# Chapter XIII

# State Responsibility under Customary International Law in Matters of Taxation and Tax Competition

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"No country ever takes notice of the revenue laws of another…" (Lord Mansfield in *Holman v Johnson*, 1 Cowp. 343, 1775).

## 1. Questions and Suggestions

### 1.1 <u>Questions about state responsibility, particularly in cases of tax competition.</u>

This 18th century quotation by Lord Mansfield had already been outpaced in 1938 when Harold Wurzel[1562] used it as a punch line in his brilliant study on extraterritorial taxation. "We stand no longer where we stood in the 18th century", wrote Wurzel, but we have never stood so far from it as now, with both the OECD and the EU taking offence at the regimes created by low tax countries.

The OECD Report on Harmful Tax Competition ("HTC"), The OECD Report "Towards Global Tax Cooperation", and the EU Code of Conduct, targeting similar tax haven countries and regimes (though with different apparent legal basis[1563]) are in the mean time sufficiently known in the international tax community and it is not necessary to discuss them further in this article unless in the context of the title[1564]. The particular questions that are raised here, concern the legitimacy under international law of a (tax haven) state[1565] creating a tax regime that is considered harmful by other states, or playing itself (through its organs) a role in

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[1562] See below

[1563] Art. 87 of the EU Treaty prohibits certain forms of state aid.

[1564] Both initiatives have a similar approach: Firstly, tax havens and tax haven regimes are identified as jurisdictions that have no or minimal taxes, lack effective exchange of information, lack transparency and do not have any requirement on companies to have a substantial activity. Further, the harmful character of the tax haven regime can, according to the Report, be derived from the "ring-fencing" of the regime. Finally, the Report recommends changes in domestic legislation (such as CFC-type legislation, mutual fund fictions etc.), terminating tax treaties and intensify international cooperation.

[1565] In this chapter I will often refer to "tax haven state" as a state or jurisdiction that enacts a regime with tax privileges.

what the OECD Report and the EU Code of Conduct consider harmful tax competition. Of course, the issue of tax competition in state responsibility cannot be studied without discussing the (similarly untouched) questions on general tax policy of a state and state responsibility. Until now, experience on both issues of responsibility for tax policy, has been limited. They have been raised mainly in the context of tax competition.

It is noteworthy to mention in this context that nor the OECD, nor the EU has to date been able to identify what makes tax competition harmful, as opposed to potentially harmful. The OECD Report "Towards Global Tax Cooperation" admits that this needs to be achieved: "… a preferential tax regime is identified as potentially harmful if it has features that suggest that the regime has the potential to constitute a harmful tax practice, even though there has not yet been an overall assessment of all the relevant factors to determine whether regimes are *actually harmful*.(italics by Edwin van der Bruggen)"[1566].

What follows are some questions that can be posed in this respect.

- ✓ May a state enact a tax regime that enables the (non-resident) taxpayer to arrange his affairs in such a way that fiscal revenue in that taxpayer's home state is decreased?[1567] Can the existence or creation of such a regime be deemed to entail state responsibility towards other states?[1568]
- ✓ What if the tax regime was or is not created by legislation but under royal decrees[1569], notifications or rulings[1570] of the Ministry of Finance or other tax authorities[1571]?

[1566] OECD Report "Towards Global Tax Cooperation", par. 10.

[1567] "The necessary starting point to identify a tax haven is to ask a) whether a jurisdiction imposes no or only minimal taxes and offers itself, or is perceived to offer itself, as a place to be used by non-residents to escape tax in their country of residence" (OECD Report on Harmful Tax Competition, OECD, 1998, p.22.)

[1568] "Countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so. This study is designed, in part, to assist in that regard." (OECD Report on HTC, ibid, ft.1567, par. 26, p.15.)

[1569] For example Belgian Coordination Centers, whose tax regime was created by Royal Decree No. 187.

[1570] For example the Dutch finance company and license company rulings.

[1571] The OECD Report on HTC mentions besides tax regimes created by an act of the legislature also favourable administrative rulings, special administrative practices and omission to enforce domestic tax law; (OECD Report on HTC, ibid, ft. 1567, p. 28-29.)

- ✓ Can a state be liable under international agreements or general principles of international law for damage created by its regime to the treasury of other states?[1572]
- ✓ Can tax haven states be held responsible for committing or allowing to commit, tax fraud? May other states successfully submit that the tax haven state has neglected to properly control its subjects (such as banks or taxpayers) engaged in international evasion?[1573]
- ✓ May a tax haven state be held responsible for refusing to exchange information with other states about taxpayers? Can the tax haven state justify its refusal based on its internal law? Can the existence or creation of internal law in that respect be considered to entail responsibility?[1574]
- ✓ May the other states retaliate, and how?[1575] What kind of countermeasures may be adopted without themselves becoming a violation of international law?
- ✓ If a tax haven state is held responsible under international law, what is the remedy? Must it stop with its illegitimate behavior (i.e. the harmful tax regime) and/or pay damages?

### 1.2. Suggestions about state responsibility particularly in cases of tax competition.

The issue of state responsibility has not received a lot of attention in the study of international taxation. Only recently did the issue come up, particularly with regard to tax competition. The Committee on Fiscal

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[1572] "All of these functions may potentially *cause harm* to the tax systems of other countries as they facilitate both corporate and individual income tax avoidance and evasion (author's italics)" (OECD Report on HTC, ibid, ft.1567, p.22.); "In a still broader sense, governments and residents of tax havens can be free riders of general public goods created by the non-haven country. Thus, on the *spending side* as well, there are potential negative spillover effects from increased globalization and the interaction between tax systems (italic by EvdB)." (OECD Report on HTC, ibid, ft.1567, p.15)

[1573] "Some jurisdictions have enacted laws that prevent financial institutions from providing tax authorities with information about investors. The most obvious consequence of the failure to provide information is that it facilitates *tax evasion and money laundering* (author's italics) "; (OECD Report on HTC., ibid, ft.1567, par 53., p. 24.; See also par. 75, p. 33.)

[1574] See previous footnote.

[1575] Chapter 3 of the OECD Report on HTC, ibid, ft.1567, par. 85-171, p. 37-62.; Appendix to the OECD Report on HTC, p. 67-71 (Recommendations and Guidelines for Dealing with Harmful Tax Practices).

Affairs of the OECD started the discussion about the legitimacy under international law of harmful tax competition as follows:

> "Countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so. This study is designed, in part, to assist in that regard"[1576]

In an interview with the OECD Observer, OWENS, Head of Fiscal Affairs confirms that countries are free to apply zero-rated taxes or no taxes at all, but are required to comply with the *international standard on transparency and exchange of information* (italic EvdB)[1577], thus suggesting that there are indeed such international norms.

Although the OECD does not, in so many words, say that harmful tax competition might constitute a breach of an international obligation (and consequently entails state responsibility), it can be deduced from the quotations above that both the premise and the objective of the OECD Reports in this matter is that harmful tax competition is and/or should be correctible by means of *international* rules. This is supported by the fact that the OECD suggests terminating double taxation conventions with uncooperative tax havens, clearly an act between states, the subjects of international law. Further support of the OECD's premise and objective can be found in the initiatives deployed in cooperation with non-member countries: the advance commitment letter, agreements etc. are transactions between subjects of international public law, and clearly intended to create international obligations, a breach of which may entail state responsibility.

The express possibility of state responsibility in this regard was endorsed by Rosembuj in his article on Harmful Tax Competition[1578].

> "Tax competition by tax havens is, by definition, harmful as it is based on supply of institutional protection for concealing overseas revenues not belonging to them. The cooperation of an international law subject or by those dependencies upon which it exercises tax powers, seriously affects other state's tax interests in an illegal way. This responsibility, harming tax interests of other states by institutional concealment of the income itself originates an obligation to rectify and even repair the state considered to be a

[1576] OECD Report on Harmful Tax Competition , ibid, ft. 1567, Par. 26
[1577] OECD Observer, "Towards world tax cooperation, 27 June 2000.
[1578] Rosembuj, T., "Harmful Tax Competition", *Intertax*, 1999, 316-334

> victim for the damage caused. The ordinary source of responsibility due to state evasion is the treaty. But, in the absence of this, the principle of harmful tax competition may be used as a platform for reparations of damages to other states given the fact that without its participation it would not have been possible to carry out."
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> "The OECD recommendations may be interpreted as a source of general principles concerning international tax law not only for its members but also by third party-states."
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> "The list of tax havens gives a framework to the general principle of harmful tax competition, which, objectively harms the interests of another state and implies international responsibility."

Malherbe notes the significance of the relationship between international law and harmful tax competition as well, but without discussing the legitimacy besides remarking the novelty of trying to curb tax competition by means of international law[1579]. J. David B. Oliver commented briefly in an *Intertax*-editorial on the relationship between the OECD Report and the enforcement of judgments under international private law[1580].

1.3. <u>Relationship between tax treaty termination and suspension, and state responsibility.</u>

Questions and suggestions about responsibility for state conduct in tax matters has, virtually for the first time, been raised with reference to tax avoidance and evasion.

In several ways, this subject is related to tax treaty termination and suspension. In the first place because state practice shows that an important reason (if not the most important reason[1581]) for states to terminate double taxation conventions, is tax avoidance and evasion:

> The US notified the Netherlands Antilles it wished to terminate their 1955 double taxation convention on June 29th, 1987. A

[1579] Malherbe, J., "Harmful Tax Competition and the EU Code of Conduct", *T.N.I.*, 2000, 18566: ("…like piracy…").
[1580] J. David B. Oliver, "Tax Sovereignty", *Intertax*, 2000, p. 146.
[1581] Some tax treaties may be terminated because the one of the states considers the conditions have shifted to its disadvantage: Indonesia terminated its treaty with The Netherlands because it considered the balance of tax distribution for oil and gas (branch profit tax of 9% in Indonesia) fit for a change.

renegotiated treaty of 1986 was never ratified by the US Congress. The US Treasury Department exclusively motivated its policy by considerations of treaty shopping[1582]; The UK government followed the US example with regard to the NL-Antilles[1583]; On the US-Bermuda DTA, similar problems are expected[1584]

Japan recently announced to terminate the participation of the British Virgin Islands and Montserrat in the UK-Japanese tax treaty. The Japanese authorities indicated a "lack of communication" was the reason, and denied that the OECD HIC Report had anything to do with the sudden decision[1585];

Denmark terminated its treaty with Portugal in 1994 to close the Madeira loophole[1586]. Later, Denmark indicated it might terminate the Denmark-Spanish treaty in order to exclude the Canary Island Free Zone of treaty benefits[1587].

Another important relationship between treaty termination and suspension, and state responsibility is that termination and suspension may also be considered to be a corrective measure for non compliance of the treaty by a state. As a matter of fact, in its report on Tax Treaty Override, the OECD only refers to termination and suspension as a remedy under international law in case of non-compliance by a state with its tax treaty obligation. It is indeed remarkable that, though there can be no doubt that customary international law about state responsibility contains the proper rules with regard to remedies of breaches of international obligations (and not the Vienna Convention on the Law of Treaties[1588]), the OECD does not mention this at al. Baker does admit the

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[1582] Crandall, F., "The Termination of the US-Netherlands Tax Treaty", *I.L.B.*, 1988, 355-380; Johnson, M.F., "Antilles Treaty Termination Favored", *Tax Notes*, July 13th 1987, 129.; Doernberg, R.L., "Selective Termination or Suspension of Income Tax Treaty Provisions", *T.N.I.*, Nov. 1990, 1130-1135.

[1583] UK Inland Revenue Press Release, March 16th, 1989. (Interest paid from the UK to the NL-Ant was not taxable in the UK)

[1584] Hainey, R, "U.S. Tax Treaty Threatened," The Royal Gazette, Oct. 1, 1998,

[1585] Official Gazette, July 28th, 2000. ; Mori, K., "Japan Says UK Treaty Will No Longer Apply to BVI and Montserrat", *T.N.I.*, 2000, 28480.

[1586] Weizman, L., "Denmark Terminates Portuguese Tax Treaty to Close Madeira Loophole", *T.N.I.*, 15th march, 1994.

[1587] Weizman, L., "Denmark Spain Treaty May Be Jeopardized By Canary Island Free Zone Legislation", *T.N.I.*, 30 January 1995.

[1588] See "International obligations found in tax treaties" in this article.

existence of remedies under international law for tax treaty override besides termination or suspension[1589].

Nevertheless, it will be shown in this article that although termination and suspension of tax treaties, and state responsibility may both be seen as corrective measures of (perceived) breaches of the international obligations on the state found in double taxation conventions, the one certainly does not exclude the other, and it may often be preferable from a policy perspective, not to terminate the treaty all together[1590].

## 2. Principles of State Responsibility

The answer to the questions above may be found in the international law of state responsibility. It is indeed a matter of international law whether or not, and under which circumstances states (as subjects of international law) are accountable towards other subjects of international law[1591].

The Draft Articles 1-35 (hereafter DA) that were adopted by the ILC so far[1592], are widely recognized as being very authoritative[1593], and may serve us to find some answers to the questions above.

The broad principle that conduct of states or their organs or agents, may entail the responsibility of that state under certain conditions, is a general

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[1589] Baker, Ph., Double Taxation Conventions and International Tax Law, 2 nd ed, Edition, Sweet & Maxwell, London, 1994, D-08.

[1590] See note 1588 above

[1591] Starke, J.G., Introduction to International Law, p. 58; Higgins, R., Problems and Process., Clarendon Press, Oxford, 1994, p. 12-13.; Jennings, R. and Watts, A., Oppenheim's International Law, 9th edition, Longman Group UK, vol. I, p. 4; Fenwick, C.G., International Law, Third Indian Reprint, 1971, p. 31; *S.S. Wimbledon*, *P.C.I.J.*, Series A, No. 1, p. 15; *Chorzow*, Judgment No. 8 of 26 July 1927, *P.C.I.J.*, Series A, No. 9, p. 21; *Corfu Channel*, Judgment of 9 April 1949, *I.C.J. Reports*, 1949, p. 23.

[1592] For a full overview of the work on State Responsibility by the ILC: "Analytical Guide to the Work of the International Law Commission 1949-1997", UN, New York, 1998, p. 226-256.

[1593] "The Draft Articles adopted so far by the ILC have undoubtedly taken on a certain importance. They are widely invoked and are often spoken of as if they are authoritative – that is to say, reflecting a widespread consensus…" (Higgins, R., Problems and Process, ibid, ft.1591, p. 148-149).; Brownlie, I., Principles of Public International Law, Clarendon Press, Oxford, 1990, p. 440.; *Contra*: "It is highly doubtful if the ILC's work on state responsibility has been based on such a consensus": Nisuke, A., "Some Critical Observations on the International Law Commission's Draft Articles on State Responsibility", *A.Y.I.L.*, 1995, 144.

principle of international law. The International Court of Justice (and its predecessors) have formulated it as follows:

> "The Court observes that it is a principle of international law, and even a general conception of law, that any breach of an engagement involves an obligation to make reparation"[1594]

It has as such been confirmed in the DA (art. 1)[1595], but also finds confirmation in state practice and writers[1596] since the days of Grotius[1597], though the opinions are more divers on the exact justification and remedies of state responsibilities.

Under which conditions may the states liability be invoked? Art. 1 DA states: "Every internationally wrongful act of a state entails the international responsibility of that state". An internationally wrongful act which results from the breach of an international obligation so essential for the protection of fundamental interests of the international community that this breach is recognized as a crime by that community as a whole, constitutes an international crime**,** according to art. 19 of the DA. Other internationally wrongful acts are called international delicts (art. 19 par. 4 DA). Furthermore, it has been recognized in international law that states may also incur liability for internationally permissible acts[1598].

With the help of these three categories (internationally wrongful acts which are international crimes, internationally wrongful acts which are

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[1594] *Chorzow Factory* (merits), P.C.I.J., ser A, no. 17, p. 29.

[1595] DA, Art. 1, Commentary (1).; Starke, J.G., see footnote 1591, p. 293.

[1596] Malenczuk, P., Akehurt's Modern Introduction to International Law, p. 254; Starke, J.G., see footnote 1591, p. 58.; Higgins, R., ibid, ft.1591, p. 12-13.; Jennings, R. and Watts, A., Oppenheim's International Law, 9th edition, Longman Group UK, vol. I, p. 4; Fenwick, C.G., International Law, Third Indian Reprint, 1971, p. 31; Spinedi, M. and Simma, B. (ed.), United Nations Codification of State Responsibility, Oceana Publications, New York., 1987, p. 287-323.

[1597] Grotius, De Iure Belli ac Pacis, Book III., ch. X, par. 4.

[1598] Report of the ILC on the work of its 32nd session, G.A.O.R., 35th sess., Suppl. No. 10 (A/35/10), chapter VII; Preliminary Report on International Liability for Injurious Consequences Arising out of Acts Not Prohibited by International Law, UN Doc. A/CN.4/SER.A/1980/334.; Magraw, D.B., "Transboundary Harm: The International Law Commission's Study of International Liability", *A.J.I.L.*, no. 80, 1986, 305.; Miatello, A., "International responsibility for the use of nuclear energy", in Spinedi, M. and Simma, B. (ed.), United Nations Codification of State Responsibility, Oceana Publications, New York., 1987, p. 287-323.; Brownlie, I., Principles of Public International Law, Clarendon Press, Oxford, 1990, p. 444.; Brownlie, I., State Responsibility Part I, Clarendon Press, Oxford, 1983, p. 49.

international delicts, and internationally lawful acts), we can start assessing the nature of state responsibility in matters of taxation[1599].

## 3. State Responsibility for International Crimes in Matters of Taxation

The title of this section in my article will make the lawyer specialized in international law frown in disbelief, but the reason why may not be immediately obvious to his tax law-colleague.

The difference between delictual and criminal liability in international law regarding state responsibility may be tempting for tax lawyers to erroneously compare it with the difference between tax avoidance and evasion in municipal law[1600].

Of course, it is true that there seem to be comparable doctrines in the domestic tax laws of different states with regard to the difference between tax avoidance and evasion[1601]. As Uckmar puts it in his General Report to the IFA in 1983:

> "Almost all countries recognize the right of the taxpayer to arrange his affairs in a way which attracts minimum tax liability, and therefore to choose legal forms which are his view the most suitable for the disposition of his affairs. However, if the sole or predominant motive of a certain transaction was to avoid tax, the form of the transaction may be ignored…"[1602]

[1599] The use of these three categories is mainly helpful not to get lost. As the ILC states: "… a joint examination of the two subjects (wrongful and lawful acts; Edwin van der Bruggen) could only make both of them more difficult to grasp" *Y.I.L.C.*, 1978, vol. II, par. 33, p. 54. Actually, one can doubt as to the practical merits of the difference, as does Nisuke, A., ibid, ft. 1593, p. 132.

[1600] Rosembuj does suggest that states are internationally responsible for tax evasion, because tax evasion is a crime, but does not specify if it is an international crime or another wrongful act. See footnote 1578.

[1601] IFA Congress "Tax Avoidance and Evasion", *Cahiers de Droit Fiscal International*, vol. 68a, 1983; Graeme S. Cooper (ed), Tax Avoidance and the Rule of Law, *IBFD* Publ., Rotterdam, 1997; Van der Bruggen, "The Importance of Being Earnest", *Intertax*, 2000, 360.; Ward, D., "The Business Purpose Test and Abuse of Rights", *B.T.R.*, 1985, 68.

[1602] Uckmar, V., "Tax Avoidance and Evasion", *Cahiers de Droit Fiscal International*, vol. 68a, 26.

That all countries know what tax evasion is, and even have similar doctrines in separating tax avoidance from evasion, does not make tax evasion an international crime in customary international law about state responsibility. It only makes it a domestic crime, which is similarly described, in different legal systems. After all, most states broadly have the same concepts to define theft, traffic violations, or corruption. Obviously, these are not international crimes in the sense of customary international law about state responsibility, either. There clearly is a difference between acts with a cross-border character that are considered a criminal offence under some or even several municipal laws, and international crimes as defined by art. 19 DA[1603].

Although there is an ongoing discussion on the criminal liability of states[1604], even a superficial look at the work of the ILC and distinguished writers learns that the concept of international crime in function of state responsibility was never intended to be interpreted in a broad sense, or in a way to align the concept to certain criminal offences in municipal law. The examples the ILC gives of international crimes in the DA (though it is true they are examples and not an exhaustive list[1605]) refer to war and aggression, colonial domination, genocide and apartheid, and massive pollution. In these cases, the ILC argues,

> "The international community as a whole and not merely one of its members now considers that such acts violate principles formally embodied in the Charter and, even outside the scope of the Charter, principles which are now so deeply rooted in the conscience of mankind that they have become particularly essential rules of general international law"[1606].

It is apparent that the ILC considers that one cannot lightly assume that an internationally wrongful act (or an infraction of the municipal criminal code, for that matter) is in fact an international crime. The ILC draws the pertinent comparison with norms of *jus cogens*,[1607] which underlines the

[1603] See further below and in part IV 2 e) of this article.
[1604] Many states agree that it is conceptually possible, but impossible to define: G.A.O.R., 31st Sess., 1976, A/C.6/SR 18, par. 35; Rosenstock, *A.J.I.L.*, 1995, p. 390.
[1605] Art. 19 par. 3 D.A. "inter alia".
[1606] Y.I.L.C., 1976, II (part II) p. 109. See also Mohr, M., "The ILC's distinction between international crimes and international delicts and its implications", in Spinedi, M. and Simma, B., ibid, ft.1596, p. 115.
[1607] On state responsibility and jus cogens: Rosenne, S., Breach of Treaty, Grotius, Cambridge, 1985, p. 65.; Starke, J.G., ibid, ft.1591, p. 55.; On treaty termination and jus cogens: Kontou, N., The Termination and Revision of Treaties in the Light of New Customary International Law, Clarendon Press, Oxford, 1994.

high standard to be applied before we may deem an internationally wrongful act to be an international crime. Examples of rules of *jus cogens* can be found in the debate on the preparation of the Vienna Convention on the Law of Treaties and concern unlawful use of force, slave trade, piracy, genocide, human rights, equality of states.[1608]

Going from genocide or aggression to tax evasion is quite a leap. One cannot, in the current status of international law, seriously debate that tax evasion can be deemed an international crime in the sense of art. 19 DA.

One must distinguish, however, between international crimes, as referred to by the DA in the context of state responsibility under customary international law on the one hand, and transnational crimes on the other hand. Though tax evasion is definitely not an international crime in the first sense, it can certainly be a transnational organized crime. In other words, there is a difference between crimes committed by a state (aggression, slavery, genocide, …) and crimes committed by state subjects with a transnational character (corruption, fraud, criminal association, …). This latter category may entail state responsibility if the state breached any international obligation it undertook to keep its subjects from committing those transnational crimes. In that case, there may be state responsibility, not because the crime is attributed to the state, but because the state failed to achieve a requirement by an international obligation to curb certain transnational crimes. This issue is therefore treated under part IV 2 e) of this article.

Furthermore, the first question that needs to be addressed is if states can conduct themselves in an internationally wrongful way in matters of taxation, before even deciding if this internationally wrongful act may constitute a crime or a delict. In other words, if an act of a state is not an internationally wrongful act, it cannot be an international crime either. This issue is dealt with under title IV but it suffices to say here that if it is determined that there is no such thing as a internationally wrongful act in matters of taxation, there can consequently be no international crime either.

### 4. State Responsibility for International Delicts in Matters of Taxation

[1608] *Y.I.L.C.*, 1966, vol II, p. 248.

## 4.1. Constitutive Elements of a Wrongful Act: Attribution to a state and breach of an international obligation

Every internationally wrongful act entails the responsibility of the state[1609]. If not as an international crime, then as an international delict. The concept of an internationally wrongful act determines the responsibility of the state.

There are two constitutive elements to have an internationally wrongful act: the conduct consisting of an action or omission needs to be attributable to the state under international law (i) and that conduct constitutes a breach of an international obligation of the state (ii)[1610]. Both conditions present considerable hurdles for state responsibility in matters of taxation.

## 4.2. Breach of an international obligation.

### *a) Requirement of the existence of an international obligation*

The second condition laid down for the existence of an internationally wrongful act of the state, is that the conduct must constitute a breach of an international obligation, as required by art. 3 b) DA. Such was already accepted in international court decisions[1611]. It is the objective element of the internationally wrongful act. The essence of wrongfulness is found in the non-conformity of a state's actual conduct with the conduct it ought to have adopted in order to comply with a particular international obligation.

In order to find a breach in an international obligation, we must discover what the obligation is. As Higgins puts it: "First of all, of course, one has to know what the obligation is before one can examine whether it can be breached"[1612].So where can we find those international obligations? The ILC enlightens:

> "In international law, as in internal law, legal obligations may be have different origins. It may be established by a customary rule of international law, by a treaty provision or by a general principle

[1609] Art. 1 DA.; Without detriment to lawful acts that may create responsibility as well.
[1610] Art. 3 DA.
[1611] PCIJ, 26 July 1927, *Chorzow case*, P.C.I.J., Series A, no 9 p. 21.; International Court of Justice, 13 sep. 1928, P.C.I.J, series a, no 17, p. 29.; PCIJ, advisory opinion 18 July 1950, *I.C.J. Reports*, 1950, p. 228.
[1612] Higgins, R., ibid, ft. 1591, p.148.

within the international legal order. In addition, states sometimes assume international obligations by a unilateral act".[1613]

Indeed, such as Greig puts it in his study of international law: "Most of the rules in international law discussed in this book would, if broken, give rise to a cause of complaint against the offending state by states affected by its actions"[1614]

*b) International obligations in matters of taxation not found in tax treaties.*

Postulate of Sovereignty.

The postulate of sovereignty is the corner stone of the power of the state to enact tax law. This has widely been accepted in international law. The only possible question that remains is if a state needs to justify the reasonableness of the nexus it uses to subject extra-territorial income. Even without answering that question, it is undisputed that if the state respects such a reasonable nexus, there are virtually no restrictions to be found in customary international law that may be deemed international obligations.

Wurzel puts it as follows: "…taxing power stems from sovereignty and sovereignty is omnipotence…". "Is there anything in the written or unwritten law of nations to indicate a universally recognized rule authoritively assigning among nations, and thereby impliedly limiting the jurisdiction to tax? The answer is very definitively in the negative…". "As far as tax experts are concerned, the majority clearly adhere to the doctrine of sovereignty as granting unrestricted taxing power"[1615].

Hinnekens: "De sovereiniteit van de staat wordt traditioneel gedefinieerd als zijn genot van de opperste en volste macht. Zij behelst als zodanig ook de fiscale (al)macht"[1616], confirmed by Schoonvl[1617].

Knechtle: "Up to the present, there has been no internationally recognized principle in public international law which limits the sovereignty of states

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[1613] *Y.I.L.C.*, 1976, vol II, Part II, 80.
[1614] Greig, ibid, p. 525.
[1615] Wurzel, ibid, ft.1562, p. 812 and 814.
[1616] Hinnekens, De Territorialiteit van de Inkomstenbelasting op Nieuwe Wegen en Grondslagen, Kluwer, Diegem, 1993, p. 67.
[1617] Schoonvliet, E., Handbook International Fiscal Recht, Biblo, Kalmthout, 1996, p. 29

in fiscal matters. (…) Fiscal jurisdiction, i.e. sovereignty in the sphere of fiscal law means the non-derivative sovereignty of a state, which is in principle internally as well as externally unlimited."[1618]
Norr: "No rules of international exists to limit the extent of any country's tax jurisdiction. (…) Within its own legal framework a country is free to adopt whatever rules of tax jurisdiction it chooses"[1619].

Griziotti, Albrecht and Allix agree[1620].

Even the writers that adhere to the "reasonable connection school" will agree that once that reasonable link is established, there are no further obligations under international law, as has been demonstrated by Qureshi: "Once a foreign element arises within the territory, there are no restrictions as such on the ambit or focus of the jurisdiction"[1621]. Mann shares this opinion: "Once a nexus such as residence and/or domicile is established, … the right to tax extends to all the taxpayers' property wherever it may arise and irrespective of its receipt within the taxing state[1622]". Martha studied the issue extensively and comes to the conclusion that: "A state may only fiscally attach those facts that are subject to its supremacy (sovereignty, either personal, territorial or functional)"[1623]

The US Supreme Court accepted an estate tax on American property formerly belonging to a British citizen residing in Cuba. The reasonable nexus being the property, the court decided that "the property is within the reach of the power of the US by nature of its *sovereignty* and could exercise as against other nations and their subjects without violating any established principle of international law.

International Courts have long confirmed this principle. The US-Mexican Claims Commission in *Cook v Mexico*: "The right of a state to levy taxes constitutes an inherent part of its *sovereignty*"[1624].

[1618] Knechtle, A., Basic Problems in International Fiscal Law, 1979, p. 37.
[1619] Norr, M., "Jurisdiction to tax and international income", *T.L.R.*, 1962, p. 431.
[1620] Martha, R.S.J., The Jurisdiction to Tax in International Law, Kluwer, Deventer, 1989.
[1621] Quereshi, A.H., "The Freedom of a State to Legislate in Fiscal Matters under General International Law", *B.I.F.D.*, 1987, p.14.
[1622] Mann, F., "The Doctrine of International Jurisdiction Revisited after 20 years", *Receuil des Cours*, 1984, vol 111 , p. 98.
[1623] Marthaa, ibid, ft.1620, p. 17.
[1624] *Cook v Mexico* 4R, Int. Arb. Awards, 1926, p. 593.

The British Venezuelan Claims Commission held Venezuela responsible in the *Santa Clara Case* for illegal tax collection for reasons of lack of *sovereignty*[1625].

The *Dragon Project Case* is a dispute between Commission of the European Atomic Energy Community (Euratom) and the United Kingdom Atomic Energy Authority about whether or not the officials of a joint energy project in the UK are entitled to an exemption for tax under international agreements. The international arbitrator stated that: ”It is quite clear that a state under its own *sovereignty* decides, as a general rule, any question of taxes to be imposed on residents in that state or on income derived from or paid in that state.”[1626]

The *European Court of Justice* has also stressed the importance of fiscal sovereignty, by lack of any express provisions to the contrary[1627].

Restrictions on Fiscal Sovereignty?

One of the much debated issues in international tax law is if there is any general principle of international law that limits the domestic tax law of a state. Mostly, the question arose in connection with extra-territorial tax laws (or tax laws that take extra-territorial circumstances in consideration). Is there any general principle of international law that would prohibit such a taxation?

To assume that sovereignty is limited in some respect, must be specifically, expressly stipulated. It cannot be deduced or implied from any other sources. “A line which would limit the exercise of sovereignty of a state within the limits of its own territory, can be drawn only on the ground of express stipulation …”[1628].

Fact is that most tax laws of states take some kind of a nexus into account before taxing a non-resident subject or income (residence, source of income, habitual abode, citizenship, law of incorporation,…). Does this mean that such a nexus is actually a requirement under international law,

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1625 *Santa Clara Estates Claim*, 9 R, Int. Arb. Awards, 1903, p. 455.
1626 Commission Euratom v. UK Atomic Energy Authority, 25 February 1967, *I.L.R.*, 1972, p. 409-413.
1627 Lehner, M., “Limitation of the National Power of Taxation by the Fundamental Freedoms and Non-dvpkdscrimination Clauses of the EC Treaty, *EC TR.*, 2000, p. 5-15.
1628 *North Atlantic Fisheries Case*, 1910, 1 HCR, p. 141 at 169.

even in absence of a treaty? Probably not[1629], but this whole discussion is in fact not relevant for the question of state responsibility for tax competition.

It is widely accepted that, once a reasonable nexus exists, the validity from an international law point of view is an undisputed consequence of fiscal sovereignty[1630]. In the case of tax competition and general tax policy, that reasonable nexus will nearly always exist. The tax regimes that are considered harmful in the OECD Report will necessarily require some nexus with the taxpayer. The residence of a tax haven company[1631], the residence of an individual[1632], the maintaining of (financial) assets within the state, the incorporation of a tax haven company, the maintaining of staff or office[1633].

Rosenbuj takes entities “devoid of substantial company activity”, without “productive activities”, which are “artificial entities lacking in international significance” into consideration when discussing avoidance by states.

Still, there is ample reason in state practice to use the formal attachments of nationality and incorporation to subject taxpayers to taxation[1634].

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[1629] Vogel, K., Double Taxation Conventions, 3 rd ed, Kluwer, 1997, p.11,; Hinnekens, L. ibid, ft.1616, p.70-85.; Martha, sec.IV. Ibid, ft. 1620, sec.IV.; Qureshi, A.H., ibid, ft. 1621, p. 21.

[1630] See above: “Postulate of Fiscal Sovereignty”.

[1631] Ginsberg, A., International Tax Planning, Kluwer, Deventer, 1994, p. 1-33.

[1632] Such as in Monaco, Nl-Antilles etc.

[1633] Such as in Singapore, Ireland etc.

[1634]The examples of states using the nationality criterion and/or the incorporation criterion are well known. Even though they perhaps do not form the majority of states, they certainly constitute too important a part to deem not doing so is universal. Many states use both the incorporation and the residence test. Some use only one of the two.; Martha, R.S.J., The Jurisdiction to Tax in International Law, ibid, ft. 1671.; Australia/incorporation (International Tax Planning Manual, CCH, 10,001); Austria/incorporation (International Tax Planning Manual, CCH, 11,011); Canada/incorporation (after 26 April 1965; Income Tax Act); France/incorporation (International Tax Planning Manual, CCH, 29,011); Germany/incorporation (International Tax Planning Manual, CCH, 31,011); India/incorporation (International Tax Planning Manual, CCH, 36,011); Italy/incorporation (International Tax Planning Manual, CCH, 40,011); Japan/incorporation is the only criterion (International Tax Planning Manual, CCH, 44,012); The Netherlands/incorporation (Mobach et.al., *Cursus Belastingrecht*, Hfdstk I, 1.0.1.b);Norway/incorporation is the only criterion (International Tax Planning Manual, CCH, 69,011); Switzerland/incorporation (International Tax Planning Manual, CCH, 83,011); Taiwan/ incorporation is the only criterion (International Tax Planning Manual, CCH, 86,011); Thailand/incorporation is the only criterion (sec. 39 Revenue Code); UK/ incorporation has been added to the

DTA's with states using the incorporation criterion, illustrate that the treaty partners are generally willing to include the incorporation criterion in art. 4 par. 3 of the DTA, and may use the effective place of management-test as a tool to decide on dual residence [1635], or, on the contrary, use the statutory seat as a decisive criterion[1636]. Support for this can also be found in the DTA's where the non-discrimination provision protects nationals, not residents. The US have been particularly successful in having their savings-clause (safeguarding their right to tax on the basis of nationality) accepted by treaty partners[1637]. International doctrine confirms that mere incorporation or nationality is enough to establish tax jurisdiction[1638]. Particularly telling is the fact that the UK has actually added the incorporation criterion to its tax law recently.

In the opinion of this author, further support for accepting a formal (but real) nexus as sufficient, can be found in case law of the international courts, namely the *Barcelona Traction Case (Second Phase)*[1639]. A company of the same name was established under Canadian law. However, its activity was limited to that of a holding company. Its subsidiaries were not at all active in Canada, but in Spain, where it developed the production and distribution of electric power. All shares were in the hands of a Belgian corporation, named Sidro, which had appointed nominee shareholders through a trust (as a consequence of the German invasion). After Spain had declared the enterprises within that state bankrupt, Belgium claimed it could act on behalf of its subjects and submitted the dispute to the ICJ. Belgium alleged it was entitled to reparations on the basis of various unlawful acts by the Spanish courts and administration. The ICJ did not accept the cause of action by Belgium, deciding that only Canada had possibility to act internationally.

> "In the present case, it is not disputed that the company was incorporated in Canada and has its registered office in that country. The incorporation of the company under the law of Canada was an act of free choice. Not only did the founders of the company seek

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criteria since 15 March 1988 (International Tax Planning Manual, CCH, 92,011). US/nationality (Mcdaniel, P. and Ault, H., Introduction to US Taxation, 4th ed., p. 33.; US/incorporation (Doernberg, R.L., International Taxation, West, 1997, 21).

1635 See i.e. the DTA's concluded by Japan, Thailand and the US.

1636 German DTAs with The Netherlands and Luxembourg; Thailand's DTA's with Vietnam, Laos and Australia determine that only the incorporation criterion may determine residence for treaty purposes.

1637 Vogel, K., Double Taxation Conventions, 3 rd ed, Kluwer, 1997, p. 85.

1638 Martha, R.S.J., The Jurisdiction to Tax in International Law, ibid, ft. 1620.; Vogel, K., ibid, ft.1637, p. 11.

1639 *Barcelona Traction Case (Second Phase)*, ICJ, 1970, 3.

> its incorporation under Canadian law but it has remained under that law for a period of over 50 years. It has maintained in Canada its registered office, its accounts and its share registers. Board meetings were held there for many years; it has been listed in the records of the Canadian tax authorities. Thus, a close and permanent connection has been established, fortified by the passage of over half a century. This connection is in no way weakened by the fact that the company engaged from the very outset in commercial activities outside Canada, for that was its declared object. Barcelona Traction's links with Canada are thus manifold".

The international tax practitioner will not fail to recognize elements familiar to offshore financial planning; the incorporation in a "more suitable" legal jurisdiction, the lack of activity within that jurisdiction, the formal nexus confirmed by board meetings, deposit of accounts, beneficial owners in another state, the use of nominees and trusts, etc. The dictum of the ICJ is therefore more than relevant in verifying the recognition for purposes of customary international law, of formal criteria in determining jurisdiction (to tax) under municipal law[1640].

International law does contain a clear restriction on fiscal sovereignty with regard to the minimum equal treatment of foreigners that would disallow confiscatory and arbitrary taxes on the property of foreigners[1641].

It is true that fiscal sovereignty is a principle that is being eroded[1642]. Both internally (endowment of fiscal power to decentralized regions of states

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[1640] It is true that there is persuasive international case law *seemingly* to the contrary, namely that does not support that a state may present a claim on behalf of a corporation on the *sole* basis of its incorporation. (See Brownlie, I., ibid, ft.1692, p. 487) That case law serves, in the opinion of this author, however to define the limits of the nationality-principle. One must take the "real and effective nationality" into consideration (*Florence Strunsky Merge Case*, *A.J.I.L.*, 1956, 154.) If, to take the example of the Barcelona Traction Company again, the effective seat of management (Cfr. Art. 4 OECD Model) would have been in Belgium, where all decisions would have been taken, where all real management activity was carried out, the outcome may have been different. On these grounds it may be assumed that a company, although incorporated in a tax haven state, has its effective seat of management in another state, has the "real and effective nationality" of that other state.

[1641] Brownlie, I., ibid, ft.1692, p. 531.; Quereshi, A.H., ibid, ft.1621, p. 16.; See also chapter 5, p.141-166, " When is Host-State Tax Treatment in Breach of the International Law of Expropriation? Notes on Goetz v. Burundi (ICSID Tribunal Decision of 2 September 1998)

[1642] In that sense, fiscal sovereignty cannot be separated from the evolution of sovereignty as a whole; (Attanasio, J.B., "Conclusions", in Franck, T.M., and Fox, such as in the P.R. China and India, or communities such as in Belgium) and externally (double taxation conventions, EU) the supreme power of the central government decreases. Taking this in consideration when discussing state responsibility for state conduct in tax matters is important, but we may not forget that all of these restrictions of state fiscal sovereignty is voluntary[1643]. This was again illustrated by the reluctance and refusal of EU Member States to accept the qualified majority vote in matters of taxation in Nice, December 2000.

Unilateral Obligations

State responsibility may be incurred in tax matters as a consequence of international obligations that have a unilateral character. These may not be confused with domestic acts providing for unilateral relief of double taxation, which do not constitute international obligations (but municipal law), and thus are not susceptible to remedy under the rules of state responsibility in customary international law.

But there are indeed international obligations in tax matters that may be found in unilateral declarations or commitments. States cannot be obliged to provide assistance to other states for tax purposes by lack of a treaty to such effect, but there is nothing in international law to prevent states to cooperate voluntarily. If a state undertakes such a promise (i.e. in exchange of notes, or diplomatic letters), later non-compliance may entail state responsibility. A good example of such a unilateral obligation can be found in a letter by the German Federal Ministry of Finance dated December 1, 1988 to the US. The German tax authorities promised to deliver information even in absence of a formal requirement to do so if, for example, a U.S. multinational with a German subsidiary structures its operations via a tax haven entity that has no treaty with Germany and Germany possesses relevant information.

The OECD initiative to curb HTC shows us another example of international obligations in tax matters that are derived from unilateral promises. The commitment contained in the letter that the OECD has already been signed by several states, constitutes a unilateral international obligation that, if breached, may entail state responsibility.
It is however unclear exactly which obligation is described in the letter:

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G.H., International Law Decisions in National Courts, Transnational Publ., New York, 1996, p. 389).

[1643] Kranz, J., "Reflexions sur la soeveranite", in Makarczyk, J., Theory of International Law at the Threshold of the 21st Centurty, Kluwer Law, Deventer, 1996, p. 191.

> "(the state) shares the concern of the OECD on Harmful Tax Competition and would like to associate itself with that work. To this end, I am pleased to inform you that (state) hereby commits to the principles of the OECD Report. In fulfillment of this commitment, (state) undertakes to implement such measures (including through any legislative changes) as are necessary to eliminate any harmful aspects of (state) regimes that relate to financial and other services"[1644].

A particular difficulty to understand the nature of the international obligation on the state by signing the "letter of commitment" is that the "harmful aspects" of the state's tax haven regime, which the tax haven state promises to eliminate, are not clearly identified. The OECD Report on HTC, and the OECD Report "Towards Global Tax Cooperation" have yet to identify which potentially harmful regimes are indeed harmful. How can a state signing the advance commitment letter promising to eliminate harmful regimes, if there is no way yet of knowing what is actually harmful (as opposed to potentially harmful)? Surely, it is fair to say that the obligations on the state contained in the advance commitment letter, are mere obligations of conduct, obliging the tax haven state to broadly adhere to the principles of the OECD Report on HTC and it may e.g. not refuse to continue the dialogue process without breaking its unilateral commitment[1645].

Conclusions

If there is any general principle of international law regarding taxation, it is that taxation is an attribute of sovereignty, the exclusive power of the state. Especially when states respect a "reasonable link" between the income or the taxpayer and their territory, there is little reason to assume general principles of international law or customary international law limits the sovereignty of the state in any way with regard to taxation. This has been confirmed by learned writers, municipal courts, international courts, international agreements and state practice.

[1644] Mitchell, D.J., "An OECD Proposal to Eliminate Tax Competition would mean Higher Taxes and Less Privacy", *T.N.I.*, 2000, 26564. According to this author, the OECD annexed an agreement to the letter, the contents of which is undisclosed.
[1645] The OECD, commenting on its own achievements in its Report "Towards Global Tax Cooperation", suggests a firm obligation has been undertaken: "The commitment necessary to avoid inclusion on the List of Uncooperative Tax Havens is a public political commitment by a jurisdiction to adopt a schedule of progressive changes to eliminate its harmful tax practices by 31 December 2005" (par. 21).

In the case of tax havens or tax competition, usually that "reasonable link" is respected in state laws.

There is no reason to assume that tax jurisdiction on the basis of incorporation or citizenship alone in absence of a treaty, is in itself an unreasonable nexus, and would thus be contrary to any general principle of international law.

*c) International obligations on the state in matters of taxation, found in treaties (besides the EU Treaty).*

Kinds of Tax Treaties

The most well known, and without a doubt the largest source of international obligations in matters of taxation are to be found in double taxation conventions on income and capital. Other notorious examples exist as well, such as agreements to prevent double taxation on international transport[1646] and less common agreements with respect to estate duties[1647] and registration taxes[1648].

Multilateral treaties in tax matters exist as well. The Nordic Double Taxation Convention[1649], The European Convention on Mutual Assistance[1650] and the Benelux Convention on Mutual Assistance and Collection of Taxes[1651], the Aadean Double Taxation Convention[1652], and

[1646] Different types of agreements exist with reference to international transport. Some only refer to shipping profits (such as the US-Hong Kong Agreement in Respect of the Taxation of Shipping Profits of 16th August 1989), others to transport over land (German-Belgian Agreement of 17 December 1964 concerning the taxation of motorized vehicles engaged in transport between the territories of both sates) and others only to air traffic (Lang, D., Taxation of International Aviation; A Canadian Perspective", *C.T.J.*, 1992, p. 881.)

[1647] General Report and National Reports of the 1985 IFA Congress, *C.D.F.I.*, 1985, 70b.

[1648] Such as the Belgian-French agreement of 20 April 1960.

[1649] Multilateral Nordic Convention for the Avoidance of Double Taxation with respect to Taxes on Income and Capital between Denmark, Finland, Iceland, Norway and Sweden of 22 March 1983.

[1650] European Convention on Mutual Assistance, 25 January 1988, concluded at Strasbourg between Denmark, Finland, Iceland, Netherlands, Norway, Sweden, US, in force since 1 April 1995. Also signed by Belgium and Poland.

[1651] Convention signed 5th September 1952.

[1652] Multilateral Double Taxation Convention, 16 November 1971, signed by Bolivia, Chili, Columbia, Ecuador and Peru.

the Double Taxation Convention of the Caricom group[1653], are well known examples.

Furthermore, international obligations with regard to taxation can be derived from treaties that prima facie have nothing to do with tax. Examples are the European Convention on Human Rights[1654], the American Convention on Human Rights[1655], Treaties for the Guarantee and Protection of Investment[1656], Treaties of Friendship and Cooperation and Most Favored Nation Treaties[1657].

International obligations on the state in tax matters found in the EU Treaty are discussed separately below.

Nature of International Obligations found in Tax Treaties.

Double taxation agreements on income and capital are a source of several international obligations on the state. One of the important international obligations that is derived from a DTA is the obligation on the state to exempt certain income from taxation in the state, or to give a credit for tax due in the other state and thus prevent possible double taxation. Other international obligations are the obligation on the state not to subject nationals of the other state to more burdensome taxation than on its own nationals[1658], the obligation on the state to engage in a mutual agreement procedure if so required by the provisions of art. 25, the obligation on the state to exchange information, and the obligation on the state to ratify the DTA[1659]. These are the international obligations specifically described in the tax treaties. A breach of these obligations constitutes a wrongful act if the conduct of the state is not in conformity with what is required.

[1653] Multilateral Tax Agreement of (8) Member States of the Caribbean Community, 6 July 1994.

[1654] European Convention on Human Rights, 4 November 1950.; Baker, Ph., "Taxation and the European Convention on Human Rights", *E.T.*, 2000, p. 298-374.

[1655] 1969, P.A.U.T.S. 36, 1970.

[1656] Jennings, R and Watts , A., Oppenheim's International Law, Longman, 1992, p. 1323.

[1657] Ustor, *Y.I.L.C.*, 1969, p. 157-86.

[1658] Art. 24 OECD Model Tax Convention.

[1659] Art. 29 OECD Model Tax Convention.; The same obligation (though with a wider scope for different ways of exchange of information) with a similar restriction (art. 21) can be found in the Convention for Mutual Assistance of 25 January 1988.

With regard to tax competition, I submit that enacting a tax haven regime is in itself not a breach of any of the international obligations on the state usually found in the DTA[1660].

It may be so, but this certainly merits further study, that the adopting of a new tax haven regime constitutes a fundamental change in circumstances in the sense of art. 62 of the Vienna Convention on the Law of Treaties, and as such would justify a unilateral termination of the treaty[1661], a question that Luthi seems to answer in the negative[1662]. This problem is however out of the realm of state responsibility.

State conduct in tax competition may be easier to criticize when a state would adopt measures specifically targeting a loophole in one particular other state's tax law. An example of such policy could be found in the Brazilian tax law of the 70's. A 25% withholding tax applied to interest paid abroad, which created rather a large tax credit in the US. But the actual tax cost for the taxpayer was much lower; the Brazilian government paid the borrower a subsidy corresponding to 85% of the tax withheld, a measure specifically drafted to increase the foreign tax credit in the US, without actually increasing the cost of the transaction[1663]. Creating a special regime that only makes sense to be used in such a way, might be deemed unreasonable and unfair, and even when it is not in direct contradiction to any international obligation on the state found in the DTA, it may be taken into account for state responsibility.

Good Faith[1664]

[1660] See also chapter 6, "Reflections on the Principle of 'Good Faith' as a Source of Normative Content for the Application and Interpretation of Double Taxation Conventions", p.167-227.

[1661] If the adoption by the state of the tax haven regime was, among other conditions, not foreseeable and can be deemed to "radically transform the extent of obligations still to be performed by the treaty". This last condition can be circumvented by the state which adopts the new regime by providing that companies benefiting of the new law do not have tax treaty entitlement.

[1662] Luthi, D., in IFA proceedings on 1989 Seminar Tax Treaties and Domestic Legislation, Kluwer, Deventer, 1991, p. 9.

[1663] Surray, S., Some Foreign Tax Credit Issues in Relationship to Developing Countries: Withholding Taxes on Interest and Discriminatory Taxes, in Hellawel, R., (ed.) US Taxation and Developing Countries, Columbia University Press, New York, 1980, p. 385-418.

[1664] See also chapter 6, "Reflections on the Principle of 'Good Faith' as a Source of Normative Content for the Application and Interpretation of Double Taxation Conventions", 167-227.

State responsibility is incurred for breaches of an international obligation, most of which can be found in tax treaties as far as fiscal matters are concerned. Treaties must be performed in good faith[1665], and tax treaties are obviously no exception. Consequently, state conduct that is contrary to applying the tax treaty in good faith, may incur its responsibility. The same conduct will not necessarily justify a suspension or termination of the treaty. That would only be the case if the non-*bona fide* performance by the other state, is also deemed a material breach.

It is one thing to confirm this broad principle. Deducing what is and what is not a *bona fide* act of the state in the light of its tax treaty obligations, is however not without difficulty[1666]. As a matter of fact, the whole good faith doctrine is, though it clearly has earned it's place in international public law (conventional and otherwise)[1667], it is hardly possible to point to other specific rules of good faith besides '*pacta sunt servanda*'. O'Connor, in his recent study, submits convincingly that good faith in international public law is directly related to **honesty, fairness and reasonableness**[1668]. How exactly those moral rules must be filled in, depends on compelling standards of honesty, fairness and reasonableness prevailing in the international community at that particular time.

That good faith is not easily definable may however not lead to an unwarranted expansion of the scope of the international obligations on the state found in double taxation conventions. As O'Connor warns:

> "As a legal principle it (good faith) must be applied where relevant, and that means it must be applied only where there is a legal obligation in question"[1669].

We must merely carry out that international obligation in good faith. It does not create new ones. David confirms this:

> "In other words, a particular obligation must not be evaded by what amounts to a strictly literal interpretation of the treaty provisions to the exclusion of all other legally relevant factors"[1670].

[1665] Art. 26 Vienna Convention on the Law of Treaties.
[1666] Ward, D.A., "Abuse of Tax Treaties", ibid, p. 397.
[1667] O'Conner, J.F., Good Faith in International Law, Dartmouth, Brookfield, 1991, 45 (and references in footnotes 17-162 of Chapter 6).
[1668] O'Conner, J.F., ibid, ft.1667, p. 121.; Also Cheng, B., General Principles of Law, Grotius Publ., Cambridge, 1987, p. 123.
[1669] O'Conner, J.F., ibid, ft.1667, p. 123.

Support for this can be found in decisions of the International Court as it made clear that it is the duty of the Court to interpret treaties, not to revise them, and the Court refused to apply a meaning to the treaties which may have been contrary to their letter and spirit[1671].
Thus, in taxation, there are no “new” obligations that can be found in tax treaties that were not already there before we started looking at them in the light of good faith. It merely means that the existing, expressly provided international obligations on the state in matters of taxation, must be executed with honesty, fairness and reasonableness.

With regard to “treaty dodging”, good faith would prevent a state from maliciously qualifying capital gains on shares as capital gains on real estate, to avoid having to share tax jurisdiction on the income in question[1672]. Doing so, would be an infraction to the good faith application of a treaty, and thus may entail state responsibility.

Cheng notes a good example of dodging of a fiscal treaty[1673]. In the *Free Zones Case*, France was under treaty obligations to maintain certain frontiers zones with Switzerland free from customs barriers. The P.C.I.J., while recognizing that France had the sovereign and undoubted right to establish a police cordon for control and even for the imposition of taxes other than customs duties, held that:

> “A reservation must be made as regards the case of abuses of a right since it is certain that France must not evade the obligation to maintain the zones by erecting a customs barrier under the guise of a control cordon[1674]”.

Untimely exercise of rights or claims may show bad faith is well accepted by international courts[1675]. With regard to tax competition, state A may not invoke a tax haven regime state B enacted without protest by A, years after its enactment, to unilaterally terminate the double taxation convention. On the other hand, it may be deemed bad faith by a state if it neglects to notify a fundamental change of tax law policy to its treaty

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1670 David, A.E., The Strategy of Treaty Termination”, Yale University Press, London & NY, 1975, p. 171.
1671 I.C.J., Rep., 1950, 221.
1672 This example was quoted in the OECD Report on Treaty Override, par. 31
1673 Cheng, B., General Principles of Law, Grotius Publ., Cambridge, 1987, p. 123.
1674 *Free Zones Case*, 1932, A/B., 46, p. 167.
1675 Temple Case, I.C.J., Rep., 1962, p. 6.

partner, an obligation that is included in the double taxation agreements[1676].

Tax treaty termination may also be done in bad faith if the terminating state does not leave the other state any opportunity, by negotiations about treaty modification, to take away the cause of termination[1677].

Tax Treaty Termination and State Responsibility.

Does the fact that most (if not all) international obligations on states in tax matters are found in treaties and not in general principles of international law, preclude state responsibility? In other words, can a state be denied reparation through state responsibility of another state because they have a tax treaty, and the injured state has the possibility to suspend or terminate that tax treaty? The question is certainly justified. After all, termination or suspension can be considered a corrective measure, even a penalty. "It may also act as a deterrent", as Gomaa says. [1678] Also state practice shows clearly that states opt for termination (by notice) when they take offence at another state's conduct in tax matters[1679].

The ILC certainly considered treaty termination and suspension as a legal consequence of a wrongful act. Special Reporteur Riphagen mentioned the exercise of the right to terminate or suspend the treaty as provided by art. 60 of the Vienna Convention as one of the possible legal consequences of the international wrongful act[1680].

Still it is clear that treaty termination and state responsibility do not exclude one another. Whether a treaty may or may not be terminated, or whether the state breaking the treaty may be liable, are two distinguishable questions. Such as in civil law and in common law, international law permits the "injured" party to claim damages *and* terminate the contract at the same time.

The arbitral tribunal in the *Rainbow Warrior Case* discussed the relationship between the rules of state responsibility and those relating to the law of treaties. The arbitration followed the incident in 1985 (when French agents destroyed the vessel), which led to an agreement between

[1676] Art. 2 par.4 OECD Model DTC.
[1677] David, A.E., ibid, ft.1670, p. 172.
[1678] Gomaa, M., Suspension or Termination of Treaties on Grounds of Breach, Martinus Nijhof Publ., The Hague, 1996, p. 119.
[1679] See I.3 in this chapter.
[1680] Preliminary Report, par. 58-61.

New Zealand and France in 1989. This agreement, brokered by the UN, provided for the French agents to remain on a French naval base in the pacific, where they were to remain for three years. They did not, and New Zealand held France responsible. The arbitral tribunal decided that the law of treaties was relevant but that:

> "the legal consequences of a breach of a treaty, and the appropriate remedies for breach, are subjects that belong to the customary law of state responsibility"[1681]

The ILC never had any problem including a breach of treaty as a wrongful act[1682].

It confirmed that state responsibility and the possibility to terminate or suspend a treaty are different things:

> "When a state approaches another state with a view to suspend… or terminate …it is not a question of precluding wrongfulness but a question which falls under the law of treaties…"[1683]

Brownlie confirms:

> "The grounds for termination … do not exhaust the matters relevant to justification for non-performance of obligations, an issue which can arise irrespective of validity or termination of the source of the obligation, the treaty itself. The topic of justification belongs to the rubric of state responsibility."[1684]

Mazzeschi puts it as follows:

> "We must bear in mind the limited purpose of the Vienna Convention on the Law of Treaties, which is not meant to be concerned with the breach of conventional obligations from the point of view of state responsibility, but only from the point of view of the law of treaties, and therefore only as regards the effects that such breach may have on the existence and operation of treaties. … However, the Vienna Convention does not exclude in the least that the right of termination and suspension may constitute

[1681] *Rainbow Warrior Case*, 1990, I.L.R., nr. 82, p. 449.; Shaw, M.N., International Law, 3d edition, Grotius Publ., Cambridge, 1991, p. 483.
[1682] Rosenne, S., ibid, ft.1607, p. 54.
[1683] Footnote 556 of the 1979 Commentary by the ILC on art. 29.
[1684] Brownlie, I., ibid, ft.1598, p. 627.

> also a legal consequence of an international wrongful act and leaves open all the questions that may arise with regard to responsibility".[1685]

Mazzeschi's thoughts are perhaps not complete. The Vienna Convention's rules on unilateral treaty termination and suspension do describe when such an act of a state is to be considered unjustified, and thus is in itself constitute a wrongful act.

From a policy point of view, the difference between termination and responsibility for reparation makes sense. A state may not wish to terminate the breached treaty at all, nor suspend it. State responsibility in international law offers an opportunity to strongly protest the breaches of the treaty by the other state without actually having to do away with the treaty all together. This lesson was soon learned by the US, after it notified the NL-Antilles of the tax treaty termination. Immediately, the Eurobond market (counting on the reduction of withholding taxes on interest) protested the US unilateral termination, eventually forcing the US government to "retract" its notification, and replace it with a "partial" termination of the double taxation agreement, this time without prejudice to the interest article of the agreement[1686]. Art. 44 (1) of the Vienna Convention does not permit partial termination or suspension unless treaty or parties agree otherwise[1687].

In the case of a multilateral treaty[1688] is it may even not be possible to terminate or suspend the treaty itself[1689]. The only possibility is in that case to demand reparation (see below VI 5.).

*d) International obligations on the state in tax matters found in the EU Treaty.*

In the EU legal order, we also find numerous examples of international obligations on the state in tax matters, all directly or indirectly derived from the EU Treaty[1690].

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[1685] Mazzeschi, P., ibid, p. 59.
[1686] Crandall, F., "The Termination of the US-Netherlands Tax Treaty", I.L.B., 1988, p. 355-380.; Johnson, M.F., "Antilles Treaty Termination Favored", Tax Notes, July 13th 1987, p. 129.; Doernberg, R.L., "Selective Termination or Suspension of Income Tax Treaty Provisions", *T.N.I.*, Nov. 1990, p. 1130-1135
[1687] On separability see however see also Gomaa, M., Suspension or Termination of Treaties on Grounds of Breach, Martinus Nijhof Publ., The Hague, 1996, p. 114-116.
[1688] See I, 2 c) "Kinds of Tax Treaties" in this article.
[1689] Mazzeschi, P., ibid, p. 69.

The EU Treaty contains little express international obligations on the Member States with reference to direct taxation[1691]. They are derived from more general treaty obligations such as:

> The obligation to respect the fundamental equality and the prohibition of discrimination (art. 7 EU Treaty)[1692];
> Free movement of merchandise and persons (art. 28 and 39 EU Treaty)[1693];
> Freedom of Establishment (art. 43 EU Treaty)[1694];
> Freedom of Performing Services (art. 49 EU Treaty);
> Prohibited state-aid measures (art. 87 of the EU Treaty).

The last obligation merits more attention because it is the legal basis for the EU Code of Conduct. It is true that the E.C.J. has not hesitated to assimilate tax privileges with state aid, and as such deem them prohibited[1695]. On the other hand, Prof. Vanistendael's recent study on fiscal support measures and harmful tax competition asks relevant questions in this respect:

> "The Treaty does not obstruct the relocation of economic activities from one Member State to another for fiscal purposes. If this view is accepted, there is no reason to automatically reject this type of

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[1690] "Indirectly" as the Parent Subsidiary Directive and the Merger Directive find their legal basis in art. 100 of the Treaty of Rome, which does not specifically address taxation; Sass, "Harmonization of Corporation Tax Systems in the EC", *EC Tax Review*, 1993, p. 77; The 'Arbitration Convention' is a treaty concluded in the framework of art. 220 of the EU Treaty; The EU Directive of 19 December 1977 concerning Mutual Assistance in Direct and Indirect Taxation refers in its explanatory part to the distortions tax evasion causes to the free movement of capital within the EU (art. 67 and 106 EU Treaty).

[1691] Harmonization of indirect taxes is provided in art. 90-93 EU Treaty.; Malherbe, J., "Fundamental rights and income tax. (in French)", in Recht zonder Omwegen, Fiscale Opstellen Aangeboden aan Prof. J.J. Couturier, Larcier, Gent, 1999, p. 459-502.

[1692] Lehner, M., "Limitation of the National Power of Taxation by the Fundamental Freedoms and Non-discrimination clauses of the EC Treaty", *ECTR*, 2000, 5-15.

[1693] Special Issue *ET*,, "The Schumacher Legacy"; Weizman, L.,"Frontier Workers and the free movement of labor within the EU", *ECTR*, 1994/3, 100-111.

[1694] Daniels, T., "The Freedom of Establishment", *ECTR*, 1999-1, 39-42.

[1695] ECJ Cases 74/76, ECJ 1977, 557, 22 April 1977; Case 91/78, ECJ, 1979, 935, 13 April 1979 ; Case 73/79, ECJ 1980, 1533 21 May 1980.; Case 18/84, 7 May 1985, Rec. C.J.C.E., 1339 (the latter is the first decision with regard to direct taxes) See also: Malherbe, J., "Fundamental rights and income tax. (in French)", in *Recht zonder Omwegen, Fiscale Opstellen Aangeboden aan Prof. J.J. Couturier*, Larcier, Gent, 1999, p. 462.

> fiscally motivated migration when it occurs within a specific sector or a select group of companies, as long as both foreign and domestic companies are free to profit from the favorable regime. Indeed, tax competition should be regarded as an asset in that it forces Member States to curb their lust for tax revenues"[1696].

> "The conclusion is that in terms of their harmful effects on free and fair competition, there is no demonstrable difference between general tax measures that are aimed at specific sectors or geographical area's. Both types of measures may have adverse effects on free and fair competition. Again, the question that presents itself is why the category of measures is accepted while the other is rejected, even though their effects on the level playing field are the same."[1697]

Prof. M. Ellis shares Prof. Vanistendael's reservations towards the EU Code of Conduct.

> "The fundamental problem of the Code of Conduct is that it tries to level a playing field that is by definition not even"[1698].

Easson makes a similar critical note:

> "It is hard to think of any tax measure that meets the criteria for identifying a harmful regime that would not also fall within the art. 92, other than measures applying only in associated or dependent territories of the member states that are outside the scope of the EU Treaty. In effect, if the state aid rules are applied as vigorously as the Commission now seems intent on, all forms of special tax breaks will have to be approved by the Commission"[1699]

From a policy point of view, rather than considering the legitimacy under prohibited state-aid obligations in the EU Treaty, the Commission and some observers are convinced of the need to eliminate tax competition within the EU, but the question remains if the EU Code of Conduct is the best way to do it[1700].

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[1696] Vanistendael, F., *EC TR*, 2000, p. 152-161.
[1697] Vanistendael, F., *EC TR*, 2000, p. 159.
[1698] Ellis, M., "The Code of Conduct in 2000: Cracking the Code or Coating the Crack?", *E.T.*, 2000, 415.
[1699] Easson, A., "The Tax Competition Controversy", *T.N.I.*, 1999, p. 3615.
[1700] See the different views on the policy considerations in the "Round Table on the EU Code of Conduct"-issue of European Taxation, 2000, vol. 40, nr. 10.; Also

*e) International obligations in treaties on criminal matters*

A special case worth mentioning in the study of state responsibility in matters of taxation and tax competition, are the international obligations on the state that are found in treaties with respect to transnational crimes. Tax evasion, as opposed to tax avoidance, constitutes an infraction of the criminal code or is otherwise penalized with a criminal sanction. The OECD's Report on HTC specifically refers to "money laundering" as an issue that is in their view related to the subject of harmful tax competition.

Quite distinctly from state responsibility for international crimes by the state, it is possible that states breach international obligations they undertook, having to do with countering transnational crime (including tax evasion) committed by their subjects or the subjects of another state.

But it is fair to say that many states are reluctant to take firm obligations (of result) upon themselves when tax fraud is concerned. The European Convention on Assistance in Criminal Matters[1701] provides in art 2A that assistance may be refused in cases of fiscal infractions[1702]. Also many bilateral agreements, such as the US-Swiss Treaty on Criminal Assistance[1703], excludes tax matters.

The UN Convention against Transnational Organized Crime, open for signature since its adoption by the UN in Palermo, 12 December 2000 contains several obligations on states to introduce legislation curbing crimes that may be tax-related, such as corruption and money-laundering[1704]. In the context of tax competition, "injured" states may refer to a tax haven state's failure to introduce adequate anti money-laundering legislation, hoping that this might also have a positive bearing on tax avoidance and evasion[1705].

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Eyskens, M., "De Euro en de Toekomst van de Fiscaliteit en de Para-fiscaliteit", in Recht zonder Omwegen, Fiscale Opstellen Aangeboden aan Prof. J.J. Couturier, Larcier, Gent, 1999, p. 23-27.

[1701] European Convention on Assistance in Criminal Matters, 20 April 1959.

[1702] The Protocol of 17 March 1978 (art. 1) has removed this ground for refusal.

[1703] US-Swiss Treaty on Criminal Assistance of 25 May 1973, par. 2.; De Saugy, J. and Chapuis, P., Banking secrecy and tax law in Switzerland, in Campbell, D, (ed) International Tax Planning, Kluwer, Deventer, p. 136.

[1704] UN Document A/55/383 add. 1; Scope of application art 3.

[1705] UN Document A/55/383 add. 1; Money-laundering; art 7.

*f) What constitutes a breach?*

Conduct or Result.

When does conduct of a state becomes a breach of an international fiscal obligation? Obviously, that depends on the nature of that obligation. The DA differentiate between obligations of conduct and obligations of result.

> "What must be emphasized at the present stage is that the conditions in which an international obligation is breached vary according to whether the obligation requires the state to take some particular action or only requires it to achieve a certain result, while leaving it free to choose the means of doing so"[1706]

It is fair to say that in matters of taxation, most of the obligations on the state are obligations of result. The state is "required to bring about a certain situation within its system of internal law"[1707], mainly the exemption of certain income or the crediting of certain foreign taxes, the exchange of certain information and the obligation not to discriminate residents of the other state.

Obligations of conduct also exist *in fiscalibus*. The obligation found in double taxation conventions to engage in a mutual agreement procedure, is a typical example of such nature. The state is only required to "endeavor to resolve the case by mutual agreement with the competent authority of the other state"[1708], without any obligation to achieve a result[1709].

A "Most Favored Nation"-clause in a double taxation agreement can be either an obligation of conduct or of result. In the Thai-US DTA, for instance, the US is obliged if it alters its policy with regard to tax sparing credits or if it reaches a double taxation agreement including a tax sparing credit with another country, to "agree to reopen negotiations with Thailand"[1710]. This is merely an obligation of conduct that can only be breached by the US if it refuses to enter into renegotiation of the tax sparing credit at all. The Most Favored Nation clause in the China-US treaty, however does constitute an obligation of result: "The Agreement shall be promptly amended to incorporate a tax sparing credit provision if

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1706 Report of the I.L.C. on its 29th session, p. 13.
1707 Report of the I.L.C. on its 29th session, p. 13
1708 Art. 25 par. 2 OECD Model Tax Convention.
1709 Vogel, K., ibid, ft.1637, p. 1378.
1710 Thai- US DTA, 26th November 1996, Exchange of Notes.

the US hereafter amends its laws concerning tax sparing or if it reaches a double taxation agreement including a tax sparing credit with another country"[1711].

Another important obligation of conduct is the obligation of means to have the tax treaty ratified. This can be deduced from art. 29 par. 1 OECD Model DTC: "This Convention shall be subject to ratification in accordance with the applicable procedures of each Contracting State". Vogel confirms this: "All that the contracting states are committed to do when signing a treaty is to initiate all further procedures required by their constitutional law. It is only after it has been ratified that a treaty as such becomes binding under international law"[1712]. Failure to do the necessary to obtain ratification incurs state responsibility under the provisions of customary international law. But non-ratification regardless of the governments' best efforts does not.

Finally, the implementation of (new) OECD Commentaries by the Member States of the OECD seems to be an obligation of conduct too. Vogel points out in his recent study that "According to art. 18c of the Procedural Rules of the OECD, such recommendations oblige the Member countries to examine whether the recommended measures are opportune."[1713].

Obstruction but no breach.

Particularly relevant for tax practice is the question if a new (tax) law or policy (such as rulings) in a state may lead to state responsibility because it seems to obstruct the achievement of the result required by a tax treaty, even when in itself those new laws or policies are not a breach of an international obligation. As an example take the case of a state (A) that enacts a law allowing "nominee ownership" of shares, bonds and licenses. The other state (B) may be worried that this law will endanger the first state's obligation to provide information if requested, for instance with regard to the "beneficial ownership" test included in the 1992 OECD Model DTC[1714]. Still, in itself the new law is not contrary to any obligations found in the tax treaty between the two states. Another example would be the publication by state A of a policy to accept a 0.125% spread on interest borrowed and interest paid on international

[1711] China-US DTA, 30th April 1984, Exchange of Notes.
[1712] Vogel, K., ibid, ft.1637, p. 1479.
[1713] Vogel, K., "The influence of the OECD Commentaries on Treaty Interpretation", *B.I.F.D.*, 2000, p. 614.
[1714] Art. 10, 11 and 12 OECD Model Tax Convention.

financial transactions. The other state (B) may worry that such would attract treaty shopping, but the policy in itself does not constitute a breach of any international obligation in the DTA.

Confronted with this issue, the ILC suggests:

> "To sum up, our analysis of state practice, international judicial decisions and the positions taken by learned writers confirms that, in the case of international obligations requiring the state to achieve a result *in concreto*, but leaving it free to do so by means of its own choice[1715], the fact that a state bound by such an obligation has adopted a measure or, in particular, enacted a law constituting *in abstracto* an obstacle to the achievement of the required result, is not yet a breach or even the beginning of a breach of the obligation in question. There will be a breach only if the
> state is found to have failed *in concreto* to achieve the result required by the obligation."[1716]

The sources the ILC refers to are convincing. Reference is made to decisions of the European Court of Human Rights[1717], the European Commission on Human Rights[1718] and other international judicial decisions[1719].

Particularly interesting from a tax point of view is the *Tolls on the Panama Canal Case*[1720]. The US Congress passed an act in 1912 to

[1715] Most international obligations found in double taxation conventions simply describe the result the contracting state must achieve or the endeavor it must engage in, without occupying itself with how the contracting state actually organizes this. The deductibility of a credit, i.e. may be a consequence of a law, a royal decree, a notification of the Minister of Finance, etc. as long as it results in the credit being deductible. This is relevant because the ILC believes that: "There can be no doubt about the conclusion that where the action or omission to have occurred is in fact not in conformity with the conduct specifically required … there is a direct breach of the obligation in question, without any other condition being required for such a finding. This finding cannot be influenced by the fact that the non-conformity of the conduct … did or did not have consequences that were actually harmful" (*Y.I.L.C.*, 1977, Vol. II, part 2, p. 16).
[1716] *Y.I.L.C.*, 1977, Vol. II, part 2.
[1717] *Becker*, 27 March 1962, *Y.E.C.H.R.*, 1962, vol. 5, p. 334.
[1718] No 290/57, *Y.E.C.H.R.*, 1960, vol. 3, p. 221; No. 867/60, *Y.E.C.H.R.*, 1961, vol. 4, p. 276.
[1719] *Mariposa Development Company Case*, UN Reports of International Arbitral Awards, vol. VI, p. 340-341.
[1720] Mcnair, A.D., *The Law of Treaties*, 2nd ed., Clarendon Press, Oxford, 1961, p. 548-549.

collect taxes on the Panama Canal from passing ships. The UK considered this tax incompatible with a prior treaty, which provided in the equal treatment of the flags of all nations. The position of the US in the case was that a the enacting of a legislative measure that seems it will be an obstacle for an international obligation to be honored by a state, is not yet a breach. Before any arbitral award, the US changed its law, but the position of the US is relevant.

It would seem that in our examples stated above, state (B) will not be able to claim that state (A) has breached an international obligation even if the new law or policy might be an obstruction to achieve the result required by the international obligations in the DTA. It may however be a changing circumstance that is taken into account to justify terminating the treaty unilaterally, but this certainly merits more study.

Most obligations on the state created by double taxation conventions are not breached by the mere enactment of laws (even directly) contrary to the treaty obligation. In most states, DTA's are deemed to restrict existing and new domestic tax law. When a state increases withholding tax on interest to a level higher than the treaty, this does not in itself constitute a breach of the treaty. After all, the legislator may find it superfluous to expressly write that a treaty may provide otherwise. In such cases, only if a law in itself expressly provides that the treaty may not interfere with the new tax law, or if such is considered the general rule in that state, may mere enactment entail state responsibility.

Seriousness of Breach.

How serious must a breach of an international obligation be in order to incur state responsibility? Can any, even minor breaches, be taken into account?

In tax matters, given the predominance of international obligations created by treaties, a different level of seriousness of the breach may entail different consequences. First, there is customary international law, which seems to accept that state responsibility for every, also minor breaches, may be in order:

> "For a breach to exist, it is by no means necessary for the act of the state to be in complete and total conflict with what is required of it by the international obligation in question. It is quite sufficient that

> one aspect or another of the conduct of the state should not be in conformity with what is required of it by that obligation"[1721]

On the other hand, the Vienna Convention on the Law of Treaties, entitles states to terminate or suspend the operation of a treaty as a consequence of a material breach only. A material breach is defined as

> a) a repudiation of the treaty not sanctioned by the Vienna Convention
> b) the violation of a provision of essential to the accomplishment of the object or purpose of the treaty[1722]

It is important to note however, that under the Vienna Convention, also a minor or trivial breach may be used to justify the termination or suspension of the treaty, as long as that minor breach concerned a provision essential to the accomplishment of the object or purpose of the treaty[1723].

In tax matters (as probably in all foreign affairs), it seems to me that states will only take offence and act upon acts of other states, which they see as serious breaches of an international obligation anyway. The difference between breaches (as in the DA) and breaches (as in the Vienna Convention) will, at least with regard to the level of seriousness, in practice not be so important[1724].

Under the double taxation agreements, new tax law, rulings and interpretations have to be notified to the other state each year[1725]. Not doing so is not a material breach of the treaty[1726]. It may however still be taken into account in questions of state responsibility.

[1721] *Y.I.L.C.*, 1976, vol II, part 2, 78.
[1722] Art. 60 par. 3 Vienna Convention on the Law of Treaties.
[1723] Gommaa, M.M., ibid, ft.1678, 33f.; It is noteworthy that the Restatement (Third) of the Foreign Relations Law of the US states that: "Not every breach is material. This section applies only to a significant violation of a provision essential to the agreement", thus submitting that both the violation and the treaty provision need to be significant. (Restatement (Third) of the Foreign Relations Law of the US, part III, Introductory note, sec. 355, comment b.); Doernberg, R.L., ibid, ft.1686, p.1132.
[1724] Rosenne already underlined the likelihood that 'material breach' and breaches in the DA might end up being similarly serious: Breach of Treaty, ibid, p. 67.
[1725] Art. 2 par.4 OECD Model DTC.
[1726] " Failing to do so has no legal consequences" (Vogel, K., ibid, ft.1713, p. 158.)

Internal law

Art. 4 of the DA states that "An act may only be characterized as internationally wrongful by international law. Such characterization cannot be affected by the characterization of the same act as lawful by internal law."
The comparison with art. 27 of the Vienna Convention on the Law of Treaties is pertinent. Failure to perform a treaty on the basis of internal law may not be invoked. The function of the similar provision in the Vienna Convention on the Law of Treaties is however with respect to application of treaties, and not for the establishing of state responsibility.
In the absence of tax treaty provisions to the contrary, the postulate of fiscal sovereignty excludes that the refusal by states to cooperate in cases of tax evasion and avoidance on basis of their internal law (tax law, banking secrecy, company law) can be a wrongful act, by lack of a breached international obligation on the subject. This is even confirmed by the double taxation conventions, which limit the exchange of information to cases that are permitted by domestic law.

## 5. Attribution of the Act to the State

This is the second condition for international wrongful act: it must be imputable on the state, and not on one of its subjects for instance.

*a) Attribution of acts by (tax) legislature, Minister of Finance and Tax authorities.*

The state can be deemed responsible for an act by all of its agents or organs. Indeed, states can only act by and through their representatives anyway[1727]. It does not matter what organ is exactly responsible for the act whether that organ of the state belongs to the constituent, legislative, executive, judicial or other powers[1728], end whether its functions are internal or international, and whether it holds a superior or a subordinate position in the organization of the state.

The legislature can be reproached to have committed an internationally wrongful act[1729] just as better known candidates such as armed forces,

[1727] *German Settlers in Poland, P.C.I.J.*, Series B, no. 6 at p. 22.
[1728] Art. 6 DA.
[1729] Brownlie, I., ibid, ft.1592, p. 449.; Schwarzenberger, G., International Law, Vol.1, 3 rd ed., p. 614-15.

police agents and officials of the executive branch[1730]. Acts by the executive branch[1731] in matters of taxation can without a doubt be attributed to the State, even when it concerns lower officials[1732].

For the purposes of taxation, several examples come to mind of *acts that can be imputed to the state*. That these acts are imputable to the state for the purposes of state responsibility does obviously not in itself mean that they are necessarily wrongful, a topic that is discussed above.

Wrongful acts by the legislator, Minister of Finance, tax department officials, etc. may be imputable on the state. Even acts by officials that were contrary to internal law or instructions of their superiors do not preclude the act from entailing state responsibility[1733].

Note however that remedies may exist under domestic law to redress the situation, in which case the state is not responsible under customary international law, unless it does not rectify the breach by its internal means[1734].

*b) Attribution of acts by companies, banks, tax advisors and other state subjects*

Rosembuj submits that tax haven states are cooperating in the tax evasion by concealing the illegal event, even though the tax evasion itself is carried out beyond the tax haven, and that this cooperation incurs international responsibility[1735].

A main difficulty for state responsibility to be applied in cases of international tax avoidance and evasion, is that the avoidance or evasion itself is done by the taxpayers of the other states, and not by the tax haven state, probably not even by subjects of that tax haven state. Income that is undeclared for income tax purposes, contrary to tax law in the home country of the taxpayer, is undeclared because the taxpayer chooses to do so. The parliament of Luxembourg, when passing an act that prohibits the tax authorities to collect information from financial institutions, is not "cooperating actively in concealing non-resident income". That law does not address the obligation the taxpayer has to declare this income at all.

[1730] Brownlie, I., ibid, ft.1592, p. 446.
[1731] Brownlie, I., ibid, ft.1592, p. 447.; Schwarzenberger, G., ibid, ft. 1729, p. 615-18.
[1732] Way, 1928, *RIAA* iv 391.
[1733] Youmans Case, 1926, 4 UNRIAA 110 at p. 115-116.; Art. 7 DA.
[1734] Art. 22, 43 Draft Article on the Law of State Responsibility
[1735] Rosembuj, T., ibid, ft.1578, p. 318.

The taxpayer remains free to arrange his affairs on his own risk. Implying that the state (or its subjects) is or should be able to verify compliance by their clients with their domestic tax law, is contrary to the confidentiality of income tax assessment, which exists in all states. It also encounters some practical obstacles that are impossible to pass. Bank accounts may be opened by customers from all over the world. How should the state know if the client of it's subject (the bank) should, according to the tax law of its home country, indeed declare certain types of income? Foreign sourced income of this kind may well be exempt[1736]. How can the bank ever be sure this has indeed been done, since the local tax authorities are bound by a confidentiality duty? Likewise, a tax haven regime in a state that exempts off-shore profits is not responsible for a shareholder misusing or abusing that regime to divert otherwise taxable profits from other states in an illegal manner. The real act that may create harmful tax competition damage, is not the creation of the regime, but its (mis-) use by the taxpayer.

Arguably, one might say that there may be entities within the tax haven state itself that are involved in the act of evading or avoiding tax. This may be tax haven companies, banks, advisors in taxation and administration, etc. But all of these are subjects of the state, and their conduct may not be assimilated with state conduct. Even if one would consider their acts wrongful, they cannot lead to state responsibility.

*c) Acts by omission*

Can one successfully submit that states should control their subjects in such a way, that also their behavior is not contrary to international law? Per analogy, one can draw the comparison with a visit of a foreign head of state to another state, who is attacked and hurt by a private protestor. Is the state where the visit takes place not required to adopt such a conduct (in this case, police protection), that the attack (though not instigated by organs or agents of the state) would have been impossible? Or, if we look for an analogy for tax purposes, must we take the example of a private boycott of certain products, which is not considered a breach (imputable to the state) of commercial treaties[1737].

A wrongful act by omission of the legislator is also possible in tax matters, but only in cases where that conduct in itself is sufficient to

[1736] E.g. remittance base taxation.
[1737] Schwarzerberger, ibid ft.1729, p. 145.

constitute a breach of an international obligation incumbent upon the state.

Holding the state responsible for neglecting to do the necessary to prevent the occurrence of tax avoidance and evasion by its subjects (not its agents or organs) towards another state, is only possible if a specific obligation[1738] to do so exists. "Negligent conduct of the organs of the state does not become an actual breach of the international obligation unless the conduct itself is combined with an external event, one of those events which the state should specify have endeavored to prevent"[1739].

*d) Responsibility for the Judiciary.*

In tax matters, the judiciary may breach an international obligation on the state, such as deciding a tax dispute without recognizing tax treaty provisions. Though it is not disputed that the judiciary is a state organ for which the state is responsible, there are other considerations as well.

As Schwarzenberger notes: "In order to live up to the minimum standard of international law, a state is also expected to grant to the judiciary a maximum of independence from the executive. It would, therefore, be unreasonable to hold a state, which complies with the principle of immunity from the judiciary from government direction, responsible for acts of the judiciary within the legitimate scope of their judicial duties."[1740]

## 6. State Responsibility for Lawful Acts

There is a discussion in international law about the existence of liability which states may incur while no internationally wrongful act has taken place, and it is not certain that it finds support in state practice and international courts[1741] Mainly for this reason, the state responsibility for lawful acts does not seem to be an appropriate platform to discuss state conduct in matters of taxation.

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[1738] As was discussed above IV 2 b): "Postulate of Sovereignty".
[1739] *Y.I.L.C.*, 1973, vol. II, 182.
[1740] Schwarzenberger, G., ibid ft.1729, p. 145.
[1741] Brownlie, I., SR, ibid, ft.1592, p.50.; Also Magraw confirms that fundamental questions still remain. Magraw, ibid, ft.1598, *A.J.I.L*, 1986, p. 305.

Putting tax law and tax competition against the background of state responsibility for lawful acts also seems inappropriate taken into account that the main topics here are pollution and nuclear energy.

Brownlie suggests that delictual state responsibility can be applied instead.

## 7. Forms and Function of Reparation

### 7.1 Claims can only be made by States

The plaintiff in international public law must be a subject of international law, such as sovereign states or certain international organizations that are endowed with international personality[1742]. A taxpayer that alleges to be injured by the breach of an international obligation by a state cannot sue that state under customary international law of state responsibility. Instead, the taxpayer depends on the discretion of "his" state to do such. Of course, the taxpayer is free (or, in most cases required) to seek remedy at the level of municipal law and courts. In states where the breach of an international obligation by municipal tax law is also recognized as unlawful in municipal law, the taxpayer may suffice with seeking remedy in the courts of the responsible state. Rezek expressed his doubts whether non-resident taxpayers would indeed have access to the courts of a responsible state, but such is in the opinion of this author not entirely justified[1743]. Where a non-resident taxpayer has been assessed by a state, usually the same or similar legal recourses are open to him in administration or judiciary.

As Starke notes: "A state is deemed to be injured through its subjects, or to be asserting its right to ensure respect for the rules of international law vis-à-vis its own nationals, and once the intervention is made or the claim is laid, the matter becomes one that concerns the two states alone. The injured subject's only right is to claim through his state as against the

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[1742] *Mavrommatis Palestine Concessions Case* (Jurisdiction) (1924), Pub PCIJ Series A, No 2, p. 12.

[1743] Rezek, J.F., in IFA Seminar Proceedings on Tax Treaties and Domestic Legislation, ibid, p. 5. ("In this case, if the defaulting state is their state of domicile, they have recourse to the courts to claim their rights. However, if the damage they have sustained results from the non-operation of a treaty by a foreign state where they have no residence, the situation tends to become particularly difficult, for these persons will then depend on being granted diplomatic protection by their national state, which would take action against the defaulting state…")

state responsible"[1744]. Whether or not "his" state is required to sponsor his claim is a matter of municipal law, but it usually is a discretionary decision by the government.

Which states may act on behalf of the subject may cause particular *difficulties in fiscalibus* when corporate taxpayers are concerned. In customary international law, nationality determines which state may act. Not only is nationality for juristic entities not always obvious, but it has also been held that the nationality of shareholders is not sufficient for a state to claim it has a cause of action on behalf of its subjects. Only the state of the nationality of the company would have possibility to act[1745].

### 7.2 Necessity of consent by states?

Other authors have briefly suggested that in tax matters, dispute settlement under international customary law[1746] is not appropriate because the agreement of both parties is necessary for any international court to hear the case[1747]. It is true that for peaceful settlement of international disputes, the consent of the will of the parties must be there[1748].

This author submits however, that such does not deprive state responsibility under customary international law of all usefulness to curb certain practices of states that may be deemed breaches of international obligations in tax matters. In foreign affairs, all dispute resolution is based on the consensus of the parties to resolve the issue peacefully. Still, this does not seem to have diminished international judicial procedures

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[1744] Starke, J.G., ibid, ft.1590, p. 314.; *Paneveys-Saldutiskis Rly Case* (1939) Pub PCIJ Series A/B No 76.
[1745] *Barcelona Traction Case*, (second phase) ibid, p. 3.
[1746] It is important to distinguish between disputes between states on the one hand, and disputes between a subject of a state with the tax authorities of his own state or those of another state on the other hand. Disputes of the latter kind are addressed by municipal law and proceedings, and possibly by the Mutual Agreement Procedure or special arbitral clauses (Bricker, M.P., "Arbitration Procedures in Tax Treaties", Intertax, 1998, p. 97-108.; IFA Seminar, Resolution of Tax Treaty Conflicts by Arbitration, vol. 18e 1993). Such mechanisms do not address conflicts between states, even though a state may lend diplomatic protection to a taxpayer grieved by another state, and thus make it a dispute between subjects of international public law. If the latter would indeed happen, the mutual agreement procedure will not be able to solve the difference.
[1747] Luthi, D., ibid, ft.1662, p. 51.
[1748] I.e. Art. 36, Statute of the International Court of Justice.

and arbitration in the least. Why should international obligations in tax matters be any different?

Furthermore, it is not at all certain that the procedure will fail because of lack of cooperation by the responsible state, as Shay suggests[1749]. States may very well prefer to defend their policy on the merits, and to do away with allegations of having broken its promises. States may also be compelled to consent to a proceeding, under threat of treaty termination or suspension.

Particularly interesting, and from a legal point of view more compelling, is the possibility that a state may easily have already accepted the compulsory jurisdiction of the court *ante hoc*. Non-cooperation by the responsible state, will in that case not stop the International Court of Justice (ICJ) from having jurisdiction anyway. Submitting a current dispute to the International Court of Justice by special agreement is after all not the only way to establish the jurisdiction of the ICJ. States may have accepted the jurisdiction of the court in all kinds of treaties and conventions[1750]. The reader is of course aware that double taxation conventions do not contain a clause referring to the jurisdiction of the ICJ[1751]. Compulsory jurisdiction (including in matters of taxation) may however be found in "treaties of friendship and cooperation", "treaties for the peaceful solution of disputes", or any other international agreement between the two (or more) states. The extent of the subject matter may be limited, or quite general depending on the treaty. Although general treaties of friendship, cooperation etc. may certainly contain tax provisions, and thus a reference in the treaty to the jurisdiction of an international court may be appropriate, one will have to verify each treaty on a case-by-case basis.

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[1749] Shay, S.E., in IFA proceedings of 1989 seminar Tax Treaties and Domestic Legislation, p. 21. ("Each of these approaches requires the cooperation of the offending state and therefore is unlikely to succeed")

[1750] Art 36 (2) Statute of the International Court of Justice; Rosenne, Law and Practice of the International Court, 2nd ed 1985, p. 291.; Brownlie, I, ibid, ft.1598, p. 721.; Szafarz, The Compulsory Jurisdiction of the International Court of Justice, 1993, chapter 3.

[1751] The mutual agreement-mechanism of art. 25 of the OECD Model has been created to offer some recourse for taxpayers that allege to be (or may be) injured by an "action … not in accordance with the provisions of this convention", which is just another way to describe a breach of an international obligation on the state(s) found in the tax treaty. The OECD Model provides that the Competent Authorities shall endeavor to arrive at a satisfactory solution.

That (old) treaties may surprise states as to the competence of an international court became painfully clear to the US in 1894, when the ICJ declared itself competent to hear a case presented by Nicaragua (on paramilitary activity sponsored by the US in that country) on the basis of a 1956 "Treaty of Friendship, Commerce and Navigation"[1752], despite very strong objections by the US.

Also, and perhaps more importantly, the compulsory competence of the ICJ may be established by application of art. 36 (2) of the Statute of the ICJ, generally referred to as "the optional clause". It provides that the states which are party to the Statute[1753] may at any time declare that they recognize the jurisdiction of the Court. Some 62 acceptances of that nature have been deposited with the Secretary-General of the UN[1754]. The acceptance may include restrictions or a condition of reciprocity[1755], but are besides that of a general nature. The declaration by the UK, for instance, does in the opinion of this author not exclude any disputes with other states on matters of international obligations on the state found in matters of taxation. Therefore, any other state which has also made use of "the optional clause" (62 states until now) not having excluded matters of taxation either[1756], may be certain the ICJ will have jurisdiction on a claim introduced for breach of an international obligation on the state in tax matters[1757]. If this suggestion is confirmed by further study of the other 61 declarations, it would mean the jurisdiction of the ICJ is automatically established, even against the will of a state responsible for a breach of an international obligation in tax matters. Needless to say, this issue undoubtedly merits further attention, because it certainly has the potential to take the edge of the argument that remedies of international law would not be successful in curbing tax treaty override, by lack of jurisdiction of an international court.

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[1752] *Nicaragua Case (Jurisdiction Phase),* ICJ Reports, 1984, 392 at 426-9.

[1753] All UN member states are parties to the Statute of the ICJ, since the Statute of the ICJ was annexed to the Charter of the UN.

[1754] The US has withdrawn its declaration as a result of the *Nicaragua Case*. France did the same as a result of the *Nuclear Tests Cases*.

[1755] Szafarz, ibid, Chapter 3.

[1756] A consequence of the condition of reciprocity is that the least common demeanor of the two declarations determines the scope of jurisdiction; Harris, D.J., Cases and Materials on International Law, 5th ed. 1998, Sweet & Maxwell, London, p. 1003.

[1757] It is true that the UK declaration excludes "disputes which the UK has agreed with the other party or Parties thereto to settle by some other method of peaceful settlement". This author is of the opinion that the "mutual agreement procedure" of art. 25 OECD Model, cannot be regarded as such as it does not address the grievances of the contracting states (as does the ICJ) but those of taxpayers.

Finally, in certain cases, consent is also eliminated as a condition for the settlement of disputes by the DA on state responsibility[1758]. Within the scope of the DA, the responsible state may even without its consent be compelled to cooperate in the settlement process (pre-arbitration and, subject to conditions, also by arbitration) if it is later a state party present to the convention.

### 7.3 Reparation: Compensation and Satisfaction.

The types of damages and forms and functions of reparation are to be handled with caution. According to Brownlie, it may be dangerous to extrapolate the rules of damage reparation in municipal law to international law[1759]. States will not necessarily be required to pay financial damages, nor will it always be possible. It is also wrong to assume that, as under private law, damage must be shown to present a claim under state responsibility[1760]. There are two kinds of reparation in international customary law: compensation (paying damages) and satisfaction (other measures of reparation).

With regard to compensation, states will often have a particularly hard time in proving the exact amount of financial loss incurred as a consequence of the breach of an international obligation by another state in tax matters. It may, for example, not always be obvious how to calculate the loss of fiscal receipts due to treaty override by the other state. Other cases may be more straightforward. When a state cannot successfully re-assess one of its taxpayers because the other state did not exchange the required information in time, it may be easier to show damages afterwards.

Though financial compensation is not to be excluded of having any value in tax matters, satisfaction seems more useful in this respect. Reparation by satisfaction often involves a “moral” or “political” compensation such as an apology, correcting the breach committed by one of the organs or agents of the state, and taking measures to prevent the occurrence from happening again[1761]. This may be the appropriate course of action for a

[1758] Art 54-60 DA provide rules on negotiation, mediation, conciliation and arbitration. Art. 58 (2) DA establishes compulsory jurisdiction (on unilateral submission) of the Arbitral Tribunal for states parties to the convention in certain cases.
[1759] Brownlie, I., ibid, ft.1592, p. 460.
[1760] Higgins, R., ibid, ft.1590, p. 163.; Tanzi, A., “Is Damage a Distinct Condition for the Existence of an Internationally Wrongful Act?”, in Spinedi (ed), ibid, I.
[1761] Brownlie, I., ibid, ft.1592, p. 463.

state that wishes to strongly protest the systematic non-observance by tax authorities in another state of international fiscal obligations found in the treaty. Governments may this way be pressured to instruct tax officials to give due attention to exchange of information requests, not to interpret local tax laws and regulations in a way contrary to the tax treaty, to recognize treaty provisions when issuing guidance rulings or notifications, etc. It may also be a useful remedy to convince states to, when enacting new tax laws or regulations possibly contrary to the tax treaty, clearly state the effect of the new laws or regulations in case a tax treaty applies.

## 8. Conclusions

The responsibility of states for their conduct in matters of taxation can be invoked if that conduct is attributable to the state and constitutes an international crime, an international delict (international tort) or, in some cases, a lawful act. This right to reparation through state responsibility exists independent of the right of a state to terminate or suspend a tax treaty, even though in current state practice, termination by notice has seemed to be the only response to conduct in tax matters (mainly tax competition).

The concept of international crime cannot be interpreted in such a way that it would include evasion of the domestic (municipal) tax law by taxpayers. Responsibility for lawful acts is not an appropriate legal basis for conduct of states in tax matters either.

The appropriate standard to assess conduct of states in matters of taxation is the breach of an international obligation that is imputable on the state.

### 8.1 The breach of an international obligation

Taxation is an attribute of sovereignty, and fiscal sovereignty may well be virtually unrestricted in international law. Especially when states respect a “reasonable link” (a possible condition that is fulfilled in the practice of tax haven states by reference to the link of incorporation) between the income or the taxpayer and their territory, there is little reason to assume general international law limits the fiscal sovereignty of the state in any way. This is confirmed by learned writers, municipal courts, international courts, international agreements and state practice. Thus, we must look at international treaties, particularly double taxation conventions, but other important treaties exist as well (EU Treaty, Mutual Assistance, non-tax treaties, etc.) as the primary source of international obligations on states in matters of taxation.

Given the postulate of fiscal sovereignty, the enactment of low-tax regimes by states cannot be deemed a wrongful act. Even in case a tax treaty applies, that conclusion does not change. Double taxation conventions do not have as a purpose to create a status quo in tax law between the states. They merely look for solutions in situations where double taxation may occur. Double relief, which may be the consequence of the adoption of the tax haven regime, is not in itself contrary to international obligations usually found in the DTA. It is true that double taxation agreements are also concluded to curb tax evasion and avoidance, by i.e. the exchange of information, but the international obligations found in the DTA of this nature cannot be assimilated with a serious restriction on the tax sovereignty of the state. Quite to the contrary, they are conventionally limited by domestic (municipal) law.

Many of the international obligations found in a double taxation conventions can however without a doubt be breached in such a way that the responsibility of the state is engaged. But it is necessary though sufficient that the result of the act is the violation of the obligation found in the treaty, and not simply an obstruction to fulfillment of the treaty obligation. The international obligations found in a double taxation convention can be separated in obligations of result (exempt or credit, non-discrimination, exchange of information) and obligations of conduct (ratification, mutual agreement). The first category is breached by failure to deliver the promised result alone, the second by failure to try.

Changing tax law, in particular the adopting of measures that affect the balance of tax distribution between the contracting states, may however be a justifiable ground to **unilaterally terminate or suspend** the agreement on the basis of the law of treaties (and state practice of termination by notice confirms this). This issue however merits further study, and it falls out of the scope of state responsibility in international customary law.

8.2 Imputable on the state.

The act that results in the breach of an international obligation must be attributable on the state. This means that the breach must be the result of an act by state organs ( i.e. tax legislature, Minister of Finance, Department of the Treasury, tax administration, …) or state agents ( i.e. an employee of the Ministry of Finance, tax administration official, … ).

With regard to tax avoidance and evasion, the harmful behavior is engaged in by the taxpayer himself, possibly in cooperation with certain subjects of the (tax haven) state, such as base- and conduit-companies, banks, advisors, etc. Acts by these persons can only be attributed to the state, and thus engage state responsibility, in the unlikely case where they are deemed to have acted on behalf of the state. Taking into consideration the unlimited power of fiscal sovereignty (particularly when a reasonable link is respected), states cannot invoke neglect by the tax haven state's legislature in supervising or trying to curb avoidance or evasion engaged in cooperation with the tax haven state's subjects.

### 8.3 Is state responsibility useful in international tax law?

#### *a) General Considerations*

The question raised here is not rhetorical. State practice has shown little enthusiasm for pursuing remedy for breaches of international obligations in tax matters until now, though corrective unilateral treaty termination has occurred more frequently.

One must bear in mind, however, that state responsibility is a remedy that is only open to the subjects of international public law; not to taxpayers. Most of the consequences of a breach of i.e. a tax treaty by a state, will only be felt by the subjects of a state. A state that raises its withholding taxes regardless of tax treaty provisions, will upset the taxpayers of the other state, without reducing the tax receipts of that other state. The state of the "injured" subjects will have no financial motivation to seek remedy for the wrongful act, (though it might be advised to act anyway). Only when states realize that they are losing revenue, they will be sure to consider taking action.

The fact that consent of the responsible state would be required to arrive at a dispute resolution under state responsibility, and that such would make this recourse unsuccessful from the start, has been submitted by SHAY in matters of taxation[1762]. Consent may however be given *ante hoc* under the application of the optional clause of the Statute of the ICJ, or

[1762] Shay, S.E., in IFA proceedings of 1989 seminar Tax Treaties and Domestic Legislation, ibid, p. 21.

even in earlier (non-tax) treaties that address the peaceful solution of disputes between states. Also, it is not at all certain that the responsible state would refuse the jurisdiction of the ICJ. In any case, the injured state still has the possibility to compel the responsible state to consent to a legal proceeding by threatening with tax treaty termination. Finally, a claim based on state responsibility is independent of a possible tax treaty termination. Both may be initiated, even at the same time. These arguments prove at least that a recourse under state responsibility offers more possibilities for remedy than mere tax treaty termination, and none less. Consequently, this author begs to differ with the suggestion of the learned writer quoted above.

Finally, it is fair to say that state responsibility has long developed in the rather restricted area of (mal)treatment of aliens by agents of another state. Recently, and particularly since the codification process by the ILC has resulted in a first large number of DA only in 1996, the scope of wrongful acts by states that is being scrutinized, is rapidly expanding. States are not (yet) used or aware of having this recently by the ILC adopted framework of state responsibility at their disposal in tax matters, but the present study proves, that at least in theory, breaches of international obligations in tax matters may entail state responsibility.

*b) To curb "treaty override" and "treaty dodging"*

State responsibility may become a useful tool in international public law to curb the conduct of states that is in clear violation of treaty obligations. Furthermore, it may be appropriate in cases where states cunningly (or unintentionally) undermines clear tax treaty obligations by formulation of new legislation that frustrates the treaty (which Vogel calls "treaty dodging"[1763].

The rather blunt instrument of treaty termination and suspension is not appropriate in many cases where the "injured" state wishes not to jettison the double taxation convention all together. The example of the partial termination of the US/NL-Antilles DTA notwithstanding[1764], it is quite debatable if treaty termination and suspension is feasible for applying gradation in its corrective character. The injured state either terminates or it does not. The only nuance is that a state may only threaten to terminate the treaty.

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[1763] Vogel, K., ibid, ft.1629, p. 65.

[1764] Art. 44 (1) of the Vienna Convention does not permit partial termination or suspension unless treaty or parties agree otherwise.

By appealing on state responsibility for breaches of international obligations on the state found in the DTA, the injured state has an opportunity to strongly protest treaty infringement by the other state, and even receive reparation, without doing away with the treaty in question. As discussed above, treaty termination may also not even be an option open to the state for legal reasons.

As explained above, with regard to reparation, there are several circumstances where a claim based on state responsibility may have a place in the foreign affairs policy of a state. Not only the enactment of a law in clear violation of tax treaty obligations, but also “treaty dodging” in the other state may be addressed. The systematic non-observance of treaty obligations by tax authorities of a state may be strongly protested by another state through this course of action as well. Lack of (timely) cooperation in exchanging information, failure to recognize tax treaty obligations in the issuance of tax authorities’ notifications and instructions, etc can be addressed using customary law on state responsibility. It may also be used to convince states to leave no doubt on the tax treaty application, when enacting new tax laws that might otherwise be seen as a breach of treaty obligations.

*c) To curb tax competition.*

In the opinion of this author, state responsibility under customary international law is not an appropriate cause of action to combat tax haven regimes adopted by states and harmful tax competition, even where double taxation agreements are in force between the tax haven state and the “injured” state.

First of all, because the effectiveness of state responsibility in tax matters is impeded by the almost complete lack of any international obligations on the state besides those found in treaties. In other words, if the tax haven state did not conclude any tax treaty with the “injured” state, it will be impossible to maintain that there was any international obligation breached.

Secondly, because even when a DTA applies between the two states, it is very doubtful whether the adoption of a tax haven regime by one of them would constitute a breach of the treaty. After all, the DTA does not contain any obligation to refrain from adopting new tax law, or to maintain any kind of status quo in tax laws between the states. Treaty termination (without notice) on the basis of the *rebus sic stantibus* doctrine might be a more appropriate cause of action for the state, because a breach of the treaty is not necessary in this case, but this certainly merits further study,.

If states want to curb harmful tax competition, they will have to do it with countermeasures (see below) and voluntary obligations (see above IV, 2, b "Unilateral Obligations") undertaken by the tax haven states. As is obvious to the reader, it seems that the same courses of action have been undertaken by the OECD.

### 8.4 Tax Competition Countermeasures

In its Report on Harmful Tax Competition, the OECD recommends several courses of action to its members: introducing CFC-type legislation, foreign investment fund tax laws, restrictions on participation exemption, bank secrecy, terminating tax treaties, limit treaty entitlement

It is noteworthy that the legitimacy of the countermeasures is in direct relationship with the legitimacy of the state conduct itself[1765]. If one accepts the considerations about state responsibility and tax competition above, the legitimacy of the countermeasures is inescapable. If states are not restricted in enacting privileged tax regimes, other states may enact countermeasures that illustrate their unrestricted fiscal sovereignty as well. This is a consequence of the fact that in international public law, there are no obligations on a subject which are not matched by an international subjective right of another subject.[1766]

The opposite is obviously also true. If one would assume that states are obliged to take into account the effect of their tax laws on other states (besides express obligation to do so), the countermeasures (such as CFC regimes) would break the same rule.

### 8.5 Possible future developments.

Customary international law is in constant development. The codification of the customary rules on state responsibility is certain to widen the scope of wrongful acts by states that are (will be) scrutinized in its light. It has been shown that tax treaty suspension or termination is a blunt instrument, and in most cases, a possible breach does not warrant

[1765] Also see Alla, D., ibid, p. 144-146.
[1766] *Y.I.L.C.*, 1973, Vol.II, 182 par. 9.

(economically) to jettison the entire treaty. Such became clear even to the US when that state terminated its tax treaty with the NL Antilles, only to restore parts of it not much later.

*De lege ferenda*, taking into account the rapidly expanding network of tax treaties, and the growing awareness by governments that breaches of tax-obligations by other states will be felt in their own treasury, it is *almost unavoidable* that the codification-process of state responsibility will also attract attention in matters of taxation.

Predicting what will, and what will not become a general principle of international law is risky. With regard to state responsibility, for example, as recent as in the 1950's state responsibility for massive pollution was not generally accepted. Who knows if fifty years from now, tax competition has become a generally accepted restriction on fiscal sovereignty? But it will take much more than one OECD Report (an organization with 22 member-states, but hardly comparable to the 190 or so members of the UN) that was, by the way, opposed in strong terms by two of its own members, to make it so.

Until that time, this author is convinced, countries will not cease to take notice of each other's tax laws, thus disproving Lord Mansfield's dictum of 1775. But will states that take offence at other states' competitive regimes, at the same time agree to sacrifice a part of their own fiscal sovereignty as well? What would be the cost of that? For in international public law there rarely is a sword which cuts on only one side.