F. 212

LEAGUE OF NATIONS

DOUBLE TAXATION

AND

TAX EVASION

Report and Resolutions

SUBMITTED BY THE

TECHNICAL EXPERTS

to the Financial Committee of the League of Nations.

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F. 212

Geneva, February 7th, 1925.

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C. 368. M. 115. 1925. II.

Geneva, June 11th, 1925.

DOUBLE TAXATION AND TAX EVASION.

Extract of the Report of the Financial Committee to the Council of the League of Nations.

June 8th, 1925.

(1) At the end of 1921, the Financial Committee, instructed by the Brussels Conference to discover possible ways of solving the double taxation problem, decided that it would first of all investigate the question from a purely general point of view.

They therefore entrusted the task of studying double taxation in its theoretical aspect to four expert economists, whose report (Document F. 19) was published in March 1923.

In June 1922, the Financial Committee decided to call in a number of technical experts on fiscal matters to examine from an administrative and practical point of view both the problem of double taxation and that of tax evasion, which had just been submitted to the League of Nations. These experts sought to obtain every kind of information which could be of value, and, in particular, they were in communication with the International Chamber of Commerce, which had, from the time of its foundation, been investigating the question of double taxation.

The conclusions now before the Congress of the International Chamber follow closely those of the experts, and the results of the discussions of the Congress may be of help in the subsequent work by the League of Nations.

At the suggestion of the Financial Committee, the resolutions of the experts were published in March 1925, with an explanatory report (Document F. 212).

(2) During its present session, the Financial Committee examined this text. M. d'Aroma, who had presided over the work of the technical experts, came to Geneva and personally submitted a number of comments on the report and the resolutions.

(3) The Financial Committee support the recommendations of the experts concerning the proposal to convene a Conference of technical experts on a wider basis and including representatives of countries other than the seven which nominated the present experts. This Conference would take the resolutions of February 7th, 1925, as its basis, and would see if it were possible to draw up preliminary drafts for international Conventions.

(4) The Financial Committee strongly urge that the future Conference should, while seeking to provide a remedy for tax evasion and double taxation, take into consideration the disadvantage of placing any obstacles in the way of the international circulation of capital, which is one of the conditions of public prosperity and world economic reconstruction.

(5) Subject to this observation, the Financial Committee are in agreement with the general lines of the ideas set out by the experts in their resolutions of February 7th, 1925.

RESOLUTIONS OF THE COUNCIL OF THE LEAGUE OF NATIONS.

I. *March 11th,* 1925:

The Council authorises the Secretary-General and the Financial Committee, if the latter think fit, to invite certain Governments to appoint experts with a view to holding a conference of experts on double taxation and tax evasion.

II. *June 11th,* 1925:

The Council notes the great progress made in the examination of the problems of double taxation and tax evasion. It has received the report and the resolutions of the technical experts, which were published in March 1925 at the suggestion of the Financial Committee. It notes that the Financial Committee are in agreement with the principal conclusions of this document and that they support the recommendation made to summon a conference of technical experts on a wider basis. On these latter points, the Council confirms its previous decision given on March 14th, 1925, and instructs the Secretary-General to issue the necessary invitations on its behalf.

C. 115. M. 55. 1925. II.

Note by the Secretariat.

At the end of 1921, the Financial Committee, instructed by the Brussels Conference to discover possible ways of solving the Double Taxation problem, decided that it would first of all investigate the question from a purely general point of view.

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The present document, which is the outcome of the work of these technical experts, was submitted by them to the Financial Committee on February 7th, 1925. The latter has not yet considered it. It has, however, as in the case of the economists' report, authorised publication, believing that full and free discussion of the ideas contained in this valuable report — alike in scientific and administrative quarters, and in commercial and business circles generally — should, by enlightening both public opinion and the interested parties, help considerably in paving the way for the acceptance of such measures as would effectually solve the problems at issue.

It must therefore be understood that, at the moment, the following document does not express the views of the Financial Committee, but merely those of its authors, who, moreover, have given their opinion as technical experts and not as Government representatives.

Geneva, February 1925.

Geneva, February 7th, 1925.

PRELIMINARY NOTE

On October 17th, 1922, the Secretary-General of the League of Nations, in accordance with a proposal which was made by the Financial Committee and approved by the Council, requested a number of European countries to state whether they would be prepared to nominate a technical official to sit on a Committee formed to study the questions of double taxation and tax evasion. The Financial Committee considered that "in order to arrive at any real solution of these two important questions, it was essential to obtain the opinion of the representatives of certain Governments. Still better results might be anticipated if a meeting of these representatives were convened in order to discuss the possibility of an agreement to enable common action to be taken upon certain points, and to permit the drawing up of schemes, bilateral agreements and other arrangements concerning double taxation and the evasion of taxation".

The Governments thus consulted agreed and nominated the following official experts:

Belgium:	M. Clavier, Director-General of Direct Taxation.
Czechoslovakia:	Dr. Valnicek, Head of Department at the Ministry of Finance.
France:	M. Baudouin-Bugnet, Director-General of Direct Taxation.
Great Britain:	Sir Percy Thompson, K.B.E., C.B., Deputy-Chairman of the Board of Inland Revenue.
Italy:	Prof. Pasquale d'Aroma, Director-General of Direct Taxation.
Netherlands:	Dr. Sinninghe Damsté, Director-General of Direct Taxation, Customs and Excise.
Switzerland:	M. Blau, Director of the Federal Taxation Department.

After the third session, the British member, Sir Percy Thompson, was appointed to sit upon a commission in India, and his place was taken by Mr. G. B. Canny, C.B., of the Board of Inland Revenue. M. Baudouin-Bugnet, the French member, having been appointed one of the "Presidents de Chambre" at the Audit Office, was replaced by M. Borduge, his successor as Director-General of Direct Taxation.

As their official duties made it impossible for them to be absent from their country for any length of time, the experts met on five occasions, at Geneva:

First Session:	June 4th-9th, 1923.
Second Session:	October 8th-13th, 1923.
Third Session:	March 31st-April 7th, 1924.
Fourth Session:	October 20th-27th, 1924.
Fifth Session:	February 2nd-7th, 1925.

They elected as their Chairman, for the entire work of the Committee, Dr. Pasquale d'Aroma, the Italian representative. M. Léon-Dufour, Secretary of the Financial Committee of the League of Nations, acted as Secretary.

The experts have submitted separate memoranda — about twenty in all — to the Financial Committee [1]. In these they explain the legislation in their respective countries or give their personal views. Moreover, at the end of each session — the Minutes of the various meetings can be consulted at the Secretariat of the League of Nations by the members of the Financial Committee — they reported to the Financial Committee on the progress of their work [2]. It is impossible to reproduce here the numerous documents which give in detail the results of their investigations.

The experts have now the honour to submit to the Financial Committee the text of the *resolutions* on which they have agreed. The resolutions are preceded by a *report* containing a statement of the grounds on which they are based and a commentary thereon.

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[1] M. d'Aroma	Documents	F. 46 and 144.
M. Baudouin-Bugnet and M. Borduge . .	»	F. 40, 141, 167 and 204.
M. Blau	»	F. 34 and 129.
M. Clavier	»	F. 47 and 192.
M. Sinninghe Damsté	»	F. 35, 77 and 123.
Sir Percy Thompson	»	F. 37, 38 and 130.
Dr. Valnicek	»	F. 41, 48, 51 and 139.

[2] First Session, Document F. 50; Second Session, Document F. 80; Third Session, Document F. 146; Fourth Session, Document F. 193.

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DOUBLE TAXATION AND TAX EVASION.

REPORT AND RESOLUTIONS

submitted by the TECHNICAL EXPERTS to the Financial Committee.

PART I.

INTRODUCTION.

Our task, as we understood it, consisted in endeavouring to bring about a more equitable international assignment of taxation, to prevent the evil effects of double taxation and to check tax evasion. But we have fully recognised that no change can be made in the present condition of affairs without some modification of the domestic legislation of the various countries or without international conventions.

It should therefore be understood that the recommendations on which we have agreed and which are set out in the following pages will be of no practical value unless the League of Nations adopts them, and unless the various countries themselves, in the free exercise of their sovereign powers, recognise them and obtain parliamentary approval for the laws and conventions which they will necessitate.

We have regarded our task as being that of technical experts endeavouring to prepare the best possible system for remedying the evils of double taxation and tax evasion. We have contributed to the common stock the experience we have gained in our official capacity, and it has been our desire, by omitting consideration of interests of too special a character, that this experience should serve the general interests of all States Members of the League, and even non-Members. On more than one occasion we have had before us proposals which some of us desired to accept — and indeed have accepted — as technical experts, although they were at variance with our own legislation and even with the general trend of opinion of our Governments or their expressed views. We were able to do so because we knew that our agreement or non-agreement to any particular proposal would not in any way bind the Governments by which we were nominated.

The terms of reference given us by the League of Nations were of a very general character, and although only seven European countries were asked to nominate representatives — since the Council and the Financial Committee felt that they were bound to proceed slowly in so complex a question — the experts selected have attempted to carry out their task in an international spirit in conformity with the high purpose of the League.

PART II.

DOUBLE TAXATION.

1. INVESTIGATIONS CONDUCTED PREVIOUSLY TO, OR AT THE SAME TIME AS, OUR OWN.

Certain work accomplished outside the Financial Committee has been of great assistance to us.

First of all, we may mention the discussions which have taken place at several of the Congresses of the *Institute of International Law* with regard to the problem of double taxation, and, in particular, the resolutions on succession duties [1] adopted at its Thirtieth Congress at Grenoble in 1922.

On July 2nd, 1923, the *Economic Committee of the League of Nations* obtained the Council's approval for a series of recommendations which were, as a result, communicated to all States Members of the League. The object of these recommendations was to secure the application of part of Article 23 of the Covenant (equitable treatment of industry); they referred, among other matters, to the fiscal treatment of foreign companies and nationals. We have paid special attention to Article 3, which relates to the principle to be followed in taxing foreign undertakings established in a country and the observations which the Economic Committee formulated in connection with this article when communicating it to the Financial Committee[2]. This question is related to that of double taxation, and we entirely concur in the recommendations which have been submitted to the States Members of the League.

The League of Nations *Sub-Committee on Ports and Maritime Navigation*, which is a sub-section of the Advisory Committee for Communications and Transit, requested us to hear its representatives during our fourth session in Geneva.

In October 1924, these representatives explained to us the Sub-Committee's views on double taxation in the case of the shipping industry, which are practically the same as those of the International Chamber of Shipping.

The International Chamber of Commerce was no sooner founded than it placed on its agenda the problem of double taxation (Resolution No. 11 of the Constituent Congress in 1920). The London Congress in 1921 adopted four general principles[3]. The special Committee appointed in London to report on the question continued its work under the Chairmanship of Professor SUYLING (Netherlands). It attempted to embody the principles laid down at the London Congress in a number of rules capable of being put into actual practice. It based its suggestions on new factors which might arise in the fiscal legislation of various countries, and it took into consideration the views obtained by the Secretary-General of the Chamber after consultation

[1] Document F. 14.
[2] Document E. 92 (2), pages 2 and 3.
[3] Document E. F. S. — A. 157.

with the various national committees. On December 20th, 1922, the "Committee on Double Taxation" drew up a first series of resolutions [4] which were submitted to the Congress at Rome. These recommendations were cast in a new form after further consultations [5] on November 22nd, 1923 [6], and, finally, on March 1st, 1924 [7].

In studying this problem, the International Chamber of Commerce maintained close contact with the League of Nations, and in March 1923 [8] it communicated to the Financial Committee the principles laid down by the London Congress. The Secretary of our Committee was invited to be present at the sessions of the Committee of the Chamber in 1923 and 1924. Finally — a fact of special importance — the International Chamber of Commerce in April 1924 sent to us during our third session a delegation consisting of M. CLÉMENTEL, its President and founder, Sir Algernon FIRTH (Great Britain) and Mr. ROBINSON (United States), assisted by Mr. MCCULLOCH and Mr. ROOKER, representing the General Secretariat. This delegation explained to us the Chamber's views and commented on the resolutions adopted in March 1924. Subsequently, the Chamber sent us memoranda which it had received from the various national committees [9], setting out certain definite cases of double taxation; these we examined at our fourth and fifth sessions.

The following are the main provisions of the resolutions adopted by the Chamber [10]:

Resolution I, which applies to all direct taxes without exception, lays down the principle that—

> "In order to avoid double taxation, the best means would be to accept residence as a basis of the tax on income. They [the Committee] recognise, however, that the application of this principle could not be expected completely to preclude all taxation according to its origin of income derived from landed property or even from commercial or industrial enterprises.
>
> "In all cases, without exception, where taxation according to origin cannot be avoided, the Committee consider that a distinction must be made between taxes affecting income at its origin and those which affect the taxpayer by reason of his residence and are charged on his entire income. They consider it essential that the country of origin should confine itself to taxing incomes accrued within its territory by a tax at the source, at the same time strictly limiting this taxation.
>
> "It follows from the above that the country of origin is not entitled to require from the non-resident taxpayer declarations covering any composite part of his income, no matter what its origin may be."

The Chamber recommends that some system of relief should be adopted, but does not, however, define the system. It expresses a desire that States should come to an agreement as to the definition of fiscal residence and that more bilateral conventions should be concluded.

In Resolution II the request is made that the principle of reciprocal exemption should be applied to the shipping industry, and in Resolution III the opinion is expressed that taxes on successions should be assimilated to taxes on income.

The Italian National Committee made a reservation. It did not agree with the fundamental principle of accepting residence as the basis for all taxation. It held that, although the criterion of residence might be accepted in the case of personal taxes, the criterion of taxation according to the origin of the income is fairer and more equitable in the case of *impôts réels*.

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[4] Documents F. 5 and F. 5 *a*.
[5] Document F. 75.
[6] Document F. 109.
[7] Document F. 140.
[8] Document E. F. S. — A. 157.
[9] Documents F. 190 and F. 191.
[10] Document F. 140.

Apart from this work, which is being carried on by organisations unconnected with the Financial Committee, we have profited by the results of the investigations undertaken and completed by a *special Committee of Economists* before we ourselves began to deal with the problem. These economists were:

M. BRUINS, Professor at the Commercial University, Rotterdam;
M. EINAUDI, Professor at Turin University;
Mr. SELIGMAN, Professor at Columbia University (New York);
Sir Josiah STAMP, G.B.E., Professor at London University.

When the Financial Committee was instructed in 1921 to study the question of double taxation, it decided to examine this vast field of investigation first of all from the theoretical and scientific point of view. We have accordingly been asked to consider the administrative and technical aspects of the question.

During 1921 and 1922, the economists discussed the subject by correspondence. Then, in March 1923, they met at Geneva and drew up a report[11], a most important work of economic analysis which, in conformity with the Financial Committee's programme, was communicated to us and served as the basis for our work. This masterly report has been of inestimable value to us, and we wish to express our deep sense of obligation to the authors and to associate ourselves with the thanks officially conveyed to them by the Financial Committee and the Council of the League of Nations. It is essential for us here to analyse this document.

The first part explains the economic consequences of double taxation both as regards the equitable distribution of fiscal burdens and the influence of double taxation on economic intercourse and the free flow of capital. It approves, defines and develops the conclusions contained in a note [12] "by an anonymous author" communicated in 1921 to the Financial Committee by its British member, Sir Basil BLACKETT[13]. In its pure or extreme form, the doctrine is "that the investor throws back on the borrowing country the burden of a tax imposed by that country on its investors"[14].

The four economists examine in detail the conditions which limit, and consequently must modify, this theory. They consider the following points: investors' ignorance, investments in existing businesses, investments in lands, cases in which the tax is imposed on a progressive scale, cases in which the origin tax is smaller than the difference between the rates of interest prevailing in two countries, limitations due to the fluidity of capital and effects of supply on market conditions, etc.

The second part deals with the general principles which govern international competence in the matter of taxation. The authors recapitulate the older fiscal theories (the cost theory and the benefit theory) and the theory of nationality, and they develop the modern doctrine of "economic allegiance", to the effect that "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".

They then analyse economic allegiance and proceed to show that four questions have to be answered:

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 ?

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[11] Document F. 19 (printed booklet).
[12] The author of this note is Mr. W. H. COATES, LL.B., B.Sc. (Econ.), British Inland Revenue Department.
[13] Document E. F. S. — A. 16 *a* (printed booklet).
[14] Page 10 of Document A. 16 *a*.

The discussion leads to the conclusion that the most important elements of the question are points 1 and 4, that is to say, the origin of the wealth and the domicile of the owner who consumes the wealth.

The authors then consider in succession the various sources of wealth (immovable property, business enterprises, movable property with a fixed location, movable property without a fixed location, mortgages, shares, bonds, public securities, general commercial credits and professional earnings). They give a table [15] in which they ideally apportion economic allegiance as between origin and domicile. In their view, origin is more important in the case of land, commercial, industrial and agricultural establishments, etc., and, as far as a tax on capital is concerned, mortgages. The element of domicile is, on the contrary, more important in the case of movable property, transferable securities of every kind, general credits and personal earnings and, in so far as a tax on income is concerned, mortgages.

The third part of the report is devoted to the application of these principles and develops four general methods by which double taxation may be avoided.

In the first, which may be called "the method of *total deduction*" — a method applied in principle in the United States — the country of domicile deducts from the tax due from its residents the *whole* of the tax paid by them abroad on their income.

The second method is the extreme converse: the country of origin *exempts* all non-residents from taxes imposed on income drawn from sources within its borders.

The third method consists in dividing the tax and allocating the relief given between the two States. This is the system which has been tried in the British Empire as between Great Britain and the Dominions.

Lastly, the fourth method, which may be called the method of the *assignment* of income, consists in apportioning particular classes of wealth specifically and wholly to the countries concerned, so that, when this division has been made, each country, independently of the other, taxes the part of the wealth which is, so to speak, assigned to it.

The authors finally point out the advantages and disadvantages of each of these four systems and conclude by "looking forward to an ultimate development of national ideas on uniform lines toward method 2".

We cannot conclude this survey of earlier work, which has assisted us in our task, without some reference to the various memoranda submitted by the Economic and Legal Sections of the League of Nations and particularly to the detailed investigation into the various methods of relief which has been carried out by M. Léon-Dufour, Secretary of the Financial Committee. This investigation is illustrated by a number of graphs which give a clear idea of the practical working of the various systems, and we reproduce some of these graphs as an appendix.

2. Definite Attempts hitherto made to solve the Problem.

We were thus in possession of the views of certain committees of experts and the opinion of the commercial and industrial world as represented by the International Chamber of Commerce, and we had the report of the four economists as a solid foundation for our work. But we were also able to take into consideration the definite endeavours made by means of legislation or international agreements (especially within the last twenty years) to overcome the drawbacks of double taxation.

Certain provisions in the internal legislation of States are intended to obviate double taxation, either wholly or partially. We may quote four examples:

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[15] Document F. 19, page 39.

Since 1906, a law in Belgium [16] has provided for the reduction of the rate of taxation (this may amount to three-quarters) on profits earned abroad. The law of October 29th, 1919, concerning taxes on income allows the deduction from taxable income of that part which has already been taxed under another head and the deduction from the taxation leviable of the tax already paid on part of this income. Finally, the super-tax is not as a rule leviable on foreigners who have not been resident in the country for at least six months. As regards succession duties, the law of August 10th, 1923, authorises the deduction from the duties leviable in Belgium of the death duty on transference *(droit de mutation par décès)* levied abroad on immovable property situated abroad and forming part of the estate of a person resident in the Kingdom.

In the Netherlands [17], the tax chargeable on the total income, including income derived from abroad, is first calculated, and then the tax which *would be due* on the latter category if it were taken alone. This second sum is then deducted from the first. The actual rate of taxation abroad is not taken into consideration.

In Switzerland, the legislation of the Canton of Zurich provides that income earned in a business situated abroad shall only be taxable to the extent of one-third. The Federal law concerning the war tax contains a similar provision. The cantonal laws of Basle-Town and Geneva also grant exemption to income derived from businesses situated abroad.

In the United States [18], taxes paid abroad by a United States citizen on income originating abroad is deducted from the tax due on total income. But a maximum is fixed for this deduction. This maximum is determined by calculating the tax on the portion of the income originating abroad (at the American rate applicable to the taxpayer's total income).

The system instituted between Great Britain and the Dominions is, as regards its form, something midway between a national law and a true international treaty. The economic, financial and political ties between the various parts of the British Empire have not prevented the evils of double taxation, which have formed the subject of numerous reports and investigations, but they have rendered the conclusion of arrangements easier. These agreements are set out in a note by Sir Basil BLACKETT, member of the Financial Committee [19]. In the case of income taxed both in the United Kingdom and in a Dominion, a deduction at the Dominion rate is made from the rate charged in the United Kingdom. A maximum is fixed for this deduction (namely, one-half the rate of taxation in the United Kingdom), and it is the Dominion concerned which has to grant the necessary deduction if the total relief is to be equal to the lower of the two rates of taxation.

We now come to actual international agreements or treaties. These are already fairly numerous. They have been collected and their contents circulated by the Secretariat.

Before the war, the Austro-Hungarian Empire concluded with a number of States forming part of the German Empire certain conventions which are still in force between Prussia, Saxony, etc., and the Succession States. The treaty with Prussia, which dates from 1899, has been issued as a special document [20], as have two treaties concluded by the Canton of Basle-Town with Prussia [21] and the Grand-Duchy of Baden [22].

After the war, the new conditions resulting from the dismemberment of a number of European empires increased the difficulties arising out of the rival claims of different States. One after the other, treaties were concluded between certain of the Austro-Hungarian Succession States among themselves or between them and neighbouring States. We may mention those concluded

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[16] Memorandum F. 47 by M. CLAVIER.
[17] Memorandum F. 35 by M. SINNINGHE DAMSTÉ.
[18] See Memorandum F. 138 by the Secretariat.
[19] See Document E. F. S. — A. 16 (printed booklet).
[20] Document F. 15 (3).
[21] Document F. 15 (2).
[22] Document F. 15 (1).

by the German Empire with Austria [23] and Czechoslovakia [24] in 1921, by Austria and Czechoslovakia [25] in 1921, and by Hungary with Roumania [26] in 1923 and with Czechoslovakia [27] in 1922. The German Reich signed in 1923 a convention with seven Swiss cantons [28].

We must, however, make special mention of the Convention [29] signed at Rome on June 13th, 1921 [30], between Austria, Hungary, Italy, Poland, the Kingdom of the Serbs, Croats and Slovenes and Roumania. This instrument is the first known example of a collective convention laying down common principles to be followed by a large number of States. As a matter of fact, several of the above Powers have concluded bilateral treaties based on the same principles. The Genoa Economic Conference in 1922 especially drew the attention of all nations to this Convention.

Czechoslovakia, the only Succession State which had not signed the Rome Convention, signed a special treaty with Italy [31] on March 1st, 1924. This is the most recent treaty known.

3. Origin of the Main Ideas on which Our Work has been based.

Our discussions were based, first, on the whole of the theoretical work referred to above; secondly, on the suggestions put forward by the Institute of International Law and by the International Chamber of Commerce; and, finally, on existing laws and conventions. It was indeed far from easy to fit all this information into a single general scheme. It was even very difficult to ascertain any general tendencies in this mass of rather disconnected plans, ideas and facts. After long discussion, we finally arrived at agreement on certain fundamental points.

I. — All the treaties concluded between the Central European States both before and after the war in the main followed quite definitely the last system mentioned by the economists, namely, the system of the assignment of income, that is to say, apportionment according to country of origin. The Rome Convention, the only scheme for a collective convention which has yet materialised, embodies the same idea.

The provisions of the treaty between Italy and Czechoslovakia may be summed up as follows [32]:

If we look at this treaty as a whole, we shall see that it is based on the principle of establishing different rules according to the different categories of taxes.

With this object in view, the treaty first lays down (Articles 1-5) regulations for the application of the various *impôts réels*, and, moreover (in Articles 6 and 7), rules for the application of "personal taxes" (general income-tax and taxes on capital).

As regards the first category of taxes, the treaty adopts the following classification:

(*a*) Taxation on income derived from immovable property (Article 1);

(*b*) Taxation on income derived from moneys invested (Article 2): (1) income from capital secured by mortgage; (2) income from securities issued by the State,

[23] Document F. 29 (5 and 7).
[24] Document F. 29 (1 and 4).
[25] Document F. 10 (1 and 2).
[26] Document F. 168.
[27] Document F. 21 (1).
[28] Document F. 196.
[29] Document E. F. S. — A. 135; F. 44; Erratum to A. 135. English text.
[30] In course of ratification between certain countries.
[31] Document F. 143.
[32] This treaty, like the Rome Convention, does not deal with succession duties.

provinces, communes or any other legal entities; (3) income derived from savings bank deposits; (4) income derived from the investment of other movable capital; (5) earned income (Article 3); (6) income arising from carrying on an industry or business (Article 4);

(*c*) Taxation on life annuities and taxation on any other form of income not provided for in the preceding articles (Article 5).

According to the general rule adopted for the imposition of the *impôts réels* on all such income, the taxes must be levied in the country of *origin*, that is to say, the country in which the source of the income in question is located (situation of the immovable property, situation of the mortgage, productive occupation, operation of the factory, etc.). Provision is made for a single exception in the case of taxation of life annuities (Article 5) and other forms of income not specially dealt with in the treaty. In such cases the principle of taxation according to *domicile* is recognised.

Further, as regards the *impôts réels*, the treaty provides, with a view to giving effect to the rule of taxation in the country of *origin*, for the assignment of income derived from carrying on an industry or business, if the industry has its headquarters in the territory of one of the contracting States and one or more establishments in the territory of the other State. This rule also applies to taxation on income derived from the investment of moneys in interest-bearing concerns (current or deposit accounts, etc.), if the banks, companies or other credit establishments — which receive sums on deposit and pay interest thereon — have their headquarters in one of the contracting States and branches in the other contracting State.

As regards the second category of taxes (personal taxes), the principle of domicile is given a wider application than in the case of *impôts réels*.

Indeed, in the case of "personal taxes", the rules adopted in the treaty for the *impôts réels* apply also to the personal tax levied on the taxpayer's total income, but only in the case of income derived from immovable property, from mortgages or from an industry or business, in so far as such industry or business is not carried on by a joint-stock company, and, lastly, in the case of earned income.

On the other hand, the principle of *domicile* applies to all other categories of income (income derived from securities issued by the State, provinces or other legal entities; income derived from deposits on current account or savings-bank deposits; income derived from life annuities, and other personal income not especially indicated in the treaty).

As will be seen from the preceding paragraphs, the principle of classification and assignment of income according to origin is applied in the treaty not only to *impôts réels* but also — although within narrower limits — to personal taxes. As regards the latter category of taxation, these provisions lead to lighter taxation, because, if the income is divided up between the contracting States and the rates of tax are graduated, it is impossible to apply the rate corresponding to the taxpayer's total income. This is, no doubt, intentional, because the treaty was to be concluded between States in which the "real" taxation of income was the more important — if not almost the only — system of taxation in force. (In Italy, the supplementary graduated tax on income, which has recently been introduced, comes into force in 1925.)

Let us take, for instance, the case of an Italian resident in Italy possessing a total income of a million lire, of which 300,000 are derived from immovable property and factories in Czechoslovakia, and the rest (700,000) from securities issued either in Italy or in Czechoslovakia, immovable property or factories situated in Italy. The latter country can only apply to that portion of the income which it is entitled to tax the rate applicable to 700,000 lire.

II. — Here, then, is one first interesting feature, the importance of which we duly recognise. But there is a second point, regarding which we cannot do better than quote the four economists (Document F. 19, Part III, Section 1).

"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."

In other words, taxes based on the idea of origin are, particularly in the form of *impôts réels*, still very widely applied, and States, particularly those which are developing, and new countries would find it difficult to dispense with them.

III. — But there is yet a third point. During our discussions we were struck, in considering the comparative development of fiscal ideas, by the progress made by the conception of the personal tax based on the idea of domicile. The preponderating importance of this conception in taxation first became manifest in Great Britain and in the United States in the nineteenth century. Most of the other nations of Europe and America seem to be moving slowly but definitely in the same direction.

The idea of the personal or general tax is clearly connected with the idea of domicile and not with that of origin or source. This leads logically to the reciprocal exemption in the country of origin of income, the owner of which resides abroad, that is to say, the second method defined by the economists. But, as the economists themselves recognised, this method — which is the simplest one — although suitable in the case of two countries in which conditions are fairly equal, can hardly be applied in the case of countries "not economically balanced in this matter; countries whose relations were distinctly those of debtor and creditor".

The first method, which consists in refunding to the taxpayer the tax which he has paid abroad, places a country's budget at the mercy of increased taxation in another country. The third method (allocation of relief) has been tried within the British Empire under the most favourable conditions, *e.g.*, similar principles of taxation, a common tongue, experienced administrative staff and common attachment to the Empire. In spite of this, we do not think that it would be possible to adopt generally such a very complicated system in the international sphere.

IV. — We observed, therefore, that the method of assigning income, which formed the basis of numerous treaties in Central Europe and of a collective convention, appeared at first sight to be the one which was most generally in use. But the evolution of fiscal practice, by adding personal taxes to taxes founded on the idea of origin or by substituting the former for the latter, and our desire to attain universality in our decisions, made it necessary for us to take into account the difficulties caused by differences in the various fiscal systems. But, as we have demonstrated above — and in this respect we are in agreement with the scientific experts — none of the three systems can be applied integrally and by itself.

How were we to escape from this dilemma ? After very long discussion, we believe that we have discovered the solution in refraining from suggesting *any one single* system as applicable to every form of taxation. Our fundamental idea is based on the following fact: there exist in the world many different kinds of taxes — *impôts réels* or schedular taxes, and general or personal taxes on income (to the latter may be added succession duties and taxes on capital). We therefore began by differentiating between *impôts réels* or schedular taxes, on the one hand,

and the personal or general tax, on the other, and we have intentionally made different suggestions in connection with each of these main categories of taxes.

In the case of the *impôts réels*, we have recognised the primary importance of the idea of origin, that is to say, the system of the assignment of income; in the case of the general or personal tax, on the contrary, we have recognised the primary importance of the idea of domicile. Within each of these main categories, we have had to establish special divisions, take account of minor differences, provide for exceptions, and borrow from the Dutch and American systems the idea of deduction, though restricting the application of this idea to a small number of types of income and establishing maximum limits for such relief.

4. Comments on the Resolutions.

The division which we have established between the *impôts réels* or schedular taxes, and the general or personal income tax has been made for purely practical purposes and no inference in regard to economic theory or doctrine should be drawn from this fact. British legislation is entirely founded on the principle of the personal tax, and it is significant that the very expression "*impôts réels*" has no precise equivalent in the English language. In the course of our discussions on this subject, Sir Percy THOMPSON said[33]: "Any classification into '*impôts réels*' and '*impôts personnels*' would become positively dangerous if any attempt was made, from the mere difference of nomenclature, to draw conclusions as to the different economic effects of these taxes".

The survival in many States of the *impôt réel* is a fact which we have noted without drawing conclusions therefrom. It is due principally to two causes. New countries which need foreign capital for their general development desire to have a share in the taxes levied on income arising in their territory, and they are unwilling to leave them to the countries, often already very rich, which have provided the capital. Moreover, from a technical point of view, the collection of *impôts réels*, which does not involve the declaration by the taxpayer of his total income, is, generally speaking, easier and surer than in the case of the *impôts personnels*.

There would be no point in our undertaking here to give very detailed definitions of the *impôt réel*, also known as the schedular tax, which is charged on the income arising from specific sources and not on the income of persons as such. It is, however, important that we should dispel two possible misapprehensions. The expression "*cédulaire*" employed, for instance, in Belgian and French legislation has no more than an etymological connection with the English word "schedule", which appears in the English income-tax legislation. The "schedules" of the English income-tax are only divisions under which income is classified for the purpose of defining the rules for its computation. On the other hand, the French "*impôt cédulaire*" on immovable property, for instance, is quite unconnected with that part of the general income-tax which applies to this immovable property. The same is the case in Belgium.

Again, when we speak of taxation "at the source", we mean the *assessment* of the tax and not the method of its *collection*. In Great Britain, as on the Continent, certain taxes are collected on behalf of the Treasury by a third party — for instance, the company which pays a dividend or interest on stock. In both cases, the tax is "*collected* at the source". But in Great Britain it is a case of a personal tax, while in Italy, France, Belgium or Switzerland it is a case of an *impôt réel* or schedular tax.

(a) *Impersonal Taxes (Impôts réels).*

At the head of our resolutions with regard to *impôts réels*, we recognise the fact that "only the State in which the source of income is situated is entitled to impose impersonal or schedular

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[33] April 4th, 1924.

taxes". The various paragraphs which follow set out in detail what we hold to be the source of the income. We would here offer the following observations:

In cases in which an enterprise carries on its activities in several States, we have been led to lay down the principle of the division of income between these States. The four economists, in their Report, and particularly in its Appendix, have indicated the principles in accordance with which this division might be effected. In the various conventions concluded in Central Europe, we find that there are already provisions on this subject; we would mention particularly the Treaty, and the regulations for its application, of 1921 and 1922 between Austria and Czechoslovakia [34], and the Treaty of March 1924 between Danzig and Poland [35], which provide a sufficiently accurate basis for computing the division of profits. For instance, the latter agreement contains provisional rules which take the kilometric length as the basis or index of division in the case of transport enterprises, and gross receipts and profits in the case of other business enterprises. The regulation for the application of the treaty between Austria and Czechoslovakia also provides methods for the flat-rate computation of the profits of firms, according as the establishments sell, purchase, or purchase and sell simultaneously. A Royal Decree of August 28th, 1922, in Belgium contains similar provisions [36].

Such apportionment of profits constitutes, then, an operation which, though delicate, is feasible, and which is already carried out in several countries. It should even be noted that these operations in treaties concluded in Central Europe apply both to personal taxes and *impôts réels*.

One particular class of industrial and business enterprise, namely *maritime shipping concerns*, has engaged our special attention, and forms, as will be seen, the subject of a special resolution. The International Chamber of Commerce and the special Sub-Committee of the League of Nations which deals with maritime transit communicated to us their views on this subject. For several years past, negotiations have been in progress between seven or eight leading countries for the regulation, by bilateral agreements, of the system of taxation to be applied (on the basis of reciprocal exemption) to maritime shipping concerns. England, the Netherlands, the United States and Japan have enacted domestic laws providing for such exemption, applicable to all taxes without exception, both taxes *in rem* and the general tax on income. The United States, Norway, Sweden and Denmark have recently concluded conventions of this kind [37] with Great Britain.

We have taken these recent cases into account, but have paid even greater attention to the very special character of the maritime transport industry. When an industrial concern carries on its activities throughout the whole world, the importance of the actual headquarters, or the "brain" of the enterprise, becomes paramount; and, above all, very serious technical difficulties may be encountered in determining an apportionment of the profits. The representatives of the Maritime Sub-Committee of the League of Nations have asked how it is possible to determine the profits earned in each of the twenty or twenty-five ports at which a vessel belonging to a trans-Atlantic company may have loaded or discharged cargo, when ten or fifteen different countries have to be taken into consideration.

After carefully examining the situation, we came to the conclusions set out in the two subsections of paragraph (*a*). These conclusions, however, only apply to *impôts réels*. We first took care to lay down in the first sub-section of paragraph (*a*) that the profits of any shipping company which only calls at a port and has no office, agency or branch there should not come under the rule requiring division. In the second sub-section, we have admitted an exception to the general principle of division, although we fully realise that certain countries may not readily

[34] Documents F. 10 and F. 21 (2).
[35] Document F. 169.
[36] Document F. 47.
[37] Document F. 200.

agree to grant total exemption from *impôts réels* to the great shipping concerns which possess a definite organisation in their territory. The only solution we can suggest for this difficult problem is the conclusion of bilateral agreements which would take into account the great differences in the position of the various mercantile fleets, as well as political and general economic considerations.

Impôts réels or schedular taxes on *transferable securities* occupy an important place in the budgets of certain nations. Perhaps no question has given rise to so much discussion, both among theorists and legislators, as that of the taxation of State bonds and shares or bonds issued by companies. International conventions have dealt with this subject from very different points of view. Thus, the conventions between the countries of Central Europe and the Rome Convention have, in general, favoured the imposition of the tax by the State in which the debtor, that is to say, the incorporated company or legal entity which pays the interest, is situated.

The International Chamber of Commerce ("Committee on Double Taxation"), in its resolutions of December 1922, left States free to choose between the domicile of the creditor and the domicile of the debtor. In their report the economists, M. Bruins, M. Einaudi, Mr. Seligman and Sir Josiah Stamp, have accepted the principle that it is the State of domicile of the creditor, *i.e.*, the possessor of the security, that has the right to tax the income arising from all such securities. But they point out how the free flow of wealth is hindered by the conflicting provisions of the various fiscal laws and that the movement of capital into the State where it would, from the point of view of economic laws, be put to the best use is diverted by changes in the rate of taxation or the sudden imposition of new taxes.

We have realised how difficult it is to establish a hard-and-fast principle. In such matters, general economic considerations (need of ensuring the free flow of capital), the difference between the financial and the commercial policy of States (need for a State, according to circumstances, to seek or reject pecuniary assistance from foreign investors), and, finally, the absolute necessity of obtaining the balancing of the budget by means of appropriate fiscal arrangements are elements in the problem which cannot, in the present troubled state of the general European economic situation, be reconciled, unless we take the view that bilateral agreements will supply a corrective to the unduly rigid character of a general principle and make it possible to harmonise the various competing interests.

We have consequently drawn up resolution G, which, we should point out, only refers to *impôts réels* and not to the general income-tax. Let us suppose, for instance, that Morania levies a tax of 10 per cent. on the income from bonds issued by a Moranian company. Morania might, in principle, impose this tax without drawing any distinction between Moranian or foreign holders of these securities. But she will be able to conclude a convention with Imeria under which a person domiciled in the latter country may request the refund of, or exemption from, the aforesaid 10 per cent. tax, upon production of an affidavit or certificate proving that he is domiciled in Imeria[38]. On the other hand, Morania may agree with Imeria that this latter State retains the right to tax — for the benefit of her own treasury — the income from Moranian securities owned by persons domiciled in Imeria.

It will be seen that taxation in the country of origin is maintained as a principle, particularly for administrative reasons. For the collection of the tax in the State of domicile of the debtor, *i.e.*, of the company or legal entity paying the interest, is in point of fact easier, and affords a greater guarantee of accuracy. We also have, in our resolution, specially referred to precautions against evasion, in order to avoid excessive relief. Collusion is always to be feared: a foreigner will maintain that he is the owner of a share and will actually become so, but only for the period necessary to ensure that the person really concerned shall obtain repayment or exemption.

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[38] An affidavit is an undertaking by the State guaranteeing the identity of a person residing in its territory.

The resolution which we propose rests, therefore, on the assessment of the tax in the country of the debtor, an arrangement which corresponds to collection in the country of origin; but we recommend a series of modifications which, through the medium of bilateral agreements, provide the required elasticity.

(b) *Personal or General Taxes.*

The resolutions on which we are about to comment apply not only to the general income-tax — otherwise known as the *impôt personnel* — but also: (1) to succession duties and (2) to taxes imposed on a person's total wealth or total capital. As regards the latter, we have decided to consider only permanent taxes and to exclude exceptional charges, such as a special capital levy or war taxes. It is, in fact, almost impossible to make suggestions in regard to taxes imposed under exceptional conditions.

As has already been indicated, the first resolution, which relates to the general tax, gives preference to the principle of taxation by the country of domicile alone. In the subsequent resolutions, consideration is given to exceptions to this principle and to the practical application of these exceptions in the form either of deductions or the division of the total income.

It is desirable, in commenting on these resolutions, to take a hypothetical case and quote certain figures:

A taxpayer domiciled in Morania has a total income of 100,000 crowns, consisting of 70,000 crowns derived from Moranian securities and property, 20,000 crowns from rent or profits accruing from factories situated in Imeria, and 10,000 crowns from dividends paid by an Imerian incorporated company. It is postulated in Resolution 1 that, in principle, Morania alone is entitled to collect a tax on the total income. According to Resolution 2, when for special reasons Imeria deems it necessary to impose a personal tax applicable to income derived from Imeria but belonging to foreign nationals, the two countries should, if possible, conclude a bilateral convention. The income liable to be taxed in this way by Imeria will include income accruing from immovable property and factories in Imeria belonging to Moranians, but not dividends upon shares.

In Resolution 3, paragraphs 1 and 2, we indicate the different ways in which relief is to be given: Assuming that Imeria has imposed a general tax on all the factories and immovable property owned by Moranians, provision has to be made to prevent or limit double taxation, due to the fact that Morania might tax its own national on his income of 100,000 crowns.

Let us suppose, by way of illustration, that the rate of income-tax in Morania is 5 per cent for a total income of 10,000 crowns, 10 per cent for an income of 20,000 crowns, 30 per cent for an income of 80,000 crowns and 40 per cent for an income of 100,000 crowns.

In the case referred to above, the general income-tax collected by Morania would normally amount to 40,000 crowns.

First Method.

Under (*a*): Morania calculates the tax which *would* be levied on 20,000 crowns (the income subject to relief), *i.e.*, 10 per cent of 20,000 crowns, or 2,000 crowns. Morania grants a deduction to the extent of 2,000 crowns, and will therefore only collect 38,000 crowns, irrespective of the rate of taxation applied to that income in Imeria. This method has the merit of obviating all check upon the tax actually paid in Imeria by the taxpayer. It exposes the Moranian Treasury, however, to the risk of exempting a Moranian national from a sum larger than that which he has actually paid abroad. We have accordingly suggested, under (*b*), another method of relief.

Under (*b*), account may also be taken of the rate of the Imerian tax chargeable on immovable property and factories. Let us assume that this tax is 8 per cent, *i.e.*, that it amounts to 1,600 crowns. Morania will give relief to the extent of 1,600 crowns and will only collect 38,400 crowns. Should the Imerian rate of tax be higher than the Moranian on the same sum — should it amount, for example, to 12 per cent — Morania may limit the relief to that corresponding to her own rate, *i.e.*, 2,000 crowns, and may collect 38,000 crowns; this leads to the same result as that indicated under (*a*). As Imeria continues to enforce its 12 per cent rate, the taxpayer will have to pay 2,400 crowns as the Imerian tax and will receive relief in Morania only to the extent of 2,000 crowns. It may therefore be argued that in this case there will be double taxation to the extent of 400 crowns, owing to the difference between the rates of taxation in the two countries.

This method of calculating relief has already been suggested by the four economists in the case of succession duties. As stated above, it has been applied in Belgium for the past year.

The last paragraph in (1) embodies a different conception, intended to prevent the abuses which might possibly occur in spite of the limited number of exceptions admitted to the principle of the general tax being collected in the country of domicile. Take the case of a Moranian manufacturer or landowner whose total income is 100,000 crowns, 90,000 crowns of which he derives from immovable property or commercial establishments situated in Imeria. Relief in this case would, even when the maximum is applied, represent a very large sum. Our proposal is that the country of domicile should in every case limit the relief it gives to a certain percentage of the tax imposed on the whole of the income, for example, to a fourth of the tax, *i.e.*, $1/4 \times 40{,}000 = 10{,}000$ crowns. The object of this arrangement is that the party concerned should be taxed in his country of residence, where he enjoys the protection of the laws and obtains the advantage of national institutions.

Second Method.

Morania concludes a convention with Imeria providing for a division of the income subject to relief; for instance, such revenue may be assigned in the proportion of 3/4 to Morania and 1/4 to Imeria. We shall continue to employ the figures already used and shall assume that a Moranian possesses a total income of 100,000 crowns, 20,000 of which (rents and profits accruing from factories) are derived from Imeria. The latter country will not tax the 20,000 crowns — the actual income derived from the factories and immovables — but only 5,000 (at her own rate of taxation). Morania will tax the remaining three-quarters, *i.e.*, 15,000 crowns, but she will not tax the remaining quarter at all. The result is that, instead of taxing the 100,000 crowns (as under the first method) and granting relief, Morania will tax only 95,000 crowns. She will, however, tax this amount not at the rate applicable to 95,000 crowns but at the rate applicable to 100,000 crowns. She will therefore collect 40 per cent on 95,000 crowns, *i.e.*, 38,000 crowns.

Should each country receive half, Imeria would tax 10,000 crowns as income from factories and immovable property; Morania would tax 90,000 crowns at the rate, however, of 40 per cent applicable to 100,000 and would thus collect 36,000 crowns. Should the division be made so that a fifth went to Imeria, Morania would collect 40 per cent on 96,000 or 38,400, which is more than she would obtain under the first method.

The system outlined in No. 2, therefore, resembles that of the simple division of income, but differs from it in that the scale of taxation applied by the country of domicile is always the scale applicable to the entire income, although the whole of the latter is not taxed in the country of domicile. This is a difference which, having regard to the steeply graduated rates of modern taxation, may prove to be of great importance. Apart from the consideration referred to above, the proposed arrangement appeared to be necessary in order that persons with the same total income should not be called upon to pay taxes of very different amounts, according as they derived their income from a single country or from a number of countries.

Both the methods proposed for affording relief [39] clearly uphold the principle of taxation by the country of domicile. Under both systems it is necessary for the country of domicile to be aware of the taxpayer's total income, and, in both cases, the rate corresponding to such total income is applied by the country of domicile.

The field to which the relief is applicable, *i.e.*, the list of special types of income which may be subjected to the general tax elsewhere than in the country of domicile and in respect of which relief may be given (first method), or a division may be made (second method), is not clearly demarcated in our resolutions and may be enlarged as a result of discussions between States concluding bilateral conventions. We have merely pointed out that these forms of income include income from immovable property and industrial, agricultural and commercial concerns, but not dividends.

In this respect it is interesting to compare our resolutions with the terms of the Rome Convention [40] and other treaties, for example, the treaty between Italy and Czechoslovakia [41]. It is laid down in Article 6 of the latter treaty, which relates to personal taxation on the total income of the taxpayer, that "income derived from immovable property, industry, or commerce (in so far as such industry or commerce is not carried on by joint-stock companies), mortgages and earned income shall be dealt with according to the rules laid down in the respective articles relating to these sources of income. In the case of every other kind of income, including

[39] Detailed comparison of these systems *inter se* and also of these systems with the methods employed by various States is given in the appendix with the help of graphs.

[40] Document E. F. S. — A. 135.

[41] Document F. 143.

dividends from shares and interest on securities, taxation shall be levied" by the country of domicile. The list of exceptions to the principle of domicile accordingly includes mortgages and earned income in addition to the income given in our list.

Resolution 4 supplements the first three resolutions. It calls attention to the necessity of special arrangements to deal with the complications arising from the difference in the character of various systems of taxation, seeing that some countries merely impose a general income-tax, others only schedular taxes, whereas others again make use of both these taxes. This is a question where the decisive factor will be the relative importance in each particular case of the interests involved. It should be stated that the sacrifices which the country of origin may possibly be called upon to make in connection with schedular taxes will *a priori* perhaps be smaller than the sacrifices required in the case of a general income-tax. Experience shows that the rates of these latter taxes, being graduated, are liable in most cases to reach a much higher level than the rates of the *impôts réels*.

(c) *Fiscal Domicile.*

Throughout the whole of the foregoing we have constantly met the expressions "country of domicile", "domicile of the debtor", "domicile of the creditor", etc. One of the most difficult parts of our work is to determine the exact meaning of these expressions. Domicile has, moreover, a different meaning according as it is applied to individuals and to legal entities.

On reading works on fiscal theory, or the internal laws of various States, or existing international conventions on taxation, we are constantly struck by the variety of the terms used—domicile, residence, mere stay, abode, nationality, seat and locality of the main establishment. These terms recur and overlap, and it is impossible at the first glance to form a clear conception applicable to the subject of double taxation. The Legal Section of the League of Nations Secretariat has set out in a highly interesting memorandum [42] all these differences relating to legislation and theory.

We are of opinion that our first step should be to eliminate a possible source of confusion. The resolutions which follow refer only to principles or to treaties relating to double taxation, and we are far from suggesting that, in regard to domicile, mere residence, etc., the various States should modify their conceptions of private, administrative or even internal fiscal law. In reading these resolutions, it should be borne in mind that they apply only to *fiscal* domicile, and only to fiscal domicile defined purely with a view to the application of the preceding resolutions.

Secondly, we have acquired the conviction that no single solution can be applied indiscriminately to all categories of taxes. A given conception of fiscal domicile, which would serve as the basis for an agreement in respect of one class of taxes, would be useless in dealing with another class. There is nothing illogical about this; even in the internal legislation of individual countries the fiscal domicile of the taxpayer is not always regarded in the same light, where the major categories of taxation are concerned.

We have had therefore, in the case of individuals, to consider two distinct definitions, one applicable to income-tax and the other to succession duties. Annual taxes are taxes applicable to the taxpayer's activities and to the income which he has acquired during a short period. They are apt to be modified year by year according to changes in the taxpayers' financial position Succession duties, on the other hand, are levied once and for all, and the intention is to assess the whole of the taxable "faculty" of a person at the time when his capital and property are about to change hands. It will be realised that nationality may be an important consideration in connection with succession duties. It is also conceivable that account should be taken, on the other hand, of a number of different residences in the case of annual taxes. We lay down general principles and provide for exceptions to which effect can be given by bilateral agreements.

[42] Document F. 43.

The resolution relating to general income-tax consists of three paragraphs. The first states the principle and the second provides for the not-infrequent case of persons who have residences in, or regularly visit, a number of countries. It is couched in somewhat elastic terms, the object being to admit arrangements of all kinds. Experience shows, indeed, that no universal rule can be formulated. Czechoslovakia has concluded conventions with five other countries: the treaty with Austria provides that a taxpayer who has been resident for eight months in one of the two countries shall be taxed by that country; the conventions with Italy and Poland, on the other hand, recognise a division of the income in one case, and in the other, by way of exception, a division of the tax, in proportion to the period of sojourn in the respective countries.

We desire to call special attention to the last paragraph in our resolution, which reads as follows:

> "States shall always be free to tax their nationals on that part of their total income, wealth or capital not taxed under the terms of the previous paragraphs."

Actuated by considerations of justice, we have sought to prevent an abuse which is occurring to an ever-increasing extent. Wealthy persons who have invested their property in easily transferable securities move from one country to another, making only a short stay in each, and possess no immovable property in their own name. They may thus evade all treaty provisions, as these provisions necessarily have regard to external indications or other evidence of a real sojourn in the country. It is our object in the last paragraph of the resolution to frustrate the aims of these taxable persons and, in short, to give the State of which they are nationals the right to charge the taxes which they have sought to avoid by withdrawing themselves from the contractual provisions laid down by the various States.

In the case of legal entities (joint-stock companies), we propose that the fiscal domicile should be the place where the concern has its effective centre, *i.e.*, the place where the "brain", management and control of the business are situated.

If this definition is accepted, businesses will be prevented from nominally transferring their headquarters to a place where the taxes are lower than in the country in which the effective centre of the business is situated.

PART III.

TAX EVASION.

1. Definition — Theoretical Investigations and Definite Attempts to deal with the Problem.

It may, perhaps, be useful to preface the following considerations by dispelling a misunderstanding and defining the scope of the questions relating to tax evasion, a subject which public opinion often confuses with the exportation of capital. Capital is exported abroad for many reasons. Some investors think that the rate of interest abroad is more attractive or suppose that their capital will be better managed abroad; some seek to protect themselves against risks of ultimate expropriation and yield to fears of a political nature; others desire in general to minimise their risks by dividing up their wealth in a number of different countries. Finally — and there have been many and striking instances of this fact in recent years — nationals of a country whose budget shows a deficit, and whose issues of paper money become more and more numerous, fear above all the definite depreciation of their currency, which in that case is the cause of the export of capital abroad and its failure to return to the owner's own country. In this flight of capital due to these various reasons, considerations of taxation play only a secondary part.

The matter on which we have been working has been taxation evasion, that is to say evasion which, particularly by means of the flight of capital, enables the interested persons to escape taxation which is legally due. On the one hand, there are cases of taxpayers who deliberately defy the law and resort to concealment; on the other hand, there are the individuals who, owing to carelessness, forgetfulness or negligence, do not carry out their obligations in the matter of taxation, or who, where (owing to the obscurity of the law) doubts exist as to its interpretation, take the benefit of the doubt in their own favour.

We recognise that the extent to which evasion of taxation occurs differs greatly in different countries and that the nature of this evasion also differs widely. In some countries evasion is mainly due to fraud; but there are others in which evasion due to fraud is almost negligible and the evasion which exists is mainly due to the other reasons which we have mentioned. But, without doubt, whatever may be the cause of the evil, the budgets of many countries are suffering in a greater or lesser degree from the open wound of tax evasion, and in such cases the expert officials of revenue departments can, least of all, afford to disregard this evil. But we are impressed by the moral character of the problem before us. It is true that there are many possible causes for a deficit in the collection of public revenues, from bad harvests and unemployment to export of capital, itself caused by the various considerations above mentioned. But none of these has the immoral character peculiar to fraudulent evasion, and none, we may add, has such a decidedly international character.

The fact, therefore, that the League of Nations has been occupied with the question since the third year of its existence need cause no surprise. But the question differs from that of double taxation in that, as far as we are aware, no enquiry has been conducted by any international body on the subject of tax evasion.

The definite attempts made by Governments to combat evasion in the international field have not been numerous.

In 1843 and 1845, Belgium concluded with France and the Netherlands[43] conventions for the exchange of information concerning immovable property possessed in one of the contracting countries by inhabitants of the other. In 1907, France concluded with Great Britain an agreement[44] under which the taxing authorities of the two countries exchange certain information with a view to counteracting the evasion of death duties. After the war, Germany concluded with Czechoslovakia and Austria[45] detailed arrangements for administrative and judicial assistance in taxation questions. In the treaty between Italy and Czechoslovakia[46], Article 11, it is stated in general terms that the parties will "assist each other in levying and collecting direct taxes", and it is indicated that a separate convention will be concluded on the subject.

These few examples showed us, however, the path, or rather the paths, which had to be followed. There are, indeed, two distinct lines of approach to the subject of taxation evasion looked at from an international point of view — the one leading to detection of evasion in the *assessment* of tax, the other to the *recovery* of tax. In the one case, the taxpayer invests his capital or cashes his coupons abroad, and leaves the revenue authorities of his country in ignorance of his wealth; in the other, the taxpayer who is lawfully taxed in his own country takes refuge in another country in order to make the recovery of tax from him impossible. We have examined both aspects of the question, and have submitted certain resolutions which will be found below in regard to each of them.

2. Evasion in the Assessment of Taxes.

We should point out first of all that, in investigating the question of double taxation, we are almost inevitably led to consider the possibility of some sort of international co-operation between the various taxation authorities. Thus, the Financial Committee's terms of reference to the four economists[47] included the question: "To what extent should the conventions on the subject of double taxation establish an international control to prevent fraudulent claims for relief ?" During our discussions on fiscal domicile we had to examine evasion in the case of taxpayers without any fixed residence. In connection with the system to be applied to transferable securities, we have seen how necessary it is to provide against the abuse of claims for relief from taxation, inasmuch as we are dealing both with exemption from and repayment of tax.

But this is not all. Methods of assessing various taxes may react on each other. Let us take the case of a taxpayer domiciled in Morania and possessing Imerian transferable securities payable in Imeria. If he wishes to obtain exemption from the Imerian schedular tax, he must produce an affidavit proving his nationality and domicile. The Imerian revenue authorities receive the affidavit, but if they do not send it back to Morania with an endorsement as to the amount of the coupons which have been exempted from taxation, the Moranian revenue authorities will probably be unaware of the fact that their national has received this income, and will not tax him thereon. Thus, the taxpayer may wholly avoid taxation.

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[43] Document F. 7 (2 and 10).
[44] Document F. 7 (9).
[45] Document F. 29 (2 and 6).
[46] Document F. 143.
[47] Document F. 19 (Introduction).

Let us now suppose that the taxpayer has not applied for an affidavit and that, although domiciled in Morania, he has paid the Imerian schedular tax without protest. He *may* have an interest in so doing if he wishes to avoid taxation in his own country; for, by not applying for an affidavit, he hopes to leave the Moranian revenue authorities in ignorance of the very existence of his Imerian securities. He therefore pays the Imerian schedular tax, but escapes the Moranian general tax; if the Imerian securities were issued "free of tax", the question of an affidavit would not arise.

The cases which we have quoted are not imaginary, and either involuntary or deliberate tax evasion in assessment occurs very frequently. We have attempted to suggest measures the object of which is both to supply omissions in existing supervision and to combat attempts at evasion.

Our investigation into the question of double taxation and the few treaties existing between some of the European States has suggested to us the idea of the *exchange of information on taxation matters*, an idea which has been clarified and defined in the course of our deliberations. The resolutions, of which the text is annexed, call for the following comments:

What persons are to be the subject of the information to be given ? The revenue authorities of a country X will furnish to countries Y and Z information concerning persons or companies domiciled in those two countries, but not necessarily concerning the nationals of country X itself. Thus, in the example given above, Imeria will supply to Morania information concerning the income arising in Imeria of a Moranian; but it does not follow that she will necessarily give Morania information concerning income paid in Imeria to an Imerian domiciled in Morania.

It goes without saying that the conventions which we contemplate may provide for the exchange of information without any distinction of nationality.

What will be the scope of the information to be given ? Here we have drawn no distinction between the various taxes and have merely reviewed the various categories of wealth or income which a taxpayer may possess.

The headings Nos. 1, 2, 3, 5, relating to income other than that from transferable securities, call for no explanation. Heading No. 4, which is concerned with transferable securities, raises a series of very delicate questions, to which the considerations expressed at the beginning of our resolutions apply with particular force. In the case of income, evasion would theoretically be suppressed if the State in which the income is payable, or in which the interest on a deposit is credited, communicated to the State of domicile of the possessor not only the affidavit — in the case of a claim to exemption from tax — but also, in all circumstances, the total value of coupons and interest paid, in conformity with a procedure similar to that already provided for under the laws of some countries.

It would be necessary, also, upon a death, for the State of domicile of the deceased person to be furnished with all documents, such as inventories, records of legal ownership, etc., establishing the existence of the capital. This would be a generalisation and extension of the system of exchanging information now in force between France and Great Britain under the terms of the Treaty of November 15th, 1907 [48].

The question has been asked whether it would be advisable to include special provisions to combat certain practices by which it is possible to evade the payment of duties on the transfer of property from one person to another upon a death. For example, discussion turned particularly upon the question of opening "joint accounts" or other similar means whereby it is possible to escape taxation. A proposal was put forward to prohibit the opening of a joint account in any country by foreigners not domiciled in that country. After discussion, we came to the conclusion that our task was merely to offer general suggestions without discussing in detail all the various forms of procedure which facilitate tax evasion. Therefore, while fully recognising

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[48] Document F. 7 (9).

how desirable it would be to check these practices, we have not felt called upon to recommend any special measures.

We are also aware of the difficulties and objections which may be raised to all measures aimed at combating tax evasion; we shall examine the principal ones, and shall thus be able at the same time to offer a commentary on the text of our resolutions.

The first criticism passed on the existing convention between France and England is that it increases the mischievous consequences of double taxation on account of the conflict of laws in respect of domicile. "The mutual interchange of information may thus, in some cases, bring, quite correctly under existing law, the whole of a personal estate under liability to taxation in both countries" [49].

To this objection, which may be made both in respect of income-tax and succession duties, it may be replied that the proposed resolutions form an indivisible whole, and that their object is to prevent both double taxation and tax evasion. The foregoing criticism will be seen to furnish a fresh proof of the close connection between these two problems.

A second objection is based on "the inviolability of banking secrecy". The fact cannot be disguised that public opinion in many European countries does not accept the idea that public officials should have power to require information from a third party concerning a taxpayer's personal estate, and that these officials should transmit such information to another State. It will be remembered in this connection that the Genoa Conference of 1922, when it requested the League of Nations "to study the question of measures for international co-operation to prevent tax evasion", made a reservation to the effect that "any proposal to interfere with the freedom of the market for exchange or to violate the secrecy of bankers' relations with their customers is to be condemned".

We are fully aware of the importance of the part played by banks in economic life, and in putting forward our resolutions we have endeavoured to avoid hindering their activities and to preserve as far as possible the secrecy of their operations, as is shown by the following considerations, to which some of our number attach more weight than others.

In the first place, it is only a question of the exchange of information between officials who are themselves bound by the strictest rules of professional secrecy. In many countries it is the usual practice for employers to declare to the revenue authorities the amount of the salaries they pay to their employees, workmen, etc., which is perhaps as confidential as the amount of dividends received, or even the total of a deposit account in a credit establishment. There is no reason to suppose that secrecy would be violated by the revenue authorities; in practice, moreover, the transmission of information should be accompanied by every conceivable precaution against leakage.

Secondly, it is not a question of relations between bankers and their clients in the strictly economic and banking sense of the term. Handing share and bond coupons over a counter, filling in a counterfoil or list of securities, paying a customer the value in money of such interest or dividends as have previously been paid in or will be paid in later by the corporate trading body issuing the security, cannot be said to involve on the part of the bank any estimate of the financial position of the customer or, on the part of the customer, any confidence in the ultimate solvency of the bank, which acts as an intermediary. The position is different in the case of sums left on deposit or current account.

However, having regard to the importance of the objections, we have sought to indicate in the actual wording of our resolutions the great care which should be displayed in acting on the lines of our suggestions. In the second preliminary observation we point out that we make our recommendations as technical experts, and go on to state that "it will only be possible to carry out

[49] See Document F. 7, No. 6, page 17, Sect. 12.

these recommendations in any given country if public opinion in that country is sufficiently prepared, and if the Government of the country considers that the measures advocated are compatible... with public opinion".

Thirdly, one of our number expressed himself apprehensive on a certain point. He said that tax supervision in his country worked excellently, thanks to the patriotism of the people, who understood that the system of collection at the source, the communication of documents to the revenue officials and all other administrative measures were conceived and applied in the interests of the national exchequer. If, however, they believed that such information would be utilised for the benefit of the exchequer of another State, he thought that his countrymen (bankers, employees in business houses and officials alike) would be less ready to accept such measures, and this attitude might react prejudicially on the collection of taxes in the country itself.

In order to meet this objection, we have been careful to say in our second preliminary observation that "the carrying out of our recommendations will only be possible in any country if the Government of the country considers that the measures recommended are compatible... with the system employed by the said Government for the collection of its own taxes".

There remains a fourth difficulty, the most serious of all. Suppose that two or three, or even five or six, countries conclude with one another a convention on the lines indicated, and that the transmission of information succeeds to the satisfaction of all. Has the problem been really solved ? Not entirely; for in each country, although the system is complete as regards the other contracting countries A, B, C, and D, it is not so *intrinsically*. There is nothing to prevent the taxpayer from transferring his securities to yet another country which has not concluded any convention with the countries A, B, C and D; and, in spite of the barriers to exportation which may be set up by the countries A, B, C and D, that country will become, if not a convenient refuge, at least a possible haven for unscrupulous taxpayers.

This objection undoubtedly falls to the ground if it is pushed too far. It would be an exaggeration to say that, if there were a single country outside the various conventions against tax evasion concluded by the rest of the world, everything previously achieved would be rendered nugatory. Nevertheless, reduced to its real proportions, the difficulty remains a serious one. If only two or a few States conclude an agreement, there is some danger of a flight of capital with the object of avoiding taxation.

Notwithstanding this, however, we felt that we ought to suggest appropriate remedies to deal with evasion in connection with the assessment of taxes. But in order to mark the importance of this point, we have prefaced our text by an observation which forms an integral part thereof, and which we venture to quote: "The question of fiscal evasion can only be solved in a satisfactory manner if the international agreements on this matter are adhered to by most of the States and are concluded simultaneously. Otherwise the interests of the minority of States which would alone have signed the conventions might be seriously prejudiced".

It remains to explain the penultimate paragraph of our resolution. We were unanimous in recognising, in principle, that, to secure the effective suppression of tax evasion, there should be a general and complete exchange of information necessary to the assessment of taxes. Nevertheless, in view of the fact that the legislation of a great number of countries does not as yet allow the revenue authorities to obtain certain information, whether it be from the taxpayer himself, or a third party; that public opinion in different countries is opposed to any extension of the powers of the revenue authority in this sphere; that, consequently, it would be difficult at the present time to secure any alteration of the law in those countries; and, finally, having regard to the considerations set out in the preceding paragraphs, we have to recognise that the exchange of information should actually be limited to that in the possession of States or which they can obtain in the course of their administrations. This is the first step in the struggle against tax evasion.

3. Evasion in the Recovery of Taxes.

The distinction which is drawn in all fiscal legislation between measures for the assessment of taxes and measures for their recovery must necessarily find a place in our investigations on evasion. In this sphere also taxpayers may endeavour to leave their country to escape the just claims of their country's exchequer.

We submit three resolutions regarding the action which might be taken by the administrative or judicial authorities of a State with a view to the recovery of taxes.

In drafting these resolutions, we have endeavoured to avoid all interference with national sovereignty. In paragraph 2, we state explicitly that the taxes to be recovered are not to be regarded as privileged debts in the State to which application is made. Should a fiscal claim not yet possess the final character of "*res judicata*", a State need only take conservatory measures (paragraph 3). The production of documents authorising executory measures is a question which the States concerned will have to regulate in bilateral conventions in conformity with their internal legislation.

We have not considered it necessary to enter into further details. The treaty concluded between Czechoslovakia and Germany in 1921 [50] supply a number of very valuable instances of the application of the ideas contained in the resolutions.

It will be observed that we have not laid such stress on the general and even universal character which ought to distinguish these conventions as we did in the case of evasion in regard to the assessment of taxation. There are States which may, indeed, consider themselves better protected than others by their geographical position against the risk of this kind of evasion; they may consequently be less ready to conclude conventions. It is, however, incontestable that neighbouring States situated in the same continent have a vital interest in taking action against wealthy taxpayers who leave their country rather than bear their proper share of the public charges.

4. Tax Evasion : Conclusion.

Before concluding our remarks, we think it desirable to draw attention to the connection which exists between the two problems of tax evasion and double taxation. In the course of our report, we have already noticed this fact in one of its aspects. On the one hand, conventions suggested for avoiding double taxation may contain special measures against evasion, destined to prevent any abuse arising from their application; on the other hand, the exchange of information may perhaps lead to duplication in the levying of taxes. This is tantamount to saying that, in elaborating any practical measure for dealing with one of these problems, account must also be taken of the other.

But before any reform can be undertaken — indeed, as soon as we come to consider whether, and to what extent, remedies can be found for the evils of double taxation and tax evasion — we perceive the points which these problems have in common. In every country taxation questions are daily assuming greater importance, and, in the opinion of certain observers, are tending to bring the Minister of Finance and the taxpayer into opposition. On the one hand, we have the State, whose functions and charges are constantly increasing, and, on the other, the citizen, who is obliged from his income, or even from his capital, to provide the necessary funds.

In the international sphere, also, we see two opposing tendencies. Taxpayers, alarmed by proposals for fiscal control, do not understand why, before or during the framing of measures

[50] Document F. 29 (2).

which may prove embarrassing to them, States do not come to some agreement in order suitably to define their respective jurisdictions as regards taxation, and to avoid double taxation. On the other hand, if States, in concluding agreements to avoid double taxation, are driven to make sacrifices in the matter of the yield from taxation, owing to the granting of exemption, or relief, or the reduction in the rates of their taxes, etc., they may properly endeavour to find compensation for what they thus surrender in measures against tax evasion.

Essentially, however, the connection between the two problems is much more a moral than a material one; the idea of justice in the distribution of taxes is the predominating consideration in all the investigations which we have conducted, both in regard to double taxation and evasion. The International Chamber of Commerce, which had, of course, only to investigate the first problem and which represents a large body of taxpayers throughout the world, clearly perceived this close dependence, and a delegation from that body in April 1924 informed us, through its spokesman, M. Clémentel, that "business men, who are a very worthy class, will welcome any carefully considered and equitable measures which the experts may think it desirable to propose for the prevention of tax evasion".

We desire to point out that these measures are in the interest of all honest taxpayers. At the present time, there is a great deal of concealment of income, and there are taxable persons who pay no taxes at all. If the tax on all this income could be brought into the treasuries of the various States concerned, those States would find, as compared with the present position, a very important additional yield, which might not only enable them to indemnify themselves for the sacrifices necessitated by the abolition of multiple taxation, but also to reduce the rates of their taxes or to redeem their loans. We have clearly shown that public opinion in a number of countries is not yet ripe for the adoption of certain of the proposed measures. A change may, perhaps, take place when public opinion comes to realise clearly that the suppression of evasion may, and indeed must, contribute to lightening a burden of taxation on those honest citizens whose case was authoritatively placed before us by M. Clémentel, the first President of the International Chamber of Commerce.

Further, the question is one of interest for all States, even for those in which, owing to special circumstances, the question of tax evasion is perhaps of less importance than in others. The balancing of the budgets of the different countries is, indeed, one of the principal factors in the stabilisation of the exchanges, so essential to the re-establishment of normal economic relations. The crisis in the export trade, with its lamentable corollaries — unemployment, restriction of international relations with resultant paralysis *(inter alia)* of luxury trades — will be largely overcome if nations understand that their general interests are closely bound together, and that, above all, an endeavour should be made to secure the reign of morality among the peoples of the world.

The League of Nations is peculiarly qualified to support this principle of economic and moral solidarity.

Note.

We have applied ourselves to the study of *direct* State taxes. Where the communes or provinces of a State levy an additional percentage tax upon the basis of the State's direct taxes, any question of double taxation can be solved by the adoption of our resolutions. We recognise, however, the possibility of double taxation and evasion in the case of other kinds of taxes; but we have reached the conclusion, after consideration, that this latter matter should not be the subject of any prolonged examination on our part.

In the *first* place, the financial results of double taxation and evasion in this class of taxes are, in our opinion, very limited; in the *second* place, the differences and complexities of the various legislatures are far more accentuated in this sphere than in the sphere of direct taxes.

For these reasons, we think we ought to limit ourselves to expressing the hope that States will, in this connection, draw up special rules, which would be the subject of examination in other quarters.

PART IV.

GENERAL CONCLUSION.

The Financial Committee has now before it the resolutions which we adopted and the commentaries on their origin and scope.

I. It is, of course, not for us to state what action should be taken on these resolutions; that is a question on which a decision can be taken only by the Financial Committee and the Council of the League of Nations, who requested our several Governments to nominate us to carry out this enquiry. We have considered it useful, however, to indicate to the Financial Committee the results of our discussions regarding the subsequent course of the enquiries conducted and the work done in regard to double taxation and tax evasion.

We would suggest that the Financial Committee might consider the desirability of summoning a conference of technical experts on broader lines than our own gatherings. In the first place, a larger number of countries might be represented on this conference. During our discussions we fully realised the invaluable assistance which we would have derived in our investigations from the presence of experts belonging to certain countries, both on account of the economic and financial importance of these countries and the peculiarities of their legislation. Again, this new conference of experts should be given *terms of reference* different from ours. They might be based on the resolutions we are now submitting, but they should instruct the delegates to ascertain if it be possible to prepare preliminary draft conventions. The latter might provide the programme for an international conference, which would not, of course, be summoned until the conventions had been sufficiently considered and until public opinion in the various countries had been adequately informed and educated on these problems.

Broadly speaking, this is the procedure which we personally consider desirable for the purpose of continuing the work in the field which we have explored.

II. We now desire to lay before the Financial Committee the opinions we formed in the course of our discussions after considering the work undertaken and successfully carried through by the League of Nations in other economic spheres and the memoranda supplied by the Legal Section of the Secretariat.

Let us take the case of an international treaty on double taxation or tax evasion concluded between two or more countries. Who, it may be asked, will settle the difficulties connected with the application or interpretation of this treaty ? A number of international conventions contain provisions laying down a procedure by which resort may be had to a technical body with a view to obtaining an amicable settlement before a dispute between two or more of the contracting States regarding the interpretation or application of the convention is brought before the Permanent Court of International Justice or any other arbitral tribunal.

This is indeed the system laid down, with various modifications, in the Convention relating to Customs Formalities (Article 22), the Convention on the Freedom of Communications and

Transit signed at Barcelona in 1921 (Article 13) and the Statute on the International Regime of Railways signed at Geneva in 1924 (Article 35).

We have thought that one of the questions which it might be desirable to consider in the future is that of the creation of an international organisation.

This body would undertake the duties of conciliation or voluntary and advisory arbitration between States in regard to the interpretation of the conventions concluded between them. It would possess no judicial power strictly so called and would not act as a court of appeal in regard to individual cases.

It is also possible that this institution might assist States by giving them advice, if they so requested, and might help them to conclude conventions or to give conventions already drafted a more general character.

At the present stage of the work undertaken in connection with double taxation and tax evasion, we cannot, of course, do more than make very general suggestions. The practical carrying out of these suggestions will depend on the action which the Financial Committee or the Council may think it desirable to take in regard to our resolutions.

In concluding this report, we are specially anxious to testify to the spirit of friendliness and concession which has characterised all our proceedings. Every one of our number has endeavoured to contribute as largely as possible to the solution of one of the most important questions now before the League of Nations.

Throughout the whole course of our work we have received most valuable assistance from M. Léon-Dufour, Secretary to the Financial Committee. During our protracted discussions he has made valuable suggestions and assumed the heaviest share in the work of framing our report. The appendix to this report reproduces, moreover, with the aid of graphs, his highly interesting investigation into the question.

We desire to express our high appreciation of the aid thus generously given us and the assistance of the members of the Secretariat, who have so ably interpreted and summarised our discussions.

(Signed) d'Aroma.
Blau.
Borduge.
Canny.
Clavier.
Sinninghe Damsté.
Valnicek.

TEXT OF THE RESOLUTIONS.

Double Taxation.

I. Impersonal or Schedular Taxes *(Impôts réels)*.

Generally speaking, the experts recognise that only the State in which the source of income is situated is entitled to impose impersonal or schedular taxes. They applied these principles in succession to various kinds of income:

A. *Immovable property* (land and buildings): Taxes on the actual or presumed rental value should be levied by the State where the property is situated.

B. *Agricultural undertakings*: As above.

C. *Industrial and commercial establishments.*

1. When the whole of an undertaking is carried on in one and the same country, the income should be regarded as originating in that country, irrespective of the nationality of the owner of the undertaking.

2. If the enterprise has its head office in one of the States and in another has a branch, an agency, an establishment, a stable commercial or industrial organisation, or a permanent representative, each one of the contracting States shall tax that portion of the net income produced in its own territory. Therefore, the financial authorities of the interested States shall be able to request the taxpayer to hand in general balance-sheets, special balance-sheets and all other relevant documents.

(*a*) In the case of *shipping enterprises, railway companies, trans-Atlantic cables, aerial navigation companies and electrical power undertakings*, the principle of division is applicable, in proportion to the profits originating in a particular country, provided that there exists in that country a genuine organisation (office, agency or branch) in which business is actually carried on and that it is not — as in the case of shipping companies, for example — merely a question of vessels calling at ports.

Nevertheless, in the case of maritime navigation undertakings, in view of the very particular nature of their activities and of the difficulty of apportioning their profits, particularly in the case of companies operating in a number of countries, the experts admit an exception to this principle — to the effect that the tax should, subject to reciprocity, be imposed only by the country in which the real centre of management and control of the undertaking is situated.

(*b*) *Insurance companies.* — The principle of division also applies to profits realised through an insurance agent representing in the same locality more than one company.

(*c*) *Banks.* — The same principle of division; excluding, however, operations effected by a bank belonging to a specified country in another country, when its operations are confined to discounting or to paying over money.

D. *Mortgages.* — The State in which the immovable property is situated should alone have the right to levy a schedular tax on mortgages.

E. *Directors' fees.* — The State which has the right to levy this tax is the State in which the company has its fiscal domicile.

F. *Earned income.* — The tax should be levied in the State in which the trade or profession is normally and habitually carried on, subject to the right of States to conclude among themselves special conventions to meet the case of persons employed in the neighbourhood of a frontier, or engaged in a profession, employment or trade which necessitates crossing the frontier.

G. *Transferable securities, deposits and current accounts.* — As regards interest on:

(1) Public funds and bonds issued by companies or other legal persons;
(2) Deposits and current accounts:

the State in which the debtor is domiciled shall, as a rule, be entitled to levy the schedular tax, but the experts recommend the conclusion of agreements whereby (particularly by means of affidavits and subject to proper precautions against fraud) reimbursement of, or exemption from, this tax would be allowed in the case of securities, deposits or current accounts of persons domiciled abroad, or whereby the tax would be levied either wholly or in part by the State in which the creditors are domiciled.

Public funds include bonds issued by the State, provinces, departments, communes and by regularly constituted public bodies.

As regards interest on deposits or current accounts, the head or branch office which pays the interest should be regarded as the debtor.

The above regulations shall also apply to the various kinds of schedular taxes on dividends charged upon shareholders, it being clearly understood that there is no reference here to the tax on industrial and commercial profits mentioned in paragraph C above.

H. *Various credits and annuities.* — As regards interest on credits other than those already considered, and on annuities, the State in which the creditor is domiciled shall have the right to impose the schedular tax.

The definition of "domicile" shall in this instance be the same as that adopted for the purposes of the general income-tax.

II. Personal or General Income-Tax.

1. The general income-tax, *i.e.*, a tax (which may be at a progressive rate) charged upon the whole income of a taxpayer, from whatever source derived, should, in principle, be imposed only by the State of domicile.

2. When for its own reasons a State, other than the State of domicile, finds it necessary to impose a general income-tax on income arising from a particular source or sources in its own country, bilateral conventions should, if possible, be entered into between the States concerned with a view to avoiding any double imposition caused by taxation of this character. The kinds of income upon which the State of origin may impose such a tax include: (*a*) income from immovable property; (*b*) income from agricultural undertakings and industrial or commercial establishments, exclusive of dividends upon shares therein.

3. The precise method of avoiding double taxation must be a matter to be worked out in detail between the States concerned, having regard to the circumstances and nature of the respective fiscal systems; but the experts indicate two methods which may be of assistance to any States which may contemplate entering into such conventions:

(1) Deduction by the State of domicile from the general income-tax of a sum which will be:

(*a*) Either the tax calculated according to the State's own scale and charged exclusively on income produced in the other countries, each of the latter being taken separately,

(*b*) Or the tax actually paid abroad on the income arising abroad; this sum may be limited to the amount to be deducted in accordance with paragraph (*a*).

In order to prevent a taxpayer whose entire income arises abroad from escaping all taxation in his State of domicile, the amount to be deducted on the above basis should in all cases be restricted to some fraction of the total tax chargeable in the State of domicile.

(2) In the State of the origin of the income, only a portion of the income arising there should be taxed, the other portion being taxed in the State of domicile of the taxpayer, but at the rate applicable to his total income from every source.

4. Similar steps might be taken, or exemption might be granted, in the country of the origin of the income by means of bilateral conventions in cases where double taxation arises by reason of the existence of a general tax in the country of domicile, side by side with schedular taxes in the country of the origin.

III. Permanent Taxes on the Taxpayer's Total Wealth or Capital: Succession Duties.

The rules adopted for the general income-tax are applicable *mutatis mutandis* to permanent taxes on the taxpayer's total wealth or capital and to succession duties.

IV. Fiscal Domicile.

1. *Fiscal Domicile of Individuals.*

A. *General Income-Tax* (taxes on the total wealth or capital).

The State of domicile, for purposes of the general income-tax, shall be the State in which the taxpayer normally has his residence for a portion of the year, the term "residence" being understood to mean a permanent home.

If a taxpayer has a residence or sojourns otherwise than occasionally in different States, each of the said States may levy a general tax; it is desirable, however, in order to avoid double taxation, that those States should adopt a special standard of liability to taxation, or else that they should agree on a proportional division of taxation.

States shall always be free to tax their own nationals on the whole of their income, wealth or capital not taxed under the terms of the above paragraph.

B. *Succession Duties.*

The State in which the deceased had, at the time of his death, chosen to take up his residence with the manifest intention of remaining there, shall for purposes of succession duties be considered as the State of domicile.

States which are unable to accept this definition in its entirety shall retain their own internal legislation. Should double taxation ensue, they might, for the purpose of avoiding it, agree to base taxation upon the nationality or the principal establishment of the deceased or to adopt some method of relief.

2. Fiscal Domicile of Companies or Corporate Bodies.

The State which has the right to levy the tax is the State in which the head office is situated, or, if that office is not the real centre of management and control of the undertaking, the State in which this centre is situated.

Tax Evasion.

A. Assessment of Tax.

In view of the very special nature of the problem of tax evasion, the experts consider that they must, at the outset, submit the following observations, which should be read together with the text of their recommendations:

1. Unlike double taxation, in connection with which any problems arising between two States can be settled appropriately by means of bilateral conventions, the question of tax evasion can only be solved in a satisfactory manner if the international agreements on this matter are adhered to by most of the States and if they are concluded simultaneously. Otherwise, the interests of the minority of States, which would alone have signed the conventions, might be seriously prejudiced.
2. As regards the carrying out of the recommendations, which the members of the Committee, in their capacity of technical experts, submit as being in their opinion the most suitable for counteracting tax evasion, the experts desire to emphasise the fact that it will only be possible to carry out these recommendations in any given country if, in the first place, public opinion in that country is sufficiently prepared, and, secondly, if the Government of the country considers that the measures advocated are not only compatible with public opinion, but also are required for the collection of its own taxes.

The experts consider that the effective method of avoiding tax evasion is for the revenue authorities to undertake to supply on a basis of reciprocity to other countries, in respect of persons or companies domiciled in those countries, such information as may be required for tax assessment, for which purpose it is necessary to ascertain both the income and capital value of:

(1) Immovable property;
(2) Mortgages;
(3) Industrial, commercial or agricultural undertakings;
(4) Movable securities, deposits and current accounts, as determined by means of affidavits or any other documents, proving the existence of capital or the payment of the income;
(5) Earned income, including directors' fees.

Nevertheless, having regard to circumstances of different kinds, the experts recognise that this exchange should be limited actually to the information which is in the possession of States or which the States can obtain in the course of their fiscal administrations.

In the opinion of the Committee, it is essential that agreement on the subject of tax evasion should be reached, if not universally, at least by a majority of States, in order to obviate the serious disadvantages which might result for certain countries if the procedure in question were adopted by a minority of States only.

B. Collection of Tax.

(Administrative and Judicial Assistance.)

States might consider the possibility of allowing their administrative or judicial authorities to act for other States for the recovery of fiscal debts the liability for which can be shown to be *res judicata*. If this principle were adopted, States would conclude with one another, for its application, Conventions which might contain the following provisions:

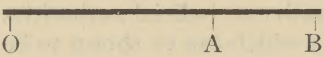
1. Each State shall recover within its territory, in accordance with its own law, taxes due in another State, including taxes due from persons not nationals of the latter State. The State to which such an application is made may not, however, be requested to apply any method of execution not provided for under the law of the State making the application.
2. Taxes to be recovered shall not, in the State to which application is made, be regarded as privileged debts.
3. Prosecutions and other measures of execution shall be carried out, without exequatur, on the production of documents proving that the liability in question is *res judicata*. If the fiscal debt may still be the subject of an appeal, conservatory measures may be taken on the production of a decision executable against the debtor.

APPENDIX.

NOTE BY M. LÉON-DUFOUR ON THE VARIOUS METHODS SUGGESTED FOR REMEDYING DOUBLE TAXATION AND THEIR GRAPHICAL REPRESENTATION.

The various methods suggested for the avoidance or alleviation of double taxation consist of different expedients, designed to exempt or relieve certain incomes, to divide between the two Governments concerned the taxes collectible, or to classify the incomes into various categories so as to determine those which are taxable in each country. To assist in elucidating the question, it may be useful to employ graphical methods to illustrate the various systems.

Let the different portions of the income or capital of a taxpayer domiciled in country X be shown on a horizontal line drawn from a point O. Let OB represent the whole income or capital and AB the part of this income or capital taxed in another country Y, which is known as the "country of origin", to indicate that the income or capital in question is derived from abroad.



Country X clearly has the right to tax the portion of the wealth represented by OA. Double taxation results from the fact that both country X (country of domicile) and country Y (country of origin) desire to tax a part or the whole of AB.

When later we come to refer to income, it must be understood that, in reality, it is rather with general wealth that we are concerned, because this wealth is taxed in some cases according to its capital value and in other cases according to the annual income or profits which it brings in.

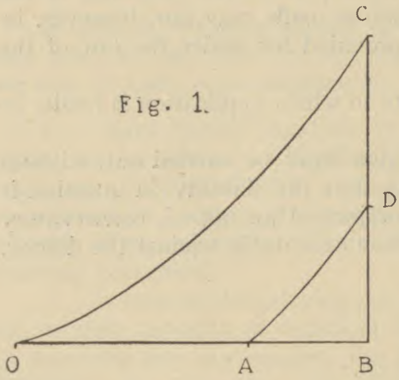


Fig. 1.

Having thus shown the income or wealth by a horizontal line, we can now show by means of a vertical line the total tax in respect of each amount of income for each of the two countries X and Y; we can then work out curves of taxation (Fig. 1) which will start respectively from the point O in the case of country X and from the point A in the case of country Y. For example, the income OB will be liable in country X to a tax represented by BC; the income AB will be required in country Y to pay the tax BD. These curves are straight lines when the scale of taxation is proportional; when, however, it is graduated, they assume a hyperbolic form. If there is complete double taxation, the tax claimed by country X would be represented by BC and the tax claimed by country Y by BD. BD represents the amount of the double taxation.

Let us now examine the various measures which the two countries X or Y may take to abolish or limit double taxation. These measures are based on two distinct ideas, which can, however, be combined. The first group of measures aims at *an assignment of income.* Since the country of domicile X and the country of origin Y both have claims on the income AB, they will arrange to apportion this income so as to prevent any overlapping of claims.

The second group of measures is based on *the calculation of the tax.* Assuming a definite assignment of income as between X and Y, these countries then agree to apportion the tax and grant relief in accordance with certain rules.

Methods II and IV below [1] are based exclusively on the consideration of income; and

[1] I have thought it advisable to retain the nomenclature of the methods already explained by the four economists, and have therefore numbered the first four methods indicated below so as to correspond to the numbers in the economists' report (Document F. 19, Part III, Section 1) and to those in the report by the Technical Experts (pages 9 and 10 of the present brochure).

Methods I, III and V exclusively on the calculation of tax: before the other methods (VI and VII) can be applied, the income must first be allocated and the method of calculating the tax settled.

Method I. — Total Deduction.

Country Y collects the tax BD on the income AB, which under its own legislation is taxable in that country. The country of domicile X first calculates the tax on the whole of the taxpayer's income OB. It then deducts BD, the amount of the tax actually collected by the country of origin, without any restriction whatever. It therefore only collects CD (Fig. 2).

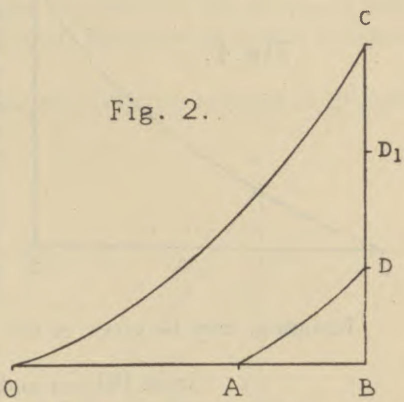


Fig. 2.

This system has the great disadvantage of placing the budget of the country of domicile X at the mercy of country Y. If the latter increases its scale of taxation and collects BD_1 instead of BD, country X will find the amount of its tax reduced and will only collect CD_1 instead of CD.

This system may lead to curious results:

(*a*) Take the case of two taxpayers, Peter and Paul. The former has his entire capital OA invested in X, his country of domicile; the latter, who is a richer man than Peter, has in his country X the same capital OA as his neighbour, but has in addition the capital AB invested in a foreign country Y. If the system of total deduction is adopted, without any maximum being fixed, the taxpayer Paul will pay his country of domicile the sum represented by CD_1. This is less than the amount paid by his less wealthy neighbour Peter, who, however, has the same amount of capital invested in their common country of domicile.

(*b*) A taxpayer invests part AB of his fortune abroad in 1924, it being assumed that his total wealth OB is the same as it was in 1923. If there is no limit to the amount of the relief, the State of domicile will remit for 1924 BD_1, *i.e.*, a sum larger than the tax on the portion of the wealth invested abroad when calculated on its own scale. In 1924, it would give up more than it collected in 1923 — an inequitable arrangement.

(*c*) Finally, if (Fig. 3) the scale of taxation is higher in country Y than in country X, and if the income AB is considerably larger than the income OA, it may well happen that point D appears above point C, in which case total relief becomes impossible, since the country of domicile collects less than the other country.

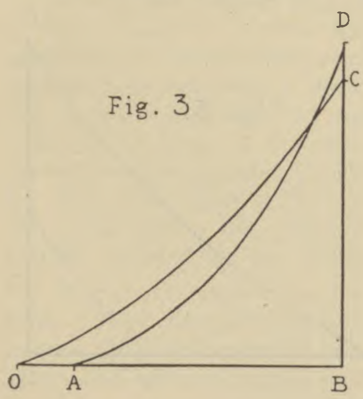


Fig. 3

Hence both theorists and legislators themselves have been led to apply correctives to this system by fixing a *maximum* for the relief borne by the State of domicile. This is what was called for by the Special Committee of the International Chamber of Commerce in its 1922 draft resolution (Doc. F. 5*a*); it is also the principle embodied in Methods V (American Legislation) and VI (League of Nations Experts), which we shall consider later on.

Method II. — Exemption of the Non-Resident.

This method decides the problem of double taxation by carrying to its limit the idea of the division of income, *i.e.*, it exempts all income earned abroad from taxation by the country of origin.

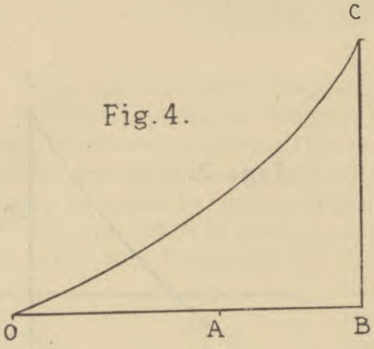


Fig. 4.

Let OB be the total income of a taxpayer domiciled in X. The distinction between OA, income earned in X, and AB, income earned in Y, disappears. Country Y collects nothing and country X collects the tax BC on the income OB at the rate applicable to such income.

This method is advantageous to creditor countries which have numerous investments abroad. It leads, however, to the result that, if there are two taxpayers in the country of origin Y who possess identical immovable property or factories bringing in the same income AB, the one domiciled in Y will be liable to the tax, while the other will be exempt.

Instances may be given of the partial application of this method:

1. Great Britain and the United States have concluded a convention in regard to the profits earned by shipping companies, under which British vessels plying to American ports are exempted from all taxation, subject to reciprocal treatment being given to American vessels plying to British ports. It will, however, be seen that this does not imply the remission of taxation on the whole of the income derived from the foreign country. Taxation is remitted only in respect of a very special kind of income.
2. As regards succession duties, the entire estate (with the exception of immovable property) is considered as forming an indivisible whole under the treaty between Austria and Germany, and it is assigned to the State of domicile or the State of which the deceased was a national.

Method III. — Allocation of Relief.

The portion BD of the tax collected by country Y is divided, as a result of a convention, into two portions:

A portion BG, which will still be collected by country Y, and a portion DG, which is relinquished by country Y. Thus the country of domicile X only collects GC, instead of BC. The burden of the relief has been shared.

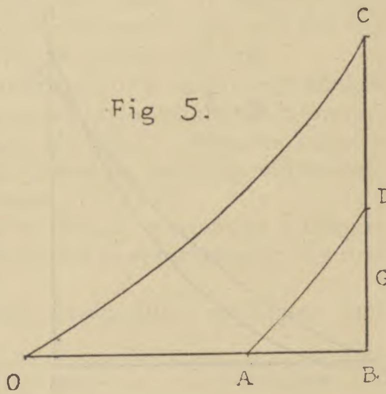


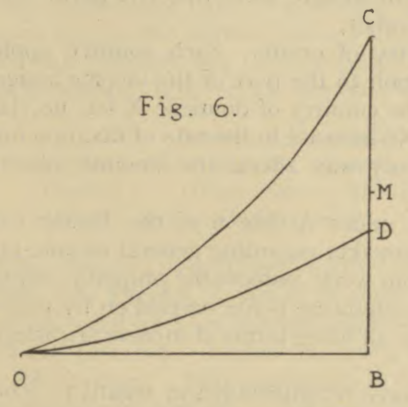
Fig 5.

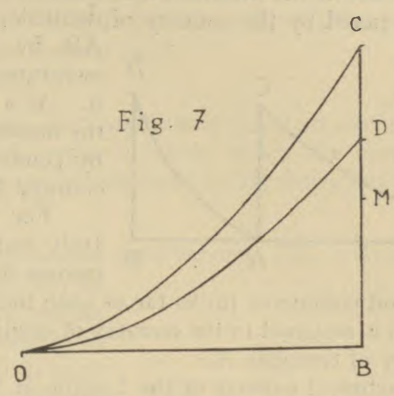
This is the method which, with some alterations and qualifications, has been adopted between Great Britain and its Dominions. The problem has been divided into two distinct parts; the complete relief from double taxation being effected, on the one hand, by a sacrifice on the part of the United Kingdom, and, on the other hand, by another and subsequent sacrifice on the part of the Dominion. The arrangement recommended in the report of the Royal Commission of 1920 in paragraph 70 (see Document E.F.S./A. 16, p. 31) is as follows:

"1. That in respect of income taxed both in the United Kingdom and in a Dominion, in substitution for the existing partial reliefs there should be deducted from the appropriate rate of the United Kingdom income-tax (including super-tax) the whole of the rate of the Dominion income-tax charged in respect of the same income, subject to the limitation that in no case should the maximum rate of relief given by the United Kingdom exceed one-half of the rate of the United Kingdom income-tax (including super-tax) to which the individual taxpayer might be liable; and

"2. That any further relief necessary in order to confer on the taxpayer relief amounting in all to the lower of the two taxes (United Kingdom and the Dominion) should be given by the Dominion concerned."

Let us suppose, for the sake of simplicity (Fig. 6), the case of a taxpayer resident in England





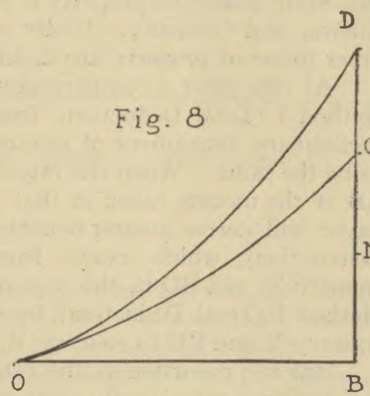
whose total income OB is derived from a Dominion. Let BC be the tax due in the United Kingdom, M being the centre of BC. If the Dominion tax BD is less than BM, the United Kingdom relinquishes BD and there is no double taxation.

If the Dominion tax BD is larger than BM (Fig. 7), the United Kingdom does not agree to give relief to the whole extent of BD. It only relinquishes BM. If the Dominion continued to levy BD, there would be double taxation to the extent of DM.

The Dominion should therefore give up the part DM of the tax due to it. The result is that the taxpayer contributes CM to the United Kingdom and BM to the Dominion.

It may also happen that the Dominion tax BD (Fig. 8) is higher than the United Kingdom tax BC. Under the provisions for the granting of relief by the United Kingdom contained in paragraph 1, the United Kingdom relinquishes BM, which is half BC. In order that the relief should be equal to the lower of the two taxes in accordance with the provisions of paragraph 2, the Dominion should relinquish CM.

The total relief is then equal to BC and consists of two equal parts: BM, granted by the United Kingdom, and MC, granted by the Dominion.



The above remarks are quite general and illustrate the method of relief in its most simple form. They disregard many details which complicate the problem considerably. Under the scheme, the relief in respect of any income is to be computed by reference to the respective rates of tax and without regard to any variation in amount between the United Kingdom and the Dominion assessments for the year of claim; and, as pointed out in the report of the Royal

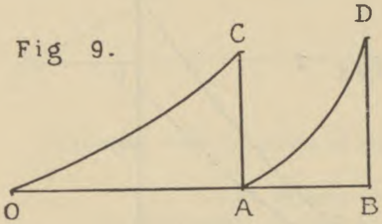
Commission, the same source of income may be assessed at very different figures according to United Kingdom legislation and according to Dominion legislation. The taxation of dividends on shares also gives rise to complications.

As a matter of fact, neither the economists nor the Government experts think that the system adopted within the British Empire can be brought into general use for international purposes.

Method IV. — Rome Convention or Simple Assignment of Income.

The whole of the income OB is divided as a result of an agreement into two parts, one part, OA, being taxed by the country of domicile, and the other, AB, by the country of origin. Each country applies its own rates of taxation to the part of the income assigned to it. As a result, the country of domicile X has no claim on the income AB. No increase in the rate of taxation imposed by country Y in any way affects the amount collected by country X.

Fig 9.



For example, under Article 6 of the Treaty between Italy and Czechoslovakia regarding general income-tax, the income derived from work, immovable property, mortgages, industry and commerce (in so far as such industry or commerce is not carried on by joint-stock companies) is assigned to the country of origin Y, while all other forms of income are assigned to the country of domicile X.

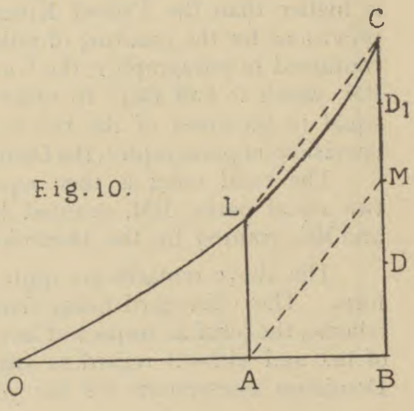
The technical experts of the League of Nations have recommended in regard to schedular taxes or *impôts réels* the adoption of the principle that the income should, in the case of an industrial or commercial undertaking with branches in more than one country, be divided (Resolutions, Chapter I, C. 2.)

As regards succession duties, all immovable property is assigned to the country of origin (the State where the property is situated) under the treaties concluded between Czechoslovakia, Austria and Germany. Under most of these treaties (Czechoslovakia with other countries), other forms of property are divided up.

At this point a comparison should be drawn between Method IV (Rome Convention) and Method I (Total Deduction), from the point of view of the taxpayer's interests, assuming the preliminary assignment of income between the country of origin and the country of domicile to be the same. When the rate of taxation in the country of origin is low, or when the portion AB of the income taxed in that country is small, the taxpayer will derive greater benefits under Method IV (Rome Convention), which exacts from him AL in the case of country X, and BD in the case of country Y, than under Method I (Total Deduction), by which he has to pay CD to country X and BD to country Y.

But in proportion as the rate of taxation in the country of origin is raised (or the proportion of AB to OB increases), the difference between the results produced by the two methods diminishes. Draw a line AM parallel to the straight line LC. When, on account of an increase in the rate of taxation, point D happens to be at M, the two methods of calculation give the same result. Country X collects AL = CM and country Y collects BM.

Fig. 10.



If point D_1 is above M, and if the country of origin collects BD_1, the country of domicile collects AL = CM under Method IV (Rome Convention) and CD_1 (which is less than CM) under Method I, the method described as the "total deduction" system.

Method V. — American Legislation.

Under this system, just as in Methods I and III above, there is no assignment of income as between any two countries. Taking the income exactly as it is taxed, American legislation recognises the principle of deduction, as in Method I, but sets a limit to its action. Instead of dividing up the tax, as in Method III, American law lays down a maximum limit of deduction, calculated solely in accordance with the laws of the country of domicile.

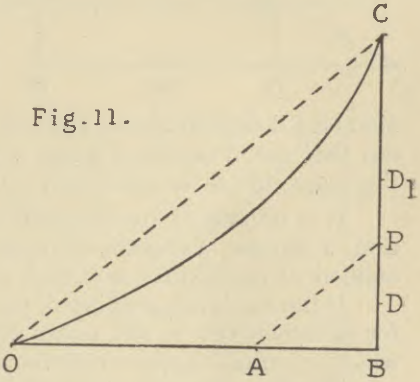
Any income-tax paid to a foreign country by a taxpayer who is a citizen of the United States on his income derived from a foreign country is deducted from the total amount of the Federal tax (Section 222 (*a*), paragraph 2, of the Federal law).

A maximum, however, is imposed in paragraph 5:

> "The amount of the credit taken under this subdivision shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income .... from sources without the United States bears to his entire net income ... for the same taxable year."

Take the case of a citizen of the United States whose total income, OB, is $100,000, part of which, AB, $20,000, is earned in country Y. Let BD be the tax collected by Y on the $20,000 and BC the American tax on the $100,000. Under the law a maximum rate of relief, BP, is fixed. This maximum is determined in such a way that the ratio of BC to BP is the same as the ratio of OB = 100,000 to AB = 20,000. Point P on the graph will be obtained by drawing a straight line AP parallel to the straight line OC.

Fig. 11.



In this way, if the tax collected by the country of origin is less than BP, the United States will collect CD, and we get the same result as under Method I.

If, in consequence of the increase of the rate of taxation in the country of origin, point D_1, indicating the tax BD_1 collected by the country of origin, falls above P, the United States collect CP and the country of origin BD_1. Double taxation, represented by the section D_1P, therefore, exists to some extent.

* * *

As we pointed out previously, the systems which we are about to consider, *i.e.*, the systems proposed by the technical experts of the League of Nations, assume that the countries concerned have, as in Method IV, carried out a classification of income by previous agreement. After this assignment of a revenue has been made, certain rules for calculating the tax are proposed (Resolutions — Chapter II, paragraph 3).

In principle, the country of domicile alone is entitled to collect the general income-tax. But, as an exception to this principle, the experts lay down that the country of origin may tax income accruing from immovable property, agricultural undertakings and industrial and commercial establishments, exclusive of dividends.

The methods recommended by the technical experts for the prevention of double taxation which may result from these exceptions are indicated below as Methods VI and VII.

Method VI.

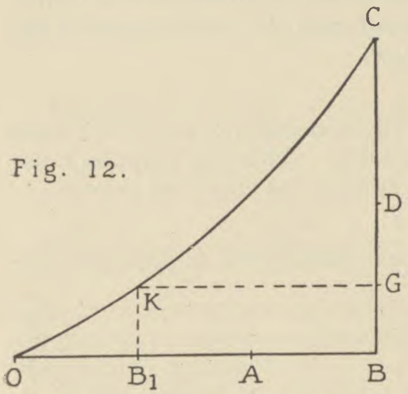
The technical experts propose that the State of domicile shall deduct from the general income-tax a sum which will be:

(*a*) Either the tax calculated according to the State's own scale and charged exclusively on income produced in the other countries, each of the latter being taken separately;
(*b*) Or the tax actually paid abroad on income arising abroad; this sum may be limited to the amount to be deducted in accordance with paragraph (*a*).

In order to prevent a taxpayer whose entire income arises abroad from escaping all taxation in his State of domicile, the amount to be deducted on the above basis should in all cases be restricted to some fraction of the total tax chargeable in the State of domicile.

Paragraph (*a*) may be explained as follows: Let AB represent income taxed by the country of origin Y, *i.e.*, the income in respect of which relief is to be given. As the tax is graduated, we must draw, from O, the line OB_1 = AB, and erect a perpendicular from B_1 intersecting the curve at point K. Now draw a horizontal line KG. The deduction provided in paragraph (*a*) is represented by BG. The country of domicile will collect CG instead of BC. The country of origin will collect the tax on income AB at its own rate, *i.e.*, BD. There will accordingly be double taxation DG if the tax BD collected by the country of origin is greater than BG.

Fig. 12.



This deduction was also recommended, as the maximum relief, by the four economists in connection with succession duties (Document F.19, p. 44).

In paragraph (*b*) the technical experts revert to Method I described above, under which the relief given is equal to the tax actually paid abroad, but they are in favour of fixing a maximum which is, in point of fact, calculated by applying the same rule as in paragraph (*a*), *i.e.*, BG.

It is interesting (omitting all consideration of questions relating to the previous classification of income, a classification not carried out under the American system) to compare the method of calculation described above as No. V with the present method (No. VI).

If the tax is not graduated, the deductions under the two systems will be the same (Fig. 13); for an income OB_1 = AB, under the rate applied by the country of domicile, the tax will be B_1K, which is equal to the maximum relief BP.

The tax, however, is frequently graduated. If we combine in Fig. 14 the features of Figs. 12 and 11, we shall see where the difference arises.

Fig. 13.

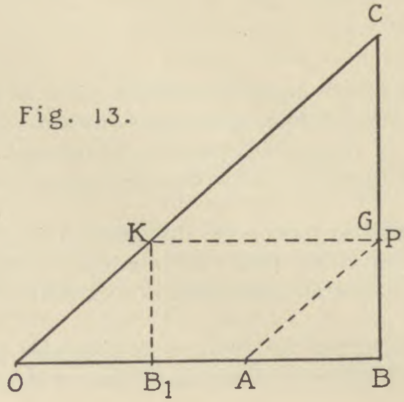
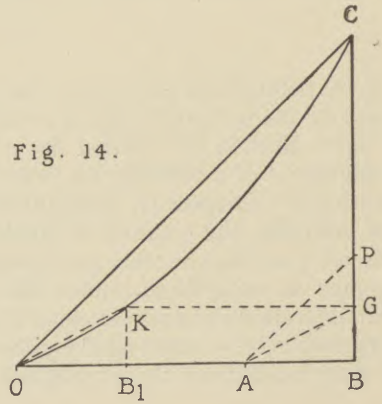


Fig. 14.



The maximum BP laid down by American law is obtained by drawing, from point A, a line parallel to the straight line OC; the maximum proposed by the League of Nations experts is obtained by drawing a line parallel to the straight line OK. The curve OC being concave, it is clear that any point K taken between O and C on the curve will give an angle KOB, which is less than the angle COB. The American maximum BP is therefore always greater than the maximum BG, no matter what may be the ratio between the income assigned to the country of origin and the country of domicile respectively, *i.e.*, no matter what may be the position of point A on the line OB.

The idea which forms the starting-point for determining the maximum is the same in both methods, *i.e.*, the country of domicile should not, by reason of the fact that a part (AB) of the taxpayer's property is invested abroad, remit a sum larger than the tax on that portion *calculated at its own rate of taxation.* Under Method V, however, the rate adopted for the purpose of this calculation is that applicable to the taxpayer's total income; under Method VI the rate is that applicable only to the portion invested abroad. It is this difference which is illustrated by the graph Fig. 14.

It is necessary also to discuss the last paragraph of the recommendations of the technical experts quoted above. The paragraph is as follows:

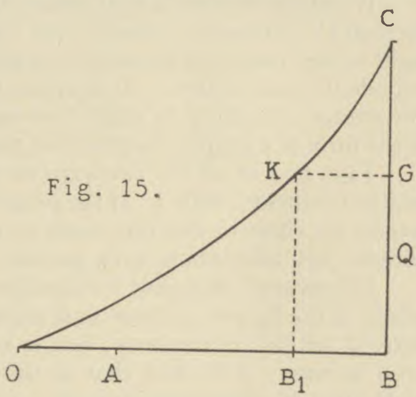
> "In order to prevent a taxpayer whose entire income arises abroad from escaping all taxation in his State of domicile, the amount to be deducted on the above basis should in all cases be restricted to some fraction of the total tax chargeable in the State of domicile."

The first clause in the above sentence furnishes an obvious reason for imposing this maximum, but this fraction-limit would also operate when the income is not entirely derived from abroad. If a very small portion (OA) of the taxpayer's property is invested in his own country, the deduction provided for in paragraphs (*a*) and (*b*) (ascertained as in Fig. 12 by making $OB_1 = AB$, and taking $BG = B_1K$) would be BG; this would absorb practically the whole of the tax to the detriment of the country of domicile. The fraction-limit BQ accordingly operates in any case, the result being that there are separate maxima:

A maximum provided for in paragraphs (*a*) and (*b*), calculated in accordance with the amount of the income derived from abroad; and

A fractional maximum as provided for in the third paragraph, fixed as a flat rate, at a quarter, fifth, one-tenth, etc., of the tax chargeable on the taxpayer's total wealth.

Fig. 15.



Method VII.

As an alternative method, the technical experts propose (Chapter II, resolution 3, paragraph (2)):

> " Taxation in the State of origin of only a portion of the income arising there, the other portion being taxed in the State of domicile, but at the rate applicable to the total income from every source."

Let us suppose that a taxpayer domiciled in country X possesses a total income (OB) amounting to 100,000 francs, of which 80,000 francs (OA) are earned in X, and 20,000 francs, (AB), consisting of profits accruing from a factory, are earned in Y. If we assume that the two countries X and Y have, by treaty, agreed that a portion — three-quarters, for instance — of the income derived from the factory will be taxed in the country of origin, the remaining quarter (AF) should be taxed by the country of domicile X at the rate applicable to the whole.

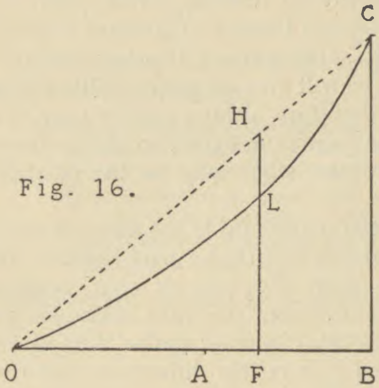


Fig. 16.

The rate applicable to the whole is represented by the angle COB. We now draw a perpendicular from the point F, intersecting the straight line OC at H. The country of domicile X will collect FH, *i.e.*, the part AF (5,000 francs) of the income derived from the factory will be taxed at the rate corresponding to 100,000 francs (OB) in exactly the same way as the remainder of the income, and not at the rate corresponding to 85,000 francs (OF), which would give a tax FL (less than FH).

The country of origin Y, on the other hand, will tax 15,000 francs, representing three-fourths of the income derived from the factory (FB).

At what rate will it levy this tax ?

It will do so not at the rate applicable to the 15,000 francs but at that applicable to the taxpayer's total income in country Y. It is even conceivable that the country of origin Y itself might, in the same way as country X, take into consideration the whole of the taxpayer's wealth.

If the wealth of a taxpayer domiciled in X is located in three different States, X, Y and Z, Fig. 16 shows the manner in which the State of domicile X would apply the tax. AB may still be taken as representing the total income located abroad, and AF the total lump portions of this income assigned to the country of domicile X.

It will be observed that under this method (Method VII) the technical experts start from Method IV (Rome Convention), but take into consideration the graduated rate of the tax and the right of the country of domicile to apply this rate even to the portion of the income which is derived outside its own borders. It is interesting to note the consequences of variations in the "treaty" percentage according to which the income is divided between the two countries, *i.e.*, to note, in the form of a graph, the effects of the movements of point F between points A and B in Fig. 16.

Take first of all the two extreme cases: that in which point F coincides with B, and that in which it coincides with A. If the point F coincides with B, this means that the country of domicile retains its right to tax the whole of the income derived abroad, *i.e.*, there is double taxation without any alleviation, even partial.

If, however, the point F coincides with A, this means that the country of origin can tax the whole of the income at issue as it wishes, and that the country of domicile taxes only the income derived within its territory; but it taxes this income at the rate applicable to the taxpayer's total income. It is clear that in this extreme case Method VII is in actual practice the same as Method V (American Method). Let us again (Fig. 17) consider Fig. 13 above, in which the straight line AP is parallel to the straight line OC. Under the American Method, the State of domicile collects CP. In the method we are at present explaining, the country of domicile will levy an amount obtained by drawing from point A a perpendicular intersecting the straight line OC at the point H. It is obvious that AH is equal to CP, since the straight lines AP and OC are parallel.

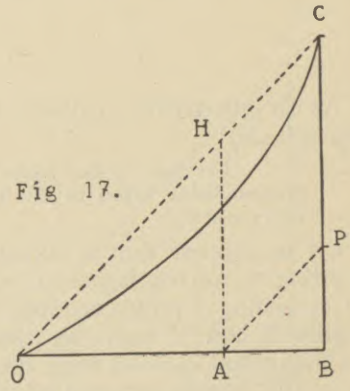


Fig 17.

It is now desirable to ascertain what occurs in cases between the two extremes when point F shifts between A and B. We can, for instance, compare Method VI with Method VII, *i.e.*, the two methods proposed by the League of Nations technical experts. It will then be seen that, according to circumstances, the country of domicile will, purely from the point of view of taxation, choose one or other of these methods. This means that Method VII, which rests on the division of income with a maximum rate, will afford greater or lesser advantages than Method VI, according to the percentage adopted by agreement for the division of the income.

If in Fig. 18 we take the point G, which was fixed in the manner shown in Figs. 13 and 14 by making $OB_1 = AB$, drawing the perpendicular B_1K and then drawing the horizontal line KG, the country of domicile will collect the sum CG under Method VI. If a line is now drawn from point G parallel to the straight line OC, it will intersect the horizontal line OB at a point R.

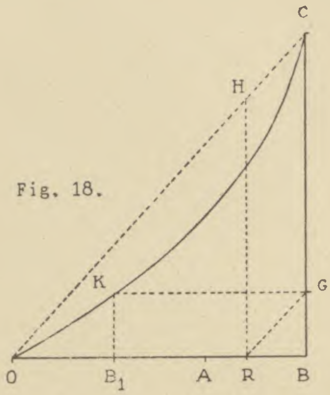


Fig. 18.

If the income is divided in the manner proposed under Method VII in such a way that point F coincides with R, it is clear that Methods VI and VII are in this instance identical, for in this case the straight line RH, representing the tax collected by the country of domicile, is obviously equal to the straight line CG.

If point F falls to the right of point R, the country of domicile collects under Method VII a sum larger than CG.

If, on the other hand, point F falls to the left of point R, the country of domicile collects under Method VII an amount less than the amount CG which it collects under Method VI.

It will accordingly be seen that various countries may find it convenient to adopt Methods VI and VII, the two methods proposed by the technical experts, as being applicable to a special set of circumstances or to differences in systems of taxation.

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