



Asian Institute of
International Financial Law
The University of Hong Kong

Taxation Law Research Programme (TLRP)

The Future of Tax Jurisdiction



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Professor Miranda Stewart

Melbourne Law School

University of Melbourne

m.stewart@unimelb.edu.au

Forthcoming book: *Tax and Government in the Twenty-First Century*
(Cambridge University Press, 2022)

This seminar discusses the future of tax jurisdiction. Tax jurisdiction is a function of state capacity, technology and politics. It reflects changing labour and capital relations and only partly depends on territorial boundaries. Tax concepts of residence and source have changed over time as the capability to tax mobile consumption, labour and capital changes. Governments extend or retract tax jurisdiction over income, entities and activities outside their territory. Tax jurisdiction is changed by cooperation between states, which has grown significantly in the last decade, although states continue to compete in some important respects. The speaker will illustrate the discussion with some examples of the evolution of tax jurisdiction, ranging from individuals as residents, workers, investors or consumers, to corporations subject to the latest global deal for taxation of multinational enterprises around the world.

Miranda Stewart is Professor of Law at the Melbourne Law School, University of Melbourne and is an Honorary Professor and Fellow at the Tax and Transfer Policy Institute at the Crawford School of Public Policy, The Australian National University. Miranda carries out research, advisory and teaching across a wide range of topics on taxation law and policy. Her forthcoming book is *Tax and Government in the Twenty-First Century* (2022, Cambridge University Press).

Outline

- Tax jurisdiction and the nation state
- Economic allegiance
- Tax jurisdiction over individuals
- Tax jurisdiction over corporations (and other entities)
- The rise of the market jurisdiction and taxing consumers
- Rules of convenience for a global digital era

Elements of a tax law

- Tax base
- Tax rate
- Timing of taxation
- Tax unit
- Treatment of intermediaries (firms/corporations)
- **Jurisdiction**

Paul McDaniel, 'Comments' in Joseph Pechman (ed.), *What Should Be Taxed: Income or Expenditure?* (Washington, DC: Brookings Institution, 1980), 282–3.

Tax and the borders of the state

- The legal fiction of national borders
- The administrative constraint on tax jurisdiction
- Economic allegiance as a basis for jurisdiction
- The international law duty of one state to another
- Tax jurisdiction requires **rules of convenience**
- Tax competition and co-operation between states – both expressions of sovereignty

The legal fiction of national borders

- Treaty of Westphalia (1648)
 - “a political imaginary that mapped the world as a system of mutually recognizing, sovereign territorial states” (Falk, 2002)
- This creates difficulties because:
 - “A gain does not recognise national borders. Borders are created by humans” (Prebble, 1994)

Jurisdiction, benefit and sovereignty

- Philip Jessup, *Transnational Law* (1956): Jurisdiction ***in personam*** does not rely only on a territorial presence
 - “the history of all laws opens with an entirely personal conception of law: every man possessed only the rights and duties with which the laws of his own tribe, city, or class invested him, and could not be judged by any other”
 - ‘Territoriality of jurisdiction’ is a **rule of convenience** ‘not a requirement of justice or even a necessary postulate of the sovereignty of the State’ (citing Lauterpacht)
- Peggy Musgrave, 2001: It is the **service of the state to its people** that entitles it to ‘a degree of tax sovereignty over the income-earning activities abroad of their residents’

Economic allegiance as tax jurisdiction

- Tax jurisdiction *in rem*...
 - ‘where is wealth acquired, where does it exist, where do the property rights become enforceable, and where is the wealth disposed of’

Edwin RA Seligman, Double Taxation and International Fiscal Cooperation (1928), 112–13

- The **administrative constraint** of the state is fundamental
 - For effective taxation, we need to align **legal** jurisdiction with **enforcement** jurisdiction

Summary of principles for tax jurisdiction

- The **benefit theory** : the taxpayer has a duty to pay taxes to the state in relation to the benefit obtained from the state
- The **ability to pay theory**: the taxpayer has a right to just taxation; this is usually best achieved by the **residence** state
- Effective tax jurisdiction relies on the **ability of the state to administer** and the **taxpayer to comply** with the tax
- States have a **duty to each other** to permit the legitimate exercise of tax jurisdiction by all states

Residence and source

- Traditional concepts with long histories
 - Residence as a basis for worldwide income tax jurisdiction (*But not in Hong Kong!*)
 - Source: territory, nexus and attribution
- The concepts of **residence** and **source** are meaningful and not empty concepts when applied to *real people*
 - But always proxies for reality, and posing difficulties at the margins
 - In contrast, they are more difficult when considering taxation of corporations or firms
- Resolving conflicts between states

Residence of individuals

- **A real and useful concept**, but with challenges at the margin
 - Residence ‘conflict’, ‘duplication’, and ‘creep’
 - New residence, departing residents
 - Mobile workers
 - What role for ‘citizenship’ jurisdiction?

Jurisdiction over labour income

- The place of performance where work is carried out ... but ...
 - Mobile workers?
 - Digital and remote workers?
 - Transnational workers? (e.g. *Schumacker, EU*)
- Characterisation as **employee** or an **independent contractor** may make a big difference – but why?
- The administrative constraint: withholding vs declaration or tax return systems
- ***E.g. The mobile professor... teaching online***

Jurisdiction over capital income

‘Land is a subject which cannot be removed; whereas stock easily may. The proprietor of land is necessarily a citizen of the particular country in which his estate lies. The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could either carry on his business, or enjoy his fortune more at his ease. By removing his stock he would put an end to all the industry which it had maintained in the country which he left. Stock cultivates land; stock employs labour. A tax which tended to drive away stock from any particular country would so far tend to dry up every source of revenue both to the sovereign and to the society. Not only the profits of stock, but the rent of land and the wages of labour would necessarily be more or less diminished by its removal.’

Adam Smith, *Wealth of Nations*

Jurisdiction over capital income

- The ‘residence’ state, or withholding on flows of dividends, royalties and interest
 - Territorial basis is reasserted in the differential treatment of land, versus other kinds of capital income
- The challenge of mobility of capital income
- The terrain of “offshore”
 - Capital holdings in low tax jurisdictions
 - Legal and administrative constraints
- Government cooperation enhances residence jurisdiction over capital income
 - Why has this only been achieved in the last decade?
 - Future trends

Residence of corporations

- A geographic fiction layered on a legal entity fiction
- Corporate 'residence' is useful to determine administrative control for tax enforcement, and perhaps in allocating responsibility to alleviate double taxation
 - Where are multinational corporate groups?
 - Everywhere and nowhere, dependent on the multi-limbed presence in multiple states
- But should not be used to determine the 'substance' of the primary tax jurisdiction

Jurisdiction, or tax nexus of corporations

- Source taxation where corporations do business
 - In reality we look through the corporate form
 - Permanent establishment: a ‘fixed place’ of business
- **A rule of convenience that is past its use-by date**
 - Less and less capable of identification and enforcement
- Era of ‘stateless income’
 - Generated by MNEs being ‘everywhere’
 - Corporate income generated in global digital economy achieved excessively low tax rates
 - MNEs enfolded tax havens and could control attribution of corporate profit

Jurisdiction over corporations

- Multinational enterprises combine juridical and territorial elements to extract value
 - Like states...
 - How can we unpack this enfolding of jurisdiction into the multinational enterprise?
- Governments have attempted to shut down profit shifting
 - “BEPS” project
- But if tax planning/profit shifting is halted, real business or investment shifting may result
 - Can we identify immobile base for corporate taxation?
 - Can governments cooperate to set a floor on tax competition?

The rise of the market jurisdiction

- What is a ‘market’?
 - Location of the end-consumer
 - Who is a **real person**, so their geographical location may be meaningful
- Where are end-consumers?
 - Individual residence, again, is paramount
- But, what is the jurisdictional right of the market jurisdiction?
 - Sales taxes
 - Corporate tax

The rise of the market jurisdiction

- Sales taxes on e-commerce: global digital consumption
 - Could governments co-operate to collect and distribute revenues between each other?
 - European Union “One-Stop-Shop” for e-commerce
- Digital Services Taxes
 - A unilateral solution of governments
 - Apply to large digital or data-based MNEs
- Digitalisation and corporate tax
 - Should the consumer or market country have jurisdiction over corporate tax?
 - Old concepts of ‘source’ or ‘residence’ did not address this, except where physical sales presence in the territory

The Inclusive Framework Two-Pillar Solution

- Pillar One: ‘Market’ jurisdiction over corporate tax
 - Tax on ‘super-profits’ of biggest, most profitable MNEs
 - Global MNE corporate group
 - Formulary allocation of profit to market jurisdictions
 - Based on total sales to consumers in the jurisdiction
- Pillar Two: Global anti-Base Erosion Rule (GloBE)
 - Not a global tax: interlocking domestic country rules
 - Applies if a country’s effective tax rate on a company in a MNE group is below 15%
 - ‘Top-up’ tax levied by another country where the MNE operates
 - Stop ‘race to the bottom’? Or set a new ‘low’ corporate tax rate expectation?

Updating the **rules of convenience** for tax jurisdiction of individuals

- Individual residence is more important than ever
 - Can be located in geographic space and nexus to the benefiting state can usually be identified
 - Income or consumer value can be measured
- Governments can co-operate to support individual income and consumption taxation
 - Especially on offshore e-commerce and wealth holdings
- Governments must also ensure there is not excessive taxation across jurisdictions
 - Residence state has responsibility to alleviate double tax

Updating the **rules of convenience** for tax jurisdiction over corporations

- Corporate tax is still important
 - As a proxy for taxing something else: capital; consumers; super-profits from the global digital economy
 - Residence is useful for convenient administration, but...
 - Tax should be on the basis of **production or consumption**
- The issue to date has been not, *which countries can tax but can we tax at all?*
- Governments may cooperate to tax global digital economy
- If we can collect tax on global digital economic return ... then, *which countries* can tax becomes more important
 - How to share globally collected tax fairly?
 - Are 'source' and 'market' countries in a contest for jurisdiction?
 - Which country has responsibility to alleviate double tax?

Thank you



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