PREVENTION OF INTERNATIONAL DOUBLE TAXATION AND FISCAL EVASION

TWO DECADES OF PROGRESS UNDER THE LEAGUE OF NATIONS

BY

MITCHELL B. CARROLL

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PREVENTION OF INTERNATIONAL DOUBLE TAXATION AND TAX EVASION

TWO DECADES OF PROGRESS UNDER THE LEAGUE OF NATIONS

Inasmuch as the movement to relieve trade between countries from the burdens of international double taxation was begun about twenty years ago, and as the Fiscal Committee of the League of Nations had its first meeting about ten years ago, it seems appropriate, on the occasion of this meeting of the Fiscal Committee in 1939, to review the accomplishments of the work done under the auspices of the League.

THE PROBLEM OF DOUBLE TAXATION

Although prior to the world war there had been a few provisions in national tax laws and in bilateral treaties between Central European States for the prevention of double taxation, the general movement to remove this serious obstacle to commerce did not begin until after the war, when the leading nations turned their attention again to foreign trade. Many countries had increased their tax rates to the maximum, and business enterprises which ventured into the territory of other States in order to market their products found themselves subjected to an accumulation of levies abroad and at home which often exceeded half the income and, where certain surtaxes were incurred, even more than the entire income. Many countries exercised jurisdiction over the entire income of individuals and companies resident in their territory, including income derived from sources in other countries, and, conversely, countries extended their jurisdiction over foreign enterprises on any possible basis and to the fullest extent conceivable. Thus, some imposed liability because of the mere solicitation of sales within the country, and others because of the maintenance of a business connection or a current of business (*courant d'affaires*) within the country.

Although some Governments made a distinction between trade *with* and trade *within* the country, holding that only the carrying-on of trade within the country gave rise to tax liability, their courts wove such a fine web of reasoning to sustain liability that the sale of raw materials and commodities through local commission agents or brokers often gave rise to tax liability, and the practical difficulty of determining profits derived from such sales tended to curtail such transactions. The opening of a sales office or an assembly plant or any other kind of permanent establishment gave rise to liability to the income tax, and most countries treated as a permanent establishment the effecting of sales through an intermediary or agent who acted regularly for an enterprise, and especially if he concluded contracts for its account.

When goods were sold within the country, the profit was considered to arise at that time, but the country of sale generally claimed jurisdiction over the entire profit realised from such sales over the cost of production in other countries. Inasmuch as the country in which the goods were produced claimed that most, if not all, of the profits eventually derived were attributable to the productive activities carried on in its territory, and if the country in which the enterprise had its head office, especially if the head office were in the country of production, claimed jurisdiction over the entire income, serious multiple taxation inevitably arose.

Some administrations were not content with determining the profits of a local branch on the basis of factors within their jurisdiction, but demanded of the head office its accounts showing net income arising from operations throughout the world, in order that they might determine the proportion of the entire net income attributable to activities within their territory. If several countries of different languages, different tax laws and different accounting practices all asked the enterprise to supply head office accounts, translated and adapted to their different laws and practices, in order that each might cut its slice of the entire net income, the resulting burden on the enterprise is evident, especially in view of the propensity of each administration to attribute the largest portion of the net income to the activities within its border.

In order to avoid this burden, corporations quite generally organised a local company, so that the business assets within the country might be readily segregated. If the subsidiary showed losses, its separate legal existence did not daunt the ingenious collectors of taxes. They evolved theories which justified extending the fiscal arm to collar the foreign corporation and bring it within the jurisdiction of their courts : the subsidiary company was held to be a mere " organ " of the foreign corporation, or to constitute with the parent corporation an " economic unity ", or the parent corporation, through controlling a subsidiary corporation with similar objects, was itself viewed as extending its exploitation into the taxing jurisdiction. Such theories not only served to reach foreign parent corporations but even to corral foreign grandparent or great-grandparent corporations.

Although the prime objective of most countries was to export goods, some Governments, in their quest for revenues, even sought to impose tax on the profit deemed to have been derived through purchasing within the country. Perhaps the most burdened organisations were the steamship companies that loaded and unloaded passengers and freight in a number of different countries, each of which attempted to claim its share of the entire net income, earned for the most part for transport services on the high seas and therefore not within the jurisdiction of any of the taxing States. While many countries were in desperate need of capital, whether in the form of loans to the Government or loans or investments in local enterprises, their

Governments often sought to impose such high taxes on interest or dividends as to constitute a serious barrier to the influx of wanted funds. In short, the grasping for revenues was tending seriously to obstruct efforts to restore trade, and business enterprises were so restricted by the network of tax liabilities that they hesitated to assume the risks of foreign commerce, which were serious enough apart from any question of tax liability.

Various Governments whose foreign commerce was of such importance as to justify initial sacrifices undertook to encourage their domestic enterprises by saying, in effect : " Trade abroad and pay the tax in the foreign country, but I will give you a certain amount of relief against your home tax ". Long before the war, the Netherlands, in view of its large colonial and trade interests, had led the way in this type of relief by allowing, in its income-tax law of 1893, the individual taxpayer deriving income from a colony or foreign country to deduct from the graduated tax payable to the Netherlands Government the tax he would have to pay if his net income were equal to that which he derived from a given colony or foreign country (*Taxation*, Vol. II, page 34). In its Law of January 11th, 1918, the Netherlands allowed a domestic company to deduct from its distributed income, for the purposes of the tax on dividends, two-thirds of that part of the dividend which corresponded to the foreign profits (*Collection*, Vol. I, page 197). In 1906, Belgium authorised a reduction of three-fourths in its rate applicable to income derived from foreign sources (document F.212, page 11).

Pressed by war needs to keep up trade within the Empire, in 1916, the United Kingdom had granted a certain relief against its tax (Section 43, Finance Act of 1916, reproduced in Section 55 of the Income Tax Act of 1918), which was replaced by a dominion income-tax relief still in effect (Section 27, Finance Act of 1920, since amended by the Finance Act of 1927, Schedule V, part II, paragraph 2, (*iii*)). Under this provision, individuals or companies resident in the United Kingdom were allowed to deduct from their United Kingdom tax the dominion tax on income from sources within its territory, provided it did not exceed half the United Kingdom rate ; if it exceeded this proportion of the British tax, the dominion itself was supposed to forgo the amount by which its tax exceeded half the United Kingdom tax. As regards British trade with countries outside the Empire, another provision in the British Income Tax Act (Rule 2, Case V, Schedule D, Income Tax Act of 1918) is construed to free from tax profits from a business managed abroad unless remitted to the United Kingdom. Such a provision obviously tends to have the effect of encouraging the investment of profits abroad in the building-up of separately managed businesses.

In 1918, the United States adopted a policy of relief applicable to all foreign countries, which consisted in allowing a credit for the income taxes paid in foreign countries against the United States tax on entire net income, but in 1921 the proviso was added that this credit should not exceed the same proportion of the United States tax as the income from the foreign countries bore to entire net income. Other countries were giving their national enterprises relief in different ways. Thus, France subjected its home enterprises to profits tax only in respect of profits attributable to a local permanent establishment, thereby exempting profits allocable to an establishment in another country. Italy soon followed this example and, in general, other schedular taxes were imposed only on income from various local sources. Provisions of essentially similar import were found in the laws of the various Swiss cantons and of Central European and other States.

In each of the foregoing cases, the home country of the enterprise, which will be termed herein the " country of fiscal domicile ", by unilateral action, gave up all, or a part of, its tax on the foreign income. The Governments knew full well, however, by removing these obstacles to the bringing home of foreign income, they would collect tax when this addition to national wealth was paid out as salaries to employees, for supplies to keep the factory going, or as dividends to shareholders, and that they would further participate through taxation when the money circulated from hand to hand. However, in each of these countries mentioned, there was a strong movement in commercial as well as governmental circles to bring about a sharing of the burden of relief as between the country of fiscal domicile and the other country of source.

In 1921, realising the utter impracticality of trying to determine the proportion of the profits of foreign shipping companies earned in the United States, the American Government, after trying several formulæ to effect a fair allocation, decided that the only solution would be to cut the Gordian knot and offer an outright exemption for the profits of foreign shipping companies if the country to which they belonged accorded American shipping enterprises an equivalent exemption (Section 213(*b*) (8), Revenue Act of 1921). It is of interest that this provision was enacted a little over one hundred years subsequent to the Netherlands Law of May 21st, 1819, which exempted, on condition of reciprocity, foreign ships from the business licence tax (*droit de patente*), which, broadly speaking, was a precursor of the income tax.

Reciprocal concessions on a broader basis were adopted in a number of bilateral agreements between various Central

European Governments prior to the war, and soon thereafter these countries began to negotiate new and broader agreements.

Perhaps the earliest general treaty on the avoidance of double taxation was that concluded by Austria-Hungary with Prussia on June 21st, 1899, and this was followed by treaties with other German States, such as Liechtenstein in 1901, Saxony and Bavaria in 1903, Wurtemberg in 1905. In 1907, Austria and Hungary concluded such a convention between themselves. Other pre-war treaties were those between Austria and Baden in 1908, Prussia and Luxemburg in 1909, Prussia and Basle-Town in 1910/11, Austria and Hesse in 1912, and, in 1913, those between Germany and Zurich, Luxemburg and Hesse, Austria and Bavaria, Basle-Town and Baden (*Collection*, Vol. I, page 249).

Germany took the lead after the war by reaching an understanding with the Saar Territory in 1921 on income taxes, and by signing with Czecho-Slovakia, on December 31st, 1921, a treaty for the avoidance of double taxation in the field of income and property taxes (*Collection*, Vol. I, page 9), and this was followed on May 23rd, 1922, by a similar treaty with Austria (*Collection*, Vol. I, page 15). Italy invited the Succession States of the Austro-Hungarian Empire—namely, Austria, Hungary, Poland, Roumania and the Kingdom of the Serbs, Croats and Slovenes—to a conference in Rome, which resulted in a multilateral Convention, signed April 6th, 1922 (*Collection*, Vol. I, page 73). This splendid attempt at multilateral action, however, came into effect only as between Italy and Austria. These and other treaties that were negotiated during the wave of international commerce in the 1920's, and even during the depression and subsequently, will be briefly described later, but they are mentioned at this point to evidence the widespread interest in preventing double taxation which centred in the League of Nations.

BEGINNING OF LEAGUE WORK ON DOUBLE TAXATION

The work of the League of Nations on the prevention of double taxation was begun towards the end of 1921, when its Financial Committee, acting on a recommendation of the International Financial Conference held the previous year in Brussels, entrusted the theoretical study of double taxation to four economists—Professor BRUINS, of the Netherlands; Professor EINAUDI, of Italy; Professor SELIGMAN, of the United States of America; and Sir Josiah STAMP, of the United Kingdom. The International Chamber of Commerce, at its first congress in 1920, had placed double taxation on its agenda and, ever since then, the work of its Standing Committee on Double Taxation has been communicated for consideration to the League Committees, and representatives of the former organisation have been invited to attend, in an advisory capacity, the meetings held under the auspices of the League of Nations.

In June 1922, the Financial Committee of the League entrusted the study of both double taxation and tax evasion from an administrative and practical point of view to a group of high officials of the tax administrations of seven European countries (Belgium, the United Kingdom, Czecho-Slovakia, France, Italy, the Netherlands and Switzerland), and we are fortunate in still having as members of the Fiscal Committee three of the members of the original group—namely, M. BLAU, M. BORDUGE and Dr. SINNINGHE-DAMSTE, who may be considered as the representatives of the traditional spirit of international co-operation which has always inspired the experts since they began their joint work. After five sessions, from 1923 to 1925, the technical experts issued a report and resolutions (document F.212), dated February 7th, 1925.

The Committee was then enlarged to include experts from the Argentine, Germany, Japan, Poland and Venezuela. Sessions were held in 1926 and 1927, and, at the third session, experts from the United States attended for the first time. On the basis of the work previously done, this group formulated bilateral Conventions for the prevention of double taxation, the first dealing with income and property taxes, the second with succession duties, the third with administrative assistance in matters of taxation, and the fourth with judicial assistance in the collection of taxes. These Conventions, with their commentaries, are found in a report dated April 1927 (document C.216.M.85. 1927.II).

This report was sent to the various Governments, Members and non-members of the League, and, in October 1927, twenty-seven sent representatives to the General Meeting of Government Experts on Double Taxation and Tax Evasion. This group revised somewhat the draft Convention dealing with income and property taxes and added two more which seemed more susceptible of use by States with tax systems different from that envisaged in the first draft. This meeting also adopted with minor changes the draft Conventions on succession duties and on administrative and judicial assistance (document C.562. M.178.1928.II).

Pursuant to the recommendations of the General Meeting of Government Experts that a permanent committee be formed, the Fiscal Committee was named by the Council of the League, and has been meeting since 1929.

The reports of these successive groups, composed in part of the same members, will be described below with a view to showing the reasons for the recommendations which still stand and serve as guides in the formulation of treaties.

REPORT OF THE ECONOMISTS, 1923

The report of the economists, dated April 3rd, 1923 (document E.F.S.73.F.19), defines the extent to which double taxation may be a burden on existing economic rewards or else an interference with new or potential economic intercourse, and, in the latter connection, shows how a tax imposed on interest in the country of the borrower must ordinarily be assumed by the borrower and therefore constitutes a barrier to the flow of capital. The report also develops the doctrine of economic allegiance, the underlying theory being that a "part of the total sum (of taxes) paid according to the ability of a person ought to reach the competing authorities according to the economic interest under each authority. The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that the liability should be divided among the tax districts according to his relative interests in each." In determining economic allegiance, there are four main questions :

(1) Where is the yield physically or economically produced ?

(2) Where are the final results of the process as a complete production of wealth actually to be found ?

(3) Where can the rights to the handing over of these results be enforced ?

(4) Where is the wealth spent or consumed or otherwise disposed of ?

However, the report observes that the most important factors are (1) the origin of the wealth and (4) the residence or domicile of the owner who consumes the wealth.

The report notes that the States with income taxes might be roughly placed in three categories :

(1) Those whose fiscal system merely consists of separate taxes upon things and different objects of wealth (such as the pre-war *impôts réels* of France and Belgium and the *Ertragssteurern* of the German States) ;

(2) Those which have a system of taxes upon separate sources of income which are often supplemented by a progressive tax upon total income (such as the various *impôts cédulaires* and general income tax of France, and a similar classification of taxes in Italy) ;

(3) Those countries which have a pure income tax imposed on the entire net income of citizens or resident individuals, but only on income from domestic sources in the case of non-residents (as, for example, in the United States, the United Kingdom, Germany and the Netherlands).

After discussing the economic allegiance of various classes of wealth for purposes of taxation, the report concludes that it would be desirable ideally to apportion economic allegiance as between origin and domicile as follows : (1) to origin—land, mines and oil-wells, commercial establishments, agricultural implements, machinery, flocks and herds ; and vessels to the place of registry ; and (2) to domicile—money, jewellery and furniture, income from mortgages, corporate shares and bonds and public securities, general credits and professional earnings. Expressed in another way, all corporeal wealth, including immovables and tangible movables, except money, jewellery, furniture and the like, would be assigned predominantly or wholly to the place of origin ; all intangible wealth, except the property value of mortgages, would be assigned predominantly or wholly to domicile or residence. The report admits, however, that to allocate the exact proportion of economic allegiance to each category is almost impossible.

Inasmuch as the prevention of double taxation involves concessions on the part of either the country of residence or that of origin, or by both, the report of the economists then states broadly four alternative methods for preventing double taxation which reflect to a large degree provisions that had already been tried out in internal legislation or treaties. Briefly, the four methods are as follows :

(1) The country might deduct from the tax due from its residents any tax paid by them on their income from abroad. An example of this is the limited credit for foreign taxes allowed by the United States.

(2) The converse—namely, that the country of origin should exempt all non-residents from taxation on income derived from sources within its border. This should have the effect of increasing the flow of capital from abroad and the development of less favoured regions. The provision for reciprocal exemption of shipping profits is generally placed in this category.

(3) It may be possible by conventions to divide specific taxes so that a portion would be borne by the country of origin and the remainder by the country of residence. This proposal reflects somewhat the basic theory of the British dominion income-tax relief, whereby Britain gives up a maximum of half its tax, presupposing that the dominion will forgo the part of its tax which exceeds half the British rate.

(4) By convention it might be determined to attach origin taxation specifically and wholly to broad classes of investment or embodiment of wealth such as rents of land and of houses, and mortgages of real property, but to exempt the non-residents in respect of income derived from business securities. The country of residence would allow the whole of the foreign tax as a deduction from its income tax on the resident in respect of the former sources of income, but would tax other sources in full. The country of origin would retain its specific origin taxes in full.

The conclusion of the report is that, in the case of a developed form of income taxation, the reciprocal exemption of the non-resident under method (2) is the most practical and desirable way of avoiding the evils of double taxation, and should be adopted wherever countries feel in a position to do so. If, however, countries are reluctant to abandon the principles of origin, method (4) is suggested, with possible adaptations of method (3).

Looking toward the future, the report envisages the possibility of a development away from earlier stages of economic thought typified by strict adherence to the principles of origin and stated that, as semi-developed countries become more industrialised, with the resulting attenuation of the distinctions between debtor and creditor countries, the principles of personal faculty at the place of personal residence will become more widely understood and appreciated, and the disparity between the two principles will become less obvious, " so that we may look forward to the ultimate development of national ideas on uniform lines towards method (2), if not as the more logical and theoretical and defensible economic view of the principles of income taxation, at least as the most practical solution of the difficulties of double taxation ".

REPORT OF TECHNICAL EXPERTS, 1925

The report of the experts from seven countries, appointed in 1922, was published on February 7th, 1925 (document F.212), after the Committee had held five sessions during the years 1923 to 1925. The task of this Committee, as understood by it, consisted in endeavouring to bring about a more equitable assignment of taxation to prevent the evil effects of double taxation and to check tax evasion, but it recognised that no change could be made in the then condition of affairs without some modification of domestic legislation of the various countries or without international conventions.

The report first acknowledges the assistance received from other institutions which, at the time, were working on the subject of double taxation, including the Institute of International Law and the International Chamber of Commerce. Note had been taken particularly of resolution No. 1 adopted at the London Congress of the International Chamber in 1921, which, in substance, held that, in order to avoid double taxation, the best means would be to accept residence as a basis of a tax on income, but with the admission that this principle could not be expected completely to preclude all taxation according to its origin of income derived from landed property or even from commercial or industrial enterprises. Resolution No. 2 of that Congress urged that the principle of reciprocal exemption be applied to the shipping industry. The Technical Committee acknowledged that it had profited as well from the results of the investigations of the Special Committee of Economists.

The technical experts also took into consideration the existing provisions in internal law and treaties for the prevention of double taxation. They found it difficult to fit all this information into a single general scheme, and to ascertain any general tendencies in the mass of rather disconnected facts, but they finally arrived at agreement on certain fundamental points :

(1) All the treaties concluded between the Central European States before and immediately after the war followed, in the main, the last system mentioned by the economists—namely, the system of assignment of income, or allocation primarily according to the country of origin. The same principle was followed in the only collective Convention attempted, that between Italy and the Succession States to the Austro-Hungarian Empire (*Collection*, Vol. I, page 73).

(2) In making its second point, the report notes the observation of the economists that the survey of the whole field of recent taxation shows how completely Governments are dominated by the desire to tax the foreigner, or, in other words, that taxes based on the idea of origin are, particularly in the form of *impôts réels*, still very widely applied, and States, especially those which are developing, and new countries would find it difficult to dispense with them.

(3) The technical experts stated that they had been impressed with the increasing recourse to the personal tax based on the idea of domicile, such as in the United Kingdom and the United States, and thought that a number of other European and American nations seemed to be moving slowly in that direction. Although this development suggested that the method of reciprocal exemption in the country of origin be used, it was thought that this method could hardly be applied in the case of countries not economically balanced, and in the case of countries whose relations were distinctly those of debtor and creditor. The experts disliked the first method proposed by the economists, because they thought it left the budget of the country of fiscal domicile at the mercy of increased taxation in another country. And even though the third method of relief had been tried in the British Empire under the most favourable conditions arising from similar principles of taxation, a common tongue, experienced administrative staff, a common attachment to the Empire, nevertheless, the experts did not think it would be possible to adopt generally such a very complicated system in the international sphere.

(4) The experts noted that the method of assigning income which forms the basis of numerous treaties in Central Europe appeared at first sight to be the one which was most generally in use. However, because of the differences in the various fiscal systems, they felt that they had best refrain from suggesting any one single system as applicable to every form of taxation.

In view of the existence of *impôts réels* or schedular taxes on the one hand and general or personal taxes on the other, the experts accepted that distinction. They recognised, in the case of *impôts réels*, the primary importance of assigning income to origin, and, in the case of the general or personal tax, the primary importance of the idea of domicile. It was recognised that, in the case of individuals, fiscal domicile for the purpose of the income tax should mean the State in which the taxpayer normally has his residence for a portion of the year, the term

" residence " being understood to mean a permanent home; for the purpose of succession duties, the term means the State in which the deceased had, at the time of his death, taken up his residence with the manifest intention of remaining there (document F.212, page 33).

In the case of corporations, it was proposed that the fiscal domicile be the place where the concern has its effective centre —*i.e.*, the place where the " brain ", management and control of the business are situated—the reason being that, if this definition were adopted, companies would not be inclined to transfer their nominal headquarters to a country with lower taxes (*ibid.*, page 21).

At the end of their report, the experts proposed certain resolutions, and these served as a basis for the drafting of model conventions by a Committee to which new members were added.

REPORT OF ENLARGED COMMITTEE OF TECHNICAL EXPERTS, 1927

The enlarged Committee held three sessions—May 17th to 22nd, 1926, January 5th to 12th, 1927, and April 5th to 12th, 1927. The draft bilateral Convention on Income and Property Taxes dealt first with the impersonal taxes and then with personal taxes. It was held that the impersonal taxes on income from immovable property and mortgages thereon should be imposed only in the country in which the property is situated (Article 2). Income from public funds, bonds, including mortgage bonds, loans and deposits or current accounts should be taxable only in the State in which the debtors of such income are at the time resident. In recognition of the principle of domicile advocated by the economists, however, a proviso was added that if such income were paid in one of the States to persons domiciled in the other contracting States, the tax at source would be refunded upon the production of proper evidence, and such income might be taxed in the Contracting State of domicile of the creditor (Article 3). However, this provision was dropped by the general meeting in 1928. Income from shares, or similar interests, was assigned to the State in which the real centre of management of the undertaking was situated (Article 4).

Income from any industrial, commercial or agricultural undertaking and from any other trades or professions was made taxable in the State in which the persons controlling the undertaking or engaged in the trade or profession possessed permanent establishments, but, by way of exception, income from maritime shipping concerns was allocated for taxation only in the State in which the real centre of management was situated. The article also, in defining "permanent establishment", included real centres of management, affiliated companies, branches, factories, agencies, warehouses, offices and depots, but excluded business dealings through a *bona-fide* agent of independent status (broker, commission agent, etc.). The article also provided that, if the undertaking had permanent establishments in both contracting States, each of the two States should tax the portion of the income produced in its territory and, in the absence of accounts showing this income separately and in proper form, the competent administrations should come to an arrangement for apportionment (Article 5).

Impersonal taxes on the fees of managers and directors of joint-stock companies should be imposed in the country of the real centre of management (Article 6). Salaries, wages or other remuneration of any kind should be subject to impersonal taxation in the State where the recipients carry on their employment, but the salaries of officials and public employees serving abroad should be taxable only in the State which paid these salaries (Article 7). Public or private pensions were assigned for impersonal taxes to the State of the debtor of such income (Article 8), but annuities or income from other claims not referred to in the previous paragraphs were allotted to the State of fiscal domicile of the creditor of such income.

The personal tax on the whole income was allotted to the State in which the taxpayer had his fiscal domicile—that is, his normal residence, the term "residence" being understood to mean the permanent home. With a view to recognising the differences in tax systems, the article then provided for one formula of relief if the State of fiscal domicile had only a personal tax and another formula for relief if it had impersonal taxes and superimposed thereon a general personal tax. For the former case, the State of domicile was to deduct the lesser of either the amount which would be levied exclusively on such part of the income as was taxed in the other contracting State or the amount of tax paid in such State, including the personal tax, when, for special reasons, the State of origin had imposed such a tax on income from immovable property or from industrial, commercial or agricultural undertakings situated within its territory.

It was recognised, however, that a limit should be placed upon this relief in the form of a certain percentage of the total personal tax. In the event that the State of domicile imposed impersonal taxes, it was laid down that the deductions provided for should not include impersonal taxes which corresponded or related to income taxed in the other contracting State (Article 10). In the case of taxpayers who possess a fiscal domicile in both contracting States, each State was to impose its personal tax in proportion to the period of the taxpayer's stay during the fiscal year, or according to a division to be determined by an agreement between the competent administrations (Article 11).

The principles laid down in the preceding articles were to be applied *mutatis mutandis* to the current taxes on total wealth and capital or increment of total wealth, according to whether these taxes were impersonal or personal.

The report of April 1927 also contains a draft Convention for the Prevention of Double Taxation in the Special Matter of Succession Duties, a third on administrative assistance in matters of taxation, and a fourth on judicial assistance in the collection of taxes. As these were adopted after only minor changes by the 1928 meeting, their content will be briefly described in connection therewith.

GENERAL MEETING OF GOVERNMENT EXPERTS, 1928

The Council of the League, on June 17th, 1927, requested the Secretary-General to forward to the Governments of all States, Members and non-members of the League of Nations, the report of the technical experts on double taxation and tax evasion, with the request that they express their opinions on its contents, and to convene a general meeting of Government experts in 1928 for the purpose of discussing this report. This meeting opened at Geneva on October 22nd, 1928, and its members included representatives of twenty-seven different countries. Members of the International Chamber of Commerce attended in an advisory capacity.

The countries which had not been previously represented in the deliberations at Geneva included Austria, Bulgaria, China, Danzig, Denmark, Estonia, Greece, Hungary, Irish Free State, Latvia, Norway, Roumania, Union of South Africa, Spain, Sweden and the Union of Soviet Socialist Republics. Considering the great diversity in the tax systems of the different countries represented and the fact that so many of them had not participated in the preceding sessions which tended to unify thought, the relative unanimity of the members of that group in the report dated October 31st, 1928 (document C.562.M.178.1928.II), is remarkable.

The Convention previously drafted, which might be satisfactory if each contracting State had impersonal taxes on particular domestic sources of income and a superimposed general income tax on income from all sources, foreign as well as domestic, was not considered to be readily adaptable by a large number of the new States participating in the conference, which had tax systems consisting primarily of what amounted to a single graduated tax on income, whether applied to income derived by non-residents from local sources, or to income derived by residents from all sources, or such a tax on individuals and a separate tax on corporations. Moreover, there was a great conflict of views between representatives of countries which had capital to lend or invest abroad and those of countries which needed capital over which they should have the right to tax dividends and interest on securities.

Hence, two other model Conventions were adopted which embodied the same classifications of income but applied a different machinery for relief from double taxation. Thus

Convention I*b*, intended primarily for countries with personal taxes, gave the prior right of taxation to the country of source over income from immovable property, industrial, commercial or agricultural income, fees of managers and directors, and salaries and wages, and envisaged the allowance of a credit against personal tax on the entire income at the fiscal domicile of the taxpayer in respect of such income taxable by priority at source, similar to the credit for foreign taxes in the United States Revenue Act (now Section 131). The balance of the income was to be taxable exclusively in the country of fiscal domicile of the taxpayer. Draft Convention I*c* followed to a large extent the form of the treaties between the Central European States. It envisaged the taxation of certain kinds of income exclusively in the country of source and of certain others exclusively in the country of fiscal domicile, with an exceptional regime for the income from securities, which allocated it in principle to fiscal domicile but permitted the State of source to continue to apply a withholding tax and suggested double taxation be prevented by the States' agreeing either to a credit of the withheld tax against the tax at fiscal domicile, or to a refund of the withheld tax.

Comparison of Three Draft Conventions

All three Conventions define the fiscal domicile of an individual as his normal residence, the term " residence " being understood to mean a permanent home or, as regards legal entities, where they have their real centre of management.

The basic similarity between the three Conventions from the view-point of the various categories of income is revealed below :

(1) *Income from immovable property, including income from mortgages thereon, is subject, under Convention* Ia, *to impersonal tax in the country where situated, and the State of fiscal domicile, if it has merely a personal tax, allows a certain credit against such tax ; or if the State of fiscal domicile has both an impersonal tax on such income and a personal tax, the deduction allowed against the personal tax shall not include impersonal taxes which correspond or relate to income taxed in the other contracting State ; under Convention* Ib, *such income is to be taxed by priority in the country of source, and a certain credit is to be granted therefor against the tax in the country of fiscal domicile which is equal to the lesser of either the tax paid at source, or an amount representing the same proportion of the tax payable on total income as the income taxable at source bears to total income ; under Convention* Ic, *such income is to be taxed exclusively in the country of source.*

(2) *Income from any industrial, commercial or agricultural undertaking allocable to a permanent establishment shall be liable, under Convention I*a, *to the impersonal tax in the country where the establishment is situated, and to the personal tax in the country of fiscal domicile, subject to the same limitations as stated above in connection with the income from real property; under Convention I*b, *it is taxable by priority in the country where the establishment is situated and a credit—similar to that described above under* (1)*—shall be allowed against the tax in the country of fiscal domicile; under Convention I*c, *such income shall be taxable exclusively in the country of source.*

(3) *Fees of managers and directors shall be subject, under Convention I*a, *to impersonal taxation only in the State where the undertaking has its real centre of management, and to the personal tax in the country of fiscal domicile; under Convention I*b, *such income shall be taxable by priority in the country where the undertaking has its real centre of management and a credit for such tax shall be allowed against the tax at fiscal domicile; under Convention I*c, *such income shall be taxable exclusively in the State where the real centre of management is situated.*

(4) *Salaries, wages and other remuneration shall be subject, under Convention I*a, *to impersonal taxation in the State where the recipients carry on their employment, and to personal taxation in the country of fiscal domicile (which, generally speaking, will be the same State); under Convention I*b, *such income will be taxable by priority in the State where the recipients carry on their employment and a certain credit is allowed against the tax in the country of fiscal domicile; under Convention I*c, *such income is taxable exclusively in the country of their employment.*

(5) *Salaries of officials and public employees are subject, under Convention I*a, *to impersonal taxation in the State which pays the salaries, and the same rule is followed in Conventions I*b *and I*c, *although apparently, under Convention I*a, *they might be subject to personal tax in the country of fiscal domicile, and, under I*b, *to the tax of the country of fiscal domicile, but, in the latter case, a credit for the tax imposed by prior right would be granted against this tax.*

(6) *Interest on public funds, bonds, including mortgage bonds, loans and deposits or current accounts is subject, under Convention I*a, *to impersonal taxation in the country in which the debtor of such income is at the time resident, and to the personal tax of the country of fiscal domicile; under Convention I*b, *such income is taxable exclusively in the country of fiscal domicile; under Convention I*c, *such income is taxable in principle in the country of fiscal domicile, but if the country where the debtor resides has*

a tax withheld at source, it may continue to levy this tax. To prevent double taxation, this article suggests that either the State of fiscal domicile grant a credit for the withheld tax, or the State of source refund the tax.

(7) *Dividends on shares or similar interests shall be subject, under Convention I*a, *to impersonal taxation in the State in which the real centre of management is situated, and to the personal tax in the country of fiscal domicile; under Convention I*b, *such income shall be taxable exclusively in the country of fiscal domicile; and under Convention I*c, *such income shall be taxable in principle in the country of fiscal domicile, but if the country of source ordinarily withholds the tax from such income, it may continue to apply the tax, and the article suggests various ways of preventing double taxation, as described at the end of* (6).

(8) *Public or private pensions are subject, under Convention I*a, *to impersonal taxation in the State of the debtor of such income, and to personal taxation in the country of fiscal domicile; under Convention I*b, *public pensions are taxable in the State of the debtor of such income and a credit for such tax is allowed against the tax in the country of fiscal domicile, while private pensions are taxable exclusively in the country of fiscal domicile; under Convention I*c, *both public and private pensions are taxable only in the State of the debtor of such income.*

(9) *Annuities or income from other sources not referred to above are taxable in all three Conventions only in the State of fiscal domicile of the creditor.*

All three Conventions are alike in providing that income from maritime shipping and air navigation shall be taxable only in the State in which the real centre of management is situated. Moreover, all three Conventions embody the same concept of a permanent establishment—namely, real centres of management, branches, mines and oilfields, factories, workshops, agencies, warehouses, offices and depots shall be regarded as permanent establishments. The fact that an enterprise in one country has business dealings with the other country through a *bona-fide* agent of independent status (broker, commission agent, etc.) shall not be held to mean that the enterprise in question has a permanent establishment in that country. It is to be noted that the term no longer includes "affiliated companies" as in the 1927 draft, it having been acknowledged that such companies should be treated as independent legal entities.

Where an enterprise has permanent establishments in both contracting States, the Conventions all provide that each of the two States shall tax the portion of the income produced in its territory and that the competent administrations of the two States shall come to an arrangement as to the basis of apportionment.

There is a provision in Conventions I*a* and I*c* that the principles contained therein shall be applicable *mutatis mutandis* to recurrent taxes on total wealth, capital or increments of total wealth. All three Conventions provide for settlement of questions arising with regard to the application of the Conventions by conference between the financial administrations of the contracting States, and if disputes cannot be settled by conference, the drafts envisage recourse to a technical body approved by the Council of the League, to arbitration, or to the Permanent Court of International Justice.

Draft Conventions on Succession Duties and Assistance

The draft Convention on Prevention of Double Taxation in the Special Matter of Succession Duties (document C.562. M.178.1928.II, page 22) recognises the right of the country of domicile of the deceased to levy its tax on his total property, and the right of the other contracting State to tax exclusively the property situated in its territory. However, to prevent the double taxation of categories of property listed in the Convention, the State of domicile is to grant a credit against its tax equal to the lesser of (*a*) the actual amount of duty levied by the country of domicile on assets situated in the other country, or (*b*) the actual amount of tax payable on such assets in the country where they are situated.

The draft Convention on Administrative Assistance in Matters of Taxation (*ibid.*, page 25) provides primarily for an exchange of information on certain classes of income flowing from sources in one country to persons resident in the other. The draft Convention on Assistance in the Collection of Taxes (*ibid.*, page 29) provides for mutual aid in enforcing judgments against taxpayers.

Subjects proposed for Later Study

The study of rules for the apportionment of profits of undertakings operating in several countries was one of the subjects which the general meeting of Government experts recommended for the consideration of a permanent committee to carry on the work already launched. Among other subjects suggested were methods for the prevention of double taxation in the matter of patent and copyright royalties, measures for the avoidance of the double taxation of trusts and companies possessing a large number of transferable securities, and the rendering of assistance to the Council in all questions of taxation even outside the problems of double taxation and administrative assistance and co-operation for the collection of taxes.

The report of the meeting also envisaged the annual publication of conventions on double taxation, administrative assistance and assistance in the collection of taxes, the preparation of memoranda on existing systems of taxation, and also the examination of various other subjects which have been treated in the annual reports of the Fiscal Committee.

WORK OF FISCAL COMMITTEE SINCE 1929

The Fiscal Committee has held nine sessions, including the present one, as follows : October 17th to 26th, 1929 ; May 22nd to 31st, 1930 ; May 29th to June 6th, 1931 ; June 15th to 26th, 1933 ; June 12th to 17th, 1935 ; October 15th to 21st, 1936 ; October 11th to 16th, 1937 ; October 17th to 20th, 1938 ; and June 12th to 21st, 1939. It is now composed of nine titular and thirty-eight corresponding members from countries, some of which do not belong to the League, in all parts of the world.

The annual reports of the Committee embody valuable proposals which round out and supplement the draft Conventions of 1928, and treat subjects related to the internal functioning of the tax systems of the leading countries. The Committee's influence has been ever widening, as is evidenced by the recourse of Governments (including non-members of the League, such as the United States) to the draft Conventions and its reports and memoranda on comparative studies, and by the appeal made at the last meeting of the Assembly for the Committee to undertake the study of the basic principles that should underlie income, property and turnover taxes.

Study of Allocation of Income

The most extensive work undertaken by the Fiscal Committee was that of formulating, for tax purposes, rules for the allocation of income and capital of industrial and commercial enterprises operating in several countries. With the aid of a grant from the Rockefeller Foundation obtained through the then American member, Dr. T. S. Adams, a survey was launched which covered thirty-five different countries, representing practically all types of tax systems and economic development, including the highly industrialised countries and agricultural countries of Europe, the partly industrial, partly raw-material-producing States like the United States, Canada and Japan, and those where, primarily, foreign companies carry on mining and agricultural enterprises, such as British India, Netherlands Indies, Cuba and Mexico.

With the collaboration of the Committee's representative, who visited twenty-seven of the countries, reports were prepared in the different administrations which dealt with the legislative provisions, rulings and practices from the viewpoint of international commerce, with particular emphasis being placed upon the legislative provisions and practices followed in allocating the income of enterprises to sources within and without the country. These reports were published in the first three volumes of *Taxation of Foreign and National Enterprises*.[1] The rules and practices in regard to allocation of income were collated in Volume IV of that publication and the principles which might be used in an international agreement were set forth in Chapter 12 of the same volume. A study of accounting methods appeared as Volume V. On the basis of Chapter 12 of Volume IV, a Convention was formulated first at meetings of a Sub-Committee held in New York and Washington under the auspices of the American Section of the International Chamber of Commerce, and then at the full meeting of the Fiscal Committee in June 1933 (report of 1933, Annex, document C.399.M.204.1933.II.A [F./Fiscal 76]).

The Convention deals only with the question of the allocation of business income and therefore was thought to be susceptible of adoption by a large number of States and was made multilateral in form. It could be incorporated in general conventions to supplement the article dealing with the taxation of income from industrial and commercial enterprises, or it could be adopted as a separate convention. It was sent to the various Governments, and the thirty-three replies which were examined at the meeting in 1935 (report of 1935, Annex I, document C.252.M.124.1935.II.A [F./Fiscal 83]) indicated that the Convention was well suited to secure the objects in view, and only minor amendments were called for, although certain States whose legislation is based on different principles were not then in a position to adapt their legislation to the Convention.

Summary of Provisions of Allocation Convention

The Committee was definitely opposed to the concept of viewing the enterprise as a whole and allowing each country to claim its share of the entire net income of the enterprise in proportion to the business or assets situated in its territory. Instead, it proposed to regard the establishment or establishments in each country as an independent enterprise. It envisaged the determination of the income in so far as possible on the basis of separate accounts, which would be verified by means of local factors, thereby obviating the necessity of recourse to head office accounts. As will be seen, the method of fractional apportionment was authorised only as a last resort.

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[1] Document C.425(*b*).M.217(*b*).1933.II.A.

The Convention therefore starts with the basic principle that a contracting State will tax the industrial and commercial income of a foreign enterprise only in so far as it is allocable to a permanent establishment within its territory. This article is a restatement of the basic articles dealing with income from industrial and commercial enterprises in the draft Conventions of 1928. It avoids double taxation in the case of income derived by the foreign enterprise from effecting transactions in its territory through a *bona-fide* commission agent or broker or travelling salesman, by excluding such transactions in the definition in the protocol of what constitutes a permanent establishment.

If the profits allocable to a permanent establishment within its territory are to be taxed again at the fiscal domicile of the foreign company, double taxation will result. It is therefore suggested in a footnote to Article 1 that this double taxation be obviated by the country of fiscal domicile granting the deduction of the lesser of the two following amounts : (*a*) the tax imposed by the State of source, or (*b*) the same proportion of its own tax on total net income as the net income taxable at source bears to the total net income.

The next problem is to define business income, and this is done in Article 2 by excluding recognised categories of income which are attributable to specific sources under the various articles of the draft Conventions of 1928—namely, (*a*) income from immovable property, (*b*) interest, (*c*) dividends—in addition to other categories which were not dealt with in the draft Conventions, such as patent and copyright royalties and similar rentals or royalties arising from leasing personal property or any interest in such property, and also profit or loss from the casual purchase and sale of immovable or movable property.

Because of special provisions in the laws of different countries regarding the taxation of banks, a specific rule was provided for including in their business income all items which, in conformity with the laws in force covering national enterprises, enter into the computation of profit and loss, except income from immovable property and interest on mortgages. In computing business income, there shall also be excluded with the above-mentioned items of income, the related expenses (including general overhead) and other charges. Such items of income are to be taxed separately or together with business income, in accordance with the laws and the international agreements of the States concerned.

Article 3 of the draft Convention embodies the essence of the law and practice of a number of countries interested in international trade. It starts off with the principle that there shall be attributed to the local permanent establishment of a foreign enterprise the net business income which it would be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions. Such net income will, in principle, be determined on the basis of the separate accounts pertaining to such establishment. In other words, the basic concept is to assimilate the permanent establishment to an independent legal entity doing business with the other parts of the enterprise on the same basis as with third parties and reflecting the results thereof in its own separate accounting.

To implement this principle the fiscal authorities of the contracting States are authorised to rectify when necessary the accounts produced, notably to correct errors or omissions, or to re-establish the prices or remunerations entered in the books at the value which would prevail between independent persons dealing at arm's length.

In case the foregoing method and procedure of separate accounting fails because the establishment does not attempt to maintain accounts reflecting its own operations, or accounts which correspond to the normal usages of the trade in the country where the establishment is situated, or if, for other reasons, the rectifications envisaged cannot be effected, the fiscal authorities may resort to the method employed in many States for determining empirically the business income of local branches of foreign enterprises or even domestic enterprises—namely, that of applying a percentage to the turnover of the establishment which is fixed in accordance with the nature of the transactions of the establishment and by a comparison with the results obtained by similar enterprises operating in the country. This flexibility is necessary because the rate of net to gross for a branch marketing food products, for example, is likely to be quite different from that of an enterprise selling shoes or typewriters. Moreover, it is frequently very difficult for an enterprise which is manufacturing and selling a variety of products to have a complete cost accounting of each small class of goods which, for example, in a rubber enterprise, might range from mats to air cushions. Therefore, the article envisages the possibility of the authorities entering into an agreement with a taxpayer for the payment of tax on the basis of a presumed net income equal to an agreed percentage of the turnover. This method is followed in actual practice in some of the leading countries.

It is believed that the foregoing provisions would take care of most of the cases arising, but at the end of the article there appears a clause to deal with other and more difficult cases. If the foregoing methods are found to be inapplicable, the net business income of the permanent establishment may be determined by computation based on the total income derived by the enterprise from the activities in which such an establishment has participated. This determination is made by applying to the total income coefficients based on a comparison of gross receipts, assets, pay rolls, or other appropriate factors, provided that such factors be so selected as to insure results approaching as closely as possible those which would be reflected by a separate accounting.

The method recognised herein is that known as fractional apportionment, the essential principle being that a country in which a branch of a foreign enterprise is located may tax a certain part of the net income derived from all the activities of the enterprise. It is to be noted, however, that the Committee limited this authority by first permitting an apportionment only of the total income derived by the enterprise from the activities in which such establishment has participated, thereby excluding unrelated income from the computation. Secondly, the factors to be used in apportioning the income must be so selected as to ensure results approaching as closely as possible those which would be reflected by a separate accounting. The full implication of these provisions is set forth in detail in the above-mentioned Chapter 12 of Volume IV of *Taxation of Foreign and National Enterprises* which explains how the principles may be applied in the case of the typical enterprises—industrial and commercial, banking and financial, insurance, transport, telegraph, telephone, radio and cable, mining and agricultural enterprises.

Special Article for Banks

The draft Convention contains, in Article 4, a provision relating specifically to banking and financial enterprises that have a flow of funds from an establishment in one country to establishments in one or more other countries on which interest is charged. The general rule in the tax laws of the various countries being that one part of the enterprise may not charge interest to another, nor take as a deduction interest paid to another part, it was necessary, in carrying out the principle of separate accounting, to create the legal fiction that each branch was in effect a separate entity which would be allowed a deduction for interest paid to other parts of the enterprise, and would be taxable on income received from other parts of the enterprise. However, it must be assumed that each permanent establishment has been given a capital adequate for its purposes, inasmuch as it would be unfair to permit it to deduct interest pertaining to such capital. Hence, the rule is adopted that, if a permanent establishment in one State (creditor establishment) supplies funds to a permanent establishment in a second State (debtor establishment), for tax purposes, interest shall be deemed to accrue as income to the creditor establishment and as a deduction from gross income to the debtor establishment, and such interest shall be computed at the inter-bank rate for similar transactions in the currency used. However, from such interest there shall be excluded the interest corresponding to the permanent capital allotted to the debtor establishment, whether in the form of advances, loans, overdrafts, deposits, or otherwise.

Shipping and Air Navigation Enterprises

In view of the adoption in the drafts of 1928 of the principle of taxing shipping and air navigation enterprises only in the State where their real centre of management is situated, this provision is repeated in Article 5 of the allocation Convention, in order to exclude such enterprises from its operation.

Subsidiary Companies

Inasmuch as subsidiary companies are not regarded as permanent establishments, a provision is inserted in Article 6 to permit a State in which a subsidiary is located to recapture profits which may have been diverted from it by transactions concluded with the foreign parent enterprise on a basis other than at arm's length. This confirms the separate existence of the subsidiary and precludes the merging of the income of the subsidiary with that of the parent in accordance with the "economic unity" theory which is followed in some countries.

Definition of Permanent Establishment

This Convention is also significant because it contains the results of other work done by the Fiscal Committee to supplement or clarify the draft Conventions of 1928. More particularly, the definition of what constitutes a permanent establishment and the types of intermediaries through which a firm can do business without being regarded as having a permanent establishment was more carefully drawn at its meetings in 1929, 1930 and 1931, and the essential parts of this definition were incorporated in the definition of permanent establishment in the protocol of the draft Convention on the allocation of business income in the draft of 1933 and the revised draft of 1935. In substance, this definition provides that, when a foreign enterprise regularly has business relations in a State through an agent established there who is authorised to contract on its behalf, it shall be deemed to have a permanent establishment in that State. In accordance with the foregoing principle, a permanent establishment shall be deemed to exist when the agent established in the State : (1) is a duly accredited agent (*fondé de pouvoir*) who habitually enters into contracts for the enterprise for which he works ; (2) is bound by an employment contract and habitually contracts commercial business on behalf of the enterprise in return for remuneration ; or (3) is habitually in possession for the purpose of sale of a depot or stock of goods belonging to the enterprise.

It is furthermore specified that the term does not include a broker who places his services at the disposal of an enterprise in order to bring it into touch with customers, or a commission agent who acts in his own name for one or more enterprises and receives a normal rate of commission, or a commercial traveller not coming under any of the preceding categories.

Convention to serve for Bilateral Negotiations

As the number of States which definitely pronounced themselves to be in favour of a multilateral convention was insufficient to justify calling an international conference, the draft Convention was again sent to the various Governments as a basis for negotiating bilateral treaties.

Allocation of Income of Insurance Companies

Believing that a special provision for the allocation of income of insurance enterprises should be added to the draft Convention on the Allocation of Business Income, the Committee, in 1936, adopted such a provision. When a permanent establishment of a foreign insurance enterprise—in particular, one conducting the business of life insurance—cannot be taxed on the basis of separate accounts, the net income allocable to the permanent establishment may be determined by reference to the proportion between the premiums received in respect of the permanent establishment and the total premiums received by the enterprise (report of 1936, page 5, and Annex I, document C.450.M.266. 1936.II.A [F./Fiscal 91]).

Allocation of Property and Capital

Moreover, in 1936, provisions were also adopted for the allocation of property and capital between States for the purposes of taxation, which might either be added to the draft Convention or placed in a separate convention. In substance, they provide that an enterprise having its fiscal domicile in one of the contracting States shall not be subject to taxes on property and capital in another contracting State, except in respect of property situated and capital employed within its territory and, in the case of movable property and capital, allocable to a permanent establishment situated in such State (Article I). By way of exception, patents, trade-marks, copyrights and similar intangible property shall be taxable only in the State where the real centre of management is situated (Article II). In principle, the property and capital of the permanent establishment concerned will be taxed on the basis of the separate accounts pertaining to such establishment, subject to the necessary rectifications.

Such provisions merely define the limits of the jurisdiction of the State where the property and capital are situated ; and, to prevent double taxation, a footnote to the Convention envisages deducting from the tax on total property or capital in the State of fiscal domicile of the lesser of the two following amounts : (*a*) the tax imposed by the State of situs ; or (*b*) an amount which represents the same proportion of the tax paid on total taxable property or capital as the property or capital taxable at situs bears to the total taxable property or capital (report of October 21st, 1936, Annex II, document C. 450.M.266.1936.II.A [F./Fiscal 91]).

Patent and Copyright Royalties

An important category of income which had not been specifically dealt with in the Conventions of 1928 was patent and copyright royalties, and, at its first meeting, the Fiscal Committee undertook to study existing methods of taxing royalties on patents and so-called authors' rights. Replies to a questionnaire on the subject sent to various Governments are summarised in Appendix III to the report dated May 31st, 1930 (document C.340.M.140.1930.II [F./Fiscal 41]). The conclusion reached by the Committee was that income from authors' rights or patents, except when it may be classed as industrial and commercial income, should be taxed only by the country in which the person entitled to the income is domiciled. However, if such income is in the nature of industrial and commercial income, as where a publisher buys a writer's work in order to publish a book and place it on sale, or buys the copyright of a musical composition in order to sell the performing rights to theatre and concert managers, or where a manufacturer buys a patent to use it in manufacturing goods, or a trader buys patents from different inventors in order to sell them or lease the right of exploitation to manufacturers, the income should be taxable at the permanent establishment to which it is allocable (see report of May 31st, 1930).

In the draft plurilateral Convention referred to below, the following language was employed to express this principle :

> " Authors' rights and income from patents shall be taxable only in the State of fiscal domicile of the beneficiaries. If, however, they are collected by persons to whom these rights have been assigned for a consideration, or fall on any other grounds into the category of industrial and commercial income, they shall be taxable as such under the conditions laid down in Article 4." (Article 8, Appendix I, report of June 6th, 1931, document C.415.M.171.1931.II.A [F./Fiscal 73]).

Draft Plurilateral Conventions

The previous Committees meeting under the auspices of the League, as well as the International Chamber of Commerce, had consistently advocated the adoption of plurilateral conventions for the prevention of double taxation, and the discussions had revealed that this was hardly tenable in regard to certain classes of income, notably interest and dividends, because of the conflicts in opinions and methods of taxation. Nevertheless, the Fiscal Committee undertook to draft conventions covering classes of income in respect of the treatment of which there was considerable unanimity of opinion, as follows :

(1) The following should be taxed only at the residence of the recipient :

(*a*) Annuities ;

(*b*) Authors' rights or royalties ;

(*c*) Interest on (public) debt (except mortgages) issued after a future date to be agreed on ;

(*d*) Wages of workers living on one side of a frontier and working on the other.

(2) Salaries of public officials and employees and public pensions should be taxable only by the paying State ;

(3) Immovable property should be taxable only in the country where situated ;

(4) Profit derived by a company from the operation of industrial, commercial or agricultural undertakings should not be taxable in a country other than that in which the real centre of management is situated unless the company has

one or more permanent establishments in such other country. However, income from maritime shipping and air navigation should be taxable only in the State in which the real centre of management is situated.

The report of the special Sub-Committee, together with three drafts, which vary somewhat in form but are substantially the same in their basic provisions, is annexed to the report of June 6th, 1931 (document C.415.M.171.1931.II.A [F./Fiscal 73]). They are interesting in that they reflect a development in precision of expression since the drafting of the model Conventions of 1928 as well as the new principles developed by the Fiscal Committee in regard to income from authors' rights and patents.

Fiscal Evasion

From almost the beginning of the studies conducted under the auspices of the League of Nations, the question of fiscal evasion has been examined, and, at the 1928 Conference, the draft Conventions on Administrative and Judicial Assistance were formulated primarily to point the way to the prevention thereof. When called upon by the Assembly of the League on October 9th, 1936, to look into this question again with particular reference to evasion in the field of income from securities, the Committee formulated a provision for exchange of information which, if adopted by a large number of countries, seemed likely to prove effective. The Governments of Members of the League, and also non-members, were then asked if they would approve a general convention providing such a system, but the replies were not encouraging and the Committee was asked by the Assembly to resume the discussion of the question. As is stated in the report of October 25th, 1938 (document C.384.M.229.1938.II.A [F./Fiscal 104]) :

> " Governments showed reluctance to change their domestic legislation merely to meet the requirements of foreign administrations, and they were unwilling to ask their nationals to supply information not needed for domestic purposes."

The Committee then drafted a questionnaire with a view to determining what could be done on the basis of existing provisions in tax laws, and replies were received from thirty-three Governments. As is stated in the report of October 25th, 1938 :

> " It appeared that divergent methods of control were employed in the various countries and that the methods were for the most part the result of a slow adaptation of the laws and regulations to circumstances : gaps in the taxation

system had been closed and the administrations had shown great ingenuity in combating evasion in every form. But the efforts of the various administrations were of so special a character that it appeared to be difficult to employ the methods used by one country in other countries, and it was clear that any proposal for a general scheme would have been received with serious hesitation."

Hence it was thought that " for the problem of fiscal evasion, as for the problem of double taxation, bilateral conventions are the only possibility as they can be adapted to circumstances and the nature of the results aimed at ". The Committee therefore recommended that the answers to the questionnaires be communicated to the various Governments in order that States might use that knowledge to negotiate bilateral treaties which, without necessitating far-reaching reforms in domestic legislation, would nevertheless promote the organisation of effective measures of control, it being understood that the States, as sole judges of the advisability of concluding such agreements, would be in a position to weigh their advantages and disadvantages.

The Assembly resolution envisaged the prevention of fiscal evasion as a subject apart from that of double taxation, but it is significant that clauses for various types of assistance have generally been inserted only in treaties for the prevention of double taxation, or in supplementary Conventions. In short, the consensus of opinion seems to be that States are unwilling to help each other to enforce their respective tax laws unless they first agree to remove the inequitable burden that results from double taxation. Exchange of information is considered appropriate to prevent evasion of taxes resulting from the abuse of provisions to avoid double taxation. In the absence of provisions to prevent double taxation, exchange of information would only tend to force the liquidation of investments across frontiers, or the diversion of the flow of capital to States not parties to Conventions, or recourse to more devious methods of escaping the confiscatory accumulation of taxes.

Most-favoured-nation Clause

After examining for two years the question of incorporating the most-favoured-nation clause in double taxation treaties, the Fiscal Committee concluded that, as the bilateral or multilateral treaties on double taxation are based on the principle of reciprocity, they involve reciprocal concessions for the nationals of the contracting parties. Hence, while not wishing to give an opinion on so difficult a point of international law, the Committee considered that the most-favoured-nation clause should not be applied to the nationals of a country which had not acceded to the said agreements.

It was further suggested that, in order to prevent this point from arising, it would be desirable to make clear in future commercial or establishment treaties that the most-favoured-nation clause in its application to fiscal matters does not extend to special provisions for the avoidance of double taxation (report of May 31st, 1930, document C.340.M.140.1930.II [F./Fiscal 41]).

In the draft plurilateral Convention for the Prevention of Double Taxation for certain categories of income contained in Appendix I of the report of 1931, the following clause on this point is suggested for inclusion in the protocol :

> "Since the advantages of this Convention are accorded *subject to reciprocity*, they cannot be claimed from any contracting party, in virtue of the most-favoured-nation clause, by a State not a party of this Convention."

Co-operation with Other Groups

The Fiscal Committee has been asked to co-operate with other groups in formulating conventions. Thus, in 1929, it worked with the Permanent Committee on Road Traffic in drafting a Convention on the Taxation of Foreign Motor Vehicles (report of October 26th, 1929, document C.516.M.175.1929.II [F.Fiscal 14]). This Convention was adopted by the European Conference on Road Traffic which was held in Geneva from March 16th to 30th, 1931 (report of June 6th, 1931, document C.415.M.171.1931.II.A [F./Fiscal 73]).

Another group with which it collaborated was the Joint Committee on the Question of Customs and Fiscal Duties on Newspapers and Periodicals (reports of May 31st, 1930, and June 6th, 1931).

Comparative Studies of Tax Laws

The provisions in the draft Conventions of 1928 and the subsequent drafts on the allocation of business income as well as of property and capital, for tax purposes, represent the distillation through conference of fundamental principles in the tax laws of a number of countries which differ widely in detail. The Committee has long recognised the need of following changes in tax legislation representing technical improvements, and of endeavouring to reach agreement on certain essential points of fiscal and juridical terminology such as the concept of business income, the term employed in the draft Convention on the Allocation of Business Income between States for the purposes of taxation, which would involve consideration of the varying definitions of gross income, net income, expenses, general overhead, etc. In addition, the Committee felt that the concept of fiscal domicile should be studied (report of June 26th, 1933, document C.399.M.204.1933.II.A [F./Fiscal 76]). Consequently, questionnaires were sent out to a large number of Governments, and a considerable volume of valuable material has been received which is to be examined in connection with the new study of principles of taxation on which work is just beginning (report of October 25th, 1938, document C.384.M.229.1938.II.A [F./Fiscal 104]). Likewise, a comparative study was made of methods of collecting direct taxes and succession duties, and this has been sent to the members and corresponding members of the Committee (*ibid.*).

Study of the Behaviour of Tax Systems

In 1933, the Committee also undertook to look into the changes in tax systems due to the difficulties resulting from the world depression (report of June 26th, 1933, document C.399.M.204.1933.II.A [F./Fiscal 76]), and this has developed into a broad study of the behaviour of tax systems. The reports prepared in fourteen countries representing different types of national economy describe the behaviour of fiscal systems during the past decade and have been submitted for examination by a group of economists whose findings were considered at the meeting of the Fiscal Committee on June 12th, 1939.

The Committee devotes an important chapter of its report (document C.181.M.110.1939.II.A) to this subject.

Study of the Principles of Taxation

All these basic studies of tax systems and their efficiency, during the difficult years of the past decade, offer an excellent foundation for the work being undertaken on principles of of taxation, the purpose of which is " to study and advise upon the principles on which fiscal legislation dealing with the main categories of taxes, such as income tax, land taxes, turnover taxes, etc., should be based ". It will be recalled that this study is being undertaken pursuant to a resolution adopted by the Assembly of the League on September 29th, 1938. The

Committee intends to concentrate primarily upon the results of the experience of its members regarding the technical organisation and practical application of the chief categories of taxes, without losing sight of the effects which such taxes are likely to exercise on the economic and social development of different countries which are characteristically agricultural or industrial, creditor or debtor, or a combination thereof.

Although this work envisages primarily the internal operation of tax systems, it affords an opportunity for recommending the incorporation in national laws of the basic principles sponsored by the Committee for the prevention of extraterritorial and double taxation, thereby removing the conflicts which could otherwise be eliminated only through bilateral conventions (report of October 25th, 1938, document C.384.M.229.1938.II.A [F./Fiscal 104]).

CONCLUSION

Persistently and quietly for the past two decades, technicians have laboured at Geneva to reduce the tax burdens and barriers that obstruct the movement of trade and capital between countries. When they first began to meet, there were practically no generally recognised limits on tax jurisdiction, and the overlapping of claims of different jurisdictions on the same income or property resulted in confiscatory levies.

The League Committees have analysed the effects of such conflicting taxation from an economic viewpoint and have proposed the reduction of the bases of taxation to domicile and source. They have defined the fiscal domicile of individuals and corporations, have separated and defined sources and have proposed the most practical methods of preventing double taxation of the different classes of income. Under these proposals, if adopted, an enterprise which ventures across frontiers into a second State can be assured, at least from a tax viewpoint, of treatment in the markets there which will permit it to compete on a basis fairly equivalent to that accorded to enterprises of the second State itself or of third States.

Where an enterprise does business in several different countries (as, for example, where it produces raw materials in one, processes them in another, and sells them in a third) principles and methods of determining the income properly attributable to each have been devised. Correlative principles have been proposed for the imposition of property taxes. Principles for preventing the dual imposition of taxes on the death of individuals have also been proposed. To implement these provisions for relief, formulæ for co-operation between Governments in assessing and collecting taxes have been suggested.

These principles and formulæ have been incorporated in the draft Conventions of 1928 and the subsequent years. During their development and since then, officials meeting at Geneva have followed these precepts in concluding bilateral treaties on behalf of their respective Governments. The pioneer work of the technicians at Geneva has been reflected in the practical accommodation of existing tax systems to these principles. Even during the depths of the world economic depression, in 1930 to 1935, over fifteen general double-taxation agreements were concluded which contain many of the suggestions formulated at Geneva. Altogether, about sixty such general arrangements have been made since the Peace Conference at Versailles, a large number of which are at present in force. In comparison, the previous agreements in this field were of limited importance. A large number of these recent treaties contain more or less detailed provisions for assistance in the assessment and collection of taxes, while, in about twenty cases, such assistance has been stipulated in supplementary agreements.

A survey of the efforts to avoid double taxation by general agreements, however, is not complete without a consideration of the numerous arrangements of a more limited scope that have been concluded by States not desiring to negotiate formal general treaties, or to precede or supplement the latter.

Most important of the limited agreements are those relating to various types of business activity, and, among these, over seventy have covered the income of shipping enterprises. More than twenty exempt income derived by a foreign enterprise through the activities of certain types of agents, and about five relate to air navigation, while a larger number, some of them dating back into the nineteenth century, regulate the taxation of railroads. At least twenty provisions, including several individual articles in ordinary commercial Conventions, contain rules for the allocation or apportionment of business income or capital, and are usually general in their application. About fifteen agreements cover only earned income, usually that of persons living on one side of an international frontier and working on the other. A smaller number of agreements relate to stamp taxes, including two multipartite Conventions which, although not designed to eliminate double taxation, mitigate the sanctions that may be imposed for the failure to place upon certain instruments the stamps required by the laws of one of the parties. Another multipartite Convention, and about forty bilateral arrangements, relate to the taxation of motor vehicles. About twenty-five arrangements, a large majority of them concluded since the war, relate to death duties, not to mention a series of over sixty such arrangements adopted among the United Kingdom and the British dominions, protectorates and colonial possessions.

A further discussion of the nature of these various arrangements is given in Annex I.[1]

This work has progressed even though barriers were being raised to the flow of commerce in the form of tariffs, quotas, prohibitions and exchange restrictions. True, the efficacy of tax treaties has been reduced by these latter measures, but they have endured, and it is expected that they will endure, because they have become more and more a part of the fundamental

[1] See page 45.

law of each country which has been a party thereto. It is also to be hoped that the procedure of co-operation in this field will extend to other fields, so that the removal of the other barriers to trade may permit the full effectiveness of measures to prevent double taxation.

There is still work to be done by the Fiscal Committee in this field, and there are many conventions that could be concluded. Most of the existing treaties have been negotiated by continental European countries to facilitate trade with their neighbours. Only two of them (France and Sweden) have concluded general Conventions with a country overseas (the United States of America). Of extra-European countries, Brazil, Canada, Ecuador, Japan and the United States of America have been parties to agreements with European States on shipping profits, and Canada and New Zealand have entered into agreements dealing with business through agents. Countries could encourage trade by negotiating more of these classes of conventions.

An examination of the various Conventions shows a certain trend towards uniformity, but this might well be accelerated if the Fiscal Committee were to consider the wisdom of carrying out the proposal to study the 1928 drafts in the light of the various treaties concluded since then, with a view to formulating more up-to-date models. Furthermore, this work might be supplemented by the correlation and publication of the comparative studies on the concept of business income as well as the completion of the studies of the concept of fiscal domicile for individuals and legal entities.

It is significant that the Committee started out by endeavouring to resolve the conflicts in the application of tax laws to the enterprises of one country operating in another and that it has little by little gone into the operation of tax laws in the countries themselves. There is no subject more engrossing than the growing burden and machinery of taxation, and there is no centre better fitted than the League Secretariat to carry on an objective study of the evolution and behaviour of tax systems during the recent periods of economic stress. While tax systems develop in accordance with the economic and political exigencies in the various countries, it is often acknowledged that mistakes are being and have been made, and there is a growing tendency to look to the experience of others in order to avoid their acknowledged mistakes or to profit from their wise legislation—assuming that the economic, social and political conditions of the countries in question were sufficiently similar. Being themselves primarily administrators of taxes, the members of the Fiscal Committee have invoked the assistance of economists and other profound students of taxation, but have not lost sight of the fact that, in the last analysis, taxation is a very practical science and must be adapted to the peculiar needs of the country in question.

The Committee's new work on principles of taxation is therefore being undertaken with a background of almost twenty years of comparative studies and the selection of principles and methods most susceptible of general adoption. The very fact that the Committee almost always proceeds by unanimous action tends to assure the universality of its proposals. Until now, the Committee has represented for the most part countries with highly developed systems of taxation, and it is significant that countries in the process of revising existing legislation or introducing new taxes are looking to it for guidance.

ANNEX I

GENERAL AGREEMENTS FOR THE PREVENTION OF DOUBLE TAXATION IN CONNECTION WITH TAXES ON INCOME AND PROPERTY

Against the background of the proposals formulated at Geneva, it is interesting to examine briefly the agreements reached in the general field of taxes on income and property. The attached list (Annex II, page 52) of post-war general treaties to prevent double taxation reflects the movement to free trade from the shackles of cumulative taxes in which first one and then another of the countries of continental Europe have taken leading rôles. In the spring of 1921, Germany, in order to facilitate trade relations with the Saar Territory, reached an understanding with the Governing Commission of the Saar. This pact was evidenced by a decree of the Governing Commission which states that, on condition of reciprocity, residents of Germany should be taxed in the Saar Territory only on income from real property and commercial establishments, and that such income from Germany should be exempt in the Saar Territory. A similar decree was issued by the German Government.

Germany then negotiated a very complete arrangement with Czecho-Slovakia, while France and the Saar, in 1922, reached an agreement for relief, not only in the field of income taxation, but also with regard to stamp taxes on bills of exchange, taxes on securities and on turnover.

The reciprocal understanding which Germany reached with Czecho-Slovakia on the last day of 1921 introduced the *motif* for the handling of mutual tax problems in Central Europe. Each State could impose direct taxes on persons domiciled or habitually resident within its territory, except in respect of the property or income allotted for taxation exclusively in the other State—namely, land and buildings and the income therefrom, and mortgage interest, business establishments and profits therefrom, income from liberal professions exercised at a permanent establishment and salaries and pensions paid from public funds. If a State taxed dividends and interest by withholding at source, the tax should belong only to such State. However, where the main establishment of an enterprise was in one State and branch establishment in the other, the tax on interest accruing from the business transacted by the branch was to be deducted only for the benefit of the State in which the branch was situated. Moreover, this treaty specifically makes the clauses on real property and business establishments applicable to legal entities.

With minor adaptations to meet differences in tax laws, the same principles were incorporated in the treaties concluded by Germany with other neighbouring States, such as Austria in 1922 and Hungary in 1923, but, in the latter treaty, the clause regarding taxation at domicile was placed after the articles for taxation at source as a residuary catch-all for income which was not specifically mentioned. This residuary clause was also applicable to legal entities, the domicile of which is defined as the head office or the centre of management or control.

In a treaty which Germany concluded with the Union of Soviet Socialist Republics in 1925, concerning practical co-operation in the economic sphere, clauses to prevent double taxation of real property and business and the income therefrom embodied the principles previously described.

In 1922, the Italian Government held a conference at Rome with Austria, Hungary, Poland, Roumania and Yugoslavia for the purpose of resolving their common problems of double taxation in a multilateral convention. The Italian tax system comprises taxes on income from lands and buildings, income from capital, income from business, income from professions or employment, and a general income tax on total net income. The Convention presupposes the existence of such a system in other States and allots the specific classes of income for impersonal taxation in the country of the respective sources which are defined in a manner similar to that in the German treaties. As regards the general tax on total income, however, the treaty prescribes the same rules of taxation at source in the case of income from immovable property, mortgages, business and work, but subjects the other income to the general tax at the taxpayer's residence. The Convention was signed April 6th, 1922, but it came into effect only as between Italy and Austria.

As Czecho-Slovakia had not participated in the multipartite negotiations, Italy concluded a treaty with that country in 1924. The terminology and concepts resemble those in the early studies of the League of Nations. In fact, the Italian director general of taxes, M. d'Aroma, was chairman of the Committee of Technical Experts. The treaty assigns impersonal taxation (*imposta reale*) of income from real property to the country of source, and likewise allots income from work to the State where it is carried on, and public salaries and pensions to the State which pays them. Although, in principle, income from capital is to be taxed in the State where the creditor is domiciled, by way of exception, interest on mortgages is attributed to the

State in which the immovable property is situated, and income from securities is taxable in the State of the paying entity. A basket clause grants the right to tax life annuities and other classes of income not previously mentioned to the State in which the creditor is domiciled.

Personal taxation on the taxpayer's total income is to be levied in accordance with the foregoing principles in the case of income from immovable property, mortgages, work and business, except in so far as it is carried on by a company (for which no rule is provided presumably because legal entities were subject only to impersonal taxes). Other kinds of income, including dividends and interest on securities, are subject to the personal tax at the residence of the recipient.

In Central Europe, the effect of multilateral treaties was being accomplished through the conclusion by the States which were negotiating treaties with Germany of essentially similar treaties between themselves. Thus the German-Czecho-Slovak Treaty of December 31st, 1921, was followed by the Austro-Czecho-Slovak Convention of February 18th, 1922, and the Austro-German Treaty of May 23rd, 1922. Czecho-Slovakia concluded a treaty with Hungary on July 13th, 1923, and the tripartite ring was closed by the Hungarian treaty with Germany of November 6th, 1923. Germany entered into a provisional arrangement with Poland on March 21st, 1923 and a treaty was effected between the latter country and Czecho-Slovakia on April 23rd, 1925.

On October 31st, 1925, Germany and Italy met at Rome to sign an agreement which reflected the theories and employed the terminology that was being evolved at the Geneva meetings, yet, in substance, amalgamated the provisions in their previous treaties with other States. A distinction is expressly drawn between direct impersonal and personal taxation. As most of the important categories of income are subject under the treaty to personal as well as impersonal taxes at source, it differs little in substance from the previous Central European type of agreement. Income from the following sources is subject to impersonal and personal taxation in the country whence derived :

(1) Immovable property ;

(2) Mortgage loans ;

(3) Industrial or commercial establishments, except that maritime shipping enterprises shall be taxable only at the real centre of management ;

(4) Work, including liberal professions and public employment.

Dividends and directors' fees are subject to impersonal taxation at the head office of the enterprise and personal taxation at fiscal domicile of the recipient. Although, in principle, interest derived from the investment of funds is subject to impersonal taxation at the creditor's domicile, interest on Government and corporate bonds is taxable by the State of which the debtor is a national. Interest on savings deposits and current accounts is taxable only at the establishment where the deposit or account is located. Other income, including annuities, is subject to both impersonal and personal taxation at the domicile of the recipient.

During the following month, the Italian Government having invited Hungarian negotiators to Rome, a Convention on practically the same basis was concluded on November 25th, 1925.

In 1926, there was a lull in negotiations between continental European States ; but the British Board of Inland Revenue, seeing the trend toward taxing the major categories of income only at source, signed an agreement with the Irish Free State on April 14th, 1926, for the complete exemption by each country of all income flowing from sources in its territory to persons residing in the other State. This is still to-day the lone example of this type of general agreement, although numerous arrangements have applied the principle of reciprocal exemption at source to shipping and air navigation profits, and to income from sales through certain types of agents.

On August 11th, 1927, Denmark and Iceland negotiated a simple agreement. The following October 24th, Austria negotiated a treaty with the Swiss Confederation acting in the name of the Canton of St. Gall, which has subsequently been extended to other cantons.

Germany and Sweden concluded a very complete treaty on April 25th, 1928, and Hungary closed meshes in the Central European network by making agreements with Yugoslavia on February 22nd, 1928, and Poland on May 12th, 1928. The next year, Austria reached an understanding with its little neighbour Liechtenstein, and Poland with Danzig.

France, which had been active in the studies under the auspices of the League, then took the lead and negotiated a series of Conventions beginning with Italy on June 16th, 1930, Belgium on May 16th, 1931, the United States of America on April 27th, 1932, Germany on November 9th, 1934, Sweden on December 24th, 1936, and Switzerland on October 13th, 1937. During July 1932, France and Tunis issued reciprocal decrees for the relief from various income, stamp and succession taxes with respect to securities. In varying degrees, these agreements reflect the Geneva draft Conventions of 1928. Inasmuch as both the French and Italian tax systems embrace impersonal taxeson specific sources of income and a superimposed general income tax, draft Convention I*a* was used as a model for the Convention between these two States. However, as the French impersonal tax on income from securities is levied on dividends and interest from foreign as well as domestic securities, a special provision was inserted in Article 11 and in paragraph 7 of the protocol (*Collection*, Vol. III, pages 26 and 28) whereby France, in principle, shall deduct from its impersonal tax on such income the impersonal tax levied upon it in Italy. This treaty also contains special provisions dealing with the application of the French tax on income from securities to Italian enterprises exploiting property in France (protocol, No. 6, *Ibid.*).

As regards personal taxes, each State is to continue to levy its tax on total income upon a person having in its territory his fiscal domicile—that is to say, his ordinary residence, understood in the sense of permanent abode. Air navigation enterprises, like shipping enterprises, are taxable only in the State in which the real centre of management is situated, provided the aircraft or ships possess the nationality or fly the flag of such State.

Although the Belgian system is composed of impersonal taxes and a superimposed personal tax, the treaty between that country and France does not affect personal taxes. Its provisions on impersonal taxes follow those in Convention I*c* of 1928, including the principle of taxing income from securities at fiscal domicile but permitting an allowance, within a certain percentage, against the tax payable at domicile in respect of the tax withheld at source in the other contracting State (Article 6, *Collection*, Vol. V, page 59).

The treaty between the United States of America and France, which was negotiated during the summer of 1930 though not signed until 1932, was intended primarily to limit the application of the French tax on income from securities in the case of American corporations with branches and subsidiaries in France to a territorial basis (in the case of a branch, to a presumed dividend equal to three-fourths of the profits of the branch, and in the case of a subsidiary, to dividends plus diverted profits received by the parent) in conformity with the basic principles of the draft Conventions of 1928. It also embodies the principle of reciprocal exemption of patent and copyright royalties, and exempts, in a reciprocal clause, profits attributable to the buying of goods in one country to supply establishments in the other.

Italy, in 1931, concluded an additional agreement with France primarily to modify the previous regime for taxing Italian companies with branches and subsidiaries in France (the basis for the French tax on income from securities being limited, in the former case, to the amount of profits earned by the branch, and, in the latter, to dividends distributed by the French subsidiary to the Italian parent company, plus any profit diverted from the French to the Italian company) (*Collection*, Vol. V, page 69).

The French treaties with Germany and Sweden do not distinguish between impersonal and personal taxes and follow the lines of draft Convention I*c*, except that income from securities may be taxed both at fiscal domicile and by withholding at source. The treaty with Switzerland is substantially similar and limits both personal and impersonal taxation by the State of fiscal domicile to income not expressly allocated for taxation at source (Article 12). (All the treaties subsequent to that with the United States of America contain special provisions for restricting the extraterritorial application of the French tax on income from securities similar to those in the additional agreement with Italy.)

In 1931, the triangle between France, Italy and Belgium was completed by a treaty between the last two, essentially similar to the Franco-Italian Convention. In a treaty the same year, between Belgium and Luxemburg, personal taxes and the taxation of income from securities are not mentioned.

Germany concluded agreements embodying typical clauses with Switzerland in 1931, Finland in 1935 and Roumania and the Netherlands in 1937. Similarly broad reciprocal regulations for relief from double taxation were promulgated by Germany and Poland in 1936. During the years between 1931 and 1938, other European States concluded Conventions resembling mostly Convention I*c* of 1928—namely, in 1931, Finland and Sweden ; in 1932, Austria and Poland, Denmark and Sweden, Hungary and Roumania ; in 1933, Roumania and Yugoslavia, Belgium and the Netherlands, the Netherlands and Sweden ; in 1936, Hungary and Sweden ; in 1937, Iceland and Sweden, Hungary and Roumania, Denmark and Finland ; in 1938, Italy and Roumania, Denmark and Germany, Belgium and Germany.

In 1939, agreements were concluded between Denmark and Iceland, and the United States of America entered the stage again by signing with Sweden a general agreement which follows essentially the form of Convention I*c* of 1928.

Hence, the predominant tendency has been toward the method of attributing most classes of income for taxation exclusively at source and exempting them at the fiscal domicile of the recipient, leaving only a few items, such as income from sales in the other contracting State through a *bona-fide* commission agent or broker, income from shipping and air navigation, patent and copyright royalties, and life annuities, for taxation exclusively at fiscal domicile.

Although the principle of taxing dividends and interest only at the fiscal domicile of the recipient is frequently recognised, the country of source may exercise a prior right to tax if it has a system of collection at source applicable to such income. In this case, some treaties prevent double taxation by granting a reduction in the tax payable at fiscal domicile on such income, which varies in extent, but others permit double taxation.

While exempting the various categories of income which by treaty are taxable at source in the other State, a number of States have reserved the right to apply to the income taxable at fiscal domicile in their territory the effective rate in their progressive scale of taxes which would have been applied to entire net income. Where the rate at source is as high or higher than that at fiscal domicile, such a provision is essentially equivalent to the provision in the treaty between Sweden and the United States of America, which, at least with regard to the latter country, incorporates the principle of the credit for foreign taxes in the United States Revenue Act.

General recognition of the prior right of the country of source to tax all income except that from sales through certain classes of agents (and income of Government employees, which is taxable only by the paying State) is found in the agreement of January 10th, 1939, between the Union of South Africa and Southern Rhodesia, which prevents double taxation of income taxable in both through a novel formula, which is a variation of the practice of dividing the relief to be given between the two States concerned adopted by Great Britain in its dominion income tax relief.

However, other conventions are in the process of being negotiated along the lines previously described.

ANNEX II

SYNOPTICAL TABLE OF THE GENERAL AGREEMENTS ON PREVENTION OF DOUBLE TAXATION IN CONNECTION WITH INCOME AND PROPERTY TAXES

Year	*Germany and*	*Italy and*	*France and*	*Other treaties*	*Year*
1921	Saar Czecho-Slovakia				1921
1922	Austria	Succession States	Saar	Austria-Czecho-Slovakia	1922
1923	Hungary			Czecho-Slovakia-Hungary	1923
1924		Czecho-Slovakia		Danzig-Poland Austria-Hungary	1924
1925	U.S.S.R. Italy	Germany Hungary		Czecho-Slovakia-Poland	1925
1926				United Kingdom-Irish Free State	1926 and 1928
1927				Denmark-Iceland Austria-Switzerland	1927
1928	Sweden			Hungary-Yugoslavia Austria-Netherlands Hungary-Poland	1928
1929				Austria-Liechtenstein Danzig-Poland	1929
1930		France	Italy		1930
1931	Switzerland Luxemburg	Belgium	Belgium	Belgium-Luxemburg Finland-Sweden	1931
1932			United States Tunis	Austria-Poland Denmark-Sweden Hungary-Roumania	1932
1933				Roumania-Yugoslavia Belgium-Netherlands	1933
1934	France		Germany		1934
1935	Finland			Netherlands-Sweden	1935
1936	Poland		Sweden	Czecho-Slovakia-Yugoslavia Hungary-Sweden	1936
1937	Roumania Netherlands		Switzerland	Iceland-Sweden Hungary-Roumania Denmark-Finland	1937
1938	Denmark Belgium	Roumania			1938
				Southern Rhodesia-Union of South Africa Denmark-Iceland United States-Sweden	1939

Abbreviations used[1]

E.F.S. 73.F. 19 : Report on Double Taxation, submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, 1923.

*F.*212 : Double Taxation and Fiscal Evasion—Report and Resolutions submitted by the Technical Experts to the Financial Committee of the League of Nations, 1925.

Collection: Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion, 6 volumes, 1928-1936.

Taxation: Taxation of Foreign and National Enterprises, 5 volumes, 1932-1933.

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[1] For detailed bibliography of League of Nations publications on double taxation and tax evasion, see cover pages.

Published previously:

Report presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion. (C.562.M.178.1928.II) (Ser. L.o.N. P. 1928.II.49)	1/6	$0.40
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Seventh Session. (October 11th-16th, 1937). (C.490.M.331.1937.II.A.) (Ser. L.o.N. P. 1937.II.A.18)	6d.	$0.15
Eighth Session. (October, 17th-20th, 1938). (C.384.M.229.1938.II.A.) (Ser. L.o.N. P. 1938.II.A.21)	6d.	$0.15
Ninth Session. (June, 12th-21st, 1939). (C.181. M.110.1939.II.A.) (Ser. L.o.N. P. 1939. II.A.13)	9d.	$0.20

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