Source of Income in Globalizing Economies: Overview of the Issues and a Plea for an Origin-Based Approach

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1. INTRODUCTION

The allocation of tax jurisdiction with respect to income, including capital gains, has traditionally been based on the principles of residence and source. Well-supported doctrine has demonstrated that the source state should have the primary right to tax. Nevertheless, the residence state has traditionally claimed to have the better rights, and this is also reflected in double taxation treaties. Applications of the residence principle have created flaws in tax systems which offer opportunities for tax planning but also trigger governmental (re)actions, e.g. limitation on benefits provisions. Such (re)actions may also be considered as an attempt to strengthen the application of the source principle. But what is a source of income?

Over the last decades, economies have increasingly become globalized and business models have changed as a consequence of, inter alia, the intense growth of the service sector and international capital markets and the development of electronic business. The two fundamental systems used to identify the source of income for tax purposes – statutory source rules and the common law “facts and circumstances” doctrine – were both developed in an era of simpler commercial transactions. Are these traditional source rules still appropriate, or should new rules for the 21st century be developed? In this context, the starting points are that income should be taxed and that, conceptually, income should constitute comprehensive income.

This article presents a general overview of the issues and advocates an origin-based interpretation of the term “source”. The issues are discussed at a more general level. First, the concept of source of income is addressed from a juridical perspective. The author identifies a multitude of meanings used in source rules in international tax law and also specifies what, in his opinion, source of income should mean. In this respect, the author advocates ranking the source principle over other principles like the residence principle. Second, economic policy is addressed. Considering the globalization of economies, states should rethink the economic policy underlying their tax system. As pointed out, capital and labour-import neutrality fits best with the changed economic environment and, as a consequence, also with a source-based tax system. Third, EU law must be dealt with when transnational situations are addressed. In the field of direct taxation, the case law of the European Court of Justice (ECJ) regarding the fundamental freedoms plays an important role. The case law supports a source-based tax system, but the directives adopted in this field point in another direction. Fourth, tax treaties are discussed. The residence-based OECD Model Tax Convention has flaws which offer opportunities for tax planning and also result in governmental (re)actions. Finally, alternative origin-based source rules are outlined for some classes of income and deductions, such as business income (business profits, dividends and capital gains on shares), interest and capital gains on debt claims, royalties and capital gains on the underlying intangible property and pensions as well as personal allowances, reliefs and deductions. A summary concludes this article.

2. SOURCE OF INCOME: A MULTITUDE OF MEANINGS

2.1. Source as legal justification for income and capital tax jurisdiction

The legal justification for the right to tax and, therefore, the assignment of tax jurisdiction among states, is generally considered to be the principle of sovereignty, i.e. jurisdiction, and thus also tax jurisdiction, is an attribute of statehood or sovereignty.1 Basically, a state itself determines its taxing rights, but in international relationships, the imposition of tax is limited, on the one hand, by the limited possibilities of a state to enforce its taxing rights as a practical matter and, on the other hand, by international law.2 The injunction against arbitrariness in international law must be taken into consideration. Arbitrariness is considered to be present if there is no sufficient relationship with the state concerned and that state nevertheless imposes tax. In general, a sufficient relationship is considered to exist on the basis of e.g. citizenship, incorporation of a company under national law, domicile, residence, statutory seat of a company, place of effective management of an enterprise, permanent establishment, situs of land, and place of labour.3 A relationship can, therefore, reveal itself through a political and/or economic connection with the state concerned.4

Tax jurisdiction is based in particular on the economic relationship with the state concerned;5 at least the tax jurisdiction with respect to income and capital should, in the author’s opinion, be based on it.6 Income is produced only if a person utilizes the production factor(s) of labour or, in addition to labour, capital. The taxation of income should be linked, as much as possible, with this utilization and therefore also with the place (territory) where these factors are utilized (territory principle). Mere political allegiance is, in the author’s view, an insufficient basis for tax jurisdiction with respect to the production of income and the possession of capital because political allegiance does not produce income, nor does it establish or preserve capital.7

To determine whether a sufficient connection for assigning tax jurisdiction is present, a linkage should be made between the territory principle and the direct benefit principle, i.e. taxes should be considered as a contribution for the benefits provided to an individual through state activities.8 It should be noted that the direct benefit principle is used here merely as an underlying principle for allocating tax jurisdiction among states. Whether a state’s internal tax system should be based on this principle is beyond the scope of this article. The relevance of the direct benefit principle in the context of assigning tax jurisdiction was pointed out as early as 1892. With respect to “wirtschaftliche Zugehörigkeit”, Schanz wrote: “Jeder, der wirtschaftlich an die Gemeinschaft gekettet ist, d.h. jeder, dem aus der Erfüllung der Aufgaben des Gemeinwesens Vorteile

1. See e.g. Bühler, Ottmar, Prinzipien des Internationalen Steuerrechts (Amsterdam: Internationales Steuerdokumentationsbüro, 1964), at 260.
2. See e.g. id. at 130-137; Martha, R.S.J., The Jurisdiction to Tax in International Law (Deventer, the Netherlands: Kluwer Law and Taxation, 1989), at 23-41; and Commissie Internationale belastingvaut van lichamen, Internationale belastingvaut van lichamen, Geschriften van de Vereniging voor Belastingwetenschap, No. 196 (Deventer, the Netherlands: Kluwer, 1994), at 15.
8. See e.g. Meyer, Heiko, Die Vermeidung internationaler Doppel- und Mindeststeuerung auf der Grundlage des Ursprungsprinzips (diss. 1970, Georg-August-Universität, Göttingen), at 36-37; Vogel, Klaus, “Worldwide vs. source taxation of income – A review and re-evaluation of arguments (Part III), Intertax 393 (No. 11, 1988), at 394-395; Martha, supra note 2, at 19-21; and Rosembuj, supra note 4, at 4; Disagreeing: e.g. Kaufman, supra note 5.
erwachsen, trägt zu den Lasten bei.” Another example is Bruins et al., who discussed the direct benefit principle as part of the faculty principle or the principle of the ability to pay:

So far as the benefits [conferred by a state on a person] connected with the acquisition of wealth increase individual faculty, they constitute an element not to be neglected. The same is true of the benefits connected with the consumption side of faculty, where there is room even for a consideration of the cost to the government in providing a proper environment which renders the consumption of wealth possible or agreeable ...10

A person’s wealth gives him the ability to pay tax, economic faculty, or faculty. These terms are used here synonymously.

Based on the direct benefit principle, a person who benefits from the public expenses incurred by a state should also contribute to those expenses.11 This implies, in the author’s view, that a person who produces income, including capital gains, i.e. increases his individual faculty, or who possesses capital, i.e. maintains his individual faculty, benefits from the public expenses incurred by a state which enable him to produce income or to establish and preserve capital and should, therefore, also contribute to those expenses. This principle is further elaborated by the principles of nationality/citizenship, incorporation/siège réel, domicile/residence, source, origin and functionality. These principles are more of a qualitative nature, i.e. they indicate whether there is any justification to make a person subject to an income or capital tax in a state. Justification, or at least equity, is the most important legal principle regarding the allocation of tax jurisdiction.12 Besides these qualitative principles, the universality principle and a more limited application of the territory principle (territoriality principle) play a part with regard to the allocation of tax jurisdiction. These principles are more of a quantitative nature, i.e. if a qualitative principle applies, they determine more or less the magnitude of the taxing rights.

In a comprehensive tax system, the taxes on the production, possession, consumption and disposal of wealth need to be harmonized because an individual’s faculty as a whole should be taxed only once. If taxes are levied at these four occasions, the tax system in fact spreads the obligation to contribute to the public expenses based on the ability to pay principle over a person’s entire faculty time line, whereas, in theory at least, in a fully autarkic community, it would also be possible to tax a person’s faculty only at one time. A more open economy needs, in the author’s view, more occasions for taxation due to a desirable allocation of tax jurisdiction between the states connected with such an economy. For example, a person’s wealth might be produced in State A, after which it is transferred and kept for a while in State B, and finally consumed in State C. Allocating tax jurisdiction to all three states is justified, but needs to be balanced. This is especially true in the current era of globalizing economies.13

From the above, it follows that the principle of source is one of the basic principles on which the taxation of the production of income and the possession of wealth is/should be allocated to states. The interpretation of the term “source of income” is discussed in more detail below.

2.2. Source: a motley collection of justifications

The principle of source is commonly used by tax legislatures, judges and scholars, but the term “source” is not always clearly defined, and it is used in various meanings.14 For example, it is referred to as the state in which the tangible or intangible property in question is located or used,15 in which the services are performed, which is affected by the services, in which the contract is signed, in which the contract is executed, whose laws govern the contract,17 with which the identity of the payer is linked, in which the payer is located,18 from which the payment was made,19 or which bears the expenses.20 Thus, the term “source” is used for a motley collection of justifications for allocating tax jurisdiction. This often makes discussion burdensome because people use the same term to express different concepts.

The author considers the principle of source as an elaboration of the principle of location of wealth (situs): a person who receives income from a person or property situated in a state has such a close relationship with the state in which that person or property is physically located that the relationship justifies an obligation to support that state.21 The taxation of income in the...
source state is then justified because the income arises from a person or property situated within that state, i.e. the income physically arises in the territory of that state. The discussion below elaborates on the difference between the principle of source and the principle of origin. See 2.3.

The principle of source may also play a part in justifying the allocation of tax jurisdiction with respect to capital. If so, the state in which the property is physically situated is entitled to levy a capital tax on the property. In that case, the physical location of the property is decisive, e.g. the state in which the immovable property is situated or the bond deposited. This location (situs) should, however, be distinguished from the economic location. This issue is also discussed further below.

In the author’s view, it is not self-evident that the principle of source may serve to justify a tax on income since the income may be produced or the property may be established and preserved in a state other than the state in which the person from whom the income was received or the property is physically situated. For example, the fact that a state or department makes a payment or that the payer is located in a state does not reflect per se the cause of the production of income. For instance, in Appeal of Estate of L. McKinnon, Betram W. Bursell, and Norman Parsons Clement Executors, 6 B.T.A. 412 (1927), the US Board of Tax Appeals decided that the United States was not entitled to tax the interest paid on a foreign bond that was held in the US as security for a loan to a non-resident alien. The Board of Tax Appeals held that it was immaterial that the bond itself was temporarily or permanently within the jurisdiction of the United States: the income flowed from its origin outside the United States to a non-resident alien. With regard to a capital tax, it is merely mentioned here that a state other than the state in which e.g. a share is physically present may provide the (legal) framework to establish and preserve property (possession of wealth). Furthermore, as concerns immovable or movable tangibles or intangibles evidenced by paper (e.g. a certificate), it is possible to determine the physical location. Regarding intangibles not evidenced by paper (e.g. goodwill), however, it is impossible to determine the physical location.

For this reason alone, the principle of source might not be adequate (enough) to assign tax jurisdiction with respect to income and capital.

In relation to the principles of nationality/citizenship, incorporation/siège réel and domicile/residence, however, it follows from the closer connection of the source principle to economic allegiance and the production and possession of wealth aspects of the faculty principle that the source principle should take precedence over the other principles mentioned.

2.3. Origin-based interpretation of source

From the above, it is clear that the term “source of income” is not defined unambiguously and that it causes confusion. Therefore, the author suggests that “source of income” be interpreted only as the origin of income in respect of income taxes. In respect of capital taxes, “source of capital” should be interpreted as the economic location of capital. If this approach is adopted, source and origin would be identical in respect of income taxes, whereas currently origin is only one of the various meanings of the term “source”. In respect of capital taxes, the same would be true mutatis mutandis for the terms “source” and “economic location”. Both “origin” and “economic location” are explained in more detail below. The idea is that (future) source rules should be based on the concepts of origin and economic location, as discussed below. This way, an unambiguous system of source rules can be developed by virtue of which income and capital tax jurisdiction will be allocated to the states in which income is actually produced and capital is actually established and preserved. Such source rules will enhance not only inter-individual equity but also international equity.

2.3.1. Source interpreted as origin for income tax purposes

Taxation based on the principle of origin justifies a state taxing income that is created within the territory of that state, i.e. the cause of the income is within that state. That state makes the yield or acquisition of wealth possible. Whereas the causal relationship...
between the production of income and the territory of a state is predominant under the principle of origin, the causal relationship is of minor or no importance under the principle of source. Therefore, the principle of origin and the principle of source as currently used are not identical. If the income in question is not generated in a state but nevertheless physically appears from that state, tax jurisdiction may be allocated to that state based on the principle of source, but not the principle of origin. An example may illustrate the difference. In State O, income is generated by means of an enterprise, and the income is transferred via a corporation in State S as a dividend to a person resident in State R. Applying only the principle of origin, only State O may tax the income, but applying the principle of source, both States O and S may tax the income. The principle of source reinforces State O’s right to tax based on the principle of origin.

The principle of origin is most strongly related to taxation based on “wirtschaftliche Zugehörigkeit”, economic allegiance, the direct benefit principle, and the production of wealth aspect of faculty. Therefore, in the author’s view, it is the primary, if not the exclusive, principle on which the allocation of tax jurisdiction among the contracting states in a bilateral tax treaty on income and capital should be based. Bruins et al. thought that the principle of origin could not be the only test because “residents owe duty to the place where they live, even if ... their income [is] derived elsewhere”. This author agrees that a resident should contribute to the public expenses of his residence state, but disagrees that this should be done through a tax on the production of income. As mentioned above, the faculty principle also has a consumption aspect. Since residing is a way of consuming income but not producing income, the residence state should be entitled to levy a consumption tax, but not an income tax. In a comprehensive tax system in an international context, it is appropriate, in the author’s opinion, to allocate tax jurisdiction with respect to income merely on the principle of origin; at least this principle should be ranked first on the list of principles on the basis of which such tax jurisdiction is assigned.

2.3.1.1. Origin of income: only human activities

The origin of income does not seem to be self-evident. The US Treasury concluded that the nature of an item of income is generally important for determining its source because the source of income flows from its nature. According to Vogel, the only positive statement that can be made is that “origin”, in his wording “source”, “refers to a state that in some way or other is connected to the production of the income in question, to the state where value is added to a good. In contrast, the type of connection that establishes that ‘source’ of income cannot be defined generally”. The origin of income, as defined in Art. 2(e): “The word ‘source’ means the activity, right, or property that generates, or may generate, the income.” According to Bruins et al., “the origin of income is where the intellectual element among the assets is to be found .... The yield or acquisition [of wealth] is due ... not only to the particular thing but to the human relations which may help creating the yield”. In the US case Commis- sioner v. Piedras Negras Broadcasting, 127 F.2d 260 (5th Cir. 1942), affirming 43 B.T.A. (1941), the court stated: “We think the language of the statutes clearly demonstrates the intention of Congress that the source of income is the situs of the income-producing service. The repeated use of the words within and without the United States denotes a concept of some physical presence, some tangible and visible activity.” And Bühler stated: “Wir nennen hier den Staat, in dem die Vermögenserträge erarbeitet werden, Ur sprungstaat oder Quellenstaat.” Finally, Graetz and O’Hear argued that “[i]ncome ... is an attribute of individuals ...”.

In the author’s view, it is true that only individuals can create income and that things in themselves cannot. The intellectual element is the key component in the production of income. Through the action of an individual, whether or not a device is used, value may be added to things.

29. See e.g. van der Geld, supra note 21, at 68.
30. Disagreeing: e.g. Meyer, supra note 8, at 29.
32. See e.g. Schanz, supra note 3, at 372-380; Bühler, supra note 1, at 184; Meyer, supra note 8, at 24-49; and Graetz and O’Hear, supra note 6, at 1102-1105. The Mexico Draft Model Tax Convention (1943) of the League of Nations also highly favoured the principle of source. See e.g. Meyer, supra, at 31-33; and Bunders, E. and J.A.C.A. Overgaauw, “Terugblik op een eeuw Nederlandse belastingverdragen. Wat zal de nieuwe eeuw brengen?”, MBB 2000/1, at 23.
33. See e.g. International Chamber of Commerce, supra note 27; Endriss, supra note 27, at 71-78; and Atchabahian, supra note 27, at 315-317.
34. See e.g. Meyer, supra note 8, at 238-250; and Vogel, supra note 12.
35. Bruins et al., supra note 7, at 20.
36. See e.g. Meyer, supra note 8, at 34-36; Boyle, Michael P., et al., “The Emerging International Tax Environment for Electronic Commerce”, 28 Tax Management International Journal 357 (1999), at 366-367. In Bühler, supra note 1, at 175-176 and 184-185, Bühler mixed up, in the author’s view, the production and consumption aspects when using the term “Ursprungsland” for the state in which products are sold without the producer/seller having a permanent establishment or any physical entrepreneurial activity there.
37. See e.g. Endriss, supra note 6, at 79-82. See also Kemmeren, supra note 13, at 35-37.
38. See e.g. Endriss, supra note 6, at 67 and 82; and Atchabahian, supra note 27, at 317.
40. Vogel, supra note 12, at 223-228.
41. In both the Convention for the Avoidance of Double Taxation Between Member Countries and the Model Convention for the Avoidance of Double Taxation Between Member Countries and Other Countries Outside the Sub-region, as reproduced in an unofficial English translation in 28 Bulletin for International Fiscal Documentation 8 (1974), Supplement D.
42. Bruins et al., supra note 7, at 20.
43. Bühler, supra note 1, at 181. See also Endriss, supra note 6, at 77 and 79.
44. Graetz and O’Hear, supra note 6, at 1034.
45. See e.g. Pires, supra note 15, at 143; and Boyle et al., supra note 36, at 374.
46. See e.g. Forst, supra note 17, at 1455; and Kemmeren, supra note 13, at 37-39.
2.3.1.2. Originator of income

An important issue that remains to be resolved is whether the intellectual element may be found only in the activities of the income recipient himself or his personnel, agents, etc., or whether the intellectual element may also be found in the activities of an individual who is independent of the income recipient.\(^47\) The author thinks that, in many cases, the income recipient and the income originator coincide, e.g. the porter mentioned above or the personnel of an enterprise who are identified with the enterprise. It is also possible, however, that they do not coincide. If the income received is to a substantial extent produced through the activities of an independent person (i.e. he is the person who adds the intellectual element) and the benefits from the activities do not regard this person but are passed on to another (i.e. the income recipient), the income does not originate with the recipient but with the independent person (i.e. the originator). In the author’s view, such an independent person with respect to the income passed on can, in substance, be put on a par economically with a person dependent on the income recipient, e.g. an employee.\(^48\) For example, C, a person resident with a person dependent on the income recipient, another (i.e. the income recipient), the income does not regard this person but is passed on to another (i.e. the income recipient), the income does not originate with the recipient but with the independent person (i.e. the originator). In the author’s view, such an independent person with respect to the income passed on can, in substance, be put on a par economically with a person dependent on the income recipient, e.g. an employee.\(^48\) For example, C, a person resident in State R, granted an interest-bearing loan to an entrepreneur, E, in State O, who is active only in State O. The interest paid was then created through E’s entrepreneurial activities within State O, i.e. the cause of the interest is within State O. That state made the yield on the loan or the acquisition of interest possible. The intellectual element added to the loan granted by C must be located in E’s “sweat and tears” activities in State O. The interest was produced because E utilized the loan in his organization of labour and capital (his enterprise). The origin of the interest is in State O. C’s activities concerning the interest received may have been very limited, e.g. a phone call to his bank from his swimming pool in order to know whether the interest was paid. The taxation of income should be linked, as much as possible, with the utilization of the production factor of labour and, therefore, also with the place (territory) where this factor was utilized (territory principle) (see 2.1.), which might often be combined with the production factor of capital; nevertheless, the bilateral tax treaty between States O and R should allocate the tax jurisdiction with respect to the interest to State O.\(^49\)

2.3.1.3. State of origin

Within the framework of an enterprise, activities may be carried on in various tax jurisdictions, i.e. various places of origin, and various states of origin might be distinguished in the chain of business activities.\(^50\) For example, product Y is produced in a plant in State P. Y is subsequently transported through State T to State M, where it is warehoused and from which the marketing is done. Finally, Y is sold by a sales department in State S to a client in State C, who picks Y up at the warehouse. Five states are involved but, in the author’s view, in only four states (States P, T, M and S) may some value have been added.\(^51\) It might be true that State C offers the enterprise a market to sell Y,\(^52\) but the intellectual element, the human activity carried on by the persons in the enterprise’s sales department, is found in State S, not in State C. Therefore, State C should not be entitled to tax any part of the income produced by the enterprise.\(^53\) It is possible that activities in a state create a negative added value, e.g. because of bad marketing in State M. This should be taken into account as well when tax jurisdiction is allocated based on the principle of origin because the negative added value is caused by the activities of persons in the sales department in State M. The allocation of tax jurisdiction with respect to business profits based on the arm’s length principle flows prima facie from the principle of origin.

Because the intellectual element is considered the key component in the production of income, it might also become easier to find answers to questions regarding electronic commerce. The (key) intellectual element in a digital service, e.g. the advice of a tax lawyer, is, in the author’s view, found in the state where the tax lawyer prepared his advice. The (key) intellectual element, his labour, has added value by means of assets, e.g. the firm’s databases situated in other states.\(^54\) The tax lawyer does not add the intellectual element within the territory of the states in which the firm’s servers were established.\(^55\)

\(^{47}\) Under the US national source rules regarding services income, it was ruled as early as 1939 that the activities of an individual other than the income recipient may be attributed to the income recipient. In Helvering v. Boekman, 107 F.2d 388 (2d Cir. 1939), the court stated: “It can hardly be that when an alien employs agents in this country to do things from which he collects a profit, Congress intended to escape him, though it meant to tax him. He came here to do the service himself.”

\(^{48}\) None of the court decisions, however, purported to set forth any rules of general application regarding the attribution of activities from agents or contractors to principals for sourcing purposes. And it is not obvious what principles can be derived from case law. See e.g. Boyle et al., supra note 36, at 376, which nevertheless tried to deduce the relevant criteria from case law: (1) perhaps a distinction can be made between activities that are integral to the services that are consumed by the customer or client and activities that are merely ancillary or incidental to those services; (2) perhaps the independence of the agent is important; (3) alternatively (or in addition), the substantiality and distinctiveness of the services provided directly by the principal may be relevant; even if the principal acquires inputs that are integral, or even essential, to his rendering of services, there would seem to be a point where the principal renders enough value directly that the source of the ultimate services should not be influenced by the fact that some inputs were acquired from others; and (4) it may be important to distinguish between activities that are preparatory rather than part of the delivery of the services.

\(^{49}\) The compensation paid to the independent person and the dependent person for their respective activities might deviate because of, for example, differences in the risks concerning continuation of the activities.

\(^{50}\) See Kemmeren, supra note 13, at 39–40.

\(^{51}\) See e.g. Endriss, supra note 6, at 67.

\(^{52}\) See e.g. Boyle et al., supra note 36, at 377-378.

\(^{53}\) According to Schaumburg, Harald, Internationales Steuerrecht: Aussensteuerrecht, Doppelbesteuerungsrecht (Cologne: Verlag Dr. Otto Schmidt, 2nd ed., 1998), at 878, because of this argument, a state like State C should be entitled to tax part of the income of the enterprise. See also Alexander Hemmelrath in Vogel, Klaus, Klaus Vogel on Double Taxation Conventions (London: Kluwer Law International, 3rd ed., 1997), at 400 (Art. 7, marginal number 6).

\(^{54}\) State C might impose a consumption tax if Y is consumed in that state. In Doernberg and Hinnekens, supra note 21, at 316-317 and 319, the authors underlined this result based on international income tax principles, but noted that such an outcome would not be politically and financially acceptable to many states. Especially State C might have a problem in accepting the result, but State C should, in the author’s view, admit that no income was produced in its territory. The client did, however, consume Y within its borders and therefore, in a comprehensive tax system, State C should levy a consumption tax. Although Doernberg and Hinnekens referred to different entitlements of states regarding an income tax and consumption tax, they did not here use the complementary function of a consumption tax to an income tax as an argument that may convince State C.

\(^{55}\) But see id. at 317, where the authors seem to argue that these states call upon the principle of origin (“source” in their words) to extend their tax.
The report of Bruins et al. was rather negative on assigning tax jurisdiction with regard to, what we today call, passive income based on the principle of origin. It was believed that the undesirable phenomenon of international juridical double taxation was caused by the state of origin, not by the state of residence.\textsuperscript{65} Taxation based on the principle of origin would impede the free movement of capital.\textsuperscript{57} The exclusive right of the residence state to tax passive income would result in taxation being neutral to investment decisions under the assumption that all income and capital would be taxed in the residence state at the same level, thereby neutralizing the different levels of taxation in the states of origin. Although this reasoning seems to be convincing, the author thinks it is not.\textsuperscript{58} First, income from capital is not produced in the residence state of the creditor, but in the state of the debtor, the state of origin. Second, double taxation may also be avoided under tax treaties if the state of origin is given the exclusive right to tax. The report of Bruins et al. left this option completely untouched.\textsuperscript{59} Third, the different levels of taxation in the residence states of creditors may affect the capital markets as well. A creditor resident in a low-tax state will offer his money on the debtor’s market at a lower interest rate than a creditor resident in a high-tax state, all other factors being identical for the two creditors. The debtor’s choice will, therefore, not be tax neutral.\textsuperscript{60} Considering these arguments, it is the author’s opinion that the state of origin has the strongest, if not the exclusive, right to tax income from capital.\textsuperscript{61}

### 2.3.1.4. Origin limited to substantial income-producing activity

If the principle of origin regarding the allocation of tax jurisdiction to states via tax treaties is applied broadly, a problem might be that a person who produces income as a globetrotter may be taxed by numerous states in which he carries on income-producing activities, although the taxation by each state will be restricted to the income created by an activity within that state. After all, each income-producing activity in a state, even an occasional one, seems to justify that state’s right to tax the income produced in that state. This result should be considered undesirable, both from a theoretical and a practical point of view. It is striking that, regarding the allocation of tax jurisdiction with respect to dependent personal services, an occasional activity can create a taxing right for the state in which the activity is exercised,\textsuperscript{62} whereas regarding business profits and independent personal services, a merely occasional relationship with a state is considered to be insufficient.\textsuperscript{63} In that case, a more durable relationship is generally required.\textsuperscript{64} Such a limitation does not seem to be compatible with the principle of origin. The author thinks, however, that the activity of a person who only hops in and out of a state and produces income in that state generally lacks a sufficient nexus, a sufficient economic relationship with that state, to justify taxation.\textsuperscript{65} The Commentary (Para. 3) on Art. 7 of the OECD Model also defends this position with respect to entrepreneurial activities:

... an enterprise of one State shall not be taxed in the other State unless it carries on business in that other State through a permanent establishment situated therein. It is hardly necessary to argue here the merits of this principle. It is perhaps sufficient to say that it has come to be accepted in international fiscal matters that until an enterprise of one State sets up a permanent establishment in another State it should not properly be regarded as participating in the economic life of that State to such an extent that it comes within the jurisdiction of that other State’s taxing rights.

If this reasoning is valid for the activities of enterprises,\textsuperscript{66} the author does not see why this should be different for other activities, for example, dependent personal services. The author thinks that, for allocating tax jurisdiction with respect to income from activities, a substantial relationship between the activity and the state concerned is required.\textsuperscript{57} From a theoretical perspective, the author thinks that the requirement of a sufficient economic relationship as a consequence of the direct benefit principle, and thus also the faculty principle, implies that an occasional activity is not significant enough to be considered a sufficient relationship with a state, even though an occasional activity jurisdiction with respect to the production of income if the client is in the same state as the server.

56. See e.g. Para. 1 of the Commentary on Art. 11 of the OECD Model; Vildés Costa, supra note 14, at 94-95 and 98; and Pires, supra note 15, at 141. Within this framework, see Bühler, supra note 1, at 181, preferring Empfangstaat to Wohnsitzstaat.

57. See Para. 2 of the Commentary on Art. 11 of the OECD Model.


59. An origin-based tax introduced unilaterally may impede the free movement of capital. In Crossen, S. and A.L. Bovenberg, "Vernomogenrens- dementsheffing: vondst of miskleun", Weekblad voor Fiscaal Recht 2000/06369, at 9, the authors considered such a tax an indirect tax on labour because the higher expenses on capital will result in lower real labour income.

60. See e.g. Atchabahian, supra note 27, at 331.

61. See VerLoren van Themaat, supra note 58, at 28 and the references cited there; and Graetz and O’Hear, supra note 6, at 1058 and 1071-1072 (illustrating that, within the International Chamber of Commerce, even the United States in the early 1920s advocated the source-state taxation of dividends and interest based on the benefit principle of taxation, administrative advantages, the desire to avoid antagonizing debtor nations and the international balance of payments. See also Kemmeren, supra note 13, at 40-42.

62. For example, Art. 15 of the OECD Model, UN Model 2001, US Model 1996 and Netherlands Model 1987 (dependent personal services) may in substance result in such taxation if the 183-day rule is not satisfied.\textsuperscript{63} See e.g. Para. 2 of the Commentary on Art. 5, second indent: “this place of business must be ‘fixed’, i.e. it must be established at a distinct place with a certain degree of permanence” (emphasis added); and Para. 4 of the Commentary on Art. 14 of the 1997 OECD Model. But if there is in another State a centre of activity of a fixed or a permanent character, then that State should be entitled to tax the person’s activities” (emphasis added). The linkage to the “place of effective management of the enterprise” in Art. 8 of the OECD Model in substance expresses the same idea because the place of effective management of a material enterprise, i.e. not an enterprise created by a legal fiction, implies by the nature of an enterprise a certain degree of durability.

63. See e.g. Art. 7 (requiring a permanent establishment) and Art. 8 (referring to the place of effective management of the enterprise) of the 2005 OECD Model, and Art. 14 (requiring a fixed base) of the 1997 OECD Model, 2001 UN Model, 1996 US Model and 1987 Netherlands Model.

64. This view seems to be confirmed by e.g. Para. 1 of the Commentary on Art. 7 of the OECD Model: “The permanent establishment criterion is commonly used in international double taxation conventions to determine whether a particular kind of income shall or shall not be taxed in the country from which it originates... “ (emphasis added).

65. The author refrains here from taking a position on whether the requirement of a permanent establishment is the most desirable criterion or whether it should be replaced by another factor expressing a sufficiently durable relationship with a state. The author discusses this below. See 6.2.

66. See e.g. Aul, supra note 22, at 431.
creates an economic relationship with a state. The activity is not "an die Gemeinschaft gekettet". A sufficient relationship with a state should be considered present if a substantial income-producing activity is exercised in that state. Such a restrictive application of the principle of origin is not only rooted in theory, but is also very attractive from a practical perspective, e.g. because of the reduction in the number of states in which the globetrotter mentioned above may be taxed.68

Both legal security and the principle of equality require that it be determined which activities are considered "substantial". With respect to the exclusion of permanent establishments of a preparatory or auxiliary character, Para. 24 of the Commentary on Art. 5 of the OECD Model provides: "The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole." Inspired by this exclusion, the author thinks that the following definition of "substantial" could serve as a general criterion: An income-producing activity is considered to be substantial if the activity forms an essential and significant part of the activity as a whole.

For those who think that the term "substantial" needs further specification, former Art. 26(2)(c) of the 1992 Netherlands–United States tax treaty may offer useful elements for inspiration. The first sentence read: "Whether the trade or business of the income recipient is substantial will generally be determined by reference to its proportionate share of the trade or business in the other State, the nature of the activities performed and the relative contributions made to the conduct of business in both States."69

While it is necessary to adapt this phrase to income-producing activities in general, the author's position is that whether an income-producing activity is substantial is generally determined by reference to:

(1) the proportionate share of the activity in a state compared to the activity as a whole by which the quantity and quality of the production factors of labour and capital are taken into account, e.g. the relative scale of the exploitation activities of immovable property in a state other than the state in which the property is physically situated;

(2) the nature of the activity performed, e.g. the production of goods is different from the performance by an artist; and

(3) the relative contributions made to the activity in both states, e.g. the share in the gross income from or expenses of an activity in one state compared to the gross income from or expenses of the activity as a whole.

The relevance of each of these factors might differ from case to case. In one case, there might be more emphasis on the nature of the activity whereas, in another case, the proportionate share of an activity in a state compared to the activity as a whole might be emphasized. For practical reasons, the introduction of safe harbours could be considered, e.g. ratios based on gross income, payroll expenses and days of physical presence relating to the activity concerned on the basis of which both the contracting states and the taxpayers concerned have (more) certainty regarding the interpretation of the term "substantial". If the relevant ratios exceed fixed levels, the activity in a state is deemed to be substantial, and tax jurisdiction must therefore be allocated to that state.70

2.3.1.5. Major benefits of an origin-based interpretation of source

In the author's view, the principle of origin will enhance the principle of justice, the economic faculty principle (ability to pay), the direct benefit principle and inter-nation equity (especially between developing states), which might have all kinds of other beneficial (side) effects,71 such as an increasing inter-nation stability. Furthermore, the principle of origin will reduce international tax avoidance, and therefore also abuse of tax treaties as part of it, since taxation will then be linked with a substantial income-producing activity and not with a place of residence. Nationality, place of residence, place of signing the contract, etc., can easily be established, changed or transferred without affecting the production of income. Under the principle of origin, to avoid taxation in a state, there may be no substantial income-producing activity in that state or it must be transferred elsewhere. This will, however, actually affect the base on which the tax at issue was founded: Income. According to this standard, the keywords are: no (production of) income, no income tax. Besides, whether a person will start a substantial income-producing activity, stop the activity or transfer it depends on more factors than the income tax.72 Applying the principle of origin might also be more effective and efficient in combating international tax fraud73 since the relevant information might be more easily disclosed by the state of origin than by the residence state. For example, it will probably be easier for the state in which the business activities are carried on to locate the recipient of interest paid by an entrepreneur on a loan used in his enterprise to finance business activities. This state could make the deduction of the

68. This is attractive for the potential taxpayer, e.g. less paperwork and fewer compliance costs, and can also be beneficial for states, e.g. the perception costs might exceed the tax revenue from income from an occasional activity.

69. As the sentence read until 1 January 2005. The treaty was amended by the protocol of 8 March 2004, but a similar rule was included in Art. XXIII(3) of the memorandum of understanding of 8 March 2004.

70. See Art. 22(3)(a)(iii) of the 1996 US Model and Technical Explanation to the United States Model Income Tax Convention, 20 September 1996, Art. 22, Para. 319-323 (all the facts and circumstances are taken into account). For a critical analysis of Art. 22 and its technical explanation, see e.g. Doernberg, Richard L. and Kees van Raad, The 1996 United States Model Income Tax Convention (The Hague: Kluwer Law International, 1997), at 182-184. The author thinks that, as a starting point, all the relevant facts and circumstances should be taken into account, but it should also be noted that the three conditions mentioned will likely cover the most prominent elements and offer more guidance; thus, those conditions could be incorporated rather than the general phrase. See Kemmeren, supra note 13, at 42-44.


72. See e.g. Report of the Committee of Independent Experts on Company Taxation (Ruding Committee) (Brussels/Luxembourg: European Commission, 1992), at 93–119.

73. Following the Ruding Committee (id. at 138), the author prefers "tax fraud" to "tax evasion" because, in France, "evasion" has the same meaning as "avoidance", whether legitimate or not.
interest by the entrepreneur conditional on the entrepreneur disclosing all the relevant information about the creditor. Thus, the entrepreneur clearly has an interest in making the disclosure. The recipient can subsequently be effectively taxed.74

2.3.2. Source interpreted as economic location for capital tax purposes

In the context of a capital tax, “origin” might not be the most appropriate term because a capital tax is not justified by the production of wealth, but by the possession of wealth. In this respect, the term “economic location” is preferred.75 If a state provides the legal framework and/or physical infrastructure for establishing and preserving property, the state is justified in taxing the possession of property. If real estate is situated in State S, allocating the right to tax the mere possession of it is justified because State S, among other things, provides a legal framework for enforcing the rights to the real estate and has created a physical infrastructure for preserving it. To the author, this principle seems to be valid not only regarding immovable property, but also regarding movable property and intangible property. If movable property, e.g. equipment, is situated in State S, it benefits from the legal framework and other public services provided by State S. Because of the nature of intangible property (e.g. shares, debt claims and patents), its possession is more closely related to the legal system under which the property was established and will be preserved than to the place where it is physically present. Intangible property can generally be moved around the world quickly and easily without affecting its preservation. Therefore, tax jurisdiction with respect to the possession of intangible property should be allocated to the state under whose legal system the property was established and will be preserved. The economic location should, therefore, be distinguished from the physical location (situs).76 The temporary situs might be distinct from the true economic location. For example, a bond or a mortgage on a piece of land estate may be kept in a deposit box outside the state under whose legal system the bond or mortgage was established and is preserved. The physical situs is in substance only important in economic allegiance to the extent it reinforces the economic location.77

3. GLOBALIZING ECONOMIES NEED CAPITAL AND LABOUR-IMPORT NEUTRALITY AND A SOURCE-BASED APPROACH

3.1. Economic policies in globalizing economies and tax jurisdiction

Economic political considerations determine the magnitude of a state’s tax jurisdiction.78 In this respect, tax neutrality should prevail, i.e. taxation should not influence an efficient allocation of the production factors of labour and capital, or at least should do so as little as possible.79 The concept of efficiency is based on the assumption that productivity will be highest when the production factors are distributed by a market mechanism without public interference, or at least with as little as possible. A given economic arrangement is efficient if there can be no rearrangement that will leave someone better off without worsening the position of others.80 Economic considerations, not tax motives, should determine the behaviour of economic operators.81 Complete neutrality is probably not possible but, from an efficiency perspective, the highest possible level of neutrality should be pursued.82 Other values, like equity, may justify a deviation from this rule in specific situations. Efficiency is used here in the context of worldwide efficiency and in a narrow sense, i.e. an optimal allocation of the production factors should not be unintentionally thwarted by taxation. It should be noted that, in globalizing economies, the actions of governments are greatly limited by the actions of other governments. Spillover effects across frontiers generated by taxation seem to be more important.83 The efficiency of the world economy should be maximized by allocating the production fac-

74. See e.g. Endriss, supra note 6, at 64-65 and 67-70; Pires, supra note 15, at 144; Graetz and O’Hear, supra note 6, at 1097-1105; and Kemmeren, supra note 13, at 44-45.
75. This term was mentioned in 2.2 and 2.3. See also Bruns et al., supra note 7, at 24; Atchabahian, supra note 27, at 317; and Martha, supra note 2, at 104-108 (using the term “situs”), but also giving an example of economic location when referring to the US case De Ganay v. Lederer, 250 U.S.S. (1919), at 382).
76. According to Bruns et al., supra note 7, the economic location of property means “the place where are to be found the successive instalments of earnings which are capitalised into the fund of wealth that we call capital or, more popularly, property.”
77. Id. at 24-25. See Kemmeren, supra note 13, at 45-46.

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tors to the location where “they” earn the highest return. This will enhance worldwide prosperity, although it depends, of course, on more than the efficient creation of income, e.g. on the distribution of the income earned. Such issues are of paramount importance for a well-functioning world society, but are beyond the scope of this article.

3.2. CLIN versus CLEN economic policies

With respect to the tax effects on the international allocation of the factors of production, the focus is mostly on the movement of capital and, consequently, on the difference between the principles of capital-import neutrality (CIN) and capital-export neutrality (CEN). Both CIN and CEN and their definitions disregard the production factor of labour provided by individuals, which is considered the classical production factor besides capital. As stated above (see 2.3.1.1.), only individuals can create income; things in themselves cannot. Therefore, an individual’s activities, the production factor of labour, should not be disregarded in assessing tax neutrality. Furthermore, not only is capital increasingly mobile, but personal mobility is also increasing in globalizing economies, although the degree of capital mobility will be, and will likely remain, far greater than labour mobility. However, since tax neutrality is considered to be a valuable objective, it should not be restricted to capital. Although the difference in the degree of mobility may explain why the factor of labour has usually been disregarded in the discussion on tax neutrality, the author thinks that it should now be included in the discussion since tax neutrality with respect to labour also contributes to the efficiency of the world economy. The author thinks, therefore, that the terms CEN and CIN and their definitions need to be supplemented. At least the factor of labour should be included. Considering the factor of labour as the origin of all income, it might even be argued that the factor of capital should be replaced by the factor of labour in both the terms and their definitions. If only because of the traditional use of CIN and CEN, the author supplements only the factor of labour. Capital and labour export-neutrality (CLIN) is then defined as follows: an income recipient should pay the same total (domestic plus foreign) tax irrespective of whether he derives a given amount of labour or investment income from foreign or from domestic sources. The definition of capital and labour-import neutrality (CLIN) should then be: labour and capital funds originating in various states should compete on equal terms in the labour and capital markets of a state irrespective of the place of residence of the worker or investor. This way, the role of individuals in economics is valued (more) equally to its relevance.

From an economic perspective, applying the universality principle, and thus taxing a resident’s (accrued) worldwide income and granting a (full) foreign tax credit, is generally viewed as consistent with the overall policy of CLIN. In contrast, the territoriality principle, as a more restricted application of the territory principle, implies that the magnitude of a state’s taxing rights is determined only by the income earned or capital situated in that state. This results in exempting foreign income and capital, which is considered to be consistent with the overall policy of CLIN. The emphasis here is on inter-nation neutrality. Complete neutrality is not possible because tax systems and tax levels vary too much. Neutrality can be achieved to a certain extent if every state respects the degree and form of non-neutrality that have arisen in another state as a result of that state’s tax law. This implies that neither state will attempt to use its taxing powers to change the relative prices in the other state, i.e. the allocation should not be influenced by a state, either negatively or positively. Intér-nation neutrality requires that a taxpayer who carries on substantial income-producing activities, e.g. an enterprise, in another state and thus uses the other state’s facilities (public goods and services) can be sure of not being taxed more heavily than anyone else who, under the same circumstances, uses the facilities to the same extent. As a consequence, taxation on the basis of the universality principle must be rejected, and taxation based on the territoriality principle and the principle of origin should be accepted.

85. See e.g. Hufbauer and van Rooij, supra note 79, at 55.
86. See e.g. Vogel, supra note 71, at 28; Utz, supra note 79, at 786; and Kemmeren, supra note 13, at 69-71. For a different view, see e.g. Roin, Julie, “The Grand Illusion: A Neutral System for Taxation of International Transactions”, 75 Virginia Law Review 919 (1989), at 963-969.
87. See e.g. Vogel (Part II), supra note 83, at 311; and Capellen, Alexander W., “National and International Distributive Justice in Bilateral Tax Treaties’, Finanzarchiv N.F., Bd. 56 (1999), at 422-442.
88. See e.g. U.S. I.C.T (Joint Committee on Taxation), supra note 81, at 92-93. See also e.g. Hufbauer and van Rooij, supra note 79, at 49-61; Doernberg, supra note 81, at 3-6; Forst, David L., “The International Tax Treatment of Partnerships: A Policy-Based Approach”, 14 Berkeley Journal of International Law 239 (1996), at 241-249; and Graetz and O’Hear, supra note 6, at 1042-1043. According to Easson (supra note 6), the CIN and CEN principles do not help a great deal in providing answers to the question of how tax jurisdiction should be shared between source and residence states. Easson favoured source-state taxation for two reasons. First, capital-importing states tend, on balance, to be poorer than those that export capital. Considerations of inter-nation equity would, therefore, seem to favour source-state taxation. The second and, in his opinion, more compelling argument lay in the difficulty of taxing international capital income. According to Easson, in reality, the choice may be between source-state taxation or no taxation at all.
89. See e.g. Tobin, James, “A Proposal for International Monetary Reform”, Eastern Economic Journal 153 (1978), at 154; Tanzi, supra note 84, at 340; and Juch, supra note 81, at 115.
90. CLEN could also be achieved by taxation in the residence state and exemption in the source state or by taxation in the source state and exemption in the residence state as long as the tax bases and tax rates in all states are the same. See e.g. van Raad, Kees, Nondiscrimination in International Tax Law (Deventer, the Netherlands: Kluwer Law and Taxation Publishers, 1986), at 264-265; and Ault, supra note 79, at 372.
91. See e.g. Vogel (Part II), supra note 83, at 311; OECD, Taxing Profits in a Global Economy, Domestic and International Issues (Paris: OECD, 1991), at 177-181; Wattel, Peter, “Capital Export Neutrality and Free Movement of Persons”, Legal Issues of European Integration 1996/1, at 116-119; Ault, supra note 22, at 381; Schaumburg, supra note 52, at 606-608; and U.S. I.C.T (Joint Committee on Taxation), supra note 81, at 92.
92. See e.g. Ruding Committee, supra note 72, at 194-199; Croossen, “Om de toekomst van de vennootschapsbelasting in de Europese Unie”, supra note 79, at 800-805; and de Bont, G., P. Jissens and E. Kemmeren (eds.), Fiscal versus Commercial Profit Accounting in the Netherlands, France and Germany (Amsterdam: IBFD Publications, 1996).
93. See e.g. Vogel (Part II), supra note 83, at 313-314; Ault, supra note 79, at 576; Vito, supra note 84, at 342; Kemmeren, supra note 13, at 71-74; and Vladeren, Paul, “Why Exempt Foreign Business Profits”, 22 Tax Notes International 1095 (2002), at 1098-1100.
3.3. CLIN needs to replace CLEN

From the perspective of an optimal allocation of the production factors, investments should be made in the place(s) where production is the cheapest and should be carried out by the person(s) who can do so most cheaply. Economic considerations, not tax motives, should be decisive in this respect. This would, in the first place, apply to direct investments (enterprises). While CLEN is generally regarded as fostering efficiency, CLIN is generally regarded as fostering competitiveness. In the author’s view, however, CLIN fosters efficiency and a CLEN-based system does not. It is argued in favour of CLEN that, if a perfect capital market is presupposed, a tax system based on CLEN would not disturb competition in the state in which an investment is made. As long as the investment is profitable, a competing enterprise that is taxed more heavily in its residence state would always be able to compensate its reduced supply of after-tax capital by financing through external funds. By contrast, the author thinks that taxation based on the universality principle creates a non-neutral and therefore inefficient system due to the differences in the residence-state taxation of the competitors on the relevant market. Residents of high(er)-tax states will be deterred from investing in low(er)-tax states because the residents of the low(er)-tax states who have a higher after-tax return will have a competitive advantage. In such a case, economic decisions would not be distorted by differences in taxation because all competitors are presumably subject to the same tax treatment. A tax system based on the territoriality principle would contribute to an efficient allocation of the production factors worldwide.

CLEN has also been advocated because it prevents the shift of investment capital from high-tax to low-tax jurisdictions. Consequently, enterprises in low-tax states might increase their market share through lower prices to the detriment of enterprises resident in high-tax states, even though the latter are more efficient. Capital is then considered to be diverted from its more productive uses, and worldwide income and efficiency are considered to suffer. The same line of reasoning could be applied with regard to labour. In the author’s view, this reasoning is not valid under tax treaties because the overall general policy of states is to conclude tax treaties with bona fide states, i.e. states with a “decent” tax rate and tax base. Furthermore, if an activity can most profitably be carried on in a low-tax location, some firms will exploit the opportunity. Directly or indirectly, the production factors will flow from high-tax states to low-tax states. The real trade-off is whether the activity will be carried on by foreign-based firms or domestic-based firms. Besides, parent companies could minimize the tax on their worldwide income by shifting their legal residence from a high-tax state to a low-tax state. In globalizing economies, where globalization is accelerated by IT developments, many enterprises become or have become multinational. This might be easier to pursue because enterprises will increasingly lose their original national identity. The argument that the owners of services are much less mobile internationally than the services they supply has become or is becoming more and more obsolete. As a result, neither neutrality nor CLEN would be achieved in the long run. There would also be a reduction in the global profit tax revenues. This is true not only regarding direct investments, but also regarding portfolio investments, operational leases, and independent and dependent personal services (labour).

3.4. CLIN supports an origin-based interpretation of “source”

Neutrality, and thus tax neutrality as well, is by definition a relative issue because the question must be answered: Neutrality to whom or to what? Should the tax positions of entrepreneurs, portfolio investors, lessors, professionals and employees with foreign income be equal to the tax positions of their fellow residents with only domestic income, or should their tax positions be equal to those of their competitors on the local foreign markets. Whether a state chooses CLEN or CLIN seems to depend largely on the size and structure of its economy and the place of its economy within the globalizing economies. Economies of a more autarkic nature, like the United States, will...
likely incline more to CLEN, and a more open economy, like the Netherlands, to CLIN, if these qualifications still hold in a globalizing environment: the US economy has also become a more open economy. Political economic power might be the decisive factor for the ultimate choice. As argued above, a CLIN-based system will promote an efficient allocation of the production factors. However, even if CLEN is embraced as the leading policy, and thus a tax credit system is applied, it would still be possible to promote the principle of origin more than is done today. This could be done by (re)drafting the distributive rules in tax treaties based more on this principle. For example, the primary right to tax interest could be assigned to the state of origin, but the residence state could impose an additional tax if the income tax in the state of origin is below the residence state’s level.

As developed states are wealthy and developing states relatively poor, it is assumed that developed states export capital, which is imported by developing states. Furthermore, it is assumed that capital flows between developed states tend to be more or less balanced. These assumptions are by nature very imbalanced. As developed states are wealthy and developing states relatively poor, it is assumed that developed states export capital, which is imported by developing states.111 Furthermore, it is assumed that capital flows between developed states tend to be more or less balanced.112 These assumptions are by nature very imbalanced. As developed states are wealthy and developing states relatively poor, it is assumed that developed states export capital, which is imported by developing states.111 Furthermore, it is assumed that capital flows between developed states tend to be more or less balanced.112 These assumptions are by nature very imbalanced.

Nevertheless, the assumption regarding imbalanced capital flows between developed and developing states was generally accepted a long time ago. A residence-based system promoting CLEN would, therefore, favour the position of developed states. In contrast, an origin-based system promoting CLIN would favour developing states.113 The author concluded in 2. that a tax treaty system based on the principle of origin is superior to a residence-based system from the perspective of legal principles. Residing means consuming income; it does not produce income. Therefore, a system whose aim is to distribute tax jurisdiction with respect to the creation of income should not be based on residence. Furthermore, as discussed above, an origin-based system does not result in an inefficient allocation of economic resources. By contrast, in the author’s view, an origin-based system promotes an efficient allocation of economic resources. In such a system, the income originating in one state should be exempt, i.e. not included in the tax base, in the other state. In such a system, the principle of origin can achieve its full potential. Besides, the tax sovereignty of the state of origin will be most respected. Further, it might enable developing states to reduce the gap in economic development with developed states.114 Under an origin-based allocation of tax jurisdiction, there is an immediate connection between substantial income-producing activities carried on within a developing state and its tax proceeds. If such activities increased, the state’s budget would also increase. Consequently, that state has an incentive to promote the growth of substantial income-producing activities by enhancing its infrastructure. As a result, the state’s economic welfare would increase even more. Such a system might also have other beneficial (side) effects,115 such as promoting inter-nation stability. Therefore, in the author’s view, an origin-based interpretation of “source” is supported not only by legal principles, but also by economic principles.116

4. EU Law: Case Law Supports Source-based Taxation, Directives Do Not

4.1. Towards a common market

The EC Treaty contains a broadly phrased declaration of the Community’s purposes (see Arts. 2, 3 and 4). The most important means to reach these mixed, and even contradictory, purposes117 are the establishment of a common market and of an economic and monetary union (EMU).118 The terms “common market” and “internal market” are considered to be synonyms.119 The internal market is characterized by the abolition, as between the Member States, of obstacles to the free movement of goods, persons, services and capital. A common market requires, inter alia, a common commercial policy, a system ensuring that competition in the internal market is not distorted, and the approximation of the Member States’ laws to the extent necessary.

110. See e.g. Pires, supra note 15, at 136; and Sweet, supra note 17, at 1995.
111. See e.g. Commentary on the 2001 UN Model, Introduction at vii, and Art. 11 at 168.
112. See e.g. Bühl, supra note 1, at 186; and Capellen, supra note 87, at 435-436.
114. This will also affect a state’s budget. A residence-based allocation of tax jurisdiction, e.g. with respect to interest, reduces the tax revenue of the debtor’s state, whereas an origin-based system would prevent this. Especially when interest is deductible in the debtor’s state and not taxed or only lightly taxed by that state in the hands of the creditor (this is the most common pattern), an origin-based allocation of tax jurisdiction is also in the budgetary interests of developed states. How much revenue a developed state will lose or gain under an origin-based allocation of tax jurisdiction is an interesting question, but beyond the scope of this article. It should be noted, however, that a switch to an origin-based allocation of tax jurisdictions in tax treaties will not per se cause a loss of revenue for developed states. Furthermore, if desired, the possible negative budgetary consequences could be countered by, for example, raising and/or extending consumption taxes.
116. See e.g. Bühl, supra note 1, at 186; Endriss, supra note 6, at 62-63 and 70; and Meyer, supra note 8, at 37-40 and 44-49.
117. See e.g. Vogel, supra note 71, at 30.
118. See e.g. Endriss, supra note 6, at 75; Vogel, supra note 8, at 399; and Kemmeren, supra note 13, at 110-112.
120. See e.g. Terra, Ben J.M. and Peter J. Wattel, European Tax Law (Deventer, the Netherlands: FED, 2005), at 1-2; and Kapteyn, P.J.G. and P. VerLoren van Themaat, supra note 120, at 116, 123 and 779-780; and van der Woude, A.M., Belastingen begrens, de doorwerking van het discriminatieverbod en de richtlijnen van de EG op nationale belastingen (Delft: Eburon, 2000), at 9-10. The term “single market”, which is also frequently used e.g. by the ECI, is considered to be synonymous with both terms. See e.g. Mortelmans, supra note 119, at 107. 122. See Art. 3(16c) of the EC Treaty.
for the functioning of the common market.\textsuperscript{123} The EC Treaty itself, in Art. 14(2), defines the “internal market” as “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty”.

For operations within the EC, it is essential that the common market be analogous in nature to the domestic market of a single state.\textsuperscript{124} It should be emphasized, however, that a genuine internal market still does not exist.\textsuperscript{125} At best, we are moving towards a common market. This situation is evidenced by e.g. the fact that all 25 Member States still have their own system of direct taxation, including tax treaties. The concept of the market is reflected in the basic principle of “an open market economy with free competition” mentioned in Arts. 4 and 98 of the EC Treaty, on which the policy concerning the EMU and the Member States’ and Community’s economic policies must be based. An “open market economy” means a market economy characterized by a liberal commercial policy.

4.2. CLIN best satisfies the EC Treaty

As argued above, an open economy will likely incline more towards CLIN. Economies become increasingly open as a result of globalization. For the European Community, the concept of an open market economy is one of the fundamental principles. Therefore, the author finds strong support to base tax treaties on the CLIN principle. The EC Treaty certainly does not prohibit doing so. In the author’s opinion, CLIN best satisfies the objectives and principles of the EC Treaty. Regarding the efficiency of the common market, tax neutrality should prevail (see 3.1.). The common market is analogous in nature to the domestic market of a single state although, as mentioned above, a genuine internal market still does not exist. CLIN underscores in the best way possible the operation of such a market established by the Member States by creating a level playing field in them; labour and capital originating in the Member States will compete on equal terms in the labour and capital markets of any state irrespective of the worker’s or investor’s place of residence. The concept of such a level playing field is also reflected in the basic principle of “an open market economy with free competition” mentioned in Arts. 4 and 98 of the EC Treaty.

Regarding direct investments, the author agrees, as stated above (see 3.3.), that business competes with business, not owners with owners. Allocating tax jurisdiction based on the territoriality principle should therefore be favoured. It enables enterprises to compete on a level playing field with their foreign competitors because, presumably, all competitors are subject to the same tax treatment. This way, the freedom of establishment, and thus the internal market, will be promoted. Taxation based on the universality principle would also not be neutral with respect to cross-border independent and dependent personal services. From an economic perspective, the decision to work in a foreign country, to contract with a foreign professional or to employ a foreign employee could be hindered by such a system. A CLIN-based system, however, will be neutral with respect to the labour market in the state where the labour income is produced. The free movement of workers and the freedom of establishment, and consequently the internal market, will benefit from it. Regarding income from portfolio investments, in the author’s view, the taxation of interest will be neutral only if it does not change the market conditions under which the debtor operates. Assuming that the creditor’s tax burden is passed on to the debtor, the differences in taxation by the various (potential) creditor states will affect the market conditions under which the debtor operates. A territoriality and origin-based system, however, will be neutral with respect to the debtor’s position because the interest will be subject only to the tax imposed by the debtor’s state. The same applies mutatis mutandis to the taxation of dividends. The corporate income tax, whether or not supplemented with a dividend withholding tax, should be harmonized. Such taxation will promote both the free movement of capital and the internal market. A CLIN-based tax system would thus contribute to the efficient allocation of the production factors throughout the EC (see 3.). The author concludes, therefore, that economic policy and the fundamental freedoms secured by the EC Treaty strongly support, or at least do not prohibit, structuring tax treaties based on the principle of origin and the territoriality principle.\textsuperscript{126}

Case law shows that these principles can actually be applied under the fundamental freedoms of the EC Treaty. EU citizens and economic operators can choose within the European Community the most suitable tax system for themselves and their investments\textsuperscript{127} and can decide which of the Member States makes the most appealing “offer” regarding the tax burden and public services.\textsuperscript{128} In this respect, it should be noted that, in

\textsuperscript{123} See Arts. 3(1)(b), (g) and (h) of the EC Treaty.
\textsuperscript{124} See e.g. ECI, 9 February 1992, Case 270/80, Polydor; and ECI, 5 May 1982, Case 15/81, Gaston Schui I.
\textsuperscript{125} For criticism on the state of the internal market, see e.g. Mortelmans, supra note 119, at 101-136.
\textsuperscript{128} Tax competition is the norm within the European Union, but this norm cannot be applied unrestrictedly. The Member States may not jeopardize the other fundamental objectives of the EC Treaty when entering into tax competition with the other Member States. They may not breach the loyalty principle as laid down in Art. 10 of the EC Treaty. It is likely that this provision has to be applied in conjunction with other specific provisions of the EC Treaty, such as Art. 87 (state aid), Art. 96 (distortion of competition) and/or Art. 99 (coordination of economic policies). If, however, the Member States’ regimes, even aggressive ones, are nevertheless compatible with the EC Treaty’s objectives, there is no breach of loyalty since the general
Gilly, the ECJ ruled, inter alia, that “the differences between the tax scales of the Member States concerned, and, in the absence of any Community legislation in the field, the determination of those scales is a matter for the Member States” (emphasis added).129

The Eurowings case may also be considered very relevant in this respect. In that case, an Irish resident company which benefited from a special low corporate income tax rate of 10% (a special regime that was approved by the European Commission) leased an airplane to a German resident company. For German trade tax purposes, the German company had to add to its profit half of the lease payments made to the Irish company. If the lease payments had been made to a German resident lessor, no amount would have had to be added to the profit. The lower taxation of the Irish lessor was raised as a possible justification by the German tax administration, but it was firmly rejected by the ECJ:

[that] difference of treatment can also not be justified by the fact that the lessor established in another Member State is there subject to lower taxation. ... Any tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used to justify less favourable treatment in tax matters given to recipients of services established in the latter State. ... Such compensatory arrangements prejudice the very foundations of the single market (emphasis added).130

In Futura, the ECJ explicitly accepted the territoriality principle. The case dealt with the carry-forward of losses derived from a Luxembourg permanent establishment of a French resident company.131 The carry-forward was made subject to, inter alia, the condition that the loss be economically related to the income earned by the taxpayer in Luxembourg. Regarding this condition, the ECJ ruled that a system of calculating the basis of assessment for non-resident taxpayers which, when calculating the tax payable by them in Luxembourg, takes into account only the profits and losses arising from their Luxembourg activities is in conformity with the tax principle of territoriality and cannot be regarded as entailing any discrimination, overt or covert, prohibited by the E(EC)T Treaty.132

This case law points out that the fundamental freedoms allow the Member States to determine the structural elements of their own tax system. A Member State may fundamentally select its level of taxation and may grant special tax incentives in accordance with the EC Treaty. In addition, the Gilly and Saint-Gobain cases show that the Member States are also free to choose their own system for relieving double taxation, e.g. a tax credit or an exemption system.133 Such choices must basically be respected by the other Member States. Therefore, although CLIN best satisfies the EC Treaty, its application is not mandatory under current EC law.

4.3. Substantial income-producing activity means “economic activity” in the EC Treaty

As stated above (see 2.3.1.1.), only individuals can create income; things in themselves cannot. The intellectual element is the key component in the production of income. Through an individual’s action, value may be added to things, whether or not a device is used. The place of origin of an individual’s income is the site of his income-producing activity (see 2.3.1.1.). In addition, the author thinks that, to allocate tax jurisdiction with respect to income from activities, a substantial relationship between the activity and the state concerned is required. A sufficient relationship with a state should be considered present if a substantial income-producing activity is exercised in that state. An income-producing activity is considered to be substantial if it forms an essential and significant part of the activity as a whole (see 2.3.1.4.).

This concept of a substantial income-producing activity matches superbly the concept of “economic activity” in the EC Treaty. This is evidenced by the ECJ’s case law on “fish quota hopping”. Since fish is scarce, the EC introduced national fishing quotas to limit the volume of fish being caught. Spanish fishermen tried to obtain larger quotas in the United Kingdom by setting up a UK company. The UK tried to stop this “quota hopping” by introducing conditions for registering a vessel and, consequently, for using the UK’s quotas. A fishing vessel is eligible for registration in the UK register only if: (1) the vessel is British-owned; (2) the vessel is managed, and its operations are directed and controlled, from within the UK; and (3) any charterer, manager or operator of the vessel is a qualified person or company.

In the Jaderow and Factortame II cases,134 the ECJ ruled that the conditions concerning nationality,135 residence and domicile violate the freedom of establishment.136 The activity test (condition 2), however, is in line with the concept of “establishment” in Art. 43.137 In Factortame II, the ECJ ruled (emphasis added):

rule of tax sovereignty applies. But it should also be taken into account that political instruments, like the Code of Conduct (soft law), limit the factual scope of those sovereign rights.

129. ECJ, 12 May 1998, Case C-336/96, Gilly, Para. 47.
130. ECJ, 26 October 1999, Case C-294/97, Eurowings, Paras. 43-45. See also e.g. ECJ, 3 October 2002, Case C-136/00, Danner, Paras. 53-56; and ECJ, 11 December 2003, Case C-364/01, Barbier, Para. 71.
131. ECJ, 15 May 1997, Case C-250/95, Futura. See also ECJ, 10 March 2005, Case C-3904, Laboratoires Fournier; and ECJ, 13 December 2005, Case C-446/03, Marks & Spencer.
132. Futura, supra note 131, Paras. 21 and 22. See also Laboratoires Fournier, supra note 131, Paras. 18-19; and Marks & Spencer, supra note 131, Paras. 43 and 45-46. Disagreeing: e.g. Steyger, E., “De neven-effecten van het vrij verkeer op specifiek nationale beleidsterreinen”. SEW 1999/6, at 226-233; and van der Woude, supra note 121, at 87-88 and 98 (arguing that the territoriality principle is at right angles to the fundamental freedoms of the EC Treaty and that tax treaties might be within the scope of this principle).
133. ECJ, 12 May 1998, Case C-336/96, Gilly; and ECJ, 21 September 1999, Case C-307/97, Saint-Gobain.
135. See e.g. ECJ, 12 June 1997, Case C-151/96, Commission v. Ireland; and ECJ, 27 November 1997, Case C-629/96, Commission v. Greece.
136. These conditions also infringe Art. 294 of the EC Treaty, which involves national treatment as regards participation in the capital of companies or firms within the meaning of Art. 48. In ECJ, 14 December 1989, Case C-3987, Agegate, also a “fish quota hopping” case, the ECJ ruled similarly with respect to the free movement of workers.
20. It must be observed in that regard that the concept of establishment within the meaning of Article 52 et seq. of the Treaty involves the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period.

21. Consequently, the registration of a vessel does not necessarily involve establishment within the meaning of the Treaty, in particular where the vessel is not used to pursue an economic activity or where the application for registration is made by or on behalf of a person who is not established, and has no intention of becoming established, in the State concerned.

22. However, where the vessel constitutes an instrument for pursuing an economic activity which involves a fixed establishment in the Member State concerned, the registration of that vessel cannot be dissociated from the exercise of the freedom of establishment.

34. In this regard, it is sufficient to point out that a requirement for the registration of a vessel to the effect that it must be managed and its operations directed and controlled from within the Member State in which it is to be registered essentially coincides with the actual concept of establishment within the meaning of Article 52 et seq. of the Treaty, which implies a fixed establishment. It follows that those articles, which enshrine the very concept of freedom of establishment, cannot be interpreted as precluding such a requirement.

36. Consequently, the reply to the national court must be that it is not contrary to Community law for a Member State to stipulate as a condition for the registration of a fishing vessel in its national register that the vessel in question must be managed and its operations directed and controlled from within that Member State.

From Gebhard, it follows that the concept of establishment is very broad:

- allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his state of origin and to profit therefrom, so contributing to economic and social interpenetration with the Community in the sphere of activities as self-employed persons (emphasis added).

4.4. Case law supports source-based taxation

From the case law discussed in 4.2. and 4.3., it can be deduced not only that CLIN best satisfies the EC Treaty and that the concept of substantial income-producing economic activity matches very well the concept of economic activity in the EC Treaty, but also that CLIN supports an origin-based interpretation of “source”, or at least that it does not prevent such an interpretation.

4.5. Directives support residence-based taxation

On the other hand, the Parent-Subsidiary Directive, the Interest and Royalties Directive, and the Savings Tax Directive support residence-based taxation more than source-based taxation.139

The Parent-Subsidiary Directive shows clear traces of the principle of origin and CLIN. The aim of introducing tax rules that are neutral from the point of view of competition appeals to CLIN, as discussed above.140 A withholding tax on qualifying dividend payments is not allowed. The possible exemption at the level of the parent company for dividends received from a subsidiary is an example of applying both the principle of origin and CLIN. However, the Directive does not prescribe a system based only on these principles. The residence principle and CLEN are obviously present.141 The Member States have the choice of applying an indirect credit instead of an exemption from the tax base.

In the Interest and Royalties Directive, a choice was made to abolish the taxation of interest and royalty payments in the Member State in which they arise, whether the tax is collected by deduction at source or by assessment. The choice regarding interest underscores the broad impact of the residence principle and CLEN. On the other hand, the choice regarding royalties may generally be considered as being more in line with the principle of origin and CLIN because the state in which the royalties arise must refrain from taxing the royalty payments. In the draft Directive,142 the residence system implemented better approximated the principle of origin since the draft required that a company “qualify”, e.g. that its activities constitute an effective and continuous link with the economy of that Member State (draft Directive, Art. 3(1)(a)(i)). The draft would have coincided with the principle of origin if it had been supplemented with the following additional condition: the asset from which the royalty originates is used for pursuing the company’s economic activity, i.e. that the intangible property is managed, and its operations are directed and controlled, from within the Member State concerned. However, the final Directive does not include these conditions; consequently, it is further away from the principle of origin and CLIN than the 1998 draft.

The Savings Tax Directive also reflects to a large extent the dominance of the residence principle and

138. ECJ, 30 November 1995, Case C-55/95, Gebhard, Para. 25. Under EC law, the term “state of origin” means “home state” in this respect.


140. See e.g. de Hosson, Fred C., “The Parent-Subsidiary Directive”, Inter-tax 414 (No. 10, 1990), at 418-419.


The state of “residence for tax purposes” of the beneficial owner of the interest is in principle assigned tax jurisdiction with respect to the interest income. However, in contrast to the Interest and Royalties Directive, the Savings Tax Directive allows source-state taxation through a withholding tax. Austria, Belgium and Luxembourg apply the withholding tax system, whereas the other Member States apply the information system. The withholding tax is really based on the source principle as defined in this article, in particular, more on the paying-state principle, i.e. the state in which the economic operator, who is responsible for paying the interest for the immediate benefit of the beneficial owner, is established is entitled to levy a withholding tax. The principle of origin is explicitly overruled by the source principle, even more than once, see e.g. Arts. 1(2) and 4(1) of the Directive.

The debtor of the capital producing the interest is explicitly subordinated to the paying agent who pays the interest. It should be noted, however, that the residence state’s exclusive tax jurisdiction will be restored, i.e. no source-state taxation of the interest will be allowed, if the beneficial owner authorizes the paying agent to report information to his residence state or if he proves that he has properly informed the tax authorities in his home state. The residence principle has been further emphasized by the source state’s obligation to transfer 75% of its revenue to the residence state of the beneficial owner of the interest. Therefore, the source-state system is even applied to pursue predominantly the residence principle instead of the source principle.

**4.6. EC Treaty does not determine “source”**

As argued above, the ECJ’s case law supports an origin-based interpretation of “source”, or at least does not prevent such an interpretation. It must also be emphasized, however, that the EC Treaty does not determine the concept of “source”. As the ECJ stated in e.g. *Saint-Gobain*, the Member States are competent to determine the criteria for taxing income and wealth:

> In this regard, it must be observed first of all that, in the absence of unifying or harmonising measures adopted in the Community, in particular under the second indent of Article 220 of the EC Treaty (now the second indent of Article 293 EC), the Member States remain competent to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means, inter alia, of international agreements. In this context, the Member States are at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating powers of taxation as between themselves (see, to this effect, Case C-336/96 *Gilly*, [1998] ECR I-2793, paragraphs 24 and 30) (emphasis added).

Therefore, the EC Treaty does not force the Member States to accept a source-based income tax system or an origin-based interpretation of source. They may do so, but they are also free to use a residence-based income tax system. Their powers are not unrestricted, however. Whatever system the Member States choose, it must meet the standard that they must exercise their taxing powers consistently with Community law.

In conclusion, we see conflicting trends in EC law regarding source-based taxation. If an actual common market does not exist and 25 different income tax systems must be accepted, CLIN, source-based income taxation and an origin-based interpretation of source best satisfy the objectives and goals of the EC Treaty. The ECJ’s case law supports such an interpretation, or at least does not preclude it. On the other hand, the income tax directives are generally more in favour of residence-based taxation. In any case, the EC Treaty and the ECJ’s case law do not determine the concept of source.

**5. THE OECD MODEL: RESIDENCE-BASED FLAWS TRIGGER SOURCE-BASED CORRECTIVE ACTIONS**

Most of the current tax treaties reflect a mix of CLEN and CLIN, although CLEN seems to predominate. For example, the OECD and the UN have not chosen CLIN (tax exemption) or CLEN (tax credit), but have left it up to the contracting states. The US is clearly an adherent of CLEN, whereas the Netherlands inclines more to CLIN with regard to active income, but without doubt favours CLEN with regard to passive income. For persons who can invoke tax treaty benefits, the results under the current model tax conventions are not satisfactory. The residence principle, on the basis of which the subjects eligible for treaty benefits were established, may be identified as the (main) cause of the deficiencies. In principle, only a resident has access to a tax treaty and its benefits. Therefore, under the current system, it is of principal interest for a person wishing to benefit from a state’s treaty (network) to be a resident. Consequently, residence plays a key role in international tax avoidance, including treaty abuse, since a place of residence can be chosen or transferred in order to claim the desired treaty benefits without necessarily affecting the income-producing economic activity. None of the models mentioned in this article – the OECD, UN, US and Netherlands Models – covers the consequences of the change of residence of a person who ceases to be a resident of one contracting state and becomes a resident of the other. The legal form in which an income-producing economic activity is carried on may also have a large impact on eligibility for treaty benefits, again without necessarily affecting the income-producing economic activity. This also triggers tax arbitrage. Transparent and hybrid entities create complex problems and opportunities. The qualification depends on the circumstances and the interests to be served. In substance, the weakness of this residence-based concept has been acknowledged by the reactions of some states, e.g. the United States, as

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144. See e.g. Cardani, Angelo M., “European Taxation Policy, A Change of Tack”, in Breuninger, Gottfried E., Welf Müller and Elisabeth Strobl-Haar, (Munich: Verlag C.H. Beck, 1999), at 130-133; and Dourado, supra note 143, at 151.

145. See Kemmeren, supra note 13, at 214-219 and 222-236.

146. ECI, 21 September 1999, Case C-307/97, Saint-Gobain, Para. 56.

147. See e.g. id., Para. 57.

148. See Art. 22 of the US Model.
well as the OECD.\textsuperscript{149} The author refers, for example, to the introduction of limitation on benefits provisions, which generally limit the access to treaty benefits to residents who have a sufficient economic nexus with the state concerned. Such provisions, if fact, move away from the residence principle and come closer to the principle of origin.\textsuperscript{150} As a result of the influence of the residence principle, the income allocation rules in treaties were and are predominantly residence-based as well. The author refers, for example, to business income, dividends, interest, employment income, other income and capital gains as well as to personal allowances, reliefs and reductions. Regarding the income allocation rules, however, we may discover a move towards more source-based taxation because the residence-based allocation rules have led to unsatisfactory results.\textsuperscript{151} There are examples in some model conventions, e.g. the OECD, UN, US and Netherlands Models. Without providing an exhaustive list, the following examples may be considered as emphasizing source-based instead of residence-based taxation: international shipping and air transport (OECD, UN and Netherlands Models); branch profits tax (US Model); capital gains on shares in real estate companies (OECD, UN and US Models); artists and sportsmen, which allocation rule comes closest to the principle of origin (OECD, UN, US and Netherlands Models); private pensions (UN and Netherlands Models); social security payments (UN, US and Netherlands Models); other income (UN Model); non-discrimination of permanent establishments and foreign-held subsidiaries (OECD, UN, US and Netherlands Models) and the exemption method (OECD, UN and Netherlands Models). Although these developments may be considered promising, it will probably be a long time before there is a fundamental change in states’ policies regarding income tax treaties, i.e. moving away radically or at least substantially from a residence-based to an origin-based income tax system. However, sound economic policy for globalizing economies, improvement in the EC’s internal market, and the ECJ’s case law provide strong arguments in support of an origin-based system. Political timidity seems to be most obvious reason for not acting quickly in this direction. But the pace of globalization of states’ economies may force politicians to give up tax policies that may be considered out of date more quickly than they think politically appropriate at this time. Economics may be the inevitable driving force for accelerating to more origin-based income taxation.

6. ALTERNATIVE ORIGIN-BASED TAX SYSTEM: TAX TREATIES, EC DIRECTIVES AND DOMESTIC LAW

The discussion below outlines some key elements of an origin-based tax system which may be helpful in developing source rules for the 21st century. In this regard, not only will the rules of tax treaties need to be adjusted, but the provisions of the EC income tax directives will also have to be amended. It must be emphasized, however, that domestic tax systems will not necessarily need to be changed, but that could be contemplated as well if it is considered desirable to turn the domestic tax system unilaterally into an origin-based system. The origin-based system presented below is based on the concept of a tax treaty, which may be bilateral or multilateral. Even if CLEN is embraced as the leading economic policy and a tax credit system is applied, it is still possible to give the principle of origin a greater role than is done in the current treaties and model tax conventions.

In an origin-based treaty, the justification for allocating tax jurisdiction with respect to income and capital will be better. Origin-based rules identifying the eligible treaty subject, allocating income and capital, and eliminating double taxation will reduce significantly (at least) the deficiencies of the current models because the location of substantial income-producing economic activities is decisive for entitlement to treaty benefits and the allocation of tax jurisdiction with respect to income and capital. An appropriate allocation of tax jurisdiction with respect to e-commerce will also be better guaranteed. Tax arbitrage, including the (perceived) abuse of tax treaties, will be significantly reduced. It will not be easy to manipulate the allocation of tax jurisdiction without affecting the economic location of a substantial income-producing economic activity. The level playing field for enterprises, employees, artistes and sportsmen, debtors, lessors and lessees, and others will be improved because an origin-based system promotes CLIN. The efficient allocation of the production factors of labour and capital will also be improved. Consequently, the functioning of the EC’s internal market will be facilitated better than is currently the case. Developing states will be able to reduce the gap in economic development with developed states.

The following key elements are addressed: eligible treaty subject (this is not a source rule in a narrow sense, but it is included because it is essential to the system); business income (profits, dividends and capital gains on shares); interest and capital gains on debt claims; royalties and capital gains on the underlying intangible property; pensions; and personal circumstances.\textsuperscript{152}

6.1. Eligible treaty subject

The underlying concept is that a person who pursues or has pursued a substantial income-producing economic activity within a state is entitled to invoke that state’s tax treaties if the income or capital concerned must be attributed to that activity based on a functional analysis, i.e. the income or capital is or was functionally attributable to that activity based on a functional analysis. In an origin-based treaty, the justification for allocating tax jurisdiction with respect to income and capital will be better. Origin-based rules identifying the eligible treaty subject, allocating income and capital, and eliminating double taxation will reduce significantly (at least) the deficiencies of the current models because the location of substantial income-producing economic activities is decisive for entitlement to treaty benefits and the allocation of tax jurisdiction with respect to income and capital. An appropriate allocation of tax jurisdiction with respect to e-commerce will also be better guaranteed. Tax arbitrage, including the (perceived) abuse of tax treaties, will be significantly reduced. It will not be easy to manipulate the allocation of tax jurisdiction without affecting the economic location of a substantial income-producing economic activity. The level playing field for enterprises, employees, artistes and sportsmen, debtors, lessors and lessees, and others will be improved because an origin-based system promotes CLIN. The efficient allocation of the production factors of labour and capital will also be improved. Consequently, the functioning of the EC’s internal market will be facilitated better than is currently the case. Developing states will be able to reduce the gap in economic development with developed states.

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\textsuperscript{149} See Paras. 7 to 26 of the Commentary on Art. 1.
\textsuperscript{150} See Kemmeren, supra note 13, at 282-290.
\textsuperscript{151} See id. at 321-504.
\textsuperscript{152} For more details, see id. at 257-515.
tiation based on the legal form are eliminated, or at least substantially reduced. The same is true with respect to (abusive) treaty shopping through (hybrid) (legal) entities. As a consequence, a level playing field will be created which benefits CLIN and the development of the EC’s internal market. An economic liable-to-tax condition will be partly superfluous in this system.

In an origin-based system, an individual is entitled to invoke a tax treaty concluded by a state if he is:

1. a citizen of that state who is subject to tax because of his citizenship there;
2. a resident of that state who is subject to tax because of his domicile, residence or any other criterion of a similar nature in that state; or
3. (a) an individual who is neither a citizen nor a resident of that state but pursues or has pursued a substantial income-producing economic activity within that state and (b) the income or capital concerned must be attributed to that activity based on a functional analysis.

A resident cannot invoke the tax treaty between the residence state and the other contracting state if he can invoke the tax treaty between the other contracting state and a third state in which he pursues or has pursued a substantial income-producing economic activity to which the income concerned must to be attributed and if the residence state has also concluded a tax treaty with the third state. The same applies mutatis mutandis to a citizen in (1).

A person other than an individual is entitled to invoke a state’s tax treaty only if:

1. the person pursues or has pursued a substantial income-producing economic activity within that state; and
2. the income or capital concerned must be attributed to that activity based on a functional analysis.

From the perspective of the principle of origin, the activities of agents, whether or not dependent, should be attributed to the income recipient if the income received is in substance produced through the activities of the agents (i.e. they added the intellectual element) to the extent the benefits from their activities did not accrue to the agents, but were passed on to the income recipient. Not attaching much weight to whether a person or company operates through a dependent or independent agent will also contribute to more CLIN and to the EC’s internal market because the impact of the legal form of the operation on the allocation of tax jurisdiction will be reduced. The question of who is the income-producing agent should be considered on case-by-case basis.

If the income from a contracting state cannot be attributed to a single substantial income-producing economic activity in one state, the income should be attributed pro rata parte to all the relevant substantial income-producing economic activities in the contracting states with which the income is functionally connected. A functional connection exists if the property concerned is used for pursuing that economic activity, i.e. the property is managed, and its operations are directed and controlled, from within the state concerned.

To (better) ensure that the income so attributed is taxed in the contracting state of the substantial income-producing economic activity, the suggested rule should be supplemented as follows. The contracting state in which the substantial income-producing economic activity occurs is entitled to and will tax the income flowing from the other contracting state attributable to that activity the same way the state taxes such income in the hands of its residents (and citizens, if applicable).

With respect to capital taxes, a similar system should apply based on the economic location of the capital.

6.2. Business income: profits, dividends and capital gains on shares

In an origin-based system, tax jurisdiction with respect to business profits is allocated to the contracting state in which a person’s enterprise carries on its substantial entrepreneurial activities. As a consequence, all income, whether it arose in the contracting state in which the entrepreneurial activity is carried on, in the other contracting state or in a third state, is taxable only in the state of the substantial entrepreneurial activity, unless another income allocation rule of the relevant tax treaty derogates from this rule. A substantial entrepreneurial activity is present if the relevant entrepreneurial activity in a state forms an essential and significant part of the entrepreneurial activity of the enterprise as a whole.

For treaty purposes, the term “enterprise” is defined as an independent and durable organization which aims to participate in economic life by means of labour or a combination of labour and capital with the purpose of making a profit, which profit must reasonably be expected. This definition satisfies the freedom of establishment (Art. 43 of the EC Treaty). The distinction between entrepreneurial activities and independent personal services has been disregarded. As a rule, services or activities cannot be performed at any place other than where the individual performing them is physically present. The decisive point is where that person works, not where the results of his work are exploited.

The enterprise, as defined, must then be attributed to a person who can invoke the tax treaty. This attribution should be guided by the question: For whose account is the enterprise carried on? This person is relevant only in the third phase. First, it must be determined whether there is an enterprise, and second, if so, where that enterprise carries on its substantial entrepreneurial activities; third, it must be determined to whom the substantial entrepreneurial activities should be attributed. This makes a tax treaty less vulnerable to abuse since real economic activities with a sufficient nexus to the state determine the allocation of tax jurisdiction with respect to business income; this rule applies whether or not tangible property with a(ny) degree of permanence is used, or whether or not a person can be considered to conclude contracts in the name of a principal, in order to create or avoid a permanent establishment, as under the current systems.
Under the principle of origin, the concepts of permanent establishment, fixed base and agency permanent establishment are considered to constitute unnecessary conditions. It is sufficient that an individual pursues substantial activities for an enterprise in the state concerned: an enterprise carries on or has carried on a substantial entrepreneurial activity in the other contracting state if that activity, carried on by individuals attributable to the enterprise, in itself forms or has formed an essential and significant part of the activity of the enterprise as a whole (“a branch”). If income is attributable to a branch, but is deferred and received after the branch ceases to exist, tax jurisdiction with respect to the deferred income is assigned to the state in which the branch was situated.

The activities of individuals are attributed to the enterprise if the activities are for its account. It does not matter whether the individuals carry on the activities concerned as dependent agents or as independent agents.

If it is considered desirable to define the term “substantial” more precisely, this could be done by reference to the proportionate share of the entrepreneurial activities in the other state, the nature of the activities performed, and the relative contributions made in each contracting state to the entrepreneurial activities. For practical reasons, safe harbours could be introduced. If a minimum period of human activity is considered to be a desirable threshold for practical reasons, the minimum periods for any item of income should be harmonized as much as possible, unless the nature of the activity indicates otherwise. Since a state is assigned tax jurisdiction only if the entrepreneurial activities in that state are substantial, auxiliary and preparatory activities are excluded; so far, the alternative system will, to a certain extent, operate comparably to the current system.

If an enterprise of a person carries on substantial entrepreneurial activities in both contracting states, the profits must be allocated to both states based on the amount of income produced in each state. The attribution of profits to each part of the enterprise must be neutral. The legal form of that part of the enterprise, a branch or a subsidiary, should be irrelevant since the proportionate share of the entrepreneurial activities must be attributed to the part concerned and should so as little as possible. In determining whether income is produced in one state or the other, the arm’s length principle is decisive.

The expenses incurred for the purposes of each branch should be attributed to the part concerned and should be deductible regardless of where they were incurred. If the expenses cannot be attributed to a single part, they should be attributed pro rata parte. If, for example, a head office in one state supplies funds from the equity of the enterprise to finance substantial entrepreneurial activities in another contracting state, economic reality implies that the activities are financed with equity, not with debt. Labelling such funds as internal debt does not change this economic reality. Economic reality prevents an internal flow of interest from a substantial entrepreneurial activity to a head office. Assuming that tax neutrality requires that the profits derived in the state of investment be taxed, it would be equally non-neutral to deduct the interest paid or deemed paid to the parent company from the subsidiary’s gross income and to add it to the parent’s income if the parent supplies funds from its equity to finance the substantial entrepreneurial activities of its subsidiary in another contracting state. Funds borrowed from third parties which are channelled through the head office or parent should be taken into account at the level of the branch or subsidiary. However, tax jurisdiction with respect to the interest should be assigned to the same state because the interest paid was created through substantial entrepreneurial activities within that state. This way, it is also possible to achieve neutrality between equity and debt financing. Especially where it concerns the relationship between the head office and another substantial entrepreneurial activity of an enterprise of the same taxpayer, the issue of internal interest will not have any, or hardly any, practical relevance. For both theoretical and practical reasons, the author suggests that internal interest calculations not be made under the alternative system if funds are transferred only within an enterprise. If, however, goods or services are internally transferred, it might be appropriate to take the internal interest into account as part of the arm’s length conditions. Goods and services supplied by the head office or parent company to a branch or subsidiary should be treated the same as supplies to third parties. When (in)tangibles are transferred internally, the economic activity will change as a rule. Therefore, an internal rent or royalty can be justified based on economic reality, the principle of origin and the arm’s length principle.

If an enterprise carries on (substantial) entrepreneurial activities in states with which the enterprise’s or branch’s state does not have a bilateral tax treaty or if it carries on non-substantial activities in third states with which there are origin-based treaties, the income produced by such activities should be attributed to the branches with which the non-substantial activities are functionally most closely connected, and consequently to the contracting state in which the branches operate. This alternative system is a closed system regarding business profits. In this respect, it should be noted that, in an origin-based system determining the eligible treaty subject, it is stipulated that the income attributed to substantial income-producing economic activities in a contracting state with which it is functionally connected could be taxed in that contracting state. The contracting state in which the substantial income-producing economic activity takes place may tax the income from the other contracting state attributable to that activity the same way as the state taxes such income derived by its residents (or citizens).

Based on the principle of origin, tax jurisdiction with respect to dividends and capital gains on shares must be assigned to the state in which the profits were produced, which is not necessarily the state in which the paying company is resident. The allocation of tax jurisdiction with respect to a company’s profits, the dividends paid on its shares, and the capital gains on its shares is harmonized in order to avoid both international juridical and economic double taxation. The shareholder’s state should refrain from taxing the company’s profits, the capital gains on its shares and the dividends received by the shareholder. It should be noted, however, that the suggested allocation rules do not compel this state to apply an income exemption
system as a method to eliminate double taxation. The suggested allocation rules can also be applied under a system based on capital-export neutrality.

If the company carries on its enterprise in its residence state, the state of origin and the residence state coincide. If the enterprise also carries on substantial business activities in the other contracting state (a branch), the residence state and the state of origin do not coincide. In this case, a branch profits tax must play a role to ensure that the assignment of tax jurisdiction with respect to profits is neutral regarding the legal form in which the business activities are carried on, i.e. it does not matter whether a subsidiary pays out its profits to its shareholder or a branch transfers its profits to its head office. The same goes for capital gains. The systems are harmonized in order to avoid both international juridical and economic double taxation irrespective of whether the substantial entrepreneurial activities are carried on directly by a sole proprietor, through a branch, or through a company.

A capital tax should tax the possession, not the production, of wealth. If a state provides the legal framework and/or physical infrastructure to establish and preserve business property, the state is justified in taxing its possession. The economic location of immovable property is the situs state. With respect to movable business property situated in a state, allocating to this state the right to tax the mere possession of that property is also justified. Tax jurisdiction with respect to the possession of intangibles is allocated to the state under whose legal system the intangible was established and will be preserved. No special rule regarding debt is required.

6.3. Interest and capital gains on debt claims

Among other things, an origin-based system with respect to interest and capital gains on debt claims significantly reduces the current tension between equity and debt financing and mitigates (abusive) rule shopping.

The debtor is considered the originator of interest income. The state in which the debtor produces the interest income, which is not necessarily the residence state of the debtor, is awarded unlimited tax jurisdiction with respect to interest. Capital gains on debt claims are allocated to the same state. The expenses incurred for purposes of the interest income or capital gains are deductible.

A feasible system can be created by means of the information available in the state of origin, which will facilitate combating tax fraud. Tax neutrality will be improved, and this will also enhance the EC’s internal market.

With respect to interest received through an intermediary, e.g. a bank, a further refined origin-based system may be developed. Unrestricted tax jurisdiction with respect to the interest will be allocated to the state of the debtor of the bank. This state must take into account the bank’s spread as a deductible expense. The spread is attributed to the state in which the banking activities are carried on.

If neither of the two contracting states can be considered the true state of origin, we rely on the presumption that the debtor’s contracting state from which the interest payment is made is the state of origin for purposes of attributing tax jurisdiction with respect to the interest under the tax treaty, unless it is proved otherwise. The debtor’s contracting state is the state in which the debtor carries on his relevant income-producing economic activities or, if this state cannot be identified, the state in which the debtor, being an eligible treaty subject in an origin-based system as described in 6.1., is situated. In substance, the principle of source is then applied.

Regarding triangular situations, the tax treaty between the bank’s state (State B) and the residence state of the interest recipient (State R) must stipulate that State R will not waive its tax jurisdiction if the interest paid by an intermediary, e.g. a bank, in State B did not originate in State B or in a state with which State R has a tax treaty. Earmarking at the level of the bank of its interest earned abroad makes such a system feasible. If there is a direct connection between the funds deposited by a saver at a bank and the loans issued by that bank, the earmarking is easy to apply. If such a connection cannot be found, a pro rata parte approach may provide a feasible result. State R will waive tax jurisdiction with respect to the interest received by a saver based on certain formulas. To reduce the administrative burden on the saver, the ratio mentioned above could be exchanged between the tax administrations of the contracting states in a digitized format and, if considered appropriate, only upon the request of the saver in his tax return.

Example 1 provides a simple example illustrating how an origin-based system will operate.

Example 1
periodical payment). Royalties are subdivided into four parts:
(1) compensation for write-offs on the original market value of the intangible property concerned;
(2) compensation for maintaining the intangible property;
(3) compensation for bearing the risks; and
(4) an interest component.

The first three components are attributed to the state in which the lessor performs his activities, which is probably the place of his entrepreneurial activities. Consistent with an origin-based system with respect to interest as discussed above (see 6.3.), the interest component is attributed to the state in which the lessee performs his activities, i.e. the state in which the intangible property is used.

To the extent that separating the interest component in a particular case is considered burdensome, a fixed part (percentage) of the royalty could be classified as interest.

The expenses incurred for purposes of each of the royalty components are attributed to the component concerned and should be deductible. If the expenses cannot be attributed to a single component, they are attributed pro rata parte.

By changing tax treaties and the model conventions as proposed, the author thinks that a conflict of income classification (royalty or business/personal services income) which may arise under the UN Model will be resolved.

Regarding capital gains on copyrights, patents, trademarks, etc., the same rules apply in an origin-based system as apply to royalties, although the interest component may be considered not to constitute part of the gain concerned.

Due to the nature of intangible property, e.g. debt claims and patents, the possession of intangible property is related to the legal system under which the property was established and will be preserved rather than to the place where e.g. the loan agreement or the patent is physically present. Tax jurisdiction with respect to the possession of intangible property (capital tax) is allocated to the state under whose legal system the property was established and will be preserved.

6.5. Pensions

In substance, a pension payment consists of two components: (a) the contribution to the pension plan and (b) the growth of the contribution due to the pension fund’s investment of the money in e.g. real estate, shares and loans (the “accretions”).

The origin of the first component is the employment activity. The state in and from which the employment activity was usually or substantially exercised is entitled to tax this part of the pension payment. This component is simply deferred salary. One of the advantages is that the risk of double taxation or non-taxation as under the current treaty system due to the disparity in the tax systems regarding the deduction of pension contributions and the taxation of pension payments will be eliminated or at least reduced. Such a system is considered feasible because the pension fund should be able to trace the states in and from which the retired person concerned usually or substantially exercised his employment activity to which his pension contributions relate. If, however, the number of states involved is considered an impediment for the operation of such a system, the number can be reduced by attributing tax jurisdiction only to the states in and from which the retired person usually exercised his employment activity. If the number of states involved is still considered too many, the number could be further reduced by attributing tax jurisdiction only to the most substantial states in and from which the retired person usually exercised his employment activity, not exceeding a certain number states (e.g. five). This number will always be arbitrary.

The tax jurisdiction with respect to the second component of the pension payment (the accretions) should not be allocated either to the state where the employment was exercised or to the residence state of the pension fund. The tax jurisdiction with respect to the income from e.g. real estate, shares, loans, etc., derived by the pension fund was already attributed to the respective states of origin under the tax treaties concerned. These states should take into account part of the pension fund’s fee as a deductible expense since the pension fund in substance connects the markets of capital suppliers and capital demanders.

The origin-based system developed for pensions not only guarantees better tax neutrality, especially CLIN, but also improves the functioning of the EC’s internal market regarding the different national tax systems. It is also consistent with the subsidiarity principle.

Example 2 is a simple example illustrating how the origin-based system will operate.

6.6. Personal circumstances

Personal allowances, reliefs and reductions must be taken into account in the state of origin of the active or passive income, if necessary, pro rata parte if more than one state of origin is involved in order to prevent their utilization twice (or more). This way, the faculty principle will be satisfied on a structural basis as well as the principles of sovereignty and subsidiarity, CLIN and the fundamental freedoms of the EC Treaty. An origin-based allocation of personal allowances, reliefs and deductions is essential under both the exemption method and a tax credit system.

An origin-based system is not only justified or equitable, neutral and consistent with the EC’s internal market, but it can also be implemented feasibly. A person who wants to use his personal circumstances for tax purposes may be asked to provide the necessary information and to cooperate in this respect. In order to consider those circumstances, a state may require that the necessary information be provided with the tax return. New technologies, such as the Internet and intranets, make it possible for tax administrations to exchange the necessary information more easily than previously. The exchange of information could be made dependent on the person’s consent, e.g. by checking a box on the tax return. If such consent is not given, no personal allowances, reliefs or reductions
need to be granted. This way, the loss of tax revenue can be prevented. With respect to taking into account e.g. personal circumstances regarding interest received through an intermediary, information could be obtained consistently with the system developed in order to determine the relief for double taxation in the residence state (see 6.3.).

If the origin-based system is considered too complicated with respect to income received via intermediaries, e.g. dividends via investment companies and interest via banks, alternative approaches can be contemplated. A possible solution is for the investor’s residence state to take into account his personal circumstances, even if the dividends and interest are exempt from tax in that state, and for the state of origin to compensate the residence state for the loss of tax revenue concerning the personal allowances, reliefs and reductions attributable to the income received via intermediaries which originated in the state of origin. This way, the administrative burden on the investor may be reduced significantly, and the principle of origin may be satisfied at the highest possible level. If this system is also considered too complicated or undesirable, the author’s suggestion is to apply a system in which the residence state takes into account the personal circumstances attributable to income received via intermediaries without restriction and without a clearing mechanism.

7. SUMMARY AND CONCLUSIONS

The principle of source is commonly used by tax legislatures, judges and scholars. The term “source”, however, is not always clearly defined and is used in various meanings.

In globalizing economies, the concept of “source” should be interpreted based on the principle of origin. Taxation based on this principle justifies a state taxing the income created within that state, i.e. the cause of the income is within the territory of that state. That state makes it possible to derive income or acquire wealth. Only individuals, not things, can create income. The intellectual element is the key component in producing income. Value may be added to things by the actions of an individual, whether or not he uses a device. The place of origin of an individual’s income is where his income-producing economic activity takes place. If the income is produced to a substantial extent through the activities of an independent person (i.e. he is the person who adds the intellectual element) and the benefits from the activities are passed on to another person (i.e. the income recipient), the income originates with the independent person (i.e. the originator), not with the recipient. Only substantial income-producing economic activities should be taken into account. An income-producing economic activity is substantial if it forms an essential and significant part of the economic activity as a whole.

In the context of a capital tax, “origin” might not be the most appropriate term because a capital tax is justified by the possession, not production, of wealth. In this respect, the term “economic location” is preferred. If a state provides the legal framework and/or physical infrastructure for establishing and preserving property, the state is justified in taxing the possession of that property.

From the perspective of an optimal allocation of the production factors, investments should be made where production is the cheapest, and the production should be done by the person who can do so most cheaply. In globalizing economies, CLIN fosters efficiency; a CLEN-based system does not. Business competes with business, not owners with owners. The real trade-off is whether the activity will be carried on by a foreign-based firm or a domestic-based firm. CLIN supports an origin-based interpretation of the term “source”.

EC law contains conflicting trends regarding source-based taxation. If an actual common market has not been established and 25 different income tax systems apply, CLIN, source-based income taxation and an origin-based interpretation of source best satisfy the objectives and goals of the EC Treaty. The ECJ’s case law supports such an interpretation, or at least it does not contradict it.
not preclude it. On the other hand, the income tax directives generally favor residence-based taxation. In any case, the EC Treaty and the ECJ’s case law do not determine the concept of source.

The current residence-based system of tax treaties has necessitated source-based corrective actions, such as introducing limitation on benefits provisions, allocating capital gains on shares in real estate companies to the situs state, and allowing the state in which a permanent establishment is situated to levy a branch profits tax. The treaty system is moving slowly towards source-based taxation. The most obvious reason for not acting quickly in this direction appears to be the lack of political will, but the pace of globalization worldwide may force politicians to give up (possibly) out-of-date tax policies more quickly than they otherwise would. Economics may be the inevitable driving force for more origin-based income taxation.

This article has presented some key elements of an alternative origin-based tax system which may be helpful in developing source rules for the 21st century. The rules of the current tax treaties need to be adjusted; in addition, the EC income tax directives should be amended. Domestic tax systems, however, need not necessarily to be changed.

In conclusion, an origin-based interpretation of “source” should prevail in tax treaties and the EC income tax directives because it is justified and feasible, it improves the efficiency of globalizing economies and the EC’s internal market, it enables developing states to reduce the gap in economic development with developed states, and it improves worldwide prosperity.