LEAGUE OF NATIONS

ECONOMIC AND FINANCIAL COMMISSION

Report

ON

DOUBLE TAXATION

submitted to the Financial Committee

BY

PROFESSORS BRUINS, EINAUDI, SELIGMAN

AND SIR JOSIAH STAMP

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LEAGUE OF NATIONS

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Economic and Financial Commission

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INTRODUCTION


The Financial Committee of the League of Nations, which was entrusted with the study of double taxation, decided in September 1921 to ask certain economists to prepare a report on the matter. The following were accordingly invited:

Prof. Bruins (Commercial University, Rotterdam).
Prof. Senator Einaudi (Turin University).
Prof. Seligman (Columbia University, New York).
Sir Josiah Stamp, K.B.E. (London University).

The terms of reference given to these four experts were fixed in March 1922 by a Sub-Committee of the Financial Committee (Doc. E.F.S. 253. A. 152); they were as follows:

(1) What are the economic consequences of double taxation from the point of view:
   
   (a) of the equitable distribution of burdens;
   (b) of interference with economic intercourse and with the free flow of capital?

To what extent are these consequences similar in the different types of cases commonly described as double taxation?

(2) Can any general principles be formulated as the basis for an international convention to remove the evil consequences of double taxation, or should conventions be made between particular countries, limited to their own immediate requirements? In the latter alternative, can such particular conventions be so framed as to be capable ultimately of being embodied in a general convention?

(3) Are the principles of existing arrangements for avoiding double taxation, either between independent nations (e.g., the Rome Convention) or between the component portions of a federal State, capable of application to a new international convention?

(4) Can a remedy be found, or to what extent can a remedy be found, in an amendment of the taxation system of each individual country, independently of any international agreement?

(5) To what extent should the conventions on the subject of double taxation establish an international control to prevent fraudulent claims?

After an exchange of views by correspondence, the experts met in Geneva in March, 1923 and have drawn up the following report, which they beg to submit to the Financial Committee.

1 Professor Senator Einaudi was unable to be present at the meeting in Geneva, but he is in agreement with the views expressed in this document.
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ECONOMIC AND FINANCIAL COMMISSION

Report by the Experts

ON

DOUBLE TAXATION

PART I.

ECONOMIC CONSEQUENCES OF INTERNATIONAL DOUBLE TAXATION.

Two Classes of Economic Consequences.

The first question in the terms of reference is as follows:

What are the economic consequences of double taxation from the point of view:

(1) of the equitable distribution of burdens;
(2) of interference with economic intercourse and with the free flow of capital?

To what extent are these consequences similar in the different types of cases commonly described as double taxation?

This indicates that double taxation is regarded as having two fields of operation, in one of which the taxes may be described as burdens on existing economic rewards, and in the other as an interference with new or potential economic intercourse. It is not demonstrable how far these two fields may overlap or whether they must be mutually exclusive and exhaust the whole area of possibility. In our view, the distinction drawn is a sound one and it is fundamental. Double taxation will be either a burden or an interference, but there is very little overlapping, and nearly all actual cases can be assigned to one or the other category; whether a given tax falls into one or the other is largely determined by the time of first imposition of the tax in relation to the time when the capital is invested to which the burden applies. The economic consequences that flow from the two classes of cases are of a very widely different description.
Of course, the imposition of a new tax (or an increase in an old one), if it applies to some revenues or sources of income already in existence at that date and equally to all similar revenues or new sources of income which may come into existence after that date, will be found really to have consequences in the two fields of operation above described. But this does not invalidate the following arguments about the effect of the tax in those separate fields. It does, however, introduce important difficulties in the treatment of double taxation in practice, and it is for most administrations well-nigh impossible to maintain any relief differentiating for all future time between two sections of one class of wealth according to a date of "origin".

It may be well to give a brief description of the process of amortisation or capitalisation:

All capital goods possess a capital value which represents a capitalisation of their income value. The process through which income is transmuted into capital is expressed in the rate of interest. The equilibrium with which we have to deal here is the equilibrium between capital and income. Given a general rate of interest, any change in income values will tend to engender a change in capital values which will restore the equilibrium between the two on the old level. When the rate of interest itself changes, the equilibrium between income and capital values will be reached on a new level. The level is found in the rate of interest; the equilibrium is one between capital and income. Capital values will accordingly fall when, with an unchanged rate of interest, incomes decrease; or when, with an unchanged income, the rate of interest rises: vice versa, capital values will rise when the rate of interest falls, or when, with an unchanged rate of interest, income values increase. In so far as such changes in capital values are produced by taxes, we may speak of the capitalisation or amortisation of taxation.

This effect of a new tax is enhanced by inequality. Any inequality of taxation augments the disturbance of the economic equilibrium between the over-taxed and the under-taxed goods and under certain circumstances sets in motion forces which will establish a new equilibrium.

When a special tax is imposed on a particular class of commodities, it will, under certain conditions, fall entirely on the individual who owned the commodity before the tax was imposed; and the future purchaser, notwithstanding that he pays the tax every year, will be immune because the tax will be discounted or amortised through a depreciation of the capital value of the commodity by a sum equal to the capitalised value of the tax. The present owner of the under-taxed goods and the purchaser or future owner of the over-taxed goods will, through this tendency toward economic equilibrium, receive an equal net return on the new capital value of the goods in question. For otherwise there would be a shifting of demand from the over-taxed to the under-taxed goods which would soon re-establish an equilibrium. This process of capitalisation or amortisation may also be termed the absorption of taxation, because all the future taxes may be said to be absorbed into the lower selling price. We may therefore speak indistinguishably of the capitalisation, the amortisation, the discounting or the absorption of the tax.

Some economists emphasise more than others the general effects of capitalisation as applied to all taxes and not simply to special or unequal taxes. For the purpose of this memorandum, we regard any such change as a simple change in capital values and reserve the term "capitalisation" or "amortisation" for the phenomenon due to any inequality.

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1 These paragraphs are quoted or adapted closely from a forthcoming treatise on Public Finance by one of the authors of the present report.
The Broad Differences between the Two Classes.

The first point that emerges upon a careful consideration of the problem is that a difference exists in "economic consequences" when a new tax is imposed (or an existing tax is made much heavier) between the position of capital invested from abroad in the taxing country prior to the tax and that invested after the tax. We have arrived at the opinion that the conclusions expressed in the "Note on the Effect of Double Taxation" are incontrovertible within the sphere touched upon in that Note, i.e., the effect of double taxation upon the placing of new capital. The Note was evidently not a note upon the extent of the burden of double taxation nor the necessity for remedying it.

It may be advisable to recapitulate here a summary of its arguments.

In the illustrative terminology of the original Note, "Morania" was specified as the country of investment. This had the advantage of not raising (subconsciously) any prejudices or preconceptions which might cling round the use of an actual or specific country. The term "non-resident" investor indicates an investor outside Morania.

(1) Any non-resident investor placing his investment in Morania, knowing it will be subject to taxation there, throws back upon the borrower the burden of the Moranian tax primarily or apparently placed upon himself (the non-resident investor), and, as an investor, is not in this event subject to double taxation (paragraph 8 of the Note.)

(2) Taxation imposed in Morania on investments placed there by investors of other countries will act as an impediment to the movement of capital to Morania. The reason of this restriction of movement is that a marginal quantity of the (e.g.) British capital has by reason of the imposition of the Moranian tax (contracted with freedom from such taxation) been induced to seek other fields of investment (paragraph 12 of the Note).

(3) Any relief from double taxation given in order to encourage the movement abroad of capital which, in the absence of such relief, finds it unprofitable to move must be extended on practical grounds to all investments, whether old ones or new.

(4) Taxation imposed in the country of investment, after the date of investment, of a weight greater than that anticipated or provided for by the investor will impose double taxation in a true sense, from which the investor will find it difficult to escape owing to the effect of amortisation (paragraph 21 of the Note).

Certain conclusions follow logically from the arguments in that memorandum, which may be briefly stated as follows:

So far as concerns taxation in existence at the time when an investment is made, the "burden" of double taxation is a misnomer. It can only be rightly called a "burden" if a hindrance to free action is a "burden". As a matter of fact, it is rather a "barrier", and the appearance of double taxation is, in fact, for the most part negativized by the ordinary operation of economic forces. If, however, to be debarred from such an extensive or profitable operation as one might have had if the "barrier" did not exist is a "burden", then in this sense the barrier is a burden. But it is doubtful whether this is a very satisfactory use of terms; for in an analogous case, if an exporter, thinking that he would like to export goods to a country for the first time, finds on

1 The Note prepared for Sir Basil Blackett by an anonymous author was "circulated by him to the Economic and Financial Commission of the League" and has been published as League of Nations document N* E.F.S. 16a, A. 16a, dated May 31st, 1921.
enquiry that he is effectively "shut out" by a tariff, he would hardly describe that tariff as a
burden upon his exports when such exports do not exist. He might, however, rightly have done so
if, with an established trade, the tariffs were put on and if, with no increase of price in the importing
country, he then bore the duty. The more common tariff case, which, indeed, corresponds closely
to this taxation question is, where for many classes of goods he is excluded, but where with others
there is a sufficient rise in price in the importing country still to give him a satisfactory margin
of profit after paying the duty. So, in the case of double taxation, whatever investment exists
in the area when the barrier is put up suffers a burden; whatever investment thereafter from out-
side gets over the barrier escapes the burden. But much potential investment is kept back
altogether, and this part is "barred", not "burdened".

In some senses this case is only a particular illustration of a general theory relating to the
effects of taxes in general, including taxes on consumption. It is a truism of public finance
that a tax on consumption is not only a burden on those who consume but a barrier to those
who now no longer consume because they are dissuaded from consumption through the rise of
the price of the commodity in question due to the tax. So the burden and the barrier, in the
case of double taxation, are striking instances of this general doctrine.

The Outside Investors' Outlook.

It is clear that, when an investment has once been made and a new tax is imposed, the owner
of that investment at the moment of imposition must bear the full brunt of the burden, as the
yield of his investment is reduced by it; and if he tries to sell the investment the price that he
gets is similarly reduced in a world market on account of the burden. This unquestionably is a
burden in every sense of the word. In the case of a new investment being sought or invited
after the tax, the investor takes it into full consideration and does not make the investment
unless he can get a return at the general world rate. Broadly speaking, therefore, if any one
bears the tax or suffers the consequences of the tax burden, it is the country imposing it.

The position to non-resident investors would be somewhat as follows:

Having 100 units to invest on which is required a net yield of 6 per cent. (y), and knowing
that the gross yield will be subject to Moranian tax of 10 per cent., the non-resident investor will
calculate that this 10 per cent. tax will reduce his gross yield on the investment by \( \frac{2}{3} \) per cent.
\((x)\), and he will accordingly demand a gross yield of \( \frac{2}{3} \) per cent. If the non-resident's income
tax in his own country allows for Moranian taxes as an expense, his actual income will be:

<table>
<thead>
<tr>
<th>Gross yield</th>
<th>6.66 units ((y + x))</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less foreign tax 10%</td>
<td>.66 units ((x))</td>
</tr>
<tr>
<td>Actual income for non-resident's home taxation</td>
<td>6.0 units ((y))</td>
</tr>
</tbody>
</table>

In the British system, a deduction of foreign tax from foreign income is allowed as an expense,
as shown above. The United States provision is, however, for a deduction of the foreign tax from
the home tax (in case of its citizens), making a complete relief from double taxation entirely
at the cost of the investor's home exchequer. This will necessitate a modification of the above
figures, without, however, altering the practical conclusions. This illustration will make it clear that
the non-resident investor, by demanding 6.66 per cent. and getting it (for it is assumed that he will
not invest unless he does get it), has thrown back on the Moranian borrower the burden of
the .66 units Moranian taxation. Nominally the non-resident investor pays .66 units Moranian tax and his non-resident tax in addition, i.e., he suffers double taxation; in reality, he pays only his home or residence tax, for he has secured or protected himself against the Moranian tax by the additional yield required before he invested.

We feel, therefore, that it is undoubtedly true as a general principle that any de facto non-resident investor throws back (or will ultimately throw back) on the Moranian borrower the burden of income tax existing at the time of the investment, although that tax is primarily imposed on the non-resident lender.

At the same time, it must not be thought that the two comparatively distinct cases of barriers and burdens are entirely without influence upon each other. If the would-be investor in a foreign country's investments has been "trapped" on a previous occasion by taxes imposed after his investment has been made, or if he has seen others trapped, he will desire to take into account, when he makes a new investment, not merely the existing taxes i.e., the barriers, but also the possibility of a trap by future additional taxes; and to that extent he will amortise or insure against not merely existing taxes but the possibility of later ones. "Once caught, twice shy."

We believe the distinction drawn between the "burden" and the "barrier" has an important bearing on any practical measures which may be devised. It is quite one thing to say that no investors shall be penalised or "trapped" after they have made their investment, and quite another to say that there should be no tariff against the easy flow of invested capital, wherever it may be wanted. It may be that the practical conclusions arrived at (or remedies proposed) for both cases will prove to be the same, but it is not necessarily so, and should not be assumed so at the outset.

We have thus far spoken of the tax as a burden or a barrier for the investor. But it must not be forgotten that in the case of Morania, the country in which the investment is made, the tax cannot possibly be a barrier without proving to be a burden or, not to confuse the meaning we have attached to this term, an economic handicap to the Moranian inhabitant. That is to say, if Morania is a debtor country, making rapid strides in agriculture or industry as a result of the investment of foreign capital, the imposition of a Moranian tax on this foreign capital will tend to check the investment and thus, through the relative dearth of capital, to increase the Moranian rate of interest. The increase in the rate of interest will inevitably retard economic progress and will have complicated effects on the various classes of the community. On the one hand, a rise in the rate of interest will increase the cost of production in Morania and thus ultimately be an added charge on the consumer. Similarly, the higher rate of interest will tend to depreciate the capital value of all existing Moranian securities and thus be felt by all present owners.

This leads, however, to a slight consequential mitigation of the plain doctrine. In the ordinary case of capitalisation, as explained above, a new tax is a burden only upon the existing holder or old investor and not upon the new purchaser. In the case, however, of the Moranian tax just cited, it is possible that the increase of the general Moranian rate of interest will tend, in so far as there is a connection between interest and profits, also to augment to a certain extent the remuneration of the existing holders of Moranian shares of varying yield. And this will be especially true in the case where Morania is in a stage of rapid progress in continual need of foreign capital. The same, however, would not be true, at least during the lifetime of the securities, of the existing holder of Moranian bonds and shares whose rate of return is fixed.

From these considerations flow two consequences. In the first place, the evils of double taxation, which are ordinarily severe for old investors, while being only ostensible evils of double taxation in the case of new investors, may in the above instances have their fullest effect only in respect of a particular class of old Moranian investors, namely the bond-holders. For the old shareholders in Morania, whether Moranians or foreigners, may receive an offset or
compensation for the new taxation in their increased dividends. This may also apply to a
certain extent even to old business enterprises in general. In the second place, however, despite
this possible alleviation of the evils of real double taxation, the new Moranian tax imposes a
more than compensating burden on the great mass of the consumers — a burden which may
ultimately turn out to be far greater than appears at first blush. On the whole, a debtor
country in the peculiar circumstances of Morania ought therefore to be exceedingly chary of
levying such a new tax on foreign investments.

The Burden of Old Taxes and Recent Taxes considered.

It will be obvious from the foregoing that what we may call old taxes will not have an
equal claim with the new to relief from burdens, and that the older the tax the less of a true tax
it is as a general rule. For the property or investment is likely to have changed hands by
sale and the burden thus to have been amortised or, by general economic forces, acclimatised
to the holder, so that it has become less "burdensome." The claim to consideration of new
taxes recently imposed, or high rates of taxes recently imposed, is much more acute and real.

It is true that some writers allege that the doctrine of an old tax, like the land tax, being
no tax at all, as it has come down for many decades subject to purchase and sale and subject
to inheritance, is an unsound doctrine. They say: Suppose you repeal the tax, the existing
owner of the land is immediately benefited. Therefore the burden of the tax is upon him.
In the same way they deny the validity of the doctrine of capitalisation or amortisation leaving
the new holder free of the tax. It is said that, if the tax is repealed, the individual benefits
and therefore the incidence of the tax must be upon him. But this is obviously playing with
words. All that it really amounts to is an assertion that the incidence of the benefits of the repeal
of the tax is entirely upon holders at the time of the repeal; and the principle of amortisation
holds good with regard to that also, because all subsequent holders are compelled to buy "free"
of the special benefit, i.e., they do not get it. It is merely the converse case of amortisation,
and not the *reductio ad absurdum* of it.

Some Limitations to the Preceding Doctrine of the New Investor.

But as to this pure or extreme doctrine (that the investor throws back on the borrowing
country the burden of a tax imposed by that country on his investment) certain limiting con-
ditions must be considered. First, it must be asked whether the clear economic bargaining
of the new investor may not be offset by other economic factors, such as ignorance and inertness,
so that the investor does not make the precise catallactic calculation which we have assumed;
secondly, whether a new investment in an existing business may not sometimes contain an element
of compulsion which would tend to assimilate a new tax to an old tax; thirdly, whether the
doctrine, however true of free forms of investment, is equally true of investment in businesses
and in land; fourthly, in the case of taxes which are graduated, whether the degree or extent
of amortisation can actually be fixed, and if so, whether it extends to a large or important part
of the tax; fifthly, whether the doctrine is applicable to cases where the tax is smaller than
the difference between the rates of interest in the two countries; and, sixthly, what modifications
of the theory should be made because of fluidity of capital and conditions of supply.
(a) **Investors' ignorance.**

On the first point — the ignorance of the investor — it is clear that no practical propositions can be founded upon, or take advantage of, this factor. If the well-informed investor takes certain factors into consideration, it seems legitimate to assume that the "normal market" is made up of people with such information, especially in view of the wide publicity which gives "expert" advice over a considerable area of "foreign investment." It is true that the foreign country may succeed in getting a certain amount of money from a class of persons who are too ignorant or too lazy to know the full burdens to which their investment will be subjected. But to counterbalance this class, there will be another class who over-estimate the terrors of the unknown and who, by reason of their undue ignorance, do not put up the money they might otherwise have done and who thus, by limiting the supply, tend to drive up the price (yield) that the foreign borrower must pay. It is thought that these two classes of incorrectly informed people may tend to balance each other and that the result may not be far different from everybody acting upon precise arithmetical knowledge. The qualification to the general doctrine is therefore insignificant.

(b) **Investment in existing businesses.**

On the second point, we believe that complete and direct amortisation or absorption is only to be found in the case of new investments where the investor is quite free in his choice, as in the case of the *rentier* whose only end in view is the net revenue to be secured, and who, in making his choice, is led only by his calculations of net income and valuation of risk. The burden admittedly exists over the whole field of *old* investments made in a time of lower taxation. Even among the new investments, however, there is a class for which double taxation is not only a barrier but also a burden. A man is free to make an investment or not to make it, as he wishes, in the case of a wholly new enterprise to be started; but if a man has a going concern with a paramount need for new capital in order to preserve the old capital from extinction, he is not free in the same sense. His choice is either to let the business lose ground, to the disadvantage of his original capital in the business or to invest new capital in it, well knowing that the return upon it will, to a special extent, be taken away by taxation. So in this class of new investment there is an element of compulsion which must in many cases render double taxation a real burden. The man who feels compelled to follow up old capital with new in the same direction must be put to some extent in the same category as the man with the old investment.

(c) **Investments in land.**

The validity of the general principle may be thought to turn partly upon the fact that if the foreigner does not invest capital in Morania the relative scarcity of capital there will cause the rate of interest to rise to such a point that it will attract the foreigner and give him the yield he wants after deducting the tax. The question may be asked whether this is true of investments in land. The failure of the foreigner to invest in Moranian land would not ordinarily affect the price or the yield of the land which is there, irrespective of ownership. The selling price of the land would be a capitalisation of its present and prospective yield, and its yield would be unaffected. It is not necessary to consider the extreme cases where the change in the ownership would carry with it better methods of cultivation and a superior yield, or where the falling away of the foreign investor is so supremely important as to affect the price of land to an unlimited extent. The situation underlying the general objection in the case of land is, of
course, that, inasmuch as its annual value is settled on Ricardian principles in relation to a margin, it does not form part of the mobile world-supply like ordinarily invested capital.

It is thus suggested that investments in land are in a different category, because they are an investment in a marginal rent and, by economic teaching, questions of a margin are not affected by taxation.

There is, however, no reason whatever to suggest that a new investment in land abroad will be made on other conditions than a new investment in anything else abroad. The foreign investment in land is, in strict theory at least, a blend of investment in fixed-yield investment and in profit-making investment. In practical life the foreign investor in land is very largely only the latter, i.e., an investor in a profit-making concern, and the investment of capital in land will raise its commercial rent (interest), though not its Ricardian rent.

It is clear that in an undeveloped primitive country part of the tax must be thrown back on the Moranian borrower; and, whatever may be the state of development of the country of origin, unless the gross yield anticipated is sufficient to absorb the Moranian taxation, the foreign investor will not put his money into the venture. This must be a governing factor when considering any new investment abroad. The selling price of the land will indeed be a capitalisation of its present and prospective yield. But when the conditions affecting the capitalisation change, i.e., the rate of interest, then the "value" will be affected. One may not be able to alter the Ricardian rental point by a tax, but one can affect the rate at which it would be capitalised for purchase.

In connection with investments abroad in profit-making concerns "amortisation" is not a very apt term. In our general conception we regarded the tax as a permanent capital loss on the person owning at the time of the first imposition. But this does not happen with new investments. For investments in profit-making concerns to which, as pointed out above, investments in land must be assimilated, the real issue is whether the conditions as a whole in the country of origin are sufficient to give a yield large enough to absorb the "origin" tax and still leave enough to attract the foreign capital. If they are, then foreign capital will come; but if not, it will stay away. In the case of a profit-making investment, the tax is thus absorbed quâ expense of the business [except in the special case mentioned above under (b)], whereas, in the case of a fixed-yield investment, the tax is amortised quâ tax. If it can be so absorbed, the yield to the home and the foreign owner of Moranian land, assuming the land developed to a like stage by capital, may be the same and yet sufficient to attract and adequately to remunerate foreign capital on the net yield basis described. This, perhaps, is not the same thing as saying that the tax will be thrown back on the Moranian borrower. In the case of ordinary investments and securities, the burden still virtually rests upon Morania, because the lessened demand for Moranian securities, due to the abstention of the foreign investor, would decrease the market value of the Moranian securities; while, in the case of fixed investments like land, the influence of the abstention of the foreign investor upon the market value of the land would be less marked than in the case of wholly liquid securities. It is agreed, however, that on this point there will usually be a small difference of degree only, and that no practical utility is served by making a distinction in the case of land.

(d) Where the tax is a graduated one, how can it be amortised?

The question as to how a graduated tax in Morania to which non-resident investors are liable is amortised, where one investor would be liable at a high rate and another at a low rate, is one that raises many delicate and difficult problems, to which there is probably no final solution obtainable by analysis. Preliminary to judgment upon the issues here, one may attempt to settle the effect upon market price, in an ordinary internal market, of investments specially exempted from the graduated taxation if there were, say, two types of sellers and two types of buyers — both buyers and sellers being ordinary residents liable to a graduated tax — one seller suffering
a 10 per cent. rate of tax and another, grouping together in one simple expression the whole type of the higher class, suffering 45 per cent.; and also one buyer who has to contemplate a 10 per cent. rate after he has purchased, and another buyer a 45 per cent. rate. Any variations in the assumptions made as to buyers and sellers of these four classes or as to the capital they can put on the market would add to the intricacy of the problem.

All that one can urge is that in a complex market of many buyers and sellers, liable to diverse tax rates, there would be at least an amortisation of the highest common factor of the taxation borne by all those in the market. The ultimate price will give to some buyers a "consumers' rent," so to speak, because the tax to be borne by them is not completely amortised by the price paid, and will leave others just level or to some extent penalised. One imagines the amortisation to be probably the amount of tax which represents the centre of gravity of the demands of all the buyers in the market, the arithmetic average, so that with one rich person and a number of comparatively poor persons, the rate amortised would be closer to the minimum rate than if there were a number of rich persons and only a few moderately well off. But in so far as rich people in a market probably often benefit by a market price settled by people in different circumstances from themselves, these rich people secure a considerable consumers' rent on any particular purchase they make at the market price, so that it may be untrue to say that the rich people actually are induced to offer only such a price as will allow amortisation of their own rate of tax. They will probably offer a higher price than this would justify, and thus cut into their "consumers' rent." The matter is clearly not one susceptible of final analysis.

It is not merely upon the conditions of demand that we have to look, but also upon the controlling influence of the conditions of supply, for the degree of capitalisation will frequently stand in direct relation to the breadth and satiety of the market. In proportion, as the market becomes saturated, either because of an increase in the supply of securities or because of a falling-off in the demand by investment companies or individuals of varying degrees of opulence, the degree of capitalisation will diminish. For reasons of simplicity, this analysis will not be pursued, for obviously, if introduced, it becomes clear that the matter is still less susceptible of final analysis.

In the case of a graduated income tax consisting of a normal or base tax (with or without degression features) and a graduated surtax, we appear to be justified in stating that it would hardly be legitimate to regard the amortisation as coinciding with the level of the normal tax and ignoring the higher taxation. For the particular point in the scale at which the "normal" tax is the actual tax appropriate to the amount of income in question is more or less an accidental point, depending upon administrative machinery and the convenience of the country in question. It would lead to the rather doubtful conclusion that amortisation in the United States is limited to 8 per cent., that in the United Kingdom it is 25 per cent., and that in Germany it is non-existent, merely because the administrative method of securing graduation varies in these three countries.

Graduated taxation by the country of origin (Morania) does not, therefore, invalidate, even if in some circumstances it may modify, the general principle that the tax is thrown back on the borrowing country, so far as the placing of new investments is concerned.

The problem is not dissimilar from that arising in connection with the tax-exempt bonds of the United States. Issuers of such bonds will no doubt endeavour to fix the rate of interest offered at a point which will just attract the investor on the margin of the demand, and in normal circumstances that investor will tend to be one to whom the yield from the tax-exempt bond is just larger than the yield from a tax-liable bond. Every investor in tax-exempt bonds whose effective rate of tax per dollar of actual income is higher than the effective rate of the marginal investor will thus secure for himself a bonus in the yield of the tax-exempt bond. The suggestion that the holders of tax-exempt bonds in reality enjoy no exemption because they have to pay so much more for the bonds is, therefore, not a good one. That contention is true at the margin of investment, but not above it. Other investors, intra-marginal, get
"consumers' rents" on their investments, and the graduated taxation rearranges these and modifies their amount. It would hardly be credible that only an 8 per cent. normal tax is capitalised and that no part of the remainder all the way up to 58 per cent. is capitalised. The amount of the normal rate is only a point in a graduated scale at which it is convenient to pass from one kind of administrative method to another: it has no virtue in itself.

In the first place, this argument assumes that the 8 per cent. rate of the United States tax is a flat rate, whereas the effect of the personal and family deductions converts the flat rate into a graduated effective rate on each dollar of any individual's actual total income. If the argument as to impossibility of capitalisation of the graduated surtax is well founded, it is equally applicable in principle to the graduated effective rate of tax below the surtax point of liability. Precise analysis of the economic reactions would suggest that the point of capitalisation will lie somewhere between the lowest and the highest effective rates of income taxation per dollar of actual total income and that this point will be determined by the respective demands for, and supply of, tax-exempt securities. It might, of course, happen that in the United States, with the large amount of outstanding tax-exempt securities bought even by small investors, the point of capitalisation lies, in fact, very close to the 8 per cent. rate of tax, i.e., very close to the surtax exemption line; but, if the supply of securities were small, the point of capitalisation would undoubtedly lie very much above the surtax point of liability, and in that case much more than an effective rate of 8 per cent. would be amortised.

Where investments are made in Morania by a number of individuals whose respective total Moranian incomes make them liable to varying graduated effective rates of Moranian tax, the gross yield offered by the Moranian borrower will need to be sufficient to attract the marginal investor, who will tend, of course, to be the one whose graduated effective rate of Moranian tax is highest among the foreign lenders. In that event, the Moranian borrower will thus tend to have to pay a gross yield which is more than sufficient to take the burden of Moranian tax off the remaining investors. These remaining investors, whose respective total individual Moranian incomes must be less than the Moranian income of the marginal investor, will thus enjoy a bonus yield.

But this fact, far from invalidating the general principle that the investor throws back the tax to the Moranian borrower, confirms it. The distinctive difference between the case of the tax-exempt bonds and the case of investments in Morania, when Morania has a graduated tax, is that in the former case the bonus yield accrues to all investors above a certain limit of total income from all sources, while in the latter case the bonus yield accrues to all investors below a certain limit of total income exclusively Moranian.

More subtle considerations arise in dealing with the effect on the price of securities. Some foreign investments in Moranian securities may be of small amount, subject only to the normal tax, and others will be of large amounts subject to super-tax, only part of which may be amortised. The foreign investor, whether small or large, will not invest unless he finds it profitable to do so, and the point is how far the price of Moranian securities is affected by this fact and the real burden thrown on Morania.

The foregoing emphasises the difference between the effect, in general, of taxation and of exemption, of the broad principle of which this is a particular application. It has been put by one of the authors of this report in one of his books as follows:

"In all cases of a special graduated tax, a surplus benefit accrues to investors with a total income below a definite amount, which amount represents the point of marginal investment and therefore of capitalisation. In all cases of exemption from a graduated tax, a surplus benefit accrues to investors with a total income above a certain amount, which amount represents the point of marginal investment and therefore of capitalisation. If a special graduated tax ranging from 8% to 58% is imposed on a certain class of bonds, and
if the market conditions are such as to cause the price of the bonds to fall 20% because of
the tax, the bond-holder, who would otherwise be liable to a tax of 10% on his income, gains
10% on each dollar of bonds owned. On the other hand, if a certain class of bonds is exempt
from a general income tax or from a tax on all bonds which is graduated from 8% to 58%,
and if the market conditions are such that the bonds rise 20% in value because of the
exemption, the owner of the tax-exempt bonds, who would have been liable to a tax of 30%,
gains 10% on each dollar of bonds owned.

(c) Where the origin tax is smaller than the difference between the interest in two countries.

If the general level of return on investment in a new country A, say Morania, is far above the
general world rate, what would be the result, supposing the general world-rate return on invest-
ment of a certain kind is 8%? If the return on such investment in Morania is 10%, and if Morania
imposes an income tax of 10%, a non-resident citizen may still be tempted to invest in Morania,
where he will get 9% instead of 8% at home. It is not quite right to say that the tax imposed
by Morania is no burden upon the non-resident citizen of B, for it reduces a potential 10% to
9%, a rate which is still sufficiently high to make the non-resident invest in Morania instead
of anywhere else. In other words, as long as the discrepancy in the rate of investment in Morania,
as compared with the outside rates, is sufficiently great to attract investments because it covers
the tax, the burden will be borne by the investor and not thrown back upon Morania.

This criticism is, within the theoretical limits, valid, but the margin between the outside
rate and the Moranian rate must be a margin of real interest and not a premium for risk or
ignorance or a narrower marketability or any other economic return. The margin must be
real and not due to any risk. If it is real, then the larger it is, the more quickly it will tend
to vanish owing to the influx of new capital; and the smaller it is, the less likely is it to cover
completely the postulated new tax. Clearly, the reduction of the rate to 9% will slow down
the flow of the capital from abroad and delay the day when Morania enjoys the advantages
of foreign capital at the lowest rate. The day, therefore, when Morania must bear the burden
of its own tax according to the general principle is merely postponed if the tax is a light one,
and the apparent exception is due only to the fact that it takes time for the principle to
prevail.

(f) Limitations due to fluidity of capital and effects of supply on market conditions.

Under certain conditions the general principle may be defeated by special circumstances
relating to the fluidity or the supply of capital. For example, it has been shown in the United
States that the capitalisation due to the imposition of a special mortgage tax drove up the rate
of interest in such States as New York and California, where there was a great fluidity of capi-
tal and a proximity of lending centres like New York City and San Francisco, by the amount
of the tax and in fact by something in addition, representing an insurance premium against
the chance of the mortgage being put on the assessment list. But such a result was not
observable in a State like Wisconsin. In other words, while the general principle is incon-
trovertibly true, there may be exceptions due to abnormal conditions connected with fluidity
of capital and amount of available investment, which at times may be of practical im-
portance. But we do not lay any great stress upon this in setting out the main principle.

Summary of the foregoing. It is agreed:

1. That in most cases the imposition of a new or higher tax penalises the existing non-
resident investor.
2. That, subject to certain limitations, it prevents non-residents from making a new investment unless the terms offered by the borrowing country are such as really to throw back the burden of the tax upon the taxing country.

Imperfection in Amortisation Unimportant.

The second principle is not destroyed even though the effective rate of taxation is confined to the normal rate. If the taxing country succeeds in imposing only, say, a normal rate and not a supertax, it will generally happen that the normal rate itself is a sufficient barrier for these conclusions to be true. If a fence is erected of a certain height adequate to keep a person out, even with a substantial addition to its height it still does no more than keep that person out. Therefore, if the normal advantages offered by a country to a foreign investor are not great enough to compensate for the normal tax in the country of investment, it is quite academic to discuss how far the non-resident investor takes into consideration the graduation of the tax beyond the normal figure. It may be accepted that the exclusive effect will be identical.

Going back, however, to the first point, viz., the effect of the imposition of a tax upon existing holders, it has been assumed that the existing holder will be "hit." For if he retains the investment he will derive an income reduced below that which he anticipated, and if he attempts to part with the investment he will at once bear the capitalised loss. This doctrine, however, assumes that the person who buys it from him would be subject to a like disability, and that in buying himself free from it he thrusts the burden back upon the vendor or first holder at the time of imposition.

This will be true in the case where the tax that has been imposed is a differential tax upon this particular class of income, but it will not hold good to an equal extent if the tax in question is a part of a general income tax.

It may be accepted as a general doctrine that, while a special tax upon a specific source of income will depress pro tanto the capital market value of the properties or securities yielding that income, a general income tax on all sources of income alike has, at most, a more uncertain effect upon general security values. (As has been previously stated, economists differ as to the probable extent of this kind of change in capital values.) A foreign investor, therefore, in Morania, after Morania has put on an additional income tax, is suffering the burden of double taxation and finds his income reduced. Any other person outside Morania who buys that investment from him would be similarly burdened, and will therefore offer a lower price to buy himself free from the burden. But a resident in Morania can buy the investment from the foreign investor and not be subject to double taxation. He will therefore have no extra burden to capitalise, and will not have to offer a price very much below the price existing prior to the imposition of the extra burden. He will give the current price for securities bearing a single Moranian tax. In short, the doctrine of the capitalised burden upon the holder at the time of imposition is true only for sale to another non-resident investor, and is not true if the foreign investor sells to a resident in Morania. Thus the foreign investor is "pinched" by an unprofitable investment, but he finds a way of getting his original money back by sale in the Moranian market.

Hence, double taxation sets up, first, a tendency for new investment to be restricted to capital available within the borders of the country itself. It acts like a tariff for concentrating manufacture within the country and restricting international intercourse. It sets up a tendency for old investments to change ownership from foreigners to Moranian investors and to make the country still more self-contained. In throwing the body of foreign-held securities upon the Moranian market, it doubtless tends to depress capital values (i.e., to increase the rate of interest.
in Morania to a point where the non-resident investor would sacrifice in the reduced sale price the whole of the possible advantages he gets in escaping his double taxation by sale).

The foregoing is a special application of a general theory and deals with only one phase of general economic consequences of taxation or exemption. When we are dealing with general economic consequences of any change in values, the field becomes almost limitless and there is no recognised stopping place. It is like the discussion of the effects of a special tax on dwellings. One may consider, first, the consequences to the tenant as opposed to the owner; but it is also possible to consider further consequences where the tenant is a producer of commodities which are sold to middlemen before reaching the consumer. The economic consequences might be stated almost *ad infinitum* so far as the effect on commodities, distribution of wealth in general, consumption and national prosperity are concerned.

We have in this memorandum carried the argument to the stage indicated only because it is completely relevant to the main question of our enquiry: Which exchequer ought to bear the burden of paying for any relief given for double taxation? It has no other interest than its bearing upon this question.
PART II.

GENERAL PRINCIPLES WHICH GOVERN INTERNATIONAL COMPETENCE IN TAXATION.

SECTION I.

GENERAL OBSERVATIONS.

A. THE BASIS OF TAXATION.

The Principle of Ability to Pay.

The older theory of taxation was the exchange theory, which was related directly to the philosophical basis of society in the "social contract," according to which the reason and measure of taxation are in accordance with the principles of an exchange as between the government and the individual. This took two forms: the cost theory and the benefit theory. The cost theory was that taxes ought to be paid in accordance with the cost of the service performed by the Government. The benefit theory was that taxes ought to be paid in accordance with the particular benefits conferred upon the individual. Neither the cost nor the benefit theory was able to avoid or to solve the problem of international double taxation. For the services conferred by a given government affect not only the person of the taxpayer resident within that government's area (his personal safety, health and welfare) but also the property that he possesses within the limits of that area (not, of course, the property outside it), the services by which that property benefits being its physical defence from spoliation, its protection from various kinds of physical deterioration and the maintenance of a system of legal rights surrounding it. Where the property was in one State and the person in another State, the complications were obvious. There was, moreover, no satisfactory method of apportioning either the cost or the benefit.

There is, however, no need to enter into the details of these methods, as the entire exchange theory has been supplanted in modern times by the faculty theory or theory of ability to pay. This theory is more comprehensive than the preceding theory, because it includes what there is of value in the benefit theory. So far as the benefits connected with the acquisition of wealth increase individual faculty, they constitute an element not to be neglected. The same is true of the benefits connected with the consumption side of faculty, where there is room even for a consideration of the cost to the government in providing a proper environment which renders the consumption of wealth possible or agreeable. The faculty theory is the more comprehensive theory.

The objection may be made that faculty does not attach to things, and that many taxes are imposed upon things or objects. This is true of the so-called real or impersonal taxes as opposed to personal taxes. This distinction, however, must not prevent the recognition of the fact that all taxes are ultimately paid by persons. So-called real or impersonal taxes — taxes in rem, as
the English-speaking countries term them — which are often chosen for reasons of administrative convenience, are ultimately defrayed by persons and, through the process of economic adjustment, ultimately affect the economic situation of the individual.

When we deal with the question of personality, we are confronted by the original idea of personal political allegiance or nationality. It is first of all necessary to consider briefly the issues that arise upon political allegiance. A citizen of a country living abroad is frequently held responsible to his own country, though he may have no other ties than that of citizenship there. His is a political fealty which may involve political duties and may also confer political rights. It may well be that the political rights are such as to imply a political obligation or duty to pay taxes.

In modern times, however, the force of political allegiance has been considerably weakened. The political ties of a non-resident to the mother-country may often be merely nominal. His life may be spent abroad, and his real interests may be indissolubly bound up with his new home, while his loyalty to the old country may have almost completely disappeared. In many cases, indeed, the new home will also become the place of a new political allegiance. But it is well known that in some countries the political bond cannot be dissolved even by permanent emigration; while it frequently happens that the immigrant has no desire to ally himself politically with what is socially and commercially his real home. In the modern age of the international migration of persons as well as of capital, political allegiance no longer forms an adequate test of individual fiscal obligation. It is fast breaking down in practice, and it is clearly insufficient in theory.

A second possible principle which may be followed is that of mere temporary residence; everyone who happens to be in the town or State may be taxable there. This, however, is also inadequate. If a traveller chances to spend a week in a town when the tax collector comes around, there is no good reason why he should be assessed on his entire wealth by this particular town; the relations between him and the government are too slight. Moreover, as he goes from place to place, he may be taxable in each place or in none. Temporary residence is plainly inadmissible as a test.

A third possible principle is that of domicile or permanent residence. This is a more defensible basis, and has many arguments in its favour. It is obviously getting further away from the idea of mere political allegiance and closer to that of economic obligation. Those who are permanently or habitually resident in a place ought undoubtedly to contribute to its expenses. But the principle is not completely satisfactory. For, in the first place, a large part of the property in the town may be owned by outsiders: if the government were to depend only on the permanent residents, it might have an insufficient revenue even for the mere protection of property. In the second place, most of the revenues of the resident population may be derived from outside sources, as from business conducted in other States: in this case, the home government would be gaining at the expense of its neighbour. Thirdly, property-owners like the absentee landlords of Ireland or the stockholders of railways in the western States of America cannot be declared devoid of all obligations to the place whence their profits are derived. Domicile, it is obvious, cannot be the exclusive consideration.

A fourth possible principle is that of the location of the wealth. This again is undoubtedly to a certain extent legitimate. For a man who owns property has always been considered to have such a close relation with the government of the town or country where his property is situated as to be under a clear obligation to support it.

While the principle of location or situs seemed to be adequate as long as we were dealing with the older taxes on property owned by the living or passing on death, the term became inadequate under the more modern systems of the taxation of income or earnings. It has become customary, therefore, to speak of the principle of location in the case of property, and the principle of origin in the case of income. Further consideration makes us realise that these two principles
are not exactly coterminous; because, even though the income may be earned in a certain place, after it has been earned it becomes property, and is therefore susceptible of a different situs. Tangible, corporeal property is more difficult of movement, and in some cases, when it consists of immovables, cannot be moved at all; but certain forms of incorporeal property can be easily moved. The legal writers and the courts attempt to surmount certain of the resulting difficulties by distinguishing between the actual and the constructive location of property. We thus have the possibility of income originating in country A by trading within that country or physically arising from crops, property, etc. in that country, being actually found, so far as it consists, for instance, of securities, in a strong box in country B; so that in one sense the property, or the rights to it, may be said to exist in country B. It may, however, well be that the whole apparatus for producing the income that is non-physical, namely; the brains and control and direction, without which the physical adjuncts would be sterile and ineffective, are in country C; and therefore it may be said in another sense that the origin of the income is where the intellectual element among the assets is to be found. Finally, it may be said that the location of the property is in country D, where the owner of the property has his residence. There is thus a possible difference between the theory of origin and the theory of location, if one examines the legal view of the matter.

Apart from these considerations, however, and chiefly for reasons which are just the reverse of those mentioned in the preceding case, the location or origin of the wealth cannot be the only test. Permanent residents owe some duty to the place where they live, even if their property is situated or their income derived elsewhere.

Practically, therefore, apart from the question of nationality, which still plays a minor rôle, the choice lies between the principle of domicile and that of location or origin. Taking the field of taxation as a whole, the reason why tax authorities waver between these two principles is that each may be considered as a part of the still broader principle of economic interest or economic allegiance, as against the original doctrine of political allegiance. A part of the total sum paid according to the ability of a person ought to reach the competing authorities according to his 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. The individual has certain economic interests in the place of his permanent residence or domicile, as well as in the place or places where his property is situated or from which his income is derived. If he makes money in one place he generally spends it in another.

The Doctrine of Economic Allegiance.

The starting-point of the modern theory must therefore be the doctrine of economic allegiance. In the most complex communities, with more fully developed taxation expedients, this doctrine is given quantitative expression by reference to terms of economic faculty or ability of the individual to pay. That is to say, the taxes, though measured by things, eventually fall upon persons and ought to fall upon them in the aggregate according to the total resources of the individual, leading to progressively larger sums being paid by the people who are richer. The point is that when the money has left the pocket of the individual, its destination is not a single one but is due to all those governments to whom the individual owes economic allegiance. How, then, should the sum that he finally pays reach these several governments which render him service? The problem consists in ascertaining where the true economic interests of the individual are found. It is only after an analysis of the constituent elements of this economic allegiance that we shall be able to determine where a person ought to be taxed or how the division ought to be made as between the various sovereignties that impose the tax.
The problem of the ideal division of the tax is a little different from that of the actual remission of the tax.

There may be a conflict between the fiscal principle arrived at on purely theoretical grounds and the desirable financial or economic expedients, having regard to the state of the national budget in each country. In other words, what ought to be done may be quite clear; but what it may be practically possible for a Government to give up in the way of revenue in the light of its historical development may be quite another thing. In what follows we shall limit ourselves to the principles which ought to govern the ideal fiscal allocation of the tax.

The doctrine of economic allegiance, based on the faculty of the individual or his ability to pay, has now come to be widely accepted in connection with the ordinary taxes on property and income. But in the case of the so-called death duties, this conclusion is still only partially accepted, even in modern legislation. It is, however, in our opinion, entirely susceptible of proof that the doctrine of economic allegiance applies no less to death duties than to the income tax or the property tax.

The payment of a tax on the occasion of succession to property on death is of considerable antiquity and has assumed many forms. In former times it took the shape primarily of fees for the probate of wills. More recently it has developed into a series of taxes known by various names but including three chief forms: the tax on the property as a whole, sometimes called the estate duty or estate tax; the tax on the share going to the recipient, sometimes called the legacy duty or direct inheritance tax; and, thirdly, the tax on the recipient, graded according to the relationship, sometimes called the collateral inheritance tax.

In former times the inheritance tax or succession duty — using this generic term to cover all the various forms of the tax — was defended on the exchange principle, sometimes as a charge made by the government to defray the cost of the probate of the will, sometimes as a charge made by the government in return for the benefits conferred upon the individual through the privilege of succession. This early stage in the philosophy of the tax still lingers in some countries, especially where the legal conception prevails of the tax as a payment for the privilege of succession. In other countries where it has been customary to impose a tax on the transfer of wealth inter vivos, it was an easy step to justify the inheritance tax as a similar tax on the transfer of wealth, but in this case on the transfer from the decedent to a living person, whether his heir or successor. In all these instances, the principle of nationality or political allegiance also played a considerable rôle.

With the development of modern economic life, and especially with the greatly increased importance attached to the inheritance tax or death duties, the philosophical ground has been shifted. As in the case of other taxes, not only have political considerations given way to those of an economic nature, but the exchange theory — whether in the shape of the cost theory or the benefit theory — has been supplanted by the more modern doctrine of faculty or ability to pay. The controlling principle of the inheritance tax is therefore nowadays recognised to be that of economic allegiance, precisely as in the case of the so-called property tax or the income tax.

In the case of the estate duty, the force of economic allegiance is quite obvious. If people are to pay taxes in accordance with their ability to pay, it is open to any government to choose the time at which to measure this ability. The government may seize the elements of ability while the wealth is being created and levy an income tax; it may take the ability as found in the wealth when the yield has come to fruition and impose a property tax; it may take the wealth when it is in process of being disposed of and attempt to reach the ability by a graduated consumption tax on luxuries; or, finally, it may choose not some particular stage in the lifetime of the owner, but the period of his death, and measure the ability at that particular moment. Where, therefore, we have a tax on the inheritance as a whole, or the so-called estate duty, we are clearly no less in the presence of the doctrine of economic allegiance than in the case of an income tax or a property tax. This is especially true in so far as the tax may be regarded as a
deferred additional income tax, collected at a time which has conspicuous advantages in mitigating its burdensome character or perhaps even promoting rather than retarding the accumulation of capital.

The situation is a little less obvious in the case of a tax on the share going to the beneficiary. Here it may be said that the tax can be defended on the faculty theory, by considering the receipt of the share as an evidence of the special faculty of the individual. The general ability of the individual recipient is measured by his income; but income tax laws uniformly refrain from taxing the inheritance as income. None the less, as the share of the inheritance indubitably increases the ability of the individual recipient, it should be considered in the light of something akin to special faculty, measurable upon the individual at his residence.

But this is only the smaller aspect. It is absorbed in larger considerations. For, while it is possible to look upon a given amount of wealth at a man’s death either retrospectively or in anticipation — that is, either backward or forward — on the whole the retrospective view is dominant. The annual faculty attaching to the past income, the privilege of amassing and the privilege of settling by will, all cling round the person deceased and his place of residence; the distant residences and circumstances of ultimate beneficiaries have no influence upon the retrospective view. Graduation of the tax upon the amount of the inheritance is only a rudimentary concession to the faculty of the recipient. We have not reached that stage of thought which would impose a higher inheritance tax upon an individual simply because he was in other respects wealthier. If we levy a graduated or progressive inheritance tax, we grade the tax according to the amount of the inheritance and not according to the wealth of the recipient. Since, therefore, economic allegiance in this case is so closely associated with the inheritance as such, the conclusion follows that it is the domicile or residence of the decedent and not of the recipient that is to be considered as of paramount importance.

When we come to the question of the collateral inheritance tax, the problem of economic allegiance arises in a slightly different form. One of the essential elements in faculty or ability to pay is the sacrifice involved. The principle of equal sacrifice has been made by some authors the very corner-stone of the entire doctrine. It is obvious, however, that the more remote the relationship of the heir or beneficiary, the smaller is the degree of expectation which he might have had of succeeding to the estate, and the smaller consequently would be the sacrifice undergone by him in giving up a share of the estate. In order to render the sacrifice somewhat more equal, it is therefore necessary to increase the tax in proportion to the remoteness of the relationship. This is everywhere an accepted principle of modern death duties.

We see, then, that the principle of economic allegiance applies to the inheritance tax no less than to the income tax and the property tax.

B. The Elements of Economic Allegiance.

The Four Elements of Economic Allegiance.

On the assumption, therefore, that economic allegiance is the basis upon which the total tax paid by the individual should reach the competing authorities, we have to ask what is the true meaning of economic allegiance and what are the ways in which it can be subdivided. In what ways and to what extent can a man be served by two or more governments that he should owe them any duty?

In the attempt to discover the true meaning of economic allegiance, it is clear that there are three fundamental considerations: that of (1) production of wealth; that of (2) possession of wealth;
that of (3) disposition of wealth. We have to ask where the wealth is really produced, i.e., where does it really come into existence; where is it owned; and, finally, where is it disposed of?

By production of wealth we mean all the stages which are involved up to the point of the wealth coming to fruition, that is, all the stages up to the point when the physical production has reached a complete economic destination and can be acquired as wealth. The oranges upon the trees in California are not acquired wealth until they are picked, and not even at that stage until they are packed, and not even at that stage until they are transported to the place where demand exists and until they are put where the consumer can use them. These stages, up to the point where wealth reaches fruition, may be shared in by different territorial authorities. By disposition of wealth we mean the stage when the wealth has reached its final owner, who is entitled to use it in whatever way he chooses. He can consume it or waste it, or re-invest it; but the exercise of his will to do any of these things resides with him and there his ability to pay taxes is apparent. By possession of wealth we refer to the fact that between the actual fruition of production into wealth and the disposing of it in consumption there is a whole range of functions relating to establishing the title to the wealth and preserving it. These are largely related to the legal framework of society under which a man can reasonably expect to make his own what has been brought into existence. A country of stable government and laws which will render him those services without which he could not enter into the third stage of consumption with confidence is a country to which he owes some economic allegiance. The question thus arises as to the place where these property rights are enforceable. Mere possession without the privilege of enforcing the rights to the property is of very little economic importance.

The three considerations of weight in economic allegiance thus really become four, namely, the acquisition of wealth, the location of wealth, the enforceability of the rights to wealth and the consumption of wealth. Corresponding to these four considerations would be the four points which become of significance in considering the proper place of taxation. The principle of acquisition corresponds to the place of (1) origin of the wealth; the principle of location to that of (2) the situs of the wealth; the principle of legal rights to the place of (3) enforcement of the rights to wealth; the principle of consumption or appropriation or disposition to the place of (4) residence or domicile.

It is not pretended that every function falls easily into one of these four classes. For example, a manager of an estate in Java may be said to be the directing brain living in Java, and some of the legal rights relating to that estate may be enforceable in Java; on the other hand, the final control and direction may be in the hands of directors in Amsterdam; finally, the actual recipient of a part of the profits may be a shareholder in London. It is not easy in the last analysis to decide whether the production or origin stage can be said to end in Java or whether the brains in Amsterdam are not an essential part of all the operations concerned in production. Moreover, before the London shareholder can get hold of the wealth, two sets of legal rights may have to be exercised: first, those relating to incorporation of the company in Amsterdam; and, secondly, those relating to the ownership by the company of the property in Java. The analysis is therefore not in any sense final.

Origin or Situs.

In addition to the above, we may touch upon some further complications. When we are speaking of the origin of the wealth, we refer naturally to the place where the wealth is produced, that is, to the community the economic life of which makes possible the yield or the acquisition of the wealth. This yield or acquisition is due, however, not only to the particular thing but to the human relations which may help in creating the yield. The human agency may be:
(1) The superintendent or management of the labour and organisation at the situs, e.g., the local manager of a tea plantation;

(2) The agencies for transport over sea or land touching various territorial jurisdictions, which assist in bringing worthless objects to points at which they begin to be near their market;

(3) The seat and residence of the controlling power that decides the whole policy upon which finally depends the question whether the production of the wealth will ever be a profitable production or not. It chooses the local management, decides the character of the expenditure of capital and the times and methods of cultivation, decides the markets that are to be utilised and the methods of sale and, in short, acts as the co-ordinating brain of the whole enterprise;

(4) The selling end, that is, the place where the agents for selling ply their calling and where the actual markets are to be found.

It may be said that no one of these four elements can be omitted without ruining the efforts of the other three and spoiling the whole apparatus for the production of wealth. These have no relation whatever to the place where the final owner enjoys his income from the labours of the four elements. The four of them are thus in different measures related to the origin of the wealth, that is, its production as a physical product.

The origin of the wealth therefore may have to be considered in the light of the original physical appearance of the wealth, its subsequent physical adaptations, its transport, its direction and its sale.

Another warning may be given as to the real meaning of (1) origin and its relation to (2) situs. In order to explain this, it is necessary to recall the familiar distinction between taxes on income and taxes on capital wealth. The contrast is usually drawn between income taxes and property taxes. By the former are meant taxes on the wealth as it arises with the characteristics of a flow; by the latter are meant taxes on the embodiment of wealth as a fund or a thing. The economic distinction is, of course, that between income and capital, wealth as a flow being income, wealth as a fund being capital. Popularly, however, income taxes are contrasted with property taxes — a really indefensible nomenclature, for a man can own or have property in income from a thing as well as in the thing itself. The newer term of capital levy as opposed to income duty is really preferable. But as the older custom is so ingrained, we shall here continue to speak of property taxes as opposed to income taxes, and we shall include under the term property taxes not only taxes on the mass of wealth but taxes on various kinds of property, like land or movables; and, again, not only taxes on property in the hands of the living, but also taxes on property passing by death.

In the case of income taxes, we properly speak of the principle of origin and refer to the origin of the income or the place where the earnings are created. In the case of property taxes, however, we should more properly speak of economic location — the place where the property is economically to be found, i.e., the place where are to be found the successive instalments of earnings which are capitalised into the fund of wealth that we call capital or, more popularly, property. The true economic location is to be distinguished from the physical location, usually termed situs. Frequently, of course, these coincide. But in the case of many classes of wealth the temporary situs may be quite distinct from the true economic location. A vessel plying between two ports may at a given time be in a dry dock remote from both; a bond or mortgage on a piece of real estate may be kept in a deposit box distinct from the location of the land or from the home of the owner. Physical situs is one thing; origin or economic location is
quite another thing: they do not necessarily coincide. Physical situs is of importance in economic allegiance only to the extent that it reinforces economic location.

Residence and Domicile.

In addition to the above points as to the real meaning of origin and the connection between economic location and physical situs, somewhat similar observations are to be made in connection with the concept of residence or domicile. It is clear that by residence in this sense we mean not mere temporary residence but permanent residence, or what in some countries is called habitual residence. This, however, is not necessarily the same thing as domicile. Domicile, in English-speaking countries, is an inference from the facts, supplemented by the intention of the taxpayer. A man’s domicile is usually the place where he chooses to exercise his political rights, such as voting, and where he is summoned to discharge political obligations, like jury service. A change of domicile is a serious matter and has ordinarily to be inferred from all the surrounding facts. In French law, however, a distinction is made between legal and actual domicile, the legal domicile being the result of a legally authenticated change that is requested by the individual. The actual domicile in France, like the Wohnsitz in German law, denotes the principal or habitual residence. The domicile may be in one State according to one legal system and in a different State according to the other legal system, so that the taxpayer would be subject to simultaneous taxation in both States. Moreover, it is even possible, in some of the continental countries of Europe, to have one’s domicile in more than one place. It is clear, therefore, that, in order to avoid double taxation, domicile or habitual residence must everywhere be interpreted alike for the purposes of taxation. One of the very first points preliminary to making international conventions or agreements on double taxation is to define the terms so that there will be no possibility of misinterpretation. We should like to make the suggestion that the Legal Section of the League of Nations consider this matter and prepare a memorandum on the present use of the term “domicile” and on a possible approach to some international agreement on this subject. In this memorandum, however, we shall use the term “domicile” in the sense of permanent or habitual residence.

Passing over these considerations, it may be said that there are four main questions which have to be asked when the question of economic obligation is under consideration. They are broadly:

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?

It is obvious from this discussion that the most important factors in the situation are (1) and (4), that is, the origin of the wealth and the residence or domicile of the owner who consumes the wealth. Most of the discussion on double taxation has centred around these two points of origin and residence. It is clear, however, that the other two factors may sometimes become of importance, although in most cases they are significant only in reinforcing the claims of either origin or domicile.

It is important therefore to keep continually in mind the exact meaning of each of the four factors in economic allegiance, and in every particular case to attempt to estimate the relative weight to be attached to each of them. Upon the decision as to the relative importance of these
four factors depends the entire question of taxation and remission. Where all four factors are in agreement, no difficulty can arise; where they are in disagreement a choice must be made between them or a compromise must be adopted. If the first three principles are of overwhelming importance as compared with the fourth, i.e., if situs and the place of enforcement re-enforce the place of origin to such an extent as to make it far more important than domicile, the presumption is clearly in favour of the composite principle of origin being predominant.

Economic Allegiance and Income.

The relevance of the foregoing to different classes of taxation.

So far as taxes on earnings, yield or income are concerned, it is easy to discern at the present time a rough classification of countries into three categories:

(1) Those whose fiscal system is not developed beyond a stage of separate taxes upon things and different objects of wealth (such as France and Belgium before the war, with their impôts réels, and the German States, with their Ertragssteuern);

(2) Those that have a system of taxes upon separate kinds of wealth, which amounts in the aggregate, roughly, to a kind of tax upon total income, and are often supplemented by an actual tax upon total wealth (e.g., in France and in Italy under the law of 1919, designed to take effect in 1923 but now indefinitely postponed);

(3) Those countries which have a pure income tax upon total annual resources as one of the main sources of revenue, such, for example, as the United States, Germany, Great Britain and Holland (the scheduled system in Great Britain being merely administrative machinery towards a pure graduated tax, the schedules themselves having no separate validity or existence except as a part of the whole).

It is clear that countries with three different points of view will have a divergent outlook upon first principles.

It will be obvious that, in the case of the income tax, if our ideal of taxation is the tax on pure income, there is no such thing as the taxation of the separate stages until we have ascertained whether the whole sequence of operations has ended in a profit, and, if so, how much; and then we must go back and allocate that profit over all the different operations in the countries in which they may have taken place. In practice, such an allocation may be said almost to baffle analysis. It may well be that productive operations up to a certain point have been well and profitably conducted and that the whole of the excellent results to this point are thrown away by bad selling. Are, then, the countries that shared in the profitable stages of the operation to receive nothing? It may well be that the precise amount of profit to be allocated to particular countries is never finally determinable when we have such complex operations as the raising of produce, its transport to countries where it is sold and the direction of the whole of these operations from another country, with a set of legal apparatus in every one of these countries which is indispensable to the whole sequence. In so far, therefore, as the problem of taxation is a problem of taxing income, it may well be that the determination of these different classes of economic allegiance is not merely exceedingly difficult in practice but not always exactly determinable in economic theory.

If, however, the ideas of taxation are not so advanced as to have an all-inclusive conception of income, then different considerations arise. Countries of origin, such as tropical and agricultural countries, see only the beginnings of production; recipients of the final wealth live abroad. Are
such countries to be at the mercy of every kind of legal conception of income and income taxation in all these different countries with which they have relations before they know what their taxation is to be? They would say at once: “We must take for granted the existence of the economic and legal apparatus for the rest of the world; we know what the value of the produce is when it leaves our shores in the light of the world economic organisation. All that we can do is to measure the taxation due to us from the person who takes that away by reference to that value.” We get back, therefore, to the tax in rem or the specific tax upon things, as the main source of revenue by which economic allegiance in such countries can be gauged; and they would refuse to be bothered with questions as to whether the whole of the operations ultimately resulted in a profit or a loss to some unknown foreign recipient.

So far, therefore, as we are considering taxes upon capital wealth, such as death duties, capital levies, property taxes and other taxes avowedly on mere stages of wealth, it is well to determine theoretically to which country the true economic allegiance of the different matters falls, and such an analysis may have utility as a basis of actual practice. When, however, it comes to the consideration of the taxation of pure income, it is difficult to establish that such an analysis can have great practical value; at any rate modern income is such a composite product and such a complex conception that even theoretically it is not easy to assign in a quantitative sense the proportions of allegiance of the different countries interested. Unless in theory the quantitative assignment can be made, it obviously is difficult to make it the basis of any practical plan. In order that the theory of the assignment of economic allegiance to different countries may, however, be considered, we shall now endeavour to make a more detailed analysis of its constituent elements. We apprehend that the value of this analysis is twofold:

(1) To show which countries have the greater title in theory to impose specific taxes upon particular forms of wealth, with special reference to capital wealth in the form of succession and death duties, stamp duties, general property taxes, rates and land taxes, and other specific taxes apparently paid by things and not regulated by the financial ability of persons;

(2) To show the extreme complexity of the subject as soon as we are dealing with a tax on pure income.

Section II.

ECONOMIC ALLEGIANCE AND CLASSIFICATION OF WEALTH FOR PURPOSES OF TAXATION.

Wealth as a capital fund may be classified into movables and immovables, a classification which roughly corresponds to the Anglo-American division into personality and realty, or personal property and real estate. But movables may further be divided into corporeal and incorporeal goods, or tangible and intangible wealth. Both corporeal and incorporeal wealth, again, may be further classified according to the degree of its relation to, or dependence on, the land. Finally, wealth as a flow includes personal elements which are referable either to real estate or to personality. Accordingly we may develop the following scheme and attempt to apply to each category the four criteria of economic allegiance: origin, situs, enforceability and domicile.
Immovables.

I. IMMOVABLES: LAND AND HOUSES.

1. Acquisition or Origin.

(a) As between production and sale.

Agricultural products are generally sold and paid for on the spot, or certainly in the country where the products are produced. Even if there is an international market, the initial compensation to the producer is generally in the country of production. It is there that the first sales at least are made and that payments are received. It is true, indeed, that in certain cases, as especially in tropical productions like tobacco in Sumatra, the products are sent directly from the plantation to some other country to be sold. But in such cases we are really dealing with commercial or financial enterprises, which will be considered under a subsequent head. With the great mass of agricultural products it remains true that there is little, if any, divergence of interest between the country of production and the country of sale.

In the same way, house rents are almost always paid over on the spot. Even if they are ultimately transferred to some absentee landlord, the immediate payment is generally made to his agent in the locality. Here also, therefore, it may be said that there is in the main not likely to be any complication arising from the distinction between production and sale.

(b) As between the location of the land and the personality of the individual as contributing factors in production.

Strictly speaking, a distinction is here possible between pure economic rent and agricultural profits, and it might be said that agricultural profits depend in no small degree on the personality of the individual. In most cases, however, the individual farmer or manager must reside on the spot. It is only where the successful exploitation of the land is intimately bound up with financial and commercial considerations or, in other words, where the capital invested in the land, rather than the character of the land, is the outstanding factor, that the personality of the owner is of real importance. In most cases, however, the yield of land depends to an overwhelming extent upon the land itself. The most capable individual is almost helpless where the soil is incorrigibly poor or the rainfall inadequate. While the individual can somewhat modify the characteristics of the land, he cannot completely change them. An intelligent owner of a house in the slums will not, because of his intelligence, be able to secure a higher rent than a stupid or inefficient owner of a lot in a fashionable or business section. In general, therefore, earnings from land and houses — that is, from real estate or immovable property — may be said to be so intimately bound up with the real estate itself as to render the place where the yield arises the overwhelming factor in the element of origin. The individual landowner forms, in most cases, an economic part of the society where the land is situated; his economic interests are so closely interwoven with the land that it is there that his chief economic allegiance is due. The final destination of the produce, the place of management and of receipt of profits could all be changed, but location never.

2. Situs.

This consideration obviously re-enforces that of origin. The land is physically located where its yield arises.
3. Enforceability or legal status.

The chief element in the legal status is the protection afforded by the title to the physical property. This also is obviously bound up directly with the property itself.

4. Domicile.

It is undeniable that the individual owes some duty to the place where he lives. He receives benefits from, and confers benefits upon, that community. He receives benefits in that he enjoys not only the protection of the laws but the various conveniences that are afforded by the community where he chooses to live. Reciprocally, it is true that he confers benefits upon that community by spending his money there. The whole framework of the way he can possibly spend his life by the consumption of his income in goods and services is subject to that protection ad hoc to his own possessions as he is in process of enjoying them, and generally to the social and economic order which makes that expenditure easy and far-reaching and effective. It is, however, as we now know, really not a question of benefits conferred or of benefits received; the problem of economic allegiance is one not of benefits but of duties or obligations. From this point of view as well, it is natural to say that the community in which the individual has cast his lot and in which he lives his daily life is at least entitled to some measure of support from him.

Summing up these four considerations, we are led to the conclusion that, inasmuch as the second and third elements in economic allegiance strongly re-enforce the first (origin), domicile ought to play only a slight role as compared with origin. Most countries, as a matter of fact, allow it to play no role at all. We should be disposed, however, to maintain that, as a matter of pure theory, the claim of domicile to at least a small share ought not to be overlooked. This conclusion, however, obviously applies more completely to a tax on the property itself, whether in the form of a real tax, a land tax, an inheritance tax or a capital levy. But it is true even to some extent of a pure income tax. If an absentee landowner plays, because of his large rent roll, a considerable part in his place of habitual residence or domicile, it does seem that the place of domicile should not be entirely denied a right to ask him for at least a slight support. But, at the very best, the proportion allotted to domicile would be exceedingly small.

Business Enterprises.

II. BUSINESS ENTERPRISES OF AN IMMOVABLE CHARACTER OR CLOSELY CONNECTED WITH IMMOVABLES.

Enterprises under this head may be divided into three classes: first, those directly dependent upon the land, like mines and oil wells; secondly, those where the land plays a somewhat less important role, as in the case of industrial establishments or factories; and thirdly, those where other elements than land become of increasing importance, as commercial establishments with a fixed location.

II a. MINES, OIL WELLS AND THE LIKE.

1. Acquisition.

(a) As between production and sale.

The distinction between the place of production and that of sale is apt to be more marked than in the preceding case of immovables, for the mineral or other products are far more commonly
sold through selling agencies in different places or countries. This, however, simply means that instead of a single origin we have several places of origin — that is, instead of \( o \) (origin), we may have \( o_1, o_2, o_3 \). It involves the question not as between origin and domicile but as between the different places of origin. This point, which becomes of special importance in all business taxation, raises the problem of the allocation of earnings — a subject to which special reference is made in the addendum to Part III, section III.

(b) As between the location of the plant and the personality of the owner or manager.

The larger and more industrial the undertaking, the less possible is it to be successful without outside capital and individual enterprise, and the less possible to carry on by small individuals tied to the land. But, while the yield is more largely due to the ability of the individual than in the case of agriculture, it will in the main depend after all upon the richness of the mine or the quality and quantity of the oil. On the whole, therefore, the place of origin or economic location remains of almost as much importance as in the case of land itself.

In the case of (2) situs, (3) enforceability and (4) domicile, the considerations here are analogous to those in the preceding category.

The general conclusion, therefore, must be very much as in the case of land, with a slightly greater stress to be laid on domicile. But inasmuch as origin still constitutes the greatly preponderant element, this difference may be neglected.

II b. Industrial Establishments of Plants consisting chiefly of Factories.

1. Origin.

(a) As between production and sale.

Inasmuch as it is still more usual for the factory to have its selling agencies in various places, the problem of the division of \( o \) into \( o_1, o_2, o_3 \) is of somewhat greater importance than in the case of mines.

(b) As between location and personality.

It is true that the manager of the factory can generally do most effective work on the spot, but this is not necessarily so. In not a few instances the real brains of the management may be found at a distance. This is, however, apt to be the exception.

2. Situs.

This in the main re-enforces origin. There is, however, a modifying consideration. When once the factory is erected, location is an important factor: but it must not be forgotten that location was voluntary — the owner could quite well have decided not to erect it there but somewhere else. This is not so with agricultural land.
As regards (3) enforceability and (4) domicile, the considerations are very much as in the preceding case. An exception may, however, be noted in the case of enforceability, with corporations or companies where the place of birth (charter) may be different from the location of the head office. Inasmuch, however, as the enforceability of economic rights is now usually, through the comity of nations, extended also to corporations which are technically chartered elsewhere, this matter is not of commanding significance.

The conclusion would be that, while the importance of domicile is somewhat greater than in the case of mines because of the difference in the personal element in origin, still, on the whole, the place of origin, because of its re-enforcement by (2) situs and (3) enforceability, is of preponderant weight.

II c. Commercial Establishments with a Fixed Location, i.e., with a Main or Head Office in a Particular Place.

1. Origin.

(a) As between production and sale.

Here the influence of sales and the possible existence of many selling agencies or branches are of outstanding significance. The problem of the division of \( o \) into \( o_1, o_2, o_3 \) becomes of commanding importance.

(b) As between location and personality.

The situation here is analogous to that in the case of factories, but with still greater stress to be laid upon personality. While in most cases the commercial manager can do most effective work on the spot or in the place where the head office is situated, there are many exceptions to the rule; and control at a distance is far more possible than before.

In regard to (2) situs, (3) enforceability, and (4) domicile, the considerations are precisely the same as in the case of factories, except that as to situs a commercial business can be more easily moved than a factory, with its nexus and environment of workers and their dwellings.

The conclusion would be that, while the importance of domicile is somewhat greater than in the preceding two cases because of the personal element in the matter of origin, none the less, in the main, the place of origin, because of its re-enforcement by (2) location and (3) enforceability, remains of considerably greater significance than domicile.

In this entire second category, then, with its three divisions, we are led to the conclusion that in an ideal division a preponderant share should be assigned to the place of origin, even though this share itself, varying with the different classes, should be slightly smaller than in the case of land.

When we are dealing with property taxes, as in the case of capital levies or death duties, a distinction might further be made between the land element in the enterprise and the personal element capitalised under the name of "goodwill." In the case of an income tax, however, such a distinction would largely be meaningless.
Movables with a Fixed Location.

III. Tangible or Corporeal Movables with a Fixed Location.

As in the preceding category, such movables may be classified according to the degree of their dependence on the land. There are two chief classes:

III a. Movables Dependent Primarily on the Land.

In this class are to be put factory machinery, agricultural implements, and flocks and herds. The first two classes obviously are of no economic value apart from the plot on which, or the farm in which, they are utilised. Flocks and herds also are generally dependent upon a particular piece of land for sustenance, although in nomadic countries or places like the Far West of the United States or the Argentine, the herds are not infrequently itinerant, according to the grazing rights which may vary from month to month in the different sections. In such instances, however, we have to deal with o₁, o², o³ as in the case of commercial establishments. But whether we are dealing with a fixed or a variable location, the origin of the yield is so closely connected with the land that the entire class ought to be treated like land, i.e., only a slight importance should be attached to the domicile of the owner as over against the origin of the yield.

III b. Movables dependent not so much on the Land as on the Individual.

In this category we should put money, both coin and paper, jewelry, household furniture, pictures and libraries.

1. Origin.

As to the four elements of economic allegiance in question, since there is no money-yield at all, origin plays no part. These forms of wealth can only be enjoyed where the owner is present. The “yield” of benefits cannot be sent to him.

2. Situs.

The influence of technical location as apart from the residence of the owner is negligible. In the main, the situs may be said to follow the domicile, because the jewelry and the money, e.g., can really afford an economic utility to the owner only when associated with him or on his person. The jewelry might, of course, be left for a time in a safe-deposit box or the money put into a bank. But this in itself would not be sufficient to establish a claim of the fortuitous temporary place of deposit as an important consideration. Where the actual situs differs from the residence of the owner, constructive location must take precedence of actual location, because the constructive location is the one of real economic importance.

The only doubt here arises in some cases of household furniture, pictures and libraries. Ordinarily, of course, these movables are found in the place of residence or domicile. They would have no economic meaning anywhere else. But it may happen that an individual possesses two homes in different countries and that in each there may be found valuable furniture, pictures and libraries; yet we can properly speak of his habitual residence or domicile in only one of these countries. In such a case, the situs of his secondary home may not re-enforce, but oppose,
domicile, and in that event it is not unreasonable to say that the country of this secondary home may also prefer a claim. In fact, from this point of view, it may even be said, with some degree of reason, that a distinction might be made between household furniture and libraries over against the other categories, and that the former should go with the real estate, thus making the actual situs more important than the constructive location.

3. Enforceability.

Enforceability follows the domicile.

4. Domicile.

This is the one outstanding factor.

Since, therefore, domicile is strongly re-enforced by (3) enforceability and in most cases by (2) situs, the conclusion points to domicile as the chief consideration of weight, with the single exception that, where there are several homes, the actual physical location of the furniture, pictures and libraries (but not money or jewelry) is to be preferred to their constructive situs at the domicile of the owner.

In this whole class of cases it is obvious that there is no application at all to the income tax except possibly in so far as a professional library may help its owner to secure an income. This would, however, fall rather under the head of professional earnings, to be considered later.

IV. Tangible or Corporeal Movables not ordinarily capable of a Fixed Location.

The most striking example of this is vessels. There are in reality three classes of vessels: a) ocean tramps, b) regular ocean liners plying the high seas, and c) vessels engaged in coastwise traffic or internal navigation where the coast or the navigable water fronts on, or traverses, different countries. The fact that the same vessel may shift from one to another of these classes is embarrassing. But at any given time the distinction is generally observable.

1. Origin.

If the vessels ply the high seas, there is no particular country to which the origin of the yield can be ascribed. If, however, they ply navigable waters which traverse different countries, we have, as in several of the preceding categories, not one, but several, places of origin, that is $o^1$, $o^2$, $o^3$, and we are confronted by a problem which must be solved in a similar way. Moreover, in the case of ocean liners there are apt to be in several countries large and extensive docks and appurtenant property which materially contribute to the profitable operation of the vessels. Finally, it may be remarked that, inasmuch as the economic yield of vessels depends partly on the seamanship of the captain and to a larger degree upon the business sagacity of the owner, the element of personal management becomes of importance, and that this management may be carried on in the one or the other country. But, as in the case of immovables, the controlling consideration is the existence of the traffic: origin therefore re-enforces domicile (the home of the owner) only to a partial extent.
2. Situs.

There is no permanent physical situs in any taxable sovereignty. The mere fact that the vessel happens at any particular time to be in one port as compared with another is of very little significance.

3. Enforceability.

This is a consideration of great importance. Practically it means the country where the ships are registered and the flag of which they fly. This is perhaps the only modern instance where political allegiance still plays a rôle: for the registry of a ship is its nationality. But it plays a rôle only because of its economic implications.

4. Domicile.

The domicile of the owner is in itself of slight consequence as compared with the other elements of economic allegiance. It becomes of importance only in so far as it is re-enforced by some of the preceding elements.

In the main, then, in the case of sea-going tramps, the country of registry possesses the chief claim to economic allegiance. If, as frequently occurs, there is a distinction between the country of registry and the country of domicile or direction, the greater part of the tax ought to go to the country of registry. Where the country of registry is changed in order to evade certain obligations to the country of domicile or direction (as in the recent transfer of American vessels to the Panama flag in order to escape the rigours of the 18th amendment with reference to intoxicating liquors), there is no reason why the country of registry should not receive a preponderant share of the tax.

When we are dealing, however, with vessels plying navigable waters which traverse different countries, the place of origin becomes, at least for the purpose of the income tax, more important than (3) place of registry and should be substituted for it. It would be a case of 01, 02, 03, as found in ordinary business enterprises. A Dutch flag on a boat plying on the German Rhine should not exempt the vessel from its economic allegiance to Germany. For purposes of the property tax or death duties, however, registry should be the paramount consideration. Similar conclusions, although in a somewhat modified form, would seem to apply to ocean liners. Registry is the chief consideration, but for purposes of income tax (rather than of property tax or death duties) the other country, where expensive docks and shipping offices are found, might reasonably prefer a claim to a part of the earnings.

Securities and Credits.

V. Intangible Personalty or Incorporeal Movables.

The most important classes in this category are real estate mortgages, corporate securities, Government bonds and private credits.

V a. Mortgages on Real Estate.

I. Origin.

Strictly speaking, we ought to subdivide mortgages into two classes. In most cases, indeed, owners of real estate borrow money on mortgage in order to benefit the real estate. They desire
to put improvements into the land or to build houses on the land or to add to the area, and presumably therefore to the yield, of the land. In other cases, however, owners of real estate borrow money for purposes unconnected with the land, such as to meet personal obligations or to make outlays which have nothing to do with the land. Inasmuch, however, as it is impossible to probe into the intentions of the borrower, we must assume in the present discussion that a mortgage on real estate is in most cases intended in one way or another to benefit the real estate.

The capital loaned has, indeed, been amassed or saved by the lender; but when it has been transferred to the borrower who owns the land, its value as a capital fund and as a security for the income is to a great extent the value of, i.e., the prosperity of, the land. The economic basis of the security is, therefore, to be found in the community where the land yields its produce.

It might, indeed, be claimed that, inasmuch as the country of the borrower receives the benefit of the use of the capital, that country should not levy any tax. But to this it may be rejoined that the country of the creditor also secures a benefit through the revenue accruing to the land which might, but for the assistance rendered by the loan, either not exist or not exist to the same extent.

Again, it might be said that the country of origin (the debtor country) already, in most cases, taxes the land and ought not again to tax the mortgage on the land. In an income tax, however, the tax on the interest on the loan is deducted from the tax on the income from the land; in a property tax or inheritance tax a similar custom ought to be followed and is, in practice, very frequently followed; so that if the country of origin were prevented from imposing a tax on the mortgage it would obviously suffer.

2. Situs.

The mere fact that the piece of paper representing the mortgage is deposited in a safe or a bank apart from the residence of the owner is too insignificant to warrant a claim to serious consideration. If it were to be given any weight it would make the taxability of the security a matter of mere chance according as the security was moved from one bank or trust company to another. What is of importance here is not the actual physical location but the constructive or economic situs of the security. This would seem to be in the hands of the resident or the owner.

3. Enforceability.

This re-enforces origin, at least in the case of property taxes or succession duties. In the case of an income tax, however, it is of less significance.

4. Domicile.

This remains of considerable weight from the point of view of consumption or disposition of the wealth.

On the whole, then, the arguments seem to be balanced between origin and domicile. Considerations 1 and 3 argue for origin; considerations 2 and 4 argue for domicile. From one point of view, the mortgage on real estate ought to be treated like a factory, with somewhat more importance attached to the place of origin. On the other hand, when the mortgage covers land situated in several countries, the necessity of a fractional division of o (origin) would be embarrassing, and to that extent weakens the claim of origin.

Attention, however, must be called to the distinction between taxes on property or death duties on the one hand and taxes on pure income on the other. In the case of property
taxes, the argument in favour of origin would seem to be stronger. To assign to the mortgage as property a real economic value is to bring it into close relation to the land on which the mortgage is based. The capital security of the mortgage is the land itself. But in the income tax the case is different. The interest on the mortgage (liable to income tax) can be, and is, paid out of the other income of the borrower from far-away sources if the yield of the property fails. Moreover, the varying returns from different mortgages depend in no small degree upon the knowledge and investing ability of the lender. Again, in the case of an income tax, it is more difficult to draw the line between mortgages and other securities. In addition, if, as we shall see in a moment, the principle of domicile is to be preferred in the case of ordinary securities, it is obvious that it would be possible for the borrower to obtain his money by constituting a company with shares or bonds so as to defeat the application of the principle of origin to the mortgage.

The conclusion, therefore, would seem to be that, while the arguments are fairly balanced, the preponderant importance ought to attach to origin in the case of the property tax or death duties, and to domicile in the case of the income tax.

V b. Corporate Shares, i.e., shares in Companies or Other Associations.

i. Origin.

Corporate shares would, indeed, be worth nothing if the company had no earnings; but the yield depends after all on the activity of the legal owners, the shareholders. While the success of a venture is, of course, in part bound up with the economic prosperity of the community in which the operations are carried on, it is the shareholders who elect the board of directors and the manager. In the case of origin, therefore, as in the case of an ordinary business, the personality of the owner is of considerable importance.

It must be remembered, moreover, that we are here dealing not with a tax on the corporation or business but with a tax on the shareholder. We are not discussing the question as to whether, in an income tax, for instance, the tax on the corporation as such is to be regarded as virtually a tax upon the shareholder, and whether therefore the additional tax on the shareholder is to be considered a double tax. That is a question of double taxation arising from the imposition of two taxes by the same sovereignty; what we are concerned with in this memorandum is double taxation arising from the simultaneous taxation of property or income by different jurisdictions.

Nevertheless, if origin in the case of corporate shares be interpreted to mean the place where the dividends are earned, it is obvious that additional complications will arise from the fact that the company may produce its goods in one State and sell them in another, or have its chief office in one State and yet secure most of its earnings from sales in other States. Here the multiplicity of the claims of origin, that is, $o_1$, $o_2$, $o_3$, will constitute a serious embarrassment in considering the fractional rights of each particular share and to that extent weakens the claims of origin.

2. Situs.

This, as in the preceding case of real-estate mortgages, is negligible.

3. Enforceability.

This sometimes becomes of importance, especially in the case of registered shares as over against shares to bearer. Where there is interference with the free play of capital, the particular place in which the legal rights to the security are enforceable may become of considerable significance. What is here involved is the question of the international capital market.
4. Domicile.

This is of considerable importance, especially when it is re-enforced by some of the other factors. When, for instance, (2) situs and (4) domicile converge, the case for domicile is strong; when, in the case of securities to bearer, 2, 3, and 4 converge, the case for domicile becomes still stronger. Even in the case of registered shares, it not infrequently happens that shares can be registered in a branch office, and if this branch office, as is usually the case, is found in the place of domicile, then again 2, 3 and 4 converge in making domicile of paramount importance. Where the place of registry, however, coincides with the place of origin, as in certain registered securities, origin acquires some significance.

We must, however, remember the practical difficulty of the country of origin reaching the foreign shareholder. In a few cases this difficulty may be overcome for income tax by making the corporation itself deduct the dividends; but ordinarily this difficulty somewhat weakens the claim of origin and strengthens that of domicile. It is not easy to see how death duty or property tax can effectively be recovered by the corporation of the country of origin from a non-resident shareholder.

Moreover, if we follow the principle of origin exclusively and do not allow the country of domicile to tax any foreign corporate securities, there is grave danger that the individual may put his entire fortune into such foreign securities, in which event the country of domicile would go empty-handed.

The general conclusion, therefore, must be that, while from a certain point of view it is possible to demand a division between the principles of origin and of domicile, certain considerations come into play which make domicile the predominant factor. In the first place, the element of personality—that is, of the shareholder—enters, as we have seen, into the question of origin; secondly, even where there is a distinct place of registry, this is apt to be just as frequently the place of domicile as the place of origin; and, thirdly, under conditions of modern life, the wealth which belongs to the individual who transfers his permanent residence or domicile to another country is likely to consist to an increasing degree of such investments or securities. The preponderant argument, therefore, is in favour of domicile.

V c. Corporate Bonds.

Corporate bonds are economically, although not legally, analogous to corporate shares. In England they are often referred to as "debenture shares" and sometimes carry a title to profits. Even in other countries, where the bonds are so-called mortgage bonds, the similarity to real-estate mortgages is in reality slight. The mortgage may, in fact, be put not on the real estate but on the entire property of the corporation in question. From the economic point of view, moreover, corporate bonds, like corporate shares, really constitute a part of the corporate capital, the real difference being only that they are first in the order of preferential security. There is, therefore, slight warrant for distinguishing for the purposes here discussed between corporate bonds and corporate shares.

V d. Public Securities, i.e., Bonds of State and Local Government.

Although it might be claimed that government bonds are analogous to real-estate mortgages and that, at least for purposes of the property tax and death duties, the place of origin
(the country of issue) should prevail, the common practice of governments in exempting from taxation at least foreign-held bonds would seem to re-enforce the claim of domicile to the position of preponderant importance. As a matter of fact, it would be difficult to distinguish in principle between the bonds of a private corporation and those of a public corporation so far as the essential elements of the economic allegiance of the bondholder are concerned. We are therefore led to the conclusion that the one should be assimilated to the other.

V e. General Commercial Credits.

By this is meant the credits which result not from permanent investment of capital but from mere temporary loans or transactions. Here the considerations would seem to be as follows:

1. Origin.

As between the debtor and the creditor, the origin of the yield is due as much to the activity of the creditor as of the debtor. It is well-nigh impossible to ascribe the real economic origin to either country.

2. Situs.

The book location of the credits is of negligible importance.

3. Enforceability.

The place where the payments are to be made or are receivable is likewise really of slight weight, although in some countries, like France and Italy, some stress is laid on this. From the economic point of view, enforceability, or what the French call exigibility, is in reality of minor significance. Moreover, exigibility is by no means the only legal consideration in the question of enforceability which may also, in part at least, be found in the creditor country.

4. Domicile.

This becomes the really important factor, especially as it is partly re-enforced by (1) origin, and sometimes by (3) enforceability.

General commercial credits, therefore, ought to be taxable according to the principle of domicile.

VI. Professional Earnings and Salaries.

Inasmuch as these are due wholly to the activity of the individual, the sole factor involved is that of domicile. It is only in cases where there is a branch of the law office, engineering firm and so forth in another country that any question can arise. But in such cases the occupation becomes a commercial enterprise rather than a profession, and ought to be treated as in II b.
Conclusion.

Summing up the preceding discussion, it would be desirable ideally to apportion economic allegiance as between origin and domicile as follows:

<table>
<thead>
<tr>
<th>CATEGORY OF WEALTH</th>
<th>PREPONDERANT ELEMENT.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Origin</td>
</tr>
<tr>
<td>I. Land</td>
<td>x</td>
</tr>
<tr>
<td>II a. Mines, oil wells, etc.</td>
<td>x</td>
</tr>
<tr>
<td>II b. Commercial establishments</td>
<td>x</td>
</tr>
<tr>
<td>III a. Agricultural implements, machinery, flocks and herds</td>
<td>x</td>
</tr>
<tr>
<td>III b. Money, jewelry, furniture, etc.</td>
<td>x</td>
</tr>
<tr>
<td>IV. Vessels</td>
<td>x (regist)</td>
</tr>
<tr>
<td>V a. Mortgages</td>
<td>x (prop'y)</td>
</tr>
<tr>
<td>V b. Corporate shares</td>
<td>x</td>
</tr>
<tr>
<td>V c. Corporate bonds</td>
<td>x</td>
</tr>
<tr>
<td>V d. Public securities</td>
<td>x</td>
</tr>
<tr>
<td>V e. General credits</td>
<td>x</td>
</tr>
<tr>
<td>VI. Professional earnings</td>
<td>x</td>
</tr>
</tbody>
</table>

That is to say, the categories of wealth in which origin is more important are:

I, II a, II b, III a, IV, V a (property).

Those categories in which domicile is more important are:

III b, V a (income), V b, V c, V d, V e, VI.

Putting it another way, all corporeal wealth, including immovables and tangible movables, except III b, would be assigned predominantly or wholly to the place of origin; all intangible wealth, except V a (property) would be assigned predominantly or wholly to domicile or residence.

To allocate the exact proportion of economic allegiance to origin or domicile in each particular category is well-nigh impossible. Such an attempt would savour too much of the arbitrary. But where any two countries desire to make such an allocation, they would do well to be guided, ideally at least, by the above analysis.

Where it would be too complicated to make the exact apportionment between the claims of origin and domicile in each category of wealth, a certain rough justice can be attained by turning over all the categories of the first division completely to the place of origin, and by turning over all the categories in the second division completely to the place of domicile. What each country would lose in the one case it would roughly gain in the other, and there would be the great additional advantage of comparative simplicity.
PART III.
APPLICATION OF THE FOREGOING PRINCIPLES.

Section I.
THE GENERAL METHODS OF AVOIDING DOUBLE TAXATION.

The Four Alternatives.

The bearing of the foregoing treatment of economic allegiance upon the problem of double taxation.

It will be seen from the foregoing that the conception of faculty comprises a number of elements not all of which are of conspicuous or equal importance, the outstanding elements being those connected with acquisition or production, and those connected with outlay or consumption. The relief of double taxation, for the two-fold purpose of relieving an excessive burden upon certain individuals and of avoiding certain economic consequences to which reference has been made, involves the surrender of revenue by Governments. The question therefore at once arises: Which Governments should give up revenue, and to what extent? Obviously the foregoing discussion of economic allegiance is, in its broad aspect, pertinent to this enquiry.

But, before discussing how Governments ought to view this matter, it may be well to ask how do they, in fact, regard it in the light of their historical development and constitutional practice.

A survey of the whole field of recent taxation shows how completely the Governments are dominated by the desire to tax the foreigner. It seems to be clearly instinctive in laying down general principles to treat "origin" as of first importance, and residence as of "secondary" importance; i.e., if the origin and source of income are within a country's borders, it is assumed that that country has the prime right of taxation on that income, although it goes to some person abroad. There are a few modifications, but this is the main instinctive principle. From this flows the consequence that, when double taxation is involved, Governments would be prepared to give up residence rather than origin as establishing the prime right.

This preference for origin as the prime principle is of a piece with the common instinct that taxes are paid by things rather than by persons. But if we recognised facts and were not prevented by historical accidents and administrative cowardice or frailty from taxing every man in one sum upon his total resources instead of getting at him piecemeal, the "origin" idea would be far less instinctive. It leads directly to the consequence that countries creditor on balance should bear the main cost of relieving double taxation, and countries debtor on balance should contribute nothing to that cost. Although countries hold so instinctively to this origin principle in theory (and actually apply it when the foreigner has made investments already and is helpless), they drop the principle at once as soon as the practical question of new investment arises. Can origin, then, be so sacred a principle?

During the past year or so loans have been sought, for example, in the British money market by numerous foreign borrowers; Australia, New Zealand, France, Brazil have each recently issued their securities yielding fixed rates of return. One and all are distinguished by a common feature, namely, the exemption of the yield from all taxation, present or future, of the borrowing country. The United Kingdom itself, when under the necessity during the war of raising all the money it could abroad, offered its Government war securities to persons not domicilled (and,
as respects income taxation, even to persons not ordinarily resident) in the United Kingdom, free of all internal taxation. These practical examples strongly confirm the general principle already reached in theory that, as respects fixed-yield investments at least, the investor throws back on the borrowing country the burden of that country's taxation. In the light of these examples, it seems safe to conclude that the contention as to the burden of such taxation is irresistible.

It would seem that when Government and powerful municipalities are borrowing and attempting to attract foreign capital, they are willing to forego the tax on the foreigner, but that they would not be willing to do so in the case of the foreigner's money invested in general securities in trading concerns within their borders. It is only the urgency of their own claims they are prepared to recognise. They would need to take a much more parental interest in the affairs of their subjects, their commerce and the development of their country to be capable of such an act of self-abnegation as to recognise, by means of intentional losses of revenue, an exemption for foreign money invested in profit-making industrial enterprises within their borders. Nevertheless, this would appear to be the only logical consequence of the way in which they act in relation to their own needs. It would, no doubt, be easier to find some half-way house in this matter if we were faced with the old groups of taxes, such as taxes in rem and taxes in personam, i.e., impersonal taxes, following the land or the business wherever it might be situated, and those which follow the person only. But in a modern income tax these distinctions are lost sight of: the tax upon the land or the business has no flat relation to the value of that business, but is graduated or may be graduated with the personal fortune of the distant resident. If, for example, the Moranian authorities were to say that they would not exempt the foreigner's investment in land or in a mortgage upon their land, but that they would exempt an investment in securities, it is obvious that a Moranian business would find it easier to raise capital from abroad on general debentures or some kind of bond which approximated rather to the share class than to a charge upon property. Nevertheless, it may be possible that for some countries this is the only line upon which any practical compromise can be found, viz.: that the country of origin should have some vested right to tax the foreigner to the extent of the ordinary tax attached to property itself, even though the income from such property might form part of the general income taxed abroad.

We propose to state briefly the four main possible alternatives, but it is well to indicate here that their application to all States is by no means identical. Certain of them may have much greater force as the best remedy in countries in which taxes on specific objects of wealth are the main fiscal expedient. Again, there may be a different remedy in countries where the group of taxes is intended to have a net result equivalent to a rough income tax; and, thirdly, there may be a different choice where the main fiscal expedient is a tax on pure income. Thus one solution as between two countries falling into this last class may be best, and another solution for countries falling in the first class may be best, and again some other solution as between one country of the first class and another country in the third may commend itself.

The four alternatives broadly stated.

The four possible alternatives appear to be as follows:

(1) A country might deduct from the tax due from its residents any tax paid by them on their income from abroad (analogous to the United States practice in the case of its own citizens). This throws the whole burden of increased taxation in debtor countries upon the creditor country, and is opposed to the general practice observed by foreign Governments when issuing their loans. If this course were followed,
Governments need no longer make provision for making the loans free of tax to non-resident investors, knowing that it will fall upon the exchequer of the creditor country. It is to be doubted whether such creditor countries as the United States, Great Britain and the Netherlands, having regard to their interests abroad, would ever agree permanently to put their exchequers at the mercy of all the unknown increases of taxation of foreign Governments. This may be called the method of deduction for income from abroad.

(2) The extreme converse, viz.: that the country of origin should exempt all non-residents from taxation imposed on income drawn from sources within its borders, recognises the theoretical fact that the country wanting the money cannot successfully “tax the foreigner”; it can only shut him out. It would have the effect of increasing the flow of capital from abroad and the development of less-favoured regions. This may be called the method of exemption for income going abroad.

(3) It may be possible by convention to divide specific taxes so that a portion should be borne by the country of origin and the remainder by the country of residence, e.g., a Moranian having an investment in England and being liable to 5/- in the £ thereon might recover 2/6 from the British Government, and also in his own country be charged only half the normal rate of tax in relation thereto. This is an attempt to recognise both principles and to spread the burden upon the two Governments. It would leave in an unsatisfactory position issues of State loans, and is open to many of the objections, though not to the same extent, as those raised to the first proposal. This may be called the method of division of the tax.

(4) By convention it might be determined to attach origin taxation specifically and wholly to particular classes of investments or embodiments of wealth, such as rents of land and of houses and mortgages on real property, but to exempt the non-resident 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 such sources of income, but would charge other sources in full. The country of origin would retain its specific origin taxes in full. It would be necessary to give the country of residence complete power of charging all sources except for certain specified exemptions, so that the scope of its liability to remit the tax would be easily determined, and the investor, from his total income-tax demands, would be able to deduct certain specified taxes on any real property he might have. It might be desirable to impose some limit upon the power of the country of origin to levy in future specially heavy specific origin taxes, which would unduly deplete the exchequer of the country of residence. This may be called the method of classification and assignment of sources.
SECTION II.

APPLICATION OF THESE PRINCIPLES TO DEATH DUTIES AND PROPERTY TAXES.

Death Duties and the Method of Classification.

In considering the question of the division of economic allegiance between the two main factors of origin and residence, in the matter of succession and death duties, levies on capital, property taxes and the like, we must first consider for a moment the possible claim of some other element of economic allegiance to preference. We have, in other words, to take account here of the element of enforceability, which still plays somewhat of a rôle in certain countries in the case of succession or death duties.

Under the older theory, still accepted in the legal systems of some countries, the inheritance tax is regarded as an indirect tax or a tax on the transfer. It might then be justifiable to claim that the country of transfer alone should impose the tax. Under the newer theory of faculty or economic allegiance, however, enforceability is only one of the four elements in the problem, and constitutes, as we have learned, one of the minor elements. It is of importance, in reality, only in re-enforcing on the one hand the doctrine of origin or situs and, on the other hand, the doctrine of domicile. Of itself it ought to exert in modern times no controlling influence.

The same is to be said of the physical situs of the paper representatives of the wealth in question. The fact that the securities which form a part of an estate happen to be in a particular bank or safe deposit is in modern times of no significance. Situs is of consequence only as re-enforcing true economic location.

The real choice, therefore, in the case of the inheritance tax is between the principle of origin or true economic situs and the principle of domicile.

Applying the conclusions reached in our discussion of economic allegiance above at page 39, we should prefer the claim of origin or true economic situs in class I, real estate, and class III a, movable property closely connected with real estate, like machinery, agricultural implements and flocks and herds. On the other hand, we should undoubtedly prefer the claim of domicile in class V b, corporate shares; class V c, corporate bonds; and class V d, general commercial credits. The only points on which there might be any doubt would be the various divisions of class II, industrial and commercial enterprises; class IV, vessels; and class V a, real-estate mortgages.

As to vessels, the correct conclusion in our opinion is that the inheritance tax should be imposed by the country of registry, especially in the case of ocean-going vessels, modified, however, by the consideration that where an individual owned ships plying navigable streams which traverse several countries, the principle of registry should give way to that of origin or economic location.

In the case of real-estate mortgages, the country of location of the real estate would, as is intimated above, seem to have priority in the case of the inheritance tax, differing in this respect from the income tax.

Finally, as to industrial and commercial enterprises, it is far easier in the case of the inheritance tax than in the case of an income tax to make a distinction between the property associated with the land and the capital element or goodwill in the business. It would hence seem logical to recommend a division of the inheritance tax between the two countries, assigning to the country where the enterprise itself has been located or conducted the greater part of the tax, and to the country of the decedent’s residence, the tax on the element representing the goodwill.
In the main, therefore, it may be said in the case of the inheritance tax that the tax on the real estate or on the movables closely associated with the real estate, including mortgages, should go to the country where the real estate is located; and that the personal property not so associated with real estate, and especially the incorporeal or intangible wealth, in the shape of corporate and public securities, should be assigned to the country of the decedent’s domicile.

The conclusion would therefore be that where two competing authorities are dealing with succession or death duties, they can with profit adopt the lines of the fourth method mentioned in the last section and pay regard to the division of economic allegiance between the two main classes of origin and residence on the lines that have just been elaborated. In these competing claims, where one country has the predominant right to taxation on the grounds of origin, it might take over the entire right to include such items within its scope, this right being wholly surrendered by the other authority whose share of economic allegiance through residence was slight. In other cases the respective shares of the burden involved in granting relief on a full claim might be decided between them by specific agreement according to these principles. Finally, in the case of large wealth, the share of allegiance due to residence might be much more fully recognised than it has been. Possibly the complications arising from an attempt to get an exact assignment as under method 4 would be so great that it would be desirable to have a general compromise or commutation by making some more or less arbitrary division, i.e., method 3. It would save a great deal of academic discussion and yield more immediately practical results.

Whether, however, we provide either for a division of the tax or more simply for a remission by the one country of the tax inappropriately levied by the other, we are confronted by the existence in modern times of graduated or progressive taxation. There may be such a system of graduated succession duties in either or both of the respective countries, and it may easily happen that the remission by one country of a tax levied at a higher rate by another country might lead to embarrassment and to injustice. In order to obviate this result, we suggest the following plan:

The country of residence should apply to the entire estate the appropriate rate of tax and should then deduct from the sum thus payable the amount of the tax actually levied (according to the principle laid down above) on that part of the estate situated in the country of origin, provided that the amount so deducted does not exceed the sum which would have been levied on that part of the estate if it had been situated in the country of residence.

In order to carry out this principle of division and to obviate the dangers of double taxation, we further suggest that provision should be made for an interchange of information among the respective countries involved. If conventions are made between two countries, it would be comparatively simple to provide for this interchange of information. If a convention is made among several countries simultaneously, the possibility might well be considered of establishing some central agency to which all the relevant facts should be reported. The League of Nations might be of considerable use in this respect.

All the preceding considerations and conclusions as applicable to death duties are equally applicable to other forms of taxation of funded wealth, such as the capital levy and the general property tax, as well as to the so-called impersonal taxes (like the French and Italian impôts réels or the German Ertragssteuern) on property, produce or business.
Section III.

APPLICATION OF THESE PRINCIPLES TO THE TAXATION OF INCOME.

Income Tax and the Methods of Classification or Division.

In this section we shall discuss the income tax proper in its developed form, as found in Great Britain, the United States and the German Empire. The discussion would also apply to that part of the French income tax known as the complementary tax, or impôt global, as well as to the similar Italian tax contemplated by the Law of 1919, the enforcement of which has recently been postponed. On the other hand, the existing schedule income taxes (impôts cédulaires) of France and Italy contain such large elements of impersonal taxation (impôts réels) that they are rather to be assimilated to the taxes discussed in the preceding section, amenable to method 4 as modified by method 3.

We have already indicated that the economic conception of income is so complex and that the legal and statutory definitions of income by different countries are so diverse that the problem of double taxation is much more seriously complicated for this class of taxes than for any other. In theory we should, of course, consider that the fourth method would be the soundest. But this memorandum has already shown that it is almost impossible in economic theory to get a direct assignment of a quantitative character of finally resultant income amongst all the national agents who may be said to have had a finger in the pie. If it is theoretically difficult we may conclude that it will be no less difficult in practice unless a compromise or arbitrary assignment is adopted. To give one illustration, the simple case of a resident in country A receiving the rent of a farm in country B is the clearest example of the division of economic allegiance, as it might well be that country B could claim to have the whole of the tax on income and that country A should give up its claim. In a second instance, the resident in country A has half of the ownership of a farm in country B which in the return it produces contains the elements both of rent and of business profit. The business carried on by this resident also has other property and activities, and as a net result produces an income for the resident in country A which is similar to that imagined in the first instance. Is the income derived from rent or from profits, or from a combination of these with possible losses in other directions, or to what is it due? If there is no systematic valuation of annual yields on proper lines, how is the rental value to be determined when it is mixed with other elements? Again, a legal entity in the form of a company is interposed between the resident in country A and the farm in country B. The rent or produce of the farm is only one of the items of income of this legal entity. This company receives a real or constructive rent, it mixes this rent with losses from other sources, and as a result it pays a very small sum in the shape of dividends to the resident in country A. Has that resident received, or has he not, the rent of the farm? It will be seen that simplicity only exists in a minority of cases involving income tax and that we soon get into the region of impracticability if we attempt to apply method 4 with precision.

We are driven to ask, therefore, whether we should not endeavour to commute or compound the rights and difficulties of the fourth method by adopting the third, that is, not to attempt to get at exact elements of economic allegiance but to adopt a broad line and to say that where double taxation of income is involved each country shall give up a flat or fixed proportion of the sum due to it. This idea is very attractive, and it may well be possible to arrive at conventions between particular countries on these lines. It is necessary, however, at the outset to indicate
two important considerations that arise. First, it is not possible on the grounds of pure economic theory to indicate what proportions should actually be adopted. The reason is quickly seen. A particular country A may be much more concerned in its relations with the rest of the world as a country where origin predominates and residence is unimportant than a country B which, in its relations with the rest of the world, is predominantly a country of residence and only to a lesser extent a country of origin. Thus the proportion presenting a true compromise for country A and the rest of the world may be adopted which is inappropriate for the relations of country B to the rest of the world.

Second, the difficulty does not end here. Even for country A, when one has decided on its relationship to the rest of the world — say a proportion of one-half — that one-half may be quite an incorrect rate for every convention with separate countries with which it has to deal. That is to say, it may be its true rate in dealing with all the other countries taken together, but quite a wrong rate in dealing with them separately. The relations, for example, of Brazil to the rest of the world in the division of economic allegiance might be made up of a very large proportion of allegiance in its dealings with Great Britain and the United States and a very small proportion in its dealings with the Argentine.

These points will indicate that, even if a broad proportion could be determined for a given country by economic theory as a compromise under method 3 for the details of method 4, they would still have to be redetermined piecemeal for each separate country with which it had relations. It does not appear, therefore, that method 3 really has a fundamental basis in economic theory which is capable of easy application.

The second consideration applicable to method 3 in relation to income tax to which we ought to draw attention is no less important. Suppose it has been decided as between two countries that each should give up a half of the total tax upon income originating in one country and received in another. By hypothesis the actual rate of tax upon the resident is an amount varying with his total wealth, and in making an allowance it has to be shown what he has received or is entitled to receive from the other country. Now it is of the essence of this method that the resident shall not gain by the relief in double taxation, that is, shall not be in a better position than he would be if his income were all derived in the country where he resides. Relief is desired only to the extent of the excess over such a sum; and therefore the essence of method 3 is that the country of residence should give relief by a definite amount that has been levied in the country of origin, with, if it is desired, a maximum for that relief equal to one-half of the rate of tax levied by the country of residence. How is the rate that he has suffered in another country to be determined? The simple case of the receipt of interest on a foreign mortgage presents little difficulty; but the great mass of double taxation has a rather more complex incidence.

A common case is the following. A resident in New York holds shares in, let us say, a motor company in the United States, which has two large branch businesses, one in France and the other in England. These two branch businesses are taxed on their operations to the full in France and England, and in consequence the total resources of the corporation in the United States are reduced, and the amount of income which it distributes by way of dividends to the shareholders in New York is diminished. The shareholder realises this and has a grievance. He asks for the necessary relief under method 3. How does he establish what he has suffered? He has little knowledge of the details of the operations of his corporation and cannot explain them in detail. The actual effects upon his dividend, that is, how much greater the dividend might have been if the foreign income tax had not been imposed, can only be determined by the corporation itself. The corporation goes to the fiscal authorities and indicates to them that its income consisted of a million dollars in a given year, that $100,000 were made in France and $200,000 were made in England, and that the sums bore certain amounts of taxation in those respective countries. Owing to the ways in which the laws of those countries compute income, it may well be that the rates of tax imposed under those laws are quite different from the rate which the total tax bears
to the income computed according to United States methods. Moreover, if the English and French businesses are separate companies, the American company may have brought into its accounts only the dividends received, which may be either less or more than the profits made in that year. Thus, the determination of the actual tax which must be regarded as borne by the sums shown in the American accounts as received from these two corporations is not a simple idea in practice but may be very complex. Again, having established that but for these taxes abroad its income might have been so much larger, the American corporation then has to indicate whether the whole of this benefit would have passed to the New York shareholder or not, i.e., if the dividends paid are only $800,000 out of a million of profits, whether the tax must be regarded as wholly applicable to the dividends or as going to swell the reserves, or being proportionately divided between them.

The wider the operations of a corporation and the more complex the fiscal systems with which it has to deal, the more difficult is the determination of the actual effects of taxation abroad. Once it has arrived at a settlement with the fiscal authorities, the fiscal authorities can afford the corporation the necessary relief and enable it to pay the larger dividend to its shareholders or they can afford the information only to the corporation and enable the corporation to advise all its shareholders, who are then in a position to approach the fiscal authorities, and to deal with the necessary individual relief. The system of Great Britain under which taxation is deducted at the source from dividends enables the relief to be passed on by lessening the amount of the deduction by each corporation from its shareholders. Other systems necessitate the whole computation being made by corporations who alone can discuss it with the fiscal authorities and afterwards inform the shareholders. If, for instance, the shareholder in New York owns shares in a large number of companies, each of which arrives at different settlements on the grounds of double taxation, he must either make a series of claims for each or wait until he has received full information from all his sources of wealth and then have one complete settlement of his relief from his personal tax.

It may be said that method 3 has been actually adopted by the British Imperial Government in relation to its Dominion Governments, and this aspect needs very careful consideration. If it has been successfully adopted there, why should it not be possible elsewhere? There are, however, other important considerations. First of all, the amount of relief afforded by each Government. Under this head it will be recognised that the relations existing between the Dominions and the British Government introduce factors hitherto not discussed by us, namely, the factors of imperial allegiance and common imperial service, which induce the respective Governments to make concessions to each other. This would enable a proportion to be arrived at on particular lines which has no present parallel or analogy as between two entirely distinct Governments, whatever may be the ultimate development of feelings of interdependence and consequent spirit of concession fostered by the League of Nations. The ease, therefore, with which a proportion has been agreed upon may be deceptive if it is thought that it indicates any really economic or theoretical principle, or that it would be equally acceptable at present between two entirely unconnected Governments. Secondly, the use of a common language, the existence of a common conception of income so that divergences are of the smallest character, the easy relations that exist of a political character to enable the necessary data to be determined— all these factors would put the easy working of method 3 at a maximum in the case of the British Empire. It is not to be expected that a similar ease in working could be found as between countries with diverse language, diverse income-tax systems, diverse conceptions of income and less effective political connections.

We are given to understand that very considerable complications on the lines of those we have indicated above actually exist in the British system, and that it is only by a very highly developed civil service and a taxing department of very great intelligence and skill that these difficulties are even roughly surmounted. We are warned that even the moderate degree of
success in practice attending the British compromise with its Dominions cannot be confidently anticipated in any other circumstances.

**Income Tax and the Exemption of the Non-Resident.**

In short, we doubt whether, except in particular cases of neighbouring countries with like ideas, or in the separate commonwealths of a single inclusive federal government, the apparent facility afforded by method 3 of overriding the complications of method 4 would really be found to exist at present in practice. Method 3 accordingly offers in its practical working, and in the theoretical determinations that are necessary in the first place, such complications that we are driven to ask whether method 2 may not have much to be said for it where it is difficult to adopt 3 and where method 2 would not be unfair in its results. Over a very wide area it might well be that, after the complications of method 4 or method 3 had been worked out, the final results upon the exchequers of two adjoining countries, with no great differences in economic allegiance as between them, would not be greatly different from the results of adopting method 2; and a very great deal of trouble might be avoided if method 2 were adopted in the first instance, with its rough approximation to justice.

It follows that in those countries in which conditions are fairly equal it might be advisable to adopt method 2, and that a large part of the double taxation problem of the world as a whole, as regards the area affected, although perhaps not as regards the number of questions involved, would be covered by method 2. This would still leave, as between countries not economically balanced in this matter, countries whose relations were distinctly those of debtor and creditor, the necessity of working out some other method. Thus, over the whole field covering those countries which are, so to speak, upon an equal footing, and where the cases of double taxation are not too numerous and too complicated, method 2 would afford the readiest means of clearing up the problem. The question of the relations with important creditor countries still remains as a subject of special consideration and discussion.

There are other supplementary reasons why method 2, opposed though it is to the instinctive conceptions of many countries to-day, is worthy of consideration. The first part of our report dealing with the economic effects upon investments indicates that a debtor or borrowing country, when it really wants money, can only get it either by exempting the foreign investor from its taxes or by putting up the rate of interest to such a point as to make the country of origin itself pay the taxes normally borne by the foreigner. This leads directly to the view that method 2 has an economic foundation. The third argument in support of method 2 is that it does, in fact, conform with the actual practice of countries that require capital to-day.

Thus, method 2 has three points in its favour: first, that it accords with what Governments are doing to-day so far as the money that they cannot get themselves is concerned, and that it only requires an extension of a Government's solicitude beyond its own needs to those of its own industries; secondly, that it accords with the true economic interests of the investments of the country; and, thirdly, that it is the best escape from all the complications of methods of greater theoretical exactness.

We are united in rejecting method 1 as being, from the point of view of the income tax proper as discussed in this section, no complete and proper solution of the matter.

It may well be said that, so far, the solution provided may be very imposing in the area to which it apparently applies, but that, in fact, it deals with the fewest and least important cases and makes elaborate arrangements for the interchange of economic interests between people who, in fact, hardly ever economically meet in this connection. It may be said that it leaves still to be decided the great mass of important cases which fall between distinctly creditor
and distinctly debtor nations. Must it, then, be admitted that no solution is obtainable at the present time?

There are, no doubt, considerable administrative difficulties even in method 2. But they do not appear to be insuperable; and although they are similar in character to the difficulties under the other methods, they tend to be less difficult to manage in the case of method 2. Naturally the creditor countries tend to be those in which corporations with highly complex trading relations with the rest of the world have their headquarters, and the problem where income flows to an individual through such a corporation is more definitely within the hands of the administrative machine closely associated with those corporations. In the simple case of a resident in Holland who has income from an American farm, the United States Government can merely require evidence of ownership and the amount of American tax paid in respect thereof to be given in an approved form before some authorised representative in Holland in order to repay at the Dutchman's residence or to his agent any tax that had been paid in the United States, or, indeed, to exempt the farm from the appropriate original charge. In the case of a corporation in the United States distributing fully taxed United States income by way of dividends to the Dutchman, the duty would be upon the corporation to give the shareholder a certificate as to the amount of American tax appropriate to his dividend, that is to say, the amount by which his dividend would have been increased if no such tax had been payable, and upon the strength of this a repayment or exemption would be due to the Dutchman. In the case of government and municipal loans, the exemption of the foreigner would fit in quite closely with existing economic methods. The complicated case of the American corporation distributing dividends out of income only partially taxed in the United States would still have to be settled as between the corporation and the United States Treasury in order to indicate what actual burden was falling upon the Dutch shareholder.

The object of the foregoing is to show that even method 2 in this complicated economic world is not without considerable administrative difficulties. But it does fit more closely to the facts of the case, and especially so far as England is concerned, where the taxpayer could show clearly by his dividend warrant what British tax he has suffered, it is the most feasible method.

No doubt the creditor countries on the whole would be willing to solve the method of double taxation by offering the debtor countries method 2. They would be more reluctant to give methods 3 and 4, partly because of the greater cost falling upon their exchequers and partly because of the more complex theoretical and practical considerations at stake. On the other hand, the debtor countries would no doubt be very reluctant to accept method 2, for the reasons that it would be the most burdensome to their exchequer, and, second, that it does violence to what are at present their instinctive ideas as to their rights to origin taxation. It will be clear that under method 4, where the country of origin would tax pure and predominant origin assets, such as land and real estate, in their simple form, but would refrain from taxing shares in companies belonging to foreigners, it is open to the taxpayers by merely changing the legal entities, that is to say, by interposing a company between the property and the owner, to turn direct ownership into shareholdership. Conversely, by dissolving existing intermediate entities so that the foreign shareholder becomes a direct holder, it is possible for the individual to shift according to his own interest from one class of assets to the other and to regulate under which scheme of taxes he will fall. It is highly undesirable to have any such power in the hands of the taxpayer or to encourage any such tendencies. Method 4, even if modified by method 3, has these complications, whereas method 2 deals uniformly with the individual deriving income from abroad.

It is possible that the creditor countries might be willing to make individual conventions with debtor countries, under which method 2 would be adopted as the main method; but a concession might be made in principle to the principle of origin, limited as in method 4, not, however,
to be carried out by dealing with the individual. Thus, as between Britain and the Argentine if all British investors in the Argentine were repaid Argentine taxation by the Argentine Government and all Argentine residents were repaid by the British Government all British income tax charged at the source in respect of their British investments, then at the end of a period of a year the Argentine Government would say: “We have given up 1 million units of revenue under this system, whereas you, the British Government, on the other hand, have only given up 100,000 such units. If method 4 had been conceded and we were entitled to retain the income tax on the origin for real estate, etc., the depletion of our exchequer would have been only 800,000 units. Please put us in the position that we should have been in if method 4 had been adopted and had been practicable, and make good to us the difference of 200,000 units that we have temporarily suffered by giving up the purely origin taxes, or, on the other hand, make good some appropriate approved proportion of it.”

Things that may be too complicated to deal with administratively as between individuals and to explain to them may very well be capable of presentation between two Governments for an exchequer transfer in the aggregate; and, if the fiscal system of the Argentine enabled them to say that out of the aggregate repayments and allowances made to British investors they could assign a certain sum to income from land and buildings and so forth, then a possible basis would exist for meeting the wishes of the creditor country not to be wholly at the mercy of the debtor country’s taxation, and for carrying through the main economic principles of method 2. At the same time, so far as the debtor countries are concerned, it would be possible to avoid doing complete violence to the present obvious and strongly-held views as to their rights to origin taxation in the case of certain specific properties, and also in many instances to avoid throwing too great a burden upon the exchequers of those debtor countries.

Complete frankness requires us, however, to call attention to the fact that even this method is not without its difficulties. The reason why individuals may ordinarily be counted upon to set in motion the machinery providing for a remission of double taxation is the obvious one that they will experience the benefit in their own purse. The motive which actuates them in undergoing all manner of annoyances and obligations in their domains is pure self-interest, and they will leave no stone unturned to put all the relevant facts before the Government in question. But in so far as the Governments themselves, rather than the individuals, are invested with the obligation of classifying the repayments, it will be more difficult for the Government in question to secure from the individual all the relevant facts, since the individual will not have the same motive for presentation of all the details. This is not, indeed, an insuperable difficulty, but it is one that ought to be mentioned at this point.

At the present stage of our considerations, however, we do not see any other form of compromise which is likely to reconcile the conflicting interests and to have any prospect of success upon three points: (1) to reconcile the widely opposed interests of debtor and creditor exchequers; (2) to admit those ideas which, though widely accepted in many countries, are, in our view, in relation to income tax, to a considerable extent economically undeveloped in so far as they ascribe undue importance to origin taxation; and, lastly, (3) to conform to what is, in the experience of fiscal administrations, practically possible in dealing, in such a complex world, with the income of individual persons.

It may well be that there will be some countries which feel unable to secure the principles of method 4 by combining the administrative machinery of method 2 with an aggregate collective settlement between two exchequers, because they would be reluctant to turn over to the settlement by Government, matters which primarily affect individuals and which may be attended by so many controversial questions. In such cases there is nothing left for them but to approach other nations with a view to the adoption of conventions under method 4 as modified by 3. But we can only warn them that they will find it extremely difficult to make conventions of this character with creditor countries having highly developed income taxes because, in the administration of
method 4 even as modified by method 3, so many practical and theoretical difficulties will be found. If, however, such countries can secure a measure of relief from double taxation by a reciprocal arrangement with other countries under method 4 even as modified by method 3, because method 2 appears to them to be burdensome or economically undesirable, it may well be a start which will lead to later developments.

Conclusion.

To sum up:

(1) On the subject of income taxation in its developed form, the reciprocal exemption of the non-resident under method 2 is the most desirable practical method of avoiding the evils of double taxation and should be adopted wherever countries feel in a position to do so.

(2) Where method 2 is repugnant owing to a reluctance to abandon the principle of origin, method 4 as modified by method 3 may be the subject of mutual conventions; but even then it is best carried out by an administrative system similar to method 2, supplemented by a collective settlement on agreed lines between the two Governments.

(3) Where countries desire method 4, but do not care to have it carried out by combining method 2 with such an overhead government settlement, they must make the best arrangement they can under method 4, perhaps modified by method 3. But we hold out no hopes of this proving to be a smooth and practicable arrangement. It can be only approximate and not an instrument of that degree of sensitiveness and accuracy which developed communities expect.

Looking forward to the future, the influence of example by others and the spirit encouraged by the operations of the League of Nations indicate the possibility of a development away from localised ideas and from the earlier stages of economic thought typified by strict adherence to the principle of origin. Moreover, as semi-developed countries become more industrialised, with the resulting attenuation of the distinctions between debtor and creditor countries, the principle of personal faculty at the place of 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 an ultimate development of national ideas on uniform lines toward method 2, if not as a more logical and theoretically defensible economic view of the principles of income taxation, at least as the most practicable solution of the difficulties of double taxation.
ADDENDUM.

ALLOCATION OF EARNINGS WHERE THE WHOLE OF THE ECONOMIC STAGES ARE NOT CONDUCTED WITHIN ONE AREA.

Reference has been made in the course of the report to different degrees of allegiance which may attach to different stages of what is in the last resort a single economic action, but which can be subdivided and is in actual practice often subdivided. For example, there is first the mere sale of produce in a country where all stages up to the production of the finished article may be carried through elsewhere. Secondly, the products may not be merely sold but also adapted or altered in some way after arrival in the country. Thirdly, the actual manufacture or production may take place in the country, but the extraction of raw material and so on may be effected entirely abroad. Fourthly, in modern highly integrated industries, all stages of production, from the extraction of raw material or the growth of produce to the manufactures resulting therefrom and the final sale may take place in the hands of a single corporation, and the final result of all these stages, which may in other countries be in the hands of separate industries or people, will be represented in a single profit-and-loss account. The problem that arises in practice is how the result can be subdivided in order to indicate the different degrees of claim that a State may have upon each operation. The case of a company performing several of these operations in country A but the final operation of sale in country B is held to give country B a special claim upon the tax on the profit, but not upon the whole of it; and criteria have to be sought for assigning the profit to the other respective areas in which the economic stages have been conducted.

Such criteria of division are perhaps more easy to arrive at where a company carries on identical operations in two separate States. The more difficult cases arise where what is done in two separate States is not identical. The criteria of division of the results that are generally adopted in practice include the following:

1. Value of sales.
2. Total capital involved in the business in each country.
3. Total stocks of goods maintained in each country.
4. Where property or real estate is involved, the total value in each country (this may be modified, where value is not appropriate, by total area, cubic space or other criteria for productive output).
5. Total salaries and establishment expenses.
6. Total credits arising in each country.

The suitability of criteria depends entirely on the nature of the business, and generally their application is ad hoc. Illustrations exist, for example, in different American States of methods of dividing the property or profits of franchise companies like railways as well as of general business corporations. This is especially true of the recent income taxes in New York, Massachusetts and Wisconsin. It may well be that the experience of more advanced countries in these matters could profitably be collected and collated and used as the basis of conventions for countries to whom they are more or less novel. It would be outside the scope of our enquiry
to point to any theoretical conclusions as to which are the appropriate criteria for different classes of business, since so much depends upon what is practically available in the way of accountancy details and upon the actual economic structure of the business under consideration. It is only necessary here to say that when the criteria have been adopted and division of resources or profits has been accordingly made, then the different degrees of economic obligation on the part of the profit-making business to the respective countries is theoretically capable of discussion.

It will, for example, be realised that the obligations of the country that has a factory producing goods and selling them within the country is greater than those of one which confined its activities to selling goods but not producing them in the country. Similarly, in the converse case, the obligations of a concern performing all the economic stages within a country would be greater to that country than if it merely performed the first of them but all the remainder elsewhere. If it is desired by the Financial Committee of the League or by the other committee of officials charged with the consideration of this subject, we should be prepared to develop further ideas on the principle involved.
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