



University of St.Gallen

Institute for Law and Economics

Finding the Meaning of Nexus for Taxes – Past, Present, and Future

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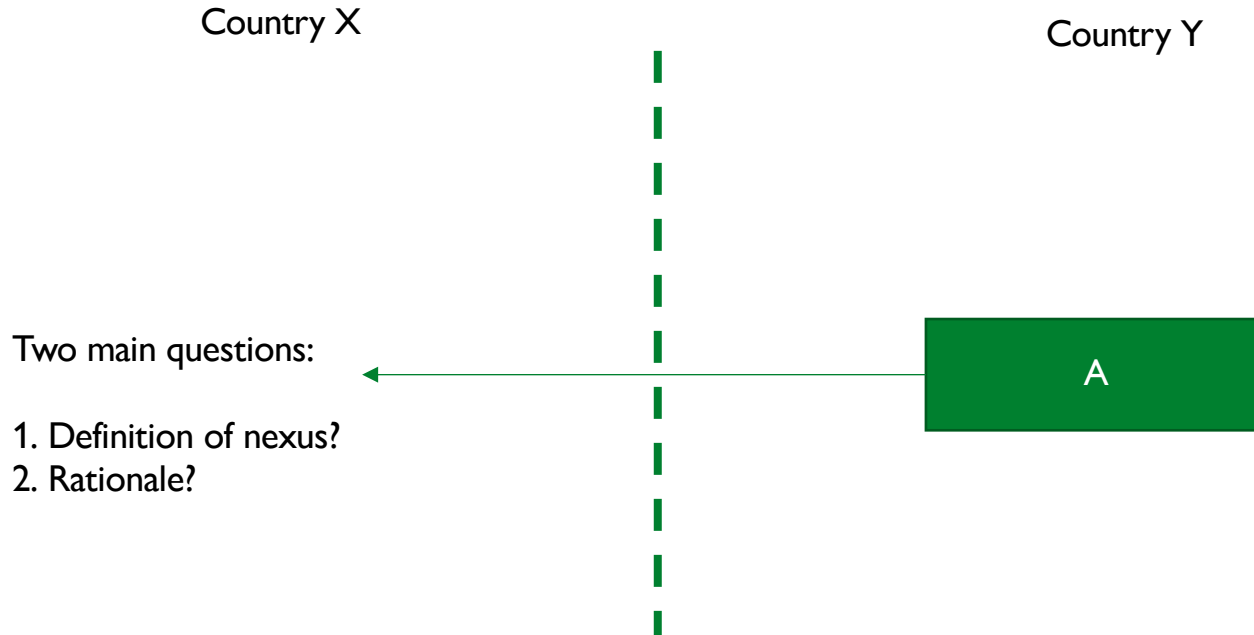
From insight to impact.

Agenda

1. Overview
2. International Law
3. General Conclusions

Overview

Overview



Terms used

Terms used to define tax nexus:

- (i) situated within**
- (ii) sourced in**
- (iii) arising in**
- (iv) property in**
- (v) listed in**
- (vi) attached to**
- (vii) incorporated in**
- (viii) has assets or business in**
- (ix) connected to**
- (x) (substantial) interest in**
- (xi) deemed to be in**
- (xii) economically linked to
etc.**

Taxes Covered (Extract from the Directives)

4.3 Income Tax

4.3.3 Dividends

4.3.4 Interest

4.3.5 Royalties

4.3.6 Income from the sale of goods

4.3.7 Income from services (general and specific)

4.3.8 Pensions

4.3.9 Employment income and director fees

4.3.10 Capital gains

4.3.11 Payments or transactions between foreign persons

Taxes Covered (Extracts from the Directives)

- 4.4 Value Added Tax (or General Sales Tax)
- 4.5 Real estate taxes.
- 4.6 Natural resources and energy taxation
- 4.7 Other (indirect) taxes
 - 4.7.1 Financial transfer tax
 - 4.7.2 Stamp duty (incl. taxes on insurance premiums)
 - 4.7.3 Customs & excise duties
 - 4.7.4 Inheritance or wealth taxes
 - 4.7.5 Digital services or economic activities
 - 4.7.6 Shipping
 - 4.7.7 Other taxes
 - 4.7.8 Specific issues concerning federal/regional tax systems
- 4.8 (Non-tax) Legal instruments & tax nexus
- 4.9 Nexus and legality (discretionary tax regimes)
- 4.10 Outlook and current policy debates
- 4.11 Overall assessment

International Law

Special Rapporteur – Professor Cedric Ryngaert

- Topical Report on “Nexus and International Tax Jurisdiction” by a pre-eminent international lawyer in the field of State jurisdiction.
- Highlights include
 - Explains why international law of jurisdiction is relevant for tax law
 - What counts as the outer limits of an acceptable tax nexus?
 - Explains how international law can evolve in this sphere
 - What is the methodological approach that should be followed
 - Considers 3 possible areas where acceptable nexus may be shifting in tax law:
 - nationality-based jurisdiction;
 - anti-avoidance jurisdiction; and
 - market-/profit-based jurisdiction

General conclusions

1. Is there an ideal tax nexus rationale from a policy perspective?

2. Are there trends in how legal systems developed or were reformed?

Trends

- Changing nexus definitions is not a very recent phenomena but a necessary feature of multi-tax systems with a need to consider societal changes.
- Nexus definitions highly depend on how each tax is designed.
- Consumption related nexus definitions have proven to be effective nexus definitions in other fields.
- Automation/digitalization will lead to an alignment of nexus definitions used for active income and for passive income (see Art. 12A UN MC)
- International private law coordination rules have become less important (but some legacies are now all pervasive and irreversible)
- Vast differences in operation of tax nexus rules: Who works out jurisdictional tax connection in actual cases? The Revenue, Parliament, or the Judiciary?
- Inconsistent spatial limitation of the payor's tax residence as connecting factor, e.g. when payment concerns a foreign business activity/PE (discernable trend for royalty income, but not much else). Cause of constitutional conflicts in India and Germany.

3. Can tax nexus be divorced from the economic structure of a country?

4. The way tax residence is defined can look like source tax nexus

5. What could be a general legal standard/s to adjudicate the limits of tax nexus?

What is a sufficient link?

Example 1: Antitrust law

EU

NON-EU

Merger



Concentration has a foreseeable immediate and substantial effect in the EU

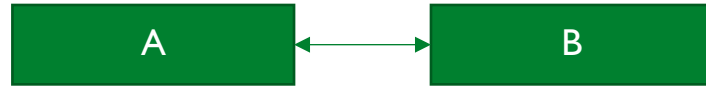
What is a sufficient link?

Example 2: Corporate income tax law

EU

NON-EU

Merger

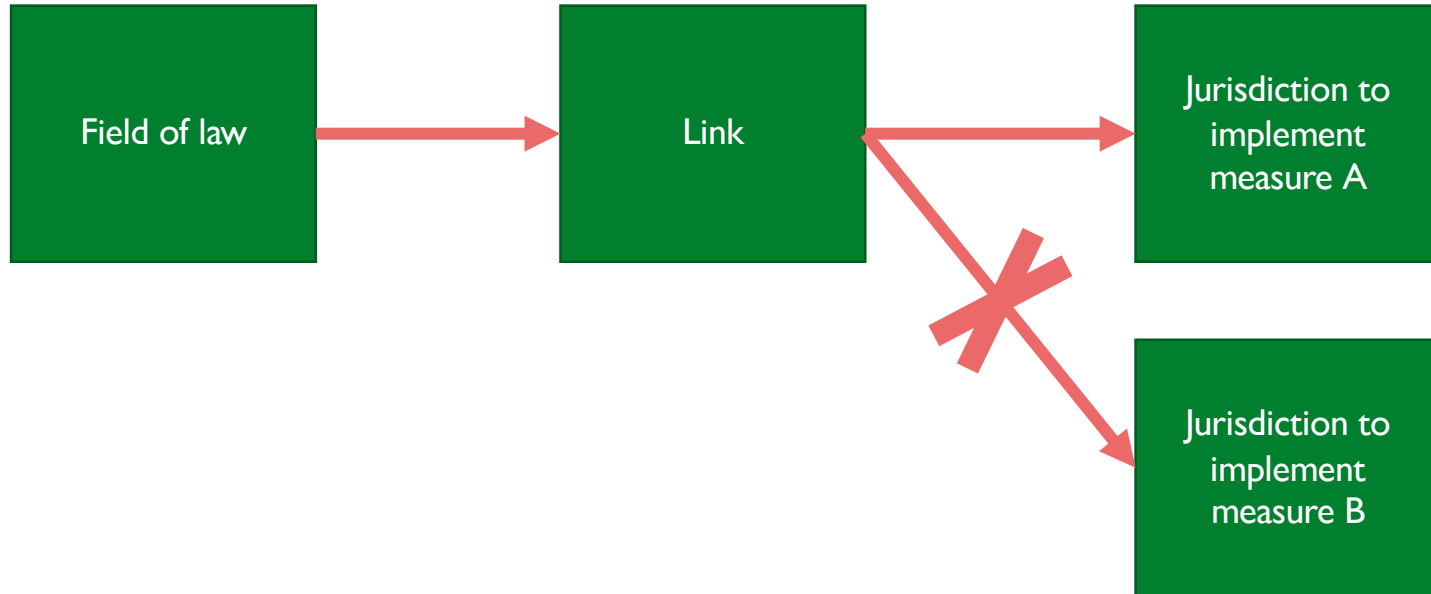


Concentration has a foreseeable immediate and substantial effect in the EU

Is «the EU» allowed to tax A and B as corporate tax payers?

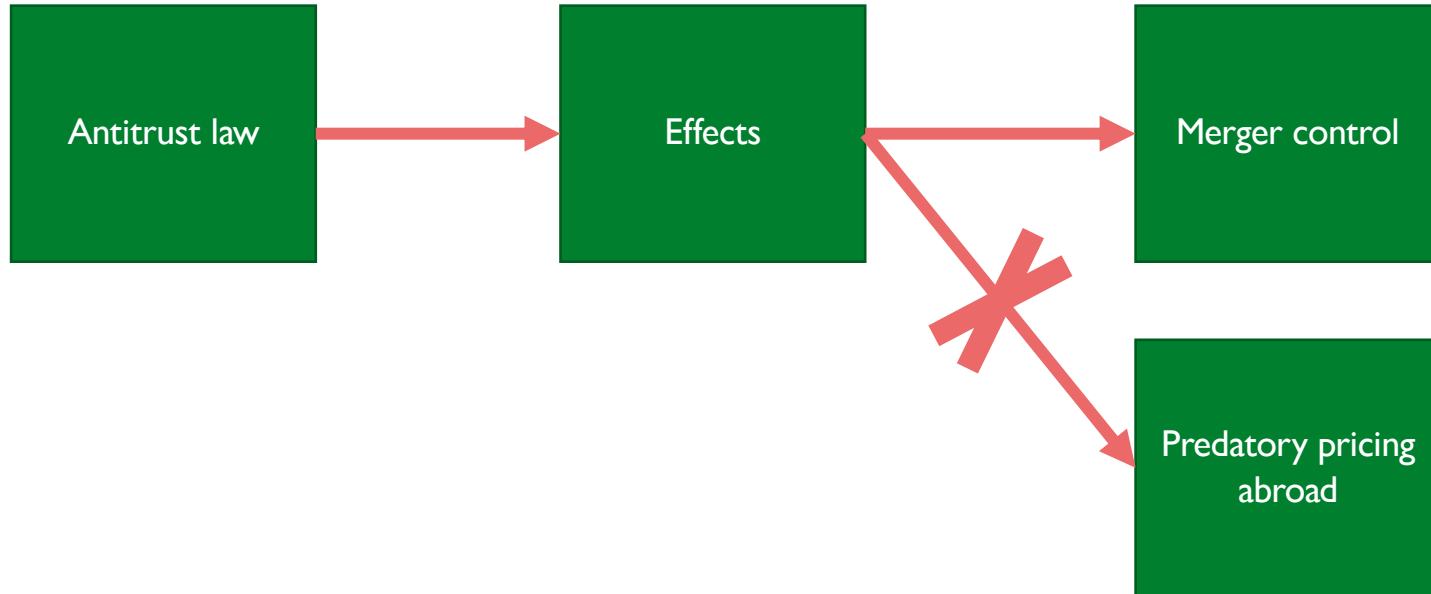
What is a sufficient link?

Each link justifies jurisdiction to a certain extent in a certain field of law



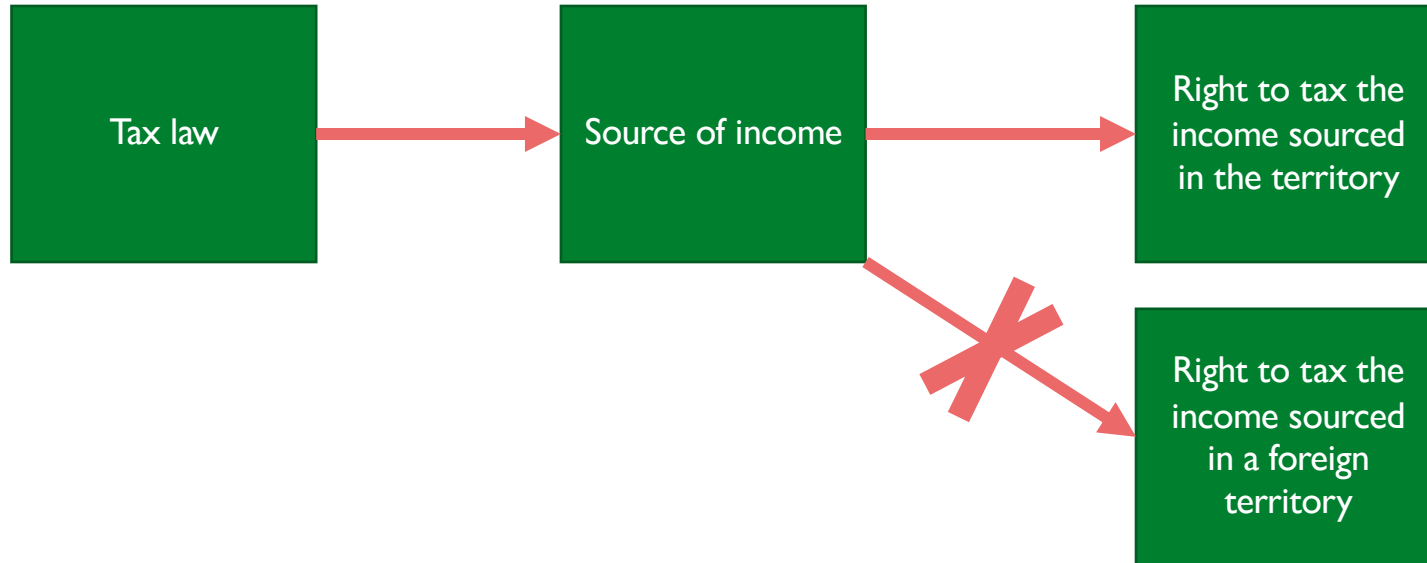
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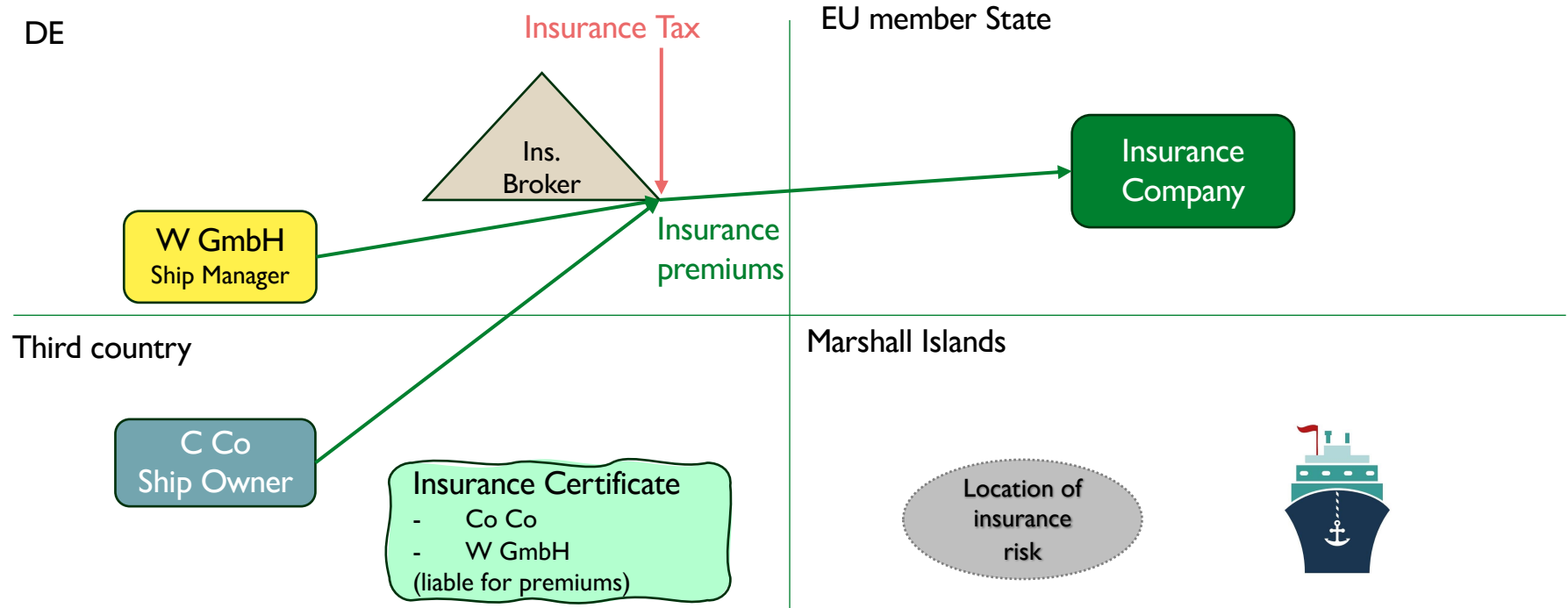


What is the legal base?

1. Customary international law
 - *Opinio iuris*
 - State practice
2. Legal precondition of the international law regime
3. Domestic legal standard
4. International treaties (e.g. friendship agreement GER-US)

Impact of international law: “sufficient appropriate nexus” in Germany

Bundesfinanzhof 12 November 2020, V R 41/18, BFHE 271, 470



General law limits on state jurisdiction to tax

Conclusion from comparative exercise:

- "Genuine link" theory generally used in shipping tax regimes (tonnage tax, demurrage, income tax incentives) of sea faring nations because this international law standard was codified in UNCLOS, which is used for national flag shipping regimes linked to tax rules.
- No evidence from the branch reports that international law and its theories about state jurisdiction is overtly/widely considered or debated in tax policy making for other taxes or industries (this is perhaps different for Pillar Two due to academic debates) BUT important landmark court decisions in Germany and India where apex courts relied on international law to limit legislative competency to prescribe jurisdictional rules for other taxes.

For fiscal policy making in a national setting, are there other legal sources and standards that are not confined to international law (but could also be present in international law)?

1. Proportionality as a universal legal norm.
2. The legal standard of reasonableness (but debated whether a general legal principle in international law)

Propositions: 1. the type of fiscal instrument, its purpose and its aim/s matter a great deal in the legal analysis. 2. The effects of a fiscal instrument are important in this analysis.

Relevant factors to adjudicate whether a tax nexus is proportionate

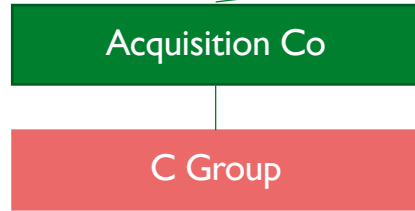
1. The nature of the fiscal instrument, its purpose and its aim.
2. The importance of the purpose of the nexus.
3. The nature and the extent of the nexus.
4. The relation between the extent of the nexus (3) and its purpose (2)
5. Are there less restrictive means to achieve the purpose?

Normative test for the outcome of the proportionality analysis:

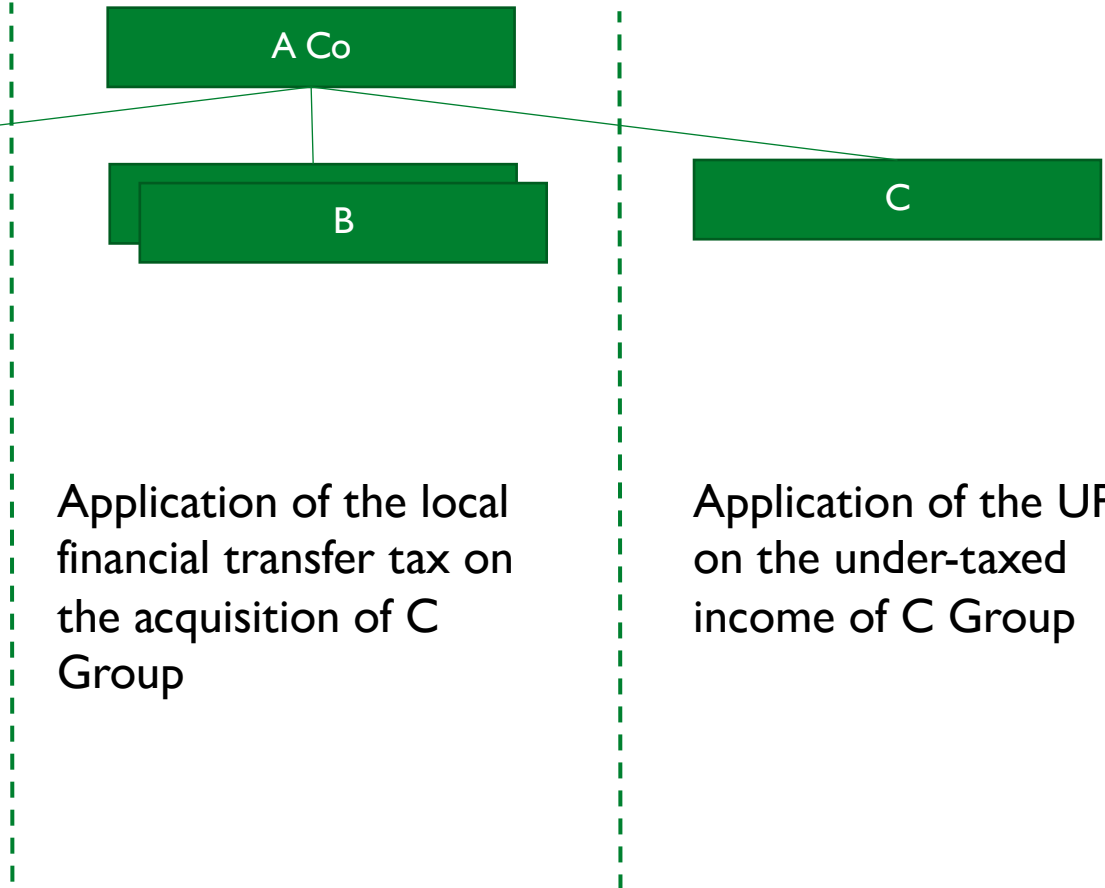
The effect of the tax nexus must be justifiable in the final instance in a society founded on the equality of nations (and the principle of non-interference).

This means not in a closed, authoritarian society based on the violation of human dignity, equality and freedom of foreign persons from other nations.

Conclusive example



ETR 12%



Application of the local financial transfer tax on the acquisition of C Group

Application of the UPTR on the under-taxed income of C Group

Thank you!

See you in Cape Town

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