

difference principle by the benefit of the "significant aggregate benefit" triggered by such cooperation or interdependence.[1654] Or, as he states:

> [I]f evidence of global economic and political interdependence shows the existence of a global scheme of social cooperation, we should not view national boundaries as having fundamental moral significance. Since boundaries are not coextensive with the scope of social cooperation, they do not mark the limits of social obligations. Thus, the parties to the original position cannot be assumed to know that they are members of a particular national society, choosing principles of justice primarily for that society. The veil of ignorance must extend to all matters of national citizenship.[1655]

Or:

> [T]his world contains institutions and practices at various levels of organization — national, transnational, regional and global — which apply to people largely without their consent and which have the capacity to influence fundamentally the courses of their life.[1656]

Even though the early Beitz does not provide for a precise definition of the threshold of interdependence that must be met in order for the difference principle to apply, he does give some guidance on why the current international world is sufficiently interdependent. Beitz argues, for instance, that poor or economically weak countries are forced to sell their resources due to higher market prices paid by foreign purchasers, and some societies are, according to him, better off due to global trade, whereas other societies do not significantly increase their level of development. As a consequence, the global economy leads to a loss in political autonomy.[1657] In other words, the international system as such is not voluntary, in the sense that states can freely choose whether they, for instance, want to become a WTO member or not. Or as he states:

> The existence of a nonvoluntary institutional structure, and its pervasive effects on the welfare of the cooperators, seem to provide a better indication of the strength of the appropriate distributive requirements.[1658]

Another fact of interdependence is that developed countries have become reliant on many resources, such as raw materials from developing or poor countries. Compared to Rawls, Beitz, therefore, argues for more extensive global distribution, particularly with regard to the distribution of resources. He is of the opinion that due to the contingent (or arbitrary) location of

1654. Beitz, 1999, p. 152.
1655. Beitz, 1975, p. 376.
1656. Beitz, 1999, p. 204.
1657. *See* Beitz, 1975, p. 374 et seq.
1658. Beitz, 1999, p. 166.

natural resources worldwide, the parties to the (worldwide) social contract under a veil of ignorance would agree on a certain "resource distribution principle."[1659] This further leads to the conclusion that the parties would agree to maximize the position of the worst off.[1660]

Therefore international economic interdependence reflects, according to Beitz, a cooperative scheme or a basic structure that is similar, but not identical to the one in a domestic circumstance, as discussed in the writings of Rawls.[1661] Moreover, as also argued by Pogge,[1662] national boundaries as such are arbitrary from his perspective, and principles of justice should apply to individuals, being the only moral units to be considered.[1663] Beitz's book has been criticized in different ways. Some scholars argue that the theory is illusionary, as it ignores the existence of states in the current international framework.[1664] Later, in the afterword of a republication of *Political Theory and International Relations* in 1999, Beitz slightly modified his line of argumentation (but not the conclusion of cosmopolitan liberalism),[1665] stating that distributive justice is not triggered by the fact of interdependence between states, but that justice principles apply primarily to equal humans, and as global institutions influence the lives of individuals, global principles of justice are appropriate.[1666] Furthermore, he uses the neutral term "interaction" instead of "interdependence" and claims that transnational interaction has led to a basic structure that requires justice considerations, as developed in *A Theory of Justice* by Rawls.[1667]

Therefore, according to the later Beitz, "this world contains institutions and practices at various levels of organization – national, transnational, regional and global – which apply to people largely without their consent and which have the capacity to influence fundamentally the courses of their lives."[1668] Beitz rightly states that there are even "transnational networks of state officials also performing global governance functions."[1669] We have seen above that this is particularly true from a tax perspective.[1670]

1659. Id., p. 141.
1660. Id.
1661. For further details *see* id., p. 154 et seq.
1662. *See* sec. 7.5.2.
1663. *See* Beitz, 1999, p. 155 et seq.
1664. Joób, p. 110, with reference to Kersting.
1665. The term is used by the author himself in the afterword (Beitz, 1999, p. 215).
1666. Id., p. 203.
1667. *See generally* Joób, p. 117.
1668. Beitz, 1999, p. 204.
1669. Beitz, 2005, p. 25, with references to Slaughter.
1670. *See* sec. 4.3.4.

In conclusion, according to Beitz, there is a global basic structure that indeed requires distributive elements. Beitz follows a normative individualism, but focuses on the distributive (economic) element and does not further discuss the political structure of his ideal international order, although he is also of the opinion that it is not necessary to overcome a system with states to achieve an international distributive justice in his understanding.[1671]

7.5.2. Pogge

The most intense debate about *The Law of Peoples* was likely triggered by several contributions from Pogge. In his articles and books on global justice,[1672] Pogge, as a former doctoral student of Rawls, often uses Rawls' *A Theory of Justice* and the incoherencies with *The Law of Peoples* as an important reference point for his ideas and theoretical approaches.[1673] The starting point of his conception was his book on Rawls' concepts, i.e. *Realizing Rawls*, which he then extended to an international perspective with a second book, *World Poverty and Human Rights*,[1674] and several articles.

In the following, we will demonstrate some of Pogge's references in order to visualize his approach to global justice or inter-state justice. From a conceptual perspective, similar to Beitz, Pogge globalizes the proposals of Rawls in *A Theory of Justice*.[1675] He argues that Rawls does not provide for a reasonable response to the arbitrariness of national boundaries as they currently exist and, therefore, for a limited application of the principles of fairness.[1676] As stated by Joób, Pogge argues that citizenship and belonging to a certain people is as contingent as the race or gender of a person.[1677] Moreover, Pogge[1678] emphasizes that Rawls falsely assumes that poverty simply stems from domestic reasons, i.e. that Rawls follows a purely domestic poverty thesis or, as he calls it, a PDPT. Pogge[1679] argues that Rawls applies a too limited duty of assistance, in the sense that if a state is a decent state, as

1671. Beitz, 1999, p. 152 et seq.
1672. E.g. Pogge, 1994, p. 195 et seq.; Pogge, 2004b, p. 1739 et seq.
1673. Most obviously in Pogge, 2004b, p. 1739 et seq. But *see also* Pogge, 1994, p. 195 et seq.
1674. Pogge, 2009, p. 1 et seq.
1675. Pogge, 1989, pp. 235 and 240 et seq.
1676. *See* on this topic, with a reference to *Realizing Rawls* Joób, pp. 135 et seq. and 157 et seq.
1677. Id, p. 157.
1678. Pogge, 2004b, p. 1753.
1679. Pogge, 2004a, p. 260 et seq.

proposed by Rawls, there is no duty of assistance, even though the relational differences might be huge. In several instances, Pogge[1680] has objected to Rawls' idea that global inequality, as such, or to be more practical, domestic poverty, is not sufficiently caused by domestic failures. We have seen above that Rawls, on the contrary, argues that the causes of poverty are mainly related to domestic failures.[1681] Therefore, Pogge follows a more egalitarian law of peoples, as compared to Rawls.[1682]

To object to the opinion of Rawls,[1683] Pogge refers to the example of the performance of students at different universities. By arguing that global factors, such as classroom quality, teaching times, reading materials, etc., may play an important role in the performance of students, he disproves the claim that only the students are responsible for their performance.[1684] Therefore, we as individuals are not solely responsible for our standard of living, but other (global) factors also have an important influence.

Pogge, who opposes the idea of having a second (abstract) negotiation session (i.e. a second original position with a second negotiation round)[1685] at an international level in order to agree on the principles of justice among peoples, has nevertheless also tried to theorize the outcome of such a second negotiation round at an international level:

> The incoherence might be displayed as follows. Suppose the parties to the first, domestic session knew that the persons they represent are the members of one society among a plurality of interdependent societies; and suppose they also knew that a delegate will represent this society in a subsequent international session, in which a law of peoples is to be adopted. How would they describe to this delegate the fundamental interests of their society? Of course they would want her to push for a law of peoples that is supportive of the kind of national institutions favored by the two principles of justice which, according to Rawls, they have adopted for the domestic case. But their concern for such domestic institutions is derivative on their concern for the higher-order interests of the individual human persons they themselves represent in the domestic original position. Therefore, they would want the delegate to push for the law of peoples that best accommodates, on the whole, those higher-order interests of individuals [footnote omitted]. They would want her to consider not only how alternative proposals for a law of peoples would affect their clients' prospects to live

1680. E.g. Pogge, 2004b, p. 1753 et seq.
1681. *See* sec. 6.3.5.
1682. *See* Pogge, 1994, p. 195 et seq.
1683. For further details *see* sec. 6.3.5.
1684. Pogge, 2010, p. 418 et seq. *See also* Pogge, 2004b, p. 1753 et seq.
1685. *See* the approach of Rawls, sec. 6.2.2.

> under just domestic institutions, but also how these proposals would affect their clients' life prospects in other ways - for example through the affluence of their society.[1686]

Furthermore, Pogge is one of the most influential critics of the current world trade system, arguing that the current setup actually harms individuals in developing countries.[1687] As a consequence, besides his former position of the need for a global distributive justice, he later argues that there should at least be a duty not to harm any other state through domestic policies. Consequently, he is one of the most influential cosmopolitans, but at the same time, he introduced the duty not to harm other states and by doing so delivered a more non-utopian idea of how to achieve more justice at an international level.[1688] Furthermore, Pogge opposes the idea of a world state, as brought forward by other authors.[1689]

Another important argument of Pogge is that developed countries impose a coercive global order on other states, which triggers responsibilities against developing countries. Furthermore, Pogge advocates in favor of more far-reaching human rights than Rawls in his book *The Law of Peoples*.[1690] In general, his (later) theory is based on empirical arguments. For instance, one of his main reasons for requiring distributive measures is that the current international order has empirically led to severe inequalities, which infringes on the rights of the poor, thus creating a duty to change the international system (including the international trade system) in order to achieve more justice. Again, this new argument that the international institution causes poverty has triggered some critiques; in particular, authors have argued that it is uncertain due to the complexity of the argument that international structure is the cause of poverty in the poorest states on the planet.[1691]

From a tax perspective, of particular interest is the idea of Pogge to implement a so-called global resource tax (GRT). At times, the term general resource dividend (GRD) is used.[1692] Pogge himself prefers the term "GRD", as the poor own parts of the global resources, similar to the share of a shareholder in the assets of a company. His main argument is that "those

1686. Pogge, 1994, p. 210 et seq.
1687. Pogge, 2009, p. 18 et seq.; Pogge, 2010, p. 417 et seq.
1688. *See* Benshalom, p. 16 et seq.
1689. *See generally* Joób, p. 164 et seq.
1690. *See* the opinion of Beitz, as demonstrated in sec. 7.5.1. *See also* on this point Nussbaum, 2004, p. 11.
1691. E.g. Risse, p. 349 et seq.
1692. *See*, with further references, Pogge 1994, p. 200. Or for further details, *see* Pogge, 2009, p. 202 et seq.

who make more extensive use of our planet's resources should compensate those who, involuntarily, use very little."[1693] The GRD would apply to resources that are extracted by a state. For instance, Iran would be obliged to pay the GRD on the oil extracted from its soil. The revenue from such a tax would be used "toward assuring that all have access to education, health care, means of production (land) and/or jobs to a sufficient extent to be able to meet their own basic needs with dignity and to represent their rights and interests effectively against the rest of humankind: compatriots and foreigners."[1694] Therefore this would require payment from the richest countries to the poorest ones. However, Pogge also states that poor states might not gain access to the funds if they reveal a misuse of the funds.[1695]

It is interesting to read that Pogge argues that the funds from the GRD could actually be used in the poorer countries, inter alia, to lower tax rates or implement higher tax exemptions.[1696] He also highlights certain tax provisions that are problematic, from his point of view. For instance, he argues that the deductibility of bribes paid in developed countries might encourage oppression and corruption in developing countries.[1697]

7.6. Pure egalitarianism

7.6.1. Caney

Caney's writings are interesting from various perspectives. As others, he also disagrees with Rawls' principles of justice developed in *The Law of Peoples*. One of his arguments why Rawls did not include principles of transnational distributive justice is that he understands Rawls' *The Law of Peoples* as a clear sign that Rawls did not want to include any obligation that non-liberal people or states are obliged to follow liberal ideas.[1698]

Furthermore, Caney questions any normative approach that is based on "Associational Accounts", such as the justification of distributive justice, depending on the interaction of societies or the coercion within a system.[1699]

1693. Pogge, 2009, p. 210.
1694. Pogge, 1994, p. 201.
1695. Id., p. 202, with references to the deviating opinion of Barry.
1696. Id., p. 201.
1697. Pogge, 2004b, p. 1754.
1698. Caney, 2001, p. 127.
1699. Caney, 2011, p. 525 et seq. *See* Barry & Valentini, p. 493 et seq., who also question the moral significance of coercion.

He follows a more humanity-centered approach to global justice. This means that questions of distributive justice are not linked to membership in a certain society, group or institution, but are instead linked to the fact that all persons worldwide are human beings. Caney, for instance, disagrees with non-cosmopolitan approaches, which argue that there is no normative claim for distributional duties at an international level due to missing reciprocity. Inter alia, he argues that one cannot derive from the argument that a state is a highly integrated system of reciprocity that, due to such integration, there is a distributional claim and that as there is no such system at an international level, no distributional claim can be made. In other words, he criticizes the link between reciprocity and questions of justice by arguing that even though there is no reciprocity, there might still be distributional claims. Or in his words:

> The claim that egalitarian principles apply in contexts of reciprocity is a plausible one. However, accepting this gives us no reason to think that equality applies only in such contexts.[1700]

Caney further deals with normative approaches based on coercion and reciprocity, such as those followed by Nagel and Blake. He demonstrates by using two societies, one with a centralized coercive system and the other being anarchic, that the power of the normativity of distributive justice is the same, i.e. it cannot be derived from the fact that there is coercion in a society that triggers distributive justice.[1701] This does not, however, mean that coercion does not trigger any questions of political legitimacy, but he instead argues that the question of international distributive justice as such is not linked to the question of coercion.[1702] He states, however, that coercion in a society triggers the need for legitimate decision-making within a society. A member of a society should be involved in designing coercive instruments that can be essential when enforcing the responsibilities of each member of the society.[1703]

According to the "variability thesis" of Caney,[1704] the level of integration affects the substantive implications of a humanitarian-centered understanding of global justice. Therefore, to a certain extent, a distributive principle applies at a global level, i.e. independently from the membership in a certain society, but the substantive implications of such a principle depend on

1700. Caney, 2011, p. 517.
1701. For more details *see* id., p. 520. For a similar critic *see also* Sangiovanni, 2007, p. 3 et seq.
1702. Caney, 2011, p. 521 et seq.
1703. Id., p. 521.
1704. Id., p. 525 et seq.

whether persons belong to a certain association, whether such an association knows coercive measures, and how such an association is interdependent. The outcome that distributive duties exist even without any institution and that distributional duties are not triggered by an institutional framework, be it at an international or a domestic level, leads the authors of the Stanford Encyclopedia of Philosophy to conclude that Caney is a "pure egalitarian". This is also the reason why Caney was not categorized as being a left or right institutionalist.

Of great importance for the present work is that Caney disagrees with discontinuity with respect to associational accounts. This means that he argues (compared to Nagel[1705] and Blake)[1706] that it is wrong to state that a society must reach a certain degree of either coercion or reciprocity to create distributive duties, and if such a level is reached, distributive duties apply in the same manner, notwithstanding the significance of coercion or reciprocity, i.e. an "all or nothing approach".

7.7. The idea of justice of Amartya Sen

7.7.1. Preliminary remarks

Another theory or, to be more precise, idea of justice that is highly attractive for the present task of questioning some of the main principles and rules of the existing international tax regime is *The Idea of Justice*, published by Sen in 2009. As with all of these fundamental treatises of political philosophy about the idea or theory of justice, it is barbarism[1707] – but a necessary task – to summarize his theory.

Sen – based on, inter alia, Adam Smith[1708] – follows a more realization-focused approach that denies the suitability of the aforementioned transcendental or ideal theories in order to judge whether a certain rule or principle at an international level should indeed be considered just or unjust. He opposes the theory of justice of Rawls, who focuses on the development of the perfect ideal institutional structure of society (or, of the world in his book *The Law of Peoples*). Or in his words: "[W]e have to seek institutions that promote justice, rather than treating the institutions as themselves

1705. *See* sec. 7.4.1.
1706. *See* sec. 7.4.2.
1707. The term is used by Sen himself when summarizing Rawls (Sen, 2009, p. 53).
1708. He refers in particular to Adam Smith, *The Theory of Moral Sentiments*, 1790 (Sen, 2009, p. 9).

manifestations of justice, which would reflect a kind of institutionally fundamentalist view."[1709]

His idea of justice is particularly interesting for the present study, as its aim is to "clarify how we can proceed to address questions of enhancing justice and removing injustice, rather than to offer resolutions of questions about the nature of perfect justice."[1710]

As the goal in the following is to review some of the main principles and rules of the international tax regime, and not to develop the perfect international tax regime, an in-depth reference to the work of Sen seems justified, as his work might indeed be helpful to enhance justice or remove injustice. For a better understanding of Sen's idea of justice, the terms "reasoning" and "impartiality", which are vital in Sen's theory, are described in more detail. Before doing so, we will highlight why the use of transcendental theories faces such application difficulties.

7.7.2. The disadvantages of transcendental (ideal) theories

7.7.2.1. Overview

The aforementioned theory of Rawls and the dispute between left and right institutionalists mainly reflect a dispute between ideal theories of justice demonstrating the structure of the ideal governing institutions worldwide.

Sen uses the term "transcendental theory" to describe ideal theories of justice, such as the theories of Hobbes, but also Rousseau during the Enlightenment period.[1711] Some others, however, have questioned the distinction between comparative theory and transcendental theory. For instance, Shapiro argues that Sen's argument that Rawls speaks of a perfectly just society is wrong, and considering Rawls' difference principle, according to Shapiro, it is apparent that Rawls also depends on comparative reasoning and incomplete orderings.[1712]

Transcendental theories aim to develop an understanding of a perfectly just society or a perfectly just world order. The mentioned theories are (often) underpinned, as shown in detail with reference to Rawls' *A Theory of Jus-*

1709. Sen, 2009, p. 82.
1710. Id., p. xi. *See also* Sen, 2006, p. 215 et seq.
1711. Sen, 2009, p. 215 et seq.
1712. Shapiro, p. 1251 et seq. *See also* Barry & Valentini, p. 511.

tice,[1713] by the contractarian methodology, as these authors argue how a hypothetical contract among the members of a society would look and what institutions would be derived from that methodology. If one tries to use transcendental or ideal theories – such as right or left institutionalism – to analyze concrete political proposals in the area of international tax law, five issues or concerns are of relevance.

First of all, when looking for a change within the international tax regime, practical constraints need to be considered. This is the main reason, for instance, why a cosmopolitan approach might, on one hand, reflect a consistent application of the original position methodology, as brought forward by Rawls, but also faces the difficulty or the impossibility of implementation. The application of a global difference principle as suggested would require a strong central governmental body at an international level, which is not feasible in the current world.[1714] Therefore, even though an ideal theory of justice based on a cosmopolitan theory might be more persuasive from a theoretical perspective, it is not helpful in deciding whether a certain rule or principle is more just than another rule or principle, because practical constraints might not be considered within an ideal theory.

Second, even the most persuasive ideal theory lacks absolute truth regarding some of its features. As an example, while I fully appreciate the impressive theory of Rawls in *A Theory of Justice*, we have no guarantee that his two principles of justice indeed reflect the sole principles for a just basic structure of a society.

Third, ideal theories can be difficult to apply to a concrete question of injustice. With respect to the international tax regime, it is very difficult to draw a concrete proposal on how the international tax regime should be designed in order to be considered just. For instance, following a cosmopolitan understanding, should we argue in favor of higher taxes on principle, even though it seems likely that such higher taxes will not be used in favor of the least advantaged in the world?

Fourth, and this is important in the understanding of Sen, ideal theories partly ignore the actual social result of perfect institutions.[1715] Therefore, even though the principles of justice within *A Theory of Justice* are persua-

1713. *See* sec. 6.2.
1714. Sen, 2009, p. 5 et seq. But *see* Barry & Valentini, p. 507 et seq., who argue that the infeasibility argument is not persuasive to deny a global egalitarian theory.
1715. Sen, 2009, p. 6.

sive, it is uncertain whether a society following these principles will indeed become a just society.

Fifth, if – as intended by the present study – one aims at advancing (global) justice in a very specific area, such as international tax law, transcendental theories are difficult, if not impossible, to apply. This means, for example, if I want to reason about whether the arm's length principle is more just than a formulary system, ideal theories might not provide sufficient details for a final judgment. In this respect, we very much support the approach of Sen, who intends with his idea of justice – and this is my personal impression – to provide non-philosophers with a tool for how, in a specific circumstance, to decide on whether Rule A or B or Principle A or B is just. In this respect, it is worth as a concluding remark to quote the last paragraph of his article on what we want from a theory of justice, which was published in 2006. This shows best why his theory or idea of justice might be more useful for authors like me, who are seeking the advancement of justice within a specific field:

> The world in which we live is not only unjust, it is, arguably, extraordinarily unjust. It is not frivolous to seek a framework for a theory of justice that concentrates on advancement, not transcendence, and also allows being globally interactive, rather than being intellectually sequestered. We have good reason to abstain from concentrating so fully on the program of identifying the totalist and possibly parochial demands of transcendental, contractarian justice. We have to move the theory of justice out of that little corner.[1716]

Therefore we would agree with Sen that transcendental theories are not sufficient to make a comparative assessment of justice.[1717] However, this still requires an analysis of whether these transcendental theories are necessary for a comparative assessment of justice.

7.7.2.2. Ideal theories as necessary comparisons

An extremely difficult question is whether these ideal or transcendental theories that focus on the design of the ideal international structure in order to achieve justice are at all necessary in order to analyze whether a concrete proposal is just. Sen dedicates several pages in his *The Idea of Justice* on this aspect and concludes that "[t]here would be something deeply odd in a general belief that a comparison of any two alternatives cannot be sensibly

1716. Sen, 2006, p. 237 et seq.
1717. *See*, in particular, id., p. 219 et seq.

made without a prior identification of a supreme alternative."[1718] In other words, he does not see a necessity in referring to ideal theory, nor is it according to him sufficient to refer to transcendental theories. Or, in his words:

> The search for transcendental justice can be an engaging intellectual exercise in itself, but – irrespective of whether we think of transcendence in terms of the gradeless "right" or in the framework of the graded "best" – it does not tell us much about the comparative merits of different societal arrangements.[1719]

We share many of the views of Sen, but on this point, we would disagree with him. The disagreement is not a severe disagreement, but might be triggered by the different intention of his *The Idea of Justice* and the present study, and it is mainly based on the practical experience gained through the present study.

As mentioned, Sen argues that for the question of comparative justice, it is not necessary to answer the question "What is a just society?". Notwithstanding the correct answer to such a question – which would go beyond the present study – we would contrarily argue that for the question "How can justice in international tax law be achieved?", reference to ideal theories is necessary, as these theories help lawyers better understand why and based on what reason moral duties exist and how these duties should influence policy decisions, even though such policy decisions might not aim to achieve a perfectly just world, but instead aim at advancing justice at an international level.[1720]

Some conclusions or reasons inherent within ideal or transcendental theories are also very insightful for the purpose of using them in a non-ideal approach, following the instruments of reasoning and impartiality, as suggested by Sen.[1721] Therefore these ideal theories, such as left and right institutionalism or pure egalitarianism, might indeed provide for guidance that might help to decide whether a certain principle or rule indeed leads to just results. Furthermore, if a claim for a certain rule or principle is based on justice considerations, but such justice considerations would be against all existing ideal theories of justice, it is difficult to uphold such a claim.[1722] Therefore, based on the experience gained within the present study, it is necessary – even if we do not aim at developing the perfect or ideal global

1718. Sen, 2009, p. 102. *See also* Sen, 2006, p. 221 et seq.
1719. Sen, 2009, p. 101.
1720. *See* Robeyns, p. 159 et seq.
1721. *See* secs. 7.7.3. and 7.7.4.
1722. *See*, for example, regarding tax competition, Ronzoni, 2016, p. 201 et seq.

tax world – to refer to ideal theories, because these theories help to better understand why we have moral duties. Furthermore, a review of those existing moral duties (and the related dispute among philosophers) helps us to shape our argumentation as to why Principle A or Principle B or Rule A or Rule B better aligns with justice requirements.

Therefore we would agree with Sen that a comparative theory of justice does not require that we answer the question of what a just society is. However, a transcendental theory of justice might nevertheless help us from a practical perspective in developing our reasons for whether Principle A or B is more just or leads to more justice.[1723] This is particularly true if the research concerns a principle related to the question of whether we have moral duties to other individuals. For instance, if we ask the question of whether the ability-to-pay principle should apply and how it should apply in a cross-border circumstance, it seems necessary to refer to ideal theories, as these theories help to better understand who should be treated equally and based on what reasons.[1724] Therefore, from our perspective, ideal theories could help to better frame a standard for global justice, which could help as a guiding orientation when reviewing a certain international legal regime, such as the international tax regime. Other international lawyers have followed a similar approach when appraising some of the core norms of international law.[1725]

7.7.3. Reasoning

According to Sen, who is a supporter of social choice theory,[1726] it is essential that we reason our judgments in order to avoid placing blind belief in principles and rules. Furthermore, it is important that any principle or rule that seems unjust be examined, as we would otherwise risk that the rule or principle is erroneously considered unjust. This indeed seems persuasive, as we clearly prefer an in-depth reasoning about justice and injustice, rather than a mere protest that something is unjust. It is also important, according to Sen, that we admit the likelihood that we will not achieve a complete

1723. *See* Robeyns, p. 161 et seq.
1724. For further detail on this topic *see* sec. 8.1.
1725. *See* Ratner, 2015, p. 64 et seq., who uses peace and human rights as "his" standard for global justice.
1726. *See generally* Sen, 2009, p. 91 et seq. Sen is highly influenced by the social choice theorists Condorcet and Arrow. We will not, in the present study, dedicate a specific chapter to social choice theory, but the remarks on the importance of reasoning and normative reasoning in various sections are essentially related to social choice theory. This is best shown by the summary of Sen on social choice as a framework for reasoning (id., p. 106 et seq.).

resolution. This means in an individual case that we might not be able to resolve all existing ambiguities or conflicting reasons.

Additionally, it is not necessary to derive a single reason for justice, as there is often a bouquet of reasons; an evaluation of such a plurality of reasons is also required.[1727] The latter means, from a tax perspective, that when rendering an evaluation of the normative value of the current international tax regime, we might not find a single reason or source of justice, such as, for example, the principle that taxation should occur where value is created.[1728] This is particularly true, as many principles are referred to by international organizations and legal scholars when demanding a certain change of the current international tax regime.

Another crucial point is the need for precise articulation and reasoning.[1729] This also allows the contribution to identify a potential axiomatic basis of an argument. As we will see in several sections below, this is of great importance from an international tax perspective, as some of the principles are derived from axioms that can be scrutinized. In a similar manner, it is crucial that we facilitate re-examinations of presumably axiomatic principles or, in the words of Sen:

> Another feature of some importance is the way social choice theory has persistently made room for reassessment and further scrutiny. Indeed, one of the main contributions of results like Arrow's impossibility theorem is to demonstrate that general principles about social decisions that initially look plausible could turn out to be quite problematic, since they may in fact conflict with other general principles which also look, at least initially, to be plausible.[1730]

Again, international tax law might also consist of principles and rules that "initially look plausible", but could indeed lead to rather unjust results. Importantly, the following sections will disclose that the question of whether a certain principle or a certain rule within the international tax regime is just might require balancing various reasons. We will not find a single reason to evaluate whether a certain development in international tax law must be considered as just. However, to reach a conclusion, we will have to prioritize the various values and reasons. This is, of course, a personal decision and as highlighted by Sen, might include "partial rankings" of the different values

1727. Id., p. 394 et seq. *See also* id., p. 194 et seq.
1728. For further details on this topic *see* sec. 11.5. This is what we called above "normative reasons". There is a close link to the reflective equilibrium in Rawls' writings. *See also* Michels, p. 11.
1729. *See* Sen, 2009, p. 109 et seq.
1730. Id., p. 107. *See also* Sen, 2012, p. 102 et seq.

and reasons.[1731] There might be cases, however, in which a person may not find a conclusion and clear hierarchy of the existing reasons and values.

Importantly, Sen mainly uses the term "public reasoning" instead of "reasoning". In this respect, he draws the relevant link between democracy and reasoning by highlighting that "public reasoning" is crucial within his idea of justice, as democracy means public reasoning. For the purpose of the present study, it is sufficient, however, to use the term "reasoning" because we have shown above[1732] that we do not refer to questions of improvement of democracy or, in more general terms, improvements of procedural justice within the present study. The focus, however, is on the question of whether a certain principle or rule is just, and reasoning is a key element for such analysis. Therefore, we would agree with Sen that it is crucial that we use manifold arguments and in-depth reasoning to judge whether a certain principle or rule is just or not or, in his words:

> When we try to determine how justice can be advanced, there is a basic need for public reasoning, involving arguments coming from different quarters and divergent perspectives. An engagement with contrary arguments does not, however, imply that we must expect to be able to settle the conflicting reasons in all cases and arrive at agreed positions on every issue. Complete resolution is neither a requirement of a person's own rationality, nor is it a condition of reasonable social choice, including a reason-based theory of justice.[footnote omitted].[1733]

7.7.4. Impartiality

Vital in Sen's idea of justice is that the analysis of whether a certain principle or rule is just must follow the viewpoint of an impartial spectator – a concept referred to already by Adam Smith.[1734] In several instances, Sen highlights the weaknesses of the contractarian ideas, such as Rawls' *A Theory of Justice,* as the results of an original position negotiation are limited to an imperfect group that formed part of the negotiation. However, Sen himself highlights the argument that impartiality is somehow linked to the original position of Rawls and his theory of justice as fairness. Or, in his words: "The deliberations in this imagined original position on the principles of justice demand the impartiality needed for fairness."[1735]

1731. Sen, 2009, p. 396.
1732. *See* sec. 2.1.6.
1733. Sen, 2009, p. 392.
1734. Id., p. 114 et seq.; Sen, 2012, p. 103 et seq. *See also* Smith, 2009, p. 1 et seq.
1735. Sen, 2009, p. 55.

According to Sen, we should ask for an "open impartiality" that also scrutinizes local values.[1736] This, however, is a difficult task, as we as researchers need to overcome our "positional perspectives", which might have grown over the course of decades. Sen further draws the link between rationality and impartiality, arguing that rationality is based on reasoning, which can sustain a critical scrutiny, and such a critical scrutiny is best achieved by an unbiased impartial approach. From an international tax law perspective, this means in simplified terms that one should not be biased when analyzing whether a certain principle or rule at an international level is just. To be more concrete, we should leave our position of academics, tax commissionaires, tax consultants or in-house counsels when discussing justice within international tax law. We should also leave our position as members of large or small economies and of high- or low-tax jurisdictions, or else there is a risk of unjustified self-justifying. Or, as Singer puts it: "It is easy to slip into a self-justifying stance, convincing ourselves we are right when we are actually wrong."[1737]

Furthermore, it is also crucial to consider the position of parties outside a certain group, as a decision of a group might have an impact on a third party that could lead to an unjust result. For instance, it seems crucial to consider not only the members of a society when analyzing justice within a new regulatory framework, such as the BEPS Project, but it is also essential that the involved parties discuss the impact of their decision on non-participating states. Otherwise, we risk running into "a trap of parochialism",[1738] i.e. we should be open to third-party opinions. This is nothing new in international law, as some authors have already referred to parochialism and the risk it poses to international law.[1739] In the international realm, it is of particular importance not to apply an imperialistic (and possibly driven by Western values) view when discussing changes for the international tax regime.

Lastly, when discussing justice at an international level, Sen also highlights the difficulty in achieving justice globally, as many different cultures and values exist. As an example, it is highly difficult to argue in favor of higher tax burdens of multinational enterprises if we acknowledge the existence of states with rather libertarian policies with generally rather low tax rates. Or, to be more precise, is it just to claim that multinational enterprises should pay more than 20% effective tax rates from a consolidated perspective, if some countries like Ireland have a tax rate of 12.5%? Therefore, value

1736. Id., p. 124 et seq.
1737. Singer, 2009, p. 931.
1738. Sen, 2009, p. 403.
1739. E.g. Tasioulas, 2010, p. 105 et seq.

pluralism is a significant challenge for a normative review of the international tax regime.[1740]

7.7.5. Is Sen sufficiently detailed to use his theory in the present study?

In his idea of justice, Sen is mainly concerned with grave injustices caused by, for instance, slavery or famine, but is his approach indeed helpful when reviewing principles and rules of the international tax regime that might likely not reflect grave injustices?[1741] In this respect, Sen assumes a person might be able to reason against slavery, but this does not necessarily indicate that the same person must be able to decide between an income tax rate of 39% and 40%.[1742] This leads Shapiro to conclude that Sen's idea of justice compared to Rawls does not provide for a criterion on how to decide between a tax rate of 70% and 35%.[1743] In general, Shapiro argues that Sen's theory does not say how to get the comparisons right or how to rightly decide between two options.[1744]

It is clear that Sen, compared to Rawls, does not provide for concrete principles on how to design a society in order to achieve justice. It is indeed more convenient to refer to Rawls to answer the question of whether a 70% or 35% income tax rate is just, since in Rawls' understanding we could at least link our line of argumentation to the difference principle and, therefore, further elaborate which inequalities are justified, given that the domestic tax system better suits the needs of the least advantaged in a society. However, when discussing justice within the international tax regime, Rawls' ideas are less helpful, as they often do not provide for guidance on how to decide between two policy options, as his principles developed in *The Law of Peoples* are only partly helpful. From our perspective, Sen's emphasis on reasoning and the "impartial spectator" methodology are more useful and might be sufficiently detailed for a study on justice in international tax law.

Therefore, Sen's *The Idea of Justice* will be the most important reference in the normative analysis in the following sections.

1740. Id., p. 109 et seq.
1741. *See generally* Sen, 2012, p. 103.
1742. Sen, 2009, p. 396. *See* Mill, 2016, p. 172 et seq., who was struggling with similar questions.
1743. Shapiro, p. 1255 et seq.
1744. Id., p. 1257.

7.7.6. How to assess injustice according to Sen

7.7.6.1. Capabilities as a factor to measure inequality

The capabilities approach, as brought forward by Sen, has its roots in the writings of Marx and Adam Smith, but also Aristotle.[1745] However, the formal starting point of the capabilities approach lies in the work of Sen itself.[1746] The capabilities approach has not directly been developed in order to build up a just world order, but it does provide guidelines in order to evaluate the richness of human beings and to evaluate the development of the well-being of peoples over a longer period.[1747] One could also call it an "outcome-oriented approach", as compared to a procedural approach, such as contractualism, according to Rawls.[1748]

According to Sen, capabilities reflect the freedom to pursue the well-being of a person or the "the actual ability to do the different things that [a person] values doing".[1749] Capabilities are different from functionings, as these might refer to the actual achieved well-being of persons.[1750] Compared to Nussbaum, Sen does not develop a concrete list of capabilities that should be fulfilled in order to achieve a just system and he also does not provide for a detailed, principle-based international structure, as developed by Nussbaum, with reference to the capabilities approach.[1751] However, he highlights the importance of freedom, which actually reflects the capabilities that a person has to achieve certain functionings.[1752]

Sen strictly opposes utilitarian ideas, arguing that utilitarian approaches focus only on utile aspects and ignore non-utile aspects in their moral judgment. For instance, Sen argues that the GNP per capita is not a measure to judge the welfare of a state.[1753] For instance, life expectancy does not directly correlate to the GDP per capita.

1745. Sen, 2004, p. 43 et seq.
1746. Id., p. 15, with many references.
1747. Robeyns Ingrid, The Capability Approach, The Stanford Encyclopedia of Philosophy (http://plato.stanford.edu/archives/sum2011/entries/capability-approach/, last visited 11 Feb. 2019).
1748. The term is used by Nussbaum, 2004, p. 13 et seq.
1749. Sen, 2009, p. 253.
1750. Sen, 2004, p. 5.
1751. *See* sec. 7.7.6.2.
1752. Sen, 2004, p. 8.
1753. Sen, 2009, p. 253.

Compared to Rawls' theory of justice, the concern is not with commodities or means of achievement when developing interpersonal cooperation. Sen argues that the approach of Rawls, who refers to the allocation of primary goods among persons within the difference principle, misses the fact that the ability of persons to actually transfer primary goods into achievements differs.[1754] Therefore, "it can be argued that the capability approach gives a better account of the freedoms actually enjoyed by different people than can be obtained from looking merely at the holdings of primary goods. Primary goods are means to freedoms, whereas capabilities are expressions of freedoms themselves."[1755]

When discussing justice beyond the borders of a state, Sen argues that justice, as such, does not stop at a certain border for two reasons. First, decisions in one country might have an effect in another country. Sen mentions, inter alia, the reaction of the US after 9/11 and its impact on other jurisdictions, or the importance of the development of medicines against AIDS in one country for infected persons in another country. Second, Sen argues that injustice in one country can lead to injustice in another country, as it might spread beyond the borders of a certain state.[1756]

7.7.6.2. Excursus: Martha Nussbaum on global justice

Nussbaum refers to the theories of Rawls in order to develop her own understanding of justice at a global level. Inter alia, she highlights the weaknesses of Rawls' position on the moral significance of states per se, arguing that the second original position by Rawls does not provide for a solution as to why nation states are morally significant, since Rawls assumes their existence as a starting point and does not question the state structure as such.[1757]

Moreover, according to Nussbaum, the second social contract argument is weak, as the state's representatives likely do not represent the interests of most of the people.[1758] The latter point of criticism was already highlighted above.[1759] Nussbaum furthermore rejects the argument of self-sufficiency used by Rawls in order to justify the second original position, as it fails to address the current problems of the world, which does not factually

1754. Id., p. 260 et seq.; Sen, 2004, p. 7.
1755. Sen, 2004, id.
1756. Sen, 2009, p. 402 et seq.
1757. Nussbaum, 2004, p. 3 et seq. For further details *see* Nussbaum, 2007, p. 230 et seq.
1758. Nussbaum, 2004, p. 5 et seq.
1759. *See* sec. 7.1.

consist of self-sufficient states.[1760] In particular, she highlights the weakness of Rawls' argument that poverty is mainly triggered by domestic policy, as she claims that the international economic system has created "severe, disproportionate burdens"[1761] for poor countries. However, to be precise, Nussbaum is of the opinion that global justice considerations are essential and that national boundaries should not be understood as moral constraints, but the question of justification and implementation needs to be distinguished. Therefore, even though one might argue that the current world order is highly unjust due to the existing outrageous poverty, it does not automatically mean that states should use force and ignore national boundaries in order to achieve a better world.[1762]

As mentioned already, Nussbaum in principle prefers the approaches of Pogge and Beitz to apply the first original position in a worldwide manner.[1763] She argues that such an approach is a considerable improvement compared to the twofold negotiation process within the work of Rawls.[1764] However, she sees some difference between the bargaining process within the first original position in the Rawlsian understanding and an application of such a negotiation among all individuals worldwide. In particular, Nussbaum argues that bargaining at a global level cannot be mutually advantageous among "rough equals", but must consider "human fellowship and human respect in a more expansive way".[1765] Therefore, she advocates for human fellowship and human respect as the measure for justice, or in other words, that certain human rights are required, as each of us was born into the society of humans.[1766]

Nussbaum, similar to Sen, follows a "capabilities approach", according to which justice for all is achieved if certain basic human entitlements are met.[1767] Therefore Nussbaum's understanding of justice as a minimum standard requires a distribution of a set of basic human entitlements among peoples:[1768] "Humanity is under a collective obligation to find ways of living and co-operating together so that all human beings have decent lives."[1769]

1760. Nussbaum, 2004, p. 6.
1761. Id., p. 7. *See also* Pogge in sec. 7.5.2.
1762. Nussbaum, 2004, p. 10.
1763. Nussbaum, 2007, p. 264 et seq.; Nussbaum, 2004, p. 10 et seq.
1764. Nussbaum, 2004, p. 11.
1765. Id., p. 12.
1766. Nussbaum, 2007, p. 270.
1767. Nussbaum, 2004, p. 4. For further details *see also* Nussbaum, 2007, p. 272 et seq.
1768. Nussbaum, 2004, p. 4.
1769. Nussbaum, 2004, p. 13.

Accordingly, she follows a human rights-centered approach. This means that the basic capabilities of human beings are actually the source for moral claims. This, however, also has the consequence that human beings are obliged to (collectively) provide other people with the required and necessary goods.[1770]

Importantly, the question of who is responsible for promoting the capabilities needs to be resolved before we can further discuss the principle of the global order, as developed by Nussbaum. In general, Nussbaum argues that we as human beings all have an obligation to promote capabilities. However, she admits that an allocation of the duties among individuals and institutions is necessary; in particular, she favors the assignment of certain duties to institutions.[1771] This is necessary, inter alia, as there would otherwise be significant confusion as to who is responsible for fulfilling what kind of duties (i.e. a collective action problem).[1772]

For the present study, it is of great interest that Nussbaum also accepts the importance of nation-state sovereignty, as it is a way to protect the human autonomy of organizing a society.[1773] In simplified terms, this means that respecting nation states, as such, is derived from the need to respect individuals.[1774] Nussbaum further states that it might be a good solution to assign one's own responsibility in this sense to an institution, such as the state at a domestic level. There might even be the need to form institutions, as it is otherwise likely that individuals might neglect their duty.[1775]

At a global level, she therefore opposes the idea of a world state,[1776] but she supports the idea of a thin and decentralized global public sphere, including a world criminal court and "a set of global trade regulations that would try to harness the juggernaut of globalization to a set of moral goals for human development."[1777] She is also in favor of "some limited forms of global taxation that would affect transfers of wealth from richer to poorer nations (such as the global resource tax suggested by Thomas Pogge)."[1778] These structural

1770. Nussbaum, 2007, p. 291.
1771. Nussbaum, 2004, p. 14.
1772. Nussbaum, 2004, p. 14 et seq.
1773. Nussbaum, 2007, p. 312.
1774. Nussbaum, 2007, p. 314.
1775. *See*, on the need for non-global institutions, Nussbaum, 2007, p. 264 et seq.
1776. Nussbaum, 2007, p. 264 et seq.; Nussbaum, 2004, p. 15.
1777. Nussbaum, 2004, p. 17.
1778. Id.

aspects of a global community are further manifested by Nussbaum in her ten (non-exhaustive) principles of a global structure:[1779]

(1) "Over-determination of responsibility: the domestic never escapes it."

(2) "National sovereignty should be respected, within the constraints of promoting human capabilities." According to Nussbaum, this means intervention as such is generally not justified (only in limited cases), but the persuasive use of funding reflects a good manner of improving human capabilities.[1780]

(3) "Prosperous nations have a responsibility to give a substantial portion of their GDP to poorer nations." However, she does not answer the question of how the allocation of funds from the rich to the poor country should occur, although she highlights that if the receiving state is democratic, the support should not undermine the sovereignty of such a state, e.g. through NGOs.[1781]

(4) "Multinational corporations have responsibilities for promoting human capabilities in the regions in which they operate." Nussbaum argues that even efficiency arguments support the need that multinationals should contribute part of their profit to the states in which they operate, as this would lead to a "stable, well-educated work-force".[1782]

(5) "The main structures of the global economic system must be designed to be fair to poor and developing countries." In particular, she highlights the fact that ethical reflections should play a more important role when debating the global economic system.[1783]

(6) "We should cultivate a thin, decentralized, yet forceful global public sphere."

(7) "All institutions and individuals should focus on the problems of the disadvantaged in each nation and region." This means, inter alia, that the world community should focus on persons with a particularly low quality of life.

1779. Nussbaum, 2007, p. 315 et seq. *See also* Nussbaum, 2004, p. 16 et seq.
1780. Nussbaum, 2004, p. 16.
1781. Id.
1782. Id.
1783. Id.

(8) "Care for the ill, the elderly and the disabled should be a prominent focus of the world community."

(9) "The family should be treated as a sphere that is precious, but not 'private'."

(10) "All institutions and individuals have a responsibility to support education, as key to the empowerment of currently disadvantaged people."

7.7.6.3. Intermediate conclusion

We draw from the capabilities approach that the capabilities of persons to achieve functionings are the more appropriate measures in order to evaluate whether the well-being of persons in a society or worldwide has increased. The growth of the worldwide GDP or the growth of the GDP in a specific state is not sufficient to decide.[1784] As we will demonstrate below, this might also influence international tax policy. Furthermore, we will also analyze what inputs we can derive from the principles developed by Nussbaum on the design of the international (tax) order.

1784. *See* sec. 11.4.3.2.

Chapter 8

Essential Conclusions

8.1. Transcendental and non-transcendental theories as non-exclusive guidelines

Before we review some of the most important principles and rules of the international tax regime, it is essential to (further) develop and outline our opinion with respect to the different existing normative theories on global justice, which were outlined in the previous chapters. This is essential for an analysis of whether a certain rule or principle leads to a just international tax regime and to develop a stringent result. Some arguments were already stated, but the following concluding sections should allow a more concise understanding of the main elements of our position. We have shown above in detail with references to the persuasive work of Sen that ideal theories of justice aiming at developing the perfect institutional framework at a national or international level might not provide for very concrete guidance on how to improve the current international tax regime to enhance justice.[1785] We support such a position based on two main arguments.

The first reason is that these ideal theories might face practical constraints. For instance, the implementation of an institutional system following a global difference principle is not feasible. Therefore, the claim for cross-border payments to fulfill (cosmopolitan) distributive duties is weak, unless there is indeed a feasible international structure allowing that the allocation of such payments indeed follows these distributive duties. Currently, such an international structure is nonexistent at an international level and its development is very unlikely. Therefore, a claim for a certain moral duty as a policy guideline is not persuasive if practical constraints disallow that such a duty is fulfilled.

A second important reason, which was highlighted above, relates to the fact that ideal theories do not guarantee that the outcomes of such an institutionalized world are as such just. Therefore, one could argue in favor of certain principles, as these seem to reflect the persuasive ideal approach, but we have no guarantee that when these principles are applied, they will indeed lead to a just result. For instance, if we were to agree on an international

1785. *See* sec. 7.7.2.

distributive duty, it is not certain that the result of adherence to such a duty would lead to a result that is presumed to be just by the people affected.

Instead, in the present study, we prefer to focus on the actual injustices in order to improve the current international tax regime, and not on ideal theories. However, some conclusions or reasons inherent in ideal theories are also very insightful and fruitful for the purpose of using them in a non-ideal approach. Therefore, these theories might indeed provide guidance that might help to decide whether a certain principle or rule indeed leads to just results. It is our understanding that when discussing justice within the current international tax regime, it is crucial to evaluate the available concepts of international distributive justice and evaluate the available understandings of the principle of sovereignty. These two elements are the core subjects of all normative theories of international law.

In an interdisciplinary study on justice and international tax law, it is not feasible to develop our own philosophical ideal theory of global justice. It is nevertheless essential to state some own reflections on the existing varieties to limit our position in the following sections and to develop a concise and consequent study on justice in the field of international tax law.[1786] Of course, such methodology bears the risk that the conclusions are weak if the (chosen) normative theory is weak. However, as we will see below, we will often consider several theories of global justice to support one or the other position. Therefore, a potential critic on the chosen normative theory of global justice might not necessarily weaken the conclusions drawn in Part IV of the present study, as the conclusion might not be based on a single theory or a single argument. One could argue that such a methodology leads to contradictory results. There is indeed such a risk, but the usage of two opposing theories can still be useful and non-contradictory. For instance, if two opposing theories would both suggest the usage of a certain principle or rule, there are persuasive reasons to suggest its application. The same is true if two opposing theories suggest the non-usage of a certain principle or rule. Therefore, there are cases in which several contradictory theories might support the same conclusion.[1787] However, before discussing our position regarding two crucial elements of ideal theories (i.e. cross-border distributive duties and sovereignty), we will argue in favor of a methodology for our normative review that is highly influenced by Sen's comparative idea of

1786. *See*, on the importance of some ideal standards for the purposes of a comparative theory of justice, sec. 7.7.2.2.
1787. *See*, for example, with an interesting example from a tax perspective, Van Apeldoorn, p. 17.

justice, which uses the instruments of (normative) reasoning and impartiality as the core elements to enhance global or societal justice.

8.2. Normative reasoning and impartiality

As mentioned already in several instances, the focus of the present study is not on procedural improvements or procedural justice to achieve a just international tax regime,[1788] but rather on measures to evaluate whether certain principles and rules are just and indeed lead to a just international tax system. To analyze whether a rule or a principle is indeed just, we need to employ in-depth normative reasoning and a review of the existing arguments both in favor of and against a certain principle or rule. This requires that we refer to values and moral duties to evaluate whether a certain principle or rule leads to just results, as international law does not provide us with a detailed framework to assess our policy suggestion.[1789] This was already indicated in the introduction of this study when outlining parts of our methodology, and we have also highlighted the particular merit of normative reasoning as a lawyer's tool.[1790] Moreover, the use of (public) reasoning as a tool to enhance justice finds major support in *The Idea of Justice* by Sen.[1791]

In this respect, it is essential that long-standing principles are questioned and that it is analyzed in detail whether a certain result is indeed just or unjust. Reasoning, as such, is of course part of a more traditional and dogmatic juridical methodology, since an important task of judges, but also of litigators, is to reason either in favor of one or another claim. This means that a positive legal analysis uses the method of reasoning to either support or refrain from a certain application and interpretation of the law. Therefore as lawyers, we should already be trained to balance several arguments to reach our conclusions. However, such reasoning is often used within a legal framework, i.e. whether the interpretation result A is more persuasive than the interpretation result B following the existing constitutional and/or legal framework.[1792] Therefore, lawyers are particularly used to deriving their arguments from certain legal or constitutional rules or principles following a dogmatic path. A work on justice in international tax law, however, needs to use the instrument of "reasoning" out of a specific legal framework such as a certain law or a constitutional framework. This means that it is crucial

1788. *See*, for instance, sec. 2.1.6.
1789. *See* sec. 2.1.2.
1790. *See* sec. 2.2.4.
1791. *See* sec. 7.7.3.
1792. *See generally* Singer, 2009, p. 899 et seq.

to rely on values and moral duties, as there is no legal or constitutional framework from which certain normative guidelines can be derived.[1793] Of course, the latter task is challenging since we, as lawyers, are not used to dealing with such questions and our methodology might not be able to answer some of the questions asked in the present study. Consequently, and this was already mentioned and justified several times, we will rely on some of the outlined philosophical theories and ideas to render a logical and persuasive analysis on the normativity of some of the most fundamental principles and rules of the international tax regime.[1794]

While doing so, it is crucial that we take the position of an impartial spectator, as also essential within *The Idea of Justice* by Sen. This means that we should set aside our position as academics, tax commissionaires, in-house tax counsels, and representatives of a strong economy, a small state, a tax haven or a high-tax country. This is an extremely difficult task, but one that is essential for a study about justice in international tax law. Not surprisingly, it was already claimed by international law scholars that "objectivity remains the central regulatory idea at which research in international law can and should be oriented."[1795] Of course, our views are influenced by our personal experience and such views might unconsciously impact our reasoning. Nevertheless, despite knowing that it seems extremely difficult to apply a fully neutral and objective view, it is still worthwhile and necessary to try as much as possible to apply an impartial perspective. Science in general and law as an academic discipline should be without prejudice and should not be driven by a political agenda.[1796] Impartiality per se might be an important instrument to extract potential non-academic and political considerations from a study.

8.3. International distributive justice – Assessment

It has been shown that there are various theories among (liberal)[1797] political philosophers as to whether an international distributive duty exists and

1793. Such a missing legal or constitutional framework has been described in sec. 4.4.
1794. *See* Peters, 2007, p. 746 et seq. We already explained in secs. 2.2.4. and 7.7.3. why we use the term "normative reasoning" instead of Sen's terminology "public reasoning".
1795. Peters, 2016, p. 27. *See also* Ratner, 2015, p. 55 et seq., who highlights the needs for impartiality in a theory of justice for international law purposes. He mainly refers to Barry. *See also*, from an international tax perspective, Lamberts, p. 49 et seq., who highlights the need for an objective standard of fair taxation.
1796. *See generally* Popper, 2015, p. 88 et seq.
1797. *See* sec. 2.1.6. on the limited reference to political philosophy in the present study.

how such a distributive duty could be sufficiently fulfilled. There seems to be considerable disagreement on whether a more state-centered or individual-centered approach is justified.[1798] The following remarks should help to better frame our position in this respect, which will be an important moral anchor for the following remarks as well as the following normative review of the international tax regime. We will limit ourselves to two elements.

First, we will outline our reasons why we deny the existence of a global difference principle following a cosmopolitan concept of global justice, as argued by authors like Pogge and Beitz.[1799] Second, we will demonstrate our own so-called "continuous approach" regarding the creation of a basic structure triggering intra-society principles of justice.

8.3.1. No global difference principle

We already outlined the reasons of several authors opposing cosmopolitan (or left institutional) concepts of global justice. Nevertheless, in the following, we will state three reasons why we will support a right institutional understanding of global justice.

First, we believe that one of the crucial reasons for the existing dispute between left and right institutionalists is triggered by the uncertainty regarding apparent constraints of the current world order and the empirical facts upon which the different normative claims are based. It is indeed persuasive, at least in the current global political structure, to argue that a cosmopolitan world order with a single-state system (or a strong international governmental body with distributive powers) is not feasible in the coming decades.[1800] In other words, we would disagree that there is currently or will soon be something like a basic structure at an international level requiring cross-border distributive duties, such as Rawls' difference principle.[1801] However, this does not mean that the ideas of left institutionalists are not at all persuasive; rather, there are significant practical constraints to hypothetically fulfill our moral duties following a cosmopolitan understanding of global justice. One could also argue that justice at an international level can only be guaranteed by changing the international institutional framework

1798. *See* sec. 7.2. *See also* Barry & Valentini, p. 485 et seq.; Caney, 2011, p. 507.
1799. *See* Pogge (sec. 7.5.2.) and Beitz (sec. 7.5.1.).
1800. And it might even be a dangerous development of a world state. *See* the arguments of Rawls in sec. 6.3.
1801. We cannot fully explore in the present study how the basic structure could be defined (for a comprehensive analysis *see* Abizadeh, p. 318 et seq.).

and, therefore, instead of asking whether we have a global basic structure triggering (domestic) distributive duties, one would need to ask whether we need a global structure, as this is the only manner to mitigate the current injustices at an international level.[1802] However, the latter is not the line of argumentation that we propose within the present study, since we currently see no feasibility of changing the international (tax) institutions in order to achieve a global basic structure which would allow a just allocation of income following a more cosmopolitan approach.

Second, one of the most essential arguments in favor of a non-cosmopolitan approach is that just international regulation, be it tax regulation or international regulation in any other field, needs to make sure that it fits the needs of very different societies or states, respectively. From a tax perspective, we should aim at an international regulatory framework that can be considered just from the perspective of the inhabitants of a state with low or high public expenditure quotas. This is also one reason why we would be against an intense international redistribution system, compared to redistribution within European countries, as the level of redistribution highly depends on the society and the democratic will of peoples. For instance, Nordic countries are famous for having a more egalitarian society with fewer inequalities compared to, for instance, the United States. However, the international tax regime should be able to be considered just from both perspectives without forcing states to follow a certain political ideology. The latter should, in an ideal world, only be subject to the democratic will of the people and not the opinion of other states. Otherwise, there is a risk of what we would call "value imperialism" through international tax policy.[1803] In other words, we deny a cosmopolitan understanding of distributive justice since, inter alia, it might conflict with the democratic will of a state not following such a liberal state concept. Therefore we see a disadvantage in cosmopolitan concepts of global justice, namely that these are not able to comply with various existing societies at a global level without forcing other states (even against democratic will) into a certain societal understanding, such as a liberal concept of justice in line with Rawls' *A Theory of Justice.* Such an argument might be similar to the communitarian critique of liberal concepts of justice as famously developed by Walzer.[1804]

1802. *See* Ronzoni, 2009, p. 243. *See also* Dietsch, 2015, 94 et seq.
1803. The term will be further referred to in sec. 12.6.2.4. Such an approach is highly influenced by Wenar, 2006, p. 95 et seq., who argues that a cosmopolitan understanding cannot meet the requirement of (democratic) legitimacy. In other words, the prevention of value imperialism protects (democratic) legitimacy.
1804. *See* Walzer, p. 1 et seq.

Third, we argue that the result of some of the existing ideal theories, with respect to the distributive effect, might not be so different. Bearing in mind the realization-based approach of Sen,[1805] it is essential to focus on the results of certain measures to evaluate whether it is a just or unjust measure. For instance, Rawls argues for the duty to assist burdened societies; Nagel, however, argues in favor of a humanitarian duty, while Pogge and Beitz seem to suggest a global difference principle. However, depending on the exact design of these different claims, the outcome might not be so different. It shows that both left and right institutionalists agree that the rich on this planet have a certain moral duty toward the poorest or the worst off, even at a global level. This is also our position, as we would argue that we – from a moral perspective – have a duty to support the worst off on this planet, but only as a humanitarian duty as it will be defined in section 8.3.3.[1806] Therefore, there is no egalitarian claim at an international level, as morality does not require that we treat all humans equally regarding principles of socioeconomic justice; rather, morality requires that we treat all humans with humanity.[1807]

In conclusion, we believe that there are specific principles of justice attached to a basic structure of a domestic society, as famously argued by Rawls, and these principles do not apply to the same extent between members of different societies (i.e. states). Of course, this triggers the immediate question of how we define the members of a society. As we will outline in the following, we suggest a continuous approach in this respect.

8.3.2. A continuous approach

In case one agrees that coercion, association and/or cooperation are morally significant, in the sense that an increased international integration and a global coercive framework might indeed trigger additional duties among the individuals in the participating states, it seems persuasive to follow what we call hereinafter "a continuous approach".

1805. *See* sec. 7.7.
1806. Such a claim is not very different than a claim that there is a moral duty to protect (some of the most essential) human rights, as suggested by other international lawyers (*see*, for example, Ratner, 2015, p. 42 et seq.).
1807. *See* in this respect Krebs, p. 19: "*Wer hungert oder schwer krank ist, hat einen moralischen Anspruch auf Unterstützung, nicht weil es anderen unverdientermassen besser geht als ihm, sondern weil es ihm schlecht geht und Punkt*."

A continuous approach means that not only the cooperation, but also the level of coercion and association, continuously create a basic structure triggering additional duties and that there is no lexical gap system according to which, for instance, all intra-society duties of justice are triggered if coercion, association and/or cooperation have reached a certain level. The main reason for following a continuous approach is that it seems illogical to claim that a certain cooperation or coercion threshold needs to be met to create several comprehensive principles of intra-society justice. For instance, the "shared institutions" argument of Nagel does not seem to require an all-or-nothing approach.[1808] In other words, the more institutions we share with individuals in another country, the more duties we owe each other. Or, the more coercive elements there are between two states, the more duties we create following Blake's coercive theory of justice in a continuous manner.[1809]

We do not understand our approach as being in opposition to the theories of global justice by right institutionalists, such as Rawls, Nagel, Blake or Risse, but we understand these theories in a more dynamic manner, considering the fact that international or supranational integration can lead to state-like global institutions and coercive structures. This type of steady integration requires that a theory of global justice can cope with the need to demonstrate the application of intra-society principles of justice during a steady integration process and to demonstrate the existing duties in intermediate situations, i.e. in a situation of coercion and cooperation at an international level, which is state-like, but not identical to a domestic system.

Therefore, it might indeed be the case that if two states share several institutions and if those two states are subject to the same coercive structure, that intra-society duties of justice exist between individuals living in these two states, even though these states might still formally be independent. Of course, these remarks can be questioned, as we have not outlined a full-fledged theory of global justice, but rather weighed the different existing theories in a more judicial manner. Nevertheless, some present and past institutional developments seem to support our continuous approach.[1810]

1808. *See* sec. 4.4.1.
1809. *See* sec. 4.4.2.
1810. Of course, this goes against a philosophical methodology concerning the development of a logical theory of global justice. But again, we would dare to develop our own global theory of justice. These remarks should help us to better frame some ideas on how to enhance justice in the international tax regime by rendering a normative review in Part IV. To do so, we aim to state our non-philosophical standpoint on how to achieve justice globally.

A very persuasive example is the EU, which is a state-like construct, but nevertheless, an Austrian resident might still not have the same duties toward a compatriot as against a person living in Romania; however, an Austrian might have more duties against a compatriot in Germany than against an individual living in a third country, such as Switzerland. Yet, if the integration of the nation-states will continue (which is currently difficult to anticipate in the EU), even further duties might be triggered on a continuous basis and the integration (i.e. coercion, cooperation and association) might reach a state that would trigger a comprehensive list of duties following, for instance, *A Theory of Justice* as a liberal intra-societal concept of justice. The same is true for federal states, such as the United States and Switzerland. At least the Swiss experience has shown that certain socioeconomic duties such as a comprehensive non-discrimination principle have only been applied in Switzerland, since the federation is more integrated, regarding both cooperation and coercion.[1811]

What does this mean for the current global structure?

Prima facie, the world is highly integrated, at least economically, through globalization and free trade, and international tax law further enhances such cooperation. We have seen that cooperation is intense in the international tax world[1812] and, furthermore, coercion also exists, as states are forced by other states or a conglomerate of states, through the use of economic sanctions, to change their domestic tax system.[1813] This brings us to the question of whether coercion, association and/or cooperation is the decisive element for triggering socioeconomic principles of justice, such as the difference principle, which are of preeminent importance for the present study.

In this respect, we believe that the existence of a coercive structure that operates in the name of the inhabitants is indeed a crucial element for triggering distributive duties. The main reason is that such a coercive system significantly influences the lives of its inhabitants and, therefore, creates duties, such as a duty for equal treatment and distributive duties, respectively. We

1811. For instance, the Swiss Federal Supreme Court was until 2004 reluctant to apply a comprehensive principle of non-discrimination between individuals living in the same canton but with one of them owning real estate in another canton, as it disallowed the inter-cantonal offset of losses. However, the case law changed in 2004. Therefore, the court is nowadays of the opinion that the non-discrimination prohibition prevails over the autonomy of cantons to tax income from immovable property. For more details *see* Simonek, 2012, p. 233 et seq.
1812. *See* sec. 4.
1813. *See* sec. 5.3.

agree, however, with Nagel[1814] that there is currently still a significant distinction between coercion within a state and globally, which might indeed create different levels of duties. Regarding the criteria of cooperation, we are of the opinion that social cooperation or physical proximity are both stronger than mere economic cooperation. This means that international trade as such is unlikely to create distributive duties, but direct social interaction, for instance, the free movement of persons is a strong factor to create cross-border duties. The latter will be further highlighted below with references to the *Schumacker* case of the ECJ.[1815] Additionally, the claim that membership in or association with a certain legal (and coercive) system triggers more egalitarian duties seems persuasive. This is also a reason why, for instance, neighboring areas of two states might have higher economic interaction compared to two areas in the same jurisdiction, but the existing duties with the same state might still be stronger than in the cross-border circumstance.[1816]

To sum up, from a tax perspective, this means that if the (tax) world becomes more integrated, "the more moral importance we may attach to the value of global equality",[1817] along with a more cosmopolitan understanding of society. However, we would currently deny the existence of cross-border distributive duties beyond humanitarian duties, with the exception of states belonging to the same supranational organization with coercive power, such as the EU.[1818] Therefore, we would disagree with Follesdall that the global basic structure is not so different from the domestic basic structure.[1819] The global basic structure is still rather fragmented compared to the domestic basic structure, triggering a comprehensive list of moral duties or principles of intra-society justice.

8.3.3. How to understand humanitarian duty

This brings us to the last remark on what we understand as a humanitarian duty. Nagel has convincingly argued not only what this could mean, but also why there is a humanitarian duty independent from the existence of a basic structure at a global level:

1814. *See* sec. 7.4.1.
1815. *See* sec. 11.2.3.2.3.
1816. *See also* Cappelen, p. 106.
1817. Caney, 2011, p. 528.
1818. It would go beyond the present study to fully explore the level of coercion, association and cooperation within the EU and its impact on the inter-state basic structure.
1819. For more details *see* Follesdal, p. 46 et seq.

> I assume there is some minimal concern we owe to fellow human beings threatened with starvation or severe malnutrition and early death from easily preventable diseases, as all these people in dire poverty are. Although there is plenty of room for disagreement about the most effective methods, some form of humane assistance from the well-off to those in extremis is clearly called for quite apart from any demand of justice, if we are not simply ethical egoists.[1820]

As we will demonstrate in Part IV with reference to the work of Deaton,[1821] we are generally in favor of supporting institution building from a tax perspective. This means that a decrease of the most severe injustices is only feasible with strong domestic institutions and this includes an effective tax system. In other words the term "humanitarian duty" in our understanding is not linked to what is called humanitarian intervention in international law as a justification to use military forces in order to protect the inhabitants of a country in cases of severe human rights violations.[1822] The justification for the use of the term relates more to our position that there is a duty toward persons in other countries living in inhumane conditions and that there is no difference principle at an international level requiring cross-border distributive payments. Therefore, when the term "humanitarian duty" is used in the following, it does not mean that we ask for intervention measures by the global community, but we argue that the international community has a duty to support the worst-off persons living in inhumane circumstances through global tax policy. This is required to achieve a just international tax law regime. Therefore we would deny that there is a general distributive duty toward developing states, as argued by other tax scholars,[1823] but there is a humanitarian duty that is internationally independent from the level of integration to reduce the most severe inhumane living conditions around the world.

Moreover, when reviewing existing cross-border humanitarian duties to the worst-off nations, it is essential that we not only reference the income per capita to decide who the worst off are, but we should also consider further analysis, such as the capabilities approach of Sen and Nussbaum[1824] or whether a state is able to protect the most essential human rights of its

1820. Nagel, p. 118.
1821. *See* sec. 11.4.3.2.2.
1822. For more details on the terminology *see* Lowe Vaughan & Tzanakopoulos Antonios, Humanitarian Intervention, Max Planck Encyclopedia of Public International Law, para. 1 et seq. (http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e306?rskey=WtVGxL&result=1&prd=EPIL, last visited 10 Feb. 2019).
1823. *See*, for example, García Antón, p. 184. However, he is not fully clear on what he means by distributive justice towards developing states.
1824. *See* sec. 7.7.6.

residents.[1825] For instance, the Human Development Index of the UN could play an important role in deciding which states or individuals should be in the focus of a certain international tax policy in order to avoid some of the most outrageous inhumane conditions.

8.4. The principles of sovereignty and fiscal self-determination – Assessment

As a preliminary remark, it is crucial to highlight that sovereignty, as understood in Part III and Part IV, is different from the legal principle of sovereignty, which we discussed in Part II, with a focus on fiscal sovereignty.[1826] Therefore, in the present section, we will not analyze how sovereignty must currently be understood from an international law perspective or whether it contains any domestic tax policy limitations, but we will discuss how the principle of sovereignty ought to be understood to achieve a just international tax regime. We already dealt partly with the interaction of morality and the legal principle of sovereignty.[1827]

8.4.1. Justifications for the protection of sovereignty

Before we discuss the essential elements of the normative goal to protect sovereignty,[1828] we will outline two main reasons why the principle of sovereignty should be protected following a right institutional approach.[1829]

First, the principle of sovereignty is essential to uphold peace at an international level and to stabilize the international world order consisting (as an

1825. It would require a separate study to outline the details of which human rights ought to be protected and what is to be understood as inhumane living conditions. From a tax perspective, reference is made to a report of the International Bar Association providing a rather comprehensive analysis of the impact of tax policies and human rights protection (*see* International Bar Association, p. 1 et seq.). Of particular interest are human rights that cannot be protected due to a lack of fiscal revenue (e.g. the right to water and sanitation or the right to adequate food and nutrition) and not necessarily human rights that are purposively infringed on by a state due to political reasons (right to equal protection before the law or the right to privacy).
1826. *See* sec. 4.1.
1827. *See* sec. 4.1.2.
1828. *See* sec. 8.4.2.
1829. Further arguments were outlined above when developing the different concepts of right institutionalists, such as Rawls, Nagel, Blake or Risse (*see* chapter 7).

empirical fact) of several sovereign states since the Peace of Westphalia.[1830] International peace, as such, is and should still be the main (but not the exclusive) goal of international (tax) policy. The underlying reason is that the avoidance of war situations leads to less severe injustices. Particularly as the world is currently in turmoil due to recent political developments, it is more crucial than ever to reconsider that the protection of peace is the ultimate goal of international cooperation. Therefore, the principle of sovereignty since the Peace of Westphalia is normatively justified because it leads to stability at an international level, and stability means in principle justice, since instability means war and war means severe injustice. Or, as mentioned by Rawls:

> Thus, they [i.e. peoples] strive to protect their political independence and their free culture with its civil liberties, to guarantee their security, territory, and the well-being of their citizens.[1831]

However, this is only true because the world today consists of several sovereign states. Therefore, a one-state world could theoretically be considered as the ideal structure; however, such a state will not appear in the coming decades and, therefore, a practical theory of justice – also a theory of justice within international tax law – must consider the existence of a world order with several sovereign states.[1832] Moreover, even the ideal claim for a world state seems weak, as was argued in detail by Rawls, with reference to Kant's work on perpetual peace.[1833] Consequently, we still see valid reasons why the Westphalian order is crucial to achieve a just international regime.

There is a second argument in favor of obeying the principle of sovereignty and protecting fiscal self-determination. Sovereignty enables states to be well-ordered and fiscal sovereignty is key to achieve a well-ordered society through shared and effective institutions. Without fiscal revenue, governing a state would be impossible. Moreover, as highlighted by Risse, but also by Nagel, institution building at a domestic level is crucial to fight the most severe injustices.[1834] Such an argument is closely linked to the

1830. *See* Rawls, 1999b, p. 36, with reference to Kant. On the importance of peace as a standard of global justice in international law, *see* Ratner, 2015, p. 65 et seq. The claim for peaceful cooperation is almighty in international law, *see*, for example, the Preamble of the VCLT, 23 May 1969.
1831. Rawls, 1999b, p. 34.
1832. *See* Dietsch, 2015, p. 32.
1833. *See* secs. 6.3.4. and 6.3.5.
1834. *See* secs. 7.4.1. and 7.4.3. *See also* Dietsch, 2011, p. 2114. Therefore, states should have the capacity "to secure a just distribution of advantages between their citizens" (Van Apeldoorn, p. 4).

fundamental philosophical debate that sovereign structures with coercive powers are necessary to guarantee liberty and freedom, as this would not be the case in the state of nature. Therefore, protecting (necessary) coercive systems as such might protect liberty and freedom, but also socioeconomic justice. Furthermore, as will be shown with references to the empirical studies of Deaton, with references to China and India,[1835] domestic policy (instead of global policy) is indeed crucial to reducing poverty in a society. This includes a just distribution of goods among the citizens, which is only possible if fiscal self-determination, i.e. fiscal sovereignty, is guaranteed.[1836] International free trade, for instance, through the abolition of juridical double taxation, might indeed increase the global GDP, but it only increases welfare to the extent that domestic policy and domestic institutions allow such an increase.[1837] In more general terms, a society cannot be just without having institutions guaranteeing justice or background justice.[1838]

Therefore an international order based on sovereign states has major advantages, but only to the extent that the sovereignty of states is indeed protected and not undermined.

8.4.2. What elements of sovereignty should be protected?

This brings us to the question of to what extent sovereignty should be protected.

A first conclusion is that sovereignty must be understood as territorial sovereignty, and not as sovereignty based on nationality. In other words, states should not be protected to render sovereignty actions on their citizens abroad, but states should be allowed to render the necessary action to guarantee the independence of their territory and, therefore, states should also be allowed to use coercive measures on foreigners living within their territory. Again, this is not a legal argument, but a normative claim due to the two reasons mentioned above (i.e. protection of international peace and protection of sovereignty to ensure domestic justice). This is still, however, a rather abstract claim. We will discuss it further in several sections in Part IV.

1835. *See* sec. 11.4.3.2.2.
1836. This is an important argument when designing limitations to tax competition. *See also* Van Apeldoorn, p. 4 et seq.
1837. For further details *see* sec. 11.4.3.2.2.
1838. *See*, on the term "background justice", Bamford, p. 128; Ronzoni, 2009, p. 235 et seq.

Furthermore, another derived conclusion is that the principle of sovereignty needs to be protected from a normative perspective, but only considering both its negative and positive components, so not in a strict Westphalian manner.[1839] This is also reflected in the current international law framework, which contains various limitations on sovereignty, such as, for instance, *ius cogens* or human rights obligations.[1840] Therefore, a state's sovereignty should also, from a normative perspective, not be unlimited. The principle of sovereignty requires that states have not only rights, but also duties or responsibilities toward other states and inhabitants in other states, respectively.[1841] To achieve a normative guideline in this respect, however, we need to be more precise.

According to our understanding, this involves states having duties to obey the existing international law obligations (e.g. *pacta sunt servanda*),[1842] but also having responsibilities toward other states to refrain from implementing (domestic) policies that have a severe negative impact on the well-being of persons living in other states. This argument is closely related to the critique of Rawls' writings that the interests of individuals are not represented in the second negotiation round at an international level in Rawls' methodology.[1843] If a domestic policy has a severe negative impact on the well-being of persons living abroad, states should, from a moral perspective, refrain from such policy.[1844,1845] However, this requires an analysis of two questions. First, whether a certain policy indeed has a severe negative impact on individuals living in another state, and second, whether such a negative impact cannot be justified by valid (i.e. moral) reasons.

Valid reasons could be that such a policy is necessary to protect the well-being of persons living in their own territory. However, we would not argue in a traditional utilitarian way that if a policy increases the well-being of four domestic individuals, but decreases the well-being of three individuals living abroad by the same amount, such a policy is justified. We also believe

1839. *See* Dietsch, 2015, p. 168, who uses, with reference to Krasner, the term "Westphalian sovereignty" to describe a situation in which "states are free from external constraints".
1840. *See* Garcia, p. 664 et seq. For more details about *ius cogens*, *see* sec. 4.4.3.2.
1841. *See* Dietsch, 2011, p. 2115. *See also* Dietsch, 2015, p. 140 et seq.
1842. *See* sec. 4.3.3.3.6.
1843. *See* sec. 7.2.
1844. The OECD/G20 uses similar wording when discussing base erosion: "[I]t poses a threat in terms of tax sovereignty" (OECD, Addressing Base Erosion and Profit Shifting [OECD 2013], p. 47). Or *see* Dagan, 2017, p. 4, regarding tax competition: "Thus, in conditions of tax competition, justice is under constant threat".
1845. As was shown in sec. 4.3.2.8.6., from a legal perspective states should refrain from harming other states. However, the scope of application of such "no harm" principle is limited and does not include potential harm through tax competition.

that it is impossible to measure levels of justice in different states against each other in order to determine whether a policy is justified.[1846] However, our understanding is that a policy, for instance, of a very poor state might be justified, even though it has a negative impact on the well-being of individuals from a rich state if it increases the well-being of some of the poorest individuals in the world as a humanitarian necessity. This sounds rather theoretical from a tax perspective, but we will further discuss such an understanding in Part IV when we discuss whether it is just to force another state to implement cross-border fiscal transparency and whether there is any difference between forcing a poor state or a rich state to change its domestic policy.[1847]

We mentioned that states only have a duty to refrain from a policy if such policy has a severe negative impact on the well-being of persons living abroad. Severe could mean that a policy would go against humanitarian duties, as outlined above. A severe impact is given if a policy in one state triggers inhumane living circumstances in another state or if a policy in one state leads to an infringement of essential human rights in another state. Reference to the term "severe" is necessary, as it would otherwise not be possible to sustain the current system of a state's independence, in general, since many policy decisions can have a negative impact on individuals living in another state, but such policies must not be understood as a detrimental infringement of the sovereignty of another state as a moral duty, but rather as a mere result of justified competition among states.

For instance, if a state supports its domestic industry with subsidies, it might have a negative impact on persons living abroad, since this might potentially lead to unemployment in other states. However, as long as such impact has no severe consequences on individuals living in other states, the state paying the subsidies should not have a moral duty to refrain from doing so unless, of course, international trade law does not allow it. In this respect, we are not referring to harmful tax competition, but to states' competition in general. Therefore, only in the case where a state policy has a severe negative impact on individuals living in another state does the first mentioned state have a moral duty to refrain from implementing such a policy. We are not suggesting that competition as such is for the benefit of all or that tax competition as such leads to a more efficient system that would increase well-being globally, but we do argue that states' competition is a necessary

1846. Such a claim seems to be made by Dagan, 2017, p. 34: "It is – I argue – unjust for a state to promote domestic justice at the expense of justice in other states."
1847. *See generally* Dietsch, 2015, p. 140.

result of the current world order containing several sovereign states and that the principle of sovereignty has a normative value in our theory of global justice, as outlined above. Or in other words, if one limits states' competition too much, one risks the stability of the current international regime and also risks that the sovereignty of states is weakened, which would again endanger our understanding of international justice requiring that state sovereignty protects international peace and enables domestic justice.[1848]

Therefore, a claim against state competition is generally weak, as it is questioning the just international structure through the protection of sovereign states. This brings us to the positive element of sovereignty, i.e. which rights states should have to protect the principle of sovereignty, a core element of our approach to international tax justice. In the following, the focus is on fiscal self-determination as an important positive right of a state derived from the more general principle of sovereignty.

8.4.3. Our understanding of fiscal self-determination

As with all other principles, the validity of the principle of fiscal self-determination is essentially connected to its exact understanding. In other words, all of us could agree that fiscal self-determination should be protected, but opinions might differ the more details we attach to the understanding of what fiscal self-determination means.

As seen above,[1849] one goal of the present study is to develop an understanding of justice that allows the application of just principles and rules that suit the needs of states following very different domestic policies. In a similar but not identical manner, it is argued, for instance, that fiscal self-determination means that "a state [is] able to be responsive to the beliefs of its citizens about what justice requires."[1850] This could mean that states have an obligation to allow or to enable other states to implement a domestic (distributive) policy agreed upon by its citizens. Therefore, fiscal self-determination understood in such a manner would mean that it partly "consists in having access to sufficient tax revenue",[1851] because otherwise a state would not be

1848. *See* our justification in sec. 8.4.1.
1849. *See* sec. 8.1.
1850. Van Apeldoorn, p. 5.
1851. Id., p. 14. *See also* Dagan, 2017, p. 4, who implicitly argues that sovereignty would require that the level of redistribution "is reached through the collective co-authorship of their citizenry".

able to fulfill the needs of its citizens. We believe, however, that this is too far-reaching. Justice does not require the protection of such a broad understanding of fiscal self-determination. In other words, the protection of fiscal self-determination to achieve international tax justice cannot mean that it is required that each state be able to define its level of domestic distribution and that each state must have access to sufficient tax revenue to decide upon its domestic level of redistribution.

If this were the case, i.e. if there were indeed a duty to protect fiscal self-determination in the mentioned broad manner, we would agree with the distinct analysis of Van Apeldoorn that this would require redistribution at an international level, even if one does not follow a cosmopolitan approach. The core argument of Van Apeldoorn is that currently, the differences between the amount of levied taxes (i.e. the "tax take") in low-income and high-income countries is so significant that the protection of a broad understanding of fiscal self-determination requires redistribution at an international level to achieve equality of fiscal self-determination. Otherwise, poor states (or low-income states) are not at all able to decide upon the level of domestic distribution due to a lack of fiscal revenue, which is a key element following the above-mentioned broad definition of fiscal self-determination. From a normative perspective, this would, moreover, mean that right and left institutional approaches would overlap, as a right institutionalist, who requires broad protection of fiscal self-determination, would consequently be supportive of global redistribution following a cosmopolitan approach. Or, in the words of Van Apeldoorn:

> Finally, I have shown that revised principles of tax justice, based on an internationalist conception of justice that is concerned with securing the effective sovereignty of independent polities, may need to prescribe the creation of globally redistributive institutions. The paper accordingly suggests that it is possible to establish a greater consensus among internationalists and cosmopolitans about the necessary reforms of the international taxation regime.[1852]

This again shows how the different ideal theories of global justice might lead to similar results, depending on the exact understanding and implementation of duties derived from a more cosmopolitan or more institutional understanding of global justice. However, we have not yet outlined how we understand the principle of fiscal self-determination for the purposes of the present study. What would be an appropriate understanding?

1852. Van Apeldoorn, p. 17.

We support a narrower understanding of fiscal self-determination in the sense that states should have the right to levy taxes on income created within their territory by using the benefits of such a state.[1853] This triggers the question of why we refer to "income created in a territory by using the benefits of a state" and why we are not arguing that fiscal self-determination means that a state has a right to tax its members, according to the membership principle, for example, suggested by Dietsch.[1854] The reasons for such a narrower understanding of fiscal self-determination are related to the arguments to protect sovereignty to achieve a just international structure.[1855]

First, territorial sovereignty is crucial to avoid wars and ensure peace, and it enables international stability, which again enhances global justice. This requires territorial integrity, which again means that states should have the right to tax income created within its borders, but which also requires that states should not tax income that was not created within their territory. The latter claim is not self-explanatory and we will further outline our position below when discussing the source and benefit principle.[1856] It should also be at the discretion of states how and to what extent they want to tax income created within their territory. Second, the protection of sovereignty is important, as strong domestic institutions are essential to achieve domestic justice, inter alia, through the protection of freedom and equality. Following the latter argument, the principle of sovereignty requires that domestic fiscal institutions can levy taxes within a state's territory to achieve a just domestic system through strong institutions. Institution building as such is crucial for domestic justice, and the protection of fiscal self-determination is crucial for institution building, but also vice versa.

Although there is a risk of circular argument, in sections 11.2., 11.5. and 11.6. when reviewing the ability-to-pay, the source and the benefit principle, we will further outline our reasons for such an approach.

1853. As mentioned above under the heading "The International Tax Regime – Scope of Research", this study mainly deals with income taxes. Other taxes might require an amended definition of what fiscal self-determination means from a normative perspective. We cannot explore, for instance, what fiscal self-determination ought to mean regarding financial transaction taxes or carbon taxes. However, the missing comprehensive definition does not harm or weaken our position, but it is a sign that further research might be required with respect to specific other non-income taxes.
1854. Dietsch, 2015, p. 80 et seq.
1855. *See* sec. 8.4.1.
1856. *See* sec. 11.5. (source principle) and sec. 11.6. (benefit principle).

8.4.4. Relation of our understanding of fiscal self-determination and tax competition

The question to be answered in the present section is whether our understanding of fiscal self-determination requires tax competition to be limited. In the following, we are not reviewing all arguments in favor of and against tax competition, but we will instead focus on how justice is used as an argument in the debate about tax competition and whether it contradicts our understanding of fiscal self-determination.

A review of the existing literature reveals that at least two arguments are made in favor of regulating tax competition to enhance justice in the international tax regime.[1857,1858]

The first is that tax competition leads to injustice as states, due to tax competition, no longer have access to sufficient revenues in order to freely decide upon a certain distribution policy (i.e. tax competition is limiting the distributive leeway of states).

The second argument is that tax competition prevents states from taxing all of their constituents, and, therefore, tax competition leads to unjust results within a society as very mobile taxpayers are able to shop their tax jurisdiction and might therefore receive beneficial treatment compared to their compatriots.

We will discuss these two main arguments in the following. With respect to the first argument, Dagan states:

1857. There is a third argument for why tax competition can be unjust or unfair. The OECD argues that tax competition is unfair if it has a distortionary influence on the location of mobile activities (*see* OECD/G20, Countering Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report [OECD 2015], p. 11). We will, however, dedicate a specific section to the interaction between justice and efficiency concerns at an international level (*see* sec. 11.4.). Similar arguments can be found in documents of the EU; *see* EU, Code of Conduct (1997): Conclusions of the ECOFIN Council meeting on 1 December 1997 concerning taxation policy, 1 Dec. 1997, 98/C2/01, para. 2.

1858. A fourth argument is that tax competition challenges equal treatment of foreign multinationals and local business (*see*, for example, Burgers & Mosquera Valderrama, p. 773). Or, in other words, foreign suppliers of goods and services should not receive beneficial treatment compared to domestic suppliers. We will discuss the question of equal treatment of foreign and domestic residents in sec. 11.2.

> Although it would be inaccurate to claim that states' authority has completely collapsed, their inability to enforce taxation equally due to competition certainly undercuts their ability to enforce a redistributive scheme.[1859]

The argument is as follows: States need to cooperate in order to sustain their coercive power and in order to allow them to decide upon their level of redistribution.[1860] As both capital and people are mobile, states might be forced to reduce their tax rates in order to compete for these mobile taxpayers, which might limit their ability to guarantee distributive justice domestically. Therefore tax competition should be regulated. As shown above,[1861] our position is that if there is a normative global claim to limit tax competition, as only this allows states to apply their redistributive policy with full discretion, we should first allow the poorest states to significantly increase their tax take. It would therefore be consequent to follow a cosmopolitan position as the difference in the ability to choose the level of redistribution between rich and poor states is so significant that this would require cross-border distributive payments before tax competition is even regulated. Poor states, even when enforcing strict limitations on tax competition, would not be able to apply a discretionary level of redistribution. Therefore, rigor requires that authors in favor of a limitation on tax competition due to redistributive concerns must follow a cosmopolitan path. However, as we explicitly deny such a cosmopolitan approach,[1862] we would also deny that redistributive concerns would require a limitation of tax competition.

This leaves us with the second claim, that tax competition prevents states from taxing their constituents, which leads to unjust results. There is a strong position in this regard. Again, Dagan states the argument as follows:[1863]

> Because of competition and the loss of the state's monopolistic power over its taxation system, redistribution has ceased to be a discretionary mechanism for promoting justice and equal participation in a democratic society and has

1859. Dagan, 2018, p. 201. *See* for a similar argument with references to the work of the EU Commission in 1996, Schön, 2003, p. 9 et seq.
1860. The argument is not, however, that regulating tax competition would enhance global welfare. The latter claim has also been made by the OECD (OECD, Harmful Tax Competition [1998], para. 4) but was challenged by other authors (Littlewood, p. 411 et seq.). We will specifically deal with the concerns of using the term worldwide welfare or global welfare in sec. 11.4.
1861. *See* sec. 8.4.3.
1862. *See* sec. 8.3.
1863. We are mainly referring to Dagan as her recently published book is the most profound analysis in respect of tax competition, international tax policy, and global justice (*see* Dagan, 2018, p. 1 et seq.).

> increasingly become a price some states are able to charge from high-ability individuals and businesses.[1864]

It is true that in an open economy, states have lost their monopolistic power over their constituents in the sense that in a globalized world, there are few obstacles to leaving a country and taking up residence in another country.[1865] Therefore globalization provides "fertile grounds"[1866] for tax competition. This is particularly true as certain citizens are extremely mobile, and in the case of an adverse tax policy decision, these citizens might leave the country. By doing so, they might be able to shop around for different tax systems and escape the tax jurisdiction of their state of origin. However, constituents leaving a country are no longer in the same basic structure, so there is a moral difference between someone living abroad and a domestic citizen. Therefore, a person leaving a country is not necessarily a justice concern for a state, unless such person is de facto still part of the basic structure of his state of origin. We showed above that coercion, association and cooperation are the crucial elements of a basic structure that trigger justice concerns among its members.[1867] Therefore, the international tax regime would be unjust if states are prohibited from taxing individuals that are part of their basic structure. Only to that extent should states regain their monopolistic power to tax their constituents (i.e. individuals belonging to the same basic structure).[1868]

This brings us back to our underlying line of reasoning, that tax competition is not considered unjust if fiscal self-determination is still protected. Consequently, we would disagree that there is a moral duty to refrain from competitive measures if these measures do not harm our understanding of fiscal self-determination.[1869] If tax competition leads to a situation in which a state is no longer able to tax what happens in its territory, then it might be considered unjust, and there would be a moral duty of justice not to pursue tax competition. The following example should help to develop a better understanding of when a moral duty of justice requires a state to refrain from competitive measures.

1864. Id., p. 35.
1865. Exit taxation would be one such obstacle.
1866. The term is used by Keuschnigg, Loretz & Winner, p. 18, in relation to European integration and its impact on tax competition.
1867. *See* sec. 8.3.
1868. In sec. 11.2.2., we will discuss the question of when a person might be part of a basic structure, inter alia, with reference to the *Schumacker* decision of the ECJ.
1869. *See* for a different position Christians, 2009b, p. 99 et seq.

If a state applies strict secrecy rules, this might lead to a situation in which individuals residing in another state are hiding their revenue abroad; by doing so, the former state undermines the fiscal self-determination of the other state as the latter state is no longer able to tax what happens in its jurisdiction. Or, in other words, one state encourages "noncompliance with the tax laws of the other countries."[1870] Therefore fiscal intransparency, as a competitive measure, is unjust, and states should refrain from implementing such rules.[1871] This will be discussed further in section 12.6. However, if a state uses tax incentives to attract individuals or enterprises, it is generally not yet an infringement of fiscal self-determination, even if certain taxpayers relocate to such a state. The other state (i.e. the state of origin) is still able to tax what happens in its territory, meaning that fiscal self-determination is still guaranteed. The same is true if one state lowers its tax rates and certain taxpayers relocate. The other states are generally not prohibited from taxing what happens in their territory.

In conclusion, it is true that in an open economy, states lose their monopolistic power over their constituents as a change in the tax system might cause some members of the society to leave the country.[1872] Even though tax competition has led to a significant decrease of corporate tax rates, tax competition, with few exceptions, has not led to a situation in which states are no longer able to tax what happens in their territory.[1873] Of course, a detailed analysis of the impacts of tax competition on fiscal self-determination would be necessary, but this goes beyond the scope of the present study.[1874] It does, moreover, not mean that we are against cooperation or

1870. OECD, The OECD's Project on Harmful Tax Practices, The 2001 Progress Report, p. 4.

1871. This is, for instance, regularly highlighted in the reports of the Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of all human rights, particularly economic, social, and cultural rights, as intransparency might disallow states from protecting certain human rights. *See*, for instance, in the Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of all human rights, particularly economic, social, and cultural rights, on his visit to Switzerland, 15 Mar. 2018, A/HRC/37/54/Add.3, p. 8.

1872. Dagan, 2018, p. 24.

1873. In some cases, developing states have granted tax incentives with devastating effects (*see*, for example, the case of Sierra Leone, as outlined in Christian Aid, Losing Out, Sierra Leone's massive revenue losses from tax incentives, Apr. 2014, available at https://www.christianaid.org.uk/resources/about-us/losing-out-sierra-leones-massive-revenue-losses-tax-incentives, last visited 14 Feb. 2019). However, tax competition seems not to have been the main reason but rather intransparent approvals of tax incentives and corruption.

1874. This would require, in particular, a review of the various legal measures that are mentioned as potentially harmful tax competition (*see* for a still valid overview OECD, Harmful Tax Competition, An Emerging Global Issue [OECD 1998], para. 61 et seq.).

against limiting harmful tax competition, but the argument is that justice, particularly distributive justice, in a basic structure does not require that competition is limited and that states refrain from competitive policies. This is not an old-fashioned approach toward regulating tax competition, but tax competition is not per se unjust, although there are other valid reasons to limit tax competition, as it might, for example, have mutual benefits for all of the involved states.

8.4.5. Intermediate conclusion

In conclusion, we have shown that justice requires the protection of sovereignty, which on one hand means that (i) states should refrain from policies that have a severe negative impact on individuals living in another state and, more important for the present study, (ii) states should be independent to tax income created within their territory by using the benefits of such a state, as this reflects our understanding of fiscal self-determination. Therefore, we share the view of some recent philosophical studies that the protection of fiscal self-determination is a critical element to achieving international justice, but as was shown, we follow a narrower understanding than, for instance, Dietsch, regarding the term "fiscal self-determination". Moreover, we argued that the international tax regime is a just regime if it is just from the perspective of very different societies, as this is a core element for a just international structure consisting of very different societies with rather different approaches regarding domestic socioeconomic justice. Therefore, justice does not require that international tax policy aims at allowing all states the highest level of distribution. If the latter were a normative claim, it would require cross-border distributive payments, which we clearly opposed above due to the detrimental impact on both the protection of international peace and the protection of domestic justice.

Part IV

Normative Review of the International Tax Regime

Preliminary Remarks

The question of just rules is closely linked to the question of whether a rule is legitimate. Or, in the words of Rawls: "[O]ne conception of justice is more reasonable than another, or as justifiable with respect to it, if rational persons in the initial situation would choose its principles over those of the other for the role of justice."[1875] Various studies have shown that unfair taxation triggers resistance among citizens and consequently weakens the cooperation between taxpayers and their state.[1876] Therefore a tax system seems to be more legitimate and more accepted by the people if it is assumed to be just and fair by the citizens. Academic discussions about fairness and justice in the framework of domestic taxation have therefore long played an important role within tax law scholarship.[1877]

However, not all authors agree that tax fairness or tax justice has an independent normative status as, for instance, Murphy and Nagel[1878] argue that tax fairness derives its validity from the overreaching goal of distributive justice. In this sense, it would be impossible to judge whether a tax system or tax regime is fair without considering any other elements of the existing order, such as social security and (other) distributive measures. However, we would agree with Dodge that we should accept that the tax system can be judged as being just, as it also reflects the reception among individuals that a tax system as such can be fair or unfair.[1879] Often mentioned as an example that people actually matter in the decision of whether a tax system is just, is the replacement of a property tax by a per person community charge by Margaret Thatcher, which had a detrimental effect on her government.[1880] Therefore, we would argue that a compartmentalized way of thinking is justified with respect to international tax law, even though injustices in other fields of international law might equalize injustice in international tax law.

In the following we will use the achieved results from Part III to challenge some of the most important principles and rules of the international tax regime. We will, in particular, refer to our understanding of cross-border

1875. Rawls, 1999a, p. 15 et seq.
1876. *See* Matteotti, 2007, p. 13 et seq., with further references.
1877. *See*, for example, Hey, § 3 para. 40 et seq., para. 110 et seq. and § 7 para. 6 et seq.; Holmes, 2000, p. 1 et seq.; Matteotti, 2007, p. 1 et seq.; Tipke, 1981, p. 1 et seq.; Vanistendael, 2010, p. 526 et seq.
1878. *See* sec. 1.3.
1879. *See generally* Dodge, p. 399 et seq.
1880. *See* Graetz, p. 282 et seq., with further references.

distributive justice[1881] and our understanding of fiscal self-determination.[1882] We will dedicate a specific section on the selection of principles of rules for the purpose of the present study.[1883]

1881. *See* sec. 8.3.
1882. *See* sec. 8.4.
1883. *See* sec. 11.1.2.

Chapter 9

Distributive Duties and International Tax Law – Some Preliminary Thoughts

9.1. Overview

One of the central questions that has been and will be referred to in many instances within the present study relates to potential distributive duties among states or individuals worldwide. We showed by distinguishing between theories of left and right institutionalists that there is a lively debate about the potential existence of cross-border distributive duties in political philosophy. The question of whether rich states indeed owe monetary duties to poor countries is a very controversial question. We developed our own understanding of this issue in section 8.3. We showed that there are indeed distributive duties at an international level to the poorest on the planet, but these are understood as humanitarian duties. However, we disagreed that there is a distributive duty comparable to Rawls' difference principle at an international level. Before starting with a detailed analysis of the international tax regime in this respect, we need to discuss whether tax law, as such, would be a valid and efficient instrument to fulfill these distributive duties, or whether other (law) instruments would provide a more accurate solution. Prima facie, it is clear that the international tax regime deals with the allocation of tax revenue and consequently with the international distribution of income. Therefore the international tax regime has the potential to fulfill international distributive duties.[1884] Nevertheless, a more detailed analysis is necessary, and is included in the following section.

9.2. Is tax law the right instrument to achieve global distributive justice?

From a methodological perspective, it is important to distinguish the questions of (i) whether there is a normative duty for distribution at an international level and (ii) whether international tax law is the right instrument to fulfill such a duty. In domestic circumstances, particularly in the United States, an in-depth discussion exists about whether tax law is indeed able to achieve a distributive effect and, more difficult to answer, whether tax law is

1884. *See* Cappelen, p. 101. *See also* Stewart, 2018, p. 309.

the ideal mechanism to achieve distributive justice, or whether other fields of law are more efficient in this respect. At this stage, the work of Kaplow and Shavel should be highlighted.[1885]

These authors argue that "any regime with an inefficient legal rule can be replaced by a regime with an efficient legal rule and a modified income tax system designed so that every person is made better off".[1886] The reason is that with a modified income tax system, all individuals are equally as well off as with the inefficient legal rule, but the government receives a surplus, as the inefficient legal rule was replaced by an efficient legal rule. Another argument to be considered relates to the questions of feasibility and accuracy. In this respect, Kaplow and Shavell assume that income taxes allow for a redistribution from all rich to all poor, which is not feasible through a change of other legal rules that might only affect a particular group of people.[1887]

From an international tax law perspective, one would need to elaborate – if one agrees with distributive duties from the rich to the poor on a global scale[1888] – how to fulfill such duties in the most efficient manner. The first question would be whether it is more efficient to use tax law or other legal measures to achieve distributive effects. If one concludes, as Kaplow and Shavell did in a domestic framework, that tax law is indeed the most efficient way of achieving distributive effects, the second question would be whether the existing income and corporate income taxes are the most efficient area of tax law or, for instance, following the idea of Pogge, whether a new global resource tax should be implemented.[1889] At first glance and arguing as a lawyer and not as an economist, the use of the existing international income tax regime in order to achieve distributive effects seems to be the most efficient option for the following reasons.

First of all, other legal measures to achieve distributive effects are not easily available at a global level. The reason is that there is no central governmental-like body at a global level that could implement and survey the working of new albeit non-tax legal measures. In this respect, the current international tax regime, which is built on domestic enforcement, seems to provide for the necessary (although non-ideal) instrument to achieve distributive effects. The system is not ideal, as it would still require consent

1885. Kaplow & Shavell, 1994, p. 667 et seq.
1886. Id., p. 669.
1887. Id., p. 674 et seq.
1888. For our opinion *see* sec. 8.3.
1889. *See*, on the proposal of Pogge, sec. 7.5.2.

among states and, as the debate within the BEPS Project has shown, it is currently rather unlikely that the international community of states would agree on an international tax regime that consists of significant distributive elements or that the community of states would agree on a more fundamental change of the international tax regime, in general. Secondly, we assume that the implementation of a new tax, such as a global resource tax, as proposed by Pogge, triggers other inefficiencies and is not an appropriate alternative. The same is true, for instance, for the proposed global wealth tax of Piketty.[1890] The problem with global taxes on wealth or resources is that these taxes require an actual redistribution of the collected taxes, which would create new opportunities for corruption and increase bureaucracy, whereas a system based on the existing income and corporate income tax regime would not face such disadvantages, as (most) states already have a more or less functioning bureaucratic structure to levy income and corporate income taxes.

In a similar manner, global taxes on wealth or resources and the distribution of such taxes trigger similar disadvantages as existing aid payments. For instance, an important argument against cross-border aid payments is that "large inflows of foreign aid change local politics for the worse and undercut the institutions need to foster long-run growth. Aid also undermines democracy and civic participation, a direct loss over and above the losses that come from undermining economic development."[1891] Such an argument would be weakened if the aid occurred through the allocation of income, as the government is built upon the contribution of domestic taxpayers,[1892] and, therefore, civic participation is less undermined.[1893] Even that allocation could be detrimental, in the case where a state heavily relies on one or a few very large taxpayers.

Another aspect to be discussed is whether transparency as such will lead to a distributive effect and whether it will lead to fewer inequalities worldwide. Oxfam has argued that the (undoubtedly) severe existing inequalities must be fought by extinguishing tax havens.[1894] Therefore, the argument is that enhanced international transparency will lead to a more equal world in

1890. Piketty, p. 515 et seq.
1891. Deaton, p. 294.
1892. Domestic taxpayer means, in this case, taxpayers living or operating in a certain territory.
1893. It is not a surprise that also the work of the UN on financing for development focuses, inter alia, on domestic revenue mobilization (*see* sec. 4.3.4.3.4.).
1894. Oxfam, An Economy for the 1% (Oxfam 2016), p. 1 et seq., available at https://www-cdn.oxfam.org/s3fs-public/file_attachments/bp210-economy-one-percent-tax-havens-180116-en_0.pdf (last visited 6 June 2019).

which wealth is more equally distributed. Oxfam mentions the use of tax havens by multinationals, but also by individuals, as the most important factor for the growth of global inequalities. According to Oxfam:

> World leaders need to commit to a more effective approach to ending tax havens and harmful tax regimes, including non-preferential regimes. It is time to put an end to the race to the bottom in general corporate taxation. Ultimately, all governments – including developing countries on an equal footing – must agree to create a global tax body that includes all governments with the objective of ensuring that national tax systems do not have negative global implications.[1895]

As we will demonstrate in the following in several instances, the question of inequalities might indeed be linked to transparency, but intransparency as such is not the sole reason why inequalities exist.[1896]

Benshalom also argues, with reference to Kaplow and Shavell, that international taxation could be a valuable option to achieve distributive effects at an international level. In his seminal article about relational-distributive duties between states, Benshalom pleads for a modification of the international tax regime in order to stimulate his ideas of relational-distributive claims.[1897] Such claims are, according to Benshalom, triggered by (unfair) trade relationships between states. Although one might disagree with the approach of Benshalom with respect to relational duties, his arguments as to why international tax law could be the instrument to achieve either relational distributive justice or global distributive justice are valid and relevant in the framework of the current post-BEPS debate. Benshalom answers such a question in the affirmative, arguing that the allocation of taxing rights would be the most effective instrument to achieve relational-distributive justice:

> In comparison to those mechanisms, fulfilling relational distributive duties through the ITR [international tax regime] would provide a crude and more administrable macro price-correction mechanism. Rather than making sure that importers of coffee pay a fair price to farmers, the developing country would retain a greater right to tax the profits of this transaction. It could then use the extra revenues generated to provide better services to their low-wage citizens. Money is fungible, and once it is allocated to a developing country, there is no way to trace whether it has reached the farmers. Tax revenues, however, will serve to raise living standards and government services in a way that should also benefit the farmers.[1898]

1895. Id., p. 7.
1896. *See*, in particular, sec. 12.6.
1897. *See* Benshalom, p. 68 et seq.
1898. Id., p. 70.

Or:

> ITR arrangements are superior to any type of alternative arrangements and the modifications required by them do not undermine the underlying premises of our political reality. They do not require the abolition of states or the regulation of commerce in foreign countries, and developing countries cannot view them as unjustified imperialist interventions in domestic matters.[1899]

Therefore, he would prefer an amendment of the international tax regime, as compared to, for instance, lump-sum payments from rich to poor countries.

In conclusion, these preliminary remarks demonstrate that the international tax regime could indeed be a means to achieve cross-border distribution of income. As a consequence, we do not propose any implementation of new global taxes, as suggested by others, but we will further analyze whether the international tax regime could be amended in order to align with potential cross-border distributive duties. These duties could be humanitarian duties, as suggested above,[1900] but also more intense egalitarian or cosmopolitan duties, depending on the underlying theory of justice.

1899. Id., p. 81.
1900. *See* sec. 8.3.3.

Chapter 10

Reception of Theories of Political Philosophy in International Tax Law

10.1. General remarks

Rawls and other political philosophers have been referenced by several scholars within international tax law who are seeking normative guidelines to define principles and rules of a just international tax regime. Some examples are Benshalom,[1901] Christians,[1902] Dagan[1903] and Valta,[1904] as well as other authors.[1905] Rawls has, furthermore, not only been used to justify a certain international tax policy, but also when evaluating (tax) justice in a domestic circumstance. However, the latter discussion – especially on whether a flat tax or a degressive tax is just in a domestic circumstance – goes beyond the scope of the present study.[1906]

Interestingly, the mentioned authors have referenced the theories of political philosophy with very different aims. Whereas Dagan and Christians have focused on the question of tax competition and justice, Benshalom and Valta focused more on the allocation of income with reference to ideas of both left and right institutionalists. All of the mentioned authors quoted several philosophers, but the chosen theories are rather different. Dagan focused on Nagel, Christians and Valta, inter alia, on Nussbaum and Rawls, while Benshalom explained the deadlock among the different theories of global justice. Not surprisingly, as the underlying theories of justice are different, the achieved results also differ. In the following, we will briefly outline the findings and proposals of Benshalom and Valta, who dealt with the allocation of income, which is also a core element of the present study. The question of tax competition and justice, as reviewed by Christians and Dagan, is

1901. *See* sec. 10.2.
1902. Christians, 2009b, p. 99 et seq.
1903. Dagan, 2017, p. 1 et seq.; Dagan, 2018, p. 1 et seq.
1904. *See* sec. 10.3.
1905. *See*, for example, Graetz, p. 277 et seq.; Infanti, p. 209 et seq.; Schön, 2018, p. 1 et seq. *See* with no explicit reference Musgrave & Musgrave, p. 63 et seq.
1906. *See*, for example, Galle, p. 1323 et seq.; Matteotti, 2007, p. 11 et seq. (in particular, p. 39 et seq.); Repetti & Ring, p. 135 et seq. *See* on this topic, Rawls, 1999a, p. 242 et seq.

not in the main focus of the present study, but we will discuss a few aspects when reviewing the normative value of cross-border transparency.[1907]

10.2. Benshalom's relational duties

Benshalom disagrees with cosmopolitanism by arguing that in the current world, consisting of several sovereign states, "no cosmopolitan egalitarian scheme is possible".[1908] He furthermore argues that debate between left and right institutionalists is "largely irrelevant" for policymakers, because the current reality is that there are several sovereign states in an economically integrated world.[1909] This means that the current reality reflects neither a pure static nor a cosmopolitan structure and, therefore, some of the most burning questions of international law cannot be answered by referring to one of these theories. Such a line of argumentation is similar to our critique above on ideal theory in general.[1910]

Benshalom develops the idea of relational duties and, by doing so, relies on neither pure left or right institutionalism.[1911] To be more concrete, he argues that global trade could potentially lead to relational-distributive duties between states, particularly considering the fact that globalization has connected persons who were formerly not related due to domestic borders.[1912] He demonstrates such duties with a very tangible example of a shoe company in Indonesia employing children and the question of who has a duty to mitigate these outrageous working conditions: the company employing the children and the Indonesian government, or additionally the consumers and other stakeholders of the company potentially living abroad?[1913] For an understanding of his approach, it is crucial to understand that Benshalom (as others) argues that many attributes of international trade are (empirically) unfair.[1914] It would go beyond the scope of the present study and is also not necessary to analyze in detail the question of whether international trade indeed leads to unfair results. However, it is crucial to understand that, according to Benshalom, these unfair terms of the international trade regime might trigger

1907. *See* sec. 12.6.
1908. Benshalom, p. 22. *See also* id., p. 32 et seq.
1909. Id., p. 25.
1910. For further details *see* sec. 7.7.2.
1911. Benshalom, p. 31 et seq.
1912. *See* id., p. 37 et seq.
1913. Id., p. 43.
1914. Id., p. 44.

relational duties.[1915] This means, in very simplified terms, that there is a relational-distributive duty, depending on the trade volume among states and on the capacity to help of the states involved.[1916] In other words, Benshalom's approach differs from some cosmopolitan ideas, as his idea of distributive justice depends on the actual trade relations between jurisdictions, and not solely on the wealth or capabilities gap between rich and poor states.[1917]

Benshalom finally proposes certain amendments to the international tax regime in order to achieve a relational-distributive effect. For instance, he proposes that source taxation as such should be increased in the relationship between developing and developed states, i.e. higher taxing rights of the developing country should be implemented. The reason is that relational duties might require a shift from residence to source taxation, as developing countries would mainly benefit from source taxation.[1918]

10.3. Valta's justification-to-tax theory

In his seminal work on efficiency, justice and development aid, Valta referred in detail to Rawls and other political philosophers with respect to his thesis about domestic and international tax justice.[1919] Valta seems to follow Rawls' static approach on distributive justice at an international level and opposes cosmopolitan ideas of global justice, as proposed by Nussbaum & Pogge.[1920] From a conceptual perspective, Valta develops a so-called "justification-to-tax theory" ("*Steuerrechtfertigungslehre*") based on an overall benefit principle or extended benefit principle ("*Globaläquivalenzprinzip*"), and reviews whether such a justification-to-tax theory is in line with Rawls' theory of justice, at both an international and a domestic level. Such a theory should, according to Valta, protect the autonomy of states, which we would assume is required by a right institutional approach, such as Rawls' *The Law of Peoples*.[1921]

According to his theory, the income of a person should be allocated among the various involved states based on the overall benefits received or re-

1915. We would prima facie agree that international trade has led to some very unjust results.
1916. Benshalom, p. 64. *See also* id., p. 69 et seq.
1917. Id., p. 61.
1918. *See* id., p. 76.
1919. Valta, p. 54 et seq.
1920. *See* secs. 7.7.6.2. and 7.5.2.
1921. *See* Valta, p. 74.

ceivable by the taxpayers in different states. Such an approach is, according to Valta, in line with the allocation of income following Von Schanz's concept of economic allegiance, as Von Schanz also refers to the usage of governmental service to generate income.[1922] "Overall" or "extended" in this sense relates to the concept that taxes (compared to levies) do not reflect remuneration for specific benefits obtained, but rather for the overall benefits obtained by the taxpayer to generate the income.

Valta argues that the extended benefit principle should allow for just taxation from an international perspective.[1923] He is of the opinion that it is the task of justice in international tax law to achieve a just allocation of taxing rights in a horizontal manner. And such allocation should follow the overall benefits provided by the states within the value-creation process:

> *Die Gerechtigkeitsaufgabe des Internationalen Steuerrechts besteht folglich darin, … horizontal für die gerechte und die autonomiewahrende Verteilung der Besteueurungsanteile anhand des Beitrags der jeweiligen staatlichen Gesamtleistung an der wirtschaftlichen Wertschöpfung zu sorgen*.[1924]

As mentioned, the extended benefit principle would require an allocation of income, depending on the benefits obtained in the involved states. This, however, does not yet answer the question of how the tax burden is to be calculated. When designing his justification-to-tax theory, Valta also refers to the ability-to-pay principle in order to decide upon the appropriate tax burden in each state.[1925] According to Valta, in an ideal situation, each state would tax its part of the income at the tax rate applicable to the worldwide income of the taxpayer (i.e. a kind of proviso safeguarding progression).[1926] According to Valta, this would require intense international coordination among the various jurisdictions; states would adjust their taxing powers ("*Steuerzugriffe*") and they would have to refrain from taxation to a certain extent.

Therefore, following his approach, states even share the responsibility for just taxation:

> *Aufgrund dieser Begrenzung gerechter Steuerhebung im vertikalen Verhältnis müssen die besteuernden Staaten ihre Besteuerungszugriffe im horizontalen*

1922. *See* id., p. 47. *See also*, on Schanz' understanding of economic allegiance, Hongler & Pistone, p. 19 et seq.
1923. For further details *see* Valta, p. 47 et seq.
1924. Id., p. 74.
1925. Id., p. 44.
1926. Id., p. 45.

> *Verhältnis abstimmen und in gewissem Umfang auf die Besteuerung verzichten. Sie tragen horizontal gemeinsam die Verantwortung für die gerechte Besteuerung auf vertikaler Ebene*.[1927]

For the moment, we will not review the approaches of Valta and Benshalom, but we will, in several instances in the following, highlight discrepancies or similarities between our understanding of how to achieve justice in the international tax regime and the approaches of Benshalom and Valta.

1927. Id., p. 74.

Chapter 11

Review of Fundamental Principles of International Taxation

11.1. Preliminary remarks

11.1.1. Distinction between principles and rules

Legal theory and legal philosophy deal in detail with the delimitation between principles and rules.[1928] A further distinction is made between rules and standards.[1929] For the purpose of the present study, however, it is not crucial that a stringent theoretical line between the terms "principles", "rules" and "standards" be drawn. This is particularly true, as the present Part IV is the only part that refers to the distinction between principles and rules. This part does not provide for a legal analysis of such a distinction, but follows a philosophical line of argumentation and challenges the normativity of some existing principles and rules of the international tax regime. Therefore, the necessary distinction (from a legal perspective) between a principle and a rule is obsolete for the purpose of the present part, as the distinction is only made to achieve a more stringent structure for the following normative analysis.

Rules are understood as norms that have a legal source, such as domestic law, international treaties or some other source of international law. Principles are understood in a very broad manner as both legal principles and policies with no legal source at an international level. Another option to distinguish between rules and principles would be to rely on the precision and specification. This means that a principle would require a case-by-case analysis, whereas a rule would provide clear requirements for triggering certain legal consequences.[1930] Such delimitation between rules and principles is not distinct, and overlaps between the two categories do exist. Some of the selected principles might also qualify as rules. For instance, the ability-to-pay principle also finds a legal base in some jurisdictions, even though it is also used as a policy to propose certain amendments within the current international tax regime. And vice versa, some rules in the following might

1928. For a comprehensive overview on the different concepts of distinguishing between principles and rules, *see* Kleinlein, p. 663 et seq.
1929. From a tax perspective *see* Dean, p. 537 et seq.
1930. *See generally* id.

also qualify as principles. As an example, the arm's length principle could also be understood as a principle or a standard, rather than as a rule, because it provides for a rather flexible regulation and does not provide taxpayers with clear guidance on what the arm's length principle actually means.[1931]

11.1.2. Selection of rules and principles

Within the international tax regime, many principles have been developed and were used to support the design of certain rules. Some of the most important principles will be analyzed in the following, as we will review whether these can withstand a normative review. Of particular interest for the present study are principles used as guidance or policies in the (long-lasting) debate over redesigning the international tax regime. We limited the work to five principles and we selected the principles based on their importance in the discussion about amending the international tax regime. By discussion, we mean the most important contributions in the past decades by authors aiming at improving the international tax regime.[1932] We did not, however, render an empiric study on the ranking of these principles. Nevertheless, we hope to cover the most essential ones by our analysis. It is our understanding that the following five principles are in general at the core of the debate about changing the international tax regime:

– the ability-to-pay-principle;
– the principle of inter-nation equity;
– the principles of neutrality and efficiency;
– the benefit principle; and
– the source principle.

Such a selection is to a certain extent arbitrary or at least based on the author's perception of their importance. However, as we do not intend to develop the ideal international tax regime but to enhance justice by amending the current international tax regime, such a selection of principles is still justified. In other words, even a pure arbitrary selection of principles would not question our findings and the results of the present study per se. Moreover, by covering these five principles, we will automatically also deal

1931. *See* id., p. 547 et seq.

1932. These principles are used (or questioned), for example, by the following authors: Fleming, Peroni & Shay, 2001, p. 299 et seq.; Graetz, p. 261 et seq.; Peters, 2014, p. 1 et seq.; Schön, 2009, p. 67 et seq.; Schön, 2010a, p. 65 et seq.; Schön, 2010b, p. 227 et seq.; Vogel, 1988a, p. 216 et seq.; Vogel, 1988b, p. 310 et seq.; Vogel, 1988c, p. 393 et seq.

with further principles such as non-discrimination and reciprocity.[1933] The mentioned principles have played a very important role as policy guidelines, but their validity as such has rarely been questioned. The most important critic to whom we will also refer in the following is Graetz, namely in his article on outdated concepts and inappropriate principles,[1934] and the thesis of Peters.[1935] Graetz, in particular, seems right when stating in a questioning manner that "many authors simply assume that the normative basis for international income tax rules is widely understood and enjoys universal agreement."[1936]

Besides the aforementioned principles, we will review whether certain rules of the international tax regime can withstand a normative analysis. Again, we selected five, as it is impossible to discuss all existing rules. Moreover, as mentioned, we are not aiming at developing a comprehensive ideal international tax regime, but rather to review some of the most important principles and rules of the international tax regime. Such an approach does not require a comprehensive analysis. Furthermore, one of the main goals is to emphasize the importance of political philosophy when discussing a redefinition of the international tax regime. The latter also does not require an exhaustive analysis of all rules and principles. We would of course suggest that our methodology could be extended to further principles and rules in a later stage. Therefore, the limitation of the review to the following five rules is also not detrimental for our results:

– the arm's length principle;
– CFC rules;
– mandatory arbitration;
– treaty abuse; and
– exchange of information.

However, it is still necessary to justify our selection of rules. Again, one could argue that such a selection is arbitrary, which is prima facie true. Yet, in order to focus also on the contemporary debate about amending the international tax regime, we have chosen rules with respect to their importance in the past BEPS debate. The BEPS Project has arguably been the most important project in the field of international tax law since the work of the League of Nations in the 1920s and 1930s.[1937] The arm's length

1933. We will deal with the principle of reciprocity in sec. 11.3. on inter-nation equity, and with the principle of non-discrimination in sec. 11.2. on the ability-to-pay principle.
1934. Graetz, p. 261 et seq.
1935. Peters, 2014, p. 1 et seq.
1936. Graetz, 2001, p. 269.
1937. *See* sec. 4.2.3.2.2.

principle[1938] was inherent in all of the transfer pricing actions,[1939] but also in Actions 1 and 7 of the BEPS Project. CFC rules[1940] were in the focus of Action 3, and different anti-abuse measures were outlined within Action 6 of the BEPS Project.[1941] Moreover, the inclusion of mandatory arbitration provisions was discussed in Action 14.[1942] Lastly, exchange of information[1943] was intensively debated within Actions 12, 13 and 15 of the BEPS Project. Therefore the rules covered by our analysis were all of particular importance during the BEPS Project.

Focusing on rules discussed during the BEPS negotiations allows us to consider the current pressing issues when discussing an amendment of the international tax regime. By combining the most fundamental policy principles used for decades to design the international tax regime and contemporary rules discussed within the BEPS Project, a rather comprehensive but of course still selective analysis is feasible. This allows us to cover a variety of topics in our normative review. As mentioned, our study is not exhaustive and there are many more rules within the international tax regime and within the BEPS Project, but at least we tried through our selection to develop a rather broad (and sufficiently) deep understanding of the term "justice" in international tax law.

It could, moreover, be argued that the present study, which reviews certain rules and principles on a selective basis, lacks a comprehensive understanding of the term "justice". For instance, it could be claimed that it is impossible to discuss whether the arm's length principle is just if one does not consider that it often aligns with non-discrimination provisions, as suggested in article 24 of the OECD MC, as these two rules are implemented in most double tax treaties. Or, in more general terms, one could argue that it is impossible to discuss whether a rule within an international treaty is just if one does not analyze the full context in which the rule operates.

A normative review based on the instruments of impartiality and reasoning as intended by the present study[1944] indeed faces the difficulty of not being comprehensive. However, the latter does not mean that the methodology in the present study is deceptive, but that it requires application of a broad

1938. *See* sec. 12.2.
1939. Actions 8-10 of the BEPS Action Plan.
1940. *See* sec. 12.3.
1941. *See* sec. 12.5.
1942. *See* sec. 12.4.
1943. *See* sec. 12.6.
1944. *See* sec. 8.2.

consideration of existing reasons either in favor of or against a certain principle or rule. The justification is that normative reasoning might help us to better understand how a legal system, such as the international tax regime, could be improved and, therefore, such a study should lead to innovation.[1945] In other words, although the present study will not develop the perfect international institutional tax system and will not develop the ideal "global tax",[1946] its results will still reflect academic progress. The aim is to achieve academic progress in international tax law by proving that certain commonly referenced hypotheses are simply wrong or that other hypothesis are stronger.[1947] And for such a purpose a selective analysis of certain rules and principles is justified.

11.2. Principle 1: The ability-to-pay principle

11.2.1. The ability-to-pay principle – An overview

As we will demonstrate in the following sections, the ability-to-pay principle is a defective principle to steer international tax policy. We will moreover argue that justice does not require that income be only taxed once in a cross-border circumstance, as argued by many others by referring to the ability-to-pay principle. In other words, there is nothing like a normative goal to achieve single taxation at an international level. This is a major deviation from more traditional studies. However, a detailed analysis is necessary and it is important to first understand the arguments in favor of and against the arm's length principle as an international tax policy principle.

Notably, the ability-to-pay principle, which is linked to or derived from the equality principle, has triggered a fundamental debate about justice in domestic tax law.[1948] This has been true for centuries. As mentioned by

1945. *See*, on innovation and normative reasoning, Michels, p. 25.
1946. *See*, for example, Schulzke, p. 105 et seq., who discusses in detail the question of how global taxes could indeed be considered a feasible and legitimate measure to achieve global justice.
1947. *See generally* Popper, 2015, p. 51.
1948. *See*, for example, from a Swiss perspective, Matteotti, 2004/2005, p. 683; Matteotti, 2007, p. 24 et seq.; Matteotti & Aebi, p. 108 et seq.; Reich, p. 5 et seq.; Wiederkehr, 2006, p. 84 et seq. *See*, from an international perspective, Bammens, p. 21 et seq.; Englisch, p. 239 et seq.; Li, 2002, p. 827 et seq.; Vanistendael, 2010, p. 527, or with references to German scholars, Hey, § 3. From a US perspective, *see*, for example, Kaplow, p. 139 et seq.; Kaufman, 1998, p. 157; Kaufman, 2001, p. 1465 et seq.; Repetti & Ring, p. 135 et seq. *See also* Dagan, 2013, p. 59 et seq., with references to the question of the ability-to-pay principle as a potential goal of income tax policy. *See*, on the interaction between the equality principle and the ability-to-pay principle, sec. 1.3.

Vogel with further references, the ability-to-pay principle was a claim of economists in the 19th century.[1949] Moreover, it was already referred to by Adam Smith in *The Wealth of Nations*, who held the following:[1950]

> The expense of defending the society, and that of supporting the dignity of the chief magistrate, are both laid out for the general benefit of the whole society. It is reasonable, therefore, that they should be defrayed by the general contribution of the whole society, all the different members contributing, as nearly as possible, in proportion to their respective abilities.[1951]

The ability-to-pay principle means – in simplified terms – that taxpayers with the same ability should be taxed equally and taxpayers with different abilities should be taxed differently.[1952] The ability-to-pay principle aligns with the underlying rationale that justice as such requires equal treatment by the state, in general, and particularly in tax law.[1953] For the purpose of the present study, the ability-to-pay principle is indeed understood as a specific feature of the equality principle for tax purposes, as it is related to the question of how to split the overall tax burden among equal citizens in a society.

Taxpayer equality has indeed been part of the core debate of fairness and justice in domestic tax law. However, it is highly disputed how to measure the ability of each taxpayer[1954] and what tax rate system would be required domestically in order not to infringe the ability-to-pay principle. As an example, there has been an intense debate in Switzerland whether a cantonal tax act providing for declining tax rates ("*degressive Steuersätze*") is in line with the ability-to-pay principle stated in the Swiss Federal Constitution.[1955] The Swiss Federal Supreme Court denied it and stated rather clearly that declining tax rates must be seen as an infringement of the ability-to-pay principle.[1956]

1949. Vogel, 1994, p. 365.
1950. Smith, 2007, para. 1743. *See also*, on the historical development of the ability-to-pay principle, Englisch, p. 439 et seq.; Kaufman, 1998, p. 157; Picciotto, 1992, p. 82. Vanistendael, 2014, p. 121, makes reference to the use of the concept by Jesus Christ in the Bible.
1951. Smith, 2007, para. 1743.
1952. E.g. Matteotti, 2004/2005, p. 683, with further references.
1953. *See* Tipke, 1981, p. 183. *See* Mill, 2016, p. 136.
1954. *See generally* Bammens, p. 21 et seq. *See also* the various statements mentioned by Vogel, 1994, p. 367 et seq. *See also* Englisch, p. 442 et seq.
1955. Art. 127(2) Swiss Federal Constitution.
1956. CH: BGE 133 I 206, 1 June 2007. *See*, for example, Behnisch & Opel, p. 363 et seq.

There are many similar disputes in other jurisdictions regarding the actual content and interpretation of the ability-to-pay principle.[1957] Furthermore, it is essential to mention the challenges triggered by the definition of income as a measurement (of several possible) of the ability of each taxpayer in an income tax system. In the present study, we cannot further discuss the existing ambiguities and disputes that have been debated concerning the term "income" relating, inter alia, to the Schanz-Haig-Simons definition of income.[1958]

In an international setup, the ability-to-pay principle has also been used to claim new tax rules or support existing provisions.[1959] The question of whether the ability-to-pay principle can and should indeed be a guiding principle for international tax policy is the focus of the following sections. However, before developing our own position, it is essential to unveil the existing opinions and arguments on this topic to achieve an impartial and well-reasoned result.

11.2.2. The ability-to-pay principle and its application at an international level

As mentioned, the ability-to-pay principle is a widespread policy principle to design a just domestic tax system. However, from an international perspective, the ability-to-pay principle is not based on one of the sources of international law mentioned above.[1960] From a legal perspective, it has been shown above that customary international law does not provide a general rule according to which tax laws must be implied in line with the ability-to-pay principle and it is also not a general principle of law.[1961] Nevertheless, the ability-to-pay principle has still been used in several ways in order to guide international tax policy.

1957. *See*, for example, from an Austrian perspective, Gassner & Lang, p. 8 et seq. *See also* Schön, 2009, p. 71 et seq. *See also* the references in *supra* n. 1948.
1958. *See*, for example, Kaufman, 1998, p. 156 et seq.; Matteotti, 2007, p. 32 et seq.
1959. For a detailed analysis from a US perspective, *see* Fleming, Peroni & Shay, p. 299 et seq. Another example is Navarro, p. 351 et seq., who seems to apply the ability-to-pay principle without questioning its application in cross-border circumstances. Some authors refer to the term "inter-individual equity", but from a material perspective the discussion about the ability-to-pay principle and inter-individual equity are very similar (*see*, with further references, Peters, 2014, p. 92 et seq.). For further existing opinions on the application of the ability-to-pay-principle at an international level, *see* sec. 11.2.2.
1960. *See* sec. 3.2.
1961. *See* sec. 4.3.2.8.3. regarding the non-customary quality.

Tipke, as an example, made some stimulating statements arguing that juridical double taxation as such is an infringement of the ability-to-pay principle and would require that states share the worldwide income among them.[1962] His approach seems to be based on equality considerations, as a person investing abroad should be treated equally compared to a person with only domestic investments. Yet, Tipke does not further discuss the question of whether, from a normative perspective, we would also be required to treat a person resident in State A and investing only in State A equally to a resident in State B and investing only in State B or to a resident in State A investing in States A and B.

Vogel claims that it is not unjust to treat taxpayers differently, depending on whether they have only domestic income or whether a taxpayer partially receives income from a foreign source.[1963] Fleming, Peroni and Shay argue that "[t]here is no reason why it [i.e. the ability-to-pay principle] should not receive similar deference when that international tax provisions are being scrutinized".[1964] Their statement can be misunderstood, as "international tax provisions" in their understanding means domestic (US) tax provisions applying to international circumstances. The authors then argue in favor of a credit system compared to an exemption of foreign income at the domestic level, as the latter would lead to an infringement of the ability-to-pay principle, particularly if the income stems from a low-tax jurisdiction, as domestic and cross-border transactions would be taxed differently.[1965] Therefore, according to these authors, the source (i.e. the origin of the payment) of the income does not matter when comparing the ability-to-pay of one taxpayer to another taxpayer.[1966]

Dodge also mentions that the ability-to-pay principle could be the basis for fair international taxation.[1967] In his view, this would first require having an international tax base in line with the ability-to-pay principle, and in a second step, each country would calculate its tentative tax base on the

1962. Tipke, 2000, p. 522 et seq. But *see* Tanasoca, p. 154, who argues that if an individual is a dual citizen, a mitigation of double taxation could even lead to unfair results as "[t]he dual citizen can enjoy the full benefits [of two states] while contributing less than his fair share."
1963. Vogel, 1994, p. 374. *See also* Valta's opinion in sec. 10.3. *See* Musgrave, 2001b, p. 1338 et seq., who makes a distinction between equity in "national" and "international" terms.
1964. Fleming, Peroni & Shay, 2008, p. 61. *See also* Fleming, Peroni & Shay, 2001, p. 306 et seq.; Fleming, Peroni & Shay, 2014, p. 19.
1965. Fleming, Peroni & Shay, 2008, p. 62 et seq. *See also* Herman, p. 130, and Opel, p. 207 et seq.
1966. Fleming, Peroni & Shay, 2001, p. 311 et seq.
1967. Dodge, p. 460 et seq. *See also* Valta's position in sec. 10.3.

worldwide tax base. In a third step, each country would calculate its part based on the presence of the person in its jurisdiction relative to the presence in the other states. Also, by referring to the ability-to-pay-principle, Bruins et al. state that single taxation would reflect the ideal solution:

> The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that the liability should be divided among the tax districts according to his relative interests in each. The individual has certain economic interests in the place of his permanent residence or domicile, as well as in the place or places where his property is situated or from which his income is derived. If he makes money in one place he generally spends it in another.[1968]

Schön states that taxation aiming at catching the full ability-to-pay tends toward residence taxation, as the source of an income is not decisive for measuring the ability-to-pay of a taxpayer.[1969] Furthermore, he emphasizes that the roots of the ability-to-pay principle are in the domestic relationship between the government and a taxpayer, and he highlights the connection of the ability-to-pay principle with worldwide taxation.[1970] Moreover, he mentions, with reference to the *Schumacker* decision of the ECJ, the difficulty of collecting the relevant information in the source country in order to measure the ability-to-pay, and concludes that the "[a]bility to pay helps to define the cake, but it does not help to slice it."[1971] Therefore, he sees a need to make use of the ability-to-pay principle to measure the relevant tax base, but not as an allocation principle.

Peters argues that the concept of inter-individual equity, which is related to the ability-to-pay principle, has increasingly been "blurred" due to the change of the state-society interaction.[1972] The latter means, in the understanding of Peters, that it is no longer possible to clearly distinguish between the national and the international realm.[1973] In other words, it is extremely difficult to find the correct comparison (i.e. a domestic or foreign resident). A different, but somehow related, approach is taken by Mason, who uses a "social-obligation theory" to judge whether taxation based on citizenship is justified.[1974] Accordingly, "membership in the American national community

1968. Bruins et al., p. 20.
1969. Schön, 2009, p. 71. *See also* his more recent position on the equal treatment of non-national taxpayers, Schön, 2018, p. 50 et seq. This is a similar position already referred to by Seligman (*see* Cavelti, 2016, para. 170 et seq., with further references). *See also* Green, p. 29.
1970. Schön, 2009, p. 72, with further references.
1971. Id., p. 73.
1972. Peters, 2014, p. 105 et seq.
1973. Id., p. 95.
1974. *See* sec. 11.2.3.2.1.

gives rise to the obligation to contribute to taxes according to ability to pay. If that assumption is warranted, the question becomes whether a person's citizenship is a good predictor of her membership in the American national community."[1975] Therefore Mason refers to a philosophical claim, according to which membership as such creates duties. This will also be of importance in the following normative review.

Recently, some mentionable articles of de Wilde have been published that follow a normative approach on the allocation of the income of a multinational enterprise based on fairness considerations.[1976] De Wilde states that it should not make any difference from a tax perspective whether a business is rendered cross-border or within a single state – the tax treatment should be the same.[1977] Therefore, he claims that not only should business income be taxed only once (i.e. a single-taxation principle), but also that the border as such is a legal construct and should, therefore, not have an influence on the taxation.[1978] He basically developed a presumably fair international tax system based on the principle of equality and argues that companies, notwithstanding their place of residence, ought to be treated equally. However, from our perspective, what is missing in his writings is reference to a clear theory of justice at an international level compared to justice at a domestic level. In fact, and we will further develop this understanding, we disagree with de Wilde that there is indeed a normative claim for a fair international system based on the principle of equality,[1979] i.e. in simplified terms, that the same rules should apply to all taxpayers worldwide. As we will show below, such an approach (i) ignores the practical constraints of a Westphalian world order[1980] and (ii) more importantly, it neither deals with inter-state justice and its implications, nor does it further develop the result of a worldwide harmonized tax system based on the equality principle and whether this would require global distributive payments.

These different opinions trigger the fundamental question of whether the ability-to-pay-principle is indeed a principle that should apply in cross-border circumstances, and, second, if the answer to such question is in the affirmative, what does it mean? Does it only mean that we have to treat,

1975. Mason, p. 211. *See also* Spiro, p. 125, who emphasizes the "difficulty of using citizenship as a platform for redistribution".
1976. De Wilde, 2010, p. 281 et seq.; de Wilde, 2011, p. 62 et seq.; de Wilde, 2015, p. 438 et seq.
1977. De Wilde, 2010, p. 287. *See*, on the potential application of the ability-to-pay principle at an international level, Li, 2002, p. 827.
1978. De Wilde, 2010, p. 291.
1979. *See* de Wilde, 2015, p. 439.
1980. *See* Knechtle, p. 19.

as suggested by Fleming, Peroni and Shay, two domestic companies (or individuals) equally, notwithstanding the fact of whether these companies receive foreign or domestic income, or should international tax policy aim at the equal treatment of two companies (or individuals) resident in two different jurisdictions? Or does it mean that we have to apply the same allocation key worldwide in order to treat all taxpayers equally? Does this mean that we have to treat all individuals equally, aiming at harmonized global tax rates?

These challenging questions must be answered with reference to political philosophy, as only normative arguments lead to non-biased and impartial results. Biased, in this respect, means that the results could be affected by domestic constitutional concepts that do not exist in other societies or which do not exist at an international level.

11.2.3. Normative review

11.2.3.1. Setting the question

In the present section, it will, inter alia, be analyzed whether the statement that individuals or corporations should be treated in the same way following the ability-to-pay principle at a global level, notwithstanding their place of residence and/or the source of their income, is valid from a normative perspective. The following example, taken from Fleming, Peroni and Shay, seems highly illustrative and sufficiently simple, but also sufficiently complex to discuss the topic in an understandable but in-depth manner:[1981]

> A & B are both residents in State X. A receives income of USD 50,000 from a source in State X. B on the other hand also receives USD 50,000 from a source in State X, but additionally she receives USD 1mln from a source in State Y. C on the other hand is a resident in State Y and earns USD 1,050,000 from a source in State Y. X is a high-tax jurisdiction and Y is a low-tax jurisdiction, or even a tax haven with no income taxes.

Concerning such a scenario, Fleming, Peroni and Shay argue that a comparison should be made between A and B to decide whether the taxation of residents of State X follows the ability-to-pay principle. This would mean that a credit system (or residence-country taxation)[1982] would better suit the need to have taxation in line with the ability-to-pay principle, as compared

1981. For further details *see* Fleming, Peroni & Shay, 2001, p. 314 et seq. *See* for a similar example Debelva, 2018, p. 575 et seq.
1982. *See* Roin, p. 1761.

to an exemption system. In case of the application of the exemption method, it could occur that B (even though her ability is USD 1mln higher than A's) would pay the same amount of income taxes as A if State Y does not levy any income taxes. Therefore such a result would be unfair according to their understanding. The argument for such a position is the following: "Each country has the right to decide the notions of tax fairness that will prevail with respect to members of its society [footnote omitted]."[1983]

The authors, therefore, argue – although not with an explicit reference to the philosophical debate – that fairness considerations are different within a state and in a cross-border circumstance, since a foreign resident is not a member of the same society or the same state, respectively. This is interesting considering the different existing theories of global justice, i.e. left and right institutionalism.[1984] Therefore the question becomes who should be treated equally to whom and based on which justification.

11.2.3.2. The underlying philosophical concepts

11.2.3.2.1. *Existing ideal theories*

Following the methodology of the present study, we need to better understand the underlying reasons from an impartial perspective for the application of the ability-to-pay principle at an international level. It is crucial to again highlight that in the present section, the discussion is not about whether there is a legal or constitutional obligation to apply the ability-to-pay principle, but whether there is a normative claim for the application of the ability-to-pay principle in an international circumstance, i.e. whether international tax policy ought to follow such a principle and what policies this would require. In the following, we leave aside the question regarding the actual outcome of the application of the ability-to-pay principle in a domestic circumstance (i.e. how ability-to-pay should be measured).[1985]

If one wants to apply the ability-to-pay principle at a global level, one could compare a taxpayer to another taxpayer in the same jurisdiction (A and B

1983. Fleming, Peroni & Shay, 2001, p. 314. *See also* Opel, p. 211, who argues that the equality principle only has an impact within a certain society (state or municipality). This basically means that we cannot compare a domestic resident person with a person resident abroad. However, such a line of argumentation likely relates to a (biased) legal understanding of the application of the equality principle and not how the equality principle ought to be understood.
1984. *See* chapter 7.
1985. *See* sec. 11.2.1.

in the example above) or apply a more cosmopolitan approach and require comparisons between a domestic taxpayer and any other taxpayer in the world (A, B and C in the example above). As we have seen above, with references to left and right institutionalism, different approaches exist. If one believes that the ability-to-pay principle applies only to members of a certain society or state, it must further be decided who belongs to such a society. The latter means whether these are all persons with the same citizenship, all persons under the same coercive structure, or all persons interacting with each other.

Therefore, from a philosophical perspective, we first need to answer the question of whether we should aim at treating all persons equally on this planet and second, if not, to which persons the equality principle and, therefore, the ability-to-pay principle following a liberal theory of justice should be relevant. These questions are intertwined and we have already outlined the most important theories of political philosophy in this respect.

The underlying justification for the application of a global equality principle would be that we are all humans and, therefore, we should treat all equally, following a cosmopolitan understanding of global justice.[1986] Another approach is – and this was shown with references to right institutionalists – that the state border is morally significant and that the duty for equal treatment applies only to a basic structure, such as a state with coercive and cooperative elements. This leads to some clarity, but also leaves some open questions.

A right institutionalist would likely argue that different tax rates in different states, even if they deviate significantly, are morally non-problematic. As an example, if B is taxed at 40% in State X on her worldwide income and C is taxed at 5% in State Y, but both have the same income, such unequal treatment is not unjust per se because these persons belong to different coercive societies and/or cooperative structures. Therefore the unequal taxation of B and C, despite having the same income, is morally justified. Other right institutionalists would argue that there is an associative obligation within a state, but not at an international level, so we therefore owe different duties. Also, the equality principle would potentially apply differently to our compatriots than to foreigners, as we, for instance, do not share the same institutions with persons living abroad.[1987] This would also mean that we do not necessarily need to treat foreigners equally (i.e. apply the same

1986. *See* the cosmopolitan ideas in sec. 7.5. and on egalitarianism *see* sec. 7.6.
1987. *See* the concept of Blake in sec. 7.4.1.

tax rate and the same deductions) unless they belong to the same association with shared institutions.

Therefore, such a brief outline of the underlying philosophical theories that were visualized above in more detail[1988] shows that the normative application of the ability-to-pay principle in cross-border circumstances might depend on the underlying philosophical concept, and the different treatment of a person residing abroad and a domestic compatriot is depending on the theoretical understanding not unjust per se. A similar approach has already been outlined by Mason, who referred to a social-obligation theory and outlined some different views of persons to which we have social obligations.[1989]

11.2.3.2.2. *Our position*

With respect to the different theories of global justice, we showed above[1990] that we follow a continuous but right institutional approach, which means that coercion, association and cooperation are relevant factors that might, depending on the intensity, create specific moral duties, such as the application of the equal treatment principle. Therefore, it is our understanding that the different treatment of persons in different states is not per se unjust and there is no moral duty to treat all humans equally from a tax perspective. However, depending on coercion, association and cooperation, further moral duties might also be triggered at a cross-border level, for instance, in highly integrated systems, such as the EU or federal states.

To shed some further light on what this means from a tax perspective and to demonstrate the importance of such philosophical reasoning from a practical perspective, we will refer to some ECJ case law in the following section.

11.2.3.2.3. *Reception in case law*

There is a stimulating example to demonstrate the actual practical effect of these theoretical considerations and to demonstrate their impact on court decisions in tax law.

The European market is, from a structural perspective, highly integrated due to the fundamental freedoms. Moreover, the EU knows several coercive

1988. *See* chapter 7.
1989. Mason, p. 196 et seq.
1990. *See* sec. 8.3.2.

measures, such as the prohibition of State aid, which is supervised by the Commission. Referring to the theories of coercion and association, the EU is an ideal example to demonstrate the potential impact of integration through cooperation and coercion on equality considerations and to show the importance of our continuous approach, as outlined above.[1991] In the EU, no legal base directly refers to or protects the ability-to-pay principle as a legal principle at a European level.[1992] The ECJ nevertheless implicitly referred to the ability-to-pay principle in a few cases, such as by comparing non-residents and residents in the *Schumacker* case, as it held the following:

> In a situation such as that in the main proceedings, the State of residence cannot take account of the taxpayer's personal and family circumstances because the tax payable there is insufficient to enable it to do so. Where that is the case, the Community principle of equal treatment requires that, in the State of employment, the personal and family circumstances of a foreign non-resident be taken into account in the same way as those of resident nationals and that the same tax benefits should be granted to him.[1993]

Therefore, the ECJ assumes a community principle of equal treatment between residents and non-residents if a person receives a considerable amount of his income from sources in another state. However, as shown in a persuasive manner by Vanistendael, the ECJ has not been consequent, as it has implemented the justification of "balanced allocation of the power to impose taxes between Member States" and, therefore, for instance, considerably limited the use of foreign losses, even though a cross-border application or consolidated application of the ability-to-pay principle would require that.[1994] For instance, in the *Lidl-Belgium* case, the court held that:

> It must be added that the Court has recognised the legitimate interest which the Member States have in preventing conduct which is liable to undermine the right to exercise the powers of taxation which are vested in them. In this connection, where a double taxation convention has given the Member State in which the permanent establishment is situated the power to tax the profits of that establishment, to give the principal company the right to elect to have the losses of that permanent establishment taken into account in the Member State

1991. *See* id.
1992. For further details *see* Vanistendael, 2014, p. 121 et seq.
1993. DE: ECJ, C-279/93, *Schumacker*, para. 41.
1994. Vanistendael, 2014, p. 121 et seq. The balanced allocation of taxing powers or the principle of territoriality as a justification for unequal treatment has been referred to in many cases of the ECJ. *See*, for example, regarding the use of foreign losses UK: ECJ, C-446/03, *Marks & Spencer*, para. 39. Or *see* in general, for example, NL: ECJ, C-337/08, *X Holding*, para. 27; BE: ECJ, C-350/11, *Argenta Spaarbank NV*, para. 35.

> in which it has its seat or in another Member State would seriously undermine a balanced allocation of the power to impose taxes between the Member States concerned (see, to that effect, Oy AA, paragraph 55).[1995]

Moreover, the ECJ has stated in many further cases that residents and non-residents are in general not in a comparable situation.[1996] This means that the ability-to-pay principle is not applicable to all cross-border situations. This triggers the question of why the ECJ does not apply a full-fledged ability-to-pay principle, but instead limits its application to a few very specific cases, such as the case of a quasi-resident in the aforementioned *Schumacker* case. Theories of political philosophy might be helpful to better understand the underlying reasoning of the ECJ.

With respect to the use of losses of a foreign PE or a foreign subsidiary, the ECJ justifies a different treatment (i.e. not in line with a union-wide application of the ability-to-pay principle), due to the fiscal sovereignty of the Member States and the justification of balanced allocation of taxing rights. The underlying reason for such limitation seems to be that the Court follows a more Rawlsian view and assumes that national sovereignty is of great importance, whereas a more cosmopolitan application of the principle of equality is not (yet) appropriate, even though in the *Schumacker* decision, the Court already applied equality considerations in a cross-border circumstance.

It is our understanding that the ECJ struggles with the philosophical question of exactly when and for what reason equal treatment is required, and in which situations the national boundaries are still morally significant and unequal treatment is justified.[1997] For instance, with respect to a cross-border commuter, the ECJ seems to assume that in such a situation (maybe due to social cooperation in the employer's state?), a foreign resident should be treated equally to domestic residents. Therefore the underlying philosophical concept could be that association and social cooperation trigger moral duties. However, the ECJ is not referring to any of the philosophical theories.

1995. DE: ECJ, C-414/06, *Lidl Belgium*, para. 52.
1996. *See*, for example, BE: ECJ, C-391/97, *Gschwind*, para. 22; HU: ECJ, C-253/09, *European Commission v. Republic of Hungary*.
1997. Of course, there is also the argument that for source states it is rather difficult to apply equal treatment, as there is a lack of information about the taxpayer in the source state (e.g. worldwide income, marital status, etc.) and, therefore, unequal treatment in the source state is not harmful. *See also* sec. 11.2.3.3.

Having in mind a continuous approach of cooperation, association and coercion, as proposed in the present study,[1998] it might be that in the upcoming years – at least if the EU further enhances an integration policy – the ECJ will apply the ability-to-pay principle in a more consequent manner in cross-border circumstances, i.e. not restricted to specific cases, such as the *Schumacker* fact pattern. Therefore, the more integrated a union of states is, the more likely it is that the ability-to-pay principle unfolds a cross-border impact, as domestic and foreign residents might be within the same coercive and associative framework. Of course, this depends on the underlying theory of global justice, but courts might accidentally and/or implicitly apply one of the existing approaches.

11.2.3.3. Practical constraints

This section deals with the question of whether there are any practical constraints that would disable the application of the ability-to-pay principle at an international level as a policy guideline either following a cosmopolitan understanding or following our approach, i.e. a continuous approach. By referring to both ideal theories (i.e. the right and left institutional approach), we try to develop a concise and comprehensive argumentation either in favor of or against the application of the ability-to-pay principle as an international policy principle.

11.2.3.3.1. *Cosmopolitan understanding*

It is essential to highlight that according to Graetz, no country has actually committed to worldwide equality.[1999] This seems obvious, as it would be impossible to treat all individuals and corporations in the same manner, regardless of their place of residence. In the following section, we will, nevertheless, as a start, hypothecate that the ability-to-pay principle would be applicable at a global level, i.e. not limited to an intra-state situation, but instead following a cosmopolitan understanding. This means that international tax law should aim at achieving the same treatment of both domestic and foreign resident taxpayers (i.e. even A and C in the example above should be treated equally).[2000]

The most obvious constraint of a worldwide application of the ability-to-pay principle relates to fiscal self-determination, as it would require a global

1998. *See* sec. 8.3.2.
1999. Graetz, p. 277.
2000. *See* sec. 11.2.3.1.

harmonization of tax rates and tax base, given that equal treatment in the resident state might lead to unequal treatment in the source state. The underlying assumption is that if we apply a cosmopolitan view, it is necessary to compare a person both to other residents and to other persons not resident in the same country, as the national boundary is not morally significant. The following example is again used to demonstrate the issue:

> A & B are both residents in State X. A receives income of USD 50,000 from a source in State X. B on the other hand also receives USD 50,000 from a source in State X, but additionally receives USD 1mln from a source in State Y. C on the other hand is a resident in State Y and earns USD 1,050,000 from a source in State Y. X is a high-tax jurisdiction and Y is a low-tax jurisdiction.

Following a cosmopolitan understanding, the normative goal would be to treat A, B and C equally. However, considering the empiric fact that the world is organized as a regime of different sovereign states, equal treatment of all persons (A, B and C) is not practically feasible and would trigger further duties, such as a global distributive duty, following a cosmopolitan theory of justice, as proposed by Rawls in *A Theory of Justice* in a domestic situation. Furthermore, if we consider the study of Murphy and Nagel,[2001] even the full harmonization of income taxes would not lead to equal treatment, as the after-tax return of a taxpayer might still be different, depending on his place of residence and, therefore, there would still be unequal treatment. We would also need to harmonize any actual governmental and potential benefit. For example, if State X has a maternity leave system and State Y does not, equal taxation of a resident in State X (e.g. A) and a resident in State Y (e.g. C) would still not lead to equal treatment, as A would potentially have access to maternity leave, whereas C would not. In a similar manner, it was also highlighted by Gutmann that the benefits obtained abroad might not only be different, but the risks related to a certain income might also considerably deviate, depending on whether it stems from a domestic or foreign source.[2002]

Within a world of sovereign states and various (overlapping) taxing rights, as well as significant differences concerning the tax base calculation, a stringent system following a cosmopolitan understanding of the ability-to-pay principle cannot be achieved, as it is not feasible (at least at the moment) from a tax law perspective to achieve full equality at an international level.[2003] This means, from a citizen's perspective, to achieve absolute equal treatment

2001. *See* sec. 1.3.
2002. Gutmann, p. 38.
2003. *See* Kaufman, 1998, p. 178 et seq., who uses the example of a credit system in a case where the source country levies higher taxes than the resident state. In this case,

considering the ability-to-pay principle on a global scale seems (politically) impossible: a resident in Denmark will not pay the same amount of taxes as a resident in Bermuda in a case where both have the same ability-to-pay. Both might also receive different governmental benefits.

11.2.3.3.2. *Our understanding*

Following our normative concept of global justice, which is driven by the protection of fiscal self-determination and a global humanitarian duty,[2004] we would support the following claim.

On the one hand, in the example above, we ought to compare the ability of A to B from the perspective of State X, because both taxpayers are presumably members of the same society and the same basic structure, i.e. the same coercive, cooperative and associative regime. However, we also need to treat B and C equally from the perspective of State Y, because C is resident in State Y and B receives a significant amount of income from a source in State Y. If B, for instance, commutes daily to Y and receives his income from the source in Y due to such employment, we could claim that B is also part of the coercive and associative regime of State Y (implicitly the opinion of the ECJ in the *Schumacker* case).[2005] Therefore both X and Y would need to treat B equally as a resident in their state from a moral perspective.

Globalization has led not only to a very integrated global economy, but also to the fact that many individuals are no longer part of only one society and one basic structure, but of several societies and basic structures, which disables a self-consistent application of a non-cosmopolitan understanding of the ability-to-pay principle. As a logical consequence, we cannot achieve equal treatment unless the tax rates and governmental benefits are harmonized. This is true for the following reasons: if State X grants B a credit on the income taxes paid in State Y, in order to achieve equal treatment with A, State Y could not treat B in the same manner as C because C would pay very few taxes and B would pay high taxes on USD 1,050,000 due to the credit system in State X. If State X exempts the foreign source income, the treatment of A and B in State X would differ because the two taxpayers would pay the same amount of taxes, even though B has significantly more income. The same is also true in some federal states with limited

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the resident state can – by granting a credit – not guarantee equal taxation, as the credit will likely be limited to the taxes due in the source state, due to a provisio safeguarding progression. *See generally* Ratner, 2015, p. 419.

2004. *See* chapter 8.

2005. *See* sec. 11.2.3.2.3.

tax rate harmonization. For instance, a taxpayer in the Canton of Schwyz in Switzerland might pay only a 20% income tax, whereas a taxpayer in the Canton of Neuchatel would pay 40% on the same amount of income. Therefore, it is impossible to achieve equal treatment if a taxpayer receives income from both cantons and if he or she is a part of two societies.[2006]

The situation is even more difficult with respect to corporations. First, we have severe doubts that we can use the philosophical reasoning on equal treatment from a state's perspective regarding corporations or other legal entities. Not to be misunderstood, we are not arguing that from a legal or constitutional perspective the ability-to-pay principle should not apply to corporations in a domestic framework. This is a matter of interpretation by domestic courts. We will not take any position regarding such domestic legal or even constitutional question. We are only suggesting that the underlying moral justifications of the need for an application of the ability-to-pay principle might be nonexistent regarding corporations. For instance, remarks on the impact of social cooperation and coercion might not apply in the same manner to legal entities as, for instance, they cannot (by definition) cooperate in the same moral manner as individuals. Furthermore, multinational enterprises operate in a worldwide and global manner that basically buries any attempt to achieve equal treatment, as there is no reference to a single state. Of course, one could argue that a legal entity belongs to the state of residence or to the state where its shares are publicly traded, but we do not see any persuasive line of argumentation to categorize all multinationals as enterprises of a single country for the purposes of an equal treatment discussion.[2007]

Therefore, particularly with respect to the taxation of corporations, but also with respect to individuals, the ability-to-pay principle is not a persuasive normative goal of international tax policy. It is even impossible to fulfill

2006. It is not surprising that the equality principle reaches its limits regarding the taxation of international facts, as several comparables might exist. *See* Rosenbloom, p. 64: "It has been a mistake to disregard the case for rough justice. The argument can always be made that no two cases stand equally before the tax laws. It is also true, however, that at some level, no two cases are relevantly different." *See also* the dissenting opinion of Judge Ginsburg in *Maryland v. Wynne*, who struggled with a similar problem that it is impossible to achieve intra-state equality by at the same time avoiding inter-state double taxation (*see* US: SC, No 13-485, 18 May 2015).

2007. As an example, all of the major shareholders of the "Swiss bank" UBS reaching a threshold of 3% in recent years were non-Swiss investors. Therefore it is doubtful to speak of UBS as a "Swiss-owned bank" or a "Swiss bank" (*see* https://www.ubs.com/ global/de/about_ubs/investor_relations/share_information/significant.html#par_textimage_14667120, last visited 10 Feb. 2019). The same is true with most multinational enterprises that are publicly traded.

the requirement of a non-cosmopolitan application of the ability-to-pay principle without harmonizing tax rates. Moreover, as we will outline in the following, worldwide taxation that would be required following a non-cosmopolitan understanding of the ability-to-pay principle infringes both the source principle and the benefit principle, as income is taxed that was created abroad by using the benefits of a foreign country.[2008]

11.2.3.3.3. *Intermediate conclusion*

To sum up, practical constraints are extremely important when discussing the application of the ability-to-pay principle at an international level. On the one hand, a cosmopolitan understanding of the ability-to-pay principle, which we deny, would require considerable cross-border distributive payments to achieve equal treatment in a presumed global society. On the other hand, a non-cosmopolitan understanding of the ability-to-pay principle struggles with the fact that increased globalization has led to the difficulty that individuals are members of more than one society, which disables the application of the ability-to-pay principle in a self-consistent manner. Moreover, a non-cosmopolitan understanding might collide with the source and benefit principles, as we will demonstrate below. Therefore, it seems in line with our understanding of global justice that different incomes (i.e. domestic and foreign) might be treated differently.[2009] We do not, however, in the present study challenge the application of the ability-to-pay principle in line with domestic legal or constitutional requirements. As mentioned, this is a matter of domestic legal or constitutional interpretation. We are only suggesting that the international tax regime does not need to be in line with the ability-to-pay principle to be considered just, or in a negative form: global tax justice does not require that international tax legislation follow the ability-to-pay principle. This brings us to the next question of whether a global single taxation principle indeed exists.

11.2.3.4. No global single taxation principle

Following our remarks above, it does not reflect a normative claim to support a single taxation principle at an international level. This means that there is no normative need to mitigate double taxation and double non-taxation.[2010]

2008. *See* secs. 11.5. and 11.6.
2009. *See* Gutmann, p. 42. *See also* Kaufman, 1998, p. 182 et seq.; Kaufman, 2001, p. 1465 et seq.
2010. *See*, with a focus on economic theory, Shaviro, 2014, p. 12 et seq. *See also* the various contributions in Wheeler (ed.), p. 1 et seq.

In other words, double taxation and double non-taxation are not detrimental to our understanding of global justice. This might be a major deviation from traditional approaches to enhancing justice in the international tax regime, arguing that both double taxation and double non-taxation are unjust.

One argument for such a position was outlined above, stating that single taxation at an international level, i.e., a situation in which income is only but at least taxed once does not necessarily lead to global equal treatment, since single taxation could mean facing very different tax rates and very different governmental benefits. Therefore, the argument that the principle of equality (or the ability-to-pay principle) requires single taxation is not true, unless tax rates and governmental benefits are harmonized, as an application of a global equality principle is currently impossible. A claim for single taxation based on a cosmopolitan application of the ability-to-pay principle is, therefore, weak, as the ability-to-pay principle is defective as an international tax policy principle, given different tax rates and different governmental benefits.

For instance, the application of a global single-taxation principle derived from a cosmopolitan understanding of the ability-to-pay principle would lead to the conclusion that justice requires that income is only taxed once, even if the tax burden of double taxation would be lower than that of single taxation. For example, assume a state taxes income at a rate of 40%, while two other states tax income at a rate of 15%. A proponent of the global application of a single-taxation principle derived from ability-to-pay would conclude that justice requires single taxation, even though the consolidated tax burden of double taxation in two states (30%) is lower than the tax burden of single taxation in one state (40%).

Moreover, as indicated already, single taxation implies a cosmopolitan understanding of global justice, which we deny. If one argues that there is a responsibility of states to share the income among themselves in order to guarantee that the consolidated tax burden of each person is not higher than it would be if all income was derived in one state (i.e. single taxation),[2011] one implies a cosmopolitan understanding of justice. Why? Only in a cosmopolitan understanding would there be a duty of a state to consider the ability-to-pay of residents in another state – i.e. non-members of its society. However, there is in general no such duty outside a cosmopolitan perspective,[2012] as it implies that a global equality principle and global

2011. *See*, for example, the position of Valta, 2014, p. 74 et seq. *See also* sec. 10.3. *See* for a similar claim Debelva, p. 581 et seq.

2012. Only in very specific circumstances might such a duty exist in a non-cosmopolitan understanding. *See* the remarks regarding the *Schumacker* case in sec. 11.2.3.2.3.

basic structure exists, triggering global equal treatment in line with the ability-to-pay principle beyond national borders. Moreover, a consequent application of the presumed requirement of states to consider the ability-to-pay, even of taxpayers that are members of another society, would obviously require significant payments from rich to poor states to come closer to such global equal treatment.

In other words, it does not make sense to require a poor state to consider the ability-to-pay of an individual resident in a rich state that receives income from a source in the poor state (and therefore potentially refrains from taxation to achieve single taxation), unless the rich state has an obligation to achieve equality at a global level through considerable fiscal transfers to poor states. Why should a poor state have a duty to share income with a rich state to ensure that a resident of the rich state is not taxed twice, but at the same time, the rich state would not have a duty to ensure that the inequalities between individuals in the rich and poor states are reasonable and aligned with a global difference principle? We do not see a persuasive argument in this respect. It seems self-evident that a poor state would only agree that there is such a duty to consider the ability-to-pay of a resident of a rich state if the rich state ensures that inequalities between individuals resident in the poor and rich states are lowered to an agreeable extent, following a cosmopolitan understanding of Rawls' liberal principles of justice. This is also one reason that, in federal states, single taxation is only considered just because there are fiscal transfers from richer to poorer member states, such as the cantons in Switzerland.[2013] The integration of nation-states into fiscal unity is an illustrative example to demonstrate what is required to achieve a just (and potentially more integrated) international tax regime, if arguments are made in favor of a more integrated and harmonized international tax regime.

11.2.4. Intermediate conclusion

At the beginning of the present chapter, we asked the question of whether a state must – from a philosophical perspective – treat foreigners and residents equally if the foreigner receives part of his income from a domestic source. We have seen that the result might depend on one's understanding of the consequence of cooperation, association and coercion, or in more general terms, on whether or not one follows a more cosmopolitan approach

2013. The Swiss Federal Constitution contains a prohibition of double taxation (art. 127(3)) and the Swiss Federal Supreme Court has ruled in dozens of inter-cantonal taxation conflicts. At the same time, Switzerland has a fiscal transfer system (*Finanzausgleich*), which requires the richer cantons to support poorer cantons (art. 135 Swiss Federal Constitution).

regarding global justice. Personally, we argued that coercion and association – but also (social) cooperation – will, following a continuous approach, indeed create additional duties cross-border, such as the duty for equal treatment.[2014]

Such a position also finds implicit support in the case law of the ECJ. The Court ruled in the *Schumacker* case that residents and quasi-residents should be treated equally.

However, the application of the ability-to-pay principle faces some significant difficulties and practical constraints in a cross-border circumstance. As was shown, from a logical perspective, it is impossible to treat all humans equally (even if there is a sufficient coercive system and sufficient cooperation following a cosmopolitan understanding) unless tax rates and governmental benefits are harmonized. Equality considerations between individuals are also, following our position on global justice, mainly a domestic (constitutional) issue.[2015]

The issue of practical constraints increases with respect to the taxation of multinational enterprises: It is impossible to treat all enterprises equally if both the source state and the resident state claim a taxing right based on different tax rates; moreover, we have seen that it is difficult if not impossible to categorize multinational enterprises as members of a single society in relation to potential intra-societal moral duties. There will always be an unequal treatment, even if one would harmonize income and corporate income tax rates. Therefore, the ability-to-pay principle is a defective principle at an international level and not a useful policy guideline.

Moreover, we showed that the claim for single taxation is weak if tax rates are not harmonized and we demonstrated that authors claiming that justice requires single taxation (i.e. no double taxation and no double non-taxation) follow a cosmopolitan path, which would require a significant fiscal transfer from rich to poor states in order to achieve global equality in a presumed global basic structure. Therefore, authors like de Wilde, Valta or Tipke, who claim that there is actually a responsibility of states to share the income of taxpayers to achieve taxation in line with the ability-to-pay principle, would in a consequent manner also need to support global distributive payments, at least following a liberal theory of cosmopolitan global justice.

2014. *See* sec. 8.3.2.
2015. *See* Kaufman, 1998, pp. 172 and 188; Kaufman, 2001, p. 1465 et seq.

11.3. Principle 2: Inter-nation equity

11.3.1. Inter-nation equity – An overview

The term "inter-nation equity" has often been mentioned by tax scholars when discussing the allocation of income between countries. Instead of the term "inter-nation equity", sometimes the terms "inter-nation justice", "economic justice among states", "inter-country equity" or "inter-jurisdiction equity" have been used identically or in a similar manner.[2016] However, as we will demonstrate, the principle of inter-nation equity has often been misused and misunderstood in the debate about redesigning the international tax regime.

The principle of inter-nation equity has, inter alia, been referenced to justify a certain income allocation, such as source taxation or residence taxation. In other words, inter-nation equity is used as a principle to achieve a fair allocation of income.[2017] Or, as stated by the OECD/G20: "[I]nter-nation equity is concerned with the allocation of national gain and loss in the international context and aims to ensure that each country receives an equitable share of tax revenues from cross-border transactions."[2018]

In a similar manner, statements like the following from Sadiq are common in international tax law literature:

> It is generally accepted that the overall aim of the international tax regime, and therefore the transfer pricing regime, is to achieve inter-nation equity, international equity and international taxpayer equity,[footnote omitted] or what Musgrave described as taxpayer equity, locational neutrality and inter-nation equity.[footnote omitted].[2019]

Inter-nation equity, however, has no legal base, neither in domestic law nor in international law. It is not contained in a treaty, nor is it a rule of customary international law or a general principle of law.[2020] The most prominent and first advocates of inter-nation equity were Musgrave and Musgrave. Inter-nation equity, as understood by Musgrave and Musgrave, relates to the

2016. E.g. Brooks, 2009, p. 471; Gutmann, p. 37; Herman, p. 131 et seq.; Ring, 2008, p. 179.
2017. *See* Douma, 2011, p. 105, with references to Jefferey. *See also* Kaufman, 1998, p. 153 et seq.; Peters, 2014, p. 98.
2018. OECD/G20, Addressing the Tax Challenges of the Digital Economy, Action 1: 2014 Deliverable (OECD 2014), p. 31.
2019. Sadiq, p. 282. *See also* Juusela, p. 25; Pinto, p. 270 et seq.
2020. On the sources of international tax law, *see* chapter 4.

question of equity among states, as compared to equity among individuals. Or, to be more precise, the principle of inter-nation equity should be thought of "in terms of national-gain sharing or revenue participation"[2021] by the source and the residence country. The principle of inter-nation equity relates to the question of source taxation, as source taxation must be considered as a loss of revenue in the resident state if a worldwide tax system is in place in the resident state.

As mentioned, Musgrave and Musgrave understand inter-nation equity as a tool to deal with the allocation of national gain and loss.[2022] Accordingly, inter-nation equity would be best achieved – although practically not feasible – by benefit taxation, as "[i]nter-nation equity under the benefit principle would be self-implementing."[2023] They further argued that taxation based (solely) on the residence principle would be undesirable, as corporate tax would be linked to the rather arbitrary decision of the residency of a corporation.[2024] However, the most important (and sometimes overlooked) remarks by Musgrave and Musgrave relate to the question of cross-border distribution and allocation of income. They concluded, in general terms, that international revenue allocation should have a distributive effect[2025] and held that source taxation as such could also be structured to allow such a distributive effect.[2026] In this respect, they proposed non-reciprocal withholding tax rates, which would be linked inversely to per capita income in the capital-importing country and to the per capita income in the capital-exporting country. Such a system would, according to Musgrave and Musgrave, lead to an improvement in states with low income per capita.

Peggy Musgrave has made many more contributions on the issue of inter-nation equity,[2027] but she has not fundamentally deviated from the aforementioned position. She later stated that neither formulary apportionment nor a separate entity approach could be understood as an objective answer

2021. Musgrave & Musgrave, p. 69. *See also* de Wilde, 2010, p. 287; Kaufman, 1998, pp. 153 and 189. For a comprehensive review of the position of Musgrave & Musgrave *see* Brooks, 2009, p. 471 et seq.
2022. Musgrave & Musgrave, p. 68 et seq.
2023. Id., p. 71.
2024. Id., p. 78. *See also* Musgrave, 1995, p. 59.
2025. *See also* the conclusion: "Ultimately, the only satisfactory solution … would be the taxation of such income on an international basis with subsequent allocation of proceeds on an apportionment basis among the participating countries, making allowance for distributional considerations" (Musgrave & Musgrave, p. 85).
2026. Id., p. 74.
2027. *See* Brooks, 2009, p. 480 et seq., with further references. *See also* Kaufman, 1998, p. 189 et seq.

to the question of allocation of income.[2028] The position of Musgrave and Musgrave has not remained undisputed; in particular, the opinions on how to achieve inter-nation equity vary.[2029] For instance, Vogel argues in a rather similar manner that inter-nation equity favors source taxation.[2030] His argument is that source taxation better aligns with the benefit aspect of income generation, and the latter is the only valid justification for taxation.[2031] Others have argued in favor of residence taxation.[2032] Kemmeren favors the origin principle (although the origin principle might be identical to the source principle, depending on the understanding):

> In the author's view, the principle of origin will enhance the principle of justice, the economic faculty principle (ability to pay), the direct benefit principle and inter-nation equity (especially between developing states), which might have all kinds of other beneficial (side) effects,[footnote omitted] such as an increasing inter-nation stability.[2033]

Peters recently argued that the principle of inter-nation equity has faced a change in the sense that, among scholars, the domestic and international domains are no longer separated. According to him, the result is a "mingling of inter-individual equity arguments and inter-nation arguments."[2034] He further states that: "Academics are making a whole range of axiological claims about their desirable interpretation of inter-nation equity. These extra-legal evaluative perspectives to inter-nation equity have their origin in economics and political philosophy."[2035] Moreover, Peters concludes that the development of an international society of states and individuals might challenge the validity of the separation between inter-individual and inter-state equity.[2036]

Brooks, who has rendered the most in-depth analysis of the usage of the term "inter-nation equity", inter alia, states that the principle of inter-nation equity as used by the Musgrave and Musgrave has been "frequently misunderstood and inadequately developed by subsequent scholars."[2037] Moreover, she held that "[i]nter-nation equity is a widely accepted, but undervalued

2028. Musgrave, 1995, p. 59.
2029. For more details *see* Peters, 2014, p. 96 et seq. *See also* Li, 2002, p. 826 et seq. For an overview *see also* Brooks, 2009, p. 487 et seq.
2030. Vogel, 1988c, p. 398. *See also* Ault, 1992, p. 577; Graetz, p. 298.
2031. Vogel, 1988c, p. 398. *See also* Pinto, p. 270 et seq.
2032. *See* the references stated by Li, 2002, n. 15.
2033. Kemmeren, 2006, p. 437.
2034. Peters, 2014, p. 105. *See also* Kaufman, 1998, p. 154 et seq.
2035. Peters, 2014, p. 101.
2036. Id., p. 105 et seq.
2037. Brooks, 2009, p. 473.

international tax evaluative criterion."[2038] It is of interest for the present study that Brooks rightly criticizes the reference of Musgrave and Musgrave to income per capita in order to decide about the potential redistribution element within the principle of inter-nation equity. Instead of a higher allocation to the lowest income per capita country, she suggests, for instance, to allocate more income to low-income countries that "better advances women's equality".[2039] Furthermore, in this sense, Infanti emphasizes the importance of an expansion of the horizon, as a pure focus on the per capita income does not lead to persuasive results.[2040]

The following section aims at analyzing whether there is indeed a normative claim for a principle of inter-nation equity and how such a claim could be justified. Before going into the details of the underlying reasons and justifications for the application of the principle of inter-nation equity, it is important to draw a demarcation line between the principle of inter-nation equity and the equality of states as a legal concept. We have seen above[2041] that there is a legal claim that states must be treated equally in international law based on sovereignty considerations, i.e. no state should have legal superiority over any other state.[2042] However, the latter legal principle does not require that, for instance, the same income allocation key should apply among states. It means, however, that each state has the right to full sovereignty and political independence at an international level. The legal principle of equality among states, however, does not provide for any guidance on how income should be allocated in a cross-border scenario.

11.3.2. Normative review

11.3.2.1. Methodological remarks

At first glance, it seems self-evident that inter-nation equity is required to achieve a just international tax system. States should, of course, be treated equitably and fairly. In this sense the term "equity" is defined as "the quality of being fair and impartial".[2043] The issue with the term "inter-nation equity", however, is that a review of its normative validity requires a common understanding. It is not persuasive to claim that the international tax

2038. Id., p. 491.
2039. *See* the references stated by Infanti, p. 216.
2040. Id., p. 222 et seq.
2041. *See* sec. 4.1.1.3.2.
2042. *See* Fassbender 2009, p. 111 et seq.
2043. Oxford Dictionary, https://www.oxforddictionaries.com/ (last visited 15 Jan. 2019).

regime should follow the guiding principle of inter-nation equity if there are significant differences regarding its content.[2044] Otherwise, this leads to opposing results by referring to the same principle. In other words, reference to the principle of inter-nation equity is weak unless its content is explained in detail. Only if its content is justified should it be used as a normative principle to design the international tax regime.

In line with the proposed methodology, mainly following Sen's *The Idea of Justice*, it is again essential to reason why we need inter-nation equity as a guiding principle of international tax policy, and to evaluate the different existing methods of how to achieve inter-nation equity. These two questions, however, might be interconnected, as the first one also depends on the answer to the second. In the following, we will first refer to the question of why there should be equity between states and then demonstrate how the questions of just income allocation and the principle of inter-nation equity interact. Moreover, a normative analysis requires impartiality, which entails that we overcome our positions that have been developed over the years.[2045]

11.3.2.2. Why should there be equity between states?

It is rather challenging to find answers to the question of why there should be inter-nation equity as it seems obvious that there should be equity among states.[2046] However, one could derive the validity of the principle of inter-nation equity from the principle of inter-individual equity. The argument is as follows: Assuming that in a domestic society, individuals should be treated equitably, this should also be true at an international level among states, as states are the agents at an international level, and are comparable to individuals within a domestic society. In a similar manner, Schön, for instance, states that: "Traditional legal wisdom has it that the principles of how to allocate taxing rights internationally somehow should reflect the justification to tax in a domestic setting [i.e. the benefit and the ability-to-pay principle]."[2047] He seems to refer to inter-individual equality, which can overlap with the term "inter-individual equity". In this respect, Peters, as mentioned earlier, speaks of a "mingling" of inter-individual equity arguments and inter-nation equity arguments.[2048] Peters indeed visualizes an

2044. *See* Devereux & de la Feria, 2014, p. 13, with references to Edgar.
2045. On impartiality and reasoning, *see* secs. 7.7.4. and 7.7.3., respectively.
2046. Even in their groundbreaking article on inter-nation equity Musgrave and Musgrave are not developing a clear justification for why there should be equity among states (Musgrave & Musgrave, p. 63 et seq.).
2047. Schön, 2009, p. 71. *See also* Gutmann, p. 37.
2048. Peters, 2014, p. 105.

important lack of normative reasoning, even though his methodology is different, as he refers to the dilution of the traditional separation between society and state, and its impact on the interpretation of the inter-nation equity principle. He does not explicitly question the principle of inter-nation equity as such based on normative reasoning.

It is our understanding that states are not protected by the same moral considerations as individuals, such as equal or equitable treatment regarding the distribution of income or regarding taxation. Of course, the treatment of states as agents of international law must also follow considerations of justice and fairness, and we have seen that there is a legal principle of equality of states. However, drawing a direct link between the allocation of benefits and burdens among individuals in a society and among states in the global society is not persuasive. There is, for instance, no central body at an international level that could force states to treat themselves equitably in the mentioned manner. However, the latter is not sufficient to question the normative validity of the inter-nation equity principle. What ought to be decisive with respect to the principle of inter-nation equity is the equitable treatment of individuals as the ultimate normative goal. However, as we have seen above, the existing philosophical concepts concerning the equitable treatment of compatriots and non-compatriots are rather different.[2049] A left institutionalist would claim, on one hand, that there are global distributive duties, whereas a right institutionalist would, on the other hand, limit distributive duties to a state's territory.

In conclusion, the term "inter-nation equity", derived from inter-individual equity, is weak, as it ignores the importance of individuals as the moral agents for policymakers. This does not mean, however, that inter-nation equity is completely invalid. The principle of inter-nation equity should, in our view, have a normative value, but it should be understood as justice among equal parties at an international level. This means, for instance, justice among states in an international negotiation process or the need for fair and balanced treaty obligations, i.e. like commutative justice in the Aristotelian understanding.[2050] The question of fair distribution of contractual obligation opens an entire research field that goes beyond the scope of the present study, but one persuasive claim that has been promoted over the centuries is that none of the parties of contractual obligation should be "enriched at the other's expense."[2051] We would disagree, however, that

2049. *See* chapter 7.
2050. *See* sec. 1.2.
2051. Gordley, p. 1655. For a comprehensive study on justice and contractual obligations *see* Arnold, p. 1 et seq.

we can use the principle of inter-nation equity in order to justify a certain income allocation key. This conclusion is not yet sufficiently reasoned and requires a more detailed analysis, which is found in the following section.

11.3.2.3. Some further thoughts on income allocation and inter-nation equity

As we have seen above,[2052] the principle of inter-nation equity is an elusive principle that has been referenced in many forms. We have already discussed the underlying justification of the inter-nation equity principle and have seen that inter-nation equity should be understood in a narrower manner requiring, inter alia, commutative justice within inter-state relations. In this form, it has a normative value. Nevertheless, in the following, we will discuss some of the allocation keys proposed among scholars by referring to the principle of inter-nation equity in order to better outline our position and its departure from existing interpretations of the term "inter-nation equity". There are two main opinions to which we will refer.

The first position is that due to the principle of inter-nation equity, the exact same allocation key should be applied for all states worldwide, be it, for instance, the arm's length principle or the same formula in a formulary apportionment system, as this would reflect equity among states. To be more precise, the allocation key should not have any relation to the economic stance of a country or any other country's specific criteria, such as the well-being of its inhabitants or the GDP per capita. In this sense, the term "inter-nation equality" is also suitable. The second position by Musgrave and Musgrave is that the principle of inter-nation equity requires a distributive element. This means an allocation system that is, for instance, linked to the income per capita in different states. Therefore, the allocation key would not be the same regarding all states, but would deviate depending on specific characteristics of the involved states. We will start with an analysis of the first position, i.e. the claim for a uniform allocation key that is detached from any country-specific characteristics.

As mentioned, the underlying justification is sometimes made by analogy, as individuals should be treated equally within a society and, therefore, states should be treated equally within the society of states. We would deny, however, that such a link between inter-individual equality and inter-nation equality requires that the allocation of income follow identical terms. This

2052. *See* sec. 11.3.1.

means the argument is weak that inter-nation equity necessarily requires that all states apply the same allocation key, such as the arm's length principle or a formulary system with the same formula, detached from any country-specific characteristics. There is no valid argument to render such an analogy, i.e. from inter-individual equality to inter-state equality. Two arguments seem sufficient to support such a conclusion:

– In a domestic society, there is nothing like an equal or equitable distribution of income comparable to the allocation of income following the same allocation key detached from any country-specific characteristics at an international level. Therefore the analogy argument is invalid, as an analogy requires comparability of the underlying fact pattern. No government system treats individuals equitably in the sense of equal distribution of income comparable to the suggested allocation of income among states applying the same allocation key.

– Even if one considers that domestic inter-individual equity can be a guiding principle for inter-state equity, it would lead to a different result than proposed. One could argue that if we indeed want to draw the analogy between inter-individual situations within a state and inter-nation equity within the society of states, it would mean that the states with a higher (financial) ability should carry more of the worldwide burden. Or vice versa, that the states with a higher ability-to-pay should receive relatively less of the income pie.

Therefore, we deny that there is indeed a normative claim to treat all states equally in the sense that the income should be allocated following the same allocation key, which is detached from any specific characteristics of a state. The argument that the equal treatment of states is valid is closely related to questions regarding the usefulness of contractualism as a methodology to derive the necessary principles of international law. Rawls would argue that inter-individual equity in a society is achieved if it follows, inter alia, the difference principle. This means, as shown above,[2053] inter alia, that inequalities are justified if they are to the advantage of the worst off in a society. However, Rawls would not apply such a principle for an inter-state relation, as he emphasizes the importance of the principles of sovereignty and independence resulting from the second negotiation process among the representatives of states in the original position. This means that Rawls would also deny the potential analogy of inter-individual equity and inter-state equity, and he would disagree that justice requires, at an international

2053. *See* sec. 6.2.3.

level, that sharing the tax pie should follow the same allocation key for all states, notwithstanding the specific characteristics of states. This is also in line with our understanding of the normative value of the principles of sovereignty and fiscal self-determination as following a right institutional, but continuous approach.[2054]

The second mentioned position of Musgrave and Musgrave, who advocate based on the principle of inter-nation equity, that income allocation should consider the economic strength of the involved states, is closely linked to left institutionalism, as proposed by Pogge and Beitz.[2055] This means that it would be required to implement an international tax regime that would follow an allocation key considering, for instance, the financial or health condition of a state or its inhabitants, as there is a distributive duty even in cross-border situations. However, even if one agrees that there is a cross-border distributive duty comparable to a cosmopolitan understanding of Rawls' domestic difference principle, which we explicitly deny,[2056] the term "inter-nation equity" is misleading to describe such a duty among individuals worldwide. Following a cosmopolitan understanding, such cross-border distributive duties are not derived because there is equity between states (i.e. inter-nation equity), but rather because it was hypothecated that in a global social contract negotiation, individuals (and not state representatives) would agree on a difference principle that would require distributive payments from the rich to the poor countries, or to be more precise, distributive payments from rich to poor individuals around the globe.[2057] This means that the term "inter-nation equity" does not suit the need to describe the second position by Musgrave and Musgrave, which follows a more cosmopolitan understanding of distributive duties among individuals.[2058]

Even if one agrees that the principle of inter-nation equity is valid and requires an international tax system with a distributive impact, we would oppose the approach that GDP per capita should be decisive, as suggested by Musgrave and Musgrave. As we will demonstrate below, and as was already indicated with references to Infanti and Brooks, there are more accurate systems to measure poverty at a global level.[2059]

2054. *See* sec. 8.3.2.
2055. *See generally* Avi-Yonah, 2000, p. 1650.
2056. *See* sec. 8.3.
2057. *See* sec. 7.5.
2058. It is questionable whether the position of Musgrave and Musgrave is indeed cosmopolitan, as their focus is on national gain and losses and not – as cosmopolitanism would require – gain and losses of individuals.
2059. *See* sec. 11.4.3.2.2.

11.3.3. Intermediate conclusion

These remarks have demonstrated that there should be justice among states, or inter-state justice, but in the Aristotelian form of commutative justice. This, for instance, requires that contractual relations are well balanced and in general reciprocal. These justice considerations are necessary following a principle that could indeed be called "inter-nation equity". Therefore, there might indeed be a normative claim for an international tax regime that considers the principle of inter-nation equity, if it is understood in such a narrow manner. However, we have developed a more distinct position with respect to the use of the principle of inter-nation equity as an allocation of income guidance.

First, we have clearly opposed the position that, as a consequence of the principle of inter-nation equity, the allocation of income must follow the same allocation key for all states. Secondly, we also outlined that the claim of distributive structuring of the international tax regime, as already suggested by Musgrave and Musgrave, by referring to the principle of inter-nation equity, is or could be based on a cosmopolitan understanding of global justice. The discussion triggered by Musgrave and Musgrave about potential distributive duties under the cloak of the term "inter-nation equity" or under any other title is essential and currently under-developed in international tax law. However, the term "inter-nation equity" seems unpersuasive for such purposes, as the philosophical debate about cross-border distributive duties is not triggered by equity considerations among states, but among individuals at a global level.

Therefore, to sum up, we do not see a need for inter-nation equity to be a guiding principle when redesigning the allocation system within the international tax regime. Its application might be limited to evaluating whether the (contractual) relationship between two or more states follows fair terms or whether the relation between two states, in general, is just.

11.4. Principle 3: Efficiency and neutrality

11.4.1. Efficiency and neutrality – An overview

The terms "efficiency" and "neutrality" are intertwined, as it is argued that to achieve an efficient tax system, the tax system should be neutral, and vice

versa, that a neutral tax system leads to an efficient tax system.[2060] In the following, we will refer to both terms.[2061] As the following sections will show, the principles of efficiency and neutrality have long been used as axiomatic principles to steer international tax policy. However, as we will demonstrate in detail, these principles have limited validity as normative guidelines at an international level. This is a core deviation from more traditional studies on international tax law that claimed that international tax policy should aim at achieving a perfectly neutral or efficient international tax regime. Again, a detailed and comprehensive review is necessary to support our position.

The aim of the present section, however, is not to develop our own ideas for achieving a perfectly efficient and neutral tax system. We prefer to leave the latter task to economists. Economists have played an important role in international tax law, and terms such as "efficiency" and "neutrality" have been intensively discussed. The terms have been used to steer domestic tax policy,[2062] but these concepts have also been crucial when designing the current international tax regime, relying on the allocation of income according to the OECD MC and the UN MC. It is not a coincidence that some of the most influential tax (law) scholars of the 21st century have an economics background.[2063]

The concept of efficiency relates to the underlying assumption that a tax system is efficient (or even optimal)[2064] if it does not distort the allocation of production factors.[2065] A neutral tax system seems wishful, as a tax system should not influence the market and a tax neutral system at an international level should achieve distortion-free trade among states to achieve or increase growth. In a perfectly efficient world, distortions would be avoided by not levying taxes at all. And distortions could at least be mitigated by an international tax base and tax rate harmonization.[2066] In other words, considering the practical constraints to achieving a presumably distortion-free system, tax neutrality at least requires that the distortive impact of taxes is as low as

2060. *See* Picciotto, 1992, p. 82.
2061. For the present study, we will not deal further with optimality such as productive Pareto optimality or general Pareto optimality (for a more distinctive analysis in this respect *see* Dietsch, 2015, p. 136 et seq.). We are more concerned with the underlying justification for efficiency.
2062. *See*, for example, Matteotti, 2007, p. 59 et seq.
2063. *See*, in particular, the work of Bruins et al. during the negotiations at the League of Nations, sec. 4.2.3.2.2.
2064. The question of whether production efficiency is indeed optimal is disputed among economists (*see* Devereux, p. 702 et seq., with further references).
2065. *See*, for example, Li, 2002, p. 828; Vogel, 1988b, p. 310.
2066. This, however, would not mean that an investment decision could be rendered distortion-free, as many other aspects are considered when analyzing an investment decision.

possible.[2067] The question of efficiency within a legal regime is not particularly related to international law or international tax law, but has been intensively discussed under the title of *Economics in Law* or *Law and Economics*.[2068]

Various studies have been rendered to demonstrate the interaction between taxation and economic distortions. Many scholars have further defined the available neutrality concepts, such as capital import neutrality (CIN), capital export neutrality (CEN) or capital ownership neutrality (CON). With respect to the question of how tax neutrality can be achieved, the spectrum of opinions is broad.[2069] Some of the main positions for how to achieve neutrality will be outlined in the following section.

It is sometimes even argued that there is a need to use "economic concepts", as the "legal concepts", such as the benefit theory and/or the ability-to-pay principle, are too vague and do not provide for any further guidance. Or, as held by Schön:

> The vague and unpromising results which are brought forward by the application of the ability-to-pay principle and the benefit principle to international tax allocation seem to give rise to a pure efficiency analysis, which tries to allocate taxation rights in a way that promotes either overall efficiency or at least national efficiency from a strictly economic point of view.[2070]

Such a statement is only partly true. As we argued in detail above, it is indeed accurate that there are few legal limitations available that would help to design a just international tax regime;[2071] nevertheless, this does not require reference to a pure efficiency analysis, but does require that we deal with the fundamental values derived from political philosophy, as intended in the present study and in the present section.

11.4.2. The never-ending fight for tax neutrality

It seems that neutrality and efficiency as international tax policy guidelines generally receive broad support from scholars, and the question of neutrality has also played an important role in the various recent policy developments

2067. *See*, for example. Graetz, p. 285; Kemmeren, 2006, p. 438; Lehner, in: Vogel & Lehner, Grundlagen para. 24 et seq.; Li, 2002, p. 828; Schön, 2009, p. 78.
2068. For further details *see* Senn, p. 170 et seq.
2069. For more details *see* Herman, p. 102 et seq.; Hines, p. 269 et seq.; Kemmeren, 2001, p. 61 et seq.; Schön, 2009, p. 78 et seq.; Smit, 2012a, p. 76 et seq.; Vogel & Rust, in: Reimer & Rust, Introduction para. 16.
2070. Schön, 2009, p. 78. *See also* Herman, p. 123 et seq.
2071. *See supra* under the heading "The International Tax Regime – Scope of Research".

at the level of the OECD/G20.[2072] The present section refers to the most important concepts of neutrality in international tax law.

First, it was argued that exclusive residence taxation is best to avoid detrimental tax distortions (i.e. CEN).[2073] This would mean that the state of residence would treat the income from an investment indifferently, whether it stems from Country A or B, or whether it is sourced in the home (i.e. resident) country of the investor. Therefore, theoretically, the investment decision (i.e. country of investment) is not distorted by tax considerations, as the tax burden is the same whether an enterprise invests domestically or abroad. In an ideal application of the CEN principle, source taxation as such would not exist. The abolition of source taxes is also one of the main arguments against CEN, as it would lead to taxation that is not in line with the benefit principle[2074] and, therefore, one could even consider such a tax system to be unfair.[2075] Furthermore, it would trigger detrimental tax-planning opportunities, as residence as such can easily (and even artificially) be shifted to a low-tax jurisdiction.[2076]

Another contrary position argues that exclusive source taxation would lead to the least distortions in the source country (i.e. CIN). This means that an investor in a certain jurisdiction would be treated indifferently, whether or not he is resident abroad. Consequently, the resident state would, for instance, exempt the income generated in a foreign PE. Or, as highlighted by Vogel:

> [A] taxpayer who conducts an enterprise in another country – or market – and thus utilizes the other country's facilities (public goods) can be sure of being taxed no more than anyone else who, under the same circumstances, uses these facilities to the same extent.[2077]

The exact definition of CIN, however, is disputed.[2078] An important argument against CIN from Schön's perspective is that it no longer reflects

2072. E.g. OECD/G20, Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report (OECD 2015), para. 6 et seq.
2073. *See* on CEN and CIN, for example, Avi-Yonah, 2016, p. 118 et seq.; Ault, 1992, p. 572 et seq.; Devereux, p. 701; Devereux & de la Feria, p. 6 et seq.; Graetz, p. 270 et seq.; Kleinbard, 2011, p. 101 et seq.; Knoll, p. 99 et seq.; Smit, 2012a, p. 80 et seq.; Steichen, p. 70 et seq.; Vogel, 1988b, p. 311 et seq.; with reference to both Richard and Peggy Musgrave, Vogel, 1997, p. 273. From a German perspective, *see* Seer, § 1 para. 98.
2074. De Wilde, 2010, p. 295.
2075. For more details on the benefit principle and fairness, *see* sec. 11.6.2.
2076. Schön, 2009, p. 80; Smit, 2012a, p. 90.
2077. Vogel, 1988b, p. 314. *See* in this respect Smit, 2012a, p. 86 et seq.
2078. *See generally* Knoll, p. 107 et seq.

reality, as in a globalized world market, state and territory are no longer a unity.[2079] Moreover, as argued, inter alia, by de Wilde, CIN does not consider the ability-to-pay principle.[2080] Other authors have brought forward similar claims. For instance, Smit argues that, "income should be taxed only in the state where that income has been generated."[2081] Furthermore, Schön holds that: "[f]rom an economic point of view, capital import neutrality looks rather weak, while capital export neutrality is still strong – yet it does not answer the question of whether to allocate taxing rights primarily to the residence or to the source country."[2082]

Lastly, CON requires that the allocation of assets is solely driven by non-tax reasons. This means, in simplified terms, that the investment decision should depend on the amount of (pre-tax) return that an investor can extract from an asset.[2083] Against CON, scholars argue that it does not consider that the goods produced in one country are often not sold in the same country, so distortions might still occur.[2084]

One way of resolving such a Gordian knot would be to try to align the three neutrality concepts, but this seems to be an impossible task.[2085] For the purpose of the present study, we would agree with Fleming, Peroni and Shay[2086] by stating that the dispute seems to be unresolved and never-ending, in the sense that all three concepts have deficiencies (and advantages). Moreover, these concepts are partly based on assumptions that do not exist in the current world. What is and what should be more essential (not only for the purposes of the present study) is that scholars or governmental bodies answer the question of whether efficiency has a normative value in the sense that international tax policy should indeed be guided by efficiency. This is in line with the methodology of the present study, as we must use

2079. Schön, 2009, p. 81.
2080. De Wilde, 2010, p. 294 et seq.
2081. Smit, 2012a, p. 100.
2082. Schön, 2010b, p. 259.
2083. *See* Schön, 2009, p. 71. The CON term was used by, inter alia, Desai & Hines, p. 487 et seq., and Devereux, even though their understanding is not identical (*see* for further references, Devereux, p. 703 et seq.). On CON, *see also* Kleinbard, 2011, p. 105 et seq.
2084. With reference to Devereux, *see* Smit, 2012a, p. 91.
2085. For a potential compatibility of CIN with CEN, *see* Knoll, p. 99 et seq., and Shaheen, p. 203 et seq., arguing that in a world with different tax rates, CEN and CIN cannot be satisfied at the same time. *See* Kleinbard, 2011, p. 105, with reference to Altshuler.
2086. Fleming, Peroni & Shay, 2008, p. 41 et seq. *See also* Gratz & O'Hear, p. 1022 and Knoll, p. 99 et seq., who provides an in-depth analysis of whether there is indeed a conflict between CIN and CEN.

the instruments of reasoning and impartiality[2087] to analyze whether a policy goal or the result of a policy goal is indeed just. This is the aim of the following normative review.

11.4.3. Normative review

11.4.3.1. Preliminary remarks

Following economic thoughts, tax neutrality, as already mentioned, leads to a more efficient or even an optimal allocation of production forces and is, therefore, desirable.[2088] Prima facie, a neutral tax system does not, however, answer the question of what a just allocation of income among jurisdictions would be.[2089] In order to answer the question of a just allocation, reference to normative theory seems necessary. In this sense, Singer stated in more general terms:

> Law professors and judges generally recognize the benefits of economic theory in choosing and justifying legal rules. What they do not sufficiently appreciate are the benefits of using the insights of moral and political theory to address the issues that economists set aside.[2090]

Singer, moreover, held that, "while economic analysis works from a given baseline – usually the status quo – and then asks whether changing that baseline improves things overall, moral and political theorists focus on defining an acceptable baseline."[2091]

As already mentioned,[2092] many authors have dealt with neutrality and international tax law, but only a few who have used such a principle have explicitly mentioned an underlying justification for a neutral international tax system. In other words, it is sometimes taken for granted that the international tax regime ought to be neutral, or at least as efficient as possible. The same holds true for governmental publications, in this respect.[2093] In the following, we will challenge some of the existing positions. To do so, it

2087. *See* sec. 8.2.
2088. *See*, for example, de Wilde, 2015, p. 438 et seq.; Smit, 2012a, p. 88. *See also* Li, 2002, p. 828.
2089. *See* Peters, 2014, p. 86 et seq., with further references.
2090. Singer, 2009, p. 935.
2091. Id., p. 936.
2092. *See* sec. 11.4.2.
2093. From a US perspective, *see* Graetz, p. 270.

is crucial to first visualize the actual underlying reasons that are referred to when arguing in favor of a neutral international tax regime.

11.4.3.2. Worldwide welfare as the underlying reason for neutrality?

11.4.3.2.1. *Setting the framework*

Most authors who provide a reason for claiming neutrality refer to worldwide prosperity or worldwide welfare as the underlying justification.[2094] Of course, this reflects the general goal of optimal tax theory, i.e. welfare maximization. A second, smaller group refers to the principle of equality to justify neutrality.[2095] These two positions will be distinguished in the following sections. A third group of tax scholars – such as Graetz[2096] or Peters[2097] – have already questioned the normative value of neutrality as a guiding principle for international tax policy.[2098]

As mentioned, most authors refer to the goal of worldwide welfare or worldwide prosperity when discussing the need for a neutral tax system. We will explicitly cite some statements in this respect to better understand the actual claim for neutrality. To begin with, Shaviro, with references to CEN, states the following:

> Where applicable, CEN maximizes worldwide welfare, without regard to how the world's wealth is split between nations, by inducing choice of investments with the highest pre-tax return. It abstracts from the question of whether a given dollar of tax revenue goes to the U.S. government or some foreign government – an issue obviously relevant to U.S. welfare, even if more or less a wash from the standpoint of worldwide welfare.[2099]

A similar line of argument is brought forward by Smit, but limited to the internal market within the EU:

> As was established earlier, freedom of investment, as an element in international economic integration between the Union and the respective non-EU Member

2094. *See*, for example, Herman, p. 124 et seq. Other authors – with no reference to the neutrality principle – emphasize that the international tax system "should be conducive to global welfare and global trade" (Postma & Schwarz, p. 792).
2095. *See* sec. 11.4.3.3.
2096. Graetz, p. 282 et seq.
2097. Peters, 2014, pp. 106 et seq. and 364 et seq.
2098. *See* sec. 11.4.4.
2099. Shaviro, 2007, p. 2.

> States is perceived to contribute to an optimal allocation of productive resources in the countries concerned through the operation of market forces, ultimately resulting in global economic growth and an increase of global welfare.[2100]

In a like manner, Musgrave also states that:

> International efficiency requires that tax systems of trading nations not interfere with the free flow of trade and capital so that resources are universally allocated where they will be the most productive, carry the highest rates of return, and thereby maximize world welfare.[2101]

Kemmeren also seems to argue for a normative basis of worldwide tax neutrality. At least, the following statement indicates such a conclusion:

> The efficiency of the world economy should be maximized by allocating the production factors to the location where "they" earn the highest return.[footnote omitted] This will enhance worldwide prosperity,[footnote omitted] although it depends, of course, on more than the efficient creation of income, e.g., on the distribution of the income earned.[2102]

Therefore Kemmeren assumes that an international tax system should be neutral because it increases worldwide welfare. But it is essential to highlight that in the last part of the quoted sentence, he mentions a certain caveat to such a statement, according to which the prosperity depends "on more" than just efficiency.[2103] As a consequence, he seems to argue that the ultimate goal of international policy (at least tax policy) is to achieve worldwide prosperity or worldwide welfare through efficiency, at the same time considering "other" aspects, such as income distribution, for example.

In conclusion, the line of arguments in favor of neutrality include several assumptions that should be further discussed in the following:

(1) Tax neutrality leads to the most efficient allocation of production factors.

(2) An efficient allocation of production factors leads to worldwide prosperity or worldwide welfare.

2100. Smit, 2012a, p. 88.
2101. Musgrave, 2001, p. 111.
2102. Kemmeren, 2006, p. 438 et seq. *See also* Kemmeren, 2001, pp. 71 et seq. and 113.
2103. He makes a similar caveat within his PhD thesis: "Complete neutrality may not be possible, but, from an efficiency perspective, neutrality at a highest possible level should be pursued. Other values, like equity, may justify a deviation from this rule" (Kemmeren, 2001, p. 113).

(3) The ultimate goal of the international tax regime should be to achieve worldwide prosperity or worldwide welfare.

These statements trigger various remarks.

Concerning the first assumption, it goes beyond the scope of the present study to question or confirm in detail the impact of tax neutrality on the allocation of production factors and potential distortions triggered by non-neutrality. This is a task for economists. However, since we will disagree with the second assumption in the following, an in-depth analysis of the first assumption is obsolete, as the second assumption is a *conditio sine qua non* for the conclusion that we should aim at achieving a neutral international tax regime in order to increase welfare.

Regarding the second assumption, we mentioned several authors who refer to "worldwide prosperity" or "worldwide welfare" as an argument for a neutral tax system. In this respect, it is prima facie unclear what, inter alia, Kemmeren, Smit, Musgrave and Shaviro mean by referring to the terms "worldwide prosperity", "worldwide welfare" or even "global welfare" as such. Does it mean maximizing the worldwide GDP? Does it mean decreasing worldwide poverty? Does it mean achieving worldwide peace? Does it mean achieving a world that better aligns with the capabilities approach of Nussbaum and Sen?[2104]

Regarding the third assumption, whether the sole goal of international tax policy should be to increase welfare, the answer again depends on how the term "welfare" is understood. As we will demonstrate in the following, we could support such an ultimate goal of international tax policy if the term "welfare" were understood in a broad manner, not only considering an increase in GDP, but also considering other elements, such as decreasing inequalities, protection of human rights and the environment. Understood in such a broad manner, the term "worldwide welfare", however, overlaps partly with the term "justice". This will be discussed further in the following sections.

To do so, and discuss some of the above ambiguities in a concise manner, we will develop three lines of arguments as to why the international tax regime should not necessarily be neutral to achieve worldwide prosperity or worldwide welfare, and we will show why a neutral international tax system does not necessarily lead to an increase of worldwide prosperity and why

2104. *See* sec. 7.7.6.

neutrality is not required to achieve a just international tax regime. First, we will demonstrate the impact of domestic policy on welfare, which can hardly be influenced in a positive manner by global neutrality. Second, we will demonstrate the utilitarian bias in the existing discussion about the increase of worldwide welfare through tax neutrality. Third, we will outline the missing distributive aspect in the current debate on worldwide welfare and neutrality.

11.4.3.2.2. *Welfare impact of domestic policy*

If we assume that the term "worldwide welfare" means "global growth" in the sense of worldwide economic growth (i.e. growth of the global GDP), there might be valid reasons from a theoretical perspective that an open market requiring a neutral tax system increases the aggregated global growth of the GDP.[2105] If we understand "worldwide welfare" in the sense that it will also decrease poverty in general or enhance capabilities, following Nussbaum and Sen,[2106] there is no empirical evidence that free markets among states with no distortion decrease poverty. Or, in the words of Singer:

> With so many different ways of assessing inequality, and so many different findings, what is the ordinary citizen to think? No evidence that I have found enables me to form a clear view about the overall impact of economic globalization on the poor.[2107]

Deaton has shown that "economic growth is the engine of the escape from poverty and material deprivation."[2108] However, according to him, "there is nothing in logic that guarantees an automatic link between growth and reductions in global poverty",[2109] and "because much of the world's population was left behind, the world is immeasurable more unequal than it was three hundred years ago."[2110] However, if we look at the number of poor people in the world, we have seen a significant decrease in recent decades.[2111] Therefore we could argue that the impressive growth of the global GDP in recent decades triggered such poverty reduction. However, as demonstrated by Deaton, such a decrease was mainly driven by domestic improvements

2105. However, such a claim is disputed even among economists (*see generally* Stiglitz, p. 101).
2106. *See*, on the capabilities approach, sec. 7.7.6.
2107. Singer, 2002, p. 89. Of course, there are many academics who are globalization critics and who challenge the argument that globalization per se leads to a reduction of poverty (*see*, for example, Stiglitz, p. 101 et seq.).
2108. Deaton, p. 327.
2109. Id., p. 41.
2110. Id., p. 23 et seq.
2111. *See* id., p. 45 (figure 6).

in China (and India). Consequently, the reduction in poverty is linked, inter alia, to the domestic policy achievements of China (and India) and not solely based on the impact of global growth or free markets.[2112]

Therefore, global growth as such might have a positive impact on the well-being and welfare of the inhabitants of a country, but it is domestic policy that is decisive for the successful welfare increase from an individual's perspective. An enhancement of domestic welfare does not, therefore, develop through global policy, but mainly through domestic policy.[2113] The claim that a neutral international system leads to an increase in welfare (i) is weak, as it ignores the impact of domestic policy, which can hardly be influenced through global neutrality, and (ii) global neutrality could even be detrimental if policymakers aiming at neutrality ignore that certain global policies might lower the chances of successful domestic policy. For instance, if someone claims that we should abolish source taxes because this increases neutrality (through CEN),[2114] such a claim might even have the harsh effect that capital-importing countries are no longer able to implement successful domestic policies, leading to a decrease in domestic welfare, since they would not have access to sufficient tax revenues.

Another element that is sometimes neglected is the interaction of global growth, inequalities and worldwide welfare. In the following, we will briefly outline the current state of research regarding the interaction of global growth and inequalities to provide a broad analysis on whether the international tax regime should indeed be neutral to increase worldwide welfare. Inequalities are from our perspective a danger for both international and domestic welfare. The World Economic Forum highlighted in its Global Risk Report 2017 that inequalities are a major global risk for (implicitly) worldwide welfare. The report, for instance, states the following:

> The combination of economic inequality and political polarization threatens to amplify global risks, fraying the social solidarity on which the legitimacy of our economic and political systems rests.[2115]

2112. For more details *see* id, p. 41 et seq. It is, therefore, not a surprise that the work of the UN concerning financing for development is as well focusing on improving domestic resource mobilization compared to more traditional cross-border aid payments (*see* sec. 4.3.4.3.4.).
2113. *See* Deaton, p. 312 et seq. Global policy might, however, have both a positive and a negative impact. The latter is often highlighted regarding the negative impact of global trade policy on developing states. *See* the remarks of Pogge in sec. 7.5.2.
2114. *See* sec. 11.2.2.
2115. World Economic Forum, The Global Risk Report 2017, p. 13, published at https://www.weforum.org/reports (last visited 10 Feb. 2019).

Global growth might have a detrimental impact on worldwide equality and inter-state equality and, therefore, on the welfare of others. This will briefly be discussed in the following, and as a starting point, reference is again made to the seminal work of Deaton.[2116] Deaton's work is not only highly interesting regarding the interaction of poverty and domestic policy, but also regarding the interaction of global growth and global inequalities. Of particular importance are his remarks on the interaction between "within-country inequality" and "world inequality", which indicate that we cannot argue that global inequality has increased in recent decades as within-country inequality has increased:

> What about the contribution of within-country inequality to world inequality? It is important – particularly at the very top of the world income distribution – but not decisive for the vast majority of people, if only because most inequality in the world comes from differences between countries, not from differences within them. So we are back to the giants – particularly China and India – and how fast they are growing relative to the rest of the world. Growth that is faster – enough – even with expanding internal inequality, particularly in China – should sweep everything before it, and the world as a whole should become more equal, at least as long as China remains poorer than average. Careful estimates, putting all the evidence together, suggest that this is in fact the case and that, in spite of countries pulling apart, and in spite of the growth in internal inequality, global inequality is stable or slowly falling. That may well be correct, though I am not convinced that we know for sure.[2117]

In a similar manner, it is argued by Atkinson that inequality in rich countries is increasing, whereas inequality between countries is decreasing, or in his words:

> [The] simple story of global inequality over the last hundred years is that there was first a period when inequality within rich countries was falling but inequality between countries was widening, now replaced by a period when inequality within rich countries is rising but inequality between countries is narrowing.[2118]

Moreover, the empirical studies of Roser also demonstrate in a persuasive manner that global inequality has decreased in the last three decades, but global inequality is still significant.[2119] For instance, as Oxfam recently held

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2116. It would go beyond the present study to fully explore the existing empirical studies about global inequalities. Several authors have developed seminal studies in this respect, to which we have already referred. *See* Atkinson, p. 1 et seq.; Deaton, p. 1 et seq.; Piketty, p. 1 et seq.

2117. Deaton, p. 262.

2118. Atkinson, p. 42.

2119. *See* Roser Max, Global economic inequality, published at https://ourworldindata.org/global-economic-inequality (last visited 10 Feb. 2019). His work is also referred to

in a rather popular manner, "[e]ight men now own the same amount of wealth as the poorest half of the world".[2120] Therefore, recent decades that have seen a significant growth of global GDP seem also to have led to a certain decrease of inequality at a global level, but at the same time, it has led to higher inequalities in domestic circumstances. It is, therefore, difficult to draw a precise line of argumentation as to whether global efficiency and global growth are reducing or increasing inequalities. Inequalities, however, trigger substantial international risks for worldwide welfare, as outlined in the abovementioned World Risk Report of the World Economic Forum or as outlined, for instance, by Stiglitz.[2121]

For the moment, we will not dig further into the question of the impact of free trade on global welfare and global inequalities, but it seems important to highlight that scholars are far from a consensus on the positive impact of global (free and unlimited) trade with no distortion through tax law or custom.[2122] There is no uniform opinion as to why a country has become rich or poor, and even more fundamentally, how to measure poverty and human development.[2123] Global growth might have decreased poverty in absolute numbers, but global growth might also have triggered enhanced domestic inequalities. Furthermore, globalization through the abolishment of tariffs and cross-border double taxation might also hinder a decrease of domestic inequalities due to competitive disadvantages.[2124]

In conclusion, the second assumption, that global growth leads to an increase of worldwide welfare is not necessarily evident if the term "worldwide welfare" is not only linked to the growth of global GDP, but also considers poverty, inequalities and further elements, such as the protection of human rights or environmental protection. The latter two elements are beyond the scope of the present study, but they should also influence the decision of whether international tax policy should aim at global growth through a

by the World Economic Forum, The Global Risks Report 2017, p. 11, published at https://www.weforum.org/reports (last visited 10 Feb. 2019).

2120. Oxfam, An Economy for the 99%, Jan. 2017, p. 2, available at https://www.oxfam.org/en/research/economy-99 (last visited 10 Feb. 2019).

2121. Stiglitz, p. 1 et seq.

2122. *See*, for example, the many studies of Deaton on measuring poverty and its relation to growth (e.g. Deaton, p. 1 et seq.). *See also* Stiglitz, p. 1 et seq. From a tax perspective *see* Dietsch, 2015, p. 111 et seq.; Infanti, p. 236 et seq. *See generally* Risse, p. 84 et seq.

2123. *See* the many references stated by Risse, p. 85. From an international tax perspective *see* Infanti, p. 209 et seq.

2124. On the topic of whether globalization is indeed limiting state action to reduce domestic inequality *see* Atkinson, p. 263 et seq.

neutral international tax regime.[2125] This entire debate is linked to the fundamental tension between justice and efficiency considerations, which we will describe, in a more abstract manner, in the following section regarding what we call the utilitarian bias of traditional welfare economics.

11.4.3.2.3. *Traditional welfare economics and utilitarian bias*

It is our understanding that a claim for an increase of global growth linked to a claim for a perfectly efficient international tax regime at least partly follows a utilitarian approach;[2126] however, the supporters of global growth through neutrality or global efficiency often do not discuss whether utilitarian ideas should even be significant at an international level.

This is something that is not only of concern regarding international tax law, but also might be a weakness of traditional welfare economics aiming at increasing the overall available utilities or later aiming at a Pareto optimal situation.[2127] It is our understanding that an increase of the available goods (or utilities) at an international level does not necessarily increase justice and welfare in the international realm. In this regard, the traditional wisdom of welfare economics aiming at an increase of the overall utilities in a system is not persuasive at an international level.[2128] Moreover, aiming at a Pareto optimal international tax regime is not helpful as there are too many alternatives available and too many rankings of values involved so a Pareto analysis will not lead to any persuasive conclusions.[2129]

2125. *See*, for example, Dietsch, 2015, p. 111 et seq. On the detrimental impact of globalization on equality *see*, for example, Stiglitz, p. 89 et seq.
2126. Although a very simplified utilitarian understanding, as will be shown in the following and, in particular, *see infra* n. 2138.
2127. Welfare economics is a normative discipline, as it aims to demonstrate "what is good and what is bad" (Feldman & Serrano, p. 1). However, it is sometimes surprising how overhasty welfare economists disagree with normative theories, such as the one of Rawls, and tend to use "the more fundamental Pareto criterion" (id., p. 224) for their methodological approach. An important failure of welfare economics was indeed that the necessary definition of welfare has been non-existent until recently (Baujard, p. 15). Of course, if one includes certain fairness elements as utilities to be considered for welfare maximizations, the delimitation between moral theory and welfare economics becomes blurred.
2128. But *see* Keen & Wildasin, p. 259 et seq.
2129. It would go beyond the present study to provide for a detailed analysis of whether Pareto efficiency is indeed a persuasive guideline both for domestic and international tax policy. For a general critic *see*, for example, Sen, 1970, p. 152 et seq.

Welfare economics as a branch of economics has developed, however, in recent decades into a more versatile discipline,[2130] detaching from its utilitarian origins.[2131] Of course, one of the most important opponents of utilitarian ideas in global economic theory was Sen.[2132] Other welfare economists also applied theories that more often consider fairness and equity, rather than solely considering the available utilities. This leads Baujard to the conclusion that "it seems now generally accepted that GDP is a questionable goal, and the definition of welfare becomes a topic of discussion."[2133] Or, for instance, Atkinson – one of the leading welfare economists of our time – argues that "a smaller cake more fairly distributed may be preferable to a larger one with present levels of inequality."[2134]

As was shown by Dietsch, the difficulty with efficiency arguments in general is that their supporters refer to different underlying values and these underlying values might not be disclosed.[2135] The mentioned tax scholars referring to worldwide welfare to justify neutrality seem to at least implicitly still follow a utilitarian bias.[2136] Utilitarianism, in this respect, means that a neutral international tax system in the sense of a distortion-free tax system would increase the global GDP, and consequently the overall available utilities and thus worldwide welfare.[2137] Not only the fact that more

2130. Sen, 2009, p. 272 et seq., with further references. *See also* Kaplow & Shavell, 2001, p. 977 et seq.
2131. Baujard, p. 2 et seq., with further references. *See also* Sen, 1979, p. 463 et seq. Already Pareto departed from a utilitarian moral philosophy as he was not aiming at maximizing the available utilities at any price but argued that a goal is desirable if "everyone can be made better off, or at least some are made better off, while no one is made worse off" (Leschke, p. 59).
2132. E.g. Sen, 2009, p. 1 et seq.
2133. Baujard, p. 16. *See*, as an example, the recommendation of Piketty, p. 479 et seq., who focuses on "rights".
2134. Atkinson, p. 243.
2135. Dietsch, 2015, p. 136. *See also* id., p. 219 et seq.: "Economic analysis of the efficiency of tax competition have neither made explicit the normative foundations of their analysis nor specified how the value of efficiency relates to other normative dimensions of tax competition such as self-determination or distributive justice."
2136. *See* sec. 11.4.3.2.1.
2137. Of course, we refer to a very simplified utilitarian position. Utilitarianism even from its beginning did not understand utilities as mere available GDP but applied a much broader understanding of utilities (e.g. Mill, 2016, p. 20 et seq.). On p. 192 Mill states, for instance, that "[j]ustice remains the appropriate name for certain social utilities which are vastly more important, and therefore more absolute and imperative, than any others are as a class." Even Adam Smith, as one of the first and most important supporters of global free trade, was not a utilitarian (for a distinct analysis of the moral theory of Smith, *see* Fleischacker, p. 1 et seq.). However, the mentioned tax scholars indeed seem to aim at maximizing the available utilities, i.e. global GDP, and, therefore, the usage of the term "utilitarian bias" seems justified.

recent welfare economists disagree with such a line of argumentation, but also the fact that Rawls, who in detail denies the application of utilitarianism within a society, did not even deal with utilitarianism at an international level, shows the weakness of using utilitarian ideas as global policy guidelines. Rawls simply denied the application of it by arguing:

> [A] classical, or average, utilitarian principle would not be accepted by peoples, since no people organized by its government is prepared to count, as a first principle, the benefits for another people as outweighing the hardships imposed on itself.[2138]

Also, Nussbaum, for instance, stated that it is critical to question the idea of mutual advantage as the goal of social cooperation.[2139] This is particularly true from an international tax perspective, as the goal of tax cooperation in the past has at least formally been mutual advantageous, which seems to have led to an unjust regime. Taking this into consideration, the position that we should aim at global growth of GDP is weak, as it is not particularly in the interest of the worst off on this planet to simply increase growth without considering, for instance, inequalities or poverty. Moreover, a claim for unlimited growth at an international level ignores the existence of a world order consisting of several sovereign states with no or very limited cross-border distributive mechanisms that could counter-balance a strict utilitarian global policy. The latter will be further discussed in the following section as another argument why an efficient international tax regime does not necessarily lead to a just international tax regime.

11.4.3.2.4. *Missing distributive mechanisms*

We could argue that neutrality as such is only a means to achieve a just system, which would still require distributing income among individuals worldwide.[2140] This would be the case, for instance, regarding the claim for efficiency in a mere domestic system, as a state could achieve a just society through a distributive system, for instance, in line with Rawls' (liberal) principles of justice developed in *A Theory of Justice*. Therefore a state should aim at an efficient legal system as it allows distributing a larger cake among its members.

2138. Rawls, 1999b, p. 40.
2139. Nussbaum, 2004, p. 14.
2140. *See* the statement of Kemmeren, 2006, p. 438 et seq., according to whom we need something more than just efficiency to achieve worldwide welfare.

However, if such a position is taken at an international level, one would first need to develop distributional mechanisms at an international level, or else the entire claim for a neutral tax system is weak. Moreover, one would need to argue why a non-neutral system could not achieve a similar distributive effect at an international level. In other words, it should be reviewed whether we could not also implement an international tax regime leading to distortions that are, however, for the benefit of the poor or that would decrease inequalities and as such increase welfare.

Furthermore, it is obvious that distributive measures are also non-neutral, as they have an impact on the fiscal policy of states (for instance, in a federation). Therefore, to claim neutrality of the international tax regime by simultaneously requiring a distributive mechanism again questions the neutrality argument and, therefore, its normative validity.

11.4.3.3. Equality as a justification for neutrality

Besides worldwide prosperity or worldwide welfare, de Wilde also argues in favor of a neutral international neutral tax regime, but one based on the principle of equality or vice versa. It is not completely clear whether he justifies a neutral system based on equality or whether he justifies an equal system based on neutrality:

> As with equity, I believe that tax neutrality is founded on equality as well. This means that, again, the ability to pay principle and the benefit principle result from that. Each business activity should be taxed in the same manner. As I see it, unequal corporate tax treatment in equal circumstances – inequality – distorts business decisions and, with that, the allocation of production factors.[2141]

Given that, de Wilde seems to suggest that all taxpayers should be treated equally and, therefore, a neutral tax system should be implemented. Compared to the approach above, it is not worldwide welfare, but equality that triggers the need for a neutral system.[2142] However, in another instance, he seems to also argue that a neutral system is required because the productivity of income is the highest if no distortion occurs:

2141. De Wilde, 2010, p. 288.
2142. *See also* Knechtle, p. 20, who argues that neutrality and equality (i.e. justice in his understanding) are conditioned to each other.

> [E]conomic efficiency is based on the presumption that the productivity of income is the highest (and with that also the fairest) when the distribution of production factors takes place on the basis of market mechanism without, or at least with as little as possible, public interference.[2143]

The latter line of argumentation is similar to that of scholars mentioned above.[2144] However, it should further be discussed why equality as such does not require a neutral tax system.

To do so, it is important to understand that de Wilde follows a global equality principle in the sense that all corporate tax payers in this world should be treated equally, because he assumes that this reflects a fair system. He suggests that the implementation of "[u]nlimited corporate tax liability for groups economically present within the respective taxing jurisdiction in conjunction with a 'credit for domestic tax that is attributable to the foreign income' would entail fairness within the corporate tax system of a state."[2145] The question of whether a corporation is economically present in a jurisdiction will basically follow the benefit principle.[2146]

Such a position would likely be challenged by Rawls and other right institutionalists, as they would argue that equality as such is only morally significant within a certain basic structure, but not at an international level.[2147] It is also our understanding that there is no normative claim for the equal treatment of all individuals and presumably all corporations worldwide, at least following our concept of global justice.[2148] Yet even cosmopolitan philosophers or left institutionalists, such as Pogge and Beitz,[2149] would challenge the position of de Wilde, as a neutral tax system built upon the benefit principle, as proposed by de Wilde, leads to inequalities, as the benefits to be obtained in poor countries are rather low. Therefore such an international system would have no (or even a detrimental) distributive effect, i.e. it would be unfair.

Therefore, it seems difficult to justify the approach of de Wilde, as it fits neither into a left nor a right institutional theoretical framework. From our perspective, it reflects a non-consequent application of the equality principle at a global level. If we were indeed of the opinion that all persons should be

2143. De Wilde, 2010, p. 293.
2144. *See* sec. 11.4.3.2.1.
2145. De Wilde, 2011, p. 77.
2146. *See* id., p. 64.
2147. For further details *see* sec. 6.3.
2148. For a detailed overview on our position on the equality principle at an international level *see* sec. 8.3.
2149. *See* sec. 7.5.

treated equally (including corporations),[2150] we might indeed be in favor of a neutral international system, but only to the extent that there is a distributive mechanism at an international level, following a liberal idea of global justice and a global application of Rawls' difference principle.

It is, in conclusion, not persuasive to argue that the principle of equality requires a neutral international tax system.

11.4.4. Intermediate conclusion

Many authors have argued that global tax neutrality would increase worldwide welfare. Schön refers to such first-best option as being full tax harmonization, and therefore an extinction of any distortive effect.[2151] However, he admits that besides the practical constraints regarding the implementation of such, even from a theoretical (economists) perspective, tax competition as such produces some efficiency gains.

We argued in the previous sections, however, that global neutrality (and full tax harmonization) is by no means a first-best solution, as it does not lead to a just international tax regime and does not necessarily increase worldwide welfare. This is a major deviation from traditional positions in international tax law. Graetz already brought up very strong and persuasive arguments as to why the neutrality and efficiency of an international tax system should not be the only drivers of an international tax system:

> Tax policy decisions, including decisions regarding a country's tax treatment of international income, should be, and inevitably are, decided based on a nation's capacity, culture, economics, politics, and history. In democracies, such decisions are determined by the votes of the nation's citizens and their representatives. Taxation without representation is still tyranny.[2152]

Or:

> As with domestic income taxation, a quest for economic efficiency can never be more than a partial explanation for international tax policy decisions. As one economist put it: "Everything is economics, but economics is not everything."[footnote omitted][2153]

2150. *See* above for our specific reservations regarding the application of the equality principle regarding multinational enterprises.
2151. *See* Schön, 2009, p. 78. But *see* his concerns on the issue of equity vs efficiency, id., p. 87.
2152. Graetz, p. 279.
2153. Id., p. 307.

Therefore, Graetz questioned the normative value of CEN and CIN, or in other words, he argues that referring to these principles limits the discussion of an appropriate international tax policy in an inadequate manner.[2154] Recently, Peters, in his highly valuable work, discussed the question of whether a tax neutral system at an international level would improve the legitimacy of international tax law.[2155] He demonstrated in detail that there are no crystal-clear arguments in favor of either CIN or CEN. This means, furthermore, that in a domestic situation, a policy advisor might obviously still refer to either CIN or CEN or neutrality, respectively, efficiency in general as an underlying principle for a domestic tax system.[2156] At an international level, however, a policymaker should be reluctant to refer to either CIN or CEN as a "normative guideline". This is true as long as the application of CIN or CEN has not been the result of a deliberative process in the sense that Peters seeks improvement of the legitimacy of international tax law.[2157] He, therefore, concluded:

> Consequently, international tax neutrality will always be a thorny source of social-scientific knowledge about international taxation. It is an attempt to define an entire universe with the help of a single word.[2158]

It is undeniable that a neutral and efficient tax system has its advantages, as it leads to efficiency gains, which might lead to growth, be it domestically or internationally. Nevertheless, the need to implement such a neutral tax system has been emphasized too much within international tax policy. From a normative perspective, it has been shown that efficiency or neutrality as a claim in the international tax debate traditionally follows a utilitarian way of thinking.[2159] The latter is a philosophical concept that is mainly rejected as a normative concept to achieve justice at an international level. Due to the focus on neutrality, the issues of distribution of income or distributive justice have, however, often been neglected.[2160] Furthermore, the references to the seminal work of Deaton show that global growth might have indeed led to a decrease in poverty, but the decrease has mainly occurred in China (and India); therefore, it might be mainly triggered by domestic policy decisions, and not by international growth through global efficiency and a lowering of trade barriers, such as through the avoidance of cross-border juridical double taxation.

2154. *See*, in this respect, id., p. 275 et seq.
2155. Peters, 2014, pp. 106 et seq. and 355 et seq.
2156. *See also* Dagan, 2013, p. 60.
2157. Peters, 2014, p. 364 et seq.
2158. Id., p. 363.
2159. *See* Singer, 2009, p. 904.
2160. But *see*, for example, Benshalom, p. 74.

This is particularly true if we consider that global growth has led to further inequalities in domestic situations and has caused other regressions, such as environmental damage. Therefore, if the goal is to increase worldwide welfare as part of international tax policy, we should first define what worldwide welfare means and then discuss how to achieve such a welfare assumption. The term "worldwide welfare" does not support the claim that the international tax regime should indeed be neutral. In other words, the claim for a certain allocation system, e.g. based on the principle of origin or based on the fractional (global) tax system by using neutrality as a supportive argument, is invalid if worldwide welfare is not defined and if the suggested policy proposal does not enhance such a welfare assumption.

11.5. Principle 4: Source principle

11.5.1. The source principle – An overview

The source principle, in simplified terms, means that taxation should occur where value is created.[2161] We could link the source principle to the benefit theory in the sense that it would be critical whether the taxpayer has obtained governmental benefits in the source state for value creation.[2162] The source principle has been one of the most important (at least formal) policy guidelines within international tax law in recent years. The current international tax regime, following the arm's length principle, attributes great importance to the source principle for income allocation as income should be taxed where value is created. Many references can be drawn to official documents in this respect, both from national and international institutions. For example, the G20 Leader's Communiqué of the Brisbane Summit in 2014 contains the following statement: "Profits should be taxed where economic activities deriving the profits are performed and where value is created."[2163]

Similar statements have been used by the OECD/G20[2164] or by international organizations aiming to achieve a fair system, such as the Global Alliance for Tax Justice, which stated in 2015:

2161. *See*, with more details, Hongler & Pistone, p. 17 et seq. However, there are many further understandings of the term "source", *see*, for example, Kane, 2015, p. 311; Kemmeren, 2001, p. 33 et seq.; Vann, p. 298.
2162. *See* sec. 11.6.2.4.
2163. G20, Leaders' Communiqué Brisbane Summit, 15-16 Nov. 2014, para. 13.
2164. E.g. OECD/G20, BEPS, Explanatory Statement, 2015 Final Reports (OECD 2015), § 1.

> The revised [Transfer Pricing] Guidelines should be regarded as only provisional, and a more fundamental reconsideration should be begun, in conjunction with the UN, to provide Guidelines based on treating MNEs according to the economic reality that they are integrated firms, and provide clear and simple rules for allocating profit to where real economic activities take place.[2165]

As already developed in another instance,[2166] the source theory has a long history.[2167] This principle has been used by many authors to justify a certain income allocation.[2168] For the purpose of the present study, we will only mention one, but likely one of the most important ones on the source principle. Musgrave argued in 1984:

> The source-based entitlement rule, however, is entirely within the states' taxing capabilities to implement. It embodies the notion that jurisdictions are entitled to tax the value added within their borders including that by non-resident factors, that is to share in the income accruing to non-resident factors and earned by them within the geographical area of that jurisdiction [footnote omitted].[2169]

Musgrave, therefore, argues that the source state is "entitled" to tax the value added within its state territory. Vogel stated in 1997 that not only from an economist's perspective, but also considering justice considerations, source taxation as such would be fair or just, as an enterprise resident in one state that derives income from another state should be treated equally, with respect to the latter income, to any another enterprise deriving income under the same conditions, i.e. in the same state.[2170] Such a line of argumentation links the source principle to equality considerations. Another important argument in favor of the source principle as an allocation rule is that the benefit principle seems to fail when it comes to an exact calculation of the benefits obtained.[2171]

2165. Global Alliance for Tax Justice, Key Points on Tax Issues for G20 Sherpas Meeting June 2015 G20 and OECD must act to prevent failure of the BEPS project, 12 June 2015, available at https://bepsmonitoringgroup.files.wordpress.com/2015/06/key-points-on-tax-issues-for-g20-sherpas-meeting-june-2015.pdf (last visited 29 Jan. 2019).
2166. Hongler & Pistone, p. 17 et seq.
2167. One of the fathers of the source principle is Von Schanz with his contribution to the question of jurisdiction to tax (Von Schanz, p. 365 et seq.). His concept of "economic allegiance" or "*wirtschaftliche Zugehörigkeit*" is similar if not identical to the source principle.
2168. *See*, for example, Tipke, 2000, p. 523 et seq., who understands the source principle with reference to the benefit principle, i.e. it should be decisive which state provided the benefits relevant for the income-generating activity.
2169. Musgrave, 1984, p. 241. *See also* Musgrave, 2001b, p. 1341 et seq.
2170. *See* Vogel, 1997, p. 273.
2171. *See generally* Schön, 2009, p. 75 et seq. *See*, on the benefit principle as a potential allocation key, sec. 11.6.2.2.

The source principle also has major disadvantages, however. The main problem is that value creation cannot be measured in an unambiguous manner. This is most obvious if one follows the discussion of whether only the supply side (i.e. the production and development) or also the demand side (i.e. the customers and the market) of an enterprise contributes to the value creation.[2172] A reliance on the supply side would mean that a state should have the right to tax income if certain functions or assets of an enterprise are within its territory. The arm's length principle follows such a supply-side understanding of the source principle. If one would implement a more demand-related understanding, the market state would have a right to tax, even though no functions or assets of the enterprise are within its territory.

The issue becomes obvious if one analyzes the taxation of enterprises of the digital economy. It is possible, for instance, that an enterprise of the digital economy can penetrate a market without being physically present there.[2173] If one follows a supply-side understanding of the source principle, the market state would not have the right to tax any of the income, even if a considerable part of the income was generated in the market state. If one follows a more demand-side approach, it would be required to allocate parts of the income to the market state. My experience shows that when students are faced with the question of what would be a fair allocation of profits of a multinational enterprise within the digital economy, and whether the market state should be allowed to tax parts of the income, the answers are very different. Some would allocate nearly the entire profit to the market state, while others would allocate nothing to the market state. However, the goal of the present section is not to discuss the different opinions regarding how value creation could be measured or how the source of income could be captured,[2174] but to discuss the normative validity of the source principle per se. To do so, two questions must be distinguished.

First, what would be an appropriate allocation key following the source principle? Or, to be more concrete, is the arm's length principle indeed reflecting value creation in the involved states? The second question is, however, should international tax policy indeed follow the source principle,

2172. *See* on this topic Musgrave, 1984, p. 245. *See also* Kleinbard, 2016, p. 145, who states with respect to territorial systems that we face the "complete inability in practice to determine the genuine geographic nexus of much business income", which seems to imply that we are unable to calculate value creation. *See* on the issue of whether value creation can indeed be measured, Devereux, p. 712 et seq.
2173. This was also a key argument why the US Supreme Court changed its understanding of the commerce clause in relation to digital enterprises (*see* US: SC, *South Dakota v. Wayfair Inc*.).
2174. *See generally* Kane, 2015, p. 311 et seq.

i.e. that taxation should occur in the state of value creation? In the following, we will only focus on the latter question, i.e. is it just to implement an international tax regime that follows the source principle? However, in a later chapter, we will further discuss the normative value of the arm's length principle as an allocation key and answer the first question.[2175]

11.5.2. Normative review

11.5.2.1. What are the underlying reasons for an application of the source principle?

Following the methodology of the present study, it is crucial that we justify every conclusion and assumption, and in line with Sen's *The Idea of Justice*, it is decisive not to over hastily conclude that a certain principle or rule leads to just or unjust results if one has not analyzed the justification for why a rule or principle indeed leads to just or unjust results.[2176] Therefore, it is firstly essential to understand why the OECD/G20, but also several authors, argue for an international tax regime in which taxation occurs where value is created, i.e. an international allocation following the source principle.

The first implicit argument of the OECD/G20 is that the alignment of taxation and value creation avoids double non-taxation and, therefore, the international tax regime should follow the source principle.[2177] Such a line of argumentation relates to the single taxation principle. However, we have seen above[2178] that the single taxation principle as such is weak as an international policy goal, as it is to a certain extent based on a global understanding of the equality or the ability-to-pay principle, which finds no support in the present study. If one indeed claims a global tax regime according to the single tax principle, according to our understanding, it would trigger distributive payments from the rich to the poor countries.[2179] The latter means that a claim for source taxation must be combined with a claim for cross-border distributive payments.

A second reason for an alignment of taxation and value creation and, therefore, the use of the source principle as an allocation rule, is related to the benefit principle. The argument is as follows: Value creation requires that

2175. *See* sec. 12.2.
2176. *See* secs. 7.7.3. and 8.2.
2177. *See* OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), p. 13.
2178. *See* sec. 11.2.3.4.
2179. *See* id.

an enterprise obtain benefits in one jurisdiction to achieve value creation and such a receipt of obtained benefits must be seen as a justification for taxation.[2180] Therefore the source principle could be derived from the benefit principle. With respect to the benefit principle, we will demonstrate below that it is indeed an important principle with normative value, but only to the extent that it justifies taxation or limits taxation, and not necessarily with respect to the allocation of income worldwide to avoid double taxation. This means that the international tax regime seems just if a state has the right to tax income that was created by an enterprise that obtained benefits from the same state. However, this also means that the international tax regime is not just if it allows taxation in a state in which an enterprise generates income that was created without any benefits obtained from such state.

A third argument relates to the entitlement of states. States should be entitled to tax income if the value was created within its territory or if the income originates in a certain jurisdiction.[2181] Such a line of argumentation is linked to the principle of sovereignty: Each state shall be entitled to tax income that has a link to its territory, as it "owns" such income. Such a link could be, therefore, defined in two ways: (i) the value was created within a territory or (ii) the income originates in a certain territory. This third justification for the source principle seems persuasive, as we have seen above that the principle of sovereignty and the principle of fiscal self-determination are both crucial to achieve a just international order.[2182] We have also seen that we understand the principle of fiscal self-determination as a territorial claim to render coercive measures with respect to a certain territory. Therefore, the claim that international policy should, inter alia, aim at allowing states to govern their territory in an independent manner is valid and also means that states should be entitled to tax income created within their territory, as this is a logical consequence of such an understanding of the principle of fiscal self-determination. Therefore, to enable fiscal self-determination, states should be able to tax what was created within their jurisdiction.[2183] This would also allow states to implement a just domestic system, as they would have access to tax revenue, but not necessarily sufficient tax revenue.[2184] The

2180. *See*, with regard to the benefit principle, sec. 11.6. *See* Green, p. 29, with reference to Musgrave & Musgrave. *See also* Benshalom, p. 75 et seq.
2181. *See* Musgrave, 1984, p. 241. *See also* Gutmann, p. 39.
2182. *See* sec. 8.4.
2183. *See* sec. 8.4.3.
2184. If one follows a broader understanding of the principle of fiscal self-determination, one would require that states have even sufficient revenues to follow the distributive policy chosen by its people. However, this is not the understanding in the present study (*see* sec. 8.4.3.).

"entitlement" argument is similar, but not identical, to the second argument that the source principle can be derived from the benefit principle.

A fourth argument relates to the idea of mutual benefits. As shown by Cappelen, this would mean that distribution (and as a matter of fact taxation) should "take place among those who participate in social cooperation,"[2185] because social cooperation increases the welfare of all participants. Therefore, if social cooperation is understood as economic cooperation, one could conclude that value creation or economic allegiance (i.e. economic cooperation) should create tax liability. However, if cooperation is not understood in a merely economic manner, but rather if social interaction is also considered, the source principle might not be appropriate to demonstrate that relevant cooperation occurs.[2186]

A fifth argument relates to potential cross-border distributive duties and the fact that developing countries would benefit most from source taxation. Therefore the normative claim for source taxation could potentially be based on existing global distributive duties. As it is argued, for instance, by Benshalom, with reference to his idea of relational-distributive duties,[2187] there should indeed be a shift from residence to source taxation, as developing countries would mainly benefit from an enhanced level of source taxation.[2188] Therefore, source taxation could indeed lead to a distributive effect cross-border, but this would require that allocation based on the source principle would indeed lead to a higher allocation for the worst off in this world. Only if this is indeed proven would such a claim for source taxation be justified, following a cosmopolitan understanding of distributive duties. However, as was outlined above,[2189] we do not follow such a cosmopolitan-like understanding of distributive duties and as we will demonstrate below, the claim that source taxation would have a distributive effect at a global level might be weak under certain circumstances.

To sum up, the source principle, if it is understood as being linked to the principles of sovereignty and fiscal self-determination[2190] (argument no. 3) and as a principle derived from the benefit principle (argument no. 2), seems indeed to have normative value. The argument that the source principle is

2185. Cappelen, p. 102.
2186. For further details *see* id., p. 102 et seq.
2187. *See* sec. 10.2.
2188. Source taxation as such does not, however, necessarily align with the idea of relational-duties, as also indicated by Benshalom, p. 75 et seq.
2189. *See* sec. 8.3.
2190. As also emphasized as one our main elements of our understanding of global justice (*see* sec. 8.4.).

important because it avoids double taxation and double non-taxation is, however, weak and finds no support within the present study (argument no. 1). The idea of mutual benefits (argument no. 4) used as a justification for source taxation is also not persuasive if one understands cooperation only in economic terms. This is the case in the present study, as we showed above with reference to Rawls and other right institutionalists, that social interaction and coercive structures might trigger duties among members of a certain society and not mere economic cooperation.[2191] In case it is proven that developing countries are indeed mainly capital-importing countries and if one argues in favor of cross-border distributive duties, which we do not beyond conducting humanitarian duties,[2192] a claim for source taxation might indeed have normative value based on distributive considerations (argument no. 5).

In the following section, we will refer to moral theory in more detail to further shed light on how the source principle could indeed be a normative guiding principle when redesigning the international tax regime. In line with the present methodology, we will refer to transcendental ideas, even though we have outlined in detail, with references to Sen, the existing limitations of the use of transcendental theories when discussing whether a specific rule or principle is just and leads to just results. As mentioned, however, some conclusions or reasons inherent within transcendental theory are also very insightful for using them in a non-ideal approach.[2193]

11.5.2.2. Reference to further philosophical ideas

In the following, we will refer to a more detailed philosophical argumentation to develop a more concrete understanding of how the source principle could indeed be a guiding principle for the design of a just international tax regime. Again, as intended by the present study, arguments of political philosophy should help to evaluate what it means to have a fair or just international tax regime, and it helps to better understand why a certain principle indeed has a normative value. As discussed above, we do not aim to develop a transcendental ideal international tax regime, but we rather intend, with references to the instruments of reasoning and impartiality,[2194] to discuss whether certain principles or rules within the international tax regime are just or unjust and/or lead to just or unjust results.

2191. *See* sec. 8.3.2.
2192. *See* sec. 8.3.3.
2193. *See* sec. 8.1.
2194. *See* sec. 8.2.

First, reference is made to existing practical constraints.[2195] It is our understanding that it is impossible to assess or measure the exact amount of "value creation" in each jurisdiction. For instance, the fact that the current international transfer-pricing regime knows significant residual profits shows the practical constraints of an allocation key following the source principle. Residual profits should not exist in an international tax regime that strictly follows the source principle as an allocation principle, as the entire income would need to be allocated to a certain source. Moreover, the aspect that the arm's length principle currently only considers the supply side of an enterprise shows the difficulty of measuring value creation, as it seems at first glance quite persuasive that the demand side also enhances the value of an enterprise.[2196] Nevertheless, to value the influence of the demand side is difficult, as is the calculation of the precise influence of the supply side. Therefore, it is more than fair to argue that a precise allocation of income is impossible based on the source principle. Neither the arm's length principle nor a formulary system can provide for an exact solution in this respect, as value creation as such can be calculated in various ways.[2197]

Second – and this argument is based on the ideas of right institutionalists, such as Rawls and Nagel[2198] – we have already stated above that the principles of sovereignty and fiscal self-determination are of great importance to achieve justice at an international level, even in a globalized world. From our perspective, double taxation is, as such, not per se unjust if it is in line with the principle of fiscal self-determination.[2199] This could be the case if two states have valid reasons as to why they should be allowed to tax a certain income. This, of course, could lead to a higher tax burden for persons generating income abroad, but as the reason for such a higher burden is the cross-border activity, and as the border is morally significant, in our understanding, such an outcome must not necessarily be considered unjust. What is important from our perspective is to understand, based on Rawls' principles of justice within *The Law of Peoples*, that the source principle justified by the principles of sovereignty and fiscal self-determination not only has a positive component as a justification-to-tax principle, but also a negative component, as demonstrated above.[2200] This means that the source

2195. *See*, on the topic of practical constraints, sec. 2.1.5. *See*, with regard to the source principle, for instance, Sadiq, p. 278.
2196. For further details, *see* Hongler & Pistone, p. 19. *See also* Cappelen, p. 103.
2197. For more details on the arm's length principle and formulary systems, *see* sec. 12.2.
2198. *See* secs. 6.3. and 7.4.1.
2199. *See* sec. 11.2.3.4.
2200. *See*, on our understanding of the principle of sovereignty, sec. 8.4.

principle should not be understood as an allocation principle, but as a non-allocation principle or a limitation-to-tax principle. States should refrain from taxing income if an income has no or a limited link to a jurisdiction. This is very much in line with the position taken in the present study and the accentuation that the principles of sovereignty and fiscal self-determination are crucial elements to achieve a just international order.[2201] Therefore, to draw the connection to the BEPS Project, the claim of the OECD/G20 that taxation should align with value creation is indeed a valid goal to protect fiscal self-determination within the international tax regime. However, the OECD/G20 has overlooked or even ignored the negative component of the source principle derived from fiscal self-determination, according to which states shall refrain from taxation to a certain extent if value has also been created in another jurisdiction. We will further discuss this concept below when reviewing CFC rules from a normative perspective.[2202]

Third, if one considers and agrees (which we do not) on distributive duties existing at an international level, following a cosmopolitan understanding,[2203] the application of the source principle as an allocation rule could lead to detrimental effects. This means that depending on the calculation of the value creation, the application of the source principle could lead to unjust results, following a cosmopolitan theory of justice. The reason is that the source principle could potentially lead to a higher allocation of income to rich countries, as rich countries are more productive and, therefore, a higher value would be created in rich countries. Low-income countries would not have the opportunity to increase their revenue, as the value creation in these states is minimal. Therefore, following the understanding of Pogge & Beitz,[2204] the application of the source principle as an allocation principle would likely not lead to a transfer of funds from the rich to the poor states and, therefore, following a cosmopolitan understanding, should not find support as an allocation principle. In a similar manner, it is shown by Van Apeldoorn that taxation in line with the source principle is non-responsive to the distribution of fiscal self-determination, which basically means that the source principle is generally non-responsive to cross-border distribution, in general.[2205]

2201. *See* id.
2202. *See* sec. 12.3.3.
2203. *See* sec. 7.5. *See also* Cappelen, p. 107 et seq. on the interaction of cosmopolitan ideas and the source principle.
2204. *See* secs. 7.5.1. and 7.5.2.
2205. Van Apeldoorn, p. 17. For a profound argument in this respect *see also* Christians & Van Apeldoorn, p. 1 et seq.

Fourth, Beitz has – without referring to international tax law – dealt with the question of value creation and its importance regarding distributive justice. He refers to the argument of Nozick, i.e. a libertarian viewpoint, that "[o]ne justification [of an international system which does not follow the difference principle][2206] is on grounds of personal merit, appealing to the intuition that value created by someone's unaided labor is properly his, assuming that the initial distribution was just [footnote omitted]."[2207] In simplified terms, my interpretation of Beitz' understanding of Nozick is that if the worldwide distribution of goods follows value creation, such a system is fair from a libertarian perspective, as taxation is with the states that created a certain value. Beitz, however, is strictly against such a system, primarily based on the argument that natural chances and social contingencies are arbitrary and, therefore, the allocation based on value creation is arbitrary and not justified.[2208] Beitz namely refers to Rawls' argument in favor of a "difference principle" at a national level and applies it at a global level.[2209] In simplified terms, and adapted to the international tax world, this means that an allocation of income based on value creation is arbitrary, as the underlying factors to measure value creation are allocated in an arbitrary manner from an individual's perspective to the involved states. In other words, if I were born in a poor country, I would likely always be disadvantaged from such an allocation key, as my country has very low productivity, so very little value creation occurs in my country. Individuals living in poor countries, therefore, have a much lower chance to benefit from the value creation of some of the largest multinationals in the world, as these are mainly (i.e. on the supply side) operating in the strong economies of the world.[2210] Again this fourth point, as already highlighted by the third point, is the potential unfair outcome of an allocation following the source principle depending on its design. Therefore, following a cosmopolitan understanding, one might disagree with the source principle as a just allocation principle, unless it is combined with distributive measures, which would compensate for the detrimental impact of an application of the source principle on the distribution of income and wealth at a global level.

2206. *See*, on the difference principle, sec. 6.2.3.
2207. Beitz, 1975, p. 379.
2208. *See* id., p. 380.
2209. *See* sec. 7.5.1.
2210. There is an entire field of research in political philosophy that we cannot fully explore in the present study. It relates to the argument that it is simply luck to be born into a rich family or rich states (*see generally* Tanasoca, p. 147 et seq.).

11.5.3. Intermediate conclusion

These references again demonstrate the importance of drawing the link between international tax law and political philosophy. As shown, the source principle has a normative value if it is linked to the principles of sovereignty and fiscal self-determination and/or if it is derived from the benefit principle.

We demonstrated above that the source principle as such could indeed be understood as a libertarian approach of allocating income, as it presumes that it is a fair allocation if the merits of the income created should be with the person who created the income. Therefore the source principle as such contains no distributive element. However, depending on the exact design, it might even have a contra distributive element if it enhances the allocation of income to rich countries. Therefore, and based on other reasons, it was argued that international tax policy should generally refrain from using the source principle as an allocation principle.

The source principle – and this is crucial – should not be understood as an allocation principle, but as a justification-to-tax, and also as a limitation-to-tax principle, in the sense that if a state has not contributed to the generation of an income, it should not be granted a taxing right. Such an understanding is different from the approach of the OECD/G20. Each state shall have the right to define "what was created" within its territory, since the allocation according to the source principle cannot be done in an unambiguous manner and, depending on the design, it might have an unintended distributive impact.

We do not argue that the need for mitigating double taxation requires an allocation key, following the source principle, but we argue that the principles of sovereignty and fiscal self-determination require the non-taxation of income that was created abroad. As mentioned already in several instances, double taxation and double non-taxation are not per se unjust and, therefore, an allocation key is not necessarily required to achieve justice in the international tax regime. From a practical perspective, the result is that we would not require that double taxation be avoided in all cases, but rather that states should at least refrain from taxing income that was created abroad. How to define what was created abroad should generally, however, be at the discretion of states, unless otherwise agreed with other states.[2211]

2211. *See*, however, our remarks in sec. 11.6.2.4.

11.6. Principle 5: Benefit principle

11.6.1. The benefit principle – An overview

One way of defining the benefit principle is that "taxpayers contribute, via taxation, in proportion to the benefit they derive from government".[2212] In a more radical manner, the benefit principle would mean that a country would only charge for the services rendered and not beyond.[2213] Closely linked to the benefit principle is the cost principle or cost theory, according to which taxes are paid based on the costs of the services performed by the state.[2214] From a historical perspective, as demonstrated by Dodge with further references, the benefit principle in a mere domestic situation has its roots in the Enlightenment period.[2215]

The benefit principle could also be linked to the Aristotelian *iustitia commutativa*.[2216] This means that taxes – and this is the underlying justification – are the price to be paid for the receipt of public goods.[2217] Therefore, according to the benefit principle, taxation in a strict sense has in principle no distributive effect, but instead relies on the benefits obtained by each taxpayer, notwithstanding the taxpayer's ability to pay. This led to an intense debate about the compatibility of the benefit principle with liberal ideas, for instance, that a liberal societal understanding contains a distributive element, such as the difference principle of Rawls.[2218] Indeed, the benefit principle as such is not able to reflect the ability to pay of the taxpayers[2219] – at

2212. Murphy & Nagel, p. 16, with further references. *See* Dietsch & Rixen, p. 157 et seq., and Dietsch, 2015, p. 80 et seq., who use the term "membership" to describe the idea that taxation should occur in the state of which an individual is a member. According to them, individuals and companies should be a member of a state if they benefit from public services and infrastructure. Therefore their idea of taxation based on membership is closely linked (but not identical) to the benefit principle. For similar but different approaches *see* Bamford, p. 132 et seq., who argues in favor of a "principle of relationship": "The principle of relationship focuses on the strength of the relationship that taxpayers have with the several states with which they have a relationship".
2213. *See*, on the topic of benefit taxation in this respect, Musgrave & Musgrave, p. 70. *See* Kaufman, 1998, p. 157, with reference to Nozick.
2214. Bruins et al., p. 18.
2215. Dodge, p. 399 et seq.
2216. *See* sec. 1.2.
2217. *See* Matteotti, 2007, p. 17 et seq., with further details and references. *See also* Dean, p. 565.
2218. *See*, on this dispute, with reference to the work of Murphy & Nagel, Kordana & Tabachnick, p. 653 et seq.
2219. *See*, for example, the decision of the Swiss Federal Supreme Court, CH: SC, BGE 133 I 206, 1 June 2007, cons. 7.1. But *see* on the so-called membership principle, considering both the ability-to-pay principle and the benefit principle, Dietsch, 2015, p. 80 et seq.

least if it is not combined with tax subsidies or distributive payments to the worst off within a state. A different, but related, concern is that a taxpayer might have losses, but would still be subject to taxation following the benefit principle, which would also infringe the ability-to-pay principle.[2220]

There have been many studies about the content of the benefit principle, from both a legal and an economic perspective.[2221] From a legal perspective, the benefit principle has been of major importance with respect to duties or levies, and their structure and design in a domestic situation. From a mere tax perspective, however, the benefit principle has been qualified as "weak" or "unsubstantial" as a design principle in a domestic framework.[2222] The benefit principle has the weakness that benefits obtained cannot be calculated and, therefore, taxation based on a strict application of the benefit principle is not feasible. This is already true in a mere domestic situation, as it is generally impossible to allocate the utility of the existing public goods among the members of a society.[2223] Furthermore, in a cross-border situation, many authors have already discussed such practical constraints of the application of the benefit principle as a potential allocation key at a global level.[2224]

Following our methodology, we will try to review whether and to what extent the benefit principle has a normative value at an international level.

11.6.2. Normative review

11.6.2.1. Setting the question

At a domestic level, we saw above that several authors have highlighted the weaknesses of the benefit principle as a (sole) normative guideline for the design of a domestic tax system. One such weakness is that the benefit principle does not align with the ability-to-pay principle. The focus in the present section, however, is on the question of whether it would be just to implement an international tax regime that would allocate the income of a person according to the benefit principle among different states for tax

2220. *See*, for example, Tipke, 2000, p. 479.
2221. *See* the studies mentioned in the footnotes 2014-2020. *See*, for instance, from a public finance perspective, Hansjürgens, p. 17 et seq.; Schmehl, p. 1 et seq.
2222. *See*, for example, Tipke, 2000, p. 476 et seq.
2223. *See* Matteotti, 2007, p. 17 et seq., with further references.
2224. E.g. Vogel, 1988b, p. 314. *See also* Hongler & Pistone, p. 19 et seq., or Von Schanz, p. 372.

purposes. To further discuss this question, it is essential – following the methodology in the present study – to use normative reasoning and impartiality as the decisive instruments.

Therefore, it is again crucial to understand why there should be an allocation of income according to the benefits obtained in the involved states. For instance, Valta, as was shown above,[2225] claims that an allocation of income according to his so-called extended benefit principle is persuasive. One of the main arguments in favor of an allocation according to the benefits obtained is – as in mere domestic circumstances – that taxes should be due if taxpayers use the benefits provided by a state in order to generate their income.[2226] Tipke suggests that if states want to achieve a (fair) international tax system according to the ability-to-pay principle, they need to split the income of a person among the states, and such a split should occur in line with the benefit principle.[2227] To be more precise, Tipke argues that the benefits that were causal for the income generation should be relevant for the allocation of income. The latter, according to Tipke, is more practical than relying on overall benefits provided by the involved states. Another approach would be to even consider the historical benefits a taxpayer obtained. This would mean that if a person is educated in a certain jurisdiction and shifts his employment to another jurisdiction, part of the income should still be taxed in the country of education, as the taxpayer obtained benefits from that state.[2228]

In the following, we will further elaborate on whether an allocation following the benefit principle leads to a just international tax system and whether the benefit principle indeed has a normative value.

11.6.2.2. Benefit principle as an allocation principle

As we will develop in the following, we disagree with the mentioned opinions that the international tax regime should follow the benefit principle in a strict manner, meaning that income should be allocated among states depending on the benefits obtained in different jurisdictions to be considered just. An allocation according to the benefits obtained does not lead to

2225. Valta, 2014, p. 47 et seq. *See* sec. 10.3.
2226. *See* Valta, p. 47, with reference to Von Schanz. *See also* Kemmeren, 2001, p. 23 et seq.
2227. Tipke, 2000, p. 522 et seq.
2228. *See*, for example, for a similar approach, Bamford, p. 132 et seq.

a just international tax regime. Such an understanding is based on at least five reasons.

First, following a cosmopolitan understanding of global justice, which we deny, an allocation of income according to the benefit principle at a global level could have detrimental effects, as the benefits obtained in rich countries would generally have a higher value, which could lead to a shift of taxable income from poor countries to developed countries. This can be demonstrated by the following hypothetical example.

Example

A Haitian professional boxer earned USD 10,000 in 2012 as a salary, which he receives from the national boxing federation. He earns very little income from sponsors. In 2012, he attended the Olympic Games and stayed in London for 3 weeks. The tax rate in London is presumably 30%, but only 10% in Haiti. Let's assume that the received benefits in the year 2012 are equal between Haiti and the United Kingdom, as the security and building of the specific Olympic premises were very expensive and, therefore, even though he stayed only a few weeks in London, the UK benefits have the same value as the Haitian benefits for the rest of the year.[2229] This would mean, following the benefit principle as an allocation principle, that London could tax USD 5,000 at 30%, i.e. USD 1,500 and Haiti could tax USD 5,000 at a rate of 10%, i.e. USD 500. This would be a strange outcome and clearly opposing cosmopolitan theories of justice, such as those developed by Pogge and Beitz.[2230]

Therefore, allocation according to the benefit principle would not fulfill our duties toward the worst off, following a cosmopolitan understanding, and such allocation could even lead to detrimental results, i.e. to a higher allocation of income to the richest states in the world. The general concern with respect to the benefit principle, therefore, is that the benefits in developed countries generally have a much higher value due to higher productivity.[2231] Of course, the use of a few rather hypothetical examples as such seems weak to question the applicability of a certain principle. However, the advocates of the benefit principle as an allocation key have not, vice versa, proven that the application of the benefit principle would indeed lead to a just allocation

2229. *See* Valta, p. 556.
2230. *See* secs. 7.5.1. and 7.5.2.
2231. Of course, this depends on the valuation of the benefits, but following market considerations, for instance, the infrastructure in low-income countries is generally less expensive than in high-income countries, and consequently, the benefits obtained are less than in high-income countries. Therefore, the example of the Haitian boxer might be a rather extreme example, but there is a general concern that the benefits obtained in developed states generally have a higher market value than benefits in developing states.

of income, while also considering the potential distributive impact following either a cosmopolitan or non-cosmopolitan understanding of global justice.

Second, as the remarks above on the principle of inter-nation equity have shown, there is generally no normative claim that (i) the allocation of income must follow identical terms at a global level, such as an allocation according to the benefit principle, and (ii) depending on the underlying understanding of global justice, there might not even be a normative claim for cooperation in order to mitigate juridical double taxation. The latter point has also been indicated above in discussing the ability-to-pay principle.[2232] Or in other words, the avoidance of double taxation by a very coordinated approach of the international state community is not necessarily required to achieve a just international system, and the single taxation principle has no normative value, following our non-cosmopolitan understanding of global justice. Therefore, considering both cosmopolitan and non-cosmopolitan ideas, the benefit principle seems to lack a normative base as an allocation principle. Both theories of global justice do not require that income allocation at an international level follows the benefit principle.

Third, we assume that the practical constraints to calculate the benefits obtained in the involved countries are too significant, so that the benefit principle could actually work as a precise income allocation principle. It is impossible to calculate all the benefits obtained by a taxpayer from different countries and render an allocation of income based on such a calculation. An allocation of income in line with the benefit principle faces considerable practical constraints.[2233]

Fourth, another argument brought forward against the use of the benefit principle as an allocation key is that the benefits obtained are not able to reflect value creation in a comprehensive manner, as it does not consider the risks taken by an enterprise that are part of a value creation chain.[2234] Prima facie, this seems persuasive, as the benefits obtained are not in direct relation to the income generated by an enterprise or an individual. However, this is only a derivative argument, as it presupposes that the source principle, i.e. the principle according to which income allocation should align with value creation, is valid from a normative perspective. However, as we saw above, we believe that income allocation as such at a global level, in line with the

2232. *See* sec. 11.2.3.4.
2233. *See*, for example, Kaufman, 1998, p. 183; Schön, 2009, p. 93. But *see* for deviating opinion on the feasibility of an allocation based on overall benefits obtained, Valta, p. 48 et seq.
2234. *See* Schön, 2009, p. 77. *See also* Green, p. 30.

source principle, does not lead to a just international tax regime. We understand the source principle only as a justification-to-tax and a limitation-to-tax principle,[2235] and we will dedicate a specific section to the interaction between the source and the benefit principle.[2236]

Fifth, as we argued that the ability-to-pay principle is not a persuasive policy guideline to design the international tax regime, we would, as a logical consequence, disagree with the mentioned position of Tipke and Valta that the ability-to-pay principle requires states to cooperate and allocate income following the benefit principle in order to avoid double taxation.[2237] Double taxation, as such, might infringe the ability-to-pay principle from a domestic perspective, but there is not a normative claim for having an international tax regime that is perfectly in line with the ability-to-pay principle. A global single taxation principle does not lead to a just international tax regime, and a just international tax regime does not require that double taxation be mitigated.

These arguments show that a consequent application of the benefit principle as an income allocation key at a global level is not feasible, and even if it were possible to calculate the income allocation in a precise manner based on the obtained benefits, an allocation according to the benefit principle would likely lead to unjust results, following both left and right institutional theories of global justice.

11.6.2.3. Benefit principle as a justification-to-tax principle?

The missing normative value of the benefit principle as an allocation principle does not mean that the benefit principle as such has no validity at all as a guiding principle in international tax law.

As shown in another instance,[2238] the benefit principle may serve as a justification-to-tax principle. This means that if a corporation or an individual obtains benefits in a jurisdiction, taxation with respect to the income that has a relation to these benefits seems justified by the state providing these benefits. This is in line with the legal principle of sovereignty, as demonstrated above, which prohibits the taxation of income if there is no genuine link (e.g. through obtaining benefits) to a certain country. However, this is also

2235. *See* sec. 11.5.2.
2236. *See* sec. 11.6.2.4.
2237. *See* sec. 11.2.3.4.
2238. For further details *see* Hongler & Pistone, p. 19 et seq.

in line with our normative understanding of the principles of sovereignty and fiscal self-determination, as states should have the right to coercively govern their territory, which involves taxing income that was created by using governmental benefits of the taxing state.[2239] If a state lacked such a taxing right, it would not be able to protect its territory to guarantee sovereignty and fiscal self-determination. Furthermore, as a logical consequence, states should refrain from taxing an income if it was created by using the benefits obtained abroad. The benefit principle should be understood as both a limitation-to-tax and a justification-to-tax principle.

One could argue that our position is contradictory, as we stated above that the benefit principle is not persuasive as an allocation key, yet we simultaneously suggest to understand it as both a limitation- and a justification-to-tax principle. Yet, there is an important difference between these two positions and the difference relates to the underlying argument. We do not argue that the need for mitigating double taxation (or the application of a global ability-to-pay principle) requires an allocation key based on benefits obtained, but we instead argue that the principles of sovereignty and fiscal self-determination require a non-taxation of income that was created by using benefits abroad. From a practical perspective, the result is that we would not necessarily require that double taxation be avoided in all cases, but that states should refrain from taxing income that was created by obtaining the benefits of foreign states. However, it should be within the discretion of states to define the threshold for taxation and to define the tax base, following such an understanding of the benefit principle. Therefore, double taxation as such might be caused by different interpretations of the benefit principle as a justification-to-tax principle, but this is not necessarily unjust.

Of course, we still face the issue that the benefits are difficult to calculate. However, if one understands the benefit principle as a rough reference for the allocation of income, i.e. as a justification-to-tax or a limitation-to-tax principle, the issue of calculating the exact income loses some importance. Therefore, there will be situations of juridical double taxation because two states would claim that a certain income was created by obtaining the benefits in its state. However, this does not lead to unjust results. It is far more important that states would follow the benefit principle as a rough reference, which would require the abolishment of worldwide tax systems. In other words, justice as a normative guideline does not provide us with an answer on how to share the income in perfect slices, but it nevertheless provides us with rather clear recommendations, such as the abolishment of worldwide

2239. *See* sec. 11.4.3.

tax systems and the protection of source taxation, as derived from the principle of fiscal self-determination. These are key elements in our understanding of global justice.[2240]

11.6.2.4. Interaction with the source principle

In the present study, it is argued that both the source and benefit principles must be understood as justification-to-tax and limitation-to-tax principles, as in such a manner, these principles indeed have a normative value. This leads us to the question of how these two principles are connected to each other, i.e. whether they overlap or whether they contradict each other. At least two results are possible; these different results are caused by the fact that the benefit principle can be understood in two different ways.

First, only benefits obtained to directly generate the income could be relevant.[2241] In this case, both principles would overlap, i.e. the value creation would be in the same jurisdiction as the benefits obtained to create such value. Second, benefits that are not relevant for the income generation could also be relevant. In this case, the principles could partly contradict each other.

Regarding corporate taxpayers, the difference might not even exist, as it is difficult to assume governmental benefits obtained by a corporate taxpayer that are not directly or indirectly relevant to the generation of income. Therefore, regarding corporate taxpayers, there is a significant overlap between the two principles. Regarding individuals, the situation is more sensitive. It is indeed possible that an individual mainly receives benefits from one state, even though a significant part of the individual's income was created in another state.

For instance, if a taxpayer receives a significant part (assume 90%) of income from passive income from a source outside his state of residence, and if such person never leaves the country, and does not receive any benefits from the source country besides the benefits to generate the income, there are valid reasons for both states to tax a significant part of the income, following our understanding of the source and benefit principles. The source state could argue that most of the income was created within its jurisdiction,

2240. *See* sec. 8.4.

2241. For instance, the fact that a state provides an Internet infrastructure is a direct benefit that a corporate taxpayer, such as an enterprise of the digital economy, uses to generate income. For more details and with further references, *see* Hongler & Pistone, p. 22.

while the resident state could argue that the taxpayer mainly obtains benefits in the resident state (i.e. infrastructure, legal protection, security). However, the fact that states would have overlapping tax claims in this situation is a clear sign that we should not specifically aim at abolishing double taxation or double non-taxation, but rather at protecting the right of both states in this example to tax parts (but not the entire) income. Moreover, as we in the present study are not arguing in favor of a precise allocation according to the benefit principle, the dispute as such is not an obstacle to achieve a just international tax regime. Even though, to achieve a stringent policy, we would recommend aligning the benefit principle with the source principle, as this is the only way to achieve an overlap between the two. In other words, it would not be possible to amend the source principle to align with the benefit principle.

Furthermore, the principle of fiscal self-determination, which is the key justification for both principles, should protect states to tax income following both of the mentioned understandings of the benefit principle, even though, in order to align it with the source principle, we support a solution that would focus on benefits which were necessary to generate income and not "other" benefits. The latter is necessarily the case regarding corporate taxpayers, as there is a general overlap between the two principles.

11.6.3. Intermediate conclusion

In conclusion, the benefit principle should not be understood as an allocation principle to avoid double taxation. We would argue, however, that the benefit principle understood as a justification-to-tax and a limitation-to-tax claim has a normative value. This means that if an income was created without any benefits from a certain state, such state should not have the right to tax the income. The normative value of the benefit principle is derived from the principle of fiscal self-determination and basically challenges worldwide tax systems which disregard whether a taxpayer has obtained the benefits of another state to generate its income. It was shown that the benefit principle and the source principle are related, but not necessarily identical. This, however, does not harm our understanding of these two principles.

Chapter 12

Review of Concrete Rules of the International Tax Regime

12.1. Preliminary remarks

In chapter 11 we discussed the normative value of some of the most important principles that scholars, governments and international organizations use to claim a certain amendment of the international tax regime. We showed to what extent these principles are indeed normative and in what cases it is not required that these principles be obeyed by international tax policymakers aiming at the development of a just international tax regime. In the following sections, we will test some of most important rules of the current international tax regime against the demands of justice, as developed in the present study.

12.2. Rule 1: Arm's length principle

12.2.1. Preliminary remarks

The international tax regime heavily relies on the OECD MC and the UN MC, both of which follow the arm's length principle to define the price of goods and services among related parties and to allocate income between a PE and its headquarters.[2242]

It has been one of the most important binary[2243] questions in international tax law – whether the arm's length principle is still (or has ever been) reasonable or whether states should shift to a formulary system. The present study does not aim at favoring either one of the systems, but emphasizes the need for reference to political philosophy and the usefulness of normative reasoning when answering questions of allocation within the international tax regime.

2242. *See* sec. 4.2.3.3.4.

2243. The term "binary" could be misleading, as both the arm's length principle and a formulary system are not solutions carved in stone, particularly with respect to formulary apportionment. Many different proposals exist that might require further arguments (*see*, for example, on fairness and the design of a formulary system Picciotto, 1992, p. 246 et seq.).

To do so, we have collected the main arguments against and in favor of the arm's length principle and a formulary system, respectively. Based on these remarks, it should be assessed whether and which arguments indeed have a normative value and whether political philosophy could guide us to an answer to the question of which system ought to be implemented. We will again use the instrument of normative reasoning and impartiality to develop a more detailed understanding.[2244]

As will be shown in the following, our methodology will lead to a rather new and innovative solution regarding the design of an international income allocation key. Inter alia, while designing an allocation key, policymakers should consider its potential distributive impact and an allocation key should be designed to guarantee taxation. These two elements will be crucial in our analysis.

12.2.2. Normative review

12.2.2.1. Arguments against and in favor of the arm's length principle

The discussion about the arm's length principle and the potential introduction of a formulary system is intense and ongoing.[2245] In particular, the recent discussion regarding the amendments of the transfer-pricing guidelines within the BEPS Project has shown that the technical discussion of what the arm's length principle actually means is without limits.[2246] The same is true for formulary apportionment, as many different formulas have been suggested and have been used domestically, be it, for instance, in Switzerland or in the United States.[2247]

We will not further outline the precise design options for a formulary system and of the arm's length principle.[2248] However, some of the following

2244. *See* sec. 8.2.
2245. For an overview on the development of the dispute between the arm's length principle and a formulary system *see* Picciotto, 1992, p. 230 et seq. *See also* Eden, p. 153 et seq.; Navarro, p. 351 et seq.; Picciotto, 2016, p. 221 et seq.; or Turina, 2018, p. 295 et seq.
2246. *See* OECD/G20, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports (OECD 2015), p. 1 et seq.
2247. For an overview on three-factor, two-factor or single-factor formulary apportionment, *see* Fleming, Peroni & Shay, 2014, p. 32 et seq.
2248. *See*, for example, the persuasive study of Turina, 2018, p. 295 et seq., on how the arm's length principle could be amended to suit the needs of emerging markets.

arguments against and in favor of a formulary system can be scrutinized depending on the actual factors of a formulary system. The same is true with respect to some arguments in favor of and against the arm's length principle, depending on its exact design.

The main arguments against the arm's length principle compared to a formulary system are the following.

First, the arm's length principle does not produce useful results, as it is sometimes impossible to create a comparable within a group and between third parties.[2249] Or in other words, an arm's length price might not always exist.[2250] Second, also denying the suitability of the arm's length principle, the principle creates an (unintended) incentive to shift income through legal and accounting devices, while simultaneously creating distortive effects.[2251] Therefore, the arm's length standard might allow for manipulation or unintended tax-planning opportunities, or what is sometimes called "transfer mispricing".[2252] The launch of the BEPS Project might be a sign that such an argument is evident. An important third argument made against the arm's length principle is that it is excessively complex and not cost-efficient.[2253] In a similar but positive manner, it is argued that a formulary system would increase the simplicity of the international tax regime.[2254] Fourth, authors argue that the arm's length principle favors capital-exporting countries, as the residual profit is always with the residence country.[2255] Fifth, Christians and Van Apeldoorn are of the opinion that in some cases market prices may not reflect fair market values as employees are traded for less than a living wage in comparable transactions and, therefore, a market value comparison might have detrimental consequences in relation to poor countries.[2256] Lastly, it is suggested that the arm's length principle allows tax havens to

2249. E.g. Avi-Yonah, Clausing & Durst, p. 510 et seq.; Devereux & Vella, p. 6. *See also* Eden, p. 155 et seq.; García Antón, p. 183; Green, p. 37 et seq.; Kleinbard, 2016, p. 131 et seq. In this respect, *see also* Rosenbloom, p. 65, or Christians & Van Apeldoorn, p. 16.
2250. E.g. McLure, 2002, p. 587. *See also* Sadiq, p. 276 et seq.; Zucman, 2014, p. 127.
2251. Avi-Yonah, Clausing & Durst, p. 511. *See also* Dietsch & Rixen, p. 167 et seq.; Fleming, Peroni & Shay, 2014, p. 53. *See also* Zucman, 2015, p. 110 et seq.
2252. Brock & Pogge, p. 4. *See* on "abusive transfer pricing" Eden, p. 154. *See also* International Monetary Fund, Policy Paper, Spillovers in International Corporate Taxation, 9 May 2014, p. 12. For an amendment of the arm's length principle in order to adapt to the existence of highly integrated global value chains, *see* Tavares, p. 243 et seq.
2253. E.g. Avi-Yonah & Benshalom, p. 376, with further references; Dean, p. 550 et seq.; Picciotto, 2013, p. 115.
2254. Avi-Yonah, Clausing & Durst, p. 512; Green, p. 67; Li, 2002, p. 853 et seq.
2255. Li, p. 839.
2256. Christians & Van Apeldoorn, p. 18 et seq.

attract income, as this would be much more difficult if a formulary system were in place.[2257]

Against a formulary system, scholars argue as follows.

First, that it does lead to an arbitrary result, as it does not always reflect the business activity of an enterprise.[2258] Second, that the system is not practical, as it would require intense (international) cooperation.[2259] Third, the implementation of a formulary system would disrupt the business world, as multinational enterprises are applying the arm's length standard for intra-group transactions, not only driven by tax law.[2260] In a similar manner, formulary apportionment would lead to distortions, as its implementation would trigger a shift of production factors to low-tax jurisdictions.[2261] The latter is an argument brought forward by developed states.[2262] Fourth, formulary apportionment has no underlying theoretical concept, such as value creation, as compared to the arm's length principle.[2263] Fifth, on a technical note, formulary apportionment is not able to deal with exchange rate adjustments.[2264] Sixth, depending on the formula, a formulary system might be detrimental for developing states.[2265]

2257. Avi-Yonah, Clausing & Durst, p. 511. *See also* Dietsch, 2015, p. 75 et seq.
2258. McLure, 2002, p. 598; Kleinbard, 2016, p. 146. *See also* Avi-Yonah & Benshalom, p. 381; Green, p. 46; Turina, 2018, p. 303.
2259. *See* Avi-Yonah & Benshalom, p. 383. In a similar manner, *see also* p. 392 et seq., i.e. the section on "[F]ormulary apportionment would revoke current international tax arrangements and require unattainable tax coordination". Notably, Avi-Yonah & Benshalom also provide for some solutions in this respect. *See also* McLure, 2002, p. 588. *See generally* OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017), paras. 1.23 and 1.27. Such international cooperation seems not feasible at the moment (Picciotto, 2013, p. 1114, with references to a statement of Saints-Amans). *See also* Eden, p. 169, who highlights the fact that the formulary system might work at a domestic level, but at an international level, important factors are missing, such as common currency, monetary, fiscal and trade policies.
2260. *See* Avi-Yonah & Benshalom, p. 387; Sadiq, p. 277 et seq. *See also* OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017), para. 1.3.
2261. *See* Avi-Yonah & Benshalom, p. 395. *See also* Grubert & Altshuler, p. 704 et seq.
2262. *See* Fleming, Peroni & Shay, 2014, p. 35.
2263. *See* McLure, 2002, p. 587. *See also* OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017), para. 1.25. In a similar manner Navarro, p. 354, argues that the arm's length principle helps to achieve a level playing field between controlled and uncontrolled situations.
2264. OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017), para. 1.26.
2265. *See*, with respect to a formula based on revenue only, Dietsch, 2015, p. 75 et seq.

12.2.2.2. Normative review of the existing debate

The present section assesses the mentioned arguments above from a normative perspective. It is important that for a normative review, we leave our position as, for instance, representatives of businesses or representatives of tax authorities (of rich or poor countries) to achieve a persuasive and impartial result. Before going into the details, we will group the mentioned arguments in favor of or against formulary apportionment and the arm's length principle.

First, there are some implementation issues against formulary apportionment. These are important because practical constraints (as already shown above)[2266] need to be considered when policymakers refer to the existing design options. These arguments mainly relate to the political implementation process. They are relevant when discussing a change in the current setup. In this respect, it seems that currently – at least this was the outcome of the BEPS Project – a change to a formulary system does not seem feasible, as no consensus exists at an international level.

A second group of arguments relates to considerations from an economist's perspective. In simplified terms, some scholars argue that the arm's length principle compared to a formulary system leads to more distortions or vice versa. From a normative perspective, as has been demonstrated above, the validity of these arguments is limited, as they are based on global efficiency considerations.[2267] Also, such efficiency considerations are, in our view, difficult to uphold at an international level *stricto senso* as major goals of international tax policy. The main reasons are that (i) full neutrality or efficiency cannot currently be achieved due to the Westphalian world order, consisting of several sovereign states, and (ii) international neutrality or efficiency does not necessarily lead to just results and to justice in international tax law. Additionally, both allocation instruments are as such arbitrary and do not reflect a single economic principle.[2268]

Of particular importance is the third group of arguments: fairness is used as an argument both against and in favor of the two principles. McLure, for instance, argues that formulary apportionment might achieve an appropriate

2266. *See* sec. 2.1.5.
2267. *See* sec. 11.4.
2268. *See* Musgrave, 1995, p. 59. *See also* de Wilde, 2015, p. 444, who also argues that "there is no such thing as a 'correct' allocation of profit".

(fair?) result "if (and only if) the apportionment factors reflect where income originates".[2269] Or as Mayer states:

> Having chosen the benefit principle as the fundamental allocation rationale, I can only state legitimately that I am convinced that the proposed system is suitable for allocating profits to the Member States in relation to the benefits enjoyed and costs incurred and in so far satisfies the requirement of interjurisdictional equity.[2270]

Both authors refer to a principle (i.e. the benefit principle (or the source principle?)[2271] in the case of Mayer and the source principle in the case of McLure) in order to conclude that a system of income allocation is fair, appropriate or in line with the requirement of inter-state equity.

In line with the methodology in the present study, the claim for a certain tax rule is not persuasive if the underlying justification is not sufficiently reasoned. It is clear that the source principle and the benefit principle are part of the existing international tax regime, but it was also argued that these cannot provide for detailed guidance on how to allocate income among states and that an allocation following either the source or the benefit principle might even lead to unjust results.[2272] This does not mean that the two principles are not valid, as we would also agree that a state has a claim to tax income if it is generated in its jurisdiction or if an enterprise receives benefits of a state in order to generate income.[2273] The latter justifies taxation, but not the allocation of income as such. These two questions have been mixed in the past and section 11.6.2.2. focused on clarifying these ambiguities.

Moreover, it is our understanding that a discussion about which allocation instrument should be applied, i.e. a formulary system or the arm's length principle, must have a focus on the actual allocation of income and not on the allocation key as such. This means that it is not useful to discuss whether the arm's length principle is fair or just if one does not consider how income is actually allocated according to the arm's length principle. The same is true with respect to a formulary system. Therefore, while arguing in favor of one of the two alternatives, it is crucial to consider whether a certain allocation will have distributive effects. This brings us to the core issue of an allocation key, such as the arm's length principle or a formulary system: These keys have distributive effects in all cases, in the sense that

2269. McLure, 2002, p. 598. *See also*, in this sense, Dietsch, 2015, p. 75 et seq.
2270. Mayer, p. 270.
2271. He is not fully clear in this respect.
2272. *See* sec. 11.5.2. (source principle) and sec. 11.6.2.2. (benefit principle).
2273. *See*, on the interaction between the source and the benefit principle, sec. 11.6.2.4.

some states will benefit from a certain key and others will lose. Therefore, in the following, it should be discussed what our own position is regarding such (distributive) allocation of income, if any, in order to further frame our position regarding the existing allocation keys.

12.2.2.3. Our position on the allocation of income

In the following, particular reference will be made to ideas of political philosophy to broaden the discussion about income allocation in general and about the ideal allocation key to better form our own approach on how and whether income should be allocated and whether the arm's length principle or a formulary system might be more persuasive. To do so, we will distinguish two questions. First, we will refer to the issue of whether a distributive effect should be achieved by an allocation key, and secondly, we will also provide arguments as to why we suggest a destination-based allocation key, if an allocation is indeed required.

12.2.2.3.1. *Distributive duties and allocation of income*

International tax policy – and as such the question of whether a formulary system or the arm's length principle should be supported – must consider the underlying goals of such policy in general. This is particularly true given the fact that tax law might indeed be the most efficient law instrument to achieve distribution or even distributive justice.[2274] Therefore international tax policy should discuss whether or not an allocation should lead to cross-border distribution. Distributive impacts of the various allocation keys, however, have been ignored or largely neglected within the international tax debate.[2275]

We demonstrated our position above on whether there is a cross-border distributive duty.[2276] The position taken in the present study is that there is indeed a cross-border duty to support the worst off on this planet as a humanitarian duty, but there is no general duty for distributive payments from rich to poor countries, as there might be within a state following a

2274. *See* chapter 9.
2275. *See*, for some exceptions, sec. 11.3.2.3. The question of distribution and the international tax regime has not yet received the necessary attention. *See*, for example, Vogel, 1988c, p. 397, who in his seminal article is rather reluctant to state any position in this respect, even though the question of distribution is fundamental for the question of source vs residence, as discussed in his seminal trilogy.
2276. *See* sec. 8.3.

liberal concept of justice, such as the one developed by Rawls in *A Theory of Justice*, and applying it in a cosmopolitan manner. One of the underlying arguments is that the existence of several sovereign states with no extensive cross-border distributive duties enhances worldwide coherence and has a stabilizing effect on the international world order, one of the ultimate goals of a just international tax policy. Moreover, the protection of sovereignty is required to enhance domestic justice. This is very much in line with the approach of the UN to enhance domestic resource mobilization.[2277]

However, we also argued that coercion, association and social cooperation as such might – on a continuous basis – create further-reaching cross-border distributive duties, for instance, triggered by a European integration.[2278] As it was outlined above, the humanitarian duty aims at protecting some of the most essential human rights and preventing inhumane living circumstances.[2279] Therefore, the economic strength of a country is not the decisive criteria but whether a state is able to enable its residents' living conditions and the protection of the most essential human rights.

The arm's length principle, as it is currently understood, uses functions, risks and assets to allocate income among related parties resident in two different states. Formulary systems, in general, also allocate income based on parameters such as assets or functions (through a payroll or a headcount element), but also based on revenue in a certain country. However, none of the systems actually refer to the question of whether income is allocated to a country with extreme poverty or to a rich country with a very high living standard. If we consider the point of view that international tax law is a very efficient instrument to fulfill distributive duties,[2280] scholars and policy advisors should focus on drafting an allocation key that might lead to a certain distributive effect on the poorest on this planet in order to mitigate the most severe injustices and fulfill our humanitarian duties.[2281] However, both the arm's length principle and formulary systems, as they are currently drafted and discussed, are not able to fulfill such a policy goal.[2282] Therefore the

2277. *See* sec. 4.3.4.3.4.
2278. For more details about our position *see* sec. 8.3.2.
2279. *See* sec. 8.3.3.
2280. *See* chapter 9.
2281. *See*, for example, Dietsch, 2015, p. 156.
2282. It would be interesting to render in-depth research on what the allocation would be globally depending on how a formulary system is structured, i.e. whether the formula includes function, assets or revenues or all of them. Such analysis, if technically feasible, could potentially demonstrate the distributive effect of different formulary systems. However, without such a study, no remarks can be made on how a formula should be structured in order to achieve a certain distributive effect, if any.

focus of future international allocation discussions should be on more flexible solutions, if feasible. We will not present a concrete proposal within the present study, but it is suggested to increase the research in this respect, considering the following remarks.

First, the importance of the principles of sovereignty and fiscal self-determination was highlighted above. We mentioned, inter alia, two reasons for the observance of the principle of sovereignty. First, institution building within a state as such is of key importance to increase (national and) worldwide welfare. And if a state's sovereignty is constantly infringed, such state might not be able to protect and safeguard its institutions. Secondly, international peace as such is endangered if a state's sovereignty is not protected and international peace as such is crucial to achieve a just international system. Therefore an allocation key must guarantee that each state is free to tax income that was created within its territory.[2283] Additionally, there is nothing like a single taxation principle as a normative claim at an international level, which means that double taxation and double non-taxation in cross-border circumstances are not as unjust per se as they seem to be at first glance.[2284]

Second, the international tax regime has failed in the past to consider the positions of the worst off in this world and the most severe injustices, and has instead focused on the increase of tax revenue in some of the richest countries. Evidence can be drawn from the fact that the BEPS Project was launched by some of the richest countries in the world, i.e. the UK, France and Germany. The focus when designing a new allocation rule or when amending the current applicable allocation rules, however, should be – in line with the OECD convention – on the "increase of general well-being",[2285] and not on the increase of effective tax rates in general. There is a significant disparity between these two aims. An international tax policy that indeed aims at improving the situation of the worst off as a humanitarian duty also enhances the acceptance and, therefore, lowers the need for coercive elements, as states would face more moral obligations to agree on the terms and conditions.

The goal should be to design an international tax policy that suits the needs of the worst off and follows our humanitarian duties. Therefore, the BEPS Project should have, for instance, contained a specific action on BEPS in

2283. For remarks on the existing negative component of the principle of sovereignty, *see* sec. 8.4.2.
2284. *See* sec. 11.2.3.4.
2285. Preamble, Convention on the Organisation for Economic Co-operation and Development, 14 Dec. 1960.

the poorest states on this planet, i.e. how to mobilize domestic resources in these states.[2286] There should have been a specific action on questions of base erosion in states with a very low human development index, with the aim of demonstrating how such states could increase their revenue without losing their competitive position, for instance, regarding commodity extraction. This is not an easy task and we do not know what the outcome will be of such international negotiations, but as states seem to be able to find a consensus regarding harmful tax competition, it is not understandable that states are not able to find a consensus on the improvement of tax administration and an increase in tax revenue in some of the poorest states.[2287] Such a consensus would indeed help these states to improve the situation of the poorest on this planet. If we reconsider that the OECD and many scholars argue that we should achieve a neutral tax system, as this would increase worldwide welfare, it is difficult to understand why there was, in fact, no emphasis within the BEPS Project on the actual manner of how to achieve worldwide welfare.[2288] In a similar manner, for instance, Infanti further states that, "it is rare to find US commentators discussing the idea that international tax provisions may constitute foreign aid or assistance."[2289]

Third, a decisive consequence of such an understanding is that international tax policy should not focus in general on the increase of tax revenue in developing states, but rather that international tax policy should aim at the abolishment of the most severe injustices in the world, with a focus on the collection of taxes in states that do not enable human living conditions or that cannot protect the essential human rights of their residents. Therefore the goal should not be to equalize the income in all states but to avoid inhumane situations. A general support of developing states by developed states goes beyond such an approach. States, notwithstanding their domestic political structure, might draw a consensus on such a policy goal, but states might not agree, for instance, on significant payments from developed states to developing states in a more substantial manner. For instance, a more cosmopolitan perspective, which would require extensive transfer payments

2286. *See*, however, for instance, the work of the UN in relation to finance for development as outlined in sec. 4.3.4.3.4.
2287. We do not argue that the OECD and G20 have not rendered any actions regarding the improvement of revenue collection in some of the poorest states. In particular, the Tax and Development Programme of the OECD has been highly influential (about the work of the Programme *see* http://www.oecd.org/ctp/tax-global/tax-and-development.htm, last visited 10 Feb. 2019). Moreover, the work of the UN, the IMF and the World Bank in this respect is of great importance. *See also* sec. 4.3.4.3.4.
2288. On the interaction between welfare economics and tax policy in the current framework, *see* sec. 11.4.3.2.
2289. Infanti, p. 218.

from the rich to the poor countries, as a consequence of an international distributive duty, might already oppose the domestic distributive elements, as a state might domestically follow a rather libertarian structure. Such more extensive distributive elements of an allocation key are, furthermore, not in line with our understanding of global justice.[2290]

Fourth, a potential approach could be to draw an allocation key, if any, that is flexible enough to consider the economic strength of the contracting states, and particularly aims at improving the situation of the worst off on this planet.[2291] Of course, one would need to consider that the application of such an allocation key might not only require a change of double tax treaties, but also domestic law, as the poorest states have often not signed many or any double tax treaties. Critics will argue that this is a naive approach, as states will never agree to an allocation rule that contains an element leading to a higher allocation to states at the lowest part of the human development index. Another point of criticism is, of course, that the allocation of income to a certain state does not necessarily improve the situation of the worst off as, for instance, corruption and/or dictatorship might limit the reach of such allocation policy. These are indeed important concerns and constraints, and these concerns and constraints need to be considered when discussing new options, but it does not lead us to the conclusion that an international tax policy, which indeed fulfills the needs of the worst off as a humanitarian duty, is not at all feasible. Therefore, it would be a matter of structuring such an allocation that would guarantee that the income allocation helps the poorest and increases the well-being of these people.

Fifth, and closely related to the allocation of income, is the enforcement mechanism and whether an extraterritorial levy of income taxes would be a feasible solution to achieve that the poorest countries in the world are indeed able to levy their taxes on, for instance, the extraction of commodities or, of great importance, taxes on bank accounts of individuals held abroad. Therefore we should further consider whether it is an option for developed states to levy taxes on behalf of poor states. Regarding individual income and wealth taxes, this could for instance be implemented by using Rubik systems.[2292] With respect to the taxation of multinational enterprises, further research should be rendered on whether the state of residence should be obliged to levy income taxes on behalf of another state, if such a state is not able to protect its tax base, for instance, because a corrupt government

2290. *See* sec. 8.3.
2291. *See*, for example, with regard to a potential design of a formulary system, Dietsch, 2015, p. 105 et seq.
2292. *See* sec. 4.1.2.

is unable to negotiate commodity extraction contracts on fair terms, i.e. involving significant tax payments in such a country. The levy of extraterritorial taxes, however, has a major disadvantage, as the developing state might not have an incentive to develop its own institutions in order to levy income taxes in an efficient manner.[2293] This must indeed be considered, as institution building is crucial to achieving domestic justice.[2294]

Sixth, it was shown in detail that the benefit principle and the source principle as allocation principles are (i) difficult to apply, as the benefits obtained in every jurisdiction cannot be calculated precisely, and (ii) it is difficult to estimate what value creation has occurred. Furthermore, we showed that, depending on the weighting of the benefits obtained, an assumed allocation according to the benefit principle might lead to a non-persuasive allocation of income, as this could lead to unfair results, i.e. a higher allocation to rich countries. Reference is made to the example of the Haitian boxer mentioned above.[2295] In a similar manner, with respect to the source principle, we argued that depending on its understanding, it will not lead to a just result, but potentially even to an unfair distribution of income among states.[2296]

12.2.2.3.2. *Intermediate remarks*

By discussing these six points, we intended to frame our position with respect to the allocation key to fulfill humanitarian duties. Therefore, international tax policy and, in particular, the discussion about income allocation should consider the interest of the worst off on this planet as a humanitarian duty. Of course, the trade share of the least developed countries (which should be in the focus of a humanitarian duty) is very small[2297] and, therefore, it would not make sense to draft an omnipotent allocation key in the interest of these countries that only affects a very small part of all cross-border trade in goods and services.

Therefore, the allocation key should be flexible enough to allow a just allocation regarding trade with the least developed states, while at the same time

2293. There is some economic research in this area on what the impact is due to aid payments to states with rather weak institutions. The levy of taxes on behalf of other states could have similar detrimental outcomes as aid payments. *See*, for example, Oechslin, p. 631 et seq. *See also*, on aid payments and institution building, Deaton, p. 268 et seq.
2294. *See* sec. 11.4.3.2.2.
2295. *See* sec. 11.6.2.2.
2296. *See* sec. 11.5.2.2.
2297. *See*, for example, the number in Table I.20 et seq. in World Trade Organization, International Trade Statistics 2015, p. 59, available at www.wto.org/statistics (last visited 14 Feb. 2019).

enabling a just allocation, if any, regarding the major part of global trade. As we will see in the following, and to provide for a more concrete proposal for an allocation key regarding the major part of international trade, we suggest a partly destination-based allocation key. For the understanding of the following section, it is crucial to consider again that we are not arguing that justice as such requires a perfect allocation of income in the sense that each income item should only be taxed once. The single taxation principle, as was shown above in detail, has no normative value.[2298] However, if there is an agreement to enhance international trade through a reduction of cross-border double taxation, we would suggest a partly destination-based allocation key. The advantages of such a partly destination-based allocation key will be outlined in detail in the following section.

12.2.2.3.3. *Advantages of a (partly) destination-based allocation*

Notwithstanding these remarks and the question of whether a future allocation key will consider the interests of the worst off on this planet as a humanitarian duty, we suggest that an allocation key, if any, should follow a partly destination-based approach.[2299] This would mean that the revenue in a state should at least partly be relevant for the allocation of income within the international tax regime. This could, for instance, be achieved through a formulary system, which relies on revenues as one parameter. Or, the arm's length principle could also be adjusted through an enhanced application of profit-split methods, which would allow an allocation of parts of the income to the market states.[2300] Other proposals, such as the GOP Tax Plan published in 2016, are also destination-based systems, but the tax base differs from more traditional corporate income tax systems.[2301] It would go beyond the present study to discuss in detail the different proposals, particularly the GOP Tax Plan, considering various technicalities and

2298. *See* sec. 11.2.3.4.

2299. Such a claim is not entirely new, as several authors have already advocated (partial or full) destination-based tax systems (*see*, for example, Avi-Yonah, 2000, p. 1670 et seq.; Devereux & de la Feria, p. 1 et seq.; Devereux & Vella, p. 19 et seq.; Schön, 2016, p. 1 et seq.). Destination-based tax systems have gained significant momentum through the so-called Ryan Blueprint or the GOP Tax Plan in the United States (*see* Avi-Yonah & Clausing, p. 1 et seq.; Weisbach, p. 1 et seq.).

2300. An example would be an upfront allocation of 30% of the income to the market states, as suggested in another instance, with particular reference to the digital economy (Hongler & Pistone, p. 32 et seq.). *See also* Schreiber & Fell, p. 1 et seq.

2301. The proposal itself speaks of a "cash-flow tax approach" (GOP, A Better Way – Our Vision for a Confident America, 24 June 2016, p. 28). Avi-Yonah & Clausing, p. 9, use the term "modified consumption-style tax". For a comprehensive overview on the different options between traditional European VAT systems and the current proposal by the GOP, *see* Weisbach, p. 9 et seq. The GOP Tax Plan was not implemented.

policies involved. Other authors have already rendered in-depth analysis in this respect.[2302] Nevertheless, some of the following remarks are also in support of other destination-based and income-like taxes.

The goal is to demonstrate in the following why an allocation of the income tax base should follow a more destination-based approach. Again, the level of abstraction in the present study should allow for the outlining of the main elements of a just international tax regime without having to deal with different implementation concerns, such as the compatibility of a destination-based corporate income tax with WTO law,[2303] double tax treaties[2304] or technical implementation issues.[2305]

If international policymakers indeed want to implement an international tax regime that allocates corporate income in a manner that should avoid both double taxation and double non-taxation (if this is considered to be just),[2306] namely a system that follows the single taxation principle, we would support a (partly) destination-based system. Two main arguments support such a position.

First, and this seems self-evident, if one suggests an allocation key, the key as such should ensure taxation. Or in other words, it would not be persuasive to suggest an allocation key that leads to no taxation from a consolidated perspective, as otherwise the necessity of taxation as such is questioned and, therefore, the necessity for an allocation is questioned. We are of the opinion that a more destination-oriented allocation key or destination-based taxation mitigates the risk of artificial profit-shifting considerably. The latter is a major reason why value added taxes (VAT) have gained momentum in recent decades, as consumption taxes are more difficult to circumvent compared to income taxes in cross-border circumstances, i.e. it is more difficult to implement profit-shifting or base-erosion schemes.[2307] Consequently, the argument in favor of taxation (i.e. the need for fiscal revenue) suggests that destination-based allocation keys are justified. Therefore, the underlying justification is not that it aligns with any potential distributive duties, but

2302. Weisbach, p. 1 et seq.
2303. *See generally* Schön, 2016, p. 1 et seq. With a particular focus on the GOP Tax Plan *see* Avi-Yonah & Clausing, p. 5 et seq.
2304. *See*, with a particular focus on the GOP Tax Plan, Avi-Yonah & Clausing, p. 14 et seq.
2305. *See* Weisbach, p. 1 et seq.
2306. *See* our position in sec. 11.2.3.4.
2307. On the design deficiencies of the GOP Tax Plan *see*, for example, Avi-Yonah & Clausing, p. 18 et seq. Of course, the question of circumvention and VAT triggers a variety of technical questions that would go beyond the present study.

rather that a more destination-based method seems to ensure taxation and, therefore, to protect fiscal self-determination. The latter is an important goal of our normative understanding of global justice.[2308]

A second argument, also favoring destination-based allocation keys, derives from the source and benefit principles, as understood above.[2309] We could also state it differently: both the benefit principle and the source principle, as understood in the present study, support a destination-based allocation key. We have seen above that both the benefit and source principles are normatively valid and are convincing, however, they are "only" understood as justification-to-tax and limitation-to-tax principles. Although we have also seen that an allocation that follows the source and the benefit principle faces, inter alia, the practical constraints that both the value creation (source principle) and the benefits obtained (benefit principle) can be measured in various manners and, therefore, there is no single understanding of both the source and benefit principles that necessarily leads to a just allocation of income.

Nevertheless, this still means that both the source principle and the benefit principle need to be considered when drafting a new allocation key, but that an allocation in accordance with these principles can be drafted in various manners. In this respect, we would argue that a more destination-based corporate income tax system would allow for the achievement of an allocation based on value creation and benefits obtained, while simultaneously ensuring fiscal self-determination. At least it seems clear that such an allocation would not conflict with the source and benefit principles.

This is true, as the market as such or the consumers (i.e. the place of revenue) are value creating. This was shown in detail in a different study with respect to the digital economy,[2310] but it is also true with respect to other industries. Demand as such seems to create value, even though the involvement of the consumers might be different, depending on the industry. For instance, if I buy a BMW, as a consumer, I will have a marketing function, as the logo of BMW will be further distributed due to my driving around the city in which I live. The same is true with respect to the benefit principle. We would argue, for instance, that market states also contribute with their benefits to the successful sale of a good. Again, this is obvious with respect to the digital economy; for instance, the business of Google would not work without the necessary IT infrastructure in the relevant revenue states.

2308. *See* sec. 8.4.
2309. *See* sec. 11.6. (benefit principle) and sec. 11.5. (source principle).
2310. Hongler & Pistone, p. 1 et seq. *See* Devereux & de la Feria, p. 11.

However, this is also true with respect to other industries. For instance, a car producer would sell fewer cars if states did not provide for the necessary infrastructure (i.e. streets, traffic lights, etc.). Therefore, as an example, BMW directly benefits from the services of different states toward their inhabitants. For instance, if Sudan builds better roads in the future, BMW is likely to sell more cars in the Sudanese market and BMW will sell more cars in general, thus creating more value in Sudan.

An argument often made against a more destination-based corporate income tax system is that it would blur the distinction between consumption taxes and corporate income taxes. However, this is not the case if the income is still the tax base and not revenue.[2311] Of course, this requires an in-depth analysis of how a (partly) destination-based taxation system could be enforced in the market states without levying taxes on gross revenue. Nevertheless, the mere fact that revenue plays a role in the allocation of the income base does not as such lead to the conclusion that an income system is unjust or unfair. Moreover, even if direct and indirect taxes are mingled, such as in the GOP Tax Plan, it does not mean that the system would be unjust at a global level. Global justice, as understood in the present study, does not even require that states levy corporate income taxes. States could also levy other taxes, such as only VAT, or intermediate taxes, such as the GOP Tax Plan, and global justice could still be secured. Of course, domestically, a constitution might require the levy of corporate income taxes.

A last argument could be that a (partly) destination-based allocation key would minimize economic distortions.[2312] However, as we have seen above, we believe that cross-border efficiency does not necessarily enhance justice within the international tax regime and, therefore, the argument that destination-based models would lead to fewer distortions is a weak argument either in support of or against a just international tax regime.

12.2.3. Intermediate conclusion

In previous sections, we outlined our opinion that justice per se does not require that income be perfectly allocated among jurisdictions, i.e. following a single taxation principle.[2313] Nevertheless, we focused in section 12.2.2.3.3. on the question of how to draft a just allocation if justice would indeed require that income be only (but at least) taxed once, and

2311. *See generally* Devereux & de la Feria, p. 9.
2312. *See* id., p. 1 et seq.
2313. *See* sec. 11.2.3.4.

whether the arm's length principle or a formulary system is more persuasive. We showed that the international allocation key should be drafted in a way that allows the increase of the well-being of the poorest in the world to fulfill our humanitarian duties. It was advocated that international organizations, such as the OECD, should dedicate an important part of their work to revenue improvements and protection in these states. Again, to avoid any misunderstandings, we are not in favor of a cosmopolitan or an egalitarian claim that aims at aligning the income per capita among states worldwide, but we do believe that international tax law, particularly the attribution of taxable income, should consider the position and the interest of the worst off as a humanitarian duty in order to avoid some of the most severe injustices.[2314]

This is one aspect that should influence international tax policy. However, we also argued that this would affect only minor parts of global trade. For the large part of global trade, we have also seen that there is a need for an allocation key, if any, to be drafted in manner that disallows circumventing taxation, or else the claim for taxation as such is weak. In other words, if we advocate in favor of taxation, we would need to support an allocation key with a low circumvention quota. Therefore we suggested that revenue as such should be an element to be considered when drafting an allocation key. A (partly) destination-based regime cannot easily be circumvented and it protects the purpose of taxation, i.e. the levy of tax revenue. It was also shown, however, that a destination-based tax system is justified, considering both the benefit principle and the source principle as justification-to-tax principles. Furthermore, it was also argued that only parts of the income are allocated to the market states, as otherwise the benefits obtained in the production states (not in the market states) and the value created in the production states would be ignored.

In conclusion, a just allocation key, if any, should consider the interests of the worst off on this planet, but it should also partially lead to an allocation to the destination of the products or services in order to ensure taxation and to align with the source and benefit principles as justification-to-tax principles. As a matter of fact, depending on the design, both the arm's length principle and a formulary system could cope with these needs. We suggested a formulary system relying partly on revenue or an enhanced use of the profit-split method as a transfer pricing method for the arm's length principle. However, as indicated in the introduction, these remarks assume that there is indeed a need for an allocation key, which we would deny.

2314. *See* secs. 8.1. and 8.3. on the issue that left and right institutionalist approaches might overlap depending on the exact interpretation of both a global difference principle and a global humanitarian duty or the duty to assist burdened societies.

Justice as such does not require that income be perfectly allocated among the involved jurisdictions. Double taxation and double non-taxation are not detrimental to our understanding of global justice.

12.3. Rule 2: CFC rules

12.3.1. Preliminary remarks

The discussion on Action 3 within the BEPS Project on the strengthening of CFC rules has shown that there seems to be broad agreement among the OECD member countries on the need for CFC rules. However, the devil is in the details and a worldwide harmonization of CFC rules is extremely challenging and faces legal constraints, inter alia, due to the case law of the ECJ in the *Cadbury Schweppes* case.[2315] Therefore, in the BEPS Project, the OECD/G20 was not successful in forcing states to harmonize their CFC rules or even force states to implement CFC rules. In the post-BEPS world, it is still within the discretion of the states whether they want to include CFC rules at all in their domestic laws and how they should be designed. However, the inclusion of CFC rules obligation into the ATAD in the EU was a strong sign in favor of such a measure as a global standard.[2316]

From our perspective, what is missing in the debate about potentially "strengthening CFC" rules[2317] – or as it was later called, "designing effective CFC rules"[2318] – is (i) a discussion about the compatibility of CFC rules with international law and (ii) a discussion about whether CFC rules as such do have a normative value. Or in other words, it should be evaluated whether CFC rules indeed lead to a just international tax system, as intended by the BEPS Project. The first question was discussed above;[2319] the present section will further analyze the second issue. To do so, it is again of importance to outline the main pro and contra arguments of CFC legislation before rendering a normative review.

2315. *See* on this discussion, for instance, Smit, 2014, p. 259 et seq. *See also* OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3 -2015 Final Report (OECD 2015), p. 17 et seq.
2316. *See* art. 7 et seq. ATAD.
2317. This was the term used within the Action Plan (*see* OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), p. 16). In the final reports, the OECD/G20 used "Designing CFC rules" (*see* OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report (OECD 2015).
2318. Id., p. 1 et seq.
2319. *See* sec. 4.1.2.2.5.

12.3.2. Arguments in favor of and against strengthening CFC rules

The most important advantage of CFC rules (not from the perspective of the taxpayer) is that they lead to a significant expansion of the tax base[2320] and, depending on the design, they indeed prevent the (artificial) shifting of income to the jurisdiction of the subsidiary. The latter means that companies with foreign operations face, from a consolidated perspective, the same (or a similar) tax burden as groups that are active only domestically. Therefore, CFC rules might indeed lead to the equal treatment of domestic companies with domestic operations and domestic companies with foreign operations, but only from the perspective of the parent state.

As was seen above with respect to the ability-to-pay principle, a worldwide tax system as such might (partly) guarantee equal treatment, but only in one of the involved states, i.e. the resident state of the parent company with regard to CFC rules. In the source state, the application of CFC rules might lead to an unequal treatment, not reflecting a potential global application of the ability-to-pay principle. CFC rules, furthermore, allow the allocation of foreign income without referring to the complex transfer pricing mechanism.[2321] Therefore simplicity reasons seem to favor CFC rules. As already indicated, CFC rules are, furthermore, also useful to limit aggressive tax planning or avoidance schemes,[2322] inter alia, through deterrent effects.[2323]

An important issue raised by Kane relates to the sovereignty aspect of CFC rules.[2324] Kane argues that to avoid foreign-to-foreign stripping, it is superior to strengthen CFC rules and not force a foreign country to implement a response rule according to Action 2 of the BEPS Project, as one cannot expect the foreign country to change its tax base just because of the request of the other party. Therefore, following such an understanding, it is not possible to enforce the application of linking rules (as proposed in Action 2 of the BEPS Project) in another state, but a similar result could be achieved by using CFC rules without infringing the sovereignty of another state. However, an important argument made in the present study against CFC

2320. *See*, with respect to Action 3 of the BEPS project, Kane, 2014, p. 321. *See also* OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report (OECD 2015), p. 14.
2321. Kane, id.
2322. *See*, for example, with respect to the Chinese CFC regime Li, 2014, p. 536. *See also* para. 1 of the Preamble to the ATAD.
2323. *See* OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report (OECD 2015), p. 13.
2324. Kane, 2014, p. 325 et seq. *See also* OECD/G20, id.

rules is that CFC rules per se (depending on the design) might infringe the principles of sovereignty and fiscal self-determination of another state.

An argument against CFC rules is that they lead to the unequal treatment of companies having a subsidiary in a low-tax jurisdiction and companies with a subsidiary in a high-tax jurisdiction (i.e. a higher tax rate than in the parent state). It could even be that CFC rules infringe constitutional rights in this respect.[2325] Depending on the structure, CFC rules might also lead to the unequal treatment of domestic and foreign subsidiaries.

In the following, we will review these arguments and demonstrate whether CFC rules should indeed be implemented and strengthened to enhance justice in the international tax regime. Therefore, we will focus on the question of whether international tax policy should indeed, from a normative perspective, aim at "strengthening" CFC rules or whether international tax policy should aim at "weakening or abolishing" CFC rules.

12.3.3. Normative review

12.3.3.1. Preliminary remarks

Prima facie, it seems in line with the position taken in the present study regarding the source and benefit principles that CFC rules as such are by no means a desirable legislation, as these rules infringe the sovereignty of other states, as taxes might be levied on income that was created exclusively abroad (source principle) by exclusively obtaining the benefits in another state (benefit principle) and, therefore, taxation should be in the other state. We outlined our understanding of the source and benefit principles as not only justification-to-tax principles, but also limitation-to-tax principles above.[2326]

It is fair to argue with Bühler that the taxation of income of a foreign subsidiary is a "radical" measure[2327] and that CFC legislation (such as that of the United States in place since 1962) touches the border of admissibility from a fiscal sovereignty perspective as a legal constraint.[2328] However, in order to further discuss whether there is a normative need for CFC rules, in

2325. *See*, with further references from a German perspective, Maciejewski, p. 449 et seq.
2326. *See* sec. 11.5.2. (source principle) and sec. 11.6.2. (benefit principle).
2327. Bühler, p. 265.
2328. Id., p. 118 et seq. *See* sec. 4.1.2.2.5.

line with our methodology, we will refer to the different ideas of political philosophy in order to develop a well-reasoned and impartial result that is in line with Sen's methodology outlined in *The Idea of Justice*.[2329]

The research question, therefore, is whether the implementation of CFC rules that lead to the taxation of income of a foreign subsidiary is just. The following assessment will mainly be based on two legs. On the one hand, we will analyze what the interaction is between CFC rules and the principles of sovereignty and fiscal self-determination as a normative guideline, and, furthermore, we will analyze the impact on the distribution of income and the application of CFC rules. These two sections should allow us to develop a rather comprehensive understanding of whether justice requires that CFC rules be strengthened, as suggested by the OECD/G20.

12.3.3.2. CFC rules and the principle of fiscal self-determination

12.3.3.2.1. *Concerns of fiscal self-determination*

One could argue, based on our standpoint on the principles of sovereignty and fiscal self-determination, that CFC rules as such should be abolished, as these rules must be understood as an infringement of the sovereignty of the CFC state – maybe not from a legal perspective, but from a normative perspective.[2330] As argued above, it is our understanding that states should, as a normative claim, refrain from infringing the sovereignty and endangering the fiscal self-determination of other states. The reason is that the principle of fiscal self-determination is essential to secure the current world order, which has brought us a huge increase in welfare and a significant reduction in inter-state wars. Furthermore, obeyance of the principle of fiscal self-determination is essential to allow justice in a domestic setting, as it favors and supports domestic institutions, and allows states to maintain their fiscal self-determination. What does that mean, however, from a tax perspective with respect to CFC rules?

The principle of fiscal self-determination would require that a state (or the people of a state, respectively) can decide whether it would like to levy corporate income taxes, VAT, income taxes or inheritance taxes, unless such a state does not infringe the sovereignty of another state with its policy. It should also be at the discretion of each state (and ideally at the discretion of

2329. *See* sec. 7.7.
2330. *See* sec. 4.1.2.2.5. On the so-called Baucus plan and the principle of sovereignty, *see* Dietsch, 2015, p. 74.

the democratic will) whether it would like to have a high or low expenditure quota, even though economic weakness might limit a state's leeway anyway.[2331] As mentioned in several instances and in the introduction to this study,[2332] the international legal structure in general and the international tax regime must be able to be considered just by different states with various (and very different) societal concepts. In an extreme situation, the international tax regime must be able to be considered just from both a socialist and a libertarian perspective. This is a decisive reason why we suggested that it is crucial that the principle of fiscal self-determination be protected, as it might also protect the (democratic) will of societies regarding the level of distribution.[2333]

From a fiscal perspective, this means that a state shall refrain from taxing income that has no link to a certain territory. States shall, furthermore, refrain from taxing the entire worldwide income of an enterprise that has only a limited link to a territory. We mentioned above that the source principle[2334] and the benefit principle[2335] should be understood as limitation-to-tax principles and justification-to-tax principles. This means that if an enterprise generates income that is sourced in two or more states, and/or if such an enterprise receives benefits from two or more states, that income should not only be taxed in one jurisdiction. With respect to CFC rules, we would assume that CFC rules solely based on the applicable tax rate (and not on any avoidance schemes) are as such unjust rules, as they ignore people's freedom to decide on their own tax system and they infringe the principle of fiscal self-determination.

The situation is different if CFC rules as such are implemented to fight abusive structures aiming at eroding the tax base in the parent state (but not the worldwide tax base). In this case, the substance of the activity of an enterprise might indeed not be in the CFC state, but in the state of the parent company and, therefore, the implementation of such CFC rules would still be in line with the principles of sovereignty and fiscal self-determination.[2336] However, there are still limitations, as the enterprise might not have any activity in the CFC state and might not obtain any considerable benefit from the CFC state, but the enterprise may actually be located in third states and/or

2331. *See* sec. 8.4. on our more narrow understanding of the term "fiscal self-determination".
2332. *See* sec. 2.1.2.
2333. *See* sec. 8.4.1.
2334. *See* sec. 11.5.2.
2335. *See* sec. 11.6.2.
2336. In these cases, CFC rules would protect the base of the parent state and not the base of any other state (for different policies in this respect *see* OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report [OECD 2015], p. 16).

might obtain considerable benefits in a third state. In this case, CFC rules can lead to unjust results if these rules allocate the overall profit of the company.

If a state implements CFC rules and does not require that the group uses an abusive structure eroding the tax base in the parent state, according to the benefit and source principle, the application of CFC rules qualifies as a coercive measure, as a state might be forced to change its domestic tax system even against the democratic will in such a state, and as other states might otherwise tax income that was created in the CFC state by using the benefits in the CFC state. When debating about coercive measures, also with respect to the application of CFC rules, it is worth referring again to Blake and his remarks on the use of coercive measures among states. As mentioned above, Blake follows an eliminate-or-justify approach when dealing with a coercive system.[2337] From a domestic perspective, we would try to justify coercive measures of the state by arguing that all citizens benefit from the use of coercive measures, for instance, the use of police forces to reduce crime. At an international level, however, the use of coercive measures by one state against another state might not be justified in a similar manner and, therefore, it seems persuasive to aim at abolishing such coercive elements at an international level. The latter would, for instance, require that CFC rules be drafted aiming at avoiding abusive structures eroding the tax base[2338] in the parent state and avoiding forcing other states to raise their tax rates and/or to tax income, notwithstanding the fact that it has no or a very limited link to the parent jurisdiction.

We will now focus on some remarks in this area within the BEPS Project and demonstrate whether the OECD/G20 considers such intermediate conclusions on the principles of sovereignty and fiscal self-determination.

We showed above that CFC rules and, in particular, the relevant threshold for the application of CFC rules should be drafted in a way that aligns with the principle of fiscal self-determination. The OECD/G20, however, has a rather strange and essentially unjust approach when discussing the specific threshold recommendations for CFC rules. The OECD/G20 explicitly denies the need for an anti-avoidance threshold, which would allow the application of CFC rules only in the event of avoidance schemes and an erosion of the parent state's tax base. The reason is that this would narrow the effectiveness of CFC rules or, in the words of the OECD/G20:

2337. Blake, 2011, p. 567 et seq.
2338. Tax base means income that was created in the parent state by using the benefits in the parent state.

> An anti-avoidance threshold requirement would only subject transactions and structures that were the result of tax avoidance to CFC rules. This could narrow the effectiveness of CFC rules as preventative measures, and it could also increase the administrative and compliance burdens of CFC rules if it were administrated as an up-front rule. Additionally, an anti-avoidance rule should not be necessary if the rules defining the income within the scope of a CFC regime are properly targeted. An anti-avoidance requirement is therefore not considered further in this report, but this is not intended to imply that an anti-avoidance requirement can never play a role in CFC rules that tackle base erosion and profit shifting.[2339]

This is a highly interesting statement, as it shows the biased approach of the OECD/G20 aiming at achieving a higher effective tax burden or, in their terms, more effective taxation. The OECD/G20 does not (at all) consider the impact of CFC rules on the fiscal sovereignty and fiscal self-determination of the CFC state. Furthermore, also regarding so-called substance analysis, the OECD is rather reluctant to consider fiscal sovereignty as an important aspect of global justice. The substance analysis would require that the parent jurisdiction evaluate the substance in the CFC state and if there is sufficient substance, it would (partly) deny the application of the CFC rule. However, the OECD highlights the potential complexity and expense of these rules and is generally rather reluctant to issue a recommendation to the state that these analyses should be included in the domestic CFC legislation:

> Substance analyses generally increase the accuracy of CFC rules, but this increased accuracy must be weighed against the increased complexity and expense of more fact-intensive substance analyses. Depending on their policy objectives, some jurisdictions may prioritise accuracy over simplicity, but others may design their rules to make their substance analyses more mechanical and less complex.[2340]

Moreover, the OECD/G20 clearly states that the aim of the BEPS Project is to prevent the erosion of all tax bases, not just of the parent state's tax base.[2341] Therefore, it is argued that CFC rules only aiming at stripping the parent state's tax base are not effective and should not be implemented. This means that the OECD/G20 implicitly suggests that states should protect the tax base of other countries through CFC rules.

These statements reveal the problematic approach taken by the OECD/G20, as the effectiveness of CFC rules, which basically means the application of higher effective tax rates at a consolidated group level (and higher global tax

2339. OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report (OECD 2015), p. 36.
2340. Id., p. 49.
2341. *See* id., p. 16.

revenue), is considered to be more important than the fiscal self-determination of states. Or to state it differently, the OECD/G20, when recommending CFC rules, mainly ignores whether and under what circumstance a CFC rule indeed infringes the independence of a state, as the sole goal seems to be to increase taxes from multinational enterprise. The protection of fiscal self-determination, however, is central to our understanding of global justice.[2342]

12.3.3.2.2. *Are CFC rules necessary to protect fiscal self-determination?*

A general argument in favor of the anti-BEPS measures is that a fight against base erosion and profit shifting is necessary, as base erosion and profit shifting undermine the sovereignty of states to tax their residents. This is a claim that should be briefly reviewed in the present section to allow for a comprehensive understanding of the tension between CFC rules and fiscal self-determination.

Again, as developed above regarding the benefit and source principles, we are of the opinion that the principle of fiscal self-determination requires that states be able, at their discretion, to tax income that was created in a certain state, and that states can tax income created by using governmental benefits in a certain state. However, we also argued that these normative principles require that states do not tax income created in another state by using the benefits of another state. Therefore, the question is whether base erosion and profit shifting indeed undermine fiscal self-determination and whether strengthening CFC rules is the appropriate answer to such potential danger.

Prima facie, base erosion and profit shifting might of course undermine the fiscal self-determination of states, as both base erosion and profit shifting might disallow a state to tax income that was created in its territory by using its governmental benefits. Therefore, a state – due to base erosion and profit shifting – might not be able to tax income as required by our understanding of the principle of fiscal self-determination.[2343] CFC rules, however, are not a measure protecting taxation in line with our understanding of the source and benefit principles as normative goals of international tax policy. CFC rules, generally speaking, protect worldwide taxation in the resident states, which is not at all required in order to protect the fiscal self-determination of a state and in order to achieve a just international tax regime. Our understanding requires that base erosion and profit shifting be avoided in the state where the income is created and benefits are obtained.

2342. For our reasons and understanding of the term "fiscal self-determination" *see* sec. 8.4.
2343. On the different opinions *see* id.

As mentioned above, the OECD/G20 argues moreover that CFC rules should be implemented and understood in a broad manner, as this would also allow protection of the tax base in third countries, particularly in source countries (including developing countries). It is undeniable that the implementation of CFC rules might lead to fewer foreign-to-foreign stripping transactions, which could indeed lead to higher taxes levied in source countries. This was already argued in the BEPS Action Plan:

> While CFC rules in principle lead to inclusions in the residence country of the ultimate parent, they also have positive spillover effects in source countries because taxpayers have no (or much less of an) incentive to shift profits into a third, low-tax jurisdiction.[2344]

However, if the OECD/G20 would indeed support the needs of source countries and the protection of the fiscal sovereignty of source states, CFC rules should include a transfer of fiscal revenue levied on income that was indeed created in the source country by using the benefit of the source country. This would mean that the income levied on income created in other countries could be taxed in the parent state, but the levied revenue should be transferred to the state whose tax base is eroded. Otherwise, this is again an inconsequent application of the source principle, as the application of CFC rules does not at all follow the principle that taxation should be in the state where value creation occurs. The application of CFC rules follows, in very simplified terms, the goal that taxation should be in the residence state unless the source state levies higher taxes. This would, for instance, be the case if all states would implement CFC rules. However, there is no normative argument supporting such an approach. This brings us to the next section, focusing on the distributive impact of CFC rules.

12.3.3.3. Distributive duties

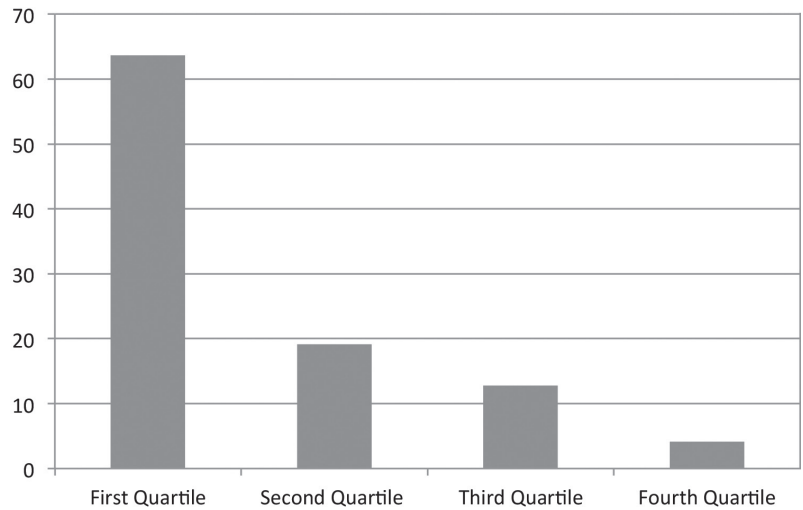
The methodology of the present study aims at a better and more diverse understanding of justice considerations in international tax law by rendering an in-depth analysis of some principles and rules from an impartial perspective. We have already used the principles of sovereignty and fiscal self-determination to judge whether CFC rules are indeed just and whether it is a just policy step to propose the strengthening of CFC rules at an international level, as stated in Action 3 of the BEPS Project. In the following, we will further highlight the interaction between CFC rules and international distributive duties, if any. In this respect, reference is made to our remarks in Part III of the present study, where we discussed the different opinions existing

2344. OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), p. 16.

among philosophers on whether there are and to what extent cross-border distributive duties.[2345] We demonstrated above that it is our understanding that there is indeed a certain distributive duty, as a humanitarian duty, to support the poorest on this planet. However, we further argued that we do not claim that there is a duty for a more cosmopolitan perspective, which would require a considerable transfer of funds from rich to poor countries in order to achieve a strong alignment of GDPs per capita at a global level.[2346]

We suggested following a continuous approach and, depending on the social cooperation and coercive system between two states, that distributive duties beyond humanitarian duties might also exist at an international level.[2347] Again, this means that the more integrated two countries are, the more duties might exist. This leads us to the question of how CFC rules operate within this framework of limited cross-border distributive duties.

To see how CFC rules currently function and whether CFC rules might indeed be seen as an instrument to achieve a just system, we analyzed the link between the GDP of countries and the likelihood of having a CFC rule. The "First Quartile" in the following figure consists of the 25% largest economies in the world (47 states). Sixty-four percent of these states have CFC rules as of 1 January 2015. In the "Second Quartile" 19% of states know CFC rules and 13% and 4% in the "Third Quartile" and "Fourth Quartile".



2345. *See* chapter 7.
2346. *See* sec. 8.3.
2347. *See* sec. 8.3.2.

We used the GDP estimates for the year 2013, as published by the World Bank, and we have used the IBFD Research Platform to decide whether a country has a CFC rule. In total, 189 states were reviewed. There are some minor inconsistencies between the IBFD platform and the data of the World Bank, and we deleted a few states, since it was not clear whether these states have or do not have CFC rules. Furthermore, there are a few deviations between the IBFD platform and the data of the World Bank with respect to which countries indeed qualify as self-governed states. However, the chosen amount of 189 states still seems to be sufficient to demonstrate a potential link between the economic strength of a state and the likelihood of the implementation of CFC rules.

The result is not surprising, as it evidently proves that the higher the GDP in a country, the higher the likelihood that a state has a CFC rule. There are many reasons for this, such as the fact that poor or small states might not be able to implement a CFC rule in their domestic tax code due to its complex implementation requirements. Furthermore, the fact that capital export is considerably lower in poor states means that the need for CFC rules and the efficiency of CFC rules might also be smaller. However, such data also shows important arguments against the use of CFC rules. The percentage within the first quarter is considerably higher for large economies. One reason might be that the negotiation position of large economies is generally stronger than that of smaller economies.

As the data shows, strengthening CFC rules, prima facie, leads to an allocation of income to large economies.[2348] We would, therefore, argue that "strengthening" these rules as such is – different from the perspective of the OECD/G20 within the BEPS Project – not necessary to achieve a just global tax system. Moreover, these rules can even be considered as contra productive concerning existing cross-border distributive duties if they apply notwithstanding the poverty level in the CFC state. In other words, our understanding of cross-border humanitarian duties would actually require that CFC rules should, for example, under no circumstance apply if the CFC country is unable to fulfill basic human entitlements and is considered one of the poorest states. This is true because the application of CFC rules might hinder investments in such countries and, therefore, potentially increase welfare. The application of CFC rules if the inhabitants of the CFC state face severe poverty seems unjust and cannot be justified by its role in fighting base erosion or profit shifting.[2349]

2348. However, we cannot fully explore the economic impact of CFC rules (*see*, for example, Egger & Wamser, p. 77 et seq.).
2349. *See* sec. 11.4.3.2.2.

In other words, if states introduce CFC rules (which are, as was shown above, already problematic from a sovereignty perspective), they should at least distinguish whether the CFC state, for instance, is Sierra Leone or Luxembourg, or whether it is the Democratic Republic of Congo or the Netherlands. This might lead to distortions, as investments into extremely poor countries would benefit from the non-application of CFC legislation, but as we have seen above, the claim for a neutral international tax regime faces practical constraints due to the different tax rates, and neutrality as such is not a fundamental principle of the international tax regime from which no deviation should be made. Therefore, if the design of CFC rules has a distortive effect of increasing investments in some of the poorest countries in the world, such policies would find support. However, according to the recommendations in Action 3 of the BEPS Project, the fiscal capacity of the CFC jurisdiction and the poverty of the inhabitants in a certain jurisdiction are irrelevant for the design of CFC rules.

The considerations of the OECD/G20 on strengthening CFC mainly relate to the question of how to achieve more effective CFC rules, which basically means how to increase the fiscal revenue in states applying CFC rules.[2350] Such an outcome is not surprising, given that the goal of Action 3 "was to develop recommendations for CFC rules that are effective in dealing with base erosion and profit shifting".[2351] Interestingly, the OECD deals explicitly with the question of what the different policy goals of CFC rules might be, depending on whether a state follows a worldwide or territorial tax system.[2352] The OECD/G20 does not, however, further discuss the potential negative impact that CFC rules might have on poor countries.

12.3.4. Intermediate conclusion

In conclusion, we referred to the principle of fiscal self-determination and to the potential existence of cross-border distributive duties as aspects of theories of global justice to discuss whether CFC rules should be considered just and/or lead to a just international tax regime. We argued that CFC rules might only lead to a just international tax regime if the tax rate in the CFC

2350. The OECD/G20 changed the title from "Strengthen CFC Rules" to "Designing Effective Controlled Foreign Company Rules" in its final report (*see* OECD/G20, Base Erosion and Profit Shifting Project Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report [OECD 2015]).
2351. Id., p. 11.
2352. *See* id., p. 15 et seq.

state as such is not the triggering event, but rather the fact that the tax base in the parent state is eroded, i.e. that the parent state can otherwise not tax income created in its territory. Otherwise, these rules infringe the principle of fiscal self-determination. The remarks on the source principle and the benefit principle have shown that these principles have normative value, as well as a limiting effect, in the sense that worldwide tax systems that are enforced by strong CFC rules are unjust, as they also catch income created abroad by using the benefits of a foreign country.

Furthermore, considering distributive duties at an international level, we showed that the data on the application of CFC rules at an international level indicated that CFC rules are mainly applied by large economies and, therefore, strengthening CFC rules leads (at least) partly to an allocation of income to large economies, which might have a detrimental effect on poorer states or weaker economies. However, not only within Action 3, but also within the entire BEPS Project, the OECD neglected any distributive considerations. Therefore, the starting point of a redesign of the international tax regime should always be an analysis of potential cross-border distributive duties, as these might significantly impact the result of a global negotiation.

12.4. Rule 3: Mandatory arbitration

12.4.1. Preliminary remarks

The question to be answered in the present section is whether we should indeed include mandatory arbitration clauses in each double tax treaty to achieve a just international tax regime. To be more precise, the question to be answered is whether justice requires the implementation of an arbitration clause or a similar dispute resolution mechanism in double tax treaties. To develop a response in this respect and as already mentioned in several instances, we will use the instruments of reasoning and impartiality, following Sen's *The Idea of Justice*, to decide whether a double tax treaty without an arbitration clause is unjust.[2353] In the following, we will first illustrate the existing arguments against and in favor of mandatory arbitration clauses[2354] before we render a normative review of the questions at hand.[2355]

2353. *See* sec. 8.2.
2354. *See* sec. 12.4.2.
2355. *See* sec. 12.4.3.

12.4.2. Arguments in favor of and against mandatory arbitration

One of the main arguments in favor of mandatory arbitration in a double tax treaty circumstance relates to the need to avoid double taxation. If a treaty only provides for a MAP, the risk of double taxation is not mitigated, as the contracting states are not required to resolve actual juridical double taxation.[2356] The OECD/G20 included a particular action in the BEPS Project concerning dispute resolution. The goal was to enhance the effectiveness of MAPs and other dispute resolution mechanisms in general.[2357] In this respect, it is argued that double taxation is not mainly resolved through actual arbitration procedures, but rather, the main effect of an arbitration clause "is prophylactic as it prevents failures of the mutual agreement procedure by strongly encouraging the competent authorities to compromise in order to reach an agreement".[2358]

In a similar manner, it is held that arbitration is necessary, as there is a lack of legal protection within a double tax treaty if the two contracting states apply a different interpretation of a certain provision.[2359] Furthermore, an effective dispute resolution mechanism, such as mandatory arbitration, leads to more certainty and predictability.[2360] As stated by Perrou: "Taxpayers, however, derive rights directly from the double taxation conventions and where a substantive right exists there must be an effective procedural right that guarantees the enjoyment of the substantive right (*ubi jus ibi remedium*)."[2361]

An argument brought forward against arbitration relies on the potential technical expertise within an arbitration procedure, which can be different between strong and weak economies. This means that strong economies might have access to more sophisticated advisory services. In a similar way, one could argue that the potential costs of arbitration procedures must be a disadvantage for developing countries.[2362] It could even be argued that an

2356. *See*, for example, the Swiss position in this respect, Schelling, p. 220. On the topic of double taxation and the need for arbitration *see* Farah, p. 710; Van Vlem et al., p. 231 et seq. *See*, with further references on the weakness of the mutual agreement procedure, Lehner, in: Vogel & Lehner, Article 25 para. 199a et seq. *See also* Tillinghast, p. 91.
2357. *See generally* OECD/G20, Making Dispute Resolution Mechanisms More Effective, Action 14: Final Report (OECD 2015), p. 1 et seq.
2358. Ault & Sasseville, p. 215. *See also* Desax & Veit, p. 429.
2359. Züger, p. 1 et seq.
2360. OECD/G20, Making Dispute Resolution Mechanisms More Effective, Action 14: Final Report (OECD 2015), p. 9.
2361. Perrou, p. 83.
2362. But *see* Ault & Sasseville, p. 214.

arbitration clause infringes a domestic equality principle as it only grants a right to appeal to foreign investors and not to domestic taxpayers.

Important for the purposes of the present study is the argument that the transfer of judicial competences to a non-governmental arbitration body undermines the sovereignty of a state.[2363] In this respect, sovereignty means that a state can no longer decide whether or not a certain item of income should be taxed, as such a decision is within the discretion of an arbitration court. But of course, sovereignty is already (voluntarily) restricted by signing a double tax treaty, as a contracting state is obliged not to tax certain items of income. Furthermore, sovereignty is only transferred with respect to the interpretation of a treaty, and not with respect to tax policy, in general.[2364] For example, even if a state signs double tax treaties containing a mandatory arbitration rule, this does not mean that such a state is no longer sovereign regarding the design of its tax treaties; of course, a state could also terminate these double tax agreements at any time following due process. Nevertheless, a domestic court might, depending on the domestic legal and constitutional framework, come to a different conclusion.[2365]

Further arguments both in favor of and against mandatory arbitration depend on the exact design of a mandatory arbitration procedure. For instance, as highlighted by Picciotto, to achieve an efficient and legitimate dispute resolution system, it is crucial that the arbitration procedure and the outcomes are open and transparent[2366] and that all parties indeed have access to the arbitration procedure, i.e. for instance, independent of their economic strength.

12.4.3. Normative review

In the present section, we will analyze whether double tax treaties without mandatory arbitration clauses are unjust or, in other words, whether justice requires the implementation of a mandatory arbitration provision. An important factual statement is that a significant part of the existing double

2363. *See* on this topic in general Walde & Kolo, p. 431, with further references. Mandatory arbitration might even trigger constitutional concerns in some states, *see* Lehner, in: Vogel & Lehner, Article 25 para. 237. *See also* Desax & Veit, p. 430; Farah, p. 710. From a South American perspective *see* Cruz, p. 533 et seq. *See also* the decision of the Argentinian Supreme Court (AR: SC, *Jose Cartellone Construcciones v. Hidroelectrica Norpatagonica S.A.*, 1 June 2004).
2364. *See* Cruz, p. 539.
2365. *See* id., p. 534 et seq.
2366. Picciotto, 2013, p. 1113.

tax treaties in force still do not contain a mandatory arbitration clause. This indicates that it might not reflect a severe injustice if a treaty does not include an arbitration clause, as states would otherwise not have signed so many (unjust) treaties without arbitration clauses.

From the term "commutative justice",[2367] one could derive that an agreement between two parties that does not include an arbitration clause is unjust, as it is not a fair exchange of contractual obligations and duties, and a state could potentially abuse its economic strength. One reason is that if one of the contracting states is a strong economy and the other is a weak economy, which is dependent on a specific double tax convention, the strong economy could consistently infringe its tax treaty obligation. This could happen, for instance, through treaty overrides (by not endangering the treaty itself), as the weak state would prefer the treaty, even though the other state infringes its obligations under the treaty. Therefore such a treaty without an arbitration clause seems unjust.

We would, however, not go so far as to argue that double tax conventions must contain a mandatory arbitration clause to be considered just in the sense of a fair balance among equal parties. A double tax convention is generally[2368] a coordination agreement between two states that mainly aims at allocating taxing rights among the parties. As we have seen above, however, the claim for a single tax principle is as such not required by justice considerations.[2369] In other words, it is our understanding that the international tax regime must not mitigate juridical double taxation in any case by implementing double tax conventions that follow the OECD MC or the UN MC and contain arbitration clauses. Justice does not require that double taxation is always avoided and justice, therefore, does not require that arbitration clauses be included in double tax treaties. However, there is indeed a persuasive claim that an arbitration clause might be beneficial from a taxpayer perspective, as their potential right to an avoidance of double taxation is protected.[2370]

The outcome of the application of an agreement without an arbitration clause might be considered unjust if one of the contracting states does not follow its treaty obligations. In this case, however, it is the non-obedience of the treaty obligations by one of the contracting states that is unjust, and not

2367. *See* sec. 1.2.
2368. *See* sec. 4.2.3.3.
2369. *See* sec. 11.2.3.4.
2370. *See* Perrou's statement in sec. 12.4.2.

the treaty itself.[2371] Arbitration clauses could indeed minimize such unjust results, as states would be forced to act in line with the treaty. However, arbitration clauses do limit the sovereignty of the contracting states, as the final decision of whether a certain income can be taxed is shifted from a governmental court to a private arbitration court. From a sovereignty perspective, this is a delicate issue and also needs to be considered, as states lose, at least to a certain extent, the right to tax and the right to fiscal self-determination. The protection of fiscal self-determination was mentioned as a normative goal of our theory of global justice.

These paragraphs should not be understood as a claim for the non-inclusion of arbitration clauses in double tax treaties. However, it is our understanding that the argument that a double tax treaty without an arbitration clause is unjust is not persuasive. Most tax conventions still have no arbitration clauses and states remain reluctant to refrain from parts of their sovereignty, which nowadays, in a globalized world, still reflects an important and reasonable claim.

12.4.4. Intermediate conclusion

In conclusion, this brief analysis on mandatory arbitration is an example in which a plurality of reasons exists both in favor of and against a rule. Some arguments might be persuasive from the perspective of a taxpayer, while others might be persuasive from the perspective of the state. Sen showed in his seminal work that there is a need to evaluate the different reasons (and also different impartial positions) in order to reach a conclusion and establish a ranking of the existing arguments.[2372] However, with respect to mandatory arbitration, such a ranking is highly difficult, at least regarding the judgment of whether justice requires the implementation of mandatory arbitration clauses.

It is our understanding that it should be at the discretion of the states to decide whether they want to transpose some of their sovereignty and transfer the competences to an arbitration court. The outcome of a negotiation process might lead to a just result, i.e. a fair balance between the parties, which is either the inclusion of an arbitration clause or not. Therefore, justice per se does not require the implementation of mandatory arbitration clauses, but other reasons might be in favor of such an implementation.

2371. *See*, for example, Kraft, p. 70, "Given the high degree of reliance on treaty provisions, treaty override appears to be extremely undesirable from a legal certainty standpoint."
2372. *See* sec. 7.7.

12.5. Rule 4: Treaty abuse

12.5.1. Preliminary remarks

We have seen above, with reference to the seminal work of Kolb, that the abuse of law rule or principle[2373] is widely applied in international law in various forms and we argued that such rule or principle indeed qualifies as a general principle of law, according to article 38(1)(c) of the ICJ Statute, even though states might apply rather different anti-abuse measures domestically.[2374] We argued that it does not harm our conclusion that the understanding of what abuse means deviates among countries, as our assessment was not based on a strict positive approach regarding the requirements for a qualification as a general principle of law, according to article 38(1)(c) of the ICJ Statute. This means that it is not required to qualify as a general principle of law that a certain principle is homogenously applied in all or most civilized countries.

In the following, we will analyze whether it is indeed just to apply an unwritten anti-abuse measure when interpreting and/or applying double tax conventions. This means that we will, inter alia, analyze whether justice requires that legal obligations ought not to be followed in all circumstances if following legal obligations would lead to unjust results. In a second step, we will discuss whether it is just to include written anti-abuse rules into double tax conventions. To be more precise, we will analyze whether the principle purpose test (PPT), as suggested by the OECD within the BEPS Project, follows justice considerations. The PPT has the following wording:

> 7. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.[2375]

2373. *See*, on our distinction between rules and principles, sec. 11.1.1.
2374. *See* sec. 4.3.3.3.2.
2375. OECD/G20, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report (OECD 2015), p. 55; *see* art. 7(1) MLI or art. 29 OECD MC.

12.5.2. Arguments in favor of and against the application of anti-abuse measures

As there is a considerable overlap between the arguments against and in favor of a PPT, as well as against and in favor of an unwritten anti-abuse principle, we merged the two sections. However, as we will see in sections 12.5.3.2. and 12.5.3.3., the normative values of the PPT and the abuse of law principle as a general principle of international law are different.

Anti-abuse measures are drafted and supported to avoid the granting of treaty benefits in inappropriate circumstances.[2376] The latter includes treaty shopping cases in which a "person who is not a resident of a Contracting State attempts to obtain benefits that a tax treaty grants to a resident of that State".[2377] Of course, a claim to avoid treaty benefits in inappropriate situations would require an in-depth analysis of what inappropriate means. With respect to the application of an unwritten anti-abuse rule, one could argue that such application is necessary to avoid highly unjust results. Justice as such indeed seems to play an important role when arguing either in favor of or against the application of an unwritten anti-abuse clause.

Within the BEPS Project, one of the overall goals was to ensure that taxation occurs where the value is created, i.e. taxation in line with the source principle.[2378] Such a purpose also seems to reflect the underlying reason for implementing an anti-abuse measure, such as a PPT. The OECD argues in more general terms that measures against treaty shopping are necessary to protect revenues.[2379] Other authors argue in a similar manner that anti-abuse measures are necessary in order to strengthen the efficiency of tax treaties.[2380]

Against the introduction of a PPT or the application of other anti-abuse measures, it is argued that these lead to significant uncertainty with respect to their application and, therefore, these provisions should not be implemented.[2381] A PPT provides the tax authorities and courts with a rather broad instrument to challenge tax planning in general. The hurdle to apply this anti-abuse rule is rather low, as the authorities would only need to prove that one of the principle purposes was obtaining treaty benefits. A PPT

2376. E.g. OECD/G20, id., p. 1 et seq.
2377. Id., p. 9.
2378. For further details *see* sec. 11.5.
2379. *See* OECD/G20, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report (OECD 2015), p. 10.
2380. *See*, with respect to tax treaties signed with developing states, Essers, p. 66.
2381. *See generally* Lang, 2014, p. 655 et seq. *See also* Simonek & Becker, p. 123.

might allow the stronger state to apply a rather biased interpretation of the treaty and to deny treaty benefits in non-abusive situations due to the broad wording of the PPT. The latter argument is again related to the question of legal certainty. Similar arguments can be drawn with respect to an unwritten anti-abuse rule, as it also creates legal uncertainty if the authorities and the courts can deviate from a legal obligation. Of course, the level of uncertainty created depends on the wording of the anti-abuse measure. The broader the wording, the more uncertainty is created, as more leeway exists to deviate, for instance, from a double tax treaty provision or a domestic tax law provision.

12.5.3. Normative review

12.5.3.1. Preliminary remarks

The questions of the following sections are whether justice requires an unwritten abuse of law principle as a general principle of international law (section 12.5.3.2.) and whether justice requires the implementation of a PPT in double tax treaties (section 12.5.3.3.).

12.5.3.2. Unwritten anti-abuse rule

Again, we follow Sen's *The Idea of Justice* and try – by impartial reasoning – to analyze whether the claim of an inherent abuse of law principle is justified. We showed above that there is indeed an unwritten anti-abuse principle inherent in any international treaty as a general principle of law.[2382] However, such legal analysis must conceptually be distinguished from the normative question of whether it is indeed just to claim that an obligation, according to an international agreement, is not binding in the case of abuse. Nevertheless, as we showed above, the analysis of whether a rule or a principle qualifies as a general principle of international law might also require considerations of moral values, and not only a strict positive analysis.[2383] Therefore, the tension is obvious between moral concerns and the sources of international law when analyzing whether a principle qualifies as a general principle of law and when analyzing whether justice requires the application of these principles. As shown, to a certain extent, naturalism still plays a role in the qualification of a principle as a general principle of law.

2382. *See* sec. 4.3.3.3.2.
2383. *See* sec. 4.3.3.2.

The questions to be discussed in the present section are not as fundamental for structuring the international tax regimes as the questions about the normative validity of the mentioned essential policy principles, such as the source principle, the benefit principle and the ability-to-pay principle. The present section deals with the question of whether justice requires that in a treaty relationship, there should be a release of contractual obligation if one of the parties acts in a misguided, abusive form. Another aspect is whether a formal contractual obligation shall in all cases be followed, even though the execution of these contractual obligations would be against elementary or fundamental ethical demands.[2384]

At first glance, it seems clear that justice requires that contractual obligations derived from an international treaty are not executed in all cases. For a more detailed understanding, however, it is crucial to first develop an understanding of which demands of justice are relevant and who are the addressees. For such an analysis, it is crucial to consider the tension between equity, justice and legal obligations. In this regard, we will start by referring to the remarks of Aristotle on *aequitas*.[2385]

An important line of thinking of Aristotle and many other authors concerning the interaction between morality and law states that equity as such is not identical to legal justice. However, as mentioned by Bürgi, the term "*aequitas*" was not clearly distinguished from the term "justice" in Rome; in fact, *aequitas* was interpreted as being identical to justice.[2386] Aristotle, however, held the following:

> [T]he equitable is just, but not the legally just but a correction of legal justice. The reason is that all law is universal but about some things it is not possible to make a universal statement which shall be correct.[2387]

He furthermore stated that:

> In those cases, then, in which it is necessary to speak universally, but not possible to do so correctly, the law takes the usual case, though it is not ignorant of the possibility of error.… Hence the equitable is just, and better than one kind of justice – not better than absolute justice, but better than the error that arises from the absoluteness of the statement.[2388]

2384. *See*, for example, CH: BGE 128 III 201, cons. 1c.
2385. For a detailed analysis *see* Chroust, p. 119 et seq.
2386. Bürgi, p. 55 et seq.
2387. Aristotle, 1137b para. 10 et seq.
2388. Id., para. 10. For further details about the interaction between the term "justice" and "equity" in the writing of Aristotle, *see* Chroust, p. 124.

Therefore, if a treaty obligation is defective due to its universal or general scope of application, it seems just to deviate from the formally binding obligation. Considering more contemporary opinions in legal philosophy, one could also cite Radbruch's famous formula to describe the tension between justice and legal certainty:

> The conflict between justice and legal certainty may well be resolved in this way: The positive law, secured by legislation and power, takes precedence even when its content is unjust and fails to benefit the people, unless the conflict between statute and justice reaches such an intolerable degree that the statute, as "flawed law", must yield to justice. It is impossible to draw a sharper line between cases of statutory lawlessness and statutes that are valid despite their flaws. One line of distinction, however, can be drawn with utmost clarity: Where there is not even an attempt at justice, where equality, the core of justice, is deliberately betrayed in the issuance of positive law, then the statute is not merely "flawed law", it lacks completely the very nature of law. For law, including positive law, cannot be otherwise defined than as a system and an institution whose very meaning is to serve justice. Measured by this standard, whole portions of National Socialist law never attained the dignity of valid law.[2389]

This means that there must be an instrument to avoid the defective and highly unjust application of the law or, as in our case, of a treaty obligation. The instrument of an unwritten anti-abuse provision seems one option to fulfill such a need at an international level. Another option would be to refer to the principle of "*ex aequo et bono*", as was shown above, with references to article 38(2) of the ICJ Statute. However, article 38(2) of the ICJ Statute is a procedural rule to be obeyed by the ICJ and, even more important, the court may only render a decision based on "*ax aequo et bono*" if the parties to the proceeding agree thereon.[2390] A different but related option would be to use methods of interpretation to avoid the application of a treaty if it would lead to highly unjust results.[2391]

These remarks on the tension between justice and legal obligations are nothing new, as the discussion reflects one of the core issues of legal philosophy. The discussion about whether it is just to apply an anti-abuse measure even

2389. This is an excerpt from the translation of Litschewski Paulson & Paulson, p. 7.
2390. *See*, on the distinction between equity and "*ax aequo et bono*", Franck, 1997, p. 54 et seq.
2391. As the present study aims at a normative review of the international tax regime, we will not further discuss the question of whether highly unjust results should, according to domestic constitutional and/or internationally valid methodological thinking, be avoided by an *extra legem* principle of abuse of law or through interpretation. Such a dogmatic analysis of the interaction between interpretation methodology and the application of the abuse of law principle goes beyond the present study. *See* sec. 4.3.3.3.2.

if an international treaty (or a contract among individuals) does not contain such an explicit provision is related to one of the most fundamental questions of law:[2392] whether and to what extent moral considerations may allow a deviation from a written legal provision or from a treaty or contractual obligation. Therefore, the discussion about the application of anti-abuse measures in general is triggered by the fundamental issue that legal norms are worded in a general and abstract manner, and consequently, there might be a need for an instrument that allows judges to avoid highly unjust results, even if such an outcome would be in line with the wording of a certain legal obligation.[2393]

For the purpose of the present study, it is sufficient to state that justice indeed requires that in an individual case, a court deviates from the wording of a treaty if the application, in line with the ordinary meaning of a term in a treaty, would lead to a highly unjust result or if it would "kill the spirit"[2394] of the law. Other tax scholars use similar approaches by using the terms "blatant injustice" or "arbitrary results".[2395] Therefore, as stated by Matteotti:

> The principle of abuse of rights is an emergency exit to protect both the integrity of the treaty network and domestic tax laws. It does not weaken but fosters the essential principle of pacta sunt servanda.[2396]

The application of an unwritten abuse of law principle, even though a treaty does not contain such a rule, seems to a have a normative value in the sense that justice requires the non-obeyance of contractual obligations in highly unjust situations.

2392. *See generally* Bürgi, p. 30 et seq.; Hart, p. 200 et seq.; Kelsen, 1960, p. 60 et seq. *See* Böckenförde, p. 119, with reference to Aristotle. *See*, for example, with regard to enforcement and other civil law procedures, Staehelin, p. 105 et seq. From a public law perspective, *see* Gächter, p. 23 et seq. *See*, from a Swiss domestic tax law perspective, Locher, 1983, p. 141 et seq. There are many more authors to be referred to and the topic as such would require an entire study. A specific debate worth mentioning is the relationship between legal norms and moral reasoning. *See*, for example, the famous debate between Posner and Dworkin (e.g. Posner, 1997, p. 377 et seq. and Dworkin, p. 1718 et seq.). Our position in the present study contradicts Posner's argument that "moral reasoning is just a fancy name for political contention" (Posner, 2007, p. 10). We have clearly argued that moral reasoning is crucial for the development of an impartial position on certain policy claims. The same must be true for the application of law, in general, and the application of double tax treaties, in particular.
2393. For further details *see* Gächter, p. 31 et seq. *See also* Chroust, p. 123 et seq.
2394. The terminology is used by Franck, 1997, p. 58.
2395. Matteotti, 2005, p. 343 or p. 350. But *see* Matteotti, 2003, p. 298.
2396. Matteotti, 2005, p. 350.

These references to the interaction between moral concerns and legal obligations were important to demonstrate the variety of justice considerations and the different demands of justice within the international tax regime. Justice as such is not only a normative policy guideline when discussing several existing options as part of international tax policy, but also a limiting factor when interpreting and/or applying double tax treaties or tax law in general. The use of terms such as "highly unjust" or "blatant injustice" shows the obvious relation between the normative claim for justice and the general principle of abuse of law.

12.5.3.3. Introduction of a PPT into double tax treaties

The second question of whether justice requires implementing a written anti-abuse measure into every double tax convention is again related to questions of commutative justice and the balance of treaty rights and obligations in a bilateral or multilateral setup, respectively. Therefore, one state might argue that a double tax treaty is unjust if it does not contain an anti-abuse measure because it might lead to an unfair allocation of income, for instance, in favor of the resident state. Another state might, however, argue that the introduction of an anti-abuse measure might lead to unfair results, as courts of one state could rule in a biased manner and, if there are no dispute resolution mechanisms, it would lead to unjust results.

As a matter of fact, it seems that no general remarks can be made on whether justice requires the implementation of a PPT into all double tax treaties. Of course, this does not mean that double tax treaties should not contain anti-abuse measures, but justice as such, from our perspective, does not require that these are necessarily included in tax treaties. In other words, the debate about whether double tax treaties should include a PPT requires reference to further arguments.

This is important to see and might also be a weak point of Sen's *The Idea of Justice*, that his method might in some circumstances not provide for any detailed guidance.[2397] The example of the introduction of a PPT as such is a good example to demonstrate that justice might not always provide for a crystal-clear answer to a specific question. However, this should not highlight the weakness of the term "justice", but rather the fact that justice is an important guideline that might help to resolve many fundamental questions triggered by cross-border taxation, yet might be of limited use when dealing with very particular questions, such as whether or not a PPT should be

2397. *See* on this topic sec. 8.1.

included in all tax treaties. Therefore, to decide whether it is persuasive to include a PPT in all double tax treaties, we need to refer to other guiding principles and reasons.[2398]

12.5.4. Intermediate conclusion

As demonstrated in the second part of the present study, we suggested that the abuse of law principle is a general principle of international law and can also be applied in a treaty circumstance, if a treaty does not contain such a provision. In the preceding paragraphs, we argued that justice as such might from a normative perspective require that a court or the tax administration deviate from the wording of a double tax convention if the application of the treaty would otherwise lead to highly unjust results. We showed that the question of whether an unwritten anti-abuse rule should apply is an important example to demonstrate the interaction between a legal claim and a moral claim. The legal claim for the application of an abuse of law principle is justified by morality reasons, and is not only based on a positive understanding of the term "general principles of law".[2399] Moreover, we demonstrated that the question of whether a double tax treaty should include a PPT to be considered just cannot be answered with our methodology. This does not mean, however, that we suggest the non-implementation or the implementation of a PPT. It means only that justice as a moral imperative does not clearly favor either the inclusion or the non-inclusion of a PPT. Other arguments – besides justice – should guide the discussion on whether a PPT should be included in double tax treaties and whether well-balanced treaties require the introduction of a PPT.

12.6. Rule 5: Fiscal transparency and economic sanctions

12.6.1. Preliminary remarks

In the last decade, the need for fiscal transparency was one of the main drivers of international tax cooperation. Many projects and legislative measures have been implemented in this respect.[2400] As was shown above, the

2398. *See*, for example, regarding the advantages and disadvantages of a PPT from a Swiss perspective Simonek & Becker, p. 107 et seq. From an international perspective *see* Báez Moreno, p. 432 et seq.
2399. *See* sec. 4.3.3.2.
2400. For a comprehensive overview of the developments worldwide since 1963, *see* Opel, p. 145 et seq.

current international tax regime consists of a bouquet of rules with respect to the exchange of information; we mentioned some of the most important ones: article 26 of the OECD MC,[2401] CMAATM,[2402] FATCA IGA,[2403] and TIEAs.[2404] Also, within the BEPS Project, the OECD has further emphasized the importance of transparency at an international level by defining the spontaneous exchange of rulings[2405] and country-by-country reporting as minimum standards.[2406]

The present section will focus on the question of whether it is indeed just to have an international transparent system, even if it was enforced by coercive measures. Such coercive measures can be and have been manifold:[2407] denial of deductibility of payments to companies resident in a non-transparent state; termination of double tax agreements; termination of trade agreements; blacklisting;[2408] and the (factual) exclusion from international trade or from the international financial system.[2409] We will analyze, inter alia, when it is justified to force other states to change their domestic laws by using international coercive measures. Therefore, the present section will (at least partly) deal with the question of the limits of tax competition and state competition. We already addressed the subject in section 4.4.4.2 but the topic would need to be covered in a comprehensive manner by a separate study.

In the following, we will refer to the traditional exchange of information, i.e. the exchange of information of bank accounts held by a resident in State A with a bank in State B. Therefore, for the purposes of the present section, fiscal transparency means that states disclose relevant information about taxpayers of other states cross-border. In line with the methodology of the present study, we will use the instruments of impartiality and normative reasoning to develop a stringent line of argumentation on justice and fiscal transparency. Impartiality is particularly important regarding the very

2401. *See* sec. 4.2.3.3.5.
2402. *See* sec. 4.2.2.
2403. Id.
2404. Id.
2405. *See* OECD/G20, Countering Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report (OECD 2015), p. 45 et seq.
2406. *See* OECD/G20, Transfer Pricing Documentation and Country-by-Country Reporting, Action 13: 2015 Final Report (OECD 2015), p. 1 et seq.
2407. *See*, with some proposals, Zucman, 2015, p. 75 et seq.
2408. To blacklist a country is often related to certain other measures, such as, for instance, the denial of the deductibility on payments to persons resident in these jurisdictions or the application of CFC rules if a subsidiary is resident in a blacklisted state.
2409. *See* Stiglitz & Pieth, p. 1 et seq.

emotional discussion on exchange of information. As highlighted by Sen, strong emotions might mislead rational thinking and rational reasoning.[2410] The discussion of fiscal transparency has been very emotional, both in states with banking secrecy, and states that feel deceived by strict banking secrecy abroad.

Therefore it is essential when analyzing the reasons in favor of fiscal transparency that one leaves their position. Position in the present section means, inter alia, either being in favor of fiscal transparency or not. For instance, a Swiss citizen would tend to argue that it was unjust that Switzerland was forced to implement the OECD standard into its treaties, but a German citizen would likely argue that it was just to use coercive measures to force Switzerland to exchange the relevant information regarding Swiss bank accounts held by Germans.

12.6.2. Arguments in favor of and against international fiscal transparency

Some authors have developed rather strong positions regarding the need for fiscal transparency. For instance, Dietsch concludes that: "the resistance we observe today to increased transparency, notably through automatic information exchange between states, is entirely based on vested interests."[2411] The following section aims at providing more guidance on the potential normative value of the principle of cross-border fiscal transparency, and we will try to outline whether indeed only "vested interests" exist.

12.6.2.1. The sovereignty debate

There has been intense debate over whether a conglomerate of states should use coercive measures, such as the ones mentioned, to change the domestic or treaty policies of other states to achieve fiscal transparency. This does not only relate to the discussion of fiscal transparency, but also to other projects at an international level that have tried to limit the legislative discretion of states. Recently, BEPS Action 5 tried to eliminate what some considered harmful tax practices in certain states by implicit economic threatening. Therefore, as mentioned, the issue to be discussed in the following is partly about fiscal transparency, but we will also outline certain elements of the

2410. *See* sec. 7.7.4.
2411. Dietsch, 2015, p. 93.

tension between justice and tax competition, in general, as this has thus far only partly been covered in the present study.[2412]

Ring, in her seminal article, mentions several statements from scholars, politicians and lobbyists regarding whether an international organization should have the power to steer domestic tax policy, at least to a certain extent.[2413] Within the present study, we will not restate her distinctive analysis in a comprehensive manner, but we will emphasize certain aspects.

Regarding banking secrecy, the sovereignty argument is a two- (or several) sided coin. One side argues that states using coercive measures to achieve the abolition of banking secrecy in other states infringe the sovereignty of these other states, as they can no longer freely choose their domestic (transparency) policy. Therefore the abolition of secrecy laws by coordinated coercive measures on tax havens could undermine the sovereignty of states.[2414] Ring also makes reference to certain statements highlighting the issue of poor and rich states, as some "poor" tax havens are obliged to change their laws due to pressure from "rich" states.[2415] Therefore it could be argued that the implementation of transparency through coercive measures is unfair, as it mainly helps rich countries. We will further review such a question below.[2416]

The other side argues that states with banking secrecy or similar legislation infringe the sovereignty of other states, as the other states are unable to render their fiscal sovereignty or fiscal self-determination, as their inhabitants are hiding their money abroad and it cannot be taxed.[2417] Therefore, states using coercive measures are not infringing the sovereignty of other states, but actually protecting their own sovereignty. Closely linked to such

2412. *See* Dagan, 2017, p. 1 et seq.; Dietsch, 2011, p. 2107 et seq.; Dietsch, 2015, p. 1 et seq.; Dietsch & Rixen, p. 150 et seq.; Rixen, p. 1 et seq.; Ronzoni, 2014, p. 1 et seq.; Ronzoni, 2016, p. 201 et seq.; Van Apeldoorn, p. 1 et seq. *See also* secs. 4.3.2.8.6. and 8.4.4.

2413. Ring, 2008, p. 183 et seq. *See also* Cavelti, 2013, p. 212 et seq.; Palan, p. 151 et seq.

2414. For more details *see* Palan, id.

2415. *See* Ring, 2008, p. 199 et seq.

2416. *See* sec. 12.6.2.2.

2417. *See*, for example, Grinberg, 2016a, p. 14 et seq. Depending on the size of cross-border tax evasion this might even disallow states to protect human rights within their territory. This claim is regularly made in the country reports of the Independent Expert of the UN Human Rights Council on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights. The reports are available at https://www.ohchr.org/EN/Issues/Development/IEDebt/Pages/IEDebtIndex.aspx (last visited 15 Feb. 2019).

a discussion is the argument that transparency is necessary so that taxes can be enforced, as in some cases, a state might – without having knowledge of foreign bank accounts – not be able to enforce outstanding taxes.[2418]

We showed above that the sovereignty principle indeed has a negative component, in the sense that states not only have rights, but also responsibilities and duties toward other states.[2419] In this respect, certain authors conclude that, "[s]tates should provide all the information necessary for other states to levy the taxes they have a right to."[2420] Therefore there seems to be a responsibility to exchange information derived from the principle of sovereignty. One could argue that this is true even if one follows a strict right institutionalist approach, as cross-border tax evasion undermines a state's sovereignty and fiscal self-determination, which a right institutionalist would aim to protect.[2421] According to Dietsch and Rixen, fiscal transparency, inter alia, means that, "national polities would regain the capacity to make collective fiscal choices about the size of the budget and the level of domestic redistribution."[2422]

However, the argument is weak. If one argues that the international community has an obligation and should take coordinated measures to enforce transparency, because intransparency questions the fiscal self-determination of states, then the international community should also take measures to allow the poorest states to achieve fiscal self-determination.[2423] The latter, however, is not currently the case. In other words, if one indeed argues that international coercive measures are justified and necessary to protect just domestic structures and allow a self-determined level of distribution, then international coercive measures would also be necessary to achieve fiscal self-determination in some of the poorest states in the world, as these states are not at all able to determine their domestic level of distribution.

However, some confusion exists in this respect due to the fact that the term "fiscal self-determination", as outlined above, can be understood in either

2418. *See generally* Opel, p. 210 et seq. This side of the coin relates to an intense debate among philosophers and political theorists concerning the (undermined) sovereignty and fiscal policy in the 21st century (*see*, for example, Dietsch, 2011, p. 2107 et seq.). On this topic, *see also* Ronzoni, 2014, p. 1 et seq.; Ronzoni, 2016, p. 201 et seq.
2419. *See* sec. 11.4.2.
2420. Dietsch, 2011, p. 2017.
2421. For further details on such a position *see* Ronzoni, 2014, p. 14 et seq. *See also* Dietsch, 2015, p. 89 et seq.
2422. Dietsch & Rixen, p. 117.
2423. For a similar perspective *see* Van Apeldoorn, p. 15.

a broad or a narrow manner.[2424] Our narrower understanding requires that states, in their discretion, are able to tax income that was created in their territory by using state benefits in such a state, but not that they can, in all cases, decide upon the level of redistribution in full discretion. Therefore, the protection of such understood fiscal self-determination does not necessarily require that the world is fully transparent, but it at least requires that a state has access to information that is necessary to tax territorial income, following our understanding of the source and benefit principles.[2425] This has already been outlined above when the interaction between fiscal self-determination and tax competition was discussed.[2426]

12.6.2.2. Poor vs rich states

Another important relation that must be analyzed is the use of tax evasion and the poverty in a state. It is argued that intensive cooperation and global fiscal transparency will help to eradicate poverty[2427] and the secretive systems that lead to injustice; for instance, the Tax Justice Network states that "[t]he offshore economy of secrecy jurisdictions is a massive root cause of social and tax injustice."[2428] This should be further discussed in the present section, as follows:

It is crucial to note that the relative amount held offshore seems to be higher in poorer countries, even though there is no direct mathematical link between poverty and the amount of offshore wealth. For instance, Grinberg states, with references to a study of the Boston Consulting Group published in 2013, that the percentage of wealth held offshore is significantly higher in developing countries than in developed countries.[2429] This was also confirmed by the work of Zucman, who calculated that in developing countries the wealth held offshore amounts to between 20% and 30%, whereas in

2424. *See* sec. 8.4.3.
2425. *See* sec. 11.5.2. (source principle) and sec. 11.6.2. (benefit principle).
2426. *See* sec. 8.4.4.
2427. Such statements have been made explicitly or implicitly by many NGOs. *See*, for example, Christian Aid, The Shirts off Their Backs, How tax policies fleece the poor, Sept. 2005. The document is available at http://www.christianaid.org.uk/images/the_shirts_off_their_backs.pdf (last visited 23 Sept. 2017); Oxfam, Tax Havens, Releasing the Hidden Billions for Poverty Eradication, 2000. The document is available at http://www.taxjustice.net/cms/upload/pdf/oxfam_paper_-_final_version__06_00.pdf (last visited 23 Sept. 2017).
2428. Tax Justice Network, tax us if you can, 2nd ed., 2012, p. 21. The document is available at http://www.taxjustice.net/cms/upload/pdf/TUIYC_2012_FINAL.pdf (last visited 25 Jan. 2019).
2429. Grinberg, 2016a, p. 15.

Europe, "only" 10% is held abroad.[2430] Furthermore, he mentions Russia and the Gulf countries, with over 50% offshore wealth, as leading the table. These numbers, as many studies have shown before, visualize the impact of domestic political structure on the amount of cross-border tax evasion. It is not a coincidence that Russia is one of the top countries, particularly considering the unpredictability of confiscatory measures.[2431] History has shown that an important driver of secrecy laws were brutal regimes, which triggered an enhanced outbound flow of money, or in the concise words of Meier:

> The broad scope of personal rights – normally extended also to aliens residing in Switzerland – merits particular legal protection in a country whose geographical position, tradition of neutrality and political stability made it for centuries a refugium for politically, religiously and racially persecuted people. It is not so long ago when Nazi agents on their ruthless drive to seize private assets of German Jews, attempted by all means to gain access to the identity of Jewish depositors in Swiss banks and thereby grossly violated the public order and sovereignty of Switzerland.[2432]

Therefore, the question is how efficient is the exchange of information regarding states with a high level of offshore wealth? Currently, fiscal transparency is not all embracing: the information on request, but also the automatic exchange of information system has instruments to avoid an exchange into untrustworthy states.[2433] This indeed seems necessary to avoid the misuse of transferred information. However, as a logical consequence, international transparency does not help individuals living in these untrustworthy states in which the rate of cross-border tax evasion seems to be the highest, as no or fewer information will be transmitted. Or in other words, the implementation of an international transparent system will primarily help well-developed and trustworthy states to tax their residents on their worldwide income and wealth. However, it will not necessarily increase the tax revenue in poor states, which are either technically unable to deal with the (automatic) exchange of information or not trustworthy to comply with requirements for cross-border tax transparency. Moreover, the Global Forum has recently highlighted the need to enable developing states

2430. Zucman, 2015, p. 52.
2431. *See*, for example, the decision of the Swiss Federal Supreme Court in the so-called "*Yukos* case" (CH: SC, 1A.29/2007, 13 Aug. 2007).
2432. Meier, p. 17. It is not the purpose of the present study to outline a detailed historical background of the Swiss or other secrecy laws.
2433. *See*, for example, art. 26(2) and (3)(c) OECD MC. For further details, *see* Commentary on the OECD MC, art. 26 paras. 11 et seq. and 19.5. *See* on the *ordre public* reservation, Opel, p. 422, and on the confidentiality requirements in the receiving state, id., p. 449 et seq.

to receive and exchange taxpayer information through automatic exchange of information.[2434] It was even stated that the implementation of an automatic exchange of information standard "is one of the key priorities of the Global Forum's work for 2018-2020 and beyond".[2435]

To conclude, forced transparency at a global level is not currently aiming at primarily helping the poorest individuals on the planet, but is instead an instrument that essentially enhances taxes in well-developed countries of the world. This is often not considered when reasoning whether coercively enforcing fiscal transparency is just. Again, it should be highlighted that these remarks cannot be understood as supporting secrecy laws, but when reasoning about the implementation of a mandatory exchange of information system, we need to have an in-depth understanding of the existing justifications for transferring money abroad. The eradication of poverty, however, is not a main goal of enforcing a transparent tax system on a global scale, at least currently. It will be seen in the future considering the recent work of the Global Forum whether fiscal transparency indeed has a positive impact on global poverty.

12.6.2.3. The importance of reciprocity

As was mentioned in section 4.2.5., reciprocity is a crucial element of a just and balanced treaty. The exchange of information has led to some extreme examples of non-reciprocal agreements, such as TIEAs. These are sometimes signed by former tax havens with – sometimes – a very low income per capita or a very low HDI, with strong economies with a very high income per capita and high HDI.[2436] These agreements are, in fact, necessary to disallow tax havens to uphold their policy of non-transparency. However, as these agreements might only aim at allowing information flow in one direction, the former tax haven might not have a direct and useful contractual right derived from the TIEA. Another example is the case in which a state with a strict territorial system signs a TIEA. Such a state has basically no interest in an exchange of information, as it does not require information on foreign bank accounts to ensure taxation of its residents.

2434. Global Forum on Transparency and Exchange of Information for Tax Purposes, The Global Forum's Plan of Action for Developing Countries Participation in AEOI, Nov. 2017, para. 1 et seq. For further details see Matteotti, 2017/2018, p. 680 et seq.
2435. Global Forum on Transparency and Exchange of Information for Tax Purposes, id., para. 32.
2436. *See*, for example, the TIEA between Liberia (HDI rank 2014: 177) and Denmark (HDI rank 2014: 4).

Another aspect to be considered is that one party of an agreement providing for an exchange of information might theoretically have a reciprocal interest in an exchange of information; however, such a state might factually not be able to benefit from an exchange. This is particularly true with respect to developing countries, which might not have domestic institutions that can effectively apply an exchange of information upon request, not to mention an automatic information exchange.[2437] Of course, one could argue that these agreements are reciprocal from a substantive perspective, as the tax haven will face fewer economic disadvantages and might have better access to the global market. However, it is again crucial that policymakers consider the development situation in other treaty states and that states do not blindly follow the need to decrease domestic tax evasion in all circumstances and also enforce the implementation of cross-border transparency by using coercive measures against very poor states. One option mentioned by Dietsch would be to enforce fiscal transparency toward all countries and simultaneously use compensatory payments toward poor tax havens to compensate these states for the loss triggered by the abolition of banking secrecy.[2438]

12.6.2.4. Further arguments to be considered

Besides these remarks on the sovereignty principle, poverty and the principle of reciprocity, further aspects need to be considered when analyzing whether it is just to implement a transparent international system by using coercive measures. For instance, it is argued that the exchange of information could lead to an infringement of human rights in the recipient state or it could lead to the abusive use of the exchanged data in the recipient state.[2439] In a similar manner, it is argued that the protection of further procedural rights might also be infringed in the sending state, depending on the applicable procedure.[2440] These arguments should not be neglected in the following assessment; however, they are at least, for the purposes of the present study, of secondary importance, as they relate to the exact design of an exchange of information system. As an example, data protection might highly depend on how the exchange system is drafted to determine to what extent the recipient state is obliged to implement certain protection measures in order to be part of the transparent tax world.

2437. *See* Dourado, p. 179.
2438. *See generally* Dietsch, 2015, p. 210 et seq.
2439. *See*, on these arguments with further references, Opel, p. 213 et seq. *See also* Dourado, p. 187 et seq. Or in more general terms secrecy laws might protect financial privacy (Kaufmann, 2002, p. 48).
2440. *See* Opel, p. 215 et seq. For further details *see* Baker & Pistone, p. 21 et seq.

Again, it is necessary to highlight that a just international tax regime must be able to be considered just from the perspective of various state models. With respect to the issue of a global exchange of information, states have very different understandings of the interaction and the relation between taxpayers and tax administration. For instance, the penalties on tax evasion vary internationally, which might reflect the different understanding of statehood. Or the level of agreed confidentiality might differ between societies.[2441] Therefore an international system of transparency must be able to consider these different approaches.[2442] And, as we demonstrated above, international tax policy should refrain from implementing policies that lead to what we called "value imperialism" by, for instance, forcing other states to implement very severe penalties for tax evasion, even though the determination of an appropriate penalty depends on different state concepts, or vice versa. Therefore, states should have the right to define the level of punishment for tax evasion, tax fraud and similar offenses independently, as there is no right or wrong in this respect. The level of punishment is a societal decision (often based on a direct or indirect democratic will) that should not be distorted, if unnecessary, by international tax policy.

12.6.3. Normative review

Some of the arguments against and in favor of fiscal transparency were already assessed in the preceding sections. The present section contains some conclusive statements, but also some further elements to outline our position in more detail.

We have shown that our understanding of the protection of fiscal self-determination as a need to achieve a just international structure requires transparency, at least to the extent that it allows states to tax income created within their territory, following our understanding of fiscal self-determination and the source and benefit principles.[2443] We denied, however, the need for the protection of a broader understanding of fiscal self-determination as suggested by Dietsch, i.e. that states should be able to define their level of distribution and, therefore, states should have access to sufficient information

2441. *See*, for instance, regarding the understanding of the Swiss Supreme Court, Kaufmann, 2002, p. 47: "Yet, within the hierarchy of constitutional values, the Swiss Supreme Court considers the protection of financial information through banking secrecy less important than the protection of other private information, such as medical data".
2442. *See* Simonek, 2010, p. 561.
2443. We came to the same conclusion when discussing the interaction between our understanding of fiscal self-determination and tax competition in sec. 8.4.4.

about domestic taxpayers. If this were indeed the case, it would also require significant payments from richer to poorer states in order to achieve equality in fiscal self-determination, which would collide with our understanding of (non-cosmopolitan) global justice.

Moreover, we argued that transparency does not necessarily reduce poverty. It was shown, in particular, that some states are unable to handle an efficient exchange of information and therefore global transparency is not necessarily improving the situation of the worst off on this planet. Therefore, we would agree with Christians that the extinction of tax havens could at worst be understood as "a means of entrenching an existing focus on a politically safe target while avoiding more difficult conversations about fundamental tax reform, especially in the context of countries with vastly different resources [footnote omitted]."[2444] A transparent tax world might enhance fiscal self-determination, but mainly of (at least currently) well-developed countries.

Prima facie, it seems clear that the exchange of information as such is necessary to achieve a just domestic tax system, as an abolition of the secrecy laws would eliminate situations in which a taxpayer can hide money abroad and, consequently, his contribution is not in line with the ability-to-pay principle from a domestic perspective, and therefore not in line with the equality principle.[2445] If no cross-border transparency exists, a government would, for instance, not be able to demonstrate to its citizens that the wealthiest persons living in its basic structure are taxed according to their ability to pay, since these persons could hide money abroad. This could, furthermore, undermine the legitimacy and sovereignty of the government. States, therefore, argue that they need an intense exchange of information system to ensure equal treatment between persons with domestic bank accounts and persons with foreign bank accounts. In this respect, some authors argue that such an exchange of information could lead to tax justice understood in a global manner, but only if the recipient state indeed has a tax system in line with the equality principle.[2446] Within such an equality debate, however, one

2444. Christians, 2010, p. 28.
2445. *See*, from a Swiss perspective, Opel, p. 207 et seq., with further references.
2446. Id., p. 211: "*Unter der Voraussetzung, dass die Besteuerung auch im Empfängerstaat nach den Grundsätzen einer rechtsgleichen Lastenverteilung erfolgt, könnte die Gewährung von Amtshilfe immerhin als Beitrag an eine global verstandene «Steuergerechtigkeit» eingestuft werden*." ["Assuming that taxation also takes place in the recipient country in accordance with the principles of equal burden-sharing, the granting of administrative assistance could at least be classified as a contribution to globally understood 'tax justice'."] [author's translation].

can find few references to political philosophy, or to the question of whether we ought to have a more global understanding of the equality principle or whether moral considerations only require that domestic residents be treated equally. As we will briefly show in the following, global transparency will not necessarily reduce global equality.

The equality argument has a weak component, and it appears particularly weak if it is used to justify economic sanctions, unless the underlying philosophical concept or understanding of the equality principle is disclosed. We have seen above, regarding left and right institutionalism, that the existing variety of opinions is rather broad on the question of whether we owe cross-border distributive duties and whether we should follow a global egalitarian theory of justice.[2447] If one follows a left institutional approach and would argue that there is a distributive duty cross-border, as there is domestically, one should for instance support enhanced transparency, particularly if it indeed has a distributive effect from the richest to the poorest on this planet. However, enforced transparency could have a detrimental impact if a poor state, for instance, is obliged to abolish its banking secrecy and simultaneously weaken its financial industry. Or even worse, if the information is used by the state and the foreign policy of such a state creates injustice in some of the poor states. Therefore, would it not be better if a poor state, such as Liberia, could implement secrecy policies to increase money inflow to its financial industry in order to increase the well-being of its inhabitants? We are fully aware that these are very delicate arguments, but they should not be ignored when discussing the normative validity of enforced transparency.

Another related aspect to be considered when using the equality argument to favor the coercive implementation of international transparency is the consideration of comparability. As we mentioned above with respect to the ability-to-pay principle, there is a practical constraint regarding the application of the equality principle at an international level.[2448] We concluded that it is not possible to achieve an international allocation system in line with the ability-to-pay principle unless taxes and state benefits are harmonized, following both a cosmopolitan and a non-cosmopolitan understanding of the ability-to-pay principle. Therefore the equality argument does not provide for a clear-cut decision on whether or not we should have a transparent tax system. However, international transparency could indeed lead to more

2447. *See* chapter 7.
2448. *See* sec. 11.2.3.3.

equal treatment, but only within the same state and the same basic structure. For instance, a domestic constitution might indeed require international transparency, as the domestic constitutional principle of equality might require that individuals be taxed on their worldwide income, which again requires that foreign bank accounts be disclosed.[2449]

As mentioned above with respect to mandatory arbitration[2450] and as highlighted by referring to the term "reciprocity",[2451] when analyzing justice within contractual relations, it is important that the demands of commutative justice are considered or our understanding of the principle of inter-nation equity.[2452] Therefore, a central argument is that it seems unjust if one forces a tax haven to sign a TIEA if the information will flow only in one direction or if one forces a state that has a territorial system to sign a TIEA. This is particularly true if the tax haven is a poor state. In this case, according to our understanding, justice would require combining the signing of the TIEA with benefits granted to the tax haven, such as having access to a full-fledged double tax treaty, another beneficial treaty or even financial payments.[2453]

As shown above, when developing the methodology of the present Part IV, it was clarified with reference to Sen that within an analysis of justice, there might be a plurality of reasons in favor of and against a certain conclusion, and it might be a very difficult task to evaluate these different reasons in order to find a persuasive result.[2454] The question of whether the enforcement of fiscal transparency through coercive measures is just requires such evaluation, as the existing arguments do not provide a clear resolution. There is no "killer argument", as stated by Singer, to resolve the question at stake.[2455] However, we showed that transparency might indeed be required to follow domestic principles of justice and to protect fiscal self-determination. But at an international level, we also outlined the weak normative base of the argument that transparency would decrease global equality and eradicate poverty.

2449. *See* our normative review of worldwide tax systems in sec. 11.5.2.
2450. *See* sec. 12.4.3.
2451. *See* sec. 4.2.5.
2452. *See* sec. 11.3.2.
2453. *See* sec. 4.2.5. However, *see supra* n. 2293 on the potential detrimental impact of aid payments.
2454. *See* secs. 7.7.3. and 8.2.
2455. Singer, 2009, p. 926.

12.6.4. Intermediate conclusion

In conclusion, the question of whether it is just to use economic sanctions to achieve international fiscal transparency is a very challenging one. It is a question without a crystal-clear answer after having reasoned following Sen's methodology. A central result of the present section, however, is that one needs to apply a distinct analysis considering the different positions of states being affected by international transparency. This means, for instance, that what could be morally right regarding the Principality of Liechtenstein is not morally justified regarding Liberia. As I have demonstrated in many instances within the present study, the work of the OECD or the G20 should, therefore, focus more on the poorest in the world as a humanitarian duty, and not on how to increase revenue within the wealthiest nations of the world. Nevertheless, the result of having a transparent world from a tax perspective has my full support, as it, inter alia, indeed allows the taxation of income that was created in a state, following our understanding of the source and benefit principles and, therefore, our understanding of the protection of fiscal self-determination.

Chapter 13

Conclusions

13.1. Preliminary remarks

We will refrain from writing a comprehensive summary of all parts of the present study. We will also refrain from providing a chronological summary of the different parts and sections of the present study. We prefer to summarize the results in the following five sections, consolidating the most important findings of the present interdisciplinary research project on justice and the international tax regime. These conclusive sections must be understood as overall conclusions and not of the findings of Part IV only. Some final remarks on Parts II and III can be found above.[2456] We will start with a section on interdisciplinary research and its success.

13.2. Interdisciplinary research and its success

The combination of political philosophy as a normative theory and international tax law has enabled us to question some of the most fundamental principles and rules of the international tax regime. It also allowed a clearer understanding of the interaction between philosophy and law. This has been crucial, as terms such as "sovereignty" or "equality of states" might have a legal value, but might also have a normative component.[2457] Currently, the two disciplines – i.e. international tax law and political philosophy as a normative discipline – are sometimes mingled, which creates (legal) uncertainty. For instance, it is sometimes unclear whether a legal claim is indeed a legal claim or whether it is "only" a normative claim. This was shown with respect to the sources of customary international law[2458] and general principles of law.[2459] By referring to these sources, we demonstrated the elusive interaction of positivism and naturalism in international law.

Particularly in the current circumstances of rapid change at an international level, a more abstract discussion on the separation and overlap of moral and legal claims is necessary. The present interdisciplinary approach helped

2456. *See* chapters 5 and 8.
2457. *See* sec. 4.1.
2458. *See* sec. 4.3.2.2.
2459. *See* sec. 4.3.3.2.

us to better understand our own discipline, i.e. in my case, international tax law. We developed a rather clear distinction between mere normative claims and actual legal claims. It was shown regarding fiscal sovereignty, for instance, that many of the arguments used to suggest justifying or denying jurisdiction to tax in an individual case are normative claims and should influence tax policy. But these claims are not necessarily derived from a dogmatic interpretation of the legal principle of fiscal sovereignty. The same is true, for instance, regarding the question of whether an unwritten abuse of law principle exists as a general principle of law at an international level.[2460]

So far, the main part of the debate about justice and fairness in international tax law has happened in a tax law (and economics) vacuum.[2461] An illustrative example is the BEPS Project, which was indeed led by tax lawyers and economists with generally no involvement of philosophy or moral theory. It is evident that all final BEPS reports neglect any discussion about global justice, in general, or the distributive effects of international tax law. At the same time, as shown, the term "fairness" is explicitly and implicitly central for the BEPS Project.[2462]

This reflects a severe contradiction. It is hardly persuasive to launch the largest project in the history of international tax law under the explicit and implicit label of "fairness" without rendering an in-depth analysis of what fairness or justice means globally.[2463] Instead, one of the main goals of the BEPS Project was to realign taxation and value creation to achieve a just international tax regime,[2464] but the OECD has not reviewed, in detail, whether this is indeed true, i.e. whether it is indeed true that an international tax regime that realigns taxation and value creation (source principle) is a just system. We have shown our arguments regarding the application of the source principle as a design goal of international tax policy,[2465] and we outlined in several instances what we expect from a just international tax regime in more general terms. International law or international tax law did not provide us with sufficient guidance on how the international tax regime ought to be designed in order to be considered just. Therefore, the detailed reference to political philosophy helped us overcome certain parochial

2460. *See* sec. 4.3.3.3.2.
2461. I owe this term to Infanti, p. 217, who speaks of "tax blinders".
2462. *See*, for example, the statements in sec. 1.5. *See also* Dagan, 2017, p. 5: "Notably, both the G20 and OECD take care not to include justice as one of their main issues of concern, sticking, instead, to the conventional pro-cooperation rhetoric that argues it would benefit all cooperating states towards sustaining their tax bases."
2463. *See generally* Christians, 2009a, p. 220.
2464. *See* sec. 11.5.1.
2465. *See* sec. 11.5.2.

positions that would not have been possible by remaining within our traditional juridical methodology.[2466]

Moreover, other disciplines, such as political philosophy, might not only lead to a clearer understanding of fundamental values, but they might also provide us as tax lawyers with creative ideas and issues that we might not have conceived. One important finding, in this respect, was to demonstrate the impact of global tax policy on distribution and the question of whether there are and to what extent distributive duties at an international level. Even though it was shown that one goal of the OECD is the "increase of general well-being",[2467] we have also indicated that the international tax regime does not de facto currently follow any distributive goals in order, for instance, to abolish poverty worldwide. With respect to the BEPS Project, we even argued that certain measures might lead to a higher allocation to strong economies, such as the protection of the current understanding of the arm's length principle[2468] and the recommendations regarding the design of effective CFC rules.[2469]

We clearly opposed such an approach and also proposed that there is a cross-border humanitarian duty at an international level. However, we argued that there is no difference principle at an international level, which would require significant cross-border distributive payments from rich to poor states. This means that international tax policy should consider existing humanitarian duties, but the international tax regime should not lead to a cross-border distribution beyond humanitarian duties. Making reference to political philosophy helped us to better frame our position regarding such a purpose of international tax policy in general.[2470]

The BEPS Project has, moreover, revealed the lack of principle-based studies that are considered by international policymakers. Brauner[2471] already stated such fear at the beginning of the BEPS Project in early 2014. The results of the BEPS Project confirmed his concern. In many instances, we have demonstrated the need to reason every single argument, and it was already shown in the introduction with references to Peters that scholars,

2466. *See* the remarks in the introduction in sec. 2.1.2. on the potential lack of normative guidelines in international law.
2467. Preamble of the Convention on the Organisation for Economic Co-operation and Development, 14 Dec. 1960.
2468. *See* sec. 12.2.2.3.
2469. *See* sec. 12.3.3.
2470. Our position is outlined in chapter 8.
2471. Brauner, 2016, p. 14.

policymakers and other parties should review their position at a higher level of abstraction, or they risk being trapped in long-applied but misguided principles. We have shown this with respect to the neutrality, the source, the benefit, the ability-to-pay and the inter-nation equity principle. Political philosophy as a value-based discipline was a key factor for the presumed success of such a detailed analysis of the normative validity of these principles. The instruments of reasoning and impartiality, along with the reference to ideal theories of global justice, allowed us to develop our own understanding of the normative validity of these principles, which is in opposition to certain long-standing or even axiomatic claims by international tax scholars and policymakers.

The present study on justice in international law has outlined some ways to strengthen justice in international tax law. Above all, we have demonstrated that legal academia should refer to political philosophy in order to develop a more comprehensive understanding of what indeed is a valid normative claim. As a conclusive example, it is still surprising that lectures on international tax law often contain a part on neutrality, be it CIN, CEN and/or CON, but lectures on international tax law generally do not refer to theories of global justice. Political philosophy should, therefore, play a more decisive role within international tax law as an academic discipline, both in teaching and researching the discipline.

13.3. Global justice and international tax law – Some conceptual conclusions

We outlined some of the most important theories of global justice and demonstrated the main reasons for disagreement in political philosophy regarding how to design a global institutional structure to achieve a just global system. Our main reference point for our normative review of the international tax regime was Sen's *The Idea of Justice,* which is, as outlined, a comparative theory of justice that is highly influenced by social choice theory.[2472] Notwithstanding the fact that we argued that comparative theories, such as that of Sen, provide for more useful instruments for the purpose of the present study, we also argued that ideal theories, such as Rawls' *The Law of Peoples*, are nevertheless necessary for a normative review of some of the most fundamental principles and rules of the international tax regime.[2473]

2472. *See* sec. 7.7.
2473. *See* on the necessity of ideal theories sec. 7.7.2.2.

We demonstrated our own position regarding the existing ideal theories of global justice, which we grouped into left and right institutionalism and egalitarianism. In this respect, not only the protection of fiscal self-determination, but also the existence of cross-border humanitarian duties was highlighted, and our position was highly influenced by right institutionalists' work on global justice.[2474] These two elements of an ideal theory of justice (i.e. humanitarian duty and protection of sovereignty and therefore of fiscal self-determination) helped us, for instance, to frame our position regarding income allocation. We support, if any,[2475] an income allocation key that aims at fulfilling our humanitarian duties on this planet, but it should also allow states to independently determine their tax regime without infringing the tax regime of another state.

Both the protection of fiscal self-determination and the fulfillment of humanitarian duties are essential elements of our understanding of how to enhance justice through the design of the international tax regime. The international tax regime should be able to be considered just from the perspective of various societies and states – in an extreme example, both from a libertarian's but also from a socialist's perspective. This also requires that we do not commit what we called "value imperialism". This means, for instance, that states should be reluctant to force other states to levy high taxes just because these states might have a higher expenditure quota. In other words, one society might aim at a low level of inequality through domestic tax measures, whereas another society might aim at very limited state functions and very limited distribution. However, states should not impose their understanding onto other states through international tax policy.[2476] Such a rather abstract discussion has also helped us frame our opinion with respect to various current issues in international tax law and regarding the BEPS Project.[2477]

To evaluate the validity of some of the most important rules and principles of the international tax regime, we referred to the instruments of "normative reasoning" and "impartiality". This was necessary to further shape

2474. *See* sec. 8.3.
2475. In several instances, we argued that the international tax regime must not necessarily split the available income into perfect pieces. In other words, double taxation and double non-taxation are from our perspective not necessarily unjust, but they result from the normative goal that states should be sovereign in defining their tax system.
2476. Such potential Machiavellianism was already outlined as one of the justice deficiencies of the international tax regime in sec. 1.5., with references.
2477. Rather suprising, therefore, are statements such as the following of Corwin, p. 136: "Simply put, morality cannot serve as a guiding principle for establishing, implementing, or enforcing complex international tax rules and standards in a global world."

our understanding of what justice in the international tax regime means. Impartiality, on one hand, requires that we leave our biased positions as tax advisors, tax commissionaires, academics and inhabitants of large or small states when discussing policy proposals. Reasoning, on the other hand, is required to, inter alia, justify every single argument that is used to support or question a certain principle or rule. In this respect, we used the term "normative reasoning" to challenge some long-existing axiomatic claims, such as that the international tax regime ought to be neutral.[2478] Normative reasoning and impartiality also helped us to better understand elusive principles, such as the principle of inter-nation equity.

At the same time, it is again important to highlight that ideal theories of global justice have not been ignored, as these theories were crucial to develop a better understanding of what justice could mean at an international level and what kind of moral claims must be considered. As an example, only by referring to ideal theories was it possible to justify based on what reasons equal treatment of compatriots or non-compatriots might be necessary, and why there might be a moral difference between equal treatment of persons living in the same jurisdiction and persons living in different jurisdictions.[2479] For instance, when referring to the case law of the ECJ on the equal treatment and the ability-to-pay principle, such as the *Schumacker* case, it became clear that in order to develop a comprehensive understanding of what just treatment means in cross-border situations, reference to ideal theories is necessary.[2480] It was also demonstrated that the ECJ might implicitly be influenced by such ideal theories of justice.

Another example is the remarks on the allocation of income, when the normative validity of the arm's length principle and a formulary system were discussed.[2481] In this respect, we referred to different ideal theories of global justice to outline and frame our opinion on this topic. For instance, we highlighted the importance of the principle of fiscal self-determination and the consideration of the potential distributive impact when designing an international allocation key.[2482]

2478. In this respect, the present study was not only influenced by Sen, who uses the instrument of public reasoning (*see* sec. 7.7.), but particularly by the work of Singer, as outlined in the introduction in sec. 2.2.4.
2479. *See* sec. 11.2.3.
2480. *See* sec. 11.2.3.2.3.
2481. *See* sec. 12.2.2.
2482. *See* sec. 12.2.2.3.

13.4. Enhanced tax cooperation and coercion and its consequences

Cooperation and coercion at an international level can trigger intra-societal moral duties, as we have seen by referencing different theories of global justice. This means, for instance, that belonging to a coercive system, such as a state, might create moral duties among the members of such, which Rawls calls basic structure, and between the members and the coercive power.[2483] We argued in favor of a continuous approach, which means that there is no specific threshold that must be met for the existence of a comprehensive list of moral duties within a society, but rather that a continuous increase of coercion, association and social cooperation will trigger moral duties on a continuous scale, potentially even between individuals living in two formally separated states.[2484] Therefore, as a very practical example, it was argued that the more integrated the EU becomes, the more intra-societal moral duties will be triggered at a cross-border level between individuals living in two different Member States. This also means that we oppose left institutionalism requiring that the same (liberal) principles of justice apply at a domestic and international level.

The question then is whether the current world order already has elements resembling a domestic society and a basic structure, respectively. Of course, the world is far from being considered a federal state in which a central power enforces certain policies globally. Nevertheless, taxation as such is one of the core state functions and a more intense international cooperation – and potentially harmonization with the combination of a coercive implementation of certain tax policies – might trigger further moral duties at the international level.[2485] The present study has shown that parts of the legislative competences in tax matters have shifted to international organizations – at least de facto and not de jure.[2486] In particular, the BEPS Project

2483. The basic structure is for Rawls the primary subject of justice. However, as was shown, it is disputed what the basic structure indeed means, i.e. whether the world or only domestic society fulfills the requirements of a basic structure. For our position *see* sec. 8.3.
2484. *See* sec. 8.3.2.
2485. Interestingly, our position is rather similar to Dagan, 2017, p. 34, who argues that "[a] multilateral regime established through cooperation is justified in promoting justice if and only if it improves (or at least does not worsen) the welfare of the least well-off in all cooperating states.[footnote omitted]." However, we would not argue that cooperation per se requires a consideration of the position of the worst off, but that enhanced cooperation and tax harmonization, in particular, lead to a global basic structure triggering cross-border duties, such as an international difference principle.
2486. *See* sec. 4.4.4.1.1.

has led to a partial harmonization of tax laws through defining minimum standards. If one further argues that we should aim at tax base harmonization at an international level, for instance, through the implementation of a formulary system, we should also consider that this might have a moral impact, as it leads to a higher level of coercion and association.

In other words, it seems unlikely that people around the world would accept a global harmonized tax system if it were not combined with global distributive mechanisms: a tax base harmonization in a federal state or at an international level always creates losers that will only accept a certain policy if they will also benefit from such a (potentially coercively enforced) regime. Moreover, there is no right or wrong regarding income allocation. It is not surprising that in federal states, tax base harmonization was essentially successful because it was combined with equalization payments or fiscal transfers between the states, such as the rather comprehensive inter-cantonal equalization scheme in Switzerland ("*Finanzausgleich*")[2487] or the more fragmented existing fiscal transfers in the United States through federal spending.[2488] Therefore, tax base harmonization without cross-border fiscal transfers is difficult, if not impossible, to achieve and to sustain.[2489]

Moreover, we believe that there is currently nothing like an international society (or basic structure) to which all members should contribute their fair share. Individuals should pay their fair share at a national, and not at an international level, following domestic principles of justice, which might deviate. Also, it might even be that an individual is a member of two societies and would need to pay his or her fair share in two societies, which is not per se unjust, following our understanding of global justice.[2490] Moreover, we clearly denied that corporations should pay their fair share globally in a consolidated manner.[2491] Global justice does not require, for instance, that

2487. The constitutional basis is art. 135 of the Swiss Federal Constitution.
2488. The United States has no comprehensive system of federal transfers to reduce fiscal disparities between the states and communities, but several measures nevertheless have an equalizing impact. For a comprehensive analysis of the differences between the US system and more distinct federal equalization grants, *see* Stark, p. 957 et seq.
2489. Of course, in a federal state fiscal transfers are not only necessary so that the member states accept a harmonized tax base but potentially also that the member states accept different tax rates in the different member states. For instance, in Switzerland fiscal transfers are, inter alia, necessary so that the tax rate differences between the cantons can be upheld.
2490. *See* sec. 11.2.3.2.2.
2491. *See* sec. 11.2. *See also* the reservation in sec. 11.2.3.3. according to which it is difficult to argue that enterprises are members of a specific society, following our continuous approach. The non-payment of their fair share, however, was one of the justice deficiencies mentioned in the introductory sec. 1.5.

a multinational enterprise pays a certain percentage of corporate income taxes in a global consolidated manner. States should be competent (but not required) to levy taxes, following our understanding of the benefit and source principles, and there is not a requirement to share the income among states to achieve a just international tax regime.[2492] Double taxation and double non-taxation are not per se unjust at an international level and must not necessarily be avoided. In this respect, we moreover demonstrated that justice does not require that we follow a single taxation principle at an international level.[2493] This is a major deviation from more traditional studies on how to achieve justice in international tax law.

Another important finding relates to the question of how international tax law can unify several different domestic fiscal policies. Ideally, as implied in the conclusive section 13.3., the international tax regime should be the common denominator that can be considered just from different perspectives. This is essential to consider from a policy perspective. International tax law cannot be drafted in an abstract manner, as it must consider the cultural and political realities and differences of all participating states. This is not only important because states might have very different levels of inter-society distribution, but also because, for instance, the relationships between taxpayers and tax authorities might be very different across the globe. Therefore, a just international tax regime should be able to cope with a broad variety of societal concepts (and democratic wills).

13.5. A new perspective on income allocation (source vs residence)

Not only since the famous trilogy of Vogel[2494] has the discussion of source versus residence been one of the most fundamental debates in international tax law. Numerous studies have been dedicated to the interaction between the two concepts and many authors have argued either in favor of or against one of the two concepts. Some authors have even questioned the need for both terms. In the present study it was claimed in several instances that states should refrain from worldwide tax systems. Therefore the taxation of residents on their global income is not justified. Source taxation, however,

2492. *See* sec. 13.5.
2493. *See* sec. 11.2.3.4.
2494. *See* Vogel, 1988a, p. 216 et seq.; Vogel, 1988b, p. 310 et seq.; Vogel, 1988c, p. 393 et seq.

should be protected. Several reasons were brought forward supporting such position.

We showed that international law only provides for very few limitations regarding the taxation of cross-border activities. Accordingly, it is sufficient that a person has a genuine link to a certain jurisdiction to create a liability and to tax even their worldwide income.[2495] However, by referring to political philosophy, we have shown that such an extensive understanding of jurisdiction to tax is unjust, as it leads to an infringement of the (normative) principles of sovereignty and the fiscal self-determination of other states.[2496] These principles are decisive to achieve a just international tax regime. We have, moreover, understood the benefit principle and the source principle as both limitation-to-tax and justification-to-tax principles. States should only tax what was created in their territory and what was created by using governmental benefits in such a state.[2497] A worldwide tax system infringes on such a normative goal. The BEPS Project is contradictory in this respect, as the OECD/G20 indeed aims at a realignment of taxation and value creation by simultaneously aiming at certain global minimum taxation and the protection of worldwide tax systems.[2498] These goals are incompatible, from our perspective, as an alignment of taxation and value creation is clearly in contradiction to worldwide tax systems.[2499]

One important justification for such a position lies in the fact that the protection of fiscal self-determination is of the utmost importance to achieve a just international tax regime. If we understand an increase in worldwide welfare as a crucial part of a just international tax policy, we should aim at protecting fiscal self-determination, as the protection of fiscal self-determination is critical for an increase in worldwide welfare through successful domestic policies.[2500] Moreover, as we do not assume a cross-border distributive duty following Rawls' difference principle in an intra-society circumstance,[2501] we are not of the opinion that an international tax regime should have a distributive goal beyond humanitarian duties. Therefore, the international tax regime should not lead to a general distribution from rich to poor states, or from developed to developing states, but should instead protect the fiscal

2495. *See* sec. 4.1.2.3.
2496. *See*, for instance, sec. 11.6.2.2.
2497. *See* sec. 11.5.2. (source principle) and sec. 11.6.2. (benefit principle).
2498. *See* on CFC taxation sec. 12.3.3.
2499. For more details *see* sec. 11.5.2.
2500. *See,* with references to the studies of Deaton, sec. 11.2.3.2.2.
2501. *See*, in favor of such a theory of global justice, the overview on Pogge and Beitz in sec. 7.5.

self-determination of poor (but also of rich, of course) states. Nevertheless, international tax policy should consider humanitarian duties to avoid the most severe injustices and inhumane circumstances.[2502]

Furthermore, it was demonstrated that worldwide taxation, i.e. taxation based on residency, is not required by the ability-to-pay principle, as the ability-to-pay principle is a defective policy principle at an international level.[2503] Moreover, we argued that a (partial) destination-based allocation key would be less attackable for base erosion and profit shifting, as it indeed protects fiscal self-determination.[2504] However, we also argued that justice per se does not require that an allocation key be implemented, which allows for perfect allocation among the countries, in the sense that each income is taxed only once. Therefore it is not necessary that double taxation and double non-taxation be avoided in all cases to achieve a just international tax regime.[2505] These are necessary consequences of the protection of fiscal self-determination of states. The fact that states might follow different opinions on what income was created within their jurisdiction following the source principle might lead to double taxation or double non-taxation, but this is not per se inappropriate and unjust. Of course, states have other interests to avoid both double taxation and double non-taxation, but justice per se does not require doing so. Regarding income allocation we, moreover, tried to frame our understanding of the source principle and highlighted the importance of considering that not only the supply, but also the demand side, should be relevant.[2506] An argument for such a position was that an allocation key relying solely on the supply side, as it is currently applied, automatically leads to a higher allocation of income to highly productive countries and, more importantly, profit shifting and base erosion cannot easily be tackled. The latter, however, should be the ultimate goal of all allocation keys. An allocation key that leads to no taxation contradicts its own purpose, i.e. that income is allocated for tax purposes.

These remarks on income allocation demonstrate the rather concrete proposals that can also be derived from the term "justice" from an international tax law perspective.[2507]

2502. The present study has not discussed in detail how these could happen, but we have indicated some approaches. For instance, *see* sec. 11.4.3.2.2.
2503. *See* sec. 11.2.3.
2504. *See* sec. 12.2.2.3.3.
2505. Double taxation and double non-taxation were also mentioned by authors as injustices in the current international tax regime. *See* sec. 1.5.
2506. *See* sec. 11.5.2.
2507. But *see* regarding the term "equity" Musgrave, 2001b, p. 1339.

13.6. The just double tax treaty

Above, we reviewed the question of the fair allocation of income at an international level and we were supportive of the protection of fiscal self-determination through the protection of the source and the benefit principle, understood as both limitation-to-tax and justification-to-tax principles. Consequently, we would also support the idea that a double tax treaty should lead to taxation in line with these principles. However, designing a just double tax treaty also requires not only that the question of allocation of income be solved appropriately, but also that the question be answered whether states should include further rules, such as a non-discrimination provision, an exchange of information clause, an arbitration provision or an anti-abuse measure such as a PPT.[2508]

In Part IV, we also reviewed some of these specific rules, particularly focusing on rules proposed during the BEPS Project, such as the inclusion of a PPT[2509] or the inclusion of a mandatory arbitration provision.[2510] Regarding these clauses, we concluded that the term "justice" might not provide us with sufficient guidelines to decide whether or not we should include these rules into a double tax treaty. There might indeed be a plurality of reasons for and against their inclusion.[2511] We might need further arguments and further normative guidance to reach a final policy recommendation. Therefore, the term "justice" is indeed weak, at least to a certain extent, as it does not resolve all issues and might even be a flawed term. Certain policy questions cannot be answered by referring to the term "justice". However, even though it is indeed true that justice is a term that might have its limits for the purposes of steering international tax policy, it still helped us develop some very precise conclusions.[2512]

Regarding the question of how to design a just international tax treaty, we highlighted the need for well-balanced treaties with reciprocal rights and duties to align with the need for commutative justice and our understanding

2508. *See*, on the content of double tax treaties, sec. 4.2.3.3.
2509. *See* sec. 12.5.3.3.
2510. *See* sec. 12.4.3.
2511. The fact that there might indeed be a situation in which justice might not lead to clear results was also highlighted by Sen – our main reference point. *See* sec. 7.7.
2512. We would, therefore, disagree with Vogel, 1988c, p. 393, who argued that "equity [which he uses as a synonym for justice] is not a concept from which conclusions can be derived by logical or mathematical implication". The theories of global justice, as referred to in the present study, contain logical elements of reasoning. However, of course, it is indeed impossible to define the term "justice" in the same way that terms are defined in "exact sciences" (*see* id.).

of the principle of inter-nation equity.[2513] Moreover, we demonstrated that international law might even allow highly unjust treaties, as there are generally no legal limitations. Therefore, due to such a lack of protection of the parties,[2514] it is crucial that the parties to an international tax treaty, be it a double tax treaty, a TIEA, a FATCA IGA, a Rubik agreement or any other tax-related agreement, aim at balancing the rights and duties in a fair manner, particularly if one of the parties has a positional disadvantage. A just international tax treaty is only just if it is considered just from an impartial perspective. As states have different interests, it seems rather difficult to develop a just double tax treaty that is suitable for all relationships.

2513. *See* sec. 11.2.3.
2514. *See also* the remarks in sec. 4.2.5.

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