The Principle of ‘Nexus’ or ‘Genuine Link’ as a Keystone of International Income Tax Law: A Reappraisal

Gadžo, Stjepan

ARTICLE

The Principle of 'Nexus' or 'Genuine Link' as a Keystone of International Income Tax Law: A Reappraisal*

Stjepan Gadžo**

In this article, the author analyses the legal status of the so-called 'nexus principle', i.e. the requirement that a qualifying connection exists between the state exercising its taxing power on the one hand and taxable subject and/or taxable object on the other. It is argued that the nexus principle forms part of general international law of income tax jurisdiction, since it has attained the status of international custom. Put differently, international customary law prohibits income taxation in the absence of both personal and territorial nexus. In the light of the well-established methodology for ascertaining international customary law, support for such conclusion is found mainly in relevant norms of tax treaty law and domestic tax laws. Accordingly, the nexus principle may be considered as a keystone of international income tax law.

1 Introduction

Notion of territoriality and its tax implications is truly an eternal source of interest in international tax scholarship.[1] This comes as no surprise, since modern states usually exercise their taxing powers with special regard to diverse points of contact between state territory on the on hand and subjective and/or objective elements of a taxable event on the other. When it comes to taxation of income, irrespective of whether it is derived directly by an individual or via a legal entity (e.g. a company), it is quite standard practice that a state asserts taxing claim on the basis of both territorial link with the person of the taxpayer (i.e. on the basis of his or her 'fiscal residence') and territorial link with the taxable object (i.e. on the basis of 'source of income').[2]

For international lawyers – who do not necessarily possess expertise in taxation – this territorial foundation of states' taxing claims appears perfectly logical, since it is aligned with the general understanding of state power to assert jurisdiction, i.e. to prescribe a rule regulating some social relationship and enforce this rule against a targeted subject.[3] Conversely, it has not been uncommon for academics and practitioners whose primary field of interest is tax law strictu sensu to ignore, at least to some extent, the role that the general framework of public international law plays in tax matters.[4] Thus, the policy choices exercised in this area by domestic and international policymakers have seldom been put to scrutiny from the perspective of public international law.[5]

Against this backdrop it is no wonder that different meanings have been ascribed to the term 'territoriality' in

Notes

* This article is an adaptation of Stjepan Gadžo, *Nexus Requirements for Taxation of Non-residents' Business Income: A Normative Evaluation in the Context of the Global Economy*, sections 2.1 & 2.2, Online Books IBFD. © 2018 IBFD, all rights reserved. The research has been supported by the Croatian Science Foundation project no. 9366 'Legal Aspects of Corporate Acquisitions and Knowledge Driven Companies' Restructuring'. The author would like to thank two anonymous peer reviewers for their comments and insightful suggestions.

** Postdoctoral Researcher at Faculty of Law, University of Rijeka and a Postdoctoral Research Fellow at IBFD, Amsterdam. Email: sgadzo@pravri.hr.

1 Among some of the most recent contributions *see* e.g. Suzanne Kingston, *Territoriality in EU (Tax) Law: A Sacred Principle, or Dépassé?*, in *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism* (Joachim Englisch ed., IBFD 2016); Luis Eduardo Schoueri, *Revisiting Territoriality as a Fundamental Principle of International Tax Law*, in *ITP @ 20 {1996–2016}: Celebrating Twenty Years of the International Tax Program of the New York University School of Law* 377 et seq. (David Rosenbloom ed., New York University School of Law 2016).

2 *See* e.g. Arnold Knechtle, *Basic Problems in International Fiscal Law* 35–37 (Kluwer 1979); Robert Couzin, *Corporate Residence and International Taxation* 6 (IBFD 2002).

3 On the term 'assertion' in the context of international law of jurisdiction *see* Patrick Capps, Malcolm Evans & Stratos Konstadinidis, *Introduction*, in *Asserting Jurisdiction: International and European Legal Perspectives* xxi–xxii (Patrick Capps, Malcolm Evans & Stratos Konstadinidis eds, Hart Publishing 2003).

4 For such criticism *see* Rutsel Silvestre Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* 11–18 (Springer 1989). In the words of Servaas Van Thiel (*Is There a Need for International Enforcement of Human Rights In the Tax Area?*, in *Human Rights and Taxation in Europe and the World* 153 (Pasquale Pistone, Miguel Poiares Maduro & Georg Kofler eds, IBFD 2011)): '*(M)ore in general, tax lawyers, including international tax lawyers, have the tendency to regard their area of the law very much as a sui generis area that has its very own concepts and methods and is a priori unrelated to any other areas of national and international law.*'

5 For some recent contributions *see* e.g. Caroline Heber & Christian Sternberg, *The Extraterritorial Reach of the German Progression Clause in Income Tax Law in the Light of International Law*, 45(3) Intertax 254 (2017); Joachim Englisch, John Vella & Anzhela Yevgenyeva, *The Financial Transaction Tax Proposal Under the Enhanced Cooperation Procedure: Legal and Practical Considerations*, (2) Brit. Tax Rev. 223 (2013).

the context of taxation.[6] While in public international law territoriality denotes a generally recognized legal basis of state jurisdiction,[7] tax scholarship has widely used this notion to describe practice of some states in determining the quantitative extent of taxpayer's income tax liability in such a way that only income from 'domestic sources' is liable to tax.[8] It may well be that this terminological confusion has led some notable tax scholars to misinterpret and underestimate the true importance of territoriality principle – as understood in public international law – for the framework of income taxation.

Admittedly, under the prevailing view in contemporary tax scholarship, the most evident function assumed by territoriality principle in income tax area pertains to setting the limits of state's income tax jurisdiction. As already noted, the most fundamental limitation is the requirement that a qualifying connection – usually labelled as 'nexus' or 'genuine link'[9] – exists between the state territory and a particular set of facts relevant for taxation. Only if this requirement is satisfied, the exercise of tax-imposing and tax-collecting powers of the state is lawful from the perspective of public international law. As put by Mines, '*nexus describes whether a taxpayer, property, or activity has sufficient connection with a state to be subject to that state's tax jurisdiction*'.[10]

However, the validity of this 'nexus principle' as a norm of general international law is still prone to some doubts in the literature.[11] For example, as asserted by Arnold: '*{The} government's power to tax is limited effectively only by the countervailing interests of other governments and the practical difficulties of enforcement and collection. There are no limitations under international law on a nation's power to tax; and in most countries, there are no constitutional limitations.*'[12]

Accordingly, a reappraisal of the status of 'nexus principle' in international tax law seems as a worthy exercise. Main research question this article seeks to answer is the following: does the requirement for an income tax nexus stem from general international law? If the answer is negative, individual states as members of international community do not have to adhere to any *a priori* limitations[13] in regulating taxation of cross-border income and the issue effectively boils down to tax policy. Conversely, if the answer is positive, then one is innately compelled to examine whether general international law also defines particular circumstances under which income tax nexus may be deemed to exist, i.e. whether the abstract nexus *principle* is further supplemented by some common definitions of nexus *criteria* (e.g. fiscal residence, fixed place of business, etc.). However, the latter question is left outside the scope of the present article, as it warrants a separate comprehensive enquiry.

It has to be clarified at the outset that the term 'general international law' is used here to denote a category of norms of international law that are binding *erga omnes*, i.e. a subcategory of international law that applies to all states as primary subjects of international law.[14] In contrast, particular international law has narrower subjective scope of application, signifying a category of norms binding *inter partes*, i.e. among a limited number of states. This differentiation is intertwined with the division between main sources of international law. In what is generally regarded as a catalogue of the sources of international law,[15] Article 38 of the Statute of the International Court of Justice lists four different source categories: (1) international treaties (conventions); (2) international custom; (3) general principles of law recognized by civilized nations and (4) judicial decisions and teachings of the most highly qualified publicists.[16] In this respect, it is widely accepted that the norms of general international law are in most cases of customary nature, while the norms of particular international law normally stem from the treaties.[17] Accordingly, particular international law of income tax jurisdiction is embodied in the network of mostly bilateral tax treaties. Conversely, an enquiry

Notes

6 For an overview *see* Francisco Alfredo Garcia Prats, *Source, Residence and Nationality in Income Tax Matters: Between International Tax Rules and EU Law*, 29(2) Rivista di Diritto Tributario Internazionale 44–47 (2013).

7 *See infra* s. 2.1.

8 *See* e.g. Michael Lang, *Introduction to the Law of Double Taxation Conventions* 23–24 (Linde 2010); Gernot Brähler, *Internationales Steuerrecht Grundlagen für Studium und Steuerberaterprüfung* 6 (Wiesbaden: Gabler Verlag 2010).

9 *See* e.g. Brian J. Arnold & Michael J. McIntyre, *International Tax Primer* 15 (Kluwer Law International 2002); Richard L. Doernberg & Luc Hinnekens, *Electronic Commerce and International Taxation* (Kluwer Law International 1999); Luca Cerioni & Pedro M. Herrera, *The Nexus for Taxpayers: Domestic, Community and International Law*, in *Value Added Tax and Direct Taxation: Similarities and Differences* 571 (Michael Lang et al eds, IBFD 2009); Harald Schaumburg, *Internationales Steuerrecht* 131 (Verlag Dr Otto Schmidt 2017).

10 Paul Mines, *Nexus*, in *The Encyclopedia of Taxation & Tax Policy* 269 (Joseph J. Cordes, Robert D. Ebel & Jane Gravelle eds, The Urban Institute 2005).

11 For a detailed account *see infra* s. 2.2.1.

12 Brian J. Arnold, *The Taxation of Controlled Foreign Corporations: An International Comparison* 1 (Canadian Tax Foundation 1986).

13 On the notion of '*a priori*' international law requirements *see* Martha, *supra* n. 4, at 17.

14 For a detailed discussion on the meaning of general international law from a normative scope-type perspective *see* Anastasios Gourgourinis, *General/Particular International Law and Primary/Secondary Rules: Unitary Terminology of a Fragmented System*, 22(4) Eur. J. Int'l L. 993, 1010–1016 (2011).

15 *See* e.g. Ian Brownlie, *Principles of Public International Law* 3 (Oxford University Press 1998).

16 Statute of the International Court of Justice, 39 AJIL Supp. 215 (1945).

17 *See* Gourgourinis, *supra* n. 14, at 1012–1013. Cf. also G. I. Tunkin, *Is General International Law Customary Law Only?*, 4(4) Eur. J. Int'l L. 534 (1993); H. Thirlway, *The Sources of International Law* 56 (Oxford University Press 2014).

into the general norms of tax jurisdiction necessarily calls for an investigation of international custom.

The article is structured as follows. Following the introductory part, section 2 provides some fundamental insights on the notion of income tax of jurisdiction and the role customary international law has in setting its limits. Section 3 examines whether the status of the 'nexus principle' as a norm of customary international law can be confirmed, primarily in the light of tax treaty norms, domestic income tax laws and relevant decisions of domestic courts. Concluding remarks are provided in section 4.

2 General International Law of Jurisdiction and Taxation of Cross-Border Income

2.1 *International Law of Jurisdiction: The Fundamentals*

Before turning our attention to the specifics of income tax jurisdiction, it seems necessary to take a step back and at least briefly summarize the fundamentals of the law of jurisdiction applicable to all subject matters. In general, the term 'jurisdiction' denotes the power of the state to declare what the law is and to decide on the means of its enforcement.[18] As we are reminded by Mann's brief, but unmistakably accurate description: '*(J)urisdiction is concerned with the State's right of regulation*'.[19] It is a notion closely related to the concept of state sovereignty, which itself stands for the supreme power of a state within a given territory[20] and provides the theoretical underpinning to the whole body of public international law.[21] In fact, one of the main functions of international law is to delimit the boundaries of state sovereignty. It does so by determining different spheres of validity – personal, spatial, temporal and material – of the state's legal order.-[22] In other words, international law determines over which persons, over which territory, in what moment of time, and over which subject matter does the state sovereignty extend.

Against this backdrop, it is imperative to draw attention to two main points. First, jurisdiction is a concept both narrower than the concept of sovereignty – since it encompasses only some of the totality of state's competences – and is wholly dependent on it.[23] Second, whenever a given set of facts upon which a particular legal rule applies is not of purely domestic nature, jurisdiction becomes a problem of international law.[24] Thus the norms of international law regulate whether a state has law-making and law-enforcing powers in each case where a certain foreign element points out to the presumed interest of another state.

There is no consensus among international lawyers on the principles that comprise international law of jurisdiction. Due to the lack of treaties regulating this area, an inquiry into international law of jurisdiction is inevitably focused on customary law.[25] Even more troubling is a dearth of decisions by international courts or tribunals that would help in identifying and formulating relevant international custom.[26] The last time international courts have directly addressed the doctrine of jurisdiction was in 1927, when the Permanent Court of International Justice (PCIJ) gave its judgment in the so-called *Lotus* case.[27] Some of PCIJ's findings in this case remain uncontroversial even today, leading Ryngaert to conclude that it '*still constitutes the basic framework of reference for questions of jurisdiction under international law*'.[28] First, PCIJ confirmed that the lawfulness of the exercise of jurisdiction is a matter of public international law. Second, PCIJ made a clear distinction between legislative and enforcement jurisdiction in elaborating on their limits under international

Notes

[18] Bruno Simma & Andreas T. Müller, *Exercise and Limits of Jurisdiction*, in *The Cambridge Companion to International Law* 135 (James Crawford & Martti Koskenniemi eds, Cambridge University Press 2012). Cf. also Cedric Ryngaert, *Jurisdiction in International Law: United States and European Perspectives* 18 (Katholieke Universiteit Leuven 2007); Bernard H. Oxman, *Jurisdiction of States*, Max Planck Encyclopedia Pub. Int'l L. http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1436?rskey=f3gol9&result=2&prd=EPIL (accessed 1 Mar. 2017).

[19] Francis A. Mann, *Studies in International Law* 6 (Clarendon Press 1973).

[20] *See* e.g. Samantha Besson, *Sovereignty* Max Planck Encyclopedia of Public International Law, http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1472?rskey=Fv4htx&result=1&prd=EPIL (accessed 1 Nov. 2017).

[21] Brownlie, *supra* n. 15, at 289.

[22] Martha, *supra* n. 4, at 23–24. This is well aligned with the general understanding of the 'State' as the 'legal order' – e.g. system of legal norms – in the tradition of legal positivism. *See* e.g. Hans Kelsen & Javier Trevino, *General Theory of Law and State* 182–183 (Transaction Publishers 2005).

[23] Mann, *supra* n. 19, at 22.

[24] *Ibid.*, at 7.

[25] Ryngaert, *supra* n. 18, at 17.

[26] On the role of international courts and tribunals in ascertaining the rules of international customary law *see* Tullio Treves, *Customary International Law* Max Planck Encyclopedia of Public International Law, http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1393?rskey=vlKjuK&result=1&prd=EPIL (accessed 1 Nov. 2017), at paras. 53–59. For the purposes of present paper, we assume that jurisprudence of domestic courts bears significance for ascertaining international custom, particularly in terms of its subjective element (*opinio juris*). *See* s. 3.3 below.

[27] *S.S. 'Lotus', France v. Turkey*, Judgment, (1927) PCIJ Series A no 10, ICGJ 248 (PCIJ 1927), 7 Sept. 1927, Permanent Court of International Justice.

[28] Ryngaert, *supra* n. 18, at 33. Cf. also Menno T. Kamminga, *Extraterritoriality* 6, http://opil.ouplaw.com/home/EPIL (accessed 1 Nov. 2017).

law.[29] Thirdly, it was confirmed that enforcement jurisdiction is based on the principle of territoriality: under international law a state is not allowed exercise its enforcement jurisdiction outside of its territory without specific permission, stemming either from an international custom or from a treaty rule.[30]

Conversely, other parts of the *Lotus* decision – particularly those concerned with the limits of substantive jurisdiction of a state – remain controversial. Put simply, the PCIJ held that states could exercise their law-making powers outside of their territory, in the absence of any international rules prohibiting them to do so.[31] This approach affords the states a wide area of discretion in the exercise of substantive jurisdiction, as they would not have to ground it on any specific permissive rule, e.g. principle of territoriality.[32] Accordingly, *Lotus* doctrine was subject of some criticism in the literature, mainly since it is underpinned by a concept of seemingly unbridled state sovereignty, which is hard to reconcile with the framework of public international law.[33] More importantly, most states have never exercised such wide discretion in their law-making powers, leading some authors to suggest that customary international law does away with the *Lotus* doctrine.[34]

Most critics of *Lotus* argue that general international law requires a qualifying connection being established between a state asserting jurisdictional claim and the subject matter at hand. This requirement has been commonly described in terms of 'sufficient', 'close', 'genuine' or 'substantial' connection or link.[35] In essence, what is required is an exercise in attaching a given set of facts with sovereign sphere(s) of a state. As two main spheres of state sovereignty are its personal sovereignty (i.e. state's power over its nationals), and territorial sovereignty (i.e. state's power over all persons and things located within its territory),[36] two generally recognized bases for jurisdiction, under public international law, are principles of nationality and territoriality.[37]

Principle of territoriality, as the most often invoked basis of state jurisdiction, affirms law-making powers of the state in a particular subject matter due to the link between relevant set of facts and its territory. The exercise of territorial jurisdiction is, however, far from straightforward in many areas of law, as probably best illustrated by cross-border criminal offences, where a state can base its jurisdiction either on the 'conduct element' or on the 'result element' of an act.[38] On the other hand, principle of nationality (or personality), which historically preceded the territoriality principle as the jurisdictional basis, reflects the idea of a special relationship existing between a state and 'its people' (i.e. its nationals), providing the state the powers to regulate its nationals' conduct, wherever they are.[39]

Some other principles of jurisdiction can be established inductively from the practice of states. Their emergence may be ascribed to the inadequacies of territoriality and nationality principles to tackle certain problems associated with the ever-changing economic and political environment.[40] It is vital to observe in this respect that the emergence of other jurisdictional principles, as well as some debatable extensions of the traditional principles (e.g. the 'effects doctrine' with regard to the principle of territoriality), serve to remind us on one of the paramount features of international law – its malleability.[41]

Malleability of international law of jurisdiction is blatantly manifested with regard to the 'genuine link' requirement, since the factors signalling its fulfilment are not only manifold, but are also susceptible to the changes in the economic and political environment. One can observe the shift away from the strictly territorial approach to jurisdiction – with concurrent acknowledgment of nationality principle – that reached its pinnacle at the beginning of the twentieth century, to various extra-territorial approaches, better equipped to face the challenges of the globalization era.[42] Against this backdrop, decision of the PCIJ in *Lotus* may be read not as a somewhat rash approval of whichever jurisdictional basis states see fit, but as both a

Notes

29 *See* Ryngaert, *supra* n. 18, at 35.

30 *See* PCIJ's judgment in *Lotus*, at 18–19.

31 *See ibid.*, at 19.

32 Ryngaert, *supra* n. 18, at 32.

33 *See* Mann, *supra* n. 19, at 26., and the references mentioned therein.

34 *See* e.g. Ryngaert, *supra* n. 18, at 38–39.; Kamminga, *supra* n. 28, at 9.

35 *See* e.g. Simma & Müller, *supra* n. 18, at 137; Michael B. Akehurst, *Jurisdiction in International Law*, in *Jurisdiction in International Law* 179 (W Michael Reisman ed., Ashgate 1999); Brownlie, *supra* n. 15, at 301.

36 *See* Martha, *supra* n. 4, 43–46.

37 Brownlie, *supra* n. 15, at 313; Cf. also Simma & Müller, *supra* n. 18, at 137.; Englisch, Vella and Yevgenyeva, *supra* n. 5, at 238.

38 *See* Simma & Müller, *supra* n. 18, at 140.

39 *See ibid.*, at 142.

40 Oxman, *supra* n. 18, at 11.

41 Simma & Müller, *supra* n. 18, at 147.

42 *See* Kamminga, *supra* n. 28, at 4.

rejection of the strict territorial approach and a farsighted acceptance of the necessity to introduce more pliability to the doctrine of jurisdiction so that it can cope with the practical problems of everyday life.[43]

It is thus clear that the answer to the question on what constitutes a sufficient jurisdictional connection varies depending on the problem at hand. In other words, there is no one-size-fits-all solution to the issue. Ryngaert submits that '*every field of law ought to be subject to its own specific jurisdictional rules*'.[44] Applying this line of thought on the problem of establishing whether there exists a sufficient jurisdictional connection necessarily calls for an operation which is not abstract, but rather entails weighing of various factors and interests in a concrete subject-matter.[45]

2.2 *Notion of Tax Jurisdiction: Review of the Literature*

In light of the preceding discussion, it is clear that the notion of tax jurisdiction should be examined with reference to the general international law of jurisdiction. The term 'tax jurisdiction' then denotes law-making and law-enforcing powers of the state in the specific area of taxation.[46] Whenever there is a foreign element – of subjective or objective nature – in a specific tax matter, tax jurisdiction becomes the problem of international law. In these cases it is possible to evaluate the lawfulness of the state's right to regulate the matter at hand and to enforce ensuing tax claim. Within the limits set by international law each state is free to decide on the specific means of asserting tax jurisdiction in relation to natural and juristic persons. In this manner 'incomplete norms' of international law are completed by domestic tax rules.[47]

2.2.1 *Theory of 'Unlimited' Tax Jurisdiction*

There are two discernible schools of thought in tax literature about the content and the extent of state's tax jurisdiction.[48] One school asserts that substantive tax jurisdiction is limited by an international law requirement for a 'reasonable connection' between the state and either the tax subject or tax object.[49] Since this view is more consistent with general jurisdictional norms (see section 2.1), it is deemed as the better one throughout this article and will be further elaborated below (see section 2.3).

A common thread shared between all proponents of the second school of thought is the denial of limitations to state's substantive tax jurisdiction under international law.[50] Hence, this doctrine is sometimes also labelled as the 'realistic doctrine (theory)'.[51] We feel that this is a misnomer and it does not do justice to the majority of its supporters. Namely, it can lead to the conclusion that the justification of a state's taxing claim lies solely in the physical power over persons and property. Martha points out that such argumentation would not be purely juristic and seems unconvincing, particularly having in mind the fundamentals of international law.[52]

In fact, most advocates of the doctrine of unlimited tax jurisdiction frame their arguments within the system of international law, usually accentuating the permissive approach to jurisdiction consecrated by the PCIJ in the *Lotus* case. This view is probably best explicated by Asif Qureshi, who begins by rejecting the idea that state's jurisdiction, with regard to matters within their territory, is limited by a requirement for a reasonable connection. '*The constraint imposed by International Law on a State's fiscal legislative jurisdiction is, it is suggested, only minimal. It is minimal in that the concern of International Law in the fiscal sphere is designed mainly to ensure the minimum standard under International Law in favour of foreigners.*'[53] With regard to the exercise of extraterritorial jurisdiction Qureshi notes that '*the constraint imposed by International Law is minimal. In fact, it is limited only by that important norm of International Law that limits a State's enforcement powers to its territory*'.[54]

It seems that Qureshi's first point is based on the analysis which falls far short of the comprehensive study

Notes

43 Cf. also Mann, *supra* n. 19, at 27–28.

44 Ryngaert, *supra* n. 18, at 787. This approach is clearly taken in the US Restatement of the Foreign Relations Law, *see* American Law Institute, *Restatement of the Law, the Foreign Relations Law of the United States* 402 et seq. (American Law Institute Publishers 1987).

45 *See* Simma & Müller, *supra* n. 18, at 149.

46 Cf. Asif H. Qureshi, *The Public International Law of Taxation: Text, Cases and Materials* 22 (Graham & Trotman 1994), arguing that '*fiscal jurisdiction refers to a State's competence to tax persons, property and transactions, or events*'.

47 *See* Martha, *supra* n. 4, at 25.

48 Qureshi, *supra* n. 46, at 24.

49 *Ibid.*

50 *Ibid.* For an overview of prominent supporters of this school of thought *see* Martha, *supra* n. 4., at 11–18; Guillermo Teijeiro, *Opening the Pandora Box in the International Tax Field*, 42(4) Tax Plan. Int'l Rev. (2015), at 5; Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* 23–24 (Cambridge University Press 2011) and the sources cited therein.

51 *See* e.g. Arvid S. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* 20 (Kluwer Law and Taxation Publishers 1991); J. Monsenego, *Taxation of Foreign Business Income Within the European Internal Market* (IBFD 2012), s. 2.3.2.

52 Martha, *supra* n. 4, at 19.

53 Qureshi, *supra* n. 46, at 29.

54 *Ibid.*, at 31.

of the state practice in taxing aliens, as provided by Albrecht almost sixty years earlier.[55] Indeed, Albrecht's analysis illustrates how the minimal standard for protection of aliens has evolved, through state practice, into a common set of standards which pose stricter limitations to tax jurisdiction under international law. Martha finds the basic weakness of Qureshi's argument in that he failed to acknowledge the legitimizing function of international law in tax matters, i.e. its role in determining whether domestic tax rules may be applied to transnational fiscal facts.[56] Qureshi's second point is probably best refuted by Jeffery, who notes: '*To say that enforcement jurisdiction is the prime regulator in international law is to confuse theory with practice. Just because a law cannot in practice be enforced does not in any way relate to its legality or otherwise.*'[57] Certainly, it is conceptually erroneous to think about limits on a state's substantive jurisdiction in terms of its enforcement capabilities. As depicted above (section 2.1) these two types of jurisdiction ought to be discerned in theory. Moreover, as exposed by Brownlie, enforcement jurisdiction is the function of substantive jurisdiction under international law, not the other way around: '*(I)f the substantive jurisdiction is beyond lawful limits, then any consequent enforcement jurisdiction is unlawful.*'[58] If Qureshi's argument would be valid, a state that has no connection whatsoever with neither subjective nor objective elements of taxation in a specific matter could lawfully impose a tax just because it has come to agreement to enforce it with another state, which is able to exercise territorial sovereignty over the relevant set of facts.

We can conclude that the theory of unlimited tax jurisdiction lacks valid support from the perspective of public international law. To claim that a state's tax jurisdiction is 'unlimited' is a contradiction in itself. Jurisdiction is a concept which is inherently limited under international law, being dependent on the concept of sovereignty. To promote a view, then, that a state can expand its tax jurisdiction as far as it sees fit means discarding the paradigm of state sovereignty.[59]

Admittedly, it seems that while most of the proponents of unlimited tax jurisdiction doctrine agree with the basic premise that jurisdiction is an aspect of sovereignty, they reject the idea that general international law sets limits to the exercise of jurisdiction, in the form of the requirement for a 'reasonable' or 'genuine' connection (see above, section 2.1). This is best manifested by Monsenego: '*As a conclusion, no internationally accepted minimum connection is required from and binding on states to exercise jurisdiction to prescribe in the field of tax law, but at the same time it is possible that jurisdiction may not be exercised in the lack of any connection.*'[60] In a similar vein, Harris and Oliver emphasize the vagueness of customary international law in respect of limitations to a state's power to tax, while admitting that '*it is, perhaps, appropriate to suggest that it requires some sort of connecting factor, some link to a state in order for that state to have a recognisable jurisdiction to tax*'.[61] Same authors, however, continue by falling in the familiar trap of confusing substantive and enforcement aspects of tax jurisdiction, asserting that '*(T)his may be little more than a reflection of the fact that, if there is no connecting factor, a state will find it near impossible to enforce its tax outside its territorial limits.*'[62]

2.2.2 *The Prevailing View: Tax Nexus as a Prerequisite for the Assertion of Income Tax Jurisdiction*

Under prevailing view in contemporary tax scholarship, general international law poses limits to the substantive facet of tax jurisdiction. While the nature of these limits is often not expressed consistently by different scholars, a common denominator can be identified in the form of a requirement for a qualifying connection between the state wishing to exercise its taxing powers and a particular set of facts relevant for taxation. Only if this connection is established, the exercise of tax-imposing and tax-collecting powers of the state shall be lawful. With regards to income tax, the connection must be established either with regard to the person of the taxpayer (person who is obliged to pay certain amount of tax under the domestic tax law of the state) or with regard to the facts contributing to the derivation of income, as the taxable object. The requirement for a qualifying connection or a nexus has been thusly framed by Klaus Vogel: '*(C)urrent international law permits taxation of foreign economic transactions when a sufficient connection exists between the taxpayer and the taxing State.*'[63]

Notes

55 A. R. Albrecht, *The Taxation of Aliens Under International Law*, 29 Brit. Y.B. Int'l L. 145 et seq. (1952).

56 Martha, *supra* n. 4, at 18. Such definition of the 'legitimizing function' of international law is provided in *ibid.*, at 1.

57 Ramon J. Jeffery, *The Impact of State Sovereignty on Global Trade and International Taxation* 43 (Kluwer Law International 1999).

58 Brownlie, *supra* n. 15, at 313. Mann offers a vivid example in his support of this statement: if the UK adopts the law regulating the price of whiskey in the Netherlands, clearly lacking the legislative jurisdiction to do so under international law, any subsequent practice aimed at enforcing such law, even with Dutch consent, would also be unlawful. *See* Mann, *supra* n. 19, at 154.

59 Cf. also Teijeiro, *supra* n. 50, at 5.

60 Monsenego, *supra* n. 51, s. 2.3.2. Cf. also John Prebble, *Ectopia, Tax Law and International Taxation*, (5) Brit. Tax Rev. 385 (1997).

61 Peter Harris & David Oliver, *International Commercial Tax* 44 (Cambridge University Press 2010).

62 *Ibid.*

63 Klaus Vogel, *Klaus Vogel on Double Taxation Conventions* 11 (Kluwer Law International 1997). Cf. also e.g. Lang, *supra* n. 8, at 23; Kees Van Raad, *Nondiscrimination in International Tax Law* 21 (Kluwer Law and Taxation 1986); Manfred Mössner, *Source Versus Residence: An EU Perspective*, 60(12) Bull. Int'l Tax'n 504 (2006).

Tax scholars who adhere to such view apparently draw their arguments from the positive international law (*lex lata*). Their views are based on the assumption that customary international law requires a personal or territorial nexus between the taxing state and the taxpayer and/or the income. This is explicitly acknowledged, inter alia, by Alexandar Rust:

> *(C)ustomary international law does not forbid double taxation but prevents states from taxing when there is no genuine link between the income and the taxing state. This link can consist in a personal (residence or citizenship) or a territorial connection. In general, states do not go so far that they tax everything which would be possible under public international law; they do not tap their full potential.*[64]

Existence of such norm of customary international law is also acknowledged by distinguished international lawyers. In the words of Akehurst: '*Customary international law permits a State to levy taxes only if there is a genuine connection between the State and the taxpayer (nationality, domicile, long residence, etc.), or between the State and the transaction or property in respect with which the tax is levied.*'[65]

Tax literature usually divides the connecting factors amounting to the income tax nexus into two groups, depending on whether, due to their existence, the taxpayer owes political or economic 'allegiance' to the country in question.[66] Nationality and fiscal residence of a person are typical factors symbolizing his political allegiance, while the location of the activity giving rise to income is a typical factor symbolizing his economic allegiance.

From a purely international law perspective, it is more accurate to divide all of the connecting factors into two groups depending on whether they relate to personal or territorial sphere of the state sovereignty.[67] Nationality (or citizenship) of a person is the only factor that subjugates that person to personal sovereignty of a state. Apart from nationality, all the other connecting factors relevant for income taxation (e.g. tax residence, location of income-producing activities etc.) will subjugate a person to territorial sphere of state sovereignty. It is therefore clear that income tax nexus can be observed in terms of principles both nationality and territoriality principles – signifying two bases for the exercise of substantive jurisdiction recognized under customary international law (see *supra*, section 2.1).

2.3 *Finding Evidence of Customary Law of Income Tax Jurisdiction*

At this point we arrive to the crux of the issue explored in the present article: does customary international law lend support to the prevailing view of tax scholarship on the limits of jurisdiction to tax income? Or, in other words, does international custom indeed prohibit taxation of a person's income in the absence of both personal and territorial nexus?

An obvious problem in providing the answer has to do with the nature of international custom. Namely, ascertaining both existence and precise content of customary international law is an extremely difficult task.[68]

A norm can achieve status of international custom only if the two following criteria are satisfied: (1) the norm is manifested uniformly and consistently in the state practice (objective element) and (2) the practice of the states is a result of the belief that they are legally obliged to do so (subjective or psychological element; *opinio juris sive necessitatis*).[69] These constitutive elements of customary law were repeatedly affirmed in the practice of international courts,[70] thus acquiring the status of international custom themselves.[71]

State practice can be manifested in manifold ways. While a detailed examination of the manifestations of state practice is beyond the scope of this article,[72] it is important to identify the material that bears special importance when it comes to ascertaining customary law of income tax jurisdiction. In this regard the overall context and the nature of the rule in question has to be taken into account.[73]

Notes

64 Alexander Rust, *Double Taxation*, in *Double Taxation Within the European Union* 3 (Alexander Rust ed., Kluwer Law International 2011). Cf. also Reuven S. Avi-Yonah, *International Tax as International Law an Analysis of the International Tax Regime* 5 (Cambridge University Press 2007).

65 Akehurst, *supra* n. 35, at 59–60; Cf. also Mann, *supra* n. 19, at 94–103; American Law Institute, *supra* n. 44, at 412.

66 *See* Wolfgang Schön, *International Tax Coordination for a Second-Best World (Part I)*, 1(1) World Tax J. 91 (2009). Examples of seminal analyses of the concepts of political and economic allegiance may be found in Georg Schanz, *Zur Frage Der Steuerpflicht*, 9(2) FinanzArchiv / Public Finance Analysis 1 (1892); Edwin Robert Anderson Seligman, *Essays in Taxation* 108–120 (Macmillan 1895).

67 *See* Martha, *supra* n. 4, at 47; Wolfgang Schön, *Persons and Territories: On the International Allocation of Taxing Rights*, (6) Brit. Tax Rev. 554 (2010).

68 Mark E. Villiger, *Customary International Law and Treaties: A Manual on the Theory and Practice of the Interrelation of Sources* 60 (Kluwer Law International 1997). Cf. also Malcolm N. Shaw, *International Law* 73–75 (Cambridge University Press 2008).

69 *See* Treves, *supra* n. 26, at 8; Ruediger Wolfrum, *Sources of International Law* Max Planck Encyclopedia of Public International Law, http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1471?rskey=tK4c54&result=1&prd=EPIL (accessed 11 Nov. 2017), at paras. 24–25.

70 For an overview of the most important judgments *see* Treves, *supra* n. 26, at 17; Brownlie, *supra* n. 15, at 5–11.

71 Brian D. Lepard, *Is the United States Obligated to Drive on the Right?: A Multidisciplinary Inquiry into the Normative Authority of Contemporary International Law Using the Arms' Length Standards as a Case Study*, 10(1) Duke J. Comp. & Int'l L. 155 (1999).

72 For an overview *see* Treves, *supra* n. 26, at 26–30; Shaw, *supra* n. 68, at 81–84.

73 *See* International Law Commission, *Report of the International Law Commission on the Work of Its Sixty-Eighth Session, 2 May–10 June and 4 July–12 August 2016*, A/71/10, at 84–87.

Since – at least on the international plane – '*practice of States in nowhere better reflected than in treaties*',[74] tax treaty law represents an obvious point of departure.[75] At the moment there are more than 3.000 bilateral tax treaties in force.[76] Even more importantly, the content and the language of double tax treaties (DTTs) is remarkably uniform. This can be ascribed to the influence of the so-called model treaties, designed over the almost one-hundred-year period by various international organizations, most influential being the League of Nations and the OECD.[77] Dagan notes that 75% of the language in actual DTTs is identical to that of the OECD Model Tax Convention on Income and on Capital (hereinafter: OECD Model).[78] Its impact is not limited to the treaty policy of developed countries – which comprise OECD's membership – but is also reflected in DTTs signed by developing countries.[79] Thus, it may be presumed that tax treaty network fulfils the requirement of 'generality' of state practice.[80] On the other hand, fulfilment of the requirements of uniformity and consistency of the state practice through DTTs will need to be assessed in relation to the norm being invoked.[81]

In the process of drafting of model tax treaties and various reports on international tax issues by the international organizations, state practice can be demonstrated by their specific statements and positions.[82] Even more importantly, this can serve as an evidence of states' belief in their legal obligations under customary international law.

Domestic law[83] – encompassing constitutional provisions, legislative acts, administrative practice and the case law of domestic tribunals – can also be submitted as an evidence of state practice on the internal plane.[84] Domestic tax law of every state contains provisions which regulate the extent of the exercise of its income tax jurisdiction. Since the rules of DTTs generally have priority in application,[85] examination of the ways the state would exercise its tax jurisdiction in their absence may give important insights on their belief on the content of customary norms.

It follows that there is abundant supply of evidence that can be used in ascertaining the objective element of customary law of income tax jurisdiction. The difficult part is ascertaining the subjective element, *opinio juris*: is there a conviction of the state that its practice – reflected primarily in DTTs and domestic tax legislation – is required by law, under the threat of sanctions of some kind?[86] This element is what distinguishes rule of customary law from the rule of international comity, which is not binding as such, or any state behaviour guided by other extralegal motives.[87]

The capacity of DTTs in proving *opinio juris* seems very dubious. Tax treaty network undoubtedly makes up an impressive body of particular international law of income tax jurisdiction. On the other hand, one should be extremely careful in pursuing a claim that a tax treaty norm has broader normative scope, belonging to the general international law. Treves contends that '*in assuming treaty obligations, States often accept limitations to their sovereignty that they deem would not be applicable to them under general international law*'.[88] This argument does not lose validity in the tax treaty context.[89] As pointed out by Mann (notably, a great proponent of the view that substantive tax jurisdiction is limited under international law): '*Hence, although the international law of fiscal jurisdiction enjoys the unique and outstanding distinction of being regulated by a network of treaties, it is open to doubt whether they are expressive of, or exceptions to, the rules of customary*

Notes

74 Wolfrum, *supra* n. 69, at 26. Cf. also, on the role of treaty provisions in identifying international custom, Treves, *supra* n. 26, at 47; International Law Commission, *supra* n. 73, at 102–106.

75 Hereinafter these international treaties will be interchangeably referred to as 'tax treaties' or by an abbreviation 'DTTs'.

76 *See* OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties* 11 (OECD Publishing 2014), http://dx.doi.org/10.1787/9789264219250-en (accessed 1 Mar. 2017).

77 Lang, *supra* n. 8, at 27–28.

78 Tsilly Dagan, *BRICS: Theoretical Framework and the Potential of Cooperation*, in *BRICS and the Emergence of International Tax Coordination* (Yariv Brauner and Pasquale Pistone eds, IBFD 2015), s. 2.2.1. For a recent empirical research on the convergence in the language of tax treaties *see* E. Ash & O. Marian, *The Making of International Tax Law: Empirical Evidence Using Natural Language Analysis* (28 June 2017). Available at SSRN: https://ssrn.com/abstract=2994217 (accessed 28 June 2017).

79 *See* Pasquale Pistone, *General Report*, in *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* 2 (Michael Lang et al. eds, Cambridge University Press 2012); OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2014* 12–15 (OECD Publishing 2014).

80 On this requirement *see* Treves, *supra* n. 26, at 35–38; International Law Commission, *supra* n. 73, at 94–96.

81 On the requirements of uniformity and consistency of state practice *see* Villiger, *supra* n. 68, at 42–45.

82 *See* Treves, *supra* n. 26, at 26.

83 It is quite common in the terminology of public international law to also use the term 'municipal law' when referring to domestic law, i.e. internal law created by a sovereign state or any of its political subunits. *See* e.g. Shaw, *supra* n. 68, at 1–4.

84 Villiger, *supra* n. 68, at 17; Shaw, *supra* n. 68, at 83–84, International Law Commission, *supra* n. 73, at 92.

85 *See* Lang, *supra* n. 8, at 33.

86 On the notion of *opinio juris see* Villiger, *supra* n. 68, at 48; Brownlie, *supra* n. 15, at 7.

87 International Law Commission, *supra* n. 73, at 97.

88 Treves, *supra* n. 26, at 48. More on the weaknesses of treaties in proving *opinio juris see* Villiger, *supra* n. 68, at 27–28.

89 *See* Qureshi, *supra* n. 46, at 34; Lepard, *supra* n. 71, at 165; Jens Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* 289–290 (Kluwer Law International 2010).

international law. They cannot, therefore be taken as a conclusive guide, then such rules are to be ascertained.'[90] DTTs are primarily instruments that create contractual obligations *inter partes.*[91] Moreover, they are a result of the often arduous negotiation process between the treaty partners, who try to implement their own policy goals into the final text of the treaty, usually starting from the provisions of the OECD Model as the basis for negotiations.[92] It is therefore hard to infer that a particular norm was ingrained in the treaty due to the belief of the parties that it is a part of the customary law. Significance of treaties for the formation of customary law hinges on the manifestation of *opinio juris 'beyond the mere contractual obligation'*.[93]

It is submitted here that *opinio juris* corresponding to the state practice embodied in DTTs may be evidenced by domestic tax law and by documentation of international organizations that have traditionally been at the forefront of international tax coordination (e.g. League of Nations, OECD, UN). Of particular importance are those provisions of domestic tax legislation which are aligned with the basic norms of the DTTs. This could serve as evidence that a state believes it is obliged to abide by the norm even outside the treaty context, because it is a part of customary international law.[94] Admittedly, this line of thinking may be prone to some criticism since the domestic legislation is more often a product of different policy choices and in that respect amounts to state behaviour motivated by extralegal reasons. However, it has been well established in the literature that national legislation may have a role in proving states' belief in the legality of certain behaviour under public international law.[95] Further helping hand for this purpose may be offered by the decisions of domestic judiciary which explicitly or implicitly refer to state obligations under general international law.[96]

3 Is the Nexus Requirement a Norm of Customary International Law?

Against the backdrop of the preceding discussion on difficulties one comes across in ascertaining customary international law, in this section we will examine whether the status of the 'nexus principle' as a norm of customary law can be confirmed.

3.1 *Tax Treaties as a Starting Point*

If one accepts the value of tax treaty network as evidence material, the objective element of international custom (state practice) can be deemed to be fulfilled with regard to the nexus principle. It should be noted at this point that DTTs are not the basis for state's power to tax under international law. It is rather – as seen from the previous discussion – the concept of state sovereignty, which pervades the whole body of international law. Since the main purpose of DTTs is to alleviate juridical double taxation,[97] their focus is on resolving cases of concurrent income tax jurisdiction. By limiting the application of certain provisions of domestic tax law DTTs in effect allocate the rights to tax between the contracting states.[98] When one contracting state acknowledges the superior tax claim of the other, double taxation is mitigated. In our view some crucial insights on the nexus issue may be inferred from the tax treaty network.

Firstly, subjective scope of DTTs is limited only to persons who are tax residents of either of the contracting states.[99] Therefore, a special kind of connection between a person and a territorial sphere of state sovereignty is required for that person to gain access to treaty benefits. Secondly, when the DTT applies, it does not regulate cases where a person is resident of one contracting state and has neither personal nor territorial connection with the other contracting state. It mainly regulates cases where a resident of one contracting state derives his income from the sources located in the other contracting state, thus acknowledging the link established between the resident and the territorial sphere of sovereignty of that other state. When such a link is established that state is designated as the '*State of source or situs*' in the Commentary to the OECD Model Convention (hereinafter: OECD Commentary).[100] Main purpose of the DTTs is then achieved by allocating the taxing rights

Notes

90 Mann, *supra* n. 19, at 95.

91 Art. 26 of the Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 Jan. 1980) 1155 UNTS 331, reads as follows: *'Every treaty in force is binding upon the parties to it and must be performed by them in good faith.'*

92 Lang, *supra* n. 8, at 27–28.

93 Villiger, *supra* n. 68, at 28. More on the value of treaties in ascertaining international custom *see* International Law Commission, *supra* n. 73, at 102–106.

94 *See* Skaar, *supra* n. 51, at 21–22. For a differing view *see* Heber & Sternberg, *supra* n. 5, at 261.

95 *See* International Law Commission, *supra* n. 73, at 100.

96 *See ibid.*

97 OECD, *supra* n. 79, at 1–3. Whether this is really the main purpose of DTTs is a subject of some debate among tax scholars and practitioners. *See* e.g. B. J. Arnold, J. Sasseville & E. Zolt, *Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century*, 50(1) Can. Tax J. 67–70 (2002).

98 Lang, *supra* n. 8, at 31–32.

99 *See* Art. 1 OECD Model.

100 *See* e.g. OECD, *supra* n. 79, at 19. Conversely, the term is nowhere to be found in the articles of the OECD Model. *See* Klaus Vogel, *'State of Residence' May as Well Be 'State of Source' – There Is No Contradiction*, 59(10) Bull. Int'l Tax'n 420 (2005).

between the residence state and the source/situs state as treaty partners. This general structure is followed in each of the more than 3.000 DTTs. It follows from the structure of the DTTs that contracting states differentiate between three types of cases falling within the scope of the treaty: (1) case where a nexus in the form of fiscal residence is established with regard to both contracting states (so-called 'dual residence' conflicts); (2) case where a resident of one contracting state has a nexus in the other state, taking the form of source/situs; and (3) case where there is no established nexus, in the form of source/situs, between the resident of one contracting state and the other state.

DTTs explicitly regulate only cases under ad) 1 and ad) 2. Thus, it can be inferred that states do not see the case under ad) 3 as a problem, presumably because in that case the 'other' contracting state (non-resident state) lacks a valid jurisdictional claim, due to the absence of an appropriate nexus. It may therefore be concluded that the nexus principle is reflected in the tax treaty network, which serves as a manifestation of general and uniform state practice.

3.2 Domestic Income Tax Law: Proving *opinio juris*

As explained above (section 2.3), DTTs can hardly be taken as a firm evidence of the corresponding *opinio juris*, as the subjective element of customary law.[101] The following analysis is thus based on the assumption that proving *opinio juris* regarding the nexus requirement entails an examination of domestic income tax law. In other words, we assume that the conviction of a state that it needs to abide to the nexus principle under general international law is nowhere better reflected than in its domestic legal system. If states would exercise its law-making powers in the field of income tax without any regard to the connection they can institute with the targeted taxpayer, submitting themselves to such limitation only in a particular setting of a DTT, then *opinio juris* must be deemed absent.

Here we face a complex relationship between domestic income tax law and tax treaty law. Historically, the amalgam of income tax provisions found in domestic laws of European countries at late nineteenth century provided the impetus for the process of international tax coordination, resulting in the adoption of first draft model treaties in early twentieth century as well as the subsequent expansion of tax treaty network. The phenomenon of juridical double taxation was a consequence of competing jurisdictional claims asserted by the different states. It was only when the states recognized the benefits of a coordinated approach that the problem of double taxation was seriously tackled on an international plane.[102] Hence, first pieces of income tax legislation, such as the UK Income Tax Act of 1799 – to which the fall of Napoleon Bonaparte's fortunes is often attributed[103] – provided a chance for states to extend their tax reach as far as it saw fit.

However, even at these humble beginnings of income tax states exercised their substantive tax jurisdiction by acknowledging the limitations linked with the concept of sovereignty. The UK Income Tax Act of 1803 provides a perfect example: while it extended the jurisdictional reach compared to its predecessor, it adhered to the basic principles of residence and source familiar to contemporary tax systems; UK residents were taxed on their worldwide income and non-residents were taxed on their income originating from the UK.[104] First income tax laws of Prussia, Austria and the Netherlands were also grounded on the principles of residence and source, with Italy being an exception, in levying only the source-based income tax.[105]

This earliest examples of domestic state practice framed the subsequent interstate discussion on resolving cases of concurrent income tax jurisdiction. In fact, the kernel of the modern tax treaty network is the Imperial Law for the Elimination of Double Taxation, adopted in 1870 in the North German Confederation (predecessor to the German Empire, formed in 1871). The law, intended to alleviate the double taxation accompanying the trade and business between the Member States of the German confederation, implemented an approach in the allocation of taxing rights between the state of residence and the state of source/situs remarkably similar to that of the twentieth century model treaties drafted by the League of Nations and the OECD.[106] In the subsequent worldwide developments of domestic income tax legislation we cannot find an example of a state exercising its substantive jurisdiction without justifying it by either personal or territorial

Notes

[101] For an argument that *opinio juris* can be evidenced by the tax treaties *see* Chantal Thomas, *Customary International Law and State Taxation of Corporate Income: The Case for the Separate Accounting Method*, 14(1) Berkeley J. Int'l L. 131 (1996).

[102] *See* Harris & Oliver, *supra* n. 61, at 16.

[103] *See* e.g. Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilization* 349–360 (Madison Books 2001).

[104] Peter A. Harris, *Corporate-Shareholder Income Taxation and Allocating Taxing Rights between Countries: A Comparison of Imputation Systems* 287 (IBFD 1996).

[105] For an overview *see ibid.*, at 288–293.

[106] On the influence of the German domestic tax legislation on the development of today's system of allocation of taxing rights *see* Harris, *supra* n. 104, at 289; Johann Hattingh, *On the Origins of Model Tax Conventions : Nineteenth-Century German Tax Treaties and Laws Concerned with the Avoidance of Double Tax*, in *Studies in the History of Tax Law, Volume 6*, 31 (John Tiley ed., Hart Publishing 2013); Sunita Jogarajan, *Prelude to the International Tax Treaty Network: 1815–1914 Early Tax Treaties and the Conditions for Action*, 31 (4) Oxford Journal of Legal Studies 679 (2011).

connection(s) with the relevant set of facts. While there have been numerous examples where the lawfulness of a jurisdictional claim was being contested, they have revolved around the usage of a particular connecting factor in relation to a particular set of facts.[107] However, as already suggested above in the introductory part of the article, this conceptually amounts to a question separate from the question of whether there is requirement for an abstract nexus between the taxpayer and the state and whether this requirement constitutes a norm of customary international law.

Proponents of the school of 'unlimited' substantive tax jurisdiction (*supra*, section 2.2.1) would probably object to the preceding line of reasoning by claiming that it was actually the limitations of the enforcement tax jurisdiction states took account of in drafting their rudimentary income tax laws, rather than the belief that their law-making powers are limited under general international law. Put differently, it could be claimed that territorially limited power of enforcement framed the extent of legislative reach of income tax from its very inception. Problem with this counterargument is that it fails to explain the frequent occasions of misalignment between the substantive and the enforcement facet of income tax jurisdiction in domestic tax laws. First UK income tax law provides a good example, curiously exempting non-resident aliens from taxation on their income originating from UK sources, even in cases where a tax could be exacted from their property located in the UK territory.-[108] In the following period the UK and the majority of other states have broaden the exercise of their substantive tax jurisdiction, taxing non-resident aliens in respect of the income arising within their territory (source principle). However, the exercise of taxing powers according to the source principle still tends to be narrower than a state's capacity to territorially enforce the tax claims against a non-resident alien. While a state can enforce an income tax claim against any property of transient aliens 'located' in its territory (e.g. real property, deposits held in domestic banks etc.), it will generally not do so, because – according to its domestic legislation – tax claim will be asserted only where a specific connection, labelled as the 'source of income', is established in respect of the person in question.[109] Hence, territorial limitation of enforcement powers cannot properly account for this self-restraint demonstrated in domestic tax law. Likewise, states have in the past, and still overwhelmingly do today, insisted in levying income taxes in respect of the foreign-sourced income of their residents (residence principle), even if being perfectly aware of the problems linked with the enforcement of such tax claims.[110]

3.2.1 *Justification to Tax as the Main Issue*

It is submitted here that in examining jurisdictional choices made by the states in domestic tax law one necessarily faces an issue more fundamental than the issue of enforcement. It is the issue of justification to tax, which lies behind every relationship between a sovereign state and the taxpayer.[111] At first glance, this is not a problem of international law – its primary function being the delimitation the spheres of sovereignty in the community of nations (*supra*, section 2.1.1) – but rather of the constitutional fundamentals of income taxation in a purely domestic setting.[112]

History can serve to show us that, ever since the uncertain beginnings of income tax in England amidst the Napoleonic wars, governments have always found it necessary to justify its imposition in respect of a particular segment of the society. This is a natural consequence of the basic economic effect of income tax: a share of the pre-tax income derived by the private actors (individuals and legal entities) is extracted from them in the form of income tax by the government, thus reallocating the economic power from the hands of the private sector to the public sector. Justifying this effect entails not only a consideration of the role of taxes in general and income taxes in particular, but also the intertwined issue of ascertaining the persons that ought to share the burden of public financing via taxation. That is what Georg von Schanz (1853–1931) expressed in terms of 'form of societal allegiance' (*Art der Zugehörigkeit zu einer Gemeinschaft*) that tax liability should be dependent upon.[113] Harris and Oliver explicate the issue as follows:

> *each community is only one member of a larger community, the community of nations. As members of various communities are mobile and may receive services from governments other than their own, the issue arises as to who are the persons from which a particular government may appropriately extract taxes. In other words, on whom does the obligation to fund a particular government fall? This issue is traditionally analysed according to the doctrine of economic allegiance.*[114]

Notes

107 *See* e.g. Martha, *supra* n. 5, 156–165.

108 Harris, *supra* n. 104, at 289.

109 Cf. also the discussion in Albrecht, *supra* n. 55, at 152 et seq.; Martha, *supra* n. 4, at 70–71.

110 On the doubts Edwin Seligman had at the end of the nineteenth century on the capacity of US tax authorities to enforce taxing claim in respect of the income of non-resident citizens and resident foreigners *see* Edwin R. A. Seligman, *The Income Tax*, 9(4) Pol. Sci. Q. 630–631 (1894).

111 For an in-depth analysis of this issue *see* Klaus Vogel, *The Justification for Taxation: A Forgotten Question*, 33(1) Am. J. Jur. 19 (1988).

112 *See* Schön, *supra* n. 66, at 71.

113 Schanz, *supra* n. 66, at 365.

114 Harris & Oliver, *supra* n. 61, at 43.

Notion of economic allegiance, as famously explained by Schanz, pertains to economic ties that the taxpayer has with a particular country.[115] It can be of varying intensity, from the mere consumption in a country to different forms of investment and business activities undertaken within the state territory.[116] This notion was, although in a modified form,[117] subsequently used in the preparatory work on the first model tax treaties, under the auspices of the League of Nations. The famous 'Economists' Report' of 1923 clarifies that both fiscal residence and source of income reflect a broader principle of economic allegiance: accordingly, their discussion on proper interstate allocation of taxing rights is based on the idea that taxing rights of each state should be determined by reference to the level of taxpayer's economic interests in that state, weighed against his/her economic interests in other state(s).[118]

However, it should be also noted that the concept of 'political allegiance' – pertaining to the degree of political ties between a tax subject and a country – also plays a part in justifying imposition of income tax in respect of a specific category of persons. For example, it is reflected in the US obstinacy in taxing its citizens on their worldwide income wherever they are, due to the benefits and various forms protection provided to them by the US government.[119] Furthermore, it is also reflected in the taxation of corporate entities' worldwide income by their country of incorporation, to legal order of which they owe their very existence.[120]

Comparative analysis of modern income tax laws demonstrates that the presumed degree of taxpayer's economic and/or political links to a country is also very important. Essentially, almost every country in the world distinguishes between two broad categories of taxpayers – residents and non-residents – in exercising its income tax jurisdiction.[121] Residents are usually taxed in respect of their worldwide income, i.e. regardless of the geographic origin of their income, while non-residents' are taxed only in respect of their income arising from domestic sources. Thus it is evident that states take the issue of justification to tax into consideration not only on the level of defining the taxable persons, but also on the level of measuring the extent of tax liability of different taxpayer categories.[122] Justification for worldwide taxation of residents' income is derived from the assumption that the location of fiscal residence correlates with the higher level of person's participation in the economic and societal dimensions of a community. Conversely, such 'special relationship' cannot be assumed to exist in respect of non-resident aliens who only derive income from the business or investment activities in a state's territory.

3.2.2 *Justification to Tax on an International Plane*

For the purposes of present article it is vital to note that the problem of justification to tax vis-à-vis the taxpayer inevitably has international implications, since same persons may concurrently owe allegiance to two or more states. Therefore, on a closer look, the nexus issue may be examined both from the perspective of state sovereignty, which is inherently limited under public international law, and from the constitutional perspective of justifying taxing claims with reference to person's economic and/or political allegiance.[123] While the former perspective entails an exercise in establishing a link between the tax subject and personal and/or territorial sphere of a sovereign state, the latter entails an exercise in establishing whether political and/or economic ties of the tax subject with the state are strong enough to justify or legitimize pertinent taxing claim. Under the latter perspective, nexus requirements are necessarily stricter, which explains why states never used their enforcement capacities to the fullest extent.

On the other hand, all manifestations of allegiance justifying the imposition of the income tax – most typical being fiscal residence and intrastate economic activity giving rise to income (i.e. source) – can be, and regularly are, articulated with reference to either personal or territorial sphere of state sovereignty. For example, when a tax

Notes

115 Schanz, *supra* n. 66, at 368.

116 Klaus Vogel, *Worldwide vs. Source Taxation of Income: A Review and Re-Evaluation of Arguments*, in *Influence of Tax Differentials on International Competitiveness: Proceedings of the Munich Symposium on International Taxation* 122 (Kluwer Law and Taxation Publishers 1990).

117 *See ibid.*, at 123.

118 League of Nations Economic and Financial Commission, *Report on Double Taxation, Submitted to the Financial Committee of the League of Nations by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp*, Doc. EFS 73, F 19., 3 Apr. 1923, at 20.

119 *See Cook v. Tait* 265 US 47 (1924) 265 U.S. 47 US Supreme Court 220.

120 Schön, *supra* n. 66, at 91.

121 Reuven S. Avi-Yonah, Nicola Sartori & Omri Marian, *Global Perspectives on Income Taxation Law* 152 (USA: OUP 2011).

122 On the conceptual distinction between these two jurisdictional levels *see* e.g. Luc Hinnekens, *When Business Grows Global, Taxes Cannot Remain Local. Quo Vadis Fiscal Principle of Territoriality?*, in *A Tax Globalist the Search for the Borders of International Taxation: Essays in Honour of Maarten J. Ellis* (HPAM van Arendonk et al eds, IBFD 2005), s. 1. Cf. also the analysis in Alexander W. Cappelen, *The Moral Rationale for International Fiscal Law*, 15(1) Ethics & Int'l Aff. 98–99 (2001).

123 Cf. also the views of Mann, *supra* n. 19, at 95–96 (pointing out how the concept of economic allegiance was used in delimiting state's tax jurisdiction) and Skaar, *supra* n. 51, at 20 (noticing the link between the debates on the 'genuine link' limitation on a state's tax jurisdiction under international law and the debates about the allocation of the taxing rights according to the various forms of societal allegiance).

claim of the state in respect of a non-resident alien is deemed to be justified due to the extent of his participation in the state's economy giving rise to income, legitimacy of the tax claim under international law is sought by referring to the pertinent income as *arising from the sources within the state territory.*[124] This is consistent with the view that income tax jurisdiction is an aspect of state sovereignty (*supra*, section 2.2.2). Accordingly, taxing claim of each state must be justified (legitimized) not only vis-à-vis the taxpayer – as a matter of domestic constitutional order – but also vis-à-vis other states, as members of international community, being a matter of public international law.[125] Setting the tax claims in the frame of deep-rooted jurisdictional principles of nationality and territoriality helps to achieve this purpose.

In this respect some doubts, however, may remain whether the above-described (see *supra*, section 3.2.1) state practice in delimiting the jurisdictional reach of their income tax laws is merely a reflex of internal constitutional limitations of state's taxing powers, having the function to determine which persons should participate in the funding of public goods. Along this line of thought, such state practice says nothing about their belief on what they are obliged to do under international law (*opinio juris*). In other words, states do not see any fundamental obstacle under international law in drafting a tax law subjugating non-resident aliens with no connection whatsoever with their territory, not even a construed one, to their tax jurisdiction. In our view there are at least two reasons why this counterargument is misleading.

First, it is apparently underpinned by a strictly dualist approach on the relationship between domestic and international law, denying any effects of international law on the 'internal sphere' of the state, i.e. the relations between the state and its citizens or between the citizens themselves.[126] Such approach is seen as obsolete in modern legal scholarship,[127] giving way to the concept of 'legal pluralism', which acknowledges the interaction or 'linkages' between different legal orders.[128] As has been noted above, the problem of income tax nexus involves not only an 'internal' perspective – in that a country needs to regulate which persons are to be considered as its tax subjects – but also an external perspective, since it is part of a broader law of jurisdiction, itself being a concern of international law.[129] Accordingly, both internal and external concerns necessarily underlie domestic nexus norms and it seems hard to clearly separate one from another.

Second fallacy of the proposed counterargument is that it fails to properly explain the extent to which states rely on territorial or quasi-territorial constructions when describing events giving rise to income taxation in their domestic laws. More famous examples include references to '*trade and business conducted in France*', '*trade within the UK*', '*income effectively connected with a US trade or business*', '*business connection in India*', as well as the practice of some states to impose withholding tax on payments derived by non-resident aliens on the basis of payor's residence.[130] While this may to some extent be ascribed to the justification issue on the government-taxpayer level, a more persuasive argument would find that the articulation of domestic nexus norms with reference to traditional principles of jurisdiction – most prominently the principle of territoriality – demonstrates states' conviction on the necessity to justify or legitimize the extent of their taxing reach on the international plane as well.

3.3 *Domestic Case Law: Confirming the Status of the 'Nexus Principle'*

While the discussion in previous section (3.2) may still leave some readers with doubts on whether the *opinio juris* as to the nexus principle is truly embodied in domestic income tax legislation, relevant jurisprudence of domestic courts may help to clear the mist. Namely, the status of the nexus principle as a norm of customary international law has been confirmed either explicitly or implicitly in a number of domestic judicial decisions.[131]

In 1958 the Supreme Court of Pakistan held that Pakistan could not tax a company resident in India in respect of its Indian-source profits since, under the rules of (general) international law, '*a legislature has authority … to tax foreigners only if they earn or receive income in the country for which that legislature has the authority to make*

Notes

[124] Similar expressions can be found in domestic income tax legislation of a number of countries. *See* e.g. Art. 6(2) of the Croatian Income Tax Act (Official Gazette of the Republic of Croatia, Nos. 177/04 – 143/14).

[125] More on this 'tripartite relationship' *see* Harris, *supra* n. 104, at 284–286.

[126] *See* e.g. James Crawford & Ian Brownlie, *Brownlie's Principles of Public International Law* 48 (Oxford University Press 2012); Shaw, *supra* n. 69, at 131.

[127] *See* e.g. Armin von Bogdandy, *Pluralism, Direct Effect, and the Ultimate Say: On the Relationship Between International and Domestic Constitutional Law*, 6(3–4) Int'l J. Const. L. 399–401 (2008).

[128] *See ibid.*, at 400; Crawford & Brownlie, *supra* n. 126, at 50.

[129] *See* the discussion in s. 2.1 *supra*.

[130] For an overview of different nexus rules employed on a domestic level in relation to non-residents *see* e.g. Roy Rohatgi, *Basic International Taxation: Volume One – Principles of International Taxation* 224–225 (Richmond Law & Tax 2005); *Comparative Income Taxation: A Structural Analysis* 495 et seq. (Hugh J. Ault & Brian J. Arnold eds, Kluwer Law International 2010); Ariane Pickering, *General Report*, in *Enterprise services* 30–31 (Sdu Uitgevers 2012), IFA Cahiers vol. 97a.
Moreover, it has to be accentuated that the criterion of residence, at least when it comes to individual taxpayers, is essentially territorial in its nature. *See* e.g. Couzin, *supra* n. 2, at 6; Schön, *supra* n. 67, at 555–556.

[131] Cf. also an overview provided in Martha, *supra* n. 4, at 157–165.

laws'.[132] *Ratio decidendi* of this case is clearly drawn from the customary international law and is consistent with the argumentation that nexus principle is in fact a customary norm.

Similar conclusions have been reached on a number of occasions in the jurisprudence of the Supreme Court of India. In the so-called *Ishikawajma* case,[133] decided in 2007, the Supreme Court made it clear that the first precondition for imposition of income tax by Indian tax authorities is the existence of a *sufficient territorial nexus with India.*[134] Notably, the court explicitly stated: '*Territorial nexus for the purpose of determining the tax liability is an internationally accepted principle.*'[135] Similar line of reasoning was confirmed in subsequent case law.[136] Interestingly, in the so-called *GVK Industries* case,[137] upon seemingly opening significant leeway for Indian tax authorities to tax extra-territorial transactions, the court reiterated its stance that certain nexus with India has to exist and that it ought to be '*real or expected to be real, and not illusory or fanciful*'.[138] Final note is deserved for the famous *Vodafone* case,[139] decided in 2012, concerned with the right of India to tax capital gains arising from an indirect sale of shares in a foreign company.[140] From the decision of the Supreme Court of India in this case it can be inferred, as put by Teijeiro, '*that the connection with the taxing state should be actual and cannot be built or construed on the basis of a legal fiction utilized to expand the state's tax jurisdiction beyond acceptable limits under international law*'.[141] One may conclude that the Court quite consistently followed the view that the establishment of a nexus is an essential step in imposing income taxation.

German Federal Constitutional Court (*Bundesverfassungsgericht*, BVerfG), went a step further in explicating the nexus requirements for taxing non-resident aliens laid down in general international law. Facts of the case decided in 1983 involved a German national convicted for cigarette smuggling by the Austrian Supreme Court.[142] After the Austrian tax authorities sought assistance from their German counterparts with regard to the collection of ensuing tax receipts, fees and interest, the convict initiated a series of remedy and appeal procedures, culminating in a complaint for the violation of his constitutional rights being submitted to the BVerfG. As one of the grounds of the constitutional complaint was that the enforcement of another state's tax claims in Germany would be contrary to the 'principles of democracy', in the light of the familiar adage 'no taxation without representation', the Court also took the norms of public international law into consideration.[143] Accordingly, it found that:

> *(T)he imposition of taxes upon a foreigner living abroad, which is founded upon a set of facts wholly or partly implemented abroad requires sufficiently appropriate points of contact for taxation by the taxing State to prevent interference, contrary to the public international law, with the foreign State's claims to sovereignty. These points of contact and their factual closeness must, from the point of view of public international law, satisfy a minimum of reasonableness.*[144]

Therefore, the limitations to substantive tax jurisdiction in the form of nexus requirement were explicitly recognized by the Court, which also provided the examples of certain factors pertaining to the satisfaction of this requirement (e.g. residence, place of establishment etc.).[145]

Similar line of reasoning was taken in a 1998 decision of the Austrian Constitutional Court (*Verfassungsgerichtshof*, VfGH) in an interesting case which did not involve cross-border business or trade of any kind.[146] The issue at hand was the legality of the exercise of taxing powers by the municipality of Vienna. According to the competence

Notes

[132] *Imperial tobacco of India v. Commissioner of income tax* (1958) 27 Int. Law Rep. 103, as cited in Mann, *supra* n. 19, at 100.

[133] *Ishikawajima-harima Heavy Industries Ltd. v. Director of Income-Tax*, [2007] 288 ITR 0408.

[134] *See* Khagesh Gautam, *Taxing Offshore Transactions in India and the Territoriality Clause – A Case for Substantial Constitutional Limitations on Indian Parliament's Power to Retrospectively Amend the Income Tax Act*, 40(4) Int'l Tax J. 23 (2014).

[135] As cited in *ibid.*

[136] For an overview *see ibid.*, at 23–28.

[137] *G.V.K. Industries Ltd. and Another vs. ITO and Another*, (2011) 4 SCC 36, 1.

[138] As cited in Shee Boon Law, *Withholding Taxes on Services Income: A 21st Century Outlaw or a Necessary Evil?*, in *Taxation of Business Profits in the 21st Century: Selected Issues Under Tax Treaties : Essays in Commemoration of IBFD's 75th Anniversary* (Carlos Gutiérrez & Andreas Perdelwitz eds, IBFD 2013), s. 4.2.2.

[139] *Vodafone International Holdings B.V. v. UOI and Others*, (2012) 6 SCC 613.

[140] For details on the facts of the case and the court's decision *see* Awanish Kumar, *Ruling in Vodafone Tax Dispute in India: Final or Fallible!*, 41(10) Intertax 516 (2013).

[141] Guillermo Teijeiro, *Opening the Pandora Box in the International Tax Field: New Trends*, 42(6) Tax Plan. Int'l Rev. (2015), at 5.

[142] *BVerfGE 63, 343* (1983) 48 Neue Juristische Wochenschrift, at 2757.

[143] *Ibid.*, at 2760–2761.

[144] *Ibid.*, at 2758 (as translated in Francis A Mann, *The Doctrine of International Jurisdiction Revisited After Twenty Years*, in *Jurisdiction in International Law* 149 (W Michael Reisman ed., Ashgate 1999)).

[145] *BVerfGE 63, 343* (1983) 48 Neue Juristische Wochenschrift, at 2758.

[146] *Verfassungsgerichtshof* [1998] Verfassungsgerichtshof G15/98,V9/98 (17 Dec. 1998). A summary of the case is provided in Michael Lang & Lisa Paterno, *Tax Coordination Between Regions in Austria – Role of the Courts*, in *Horizontal Tax Coordination* (Michael Lang et al. eds, IBFD 2012).

given to them by the federal legislation, Austrian municipalities had the competence to impose a tax on commercial announcements and to regulate the main elements of this tax. Based on their interpretation of the ensuing municipal decree, tax authorities of the Municipality of Vienna took the position that the tax should be imposed on the value of income from commercial TV and radio announcements emitted from the studios located within its territory.[147] VfGH deemed this practice to be unlawful, grounding its decision in part on the norms of public international law. It emphasized that '*(I)nternational custom permits the taxation of foreign economic transactions when a sufficient connection exits between the taxpayer and the taxing state.*'[148] Since the allocation of the taxing powers between states on an international plane and the allocation of taxing powers between sub-federal on an internal plane pursue the same objectives, the Court held that basic principles of international public law, such as the nexus norm, should be applied even in the exercise of tax jurisdiction by the Austrian municipalities. Whether the sufficient nexus existed at the case at hand was decided in the light of the aims of the pertinent tax, that being the taxation of promotional effect obtained at the territory of a municipality.[149]

The decision of the VfGH serves as reminder of the similarity between the problems associated with the exercise of tax jurisdiction by the sovereign states and the problems associated with the exercise of taxing powers by the sub-units of composite states like federations or confederations. It follows that one could also rely on the wealthy case law in the area of subnational taxation in attempting to prove existence of the nexus requirement under general international law.[150]

4 Conclusion

When it comes to 'principles' of international tax law or, more precisely, *international tax regime*, tax academics can be very roughly divided into two camps: those having the view that there are some fundamental principles underlying the whole body of international tax law[151] and those having a more sceptical approach on the issue.[152] Against this background, main aim of the present article was to analyse the legal status of the so-called 'nexus principle', i.e. the requirement that a qualifying connection exists between the state exercising its taxing power on the one hand and taxable subject and/or taxable object on the other. The analysis did not deal with tax policy aspects of the problem at hand, but was rather limited solely to verification of the status of nexus principle, in the light of the traditional division between sources of public international law.

More precisely, we argued that the nexus principle forms part of general international law of income tax jurisdiction, since it has attained the status of international custom. Accordingly, every state in the world, as a subject of international law, has to respect this *a priori* limitation of its taxing powers, particularly as regards to regulation of cross-border income taxation. Put differently, international customary law prohibits income taxation in the absence of both personal and territorial nexus.

Support for such conclusion is found mainly in relevant norms of tax treaty law and domestic tax laws. Against the backdrop of well-established methodology for ascertaining international custom, tax treaty network had special relevance as regards to the criterion of general and uniform state practice. While tax treaties are implicitly based on the assumption that income tax allocation is only relevant for states possessing a nexus in the first place, it is significantly more challenging to verify whether corresponding *opinio iuris* on the nexus requirement may be deemed to exist. In this respect key role is played by domestic tax law. It has been submitted that states have always adhered to the nexus principle in exercising their substantive income tax jurisdiction, mainly because they have to justify their tax claim in a tripartite relationship – both vis-à-vis the taxpayer and vis-à-vis other states. The interstate aspect of this relationship is founded on jurisdictional principles of nationality and territoriality, which are well entrenched in the system of public international law. Put simply, conviction of the states that the requirement for a personal or territorial nexus places limits on their taxing powers has always been mirrored in national income tax legislation. Finally, further support for such argumentation may be found in a number of decisions by domestic courts, which claimed violations of public international law in instances where exercise of income tax jurisdiction has not been substantiated by a relevant nexus.

In conclusion, nexus principle can indeed be described as one of the keystones of international tax regime, denoting one rare occasion where international customary law is relevant in income tax arena. Against this backdrop, concepts of source and residence are

Notes

[147] Lang & Paterno, *supra* n. 146, s. 3.2.

[148] *Ibid.*, s. 3.3.

[149] *Ibid.*

[150] As suggested in Mann, *supra* n. 19, at 95–96.

[151] Most notably *see* Avi-Yonah, *supra* n. 64. Cf. also e.g. Yariv Brauner, *An International Tax Regime in Crystallization*, 56 Tax L. Rev. (2002).

[152] *See* e.g. David Rosenbloom, *International Tax Arbitrage and the 'International Tax System'*, 53(2) Tax L. Rev. (2000), at 137 et seq.; Michael J. Graetz, *David R. Tillinghast Lecture Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54(3) Tax L. Rev. 261 et seq. (2001).

effectively two sides of the same coin, reflecting the idea that a sufficient nexus between a sovereign state and a person must be present to justify that state's taxing right. By the same token, Bird and Wilkie find the nexus requirement as a question prior to the endless 'source versus residence' debates.[153]

As a final point, it has to be noted that some important questions were left out of the scope of this article. Most importantly, we did not analyse whether customary international law also defines particular circumstances under which income tax nexus may be deemed to exist, i.e. whether the abstract nexus principle is further supplemented by some common definitions of nexus criteria (e.g. fiscal residence, fixed place of business, etc.). While this issue undoubtedly deserves a separate inquiry, we share the view that here the role of customary international law is severely restricted. States generally have wide freedom in defining content of abstract concepts like fiscal residence or source of income. They only have to abide with the requirement that a reasonable connection in territorial (spatial) terms has to be established. Accordingly, in this regard a high degree of flexibility pervades international tax law, as states can lawfully impose income tax on manifold bases. The decision on which among these bases will actually be relied upon is largely a matter of tax policy.

Notes

153 Richard M. Bird & J. Scott Wilkie, *Source vs. Residence-Based Taxation in the European Union: The Wrong Question?*, in *Taxing Capital Income in the European Union: Issues and Options for Reform* 94–96 (Sijbren Cnossen ed., Oxford Univ. Press 2000).