Editorial

Territoriality-Based Taxation in an Increasingly Common Market and Globalizing Economy: Nightmare and Challenge of International Taxation in this New Age

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It is traditionally argued that taxes are good if they are old: they are (grudgingly) accepted by a state's society and have found their way and final resting place in its economy. But the reasoning is no longer valid if the nature of society and the economy changes.

Recognizing the need for new tax theories and policies adapted to the new realities is one thing, their formulation and implementation is another. They must deal with the inadequacies of not just the technical architecture of the tax monument, but of the foundations on which it is built. International taxation is based on the spatial relationship between the state, as the traditional holder of tax jurisdiction and tax sovereignty, and its fiscal subjects. In 1892 Von Schanz proposed the notion of economic allegiance or attachment ('Wirtschaftliche Zugehörigkeit') as the rational, equitable and practical citation for territorial tax jurisdiction and income allocation.

We may describe the problem of territorial tax jurisdiction as fundamental, and suggest that it may find its origin in the dual nature of tribal man. According to anthropologists, man is a territorial beast: a master on his home turf and an outlaw when he intrudes into someone else's territory. But anthropologists also tell us about nomadic man, whose appetite for new hunting grounds was as big as the horizon of his environment was wide.

The ambivalence of man's nature is found in the spatial organization of the many forms of his community life, the first and foremost form of public and political community being the nation-state. It exercises sovereign fiscal rights with respect to fiscal subjects and facts situated within its territory, and has no tax jurisdiction outside of its territory. It is an academic discussion whether this territorial restriction rests on the limits of physical power or on principles of general international law.

In the tax provider territory of the state we find the stamp of tribal man's food provider territory. But Thomas Jefferson already alluded to man's nomadic existence in 1814 when he complained that 'merchants have no country. The mere spot they stand on does not constitute so strong an attachment as that from which they draw their gains'. Making profits today is less of an earthbound affair that it was in 1814, and will be less so in the next century than it is today. Enterprise has already become multinational; labour is increasingly mobile both in respect to residence and to situs of activity; capital moves freely and hotly on international markets beyond the reach of national tax authorities; big ticket leasing is a cross-border operation which makes it tax effective; trading has become global and finance houses realize their single transactions 24 hours around the clock around the globe; services are mainly rendered in areas like finance, captive issuance, (telé)communications and media, which are not tied to any specific location. As fiscal subjects, their capital, technology and activities, outreach the territorial boundaries of their state (assuming they still have a natural home state), the determination of their economic and fiscal allegiance, the allocation of their cross-border income and the effective collection of tax became a nightmare for the national tax authorities and threatened to erode their fiscal sovereignty.

The territoriality principle thus becomes the soft underbelly of the tax system. But there is no good substitute for it. When push comes to shove, fiscal policy and landscaping cannot escape the imperative of tribal man's dual nature. It is as illusory and disastrous for tax policy makers and tax theorists to believe that tax jurisdiction can be based on other than tax territory principles, as it was for Icarus to believe that his wings would take him into the sky and not plunge him into the sea. It is also as futile to disregard the reality of the expanding scene as it was for King Canute to command the ocean waves to stop.

In the disarray of this 'fin de siécle', tax policy makers turn for guidance to the tax theorists, but find that little thought has been given to the shape and form of a comprehensive tax system that is up to the challenge of the new regional and global scene. As early as 1961, the ICC complained that 'the world cannot wait the slow evolution of tax doctrine'. It is obvious that tax sovereignty must become less imperious and more responsible to the sociétas Gentium. It is also obvious that the tax territoriality principle must be adapted to the transterritorial logic of the European and global economy by the transformation of the 'frontiére-coloison' of states into 'frontiére-coopération'. In particular, we see five directions that, within different time frameworks, should get us there.

1. National tax law has entered the age of international tax reform. Rules of jurisdiction, base allocation, assessment and collection of tax will be re-examined in the light of their transterritorial logic and effectiveness. Notions of 'source' and 'residence' and of 'domestic' and 'foreign' will have meanings or applications, and will sometimes be no more than convenient labels, for describing income that is or is not taxable. National policy makers will also take into account international tax competition and acceptance from the international community.

2. The second direction or international window for the future tax system is that of further development of the world network of tax treaties. They will correct and coordinate the international tax policies of individual states. Should this multiplication and standardisation ultimately lead to a multilateral agreement of fair tax practices, in the manner of the GATT fair trade practices agreement?

3. By creating and defining an internal market as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is insured' the EEC-Treaty does not help the tax risks of territoriality, except that it also creates the contractual and institutional framework to deal with them. The notion itself of supranational tax law on the scale of a region outside of Europe is a daunting one and in line with the need of requiring new (regional) realities.

4. The fourth direction is different as far as its legal source (general international law and comity), territorial application (worldwide) and time framework (long term and uncertain) are concerned. What are the chances that even in the next century international tax articles will have become sufficiently universal, and that international legal principles of interdependency, solidarity and fairness among states will have become sufficiently specific, so as to derive from them tax principles in regard to the territorial connection required for asserting legislative and executive tax jurisdiction, rules of non-discrimination and non-double taxation etc., that are elevated to the rank of international tax law? And will they be enforceable before the International Court of Justice or an International Arbitration Board?

5. A last direction is that of alternatives. The scope for tax jurisdiction based on functionality rather than territoriality and for tax rights on behalf of mankind, is very limited. Should the emphasis of the tax system shift from income taxation to indirect taxation, user taxes and taxes on new resources, which are less vulnerable to territorial risks of tax allocation and control? Will those risks decrease as the state will provide for less government services and will accordingly need less revenues and outreach provisions and lower its rates?