

FIRST WORLD CONFERENCE WORLD PEACE THROUGH LAW

ATHENS, GREECE — JUNE 30 -- JULY 6, 1963

TITLE: General Remarks concerning the taxation of investments in debtor countries. The principle of taxation at domicile or at source*.

By P. B. DERTILIS

Professor of the University of Salonica

GENERAL REMARKS

*Concerning the taxation of investments in debtor countries
The principles of taxation at domicile or at source.*

a) *Theoretical Considerations.*

It is well known that State tax systems differ as a result of the disproportionate expansion of the national economics and the diverse nature of taxes and national tax laws, the unequal financial requirements of States and for many other reasons. They even have difficulty in adopting uniform taxation principles.

The diversity in taxation systems is also due to the need to bring the tax interests of the creditor countries exporting capital to the less-developed countries into harmony with those of the latter countries.

As we know, two taxation principles are generally applied in determining the fiscal jurisdiction of States; these are :

- a) The principle of taxation at source.
- b) The principle of taxation at domicile.

The principle of taxation at source means that the right to tax income on foreign capital investments, or the right to tax all foreign investments in a third State, lies with that third State where the foreign capital is invested or loaned and the revenue accrues. This taxation principle is naturally in opposition to the interests of States which lend or export capital.

* Doc. T3/90. Working Session (I). Topic (3) Title of Topic: Law Rules to encourage International Investment. Main Ballroom, Section (B). July 2, 1963. Time: 9 am - 12 m.

The latter States, the creditor States, obviously have every interest in applying the principle of taxation at domicile, under which the State or domicile of the lender shall have the power or right to tax the income on the investments in the debtor countries. The arguments put forward in favour of taxation at domicile are as follows :

Firstly, any tax imposed by debtor States constitutes a barrier to the importation of capital into that State and the tax imposed is a charge on the capital placed in the debtor country. When a tax is applied, the taxation decreases the revenue on the foreign property and consequently reduces the value of the stock concerned in accordance with the phenomenon of tax amortization.

Secondly, taxation by the debtor State shackles the free movement of capital from creditor countries towards debtor countries. This results in the stagnation of capital and delay in economic development in the backward economies, because of the scarceness of capital in the latter, which needs foreign capital.

Thirdly, the lack of capital in the backward economies results in rises in interest rates in those economies. The result is a greater load on the economies of the debtor countries, because they are obliged to pay a higher rate of interest in order to attain the capital essential for their operation and development.

For this reason, in the case where the debtor country taxes the income on foreign capital invested on its territory, the capitalist, domiciled in the lending State, seeks to increase the rate of interest on the capital loan in order to transfer to the economy of the debtor country the load of the tax on income from the capital loan.

I have very briefly explained the main ideas in support of the principle of taxation at domicile. I shall now turn, also very briefly, to the arguments in favour of taxation at source.

The bases of the argument that the power or right to impose a tax should lie with the State which favourizes the creation of revenue are as follows :

Firstly, the concept that the State of domicile shall have the right or power to tax revenue created outside its territorial limits is contrary to the idea underlying the payment of tax, which is that it is legitimate for the revenue from income used abroad to be taxed by the State where the revenue is produced, for the existence and operation of the State of origin of the revenue has facilitated the creation of the revenue taxed.

I considerer that the argument that the State which is the source of capital has some sort of legitimate right to impose tax is a very weak

one, because this lender country already taxed the capital placed abroad, at the beginning, when it was created within its territory.

Secondly, the phenomenon of the amortization of tax cannot serve as complete justification for the principle of taxation at domicile or for the fiscal immunity of capital from the lender State which is invested in a foreign country. A tax which may be imposed by the State of domicile, leads to a similar result.

Moreover, the phenomenon of amortization of tax is of limited application. Since it is mainly a question of tax on estate duty, no decrease in the capital tax is caused by the payment of these taxes. Thus, if we take the cause of taxation as a basis we must grant the State which is the source of revenue the power or right to impose taxation.

Thirdly, in my opinion, taxation at domicile has, amongst others, the following disadvantages :

Firstly, it makes the budgetary income, and thus the budgetary balance of a State — so necessary for the stability of its financial situation, — subject to changes in the domicile of the persons taxed.

Secondly, it limits the fiscal territory of the borrower States, to the advantage of the creditors; a situation which may also lead to a serious danger for the general economic situation in the debtor, part of the national riches pass into the property of persons domiciled abroad. Generalization of the principle of taxation at domicile may facilitate the economic penetration of the debtor states by the foreigner and the economic dependence of the debtor countries on foreign countries.

The economic independence of borrower States, on the other hand, may be improved, under certain conditions, by a suitable tax policy designed to establish a fiscal regime insuring equality of treatment for the foreign capital in the debtor countries, instead of encouraging the penetration of foreign capital designed to change the debtor country's economy.

It must not be forgotten that the granting of fiscal immunity to foreign capital or foreign companies is an anti-political act, as it favours the foreigner at the expense of the national, who also participates in all the charges demanded for the administration of the State in which the revenue is formed and also has to pay the user taxes.

The principle of taxation at domicile facilitates tax evasion, because there can be no doubt that in a case of a certain category of revenues from foreign capital, taxation at source enables the State in which the

capital was produced and acquired to apply appropriate measures which more or less prevent tax evasion.

The same result cannot be attained by the foreign State, which has no means of seizing tax income outside its territory or revenue from movables.

Consequently, the principle of taxation at source is not only in conformity with the ideas of taxation justice, but also involves a technical requirement such, for example, as the limitation, in particular, of tax evasion. The only question is that it may fail either to satisfy the desire of economically developed countries to extend their taxation jurisdiction outside their frontiers, or to adapt itself to the need of States requiring capital. However, the foregoing argument is of less value today, because national economies are starting to be subjected to international organization and to wider collaboration, created by a fact that the Community of States is leading to Community of Interests.

It must be added that the principle of taxation at domicile has the considerable advantage of backing up, by its application, a distribution of tax is related to the taxable capacity of the tax-payer. As we know, the distribution of tax must agree with the criterion of tax payable capacity. It is true that taxable capacity constitutes the distribution of the tax charges between tax-payers, who at the same time partake of the general and special advantages resulting from State administration. In my opinion, that is why revenues from abroad should not be included therein. In any case, if revenues from some foreign sources are added, it is only right to deduce the taxes paid to the debtor countries, in order to prevent the double taxation of a given revenue. However, it is necessary to protect the tax interests of the countries from which the revenue comes.

If the latter countries lose their tax income in favour of the creditor countries, it is obvious that the budgetary income of the debtor countries drops, to the advantage of the creditor countries, yet it is in particular the budgetary income of the debtor countries which constitutes, with its will to meet its engagements, the greatest guarantee for the legitimate interests of the foreign lender.

The organization of the international economy taking place in the International Community is a further guarantee for foreign investments.

b) *Greek tax law compared with the foregoing taxation principles*

It is difficult to give even a brief summary of Greek practice regarding the application of the two principles just described. However, it can be said that, especially as regards the taxation of overall revenue, the Greek legislator adopts the principle of taxation at domicile.

It must also be stressed that under Greek jurisprudence and tax legislation — as in other national tax legislation — a distinction is made between the notion of domicile and the notion of normal or temporary place of residence of the tax-payer. It should be noted that the notion of residence is encountered more frequently in tax law than in civil law. We are faced with a specific notion of tax-law-an invention, so to speak, of tax legislation.

It should also be pointed out that the concept of tax domicile is understood in Greek jurisprudence in the sense which it has in civil law. It can be said, however, particularly as concerns foreign capital invested in Greece, the Greek lawmaker applies a tax policy designed to prevent international double taxation.

To achieve this, the tax authorities in Greece employ the following methods :

a) Tax immunity is confined to capital lent to the State. Tax exoneration is foreseen in agreement regarding public loans;

b) Domestic laws apply the principle of equal treatment for foreigners working in Greece;

c) Commercial agreements include the clause of the most favoured nation which is also included in the convention of 9 July 1961, on the adherence of Greece to the Rome Treaty of 25 March, 1957, in favour of the Six-Member States of the European Economic Community;

d) Tax exemption is granted on conditions of reciprocity to foreign revenue produced in Greece;

e) Greece concludes tax conventions with certain foreign States, in order to prevent international double taxation;

f) The policy of exempting foreign capital from tax finds very wide application in several conventions, containing general or special tax exemptions for foreign capital used for public works in Greece.

It is difficult to list the various texts embodying the fiscal policy in Greece.

In my opinion, the tax powers of States must be subordinate to uniform rules dictated by mutuality of interests of the Community of States, which is already becoming clearer, because the weakening of the tax interests of debtor States must be avoided if we are to secure international economic balance.

It is a duty of international scientific associations, such as ours, to study and suggest rules and institutions to determine the tax powers of States at the present stage of evolution of the economic life of States.