ARTICLES

SITUATING THE INTERNATIONAL TAX SYSTEM WITHIN PUBLIC INTERNATIONAL LAW

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Abstract

References to an international tax system are not uncommon. Some references qualify the international tax system by making it specific to a particular jurisdiction, such as the U.S. international tax system. Other references are without qualification and appear to refer to an international tax system that is applicable to states in general. The question as to whether an international tax system that is generally applicable to states exists has been the subject of debate among many academics. The debate assumed new dimensions when its proponents claimed that the system is founded upon both treaty-based and customary international law. In this regard, it is argued that the norms of customary international law—the single tax principle and the benefits principle—form the foundation of the international tax system. This Article seeks to delineate the boundaries of the international tax system within public international law by weighing some of the norms and rules described as underlying the international tax system against sources of public international law.

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I. INTRODUCTION

References to an international tax system have long been made by tax practitioners, academics, and policy makers.[1] Whereas some of the references seem to set the confines within which the international tax system operates by specifically referencing, for example, a "U.S. international tax system," others have simply referred to an "international

1. The "international tax system" is also referred to as the "international tax regime."

tax system."[2] It would appear that the unqualified reference to an international tax system connotes a system that transcends the territorial boundaries of any particular state. To illustrate, the Organization for Economic Co-operation and Development (OECD) stated that "[t]he endorsement of the *Action Plan on Base Erosion and Profit Shifting* . . . by the Leaders of the G20 in Saint-Petersburg in September 2013 shows unprecedented political support to adapt the current international tax system to the challenges of globalisation."[3] It was again referenced in a U.S. Senate Report in relation to the passage of the laws on dual consolidated losses as follows: "[t]he committee does not believe that the United States Senate wittingly agreed to an international tax system where taxpayers making cross-border investments, and only those taxpayers, could reduce or eliminate their U.S. corporate tax through self-help and gain an advantage over U.S. persons who make similar investments."[4] But what exactly is this international tax system? Is it a system that has developed through the express consent of states as described in the Senate Report such that it is comprised of "certain legal and accounting conventions layered over a network of bilateral tax treaties"?[5] Or is it one that may be binding on states regardless of their express consent?

To answer these questions, this Article will review sources of international tax rules through the lens of public international law to identify the rules that may be applicable on the public international law plane and those that may be confined to domestic law. This review is significant to the drive towards adapting current international tax practices to the challenges of globalization in at least two respects. First, if the principles underlying the international tax system form part of customary international law, then the outcomes of international initiatives to adapt current international tax practices (e.g., the negotiation of a multilateral instrument by the OECD) should not permit reservations by states regarding provisions that reflect customary international law, except to the extent that the outcomes are, by themselves, a deviation

2. *See, e.g.*, S. REP. NO. 99-313 (1986); BERNARD D. REAMS, JR. & MARGARET H. MCDERMOTT, TAX REFORM 1986: A LEGISLATIVE HISTORY OF THE TAX REFORM ACT OF 1986: THE LAW, REPORTS, HEARINGS, DEBATES AND RELATED DOCUMENTS [i], 422 (1986); *What are the consequences of the US International Tax System?*, TAX POLICY CENTER, https://www.taxpolicycenter.org/briefing-book/what-are-consequences-us-international-tax-system.

3. OECD, DEVELOPING A MULTILATERAL INSTRUMENT TO MODIFY BILATERAL TAX TREATIES, ACTION 15 - 2015 FINAL REPORT 9 (2015) [hereinafter OECD REPORT].

4. S. REP. NO. 99-313, *supra* note 2, at 422.

5. Kimberly Clausing et al., *U.S. Corporate Income Tax Reform and Its Spillovers* 4 (IMF Working Paper No. 16/127, 2016).

from customary international law. Second, the mere fact that a state refuses to accede to a negotiated agreement that effectively codifies aspects of customary international law does not constitute a termination of that state's identical obligations under customary international law.

The Article is structured as follows: Part II will discuss sources of public international law in light of their potential to support an international tax system. Part III will scrutinize some of the claims made in favor of the international tax system, while Part IV concludes.

II. Sources of Public International Law

Article 38 of the Statute of the International Court of Justice (ICJ) is generally considered to be one of the most authoritative pronouncements on the sources of public international law.[6] Article 38 provides as follows:

> (1) The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states; (b) international custom, as evidence of a general practice accepted as law; (c) the general principles of law recognized by civilized nations; (d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law. (2) This provision shall not prejudice the power of the Court to decide a case *ex aequo et bono*, if the parties agree thereto.[7]

Some may conclude from the layout of Article 38's provisions that international conventions take precedence over the other sources by virtue of their being listed first. A more accurate reading of the Article, however, is that it sets out primary and secondary sources without creating a hierarchy among the primary sources.[8] The secondary sources found in Article 38(1)(d) are subsidiary means by which the law

6. *E.g.*, MARTIN DIXON, TEXTBOOK ON INTERNATIONAL LAW (7th ed. 2013).

7. Statute of the International Court of Justice art. 38, Oct. 24, 1945, 59 Stat. 1031, T.S. 993, https://www.icj-cij.org/en/statute (emphasis added) [hereinafter ICJ Statute].

8. JAN ARNO HESSBRUEGGE, HUMAN RIGHTS AND PERSONAL SELF-DEFENSE IN INTERNATIONAL LAW 25 (2017). The phrase "in the order following" was deleted during the drafting of article 38(1), thus effectively eliminating a hierarchy among the three sources. *See* CHARLES T. KOTUBY, JR. &

contained in the primary sources (i.e., international conventions, international custom, and general principles of law recognized by nations) may be determined. The subsequent sections will discuss the primary sources of public international law and the extent to which rules underpinning the international tax system may be derived from those sources.

A. *International Conventions*

It is trite that an international convention or treaty is generally not valid *erga omnes*.[9] Only in very limited cases of treaties dealing with practical matters, such as the delimitation of territorial boundaries, are they considered binding on all states and, thus, valid *erga omnes*.[10] Accordingly, Article 38(1)(a) refers to international conventions establishing rules "expressly recognized by the contesting states."[11] But, as will be discussed further in this section, a provision found in a treaty could be generally applicable to all states, not just signatories, if that provision evolves to become a binding rule of customary international law.

International conventions in the context of the international tax system mainly take the form of bilateral tax treaties. Bilateral tax treaties generally seek to provide relief from double taxation and avoid double non-taxation of income. Currently, there are over 3,000 bilateral tax treaties that contain provisions that shape the international tax system.[12] As mentioned previously, these provisions are predominantly applicable to states that are parties to the treaties. Indeed, owing to their bilateral nature, taxpayers have often resorted to treaty-shopping,

LUCK A. SOBATO, GENERAL PRINCIPLES OF LAW AND INTERNATIONAL DUE PROCESS PRINCIPLES AND NORMS APPLICABLE IN TRANSNATIONAL DISPUTES 9 (2017).

9. Theoretically, an international agreement may be in a written or unwritten form. For purposes of this Paper, however, "treaty" refers to a written agreement between states in accordance with the Vienna Convention on the Law of Treaties [hereinafter VCLT]. Article 2(1)(a) of the VCLT states in pertinent terms that "'Treaty' means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation." Vienna Convention on the Law of Treaties, *opened for signature* May 23, 1969, 1155 U.N.T.S. 331.

10. *See, e.g.*, Kasikili/Sedudu Island (Bots. v. Namib.), Judgment, 1999 I.C.J. Rep. 1045 (Dec. 13). *See also* DIXON, *supra* note 6, at 28-30.

11. ICJ Statute, *supra* note 7, art. 38 (emphasis added).

12. OECD REPORT, *supra* note 3.

which generally involves exploiting tax treaty reliefs for the indirect benefit of residents in a third jurisdiction.[13]

In addition to bilateral tax treaties, a multilateral tax treaty may be concluded among many states. One multilateral tax treaty (within the meaning of the Vienna Convention of the Law of Treaties) is the OECD Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting (MLI).[14] The MLI is an attempt by signatories to address the loss of corporate tax revenue through aggressive international tax planning, which has the effect of artificially shifting profits to locations where they are subject to non-taxation or reduced taxation.[15] The amendments envisaged by the MLI would ensure that profits are taxed where substantive economic activities generating the profits are carried out and where value is created.[16] Accordingly, it is aimed at altering tax treaty-related measures to address certain hybrid mismatch arrangements, prevent treaty abuse, address artificial avoidance of permanent establishment status, and improve dispute resolution.[17] It also seeks to ensure that agreements for the avoidance of double taxation on income are interpreted to eliminate double taxation with respect to the taxes covered by those agreements without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping).[18] It is hoped that through the MLI, changes agreed upon in this regard will be implemented in a synchronized and efficient manner across the network of existing agreements for the avoidance of double taxation on income without the need to bilaterally renegotiate each such agreement.[19]

Indeed, the MLI exists primarily because of the bilateral nature of tax treaties. The MLI would automatically amend the provisions of a bilateral treaty only to the extent that the parties to the bilateral treaty ratify the MLI and submit that bilateral treaty as one of the treaties they intend to amend (referred to as "covered tax agreements") in accordance with the OECD Action items on addressing certain abusive

13. *See, e.g.*, Starr Int'l Co. v. United States, 275 F. Supp. 3d 228 (D.D.C. 2017); Wells Fargo & Co. v. United States, No. 0:09-cv-02764-PJS-TNL, 2014 WL 4070782 (D. Minn. July 22, 2014).

14. OECD, MULTI. CONV. TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BASE EROSION AND PROFIT SHIFTING (Nov. 2016), http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

15. OECD REPORT, *supra* note 3, at 3.

16. *Id.*

17. *Id.* at 16.

18. *Id.* at 9.

19. *Id.*

situations.[20] This is the rule of symmetry. If one party to the bilateral treaty refuses to ratify the MLI, or even after ratifying the MLI refuses to submit that bilateral tax treaty as one of the treaties it intends to automatically amend, no such amendments can result from the other party's submission of that bilateral treaty.[21] Even in situations where both parties submit the same bilateral tax treaty, one of the parties may block the execution of certain recommended amendments through reservations.[22]

International conventions impacting the international tax system may also be found in non-tax treaties, such as trade agreements. The international treatment of the U.S. domestic international sales corporation (DISC) rules of the 1970s is one case in point. In general, the DISC rules were designed to grant a special tax exemption for exports.[23] Although the United States never conceded that the DISC rules violated international trade rules, the United States proceeded to replace the DISC rules with a regime that it considered more acceptable.[24] This example demonstrates that rules under international trade law, which is predominantly treaty law in the form of multilateral and bilateral treaties (including free trade agreements), do shape the international tax system.

A more recent example of the impact of trade agreements is the worldwide scrutiny of the 2017 U.S. tax reforms for breaches of both trade and tax agreements. For example, finance ministers from France, Germany, Italy, Spain, and the United Kingdom expressed to the U.S. Treasury Secretary Steven Mnuchin that aspects of the then-pending U.S. tax reform legislation risked hampering transatlantic trade and

20. *Id.*

21. *Id.*

22. *Id.*

23. *See* John H. Jackson, *The Jurisprudence of International Trade: The DISC Case in GATT*, 72 AM. J. INT'L L. 747 (1978) (explaining that the DISC tax provisions provided deferral of U.S. federal income tax on a percentage of export profits if certain conditions were satisfied); Domestic International Sales Corporation, Proposal of the U.S. Treasury Dept., 91st. Cong., 2d Sess. (Comm. Print 1970); Staff of House Comm. on Ways and Means, 91st Cong., 2d Sess., Summary of Testimony presented at Foreign Trade Hearings Conducted by Comm. on Ways and Means, 114-18 (Comm. Print 1970); and Foreign Sales Corporation Act, 1983: Hearings on S. 1804 before the Comm. on Finance, 98th Cong., 1st Sess. 122-75 (1983).

24. William Chou, *The $4 Billion Question: An Analysis of Congressional Responses to the FSC/ETI Dispute under WTO Export Subsidy Standards*, INTERNATIONAL LAW 39 (2005) (noting that the United States agreed to withdraw the DISC scheme to avoid retaliatory tariffs, and that in 1983, Congress adopted the foreign sales corporation regime in its place).

the world economy.[25] Also, the EU began monitoring the U.S. tax reform efforts over concerns that the changes may be "discriminatory" and conflict with World Trade Organization rules.[26] Others have raised concerns about violations of the rules of the World Trade Organization, conformity with international tax standards, and unfair competition.[27]

The outcome of the above is that a claim that an international tax system grounded in treaty law exists is supported under public international law. These rules are enshrined in both tax and non-tax treaties that may be multilateral or bilateral. As mentioned previously, from a public international law perspective, an international tax system founded upon treaties would not necessarily be valid *erga omnes*. Indeed, the international outcry against the U.S. tax reform has resounded in charges of violations of rules contained in treaties to which the United States is a signatory or party. Accordingly, they constitute rules that the United States, in its capacity as a signatory or party to the agreement, has expressly recognized within the meaning of Article 38(1)(a) of the Statute of the ICJ.[28] Indeed, in the absence of treaty law, the existence of an international tax system that applies to states must generally find footing in the other sources of public international law.

B. *International Custom as Evidence of a General Practice Accepted as Law*

1. Background

a. *Customary International Law and Opinio Juris Sive Necessitates*

Customary international law plays an important role in public international law,[29] as well as governs or possesses the potential to govern the conduct of states in every field.[30] Similar to domestic customary law,

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25. Andrea Thomas & Todd Buell, *U.S. Tax Plan Draws Attacks Abroad, Prompts Calls for Cuts in Response*, WALL ST. J. (Dec. 11, 2017), https://www.wsj.com/articles/european-finance-chiefs-hit-out-at-u-s-tax-plans-1513000469/.

26. Joe Kirwin, *EU Finance Chiefs Ask Commission to Monitor U.S. Tax Reform*, BLOOMBERG L. (Dec. 6, 2017), https://www.bna.com/eu-finance-chiefs-n73014472778/.

27. Mark Deen, Birgit Jennen & Viktoria Dendrinou, *Europe to Weigh Whether U.S. Tax Cuts Violate Global Trade Rules*, BLOOMBERG (Dec. 4, 2017), https://www.bloomberg.com/news/articles/2017-12-04/european-finance-chiefs-are-said-to-discuss-u-s-tax-cut-plan.

28. ICJ Statute, *supra* note 7, art. 38.

29. Norms of customary international law may or may not be jus cogens. Jus cogens is a legal technique which protects against fragmentation of the law into a plurality of separately applicable legal regimes under the guise of private autonomy. For more on jus cogens, see generally ROBERT KOLB, PEREMPTORY INTERNATIONAL LAW - JUS COGENS: A GENERAL INVENTORY (2015).

30. Asylum Case (Colom. v. Peru), 1950 I.C.J. Rep. 266 (Nov. 20).

rules of customary international law are generally established through international custom.[31] In the domestic setting, "custom" is generally considered to be a long held practice that possesses the force of law.[32] In order to assume the force of law, custom must not be a mere long-held and accepted practice (referred to as "usage").[33] Usage must be accompanied by the recognition by participants that they are under a legal obligation to conduct themselves in that manner.[34] Accordingly, rules of customary international law may be ascertained by establishing two components: first, that there is an international usage of a wide-spread nature; and second, that, the practice is accepted by states as law. The latter component, i.e., "o*pinio juris sive necessitatis*," may be more difficult to establish.[35] Thus, opinio juris has attracted substantial attention in literature that will not be reproduced in its entirety here.

Historical and modern theories about opinio juris have typically been divided along three strands. First, custom (i.e., "usage") is the only true element of international custom; second, opinio juris rather than usage is the most important element in the creation of customary international law; and third is the traditional view that a combination of usage and opinio juris is necessary for the creation of international custom.[36] Although much scholarship has been devoted to these theoretical discussions of opinio juris, as of today, none of these theories have attained the level of a universally accepted definition or role of opinio juris.[37] Yet, there seems to be more support, both in theory and practice, for the traditional view that international custom requires a combination of opinio juris and usage for its formation.[38]

The traditional view was codified in 1945, when the ICJ was established.[39] As previously noted, Article 38 of the Statute of the ICJ identifies the sources of law to which the ICJ may refer while adjudicating

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31. Jo Lynn Slama, *Opinio Juris in Customary International Law*, 15 OKLA. CITY U. L. REV. 603 (1990).

32. For more on the discussion of custom, see WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND: IN FOUR BOOKS (1765-69). *See also* Slama, *supra* note 31.

33. Slama, *supra* note 31.

34. *See* BLACKSTONE, *supra* note 32. *See also* Slama, *supra* note 31.

35. This Latin phrase refers to a firmly-held belief or opinion that a rule is binding by law. *See* Lotus Case (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 10 (Sept. 7).; Jurisdictional Immunities of the State (Ger. v. It.: Greece intervening), Judgement, 2012 I.C.J. Rep. 99 (Feb. 3); Slama, *supra* note 31.

36. Slama, *supra* note 31.

37. *Id.*

38. *Id. See also* ANTHONY A. D'AMATO, THE CONCEPT OF CUSTOM IN INTERNATIONAL LAW (1971).

39. ICJ Statute, *supra* note 7, art. 38.

cases.[40] Article 38(1)(b) provides in pertinent terms that "[t]he Court . . . shall apply . . . international custom, as evidence of a general practice accepted as law."[41] Thus, the Statute of the ICJ upholds the traditional view by recognizing rules of customary international law only when international usages are undertaken by states, because states accept such usages as binding (i.e., *opinio juris*). As discussed in detail below, the ICJ, including its predecessor the Permanent Court of International Justice (PCIJ), has since taken the opportunity to expound upon the formation of customary international law in accordance with this view.

b. Formation of Customary International Law through Usage

The first pronouncement by an international court on the process by which rules of customary international law are formed was in *Lotus (France v. Turkey)*.[42] In *Lotus*, the French government alleged that states had abstained from undertaking criminal proceedings in certain situations and thus it was evidence of the existence of a rule of customary international law on the matter.[43] The PCIJ disagreed.[44] It stated that unless the states involved engaged in that custom with an understanding that they were complying with a legal duty, no international custom could be claimed to exist.[45] According to the PCIJ:

> Even if the rarity of the judicial decisions to be found . . . were sufficient to prove . . . the circumstance alleged . . ., it would merely show that states had often, in practice, abstained from instituting criminal proceedings, and not that they recognized themselves as being obliged to do so; for only if such abstention were based on their being conscious of having a duty to abstain would it be possible to speak of an international custom. The alleged fact does not allow one to infer that states have been conscious of having such a duty; on the other hand . . . there are other circumstances calculated to show that the contrary is true.[46]

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40. *Id.*
41. *Id.*
42. Lotus Case (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 10 (Sept. 7).
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.* at 28 (emphasis added).

Opinio juris was again confirmed by the ICJ as necessary to the formation of international custom in *Asylum (Colombia v. Peru)*.[47] The Court distinguished between usages of state practice undertaken out of political expediency and those engaged in out of a sense of legal duty or legal right.[48] It stated that to constitute opinio juris, the state practice must be "the expression of a right appertaining to the state granting asylum and a duty incumbent on the territorial state" and not "merely for reasons of political expediency."[49] Throughout the judgment, the Court referenced the need to distinguish between usages undertaken out of "considerations of courtesy, good neighborliness and political expediency" and usages accepted as law by participating states.[50]

Similarly, in *Right of Passage over Indian Territory (Portugal v. India)*, opinio juris was upheld once again.[51] One of the issues before the Court related to the passage of the disputing states over Indian Territory.[52] The Court was satisfied that in view of all the circumstances surrounding the case, the "practice was accepted as law by the Parties" and had given rise to a right and a correlative obligation.[53] By using the "accepted as law" yardstick, the Court was able to demarcate the boundaries of the international custom between the disputants; which was more limited in scope than was alleged. Accordingly, the Court found that only the more circumscribed custom constituted rules of international law applicable to the dispute—the kind envisaged under Article 38(1)(b) of the Statute of the ICJ.[54]

Again, the ICJ in *North Sea Continental Shelf (Germany v. Denmark and the Netherlands)* underscored the two conditions for sustaining a norm under customary international law. It stated thus:

> Not only must the acts concerned amount to a settled practice, but they must also be such, or be carried out in such a way, as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it. The need for such a belief, i.e., the existence of a subjective element, is implicit in the very notion of the *opinio juris sive necessitates.* The states concerned must therefore feel that they are conforming to what

47. Asylum Case (Colom. v. Peru), Judgment, 1950 I.C.J. Rep. 266 (Nov. 20).
48. *Id.*
49. *Id.* at 277.
50. *See, e.g., id.* at 285.
51. Right of Passage over Indian Territory (Port. v. India), Judgment, 1960 I.C.J. Rep. 6 (Apr. 12).
52. *Id.*
53. *Id.* at 40.
54. *Id.*

> amounts to a legal obligation. The frequency or even habitual character of the acts is not in itself enough. There are many international acts, e.g., in the field of ceremonial and protocol, which are performed almost invariably, but which are motivated only by considerations of courtesy, convenience or tradition, and not by any sense of legal duty.[55]

More recently, the ICJ again affirmed in *Jurisdictional Immunities (Germany v. Italy: Greece Intervening)* the need for opinio juris in establishing customary international law.[56] In *Jurisdictional Immunities*, the Court was called upon to determine, inter alia, whether under customary international law Italy had violated the jurisdictional immunities of Germany by entertaining civil actions arising from Germany's actions during World War II.[57] The Court, in ruling against Italy, found extensive state practice with the requisite opinio juris that, under the circumstances, Germany's jurisdictional immunity was protected under customary international law.[58] The Court stated that "[t]hat practice is accompanied by opinio juris, as demonstrated by the positions taken by states and the jurisprudence of a number of national courts which have made clear that they considered that customary international law required immunity."[59] Opinio juris was deduced from the expressed awareness of states that their practice of according jurisdictional immunity was backed by customary international law.[60]

As these ICJ cases demonstrate, it cannot be overemphasized that the existence of opinio juris is crucial for the crystallization of usage as customary international law. There have been other theories by some contemporary authors who discount opinio juris on account of its subjective nature.[61] They argue that it raises more questions and

55. North Sea Continental Shelf (Ger. v. Den., Gen. v. Neth.), Judgment, 1969 I.C.J. Rep. 3, at 44 (Feb. 20) (emphasis added).

56. Jurisdictional Immunities of the State (Ger. v. It.), Judgment, 2012 I.C.J. Rep. 99 (Feb. 3).

57. *Id.*

58. *Id.*

59. *Id.* at 135.

60. There seems to be a contrary view from Dixon who suggests that the ICJ has since the *North Sea Continental Shelf* cases softened its view of the requirement of opinio juris such that in the *Jurisdictional Immunities* case, the ICJ found opinio juris merely from state practice, i.e., national courts refraining from entertaining civil actions against a state. But the reading of the case, however, does not support this view, as the national courts did not merely refrain but also provided judgements that spoke to their mental state (opinio juris) that they felt bound under customary international law to refrain from entertaining such actions. *See* DIXON, *supra* note 6.

61. *See* Slama *supra* note 31.

problems.[62] Accordingly, they posit that the most important element is usage, the objective component, and not opinio juris, the subjective component.[63] The position taken by this Article is that these theories may well fall within the category of teachings of the most highly qualified publicists of the various nations under Article 38(1)(d) of the Statute of the ICJ. As sources of public international law, they are subsidiary, and by their subsidiary nature should not be upheld over contrary state practice.[64] Accordingly, much weight should be given to state practice as demonstrated through overt state acts and by their acceptance of and acquiescence in the decisions of the ICJ relating to the creation of customary international law.[65]

c. Formation of Customary International Law through Treaty

Customary international law may emerge or crystallize through treaties. This may be the case even if the rules embodied in a treaty were not, at the time of conclusion of the treaty, *de lege lata* or emerging rules of customary international law.[66] It is important to note that although a treaty may propel the development of a new rule of customary international law through state practice, or enable the crystallization of emerging rules of customary international law, this crystallization is in no way presumed to be the ultimate result of a treaty.[67] Unless there is evidence that a rule of customary international law has emerged from a treaty, no such rule of customary international law should be presumed.[68] It is

62. *See id.*

63. *See id.*

64. Many public international law scholars uphold this position. For example, it has been stated that "[t]he Texaco Award was defective to the extent that it gave full weight to the notion that an international law relating to foreign investment had developed on the basis of existing arbitral awards and writings. But, it explained away the collective efforts of developing states to develop norms relating to foreign investment through General Assembly resolutions on the ground that such resolutions do not have the effect of creating international law. The Award gave greater weight to the views of individual arbitrators and writers on international law than to the views collectively asserted by a large group of states in the General Assembly of the United Nations. To that extent, the award must be regarded as lacking in legitimacy as it was based on the appreciation of an individual arbitrator, however eminent, of the relative weight to be given to competing norms." *See* INTERNATIONAL LAW AND DEVELOPING COUNTRIES: ESSAYS IN HONOUR OF KAMAL HOSSAIN, at p. 45 (Kamal Hossain et al. eds., 2014).

65. For more discussion on opinio juris as evidenced through state acquiescence, see Slama *supra* note 31.

66. Malgosia Fitzmaurice, *Third Parties and the Law of Treaties*, 6 MAX PLANCK Y.B. UNITED NATIONALS L. 37.

67. *Id.*

68. *Id.*

therefore necessary to understand the process by which a treaty provision may be considered crystallizing into a norm of customary international law and therefore applicable to nonparties to the treaty.

The ICJ provided some guidance on this process in *North Sea Continental Shelf*.[69] The Kingdoms of Denmark and Netherlands claimed that the Federal Republic of Germany was bound under customary international law to accept as binding a delimitation of the North Sea continental shelf based on the equidistance principle.[70] The pith of their argument was that the equidistance principle had crystallized through state practice as a rule of customary international law, because it had been adopted by Article 6 of the 1958 Geneva Convention on the Continental Shelf (Geneva Convention) and had been used to resolve some fifteen cases involving both parties and nonparties to the Convention.[71] The ICJ rejected this argument and identified factors that must exist for a treaty provision to become applicable to nonparties as customary international law.[72]

First, the provision must possess a "fundamentally norm-creating character" such as could be regarded as forming the basis of a general rule of law.[73] The Court noted that although when considered in isolation the equidistance principle appeared to fulfill this requirement, three factors made it impossible to reach such a conclusion.[74] In the first place, the Geneva Convention made the equidistance principle subservient to the primary obligation of effecting delimitation by agreement.[75] The Court conceded that rules of international law may be derogated from by agreement in particular cases or as between parties, but the express provision of the Geneva Convention requiring a primary obligation of states to proceed through agreement, failing which the equidistance principle would be triggered, cast doubt on the status of Article 6 as a norm-creating provision.[76] Second, the exceptions contained in Article 6 relative to special circumstances and the unresolved controversies on the meaning of the equidistance principle further cast

69. North Sea Continental Shelf (Ger. v. Den., Gen. v. Neth.), Judgment, 1969 I.C.J. Rep. 3, at 44 (Feb. 20).

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.* at 42.

74. North Sea Continental Shelf (Ger. v. Den., Gen. v. Neth.), Judgment, 1969 I.C.J. Rep. 3, at 44 (Feb. 20).

75. *Id.*

76. *Id.*

doubt on the international law status of the principle.[77] Lastly, the fact that reservations could be made to Article 6 seemed to deny the equidistance principle the same norm-creating character possessed by, for example, the principles in Articles 1 and 2 of the Geneva Convention, for which no reservation could be made.[78] In other words, the treaty provision would be considered to have a fundamentally norm-creating character if it is "capable of general application and . . . intended to be the basis for future state practice."[79] As noted by Martin Dixon, detailed treaty obligations may lack this characteristic as they are typically designed with a view to making them part of the treaty's particular code of law and not for general application.[80] On the other hand, if a treaty prescribes general standards, such as the Convention Against Torture 1984, the impetus given to customary law formation may be considerable.[81] Thus, detailed treaty provisions are unlikely to have a fundamentally norm-creating character.

The second element identified by the Court relates to the period within which the practice forms. The Court noted as follows:

> Although the passage of only a short period of time is not necessarily or of itself, a bar to the formation of a new rule of customary international law on the basis of what was originally a purely conventional rule, an indispensable requirement would be that within the period in question, short though it might be, state practice, including that of states whose interests are specially affected, should have been both extensive and virtually uniform in the sense of the provision invoked;—and should moreover have occurred in such a way as to show a general recognition that a rule of law or legal obligation is involved.[82]

In applying the elements to the facts, the Court explained that, of the fifteen cases in which the equidistance principle had been applied, four involved countries that had ratified or acceded to the Geneva Convention.[83] Those countries were thus acting in accordance with the provisions of a convention to which they had assented. Of the

77. *Id.*
78. *Id.*
79. DIXON, *supra* note 6, at 30.
80. *Id.*
81. *Id.*
82. North Sea Continental Shelf (Ger. v. Den., Gen. v. Neth.), Judgment, 1969 I.C.J. Rep. 3, at 44 (Feb. 20).
83. *Id.*

remaining cases involving nonparties to the Geneva Convention, the Court concluded that no justifiable inference could be drawn that the countries involved believed they were applying the rule out of a sense of *opinio juris*.[84] The Court also found that quite a number of states were not "specially affected" by the conventional rule because they were landlocked states.[85] Ultimately, the number of states whose interests were specially affected by the conventional rule and that had ratified or acceded to the Convention, although impressive, was hardly sufficient to support the view that a customary international law had emerged.[86]

Based on the Court's analysis, a treaty provision must be capable of forming the basis of a general rule of law in order to possess a norm-creating character. That provision typically should not be subject to reservations by states. Rather, it must facilitate a general participation by states. Further, neither the period within which the norm develops, nor the habitual nature of the practice, is determinative.

As the previous analysis demonstrates, customary international law is not based upon extensive state practice alone. Whether the practice of states is actuated by a sense of legal obligation (*opinio juris*) must also be ascertained. The acts involved must amount to a settled practice and must be carried out in such a way as to evidence a belief that the practice is obligated by law. When viewed in this manner, a distinction must be made between acts of states that would derive from a sense of legal obligation and those that are motivated by considerations of courtesy, convenience, tradition, or political expediency. The frequency or the habitual nature of the acts is not by itself enough.[87]

The mere existence of other plausible explanations as to why states engage in a practice would ordinarily not be a sufficient indication of the absence of opinio juris. Yet, whenever there is uncertainty as to whether some acts of state are motivated by a sense of legal duty, that uncertainty is further heightened if the acts in question are usually engaged in by states out of nonbinding considerations such as courtesy, convenience, tradition, or political expediency that persist in that field of practice. As previously noted, the Court in *Lotus* concluded that there was no opinio juris because the alleged fact was insufficient to found an inference that states were conscious of a binding legal duty.[88]

84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.*
88. S.S. Lotus (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 10 (Sept. 7).

On the contrary, it was reasonably established that states were acting out of nonbinding considerations.[89]

2. International Custom and the International Tax System

A search for an international tax system founded upon customary international law may be a herculean task. Customary international law is based on state practice engaged in out of a sense of opinio juris. Yet, for tax purposes, states often engage in tax practices for considerations other than opinio juris. Thus, a number of state practices in the field of taxation may not crystallize into norms of customary international law.

a. The Imposition of the Value Added Tax

The spread of the value added tax (VAT) is illustrative. When the VAT was introduced in the 1950s, only a few countries embraced it.[90] Over the next couple of decades, the VAT, which has been described as a money machine, became very popular among states.[91] Today, about 160 countries have embraced the VAT.[92] However, it would be inaccurate, or at least overly simplistic, to claim that the VAT is now a norm of customary international law on the basis of the extensive state practice. Such a notion is absurd because, as mentioned previously, state practice must be engaged in out of a sense of legal duty. States, particularly developed countries, embraced the VAT because of its heralded potential to raise increased levels of revenue, rather than out of a sense of legal compulsion.[93] Developing countries also embraced the VAT, not out of a sense of opinio juris, but either because of its popularity or to fulfill a de facto conditionality of the International Monetary Fund (IMF) to qualify for financial concessions.[94]

Three main reasons are typically provided to explain the rapid spread of the VAT: concerns over fiscal stability and growth, tax administration, and external influences. First, concerns about fiscal stability

89. *Id.*

90. OECD, CONSUMPTION TAX TRENDS 2014: VAT/GST AND EXERCISE RATES, TRENDS AND POLICY ISSUES 18, Annex B: Countries with VAT, (2014), http://dx.doi.org/10.1787/ctt-2014-en [hereinafter OECD CONSUMPTION TAX TRENDS 2014].

91. JAMES BICKLEY, A VALUE-ADDED TAX CONTRASTED WITH A NATIONAL SALES TAX, CONG. RESEARCH SERV. REP. (Feb. 1, 2008); Vito Tanzi & Howell H. Zee, *Tax Policy for Developing Countries*, 27 IMF ECONOMIC ISSUES (2001); ALAN. A. TAIT, VALUE ADDED TAX: INTERNATIONAL PRACTICE AND PROBLEMS (1988).

92. OECD CONSUMPTION TAX TRENDS 2014, *supra* note 90.

93. BICKLEY, *supra* note 91.

94. Lauren Damme et al., *Taxation Policy in Developing Countries: What is the IMF's Involvement?* (The Bretton Woods Project 2008).

and growth point to the desire of states to implement stable revenue systems, raise additional revenue, reduce cascading taxes, and remove disincentives to savings and investments.[95] Second, states are also attracted to the VAT because of its strengths for tax administration. The self-enforcing nature of the VAT increases voluntary compliance, reduces inefficiencies, and eliminates costs associated with complicated tax systems.[96] Finally, external influences also played a significant role in the spread of the VAT. For example, embracing a VAT was a requirement for new members of the EU and an IMF de facto funding conditionality.[97] Additionally, some states considered embracing the VAT to be competitive in the international market.[98] As this analysis demonstrates, the mere extensive nature of state practice in relation to taxation is not sufficient to create new norms of customary international law. Indeed, the VAT "may be thought of as the Mata Hari of the tax world—many are tempted, many succumb, some tremble on the brink, while others leave only to return, eventually the attraction appears irresistible."[99] Although irresistible, it is never considered a binding norm of customary international law. States embrace the VAT for considerations other than opinio juris.

b. Other Principles under Customary International Law

A tax practice among states, such as the implementation of the VAT, does not qualify as a rule of customary international law solely because many states engage in that practice. The question then arises whether there are principles under customary international law that may constitute customary international tax law. Two of such principles are considered in this section.

First, some have indicated that customary international law imposes a duty on states to ensure that double taxation is avoided—or at least there is an internationally accepted practice that expects the

95. Bruce Bartlett, *VAT Time?*, FORBES (June 5, 2009), http://www.forbes.com/2009/06/04/value-added-tax-opinions-columnists-bartlett.html/.

96. BICKLEY, *supra* note 91; Michael Keen & Stephen Smith, *VAT Fraud and Evasion: What Do We Know, and What Can Be Done?*, 59 NATIONAL TAX JOURNAL 861 (2006).

97. *See* TOLLEY'S VAT IN EUROPE (John Voyez ed., 3d ed. 2002); Damme et al., *supra* note 94; Scott Riswold, *Value Added Tax in Sub-Saharan Africa: A Critique of IMF VAT Policy*, 32 INTERTAX 427 (2004).

98. Leah Durner, Bobby Bui & Jon Sedon, *Why VAT Around the Globe?*, TAX NOTES (Nov. 23, 2009), https://www.taxnotes.com/tax-notes/value-added-taxation/why-vat-around-globe/2009/11/23/qjjn/.

99. TAIT, *supra* note 91, at 3.

domiciliary state to alleviate double taxation.[100] However, this practice is doubtful. If the requisite mental element existed, states would have considered themselves duty-bound to alleviate double taxation across the board. On the contrary, states have resorted to the use of over 3,000 bilateral tax treaties to address double taxation.[101] Such a large network of bilateral tax treaties is a strong indicator that the alleged customary international law rule imposing a duty on states to alleviate double taxation may be nonexistent.

Second, some have stated that customary international law exists with respect to the exercise by a state of its jurisdiction to tax.[102] They state that customary international law limits the exercise of such jurisdiction by prescribing factors upon which a state's taxing authority may be triggered, known as reasonable nexus.[103] These factors include nationality, domicile or residence, presence or doing business within the country, and location within the country of property or transaction from which income is derived.[104] Accordingly, states may be in violation of customary international law if they do not exercise their taxing rights on the basis of such factors.[105] Again, the existence of a reasonable nexus as a rule of customary international law may be doubtful because of the large network of bilateral treaties. Indeed, states use bilateral tax treaties to agree upon the reasonable nexus that must exist before a state may exercise its taxing jurisdiction under the bilateral treaty.[106]

3. Summary

The above discussion demonstrates the difficulty of ascertaining customary international law in the international tax system. This is because the element of opinio juris is necessary for the crystallization of a norm of customary international law, but opinio juris is difficult

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100. *See* American Law Institute, Federal Income Tax Project, International Aspects of United States Income Taxation 6 (1987).

101. OECD REPORT, *supra* note 3.

102. CHARLES H. GUSTAFSON ET AL., TAXATION OF INTERNATIONAL TRANSACTIONS: MATERIALS, TEXTS AND PROBLEMS (2011).

103. *Id.*

104. *Id.*

105. *Id.*

106. Generally, treaty provisions such as articles dealing with scope, tax covered, and the definition of resident establish the nexus. For example, Article 4 of the 2016 U.S. Model treaty provides that "resident of a Contracting State" means any person who, under the laws of that contracting state, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. Note, however, that such nexus is for the purpose of applying the bilateral tax treaty.

to find when examining the tax practice of states. From the implementation of the VAT to other state tax practices, opinio juris is elusive. Although irresistible, the VAT has never been considered by states as a binding norm of customary international law. States implement the VAT for reasons other than opinio juris. Further, the large network of bilateral tax treaties casts doubt on the claims that customary international law requires or expects states to alleviate double taxation and the claim that customary international law prescribes a reasonable nexus upon which a state may exercise its taxing jurisdiction.

C. *General Principles of Law Recognized by Civilized Nations*

1. Background

General principles of law recognized by civilized nations are another source of public international law contained in Article 38 of the Statute of the ICJ. The text of Article 38(1)(c) was included in the Statute of the ICJ as a means of striking a middle ground between general principles of law,[107] divined through reliance on unpredictable subjective norms, and those that are based on the express consent of states.[108] The purpose of the provision is to ensure that the ICJ does not run out of applicable principles when adjudicating cases before it.[109] Accordingly, general principles of law constitute gap fillers that the ICJ uses in addition to or in the absence of an applicable treaty provision or rules of customary international law.[110] As described next, the constituent elements of Article 38(1)(c) make the provision an autonomous source of public international law separate from general principles of international law that may be contained in universally ratified treaties and customary international law.[111]

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107. Elihu Root and Lord Phillimore are credited with providing the text of Article 38(1)(c). *See* HESSBRUEGGE, *supra* note 8, at 22.

108. As stated by Lord Phillimore, the principles must be "accepted by all nations in *foro domestico*." *See id.* at 23.

109. ADEMOLA ABASS, COMPLETE INTERNATIONAL LAW: TEXT, CASES, AND MATERIALS 49 (2d ed. 2014).

110. JOHN BALOUZIYEH, PRINCIPLES OF INTERNATIONAL LAW 71 (2d ed. 2012).

111. *See* JAMES CRAWFORD, BROWNLIE'S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 25 (8th ed. Oxford U. Press 2012); PETER MALANCZUK, AKEHURST'S INTRODUCTION TO INTERNATIONAL LAW 48 (7th ed. Routledge 1997); HESSBRUEGGE, *supra* note 8, at 21.

a. "General Principles of Law"

Article 38(1)(c) does not define "general principles" of law.[112] International courts, however, have usually resorted to the use of the Article to apply principles relating to interpretation and procedure.[113] In light of the purpose of Article 38(1)(c) as a gap filler, "general principles" may be contained in either domestic law or public international law, as the Article does not restrict the provision to either source.[114] Thus, within the meaning of the Article, the ICJ may apply principles drawn from public international law or domestic legal systems, provided other conditions of the article are satisfied.[115] Disagreements exist over the exact nature of the general principles referred to in Article 38(1)(c). Some writers are of the view that the general principles must be fundamentally norms of natural law that are recognized by the international community in some positive manner, such as the inclusion of such norms in domestic legal systems or within United Nations resolutions.[116] Other writers have taken a positivist stance.[117] They argue that the general principles of law that rightly belong to Article 38(1)(c) are those principles that are based on the express consent of states.[118] Both views are not without flaws. For example, without the requirement that the principle be recognized in some positive manner, norms of natural law may constitute unpredictable subjective norms. Likewise, the positivist view that the principle must be expressly consented to by states deviates from practice, because it is judges and not states that identify the general principles described in Article 38(1)(c).

112. The use of "law" is not to the exclusion of "equity." International courts have in some cases divined general principles of equity as opposed to general principles of law. *See* BALOUZIYEH, *supra* note 110, at 26-27.

113. For example, the principles of good faith, estoppel, and proportionality have been considered by courts to fall under this article. *See, e.g.*, Corfu Channel (U.K. v. Alb.), Merits, 1949 I.C.J. 4, 18 (Apr. 9) (identifying circumstantial evidence as a general principle); Effect of Awards of Compensation Made by the United Nations Administrative Tribunal, Advisory Opinion, 1954 I. C.J. 47, 53 (July 13) (recognizing res judicata as a general principle).

114. Thus, it is conceivable that rules from public international law (such as provisions contained in numerous bilateral treaties) may be used to obtain general principles of law recognized by states. *See* Factory at Chorzow (Claim for Indemnity) (The Merits) (Ger. v. Pol.), Judgment, 1928 P.C.I.J. (ser. A) No. 17 (Sept. 13) http://www.worldcourts.com/pcij/eng/decisions/1928.09.13_chorzow1.htm.; Corfu Channel (U.K. v. Alb.), Judgment, Merits, 1949 I.C. J. 4 (Apr. 9). The ICJ applied general principles as found in municipal law and international jurisprudence.

115. ABASS, *supra* note 109, at 49-50.

116. *See* HESSBRUEGGE, *supra* note 8.

117. *Id.* at 22.

118. *Id.* at 24.

Be that as it may, both views would result in similar conclusions, because natural law norms that are universally recognized would usually be embodied in positive law and vice versa."[119]

b. "Recognized by Civilized Nations"

The reference to "civilized nations" has been one of the shortcomings of Article 38(1)(c). Some authors describe this as a "painful relic of the Eurocentric colonial era of international law," which no longer has an independent meaning.[120] They suggest that it should be referred to as "general principles of law recognized by nations."[121] Others have suggested that after the formation of the U.N., "civilized nations" should be replaced with "peace-loving nations."[122] In the same vein, others contend that, pursuant to Article 4 of the U.N. Charter, all nations are now considered "civilized."[123] Accordingly, the provision should read: "general principles of law recognized by nations." With this rendition, however, some preliminary matters ought to be addressed. Indeed, if all nations are considered "civilized," would Article 38(1)(c) admit only the general principles of law recognized by *all* nations? That would be a very high threshold to meet. In practice, as discussed in the following section, international courts and tribunals have found principles that meet the standard of Article 38(1)(c) to the extent that they are common to the major legal systems of the world,[124] which may also raise similar concerns whether the "civilized nations" constitute the major legal systems.

c. Identifying General Principles of Law

Although "general principles of law recognized by nations" constitute one of the sources of public international law, it is not states, but rather judges who choose which principles qualify as such. Thus, one of the sources for the compilation of a catalog of general principles within the meaning of Article 38(1)(c) is case law, especially those cases adjudicated by international courts and arbitral tribunals. The drawback to this approach is that some general principles may not have been adjudicated by any tribunal. Indeed, such is the fate of principles pertaining to taxation. Not many tax cases come before international tribunals.

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119. *Id.* at 25.
120. *Id.* at 22 n.6.
121. *Id.* at 22.
122. ABASS, *supra* note 109, at 49.
123. *Id.*
124. HESSBRUEGGE, *supra* note 8, at 23.

Thus, this Article attempts to identify some general principles of law that have never been considered by an international court or tribunal. These are determined through the process typically used by a judge to identify such principles.

Typically, a tribunal identifies a general principle of law through a three-step process. First, the legal rule is ascertained and the underlying principles that are general are isolated.[125] Second, the tribunal looks for legal rules that are based on the general principle in major legal systems of the world to determine whether they are universal principles.[126] Third, the tribunal determines whether such "universal general principles" are international or may be "made international" through appropriate modifications.[127] Each of these steps will be discussed accordingly.

i. Principles that are general

The search for general principles begins with specific rules.[128] Upon finding the specific rule, the court or tribunal continues to dig until it reaches the underlying principle.[129] The underlying principle of choice is one that is general in nature.[130] Kotuby notes that "[g]eneral principles are not inventions of the law," but rather "are antecedent of law."[131] In order to be considered "general," a principle must possess such a heightened degree of reason that all parties appreciate its normative value ex ante, whatever view they might take after a dispute has arisen.[132] In other words, the judge sets out to identify a juridical foundation for rules that constitutes the legal corpus. Only the basic principle is relevant because specific state rules based on the basic principle may differ.[133]

ii. Principles that are universal

The second step is to determine whether the general principles are universal. The universal nature of the principle lies in its embodiment in legal rules, albeit in the substratum, of the major legal systems of the

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125. KOTUBY & SOBOTA, *supra* note 8, at 18.
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.* at 19.
132. *Id.*
133. *See* Michael Akehurst, *Equity and General Principles of Law*, 25 INT'L & COMP. L.Q. 801, 814 (1976).

world.[134] No overt act of states consenting to the principle is required. This is because "[w]hereas customary international law derives its legitimacy from state usage, the general principles derive their legitimacy from state recognition."[135] The embodiment of the general principle in the laws of states constitutes recognition.

The requirement that the principle be recognized in the major legal systems of the world has implications in at least three respects: the extrapolation of evolving principles; the dichotomy between major and minor ("civilized" and "uncivilized") legal systems; and the significance of unanimity or majority in the major legal systems.

The first two implications go hand in hand. Singling out general principles of law recognized by the major legal systems of the world avoids the extrapolation into public international law of general principles that are evolving and yet to be recognized by public international law. In *South West Africa (Liberia v. South Africa)*, the ICJ refused to admit into public international law the claim that a resident had a right to initiate an action in the interest of the public.[136] The ICJ stated that "although a right of this kind may be known to certain municipal systems of law, it is not known to international law as it stands at present: nor is the Court able to regard it as imported by the 'general principles of law' referred to in Article 38, paragraph 1(c), of its Statute."[137] On the other hand, such an insistence may lead a judge to conclude that certain legal systems are more "civilized" than others. The *Klöckner* arbitration is illustrative.[138] In this matter, the parties agreed that the dispute would be governed by Cameroonian law, as may be traced to France.[139] The award was annulled by the ad hoc committee of the International Centre for Settlement of Investment Disputes because the tribunal applied a principle it divined on the basis of French civil

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134. The international court or tribunal would usually disregard the "idiosyncrasies of local law."

135. In a dispute, the international court or tribunal does not seek the consent of states to the general principles. The presence of a legal rule based on the general principle is sufficient recognition by the state. *See, e.g.*, Right of Passage over Indian Territory (Port. v. India), Judgment, 1960 I.C.J. Rep. 6 (Apr. 12) (Portugal submitting outcome of comparative study of various laws of states to support its claim); Continental Shelf (Tunis. v. Libya), Application for Permission to Intervene, 1981 I.C.J. Rep 1 (Jan. 28) (Malta submitting results of comparative law study in support of the principle of intervention).

136. South West Africa (Eth. v. S. Afr.; Liber. v. S. Afr.), Judgment, 1966 I.C.J. 6 (July 18).

137. *Id.* at 47.

138. Jan Paulsson, *The ICSID* Klockner v. Cameroon *Award: The Duties of Partners in North-South Economic Development Agreements*, 1 J. INT'L ARB. 145 (1984).

139. *Id.*

law that it described as a universal principle.[140] It is unclear whether Cameroonian law was excluded because it was not part of the major legal systems of the world. The "major legal systems" requirement may sneak through the backdoor the distinction between "civilized" and "uncivilized" nations or legal systems.

The third implication relates to whether the judge must seek unanimity or majority among the major legal systems of the world. Doubtless, the more widespread a general principle is, the more likely a claim as to its universal application may be sustained. However, the ICJ and international tribunals have not insisted upon proof of widespread manifestation of a principle in every known legal system, thus rejecting unanimity as the standard.[141] A general principle of law may be considered universal if it is included "in the written laws of many legal systems."[142] The use of "many legal systems," as opposed to "major legal systems," may eliminate some of the controversies discussed previously.

iii. Principles that are international

The last step is for the international court or tribunal to determine whether the "universal general principles" determined in steps one and two are international or require modifications to suit the international plane. Not all principles common to many legal systems qualify as general principles recognized by nations within the meaning of Article 38 (1)(c).[143] In practice, general principles are rarely extrapolated lock, stock and barrel. Modifications are typically made to ensure that the principles fit the international law plane.[144] Within the meaning of Article 38(1), a general principle admitted under Paragraph (c) must be the kind that is applicable to an international dispute before the ICJ. Therefore, general principles that are universal but inapplicable to international relations of states may not be admitted into public international law under Article 38(1)(c).[145]

140. *Id.*

141. *Id.*

142. *Id.*

143. ABASS, *supra* note 109, at 55.

144. KOTUBY & SOBOTA, *supra* note 8, at 27.

145. *See* OPPENHEIM'S INTERNATIONAL LAW (Robert Jennings & Arthur Watts eds., 1992), at 36-37 (stating that "the intention is to authorize the Court to apply the general principles of municipal jurisprudence, in particular of private law, in so far as they are applicable to relations of States.").

In the Advisory Opinion to *South West Africa*, the Court stated:

> [I]nternational law has recruited and continues to recruit many of its rules and institutions from private systems of law. Article 38(1)(c) of the Statute of the Court bears witness that this process is still active. . .the way in which international law borrows from this source is not by means of importing private law institutions “lock, stock and barrel”, ready-made and fully equipped with a set of rules. It would be difficult to reconcile such a process with the application of the “general principles of law”. In my opinion, the true duty of the international tribunals in this matter is to regard any features or terminology which are reminiscent of the rules and institutions of private law as an indication of policy and principles rather than as directly importing these rules and institutions.[146]

2. General Principles of Law Recognized by Nations and the International Tax System

One of the clearest ways in which general principles of law recognized by nations in the area of taxation may be compiled is by reviewing international decisions. However, because there are not many international decisions involving tax disputes, not many principles may be gleaned through this exercise. This section attempts to identify some of the general principles of law with respect to tax through the procedure previously outlined. These include the principles of fiscal sovereignty and reasonable nexus. Needless to say, the findings of this section that have not already been decided upon by a court would merely be speculative, because it is the province of judges alone to determine which principles form part of general principles of law recognized by nations within the meaning of Article 38(1)(c).

a. Taxation based on Fiscal Sovereignty

Some scholars agree that fiscal sovereignty is the only general principle of law within the meaning of Article 38(1)(c) that may be gleaned from international and municipal decisions in relation to taxation.[147]

146. International Status of S. W. Afr., Advisory Opinion, 1950 I.C.J. 128, 148 (July 11).

147. Edwin Van Der Bruggen, *State Responsibility under Customary International Law in Matters of Taxation and Tax Competition*, 29 INTERTAX 115 (2001); Barcelona Traction, Light and Power Co. (Belg. v. Spain) Second Phase, Judgment, 1970 I.C.J. 3 (Feb. 5). *See also* Cook v. Mexico, 1930 Gen. Claims Comm’n, Int’l Arb. Awards Rep. 4, 593 (Oct. 8); Santa Clara Estates Co.,

In general, fiscal sovereignty refers to the authority of a state to manage its revenue free from intervention from other states and international bodies.

The Supreme Court confirmed the fiscal sovereignty of the United States in *United States v. Bennett.* The Court noted that the taxing power of the United States "knows no restriction except where one is expressed in or arises from the Constitution and therefore embraces all the attributes which appertain to sovereignty in the fullest sense."[148] It also recognized the right of the United States to exercise powers that inherently belong to it by virtue of its sovereignty.[149]

b. Taxation Based on Reasonable Nexus to State

Fiscal sovereignty has been qualified by states in some respects. For example, the tax laws of many states impose tax liability only upon the finding of some nexus with the state.[150] Bilateral tax treaties also recognize the nexus principle by making them applicable to taxpayers or transactions that have a nexus with a treaty partner.[151] The nexus principle has taken various forms including nationality, residence, territoriality, place of incorporation, and place of effective management. To what extent would the nexus requirement be admitted as a tax rule of public international law under article 38(1)(c)? As noted previously, the nexus principle's status as a norm of customary international law is uncertain.

The first step is to identify a legal rule, based on the nexus principle, in the laws of a state. States have generally included in their laws a requirement for the existence of a nexus before they exercise their taxing rights.[152] The idiosyncrasies of local law must be discarded in search for a principle that is general and anterior to the particular tax rule.[153] Accordingly, we need not be detained by the fact that some states require place of incorporation whilst others require place of effective management, or the finding of residency or citizenship. Thus, the

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Supplementary Claim, British-Venez. Comm'n, 1903 Int'l Arb. Awards Rep. 9, 455; Comm'n of the European Atomic Energy Community v. UK Atomic Energy Authority, 1972 Int'l L. Rep. 44, 409 (Feb. 25, 1967).

148. United States v. Bennett, 232 U.S. 299, 306 (1914). *See also* Cook v. Tait, 265 U.S. 47 (1924); United States v. Goelet, 232 U.S. 293 (1914).

149. *Bennett*, 232 U.S. at 307.

150. Van Der Bruggen, *supra* note 147, at 121. *See also Cook*, 265 U.S. at 47.

151. Bilateral tax treaties also include provisions on limitation on benefits to ensure that certain nexus with states engineered by taxpayers to treaty shopping are not respected. *See, e.g.*, U.S. MODEL INCOME TAX CONVENTION ART. 22 (U.S. DEP'T OF THE TREASURY 2016).

152. Van Der Bruggen, *supra* note 147, at 121.

153. KOTUBY & SOBOTA, *supra* note 8, at 19.

general principle may be framed as such: states exercise taxing authority upon the establishment of a reasonable nexus between a taxpayer or a transaction and the state.

The next step is to determine the universal nature of the nexus principle. This universal requirement would be satisfied if many legal systems recognized the nexus principle. Today, in over 100 states, tax liability may be triggered upon finding a person that is a resident of that jurisdiction, an item of income that originates from that jurisdiction, or an entity incorporated in or with its place of effective management located in that jurisdiction.[154] Moreover, these principles are recognized in over 3,000 bilateral treaties.[155] Accordingly, the principle satisfies the universal requirement.

The final step is to determine whether the principle is international in nature or should be subjected to some modifications to make it suitable for the international plane. As noted above, the nexus principle would be international in nature if it is of a kind that may be applied to an international dispute. Indeed, it is conceivable that a dispute over which state possesses the taxing rights over an economic activity may well be resolved by use of the nexus principle.

Accordingly, based on the principles discussed above, the nexus principle may be determined by an international court or tribunal to be a general principle of law recognized by nations within the meaning of Article 38(1)(c).[156] Indeed, to the extent that the nexus requirement is manifested through principles such as residency, place of incorporation, place of effective management, and nationality, each of these principles may be admitted into public international law in their own right if they pass the test enumerated above. Today, the United States appears to be the only state that exercises its taxing jurisdiction on the basis of citizenship. Although the use of citizenship as a nexus may not violate any rule of public international law, it may be safe to conclude that the exercise of nexus on the basis of citizenship is not a rule of

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154. Bloomberg Law Global Tax Guide – Chart Builder, BLOOMBERG L., https://www.bna.com/bltx-international/ (last accessed December 2017).

155. Bilateral tax treaties are generally based on model tax treaties that generally adopt these principles. Among the model tax treaties are the Organization of Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital 2010 [hereinafter OECD Model]; United Nations Model Double Taxation Convention between Developed and Developing Countries 2011 [hereinafter U.N. Model]; the U.S. Model Income Tax Convention of November 15, 2006 [hereinafter U.S. Model], and the recently released U.S. Model Income Tax Treaty 2016.

156. *Cf.* Van Der Bruggen, *supra* note 147, at 431-32.

public international law under Article 38(1)(c) because of the absence of universality.

III. Scrutinizing the International Tax System

From the above discussion of the sources of public international law, it is clear that the rules underlying the international tax system may be based on treaties, general principles of law, and customary international law. The bulk of the rules, however, appear to be treaty-based. This conclusion is in opposition to the view taken by some of the proponents of the international tax system. Part III examines the international tax system as described by some of its proponents in light of the sources of public international law identified previously.

A. *Background*

1. Existence of an International Tax System

Two views have often been offered by scholars in regard to the existence of an international tax system. One of the scholars arguing in favor of the existence of an international tax system is Reuven Avi-Yonah. Avi-Yonah's arguments may be found in his article, "International Tax as International Law."[157] In 2007, Avi-Yonah published, *International Tax as International Law: An Analysis of the International Tax Regime*,[158] which, to a large extent, rehashed the claims he had previously made in his 2004 journal article but with illustrations on how U.S. tax rules fit the international tax regime.[159] In 2015,

157. Reuven Avi-Yonah, *International Tax as International Law*, 57 TAX L. REV. 483 (2004). Note, however, that a somewhat modest version of this claim was made in 1995 when he stated that "[i]ndeed, much of the international tax regime can be regarded as customary international law." *See* Reuven S. Avi-Yonah, *Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1304 (1995-96).

158. REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME (2007).

159. The U.S. illustrations, however, may not be sufficient in establishing an international tax regime. This is because, generally, practices of the United States do not always reflect a rules-based international order (both customary and treaty law). An example is the U.S. position on the 1986 decision of the ICJ against the United States in favor of Nicaragua. Apart from boycotting most of the proceedings, the United States refused to observe the verdict of the Court and used its permanent seat on the U.N. Security Council to veto resolutions demanding that it comply with the decision. *See* Jeremy Page, *China's Defiance of International Court Has Precedent—U.S. Defiance; Beijing's Determination to Ignore Ruling in South China Sea Dispute Recalls American Response in Contra Case*, WALL. ST. J. (Jul. 7, 2016), https://www.wsj.com/articles/chinas-defiance-of-international-court-has-precedentu-s-defiance-1467919982/. Another example is the U.S. stance on the use of treaty overrides, which Avi-Yonah notes that it contravenes "customary international

he published, "The International Tax Regime: A Centennial Reconsideration," in which he noted that the benefits principle and the single tax principle may require modification in light of globalization.[160] Interestingly, his core claim that there exists an international tax regime founded upon customary international law has not attracted much scrutiny in literature. While some authors cite his article to explain certain international tax practices,[161] others have agreed with him that certain international tax practices have arguably become customary international law.[162] A few others have expressed utter shock at his claims,[163] sounded a word of caution on the use of labels when discussing international taxation and public international law,[164] or redirected the focus of the debate.[165] Accordingly, this Article brings to the debate perspectives from public international law as a means by which

law as embodied in the VCLT." *See* Reuven Avi-Yonah, *International Tax as International Law, supra* note 157, at 494. It appears that the United States does not conform to international law when it disagrees with an international obligation or norm. That sentiment was expressed succinctly in the Senate Report as follows: "Finally, it is the committee's view that this prohibition of double dipping is in fact necessary to prevent discrimination in favor of foreign-owned businesses and against U.S.-owned businesses in the U.S. economy. If the committee should be incorrect in its technical interpretation of the interaction between this provision and treaties, however, it does not intend that any contrary provision defeat its elimination of this double dipping loophole. The committee does not believe that the United States Senate wittingly agreed to an international tax system where taxpayers making cross-border investments, and only those taxpayers, could reduce or eliminate their U.S. corporate tax through self-help and gain an advantage over U.S. persons who make similar investments." *See Tax Reform Act of 1986, Report of the Comm. on Finance, U.S. Sen. on H.R. 3838, S. Rep. No. 313, 99th Cong., 2d Sess. (1986) Section II - Cong. Rep.*, *supra* note 2, at 422. In other words, even if there had been a public international law rule, to the extent that it conflicted with the U.S. law on double dipping, the U.S. law should prevail.

160. Reuven Avi-Yonah, *The International Tax Regime: A Centennial Reconsideration*, SSRN Scholarly Paper ID 2622883 (Social Science Research Network), June 25, 2015.

161. *See, e.g.*, Rebecca M. Kysar, *On the Constitutionality of Tax Treaties*, 38 YALE J. INT'L L. 1, 11, 17 (2013).

162. *See, e.g.*, Mitchell A. Kane, *Bootstraps and Poverty Traps: Tax Treaties as Novel Tools for Development Finance*, 29 YALE J. REGUL. 255 (2012) (stating that providing unilateral double taxation relief has arguably become customary international law); Anna A. Kornikova, *Solving the Problem of Tax-Treaty Shopping through the Use of Limitation on Benefits Provisions Comment*, 8 RICHMOND J. GLOB. L. BUS. 249 (2008) (noting that unilateral implementation of anti-abuse rules has arguably become a general principle of public international law).

163. *See* Asif Qureshi, *Coherence in the Public International Law of Taxation: Developments in International Taxation and Trade and Investment Related Taxation*, SSRN Scholarly Paper ID 2600132 (Social Science Research Network), Mar. 30, 2015.

164. *See* Allison Christians, *Hard Law, Soft Law, and International Taxation Scholarly Essay*, 25 WIS. INT'L L.J. 325 (2007-08).

165. *See* Steven A. Dean, *More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime*, 84 TUL. L. REV. 125 (2009).

the international tax system may be understood, delineated, and situated within the public international law setting.[166]

Avi-Yonah claims, *inter alia*, that

> [A] coherent international tax regime exists, embodied in both the tax treaty network and in domestic laws (both treaty-based and customary).[167] The practical implication is that countries are not free to adopt any international tax rules they please, but rather operate in the context of the regime, which changes in the same ways international law changes over time. Thus, unilateral action is possible, but is also restricted, and countries are generally reluctant to take unilateral actions that violate the basic norms that underlie the regime. Those norms are the single tax principle (i.e., that income should be taxed once – not more and not less) and the benefits principle (i.e., that active business income should be taxed primarily at source, and passive investment income primarily at residence).[168]

In an attempt to illustrate the opposable nature of the international tax regime to the generality of states, Avi-Yonah poses the following question to skeptics of the regime:

> Suppose you were advising a developing country or transition economy that wanted to adopt an income tax for the first time. How free do you think you would be to write the international tax rule for such a country in any way you wanted, *assuming that it wished to attract foreign investment*? I would argue that the freedom of most countries to adopt international tax rules is severely constrained, even before entering into any tax treaties, by the need to adapt to generally accepted principles of international taxation. Even if divergent rules have been adopted, the process of integration into the world economy forces change.[169]

166. *See* Allison Christians et al., *Taxation as a Global Socio-Legal Phenomenon*, 14 ILSA J. INT'L & COMP. L. 303 (2007-08) (discussing the need for tax scholarship to turn to fields such as international relations, organizational theory, and political philosophy to provide a broader framework for understanding the evolution of tax policy and politics).

167. *See* AVI-YONAH, *supra* note 158, at 1.

168. *Id.*

169. *Id.* at 4 (emphasis added).

Examples from Mexico, South Korea, Bolivia and the United States were provided to support the view that states are constrained in their choice of international tax rules.[170] These examples will be discussed later.

The argument in favor of an existing international tax regime that embodies the single tax principle and the benefits principle appears to be a two-legged argument. The first leg relates to the network of bilateral tax treaties. In this regard, Avi-Yonah states:

> I would argue that the network of two thousand and more bilateral tax treaties that are largely similar in policy, and even in language, constitutes an international tax regime, which has definable principles that underlie it and are common to the treaties. These principles are the single tax principle and the benefits principle.[171]

To the extent that the rule is already contained in a bilateral or multilateral tax treaty, one could appreciate the sense in which such rules would be considered rules of public international law—i.e., by means of treaty law. The claims in support of the international tax regime extend beyond the expansion of international tax rules into public international law through bilateral and multilateral tax treaty provisions. They assert that norms of customary international law have crystallized from state practice to give grounding to an international tax regime. It is important to bear in mind that if the international tax

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170. Avi-Yonah cited these examples: "Mexico had to abandon its long tradition of applying formulas in transfer pricing and adopt rules modeled after the OECD guidelines in order to be able to join the OECD. South Korea similarly had to change its broad interpretation of what constitutes a permanent establishment under pressure from the OECD. And Bolivia had to abandon its attempt to adopt a cash flow corporate tax because it was ruled not creditable in the United States. Even the United States is not immune to this type of pressure to conform, as can be seen if one compares the 1993 proposed transfer pricing regulations under IRC Section 482, which led to an international uproar, with the final regulations, which reflect the OECD guidelines. Another illustration can be derived from recent developments in both the United States and Germany regarding the application of the principle of nondiscrimination, which is embodied in all the tax treaties, to thin capitalization rules that are designed to prevent foreign taxpayers from eliminating the corporate tax base through capitalizing domestic subsidiary corporations principally with debt. When the United States first adopted its thin capitalization rules in 1989, it carefully applied it both to foreigners and to domestic tax exempts, so as not to appear to be denying interest deductions only to foreigners. The United States did this even though thin capitalization rules are an accepted part of international tax law and even though its constitutional law permits unilateral overrides of tax treaties." *Id.*

171. *Id.* at 3.

regime were based solely on treaty law, its impact would not be opposable to the generality of states. Thus, the second leg of the proposition is significant. To that end, it is argued that public international law has over time undergone changes through the interplay of tax treaty law and state practice such that norms of customary international law pertaining to international taxation have been formed. Ultimately, states "are not free to adopt any international tax rules they please, but rather operate in the context of the regime" by complying with the single tax principle and the benefits principle.[172]

2. The Single Tax Principle and the Benefits Principle

Avi-Yonah suggests that the single tax principle is a norm of customary international law that obligates states to tax income once—not more and not less.[173] The applicable tax rate to be used in furtherance of the single tax principle is determined by the benefits principle. Under the benefits principle, states are obligated under customary international law to administer their taxing rights in a manner that relinquishes the primary right to tax active business income to the source state and the primary right to tax passive investment income to the residence state.[174] He provides the justification as follows: "On a theoretical level, the benefits principle makes sense because it is primarily individuals who earn investment income, whereas it is primarily corporations that earn business income."[175]

Proceeding further, he outlines a number of reasons that make the benefits principle reasonable. On the whole, very little is said about the manner by which these principles became norms of customary international law. He, however, mentions that the distinction between the residence and source states in relation to passive and active business income "stems from the work of the League of Nations in the 1920s."[176]

This Article does not focus on whether there are valid reasons for states to embrace the single tax principle and the benefits principle. Rather, the Paper focuses on whether these principles are grounded in customary international law, as claimed. But first, questions still remain as to the exact meaning and content of these principles.

172. *Id.* at 1.
173. *Id.* at 8.
174. *Id.* at 11.
175. *Id.*
176. *Id.*

For example, in relation to the single tax principle, does being taxed only "once—not more and not less"[177] mean being taxed by only one of the states involved? Or is the principle still satisfied if both countries through a treaty share the taxation of that income so that the final combined tax rate does not exceed the tax rate that would have been applicable had only one state imposed its tax on that item of income in the absence of a treaty? The usual practice of states is to share taxing jurisdictions through the use of bilateral treaties.[178] For example, some treaties reduce withholding rates on interest to zero percent or dividends to five percent.[179] Thus, if the state with the primary taxing jurisdiction imposes tax in addition to the treaty reduced rates, does that still qualify as a single tax? Again, where the rates are reduced to zero percent under treaty and the state with the primary taxing rights refrains from taxation, would the single tax principle be violated? It appears Avi-Yonah would respond to this question in the affirmative. He states:

> When the primary jurisdiction refrains from taxation, however, residual taxation by other (residence or source) jurisdictions is possible and may be necessary to prevent undertaxation. Such residual taxation means that all income from cross-border transactions, under the single tax principle, should be taxed at least at the source rate (which tends to be lower than the residence rate), but at no more than the residence rate.[180]

If the single tax principle is binding, then a state with the primary taxing right must impose a tax. And if it refuses to tax, the state with residual taxing rights must impose a tax to ensure that the single tax principle is not violated. However, this does not appear to be the case in practice and is probably the reason the residual taxing right is described in the foregoing quotation as a supposition rather than an obligation. Thus, a violation of that principle should not attract sanctions under public international law. Moreover, residual taxation may be prevalent in the absence of a treaty. In the area of bilateral tax treaties, however, such residual taxation appears not to be supported by

177. *Id.* at 1.

178. *See, e.g.*, U.S. Model, *supra* note 155.

179. *See, e.g.*, Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, U.K.-U.S., arts. 10-11, July 24, 2001, S. TREATY DOC. NO. 107-19, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/uktreaty.pdf.

180. AVI-YONAH, *supra* note 158, at 9.

state practice. Contracting states have not typically exercised a residual taxing jurisdiction under treaty law that contravenes their domestic tax policy.

Further, do taxes on income imposed by political subdivisions or local authorities count toward the calculation or determination of the single tax principle? This question remains unaddressed, even though such provincial income taxes are looked upon with contempt by some foreign governments.[181] In this regard, Charles Gustafson notes that "[u]nhappiness on the part of a number of foreign governments with respect to the application of unitary, or formulary, income tax methods by certain states of the United States led to efforts to thwart the practice through provisions in tax treaties. The vigorous opposition by state authorities, however, overcame those efforts."[182] The question remains as to whether the inability of contracting states to successfully do away with this state income taxation method takes away from the single tax principle.[183]

Again, the single tax principle, as propounded by Avi-Yonah, is founded upon the sole practice of states' agreements to eliminate double taxation through treaties.[184] But does the single tax principle impose upon a country the duty to tax a taxpayer? Suppose parties to a bilateral tax treaty agree that in the case of interest income, the source state would relinquish its taxing rights in favor of the residence state. Does this agreement to forego the tax on interest income in favor of the other state represent the single tax principle? If that is the case, then the residence state in keeping with the single tax principle becomes duty bound to impose a tax on that interest income solely because of a bilateral tax treaty, even if its tax policy would have exempted such interest income from tax. In practice, this is not the case. Where the taxing right is allocated to a contracting state under a bilateral tax treaty, that contracting state may well impose a more favorable tax treatment than the treaty rules in relation to that item of income. The United States, for example, makes this clear by means of a savings clause in tax treaties. The U.S. Model Technical Explanation (2006) states that, in relation to Article 1(2):

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181. GUSTAFSON ET AL., *supra* note 102, at 67.

182. *Id.*

183. For more on unitary income tax method, see Chantal Thomas, *Customary International Law and State Taxation of Corporate Income: The Case for the Separate Accounting Method*, 14 BERKELEY J. INT'L L. 99 (1996); Barclays Bank PLC v. Franchise Tax Bd. of California, 512 U.S. 298 (1994); AT & T Teleholdings, Inc. v. Department of Revenue, 978 N.E.2d 371 (Ill. App. Ct. 2012).

184. AVI-YONAH, *supra* note 158, at 8.

> [T]he Convention may not increase the tax burden on a resident of a Contracting States [sic] beyond the burden determined under domestic law. Thus, a right to tax given by the Convention cannot be exercised unless that right also exists under internal law. It follows that, under the principle of paragraph 2, a taxpayer's U.S. tax liability need not be determined under the Convention if the Code would produce a more favorable result.[185]

Thus, residual taxation under public international law that is contrary to domestic tax policy appears not to be supported by state practice.

Moreover, the single tax principle and the benefits principle contradict customary international law. Customary international law has since time immemorial not opposed double taxation or double non-taxation.[186] It is mainly because of this that states enter into bilateral tax treaties. In relation to this, customary international law does not offer a state, apart from treaty law, the right to compel another to refrain from exercising a taxing right simply because it results in double taxation. It appears the only redress is through bilateral tax treaties. Avi-Yonah claims that these principles are new norms of customary international law, with the implication that now customary international law eschews double taxation or double non-taxation of income.[187] He also argues that the residence rule and the controlled foreign corporation regime have become norms of customary international law.[188] Thus, the next section will undertake an excursion into the making of public international law while juxtaposing that with some of the claims.

B. *The International Tax System and Norms of Customary International Law*

This section addresses the claim that states are bound under customary international law to conform to the international tax regime. Indeed, this is an allusion to the concept of *opinio juris sive necessitates* in public international law—i.e., states feel bound to comply with a legal

185. *See* United States Model Technical Explanation of November 15, 2006, https://www.irs.gov/pub/irs-trty/temod006.pdf (emphasis added).

186. Qureshi, *supra* note 163. As discussed in II.B, *supra*, some contrary argument exists that the domiciliary state may be expected under customary international law to alleviate double taxation through reasonable means, although the multiplicity of bilateral tax treaties casts doubt on this argument.

187. AVI-YONAH, *supra* note 158, at 4-5.

188. *Id.*

duty. Thus, without grasping the concept of *opinio juris* and customary international law, one cannot appreciate the answer given to the hypothetical question posed to skeptics. For ease of reference, the claims are grouped into two: (1) customary international tax law formed through treaty provisions, and (2) customary international tax law formed through state practice other than through treaty.

1. Customary International Tax Law Formed through Tax Treaty Provisions—The Residence Rule

According to Avi-Yonah, "The residence rule is so widely followed and incorporated into so many treaties that it can be considered part of customary international law, even though it seems contrary to widely shared understandings of nationality."[189] As discussed above, a treaty provision that may become part of customary international law should possess a norm-creating character and be capable of promoting a general practice among states. The "residence rule" appears to be a norm-creating provision. It is sufficiently general in its form and may be engaged in by most states. But does the general nature of the treaty provision suggest that it has or may crystallize into a rule of customary international law? In addressing a similar question, the ICJ in *North Sea Continental Shelf* prescribed that the wording of the provision is equally as important as the provision's norm-creating nature.[190] In that case, the provision in question applied only after state parties to the Geneva Convention failed to reach an agreement, and was also subject to reservations.[191] Based on these facts, the Court found that the provision was not a norm-creating provision. How does the residence rule in bilateral tax treaties stand up to this test? A brief review of the nature of bilateral tax treaties is necessary.

Bilateral tax treaties have become useful, because states levy taxes beyond domestic assets and economic transactions.[192] The majority of states "levy taxes on assets situated and transactions carried out in other countries to the extent that they benefit resident taxpayers."[193] Curiously, public international law does not prohibit the taxation of

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189. *See* Avi-Yonah, *supra* note 157, at 486. *See also* AVI-YONAH, *supra* note 158, at 23. Generally, under the residence rule, a person's liability to tax is dependent upon whether that person is considered a resident of the state exercising the taxing jurisdiction.

190. North Sea Continental Shelf (Ger./Den. and Ger./Neth.), Judgment, 1969 I.C.J. Rep. 3, 34-35 (Feb. 20).

191. *Id.* at 24-26.

192. Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 BERKELEY J. INT'L L. 1 (1986).

193. *Id.*

foreign economic transactions if a sufficient connection between the taxpayer and the taxing state is established.[194] That connection may be found through residence, habitual abode, citizenship, or situs of assets. Indeed, "[n]o territoriality principle of international law prohibits the application of domestic law to situations arising in foreign countries, including the taxation of foreign income for domestic purposes."[195] Further, under customary international law, double taxation that arises from the interplay of the domestic laws of two or more states is not forbidden,[196] provided that the domestic law of each state complies with its international obligations.[197] This lack of prohibition is the reason states enter into bilateral tax treaties to address cases of double taxation or double non-taxation.

It is important to bear in mind that an essential purpose of tax treaties is to promote more cooperation between the tax authorities of contracting states with a view to combating tax avoidance and evasion.[198] Through such cooperation, treaty partners can exchange information about international transactions of taxpayers. States do not enter bilateral tax treaties out of a sense of legal duty under customary international law to avoid double taxation or double non-taxation. Rather, a "fundamental rationale of income tax treaties is to prevent taxes from interfering with the free flow of international trade and investment."[199] Thus, states may choose other vehicles to address tax evasion, double taxation, or under-taxation if necessary. The United States, for example, usually concludes Tax Information Exchange Agreements with countries whose economies are not considered significant in lieu of a full-blown tax treaty.[200]

Bilateral tax treaties differ in many respects from other bilateral treaties. In the United States, for example, bilateral tax treaties are negotiated by the International Tax Counsel in the U.S. Department of the

194. *Id. See also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED § 412 (AM. LAW. INST. 1987) STATES [hereinafter RESTATEMENT (THIRD)].

195. Vogel, *supra* note 192, at 6. *See also* RESTATEMENT (THIRD) § 411.

196. Double taxation is the situation where comparable taxes of two or more states are levied on the same taxable event of a taxpayer for identical tax periods. Economic double taxation, on the other hand, involves the taxation of different taxpayers by two or more states in respect of the same subject matter and tax period. *See* Vogel, *supra* note 192, at 5-6.

197. *Id. See also* RESTATEMENT (THIRD) § 411 reporters' note 2.

198. GUSTAFSON ET AL., *supra* note 102, at 71.

199. *Id.* at 768.

200. William P. Streng, Vinson & Elkins Professor of Law, Univ. of Hous. Law Ctr., U.S. Tax Treaties: Trends, Issues & Policies - Recent Developments - Future Prospects, Presentation at Houston International Tax Forum (Apr. 2, 2009), http://www.law.uh.edu/faculty/wstreng/HoustonInternationalTaxForum.pdf, at 32-33.

Treasury's Office of Tax Policy, not by the State Department.[201] In Germany, tax treaties are typically negotiated by the Ministry of Finance who is represented by a chief negotiator.[202] Second, whereas most treaties are subject to the Vienna Convention on the Law of Treaties, questions of interpretation for tax treaties are usually governed by the Technical Explanation (Commentaries) to the model tax treaty.[203] Third, bilateral tax treaties generally resort to the use of "competent authorities" for dispute resolution.[204] The taxpayer is merely an instigator of the process, as only the Contracting States may be parties to any dispute arising from the bilateral tax treaty.[205] The taxpayer's state is not obligated to pursue the taxpayer's complaint.[206] If, however, the state decides to pursue the complaint of the taxpayer, that state shoulders all costs pertaining to the dispute and the taxpayer is excluded from the competent authority deliberations.[207] Unlike other bilateral treaties, the taxpayer is not required in any way to bear either in whole or in part the cost of the dispute.[208] "Moreover, the competent authorities' decision with respect to one taxpayer is not precedential authority with respect to any other taxpayer under the same or any other treaty."[209]

Lastly, bilateral tax treaties do not typically affect direct relations between or among states.[210] Instead, they provide a working arrangement

201. Reuven Avi-Yonah, *International Tax as International Law*, *supra* note 157, at 491-92. *See also* Vogel, *supra* note 192, at 16.

202. Vogel, *supra* note 192, at 16.

203. The drafting of bilateral tax treaties usually starts from the text of at least one of the model tax treaties. Among the model tax treaties are the OECD Model; U.N. Model; U.S. Model; and the recently released U.S. Model Income Tax Treaty 2016, *supra* note 155.

204. Generally, a competent authority is an office that is identified by a tax treaty as being responsible for addressing disputes arising from the treaty. Today, the United States has begun negotiating tax treaties that require binding arbitration in situations where the negotiating process does not result in a mutual agreement. This binding arbitration has also been incorporated into the U.S. Model Income Tax Treaty 2016. *See* GUSTAFSON ET AL., *supra* note 102, at 767-68.

205. This explains the existence of very few ICJ cases on taxation. *See* Ed Morgan, *International Tax Law as a Ponzi Scheme*, 34 SUFFOLK TRANSNAT'L L. REV. 74–77 (2011).

206. Van Der Bruggen, *supra* note 147, at 448.

207. JUAN ANGEL BECERRA, INTERPRETATION AND APPLICATION OF TAX TREATIES IN NORTH AMERICA 14, 75–81 (2007).

208. *See, e.g.*, Rev. Proc. 2015-40 (providing that, in general, no user fee is required for a competent authority request).

209. GUSTAFSON ET AL., *supra* note 102, at 72.

210. Tax treaties generally limit the jurisdiction that each treaty country may exercise to tax income from domestic sources realized by a resident of the other country. They may also provide clarification about areas in which the application of the tax laws of the treaty partners may be ambiguous or unpredictable. *See* GUSTAFSON ET AL., *supra* note 102, at 63.

for states to adapt their domestic tax laws with a view to avoiding double taxation or tax evasion in relation to taxable persons whose activities bear sufficient nexus for taxation by the two contracting states.[211] States negotiate bilateral tax treaties to reciprocate tax favors granted to their taxpayers who are typically at the center of an instance of double taxation (non-taxation).[212] Because bilateral tax treaties generally result in the application of domestic tax laws, they do not govern the conduct of states in the public international law arena or applications of foreign law. Bilateral tax treaties assume that both contracting states exercise taxing jurisdiction based on their domestic tax laws. Proceeding on that assumption, tax treaties seek to restrict the domestic tax law of both contracting states in cross-border matters.[213] Thus, bilateral tax treaties are generally seen as limiting rather than expanding tax liabilities and accordingly applicable by election of the taxpayer who must exercise the right to claim treaty protection.[214]

This is, by far, one of the most relevant distinguishing features of bilateral tax treaties. It is generally the taxpayer who would seek their application and instigate the competent authority or mutual agreement procedure to reduce the tax liability. Where there is a more favorable tax position under domestic law, the taxpayer is permitted to elect that treatment. This elective nature of bilateral tax treaties is more evident in the U.S. Model Treaty.[215] As David Rosenbloom puts it,

> [I]nternational tax conventions themselves usually make clear that they are elective: "The Convention shall not restrict in any manner any benefit now or hereafter accorded . . . by the laws of either Contracting state . . . This means, simply, that a taxpayer may reject a treaty and its contents and invoke instead its

211. Instances of double taxation do not directly erode the taxing rights of states. States by their sovereignty may choose to impose on persons with whom they have sufficient nexus taxes they consider due them, whether or not it causes double taxation. And in practice, if the taxes in a particular state are disruptive, investments may be channeled outside that state, resulting in loss of investments. States may also refrain from imposing tax in order to position themselves as appealing locations for investments.

212. In situations of double non-taxation, the domestic tax law of the treaty partner is applicable, but the treaty provisions on exchange of information and other procedural matters would help address the problem of double non-taxation.

213. Vogel, *supra* note 192, at 14.

214. KLAUS VOGEL ET. AL., *KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS: A COMMENTARY TO THE OECD-, UN-, AND US MODEL CONVENTIONS FOR THE AVOIDANCE OF DOUBLE TAXATION ON INCOME AND CAPITAL, WITH PARTICULAR REFERENCE TO GERMAN TREATY PRACTICE* (*John* Marin and Bruce Elvin trans., 3d ed. 1997).

215. U.S. Model, *supra* note 155.

> rights under domestic law, both in the United States and in the other country."[216]

The elective nature of tax treaties was further clarified by the U.S. Model Technical Explanation on Article 1(2) as follows: "A taxpayer may not, however, choose among the provisions of the Code and the Convention in an inconsistent manner in order to minimize tax."[217]

On the basis of the decision in *North Sea Continental Shelf*, this elective feature of bilateral tax treaties casts doubt on the norm-creating character of the residence principle as embodied in tax treaties. In that case, the ability of states to apply other principles over the equidistance principle in the Geneva Convention stripped the relevant article in the Geneva Convention of its norm-creating character.[218] Therefore, if taxpayers, both natural and juridical persons, are permitted to elect to suspend the application of a treaty, then that treaty is incapable of promoting a general participation among states of the kind required for the formation of customary international law. Even worse, with respect to bilateral treaties, the actors (i.e., taxpayers) are not recognized as traditional players in the public international law field.[219]

The norm-creating character of the residence principle is plunged into more doubt because a bilateral tax treaty acts like a "stencil that is placed over the pattern of the domestic law and covers certain parts."[220] As a stencil, it cannot print any "pattern" that did not already exist in domestic law. Thus, if there is any place we should look for norm-creating provisions, it should be that "pattern" in domestic law, and not the "stencil" of bilateral tax treaties. Ultimately, similar to the findings of the Court in *North Sea Continental Shelf*, the very nature of bilateral tax treaties would challenge a conclusion that the residence rule as

216. H. David Rosenbloom, *The David R. Tillinghast Lecture: International Tax Arbitrage and the "International Tax System,"* 53 TAX L. REV. 137, 164 (2000). *See also* Stephen M. Brecher, *Relationship of and Conflicts Between Income Tax Treaties and the Internal Revenue Code*, 24 T. EXEC. 175 (1972). But for a contrary view, see Vogel, *supra* note 192.

217. UNITED STATES MODEL TECHNICAL EXPLANATION ACCOMPANYING THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOV. 15, 2006 2 (U.S. DEP'T OF TREASURY 2006), https://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf.

218. *See* North Sea Continental Shelf (Ger./Den. and Ger./Neth.), Judgment, 1969 I.C.J. Rep. 3, 42 (Feb. 20).

219. It has been increasingly argued that today, non-state actors such as individuals are considered subjects of public international law. *See, e.g.*, DIXON, *supra* note 6; Jordan J. Paust, *Non-State Actor Participation in International Law and the Pretense of Exclusion*, 51 VA. J. INT'L. L. 977 (2011).

220. Vogel, *supra* note 192, at 26.

embodied in bilateral tax treaties has crystallized into customary international law simply because multiple bilateral tax treaties contain it.

Similarly, the uncertainty that plagues the single tax principle and the benefits principle raises doubts about their crystallization as norms of customary international law.[221] Moreover, to the extent that the single tax principle and the benefits principle are described as founded upon treaty law, they would suffer a similar fate as the residence principle on the basis of the decision in *North Sea Continental Shelf*.[222] If these principles, as contained in treaty provisions, merely codify what would otherwise constitute *de lege lata* or emerging rules of customary international law, then they could become norms of customary international law. However, state practice, outside of treaty law, seems to not support these principles and hence, they may not be considered *de lege lata*.

2. Customary International Tax Law from State Practice Other than through Treaty-Controlled Foreign Corporation Regime

In regard to the controlled foreign corporation (CFC) regime, Avi-Yonah states:

> Again, there was no international law challenge to the deemed dividend rule. Instead, other countries began to copy the CFC regime.... Currently, there are 23 countries with CFC rules (mostly developed ones), and the number is likely to increase.[223] Thus, it would seem that the CFC concept arguably has become part of customary international law, just like the expansion of territorial jurisdiction over international waters rapidly changed international law from the 1970s onward.[224]

The comparison between the CFC regime and the expansion of territorial jurisdiction into international waters is debatable. This is because the CFC regime did not possess extraterritorial implications of the kind that expansion into international waters did.[225] Whereas the expansion

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221. Similarly, the uncertainty makes the single tax principle and the benefits principle unlikely to qualify as general principles of law recognized by nations within the meaning of Article 38(1)(c).

222. *North Sea Continental Shelf*, 1969 I.C.J. Rep. at 3.

223. As at the time of writing this paper, there were about sixty-five countries with a CFC regime. *See* DELOITTE TAX SERVICES, GUIDE TO CONTROLLED FOREIGN COMPANY REGIMES (2014), http://www2.deloitte.com/il/en/pages/tax/articles/guide-to-controlled-foreign-company-regimes.html/.

224. Avi-Yonah, *supra* note 157, at 488; *see also* AVI-YONAH, *supra* note 158, at 25.

225. International concern over expansion into international waters bordered on matters such as delimitation of a state's territorial sea using a three-mile or twelve-mile limit and the nature of

of jurisdiction over international waters entailed the potential for violation of the sovereign space of a state, the CFC regime did not. The CFC regime stopped at the shareholders of the foreign corporation. And indeed, not all shareholders of the foreign corporation were targeted. Only those shareholders with whom the state employing the CFC regime had sufficient nexus for taxation, such as residence and citizenship, were targeted by the CFC regime. A brief description of the CFC regime is illustrative.

In the United States, the CFC regime targets U.S. persons owning ten percent or more of the total voting power or total value of stock of CFCs.[226] Taxation under the CFC regime is not on the foreign corporation *per se*, but on certain of its U.S. shareholders. Foreign corporations generally do not pay U.S. taxes on foreign source income.[227] Thus, a twin objective is usually identified as underlying the U.S. CFC regime. First, the CFC regime was instituted to prevent the deferral of U.S. tax on foreign source income sheltered in foreign corporations owned or controlled by U.S. persons.[228] On this matter, the committee reviewing the provisions of the CFC bill noted that the attempt to balance the need to maintain active U.S. business operations abroad on an equally competitive footing with other operating businesses in the same countries did not require the deferral of U.S. tax in cases involving portfolio types of investments, "or where the company is merely passively receiving investment income. In such cases, there is no competitive problem justifying postponement of the tax until the income is repatriated."[229] In other words, the CFC regime was not going after foreign corporations, but rather U.S. taxable persons who were deemed to have no business justification for escaping current U.S. taxation by keeping foreign source income in foreign corporations. Second, the CFC regime was to address the shifting of income by U.S. persons to foreign corporations and the use of machinations geared towards the reduction or elimination of taxes.[230]

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the authority or restriction a state could exercise in its territorial sea, the contiguous zone, the continental shelf, and the Exclusive Economic Zone. *See, e.g.*, Legal Issues Raised by Proposed Presidential Proclamation to Extend the Territorial Sea, 12 Op. O.L.C. 238 (1988).

226. *See* I.R.C. § 951(b) (2017).

227. One exception is where the foreign source income of a foreign corporation is taxable in the United States by virtue of its being treated as effectively connected to U.S. trade or business. *See* I.R.C. §§ 882, 864(c)(4).

228. S. REP. NO. 87-1881, at 78-79 (1962).

229. *Id.* at 83.

230. *Id.* at 78-79.

Thus, it is clear from this example that the CFC regime targeted U.S. taxable persons who owned interests in foreign corporations and, therefore, it was not expected to result in a conundrum in the international community similar to that triggered by the expansion of state jurisdiction over international waters. However, this example pertains only to the United States. For purposes of public international law, we must look beyond the practice of just one state. The question then is whether examples from other jurisdictions would controvert the argument that the CFC regime does not present an incursion into the sovereign space of states.

Many countries use CFC regimes to prevent erosion of the domestic tax base and to address the shifting of income by domestic taxpayers to jurisdictions with no or low tax rates. CFC regimes generally "eliminate the deferral of income earned by a CFC and tax residents currently on their proportionate share of a CFC's income."[231] Thus, the regime is generally triggered, and justifiably so, in situations where: a domestic taxpayer is in "control" of the CFC; the CFC is located in a "low tax" jurisdiction or a jurisdiction that imposes a tax rate lower than the rate (as specifically defined) in the shareholder's country, or, alternatively, that the CFC is located in a "black" or "grey" list jurisdiction (as opposed to a favored "white" list jurisdiction);[232] and the CFC derives specific types of income (e.g., passive income in some regimes, but all types of income in others).[233]

In effect, the trigger for the CFC regime is a domestic taxpayer who is in control of a CFC. Without this nexus, the CFC regime crumbles. CFC regimes are therefore first and foremost inward-looking in that they address specific challenges to domestic tax regimes as perpetrated by domestic players, such as residents or nationals, who employ varied devices through foreign corporations to escape domestic taxation.[234] Thus, a state's taxation of its residents who seek to be shielded by foreign corporations under their control does not constitute an incursion into the sovereign space of another country.[235]

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231. DELOITTE TAX SERVICES, *supra* note 223, at 1.

232. DELOITTE TAX SERVICES, *supra* note 223.

233. *Id.*; OECD, DESIGNING EFFECTIVE CONTROLLED FOREIGN COMPANY RULES, ACTION 3 - 2015 FINAL REPORT (2015), https://read.oecd-ilibrary.org/taxation/designing-effective-controlled-foreign-company-rules-action-3-2015-final-report_9789264241152-en#page1/.

234. *Id.*

235. *See also* RESTATEMENT (THIRD) § 412 reporters' note 4 (1987) ("Tax laws commonly provide for taxing as income a person's *pro rata* share of the undistributed income of a partnership not domiciled in the state. In the case of a corporation, the practice is limited. Until 1962, the United States taxed United States shareholders on the undistributed income of foreign

In Argentina, the CFC rules require resident shareholders to include in their taxable income the taxable profits derived by a company resident in a non-cooperative jurisdiction from certain passive income if the amount of passive income is greater than the amount of active income.[236] In Australia, qualifying Australian shareholders are subject to taxation on an accruals basis on their proportionate share of a CFC's "attributable income."[237] Under the Brazilian CFC rules, profits earned by a CFC of a Brazilian entity, whether or not distributed, must be included in the corporate income tax of the Brazilian entity.[238] In Canada, residents are subject to current taxation on their share of foreign accrual property income earned by a controlled foreign affiliate.[239] Similarly, a Chinese enterprise shareholder may be subject to current taxation to the extent of its proportionate share of undistributed profits of CFCs located in certain low tax jurisdictions where there are no valid business reasons for the decision not to distribute.[240] In Denmark, a Danish company is required to include in its taxable income the total income of a foreign or Danish subsidiary, if the subsidiary qualifies as a CFC.[241] Similarly, an Egyptian company may be subject to current taxation on the income of its CFC if certain requirements exist.[242] In Finland, Finnish residents may be subject to income tax on their share of the profits of a CFC, without regard to whether the CFC distributes the profits to its shareholders.[243] Under the French CFC rules, a French entity may be subject to tax on profits of certain foreign entities that

corporations only in the case of foreign personal holding companies, i.e., closely-held companies, controlled by United States individuals, that derive principally passive investment income. . . . Since 1962, the United States has also taxed certain undistributed 'tax haven' income of foreign operating corporations controlled by United States persons (whether individuals, partnerships, or corporations). . . . Such taxation has been held to be constitutional. . . . Other countries— Canada, France, the Federal Republic of Germany, Japan—have adopted similar legislation providing for taxation of the undistributed 'tax haven' income of a foreign entity to persons resident or domiciled in the taxing state who control the entry. From time to time, proposals have been made to tax currently to United States shareholders all undistributed income of controlled foreign corporations. . . . While such legislation has not been enacted, there seems to be no doubt that the United States could impose such a tax, especially if it makes appropriate allowance for taxes imposed by the state in which the corporation is domiciled.") (internal citations omitted).

236. The rules contain a list of countries that are classified as "cooperative" for tax transparency purposes.

237. DELOITTE TAX SERVICES, *supra* note 223.

238. *Id.*

239. *Id.*

240. *Id.*

241. *Id.*

242. *Id.*

243. *Id.*

benefit from a beneficial tax regime.[244] In Uruguay, there are no specific CFC rules that apply to entities, but specific rules apply to Uruguayan individuals that hold a direct or indirect interest in a nonresident entity.[245]

A common thread in the CFC regimes listed above is that they are triggered by the presence of a person of interest, who is a tax resident, national, or citizen of the state administering the CFC regime. Thus, the CFC regime may not be a good fit for comparison with the expansion of jurisdiction over international waters. Whereas the former is an inward-looking act that looks at closing loopholes in domestic taxation, the latter abuts territorial boundaries, which would usually at a minimum involve the interest of adjacent and opposite states.

In light of this discussion and the very inward-looking nature of the CFC regime, it is difficult to support a claim that the "spread of CFC legislation is a good example of how rapidly customary international law, in fact, can change."[246] As noted, the CFC regime is so inward-looking that it can hardly be said to have significant public international law implications. But to do this issue justice, it is necessary to employ principles of public international law to determine whether the CFC regime has emerged as international custom or a norm of public international law.

One of the principles of international law that is relevant to sustain a claim that a norm is, in fact, customary international law is that the norm must be engaged in extensively by states. In *North Sea Continental Shelf*, the ICJ noted that although evidence of practice by fifteen states was by itself inconclusive on the issue, the fifteen cases together with other factors supported a conclusion that no customary international law had been created.[247] The Court identified the factors as follows: the practice involved, although potentially a norm-creating practice, under the circumstances, lacked that quality; and no evidence as to the existence of *opinio juris* was established.[248] Instead, sufficient evidence existed to support the view that the state practice was motivated by other reasons such as political expediency.[249] The Court reached a similar conclusion in *Lotus*.[250]

244. *Id.*

245. *Id.*

246. Avi-Yonah, *supra* note 157, at 498.

247. North Sea Continental Shelf (Ger./Den. and Ger./Neth.), Judgment, 1969 I.C.J. Rep. 3 ¶¶ 75-78 (Feb. 20).

248. *Id.* at ¶¶ 76-77.

249. *Id.* at ¶ 77.

250. The S.S. Lotus (Fr. v. Turk.), 1927 P.C.I.J., (ser. A) No. 10 (Sept. 7).

As of 2004, the year Ayi-Yonah's article was published, there were twenty-three countries that had embraced the CFC regime.[251] Based on the ICJ jurisprudence, that number in and of itself is not dispositive of the issue. Indeed, today, there are approximately sixty-five countries with CFC regimes.[252]

Focusing merely on the number of states involved in the practice without examining the type of practice involved could be misleading. For example, in looking only at numbers, one could reach an absurd conclusion that the VAT has become a norm of customary international law because it is embraced by about 160 countries. This outcome, however, is incorrect, because the VAT is a type of tax that a state may elect to include in its domestic tax system. No international obligation is created or imposed on any state merely because numerous countries have found the VAT to be a useful form of taxation. Additional factors must be considered in order to determine the status of the practice in international law. The state practice under review must be capable of producing a general practice among states. Therefore, a relevant question arises as to whether the state practice permits an across-the-board application in the international community.

In the same vein as the VAT, states are recognizing that the imposition of a CFC regime is very useful in closing some loopholes in their tax systems.[253] It is of no consequence that those loopholes arise from the use of foreign corporations.[254] It is still the case that loopholes in domestic tax systems need to be closed to prevent local and domestic actors from employing devices in order to benefit from the loopholes in their domestic tax systems. Accordingly, it is purely within the sovereign will of the state to embrace or reject the CFC regime. The number of states that embrace the regime in no way creates an obligation under international law principles for other states. Viewed from this angle, it is difficult to support the claim that "[t]he United States no longer feels bound by this rule, but that is because enough other countries have adopted CFC legislation that expands the definition of nationality that customary international law has changed."[255]

Another element of the formation of customary international law noted by *North Sea Continental Shelf* is that the practice must be of a

251. Avi-Yonah, *supra* note 157, at 488.

252. DELOITTE TAX SERVICES, *supra* note 223.

253. See discussion above.

254. Qureshi, *supra* note 163.

255. Avi-Yonah, *supra* note 157, at 498 (emphasis added). For a similar position, see AVI-YONAH, *supra* note 158.

nature so as to require a general practice.[256] Here, as mentioned previously, the CFC regime is attuned to the specific domestic situations of states. The means by which it is triggered typically requires a domestic or resident taxpayer. A sovereign state's domestic tax practices do not encroach upon the taxing jurisdiction of another state. Indeed, the reason for the conclusion of bilateral tax treaties is typically to prevent double taxation or double non-taxation. This is because the tax practices of a sovereign state hardly encroach upon the taxing powers of another sovereign state. At best, they would lead to over-taxation or under-taxation of the taxpayer involved. If a sovereign state seeks to rectify this over- or under-taxation through bilateral arrangements with another state, it is because it seeks to resolve the matter as it pertains to the taxpayer and not because it feels that its sovereign space has been invaded.

Further, Avi-Yonah points to the lack of objection from states to the CFC regime as evidence of the regime's crystallization into customary international law.[257] The formation of customary law requires participation or non-participation in the rule by states whose interest are specially affected as noted by *North Sea Continental Shelf*.[258] However, the nonparticipation yardstick may not be a good measure when tax matters are concerned. Typically, the revenue rules of foreign states are accorded less attention by other states because those rules hardly affect their special interests. It is in light of this that the famous statement by Lord Mansfield was made: "[N]o country ever takes notice of the revenue laws of another."[259] This statement by Lord Mansfield would become the bedrock of the revenue rule. Although the revenue rule has metamorphosed over the years, it remains true today that, generally, states do not concern themselves with the tax rules and practices of another.[260] In limited cases, states may concern themselves with foreign

256. North Sea Continental Shelf, (Ger./Den. and Ger./Neth.), Judgment, 1969 I.C.J. Rep. 3 (Feb. 20).

257. Avi-Yonah, *supra* note 157, at 488.

258. *North Sea Continental Shelf*, 1969 I.C.J. Rep. at ¶ 73.

259. *See* Holman v. Johnson, 98 Eng. Rep. 1120, 1121 (KB 1775).

260. The revenue rule has been used by courts, *inter alia*, to refrain from entertaining actions by governmental authorities to enforce foreign judgments relating to tax claims. The rule originated with cases dealing with enforcing contracts that violated foreign tariff laws. Today, however, courts generally excuse performance of contracts that violate foreign tax and export tax law. *See* RESTATEMENT (FOURTH) OF FOREIGN RELATIONS: TREATIES (AM. LAW INST., Discussion Draft 2015). *See also* Pasquantino v. United States, 544 U.S. 349, 366 (2005) (citing Boucher v. Lawson, 95 Eng. Rep. 53, 55-56 (KB 1734)); Mun. Council of Sydney v. Bull, [1908] 1 KB 7; Gov't of India v. Taylor, [1955] A.C. 491 (HL); United States v. Harden, [1963] S.C.R. 366 (Can.); British Columbia v. Gilbertson, 597 F.2d 1161 (9th Cir. 1979); European Cmty. v. RJR Nabisco, Inc., 424 F.3d 175 (2d Cir. 2005).

tax rules. For example, a state may consider the tax rules of another to borrow certain tax practices (such as the CFC regime) or, to challenge the rules on the basis of their harmful effects (such as the EU's response to aspects of the 2017 U.S. tax reforms, as previously noted). Also, a state may engage in unilateral relief of double taxation by inquiring into the imposition of foreign taxes in order to forego their comparable tax claims.[261] As previously mentioned, the CFC regime did not encroach upon the sovereign space of states. Thus, with the U.S. CFC regime, for example, there would be no expectation for states to object to the current taxation of U.S. taxable persons who own stock in and control a foreign corporation that earns foreign source income on which there is little or no tax.

Moreover, it is rarely argued that taxation of U.S. shareholders constitutes direct taxation of a foreign corporation. The incidence of taxation of dividends and deemed dividends in the hands of shareholders is generally not borne by the entity making the distribution. Rather, the reverse is true. Much scholarship has focused on the incidence of corporate taxation on the diminution of the wages of labor, returns to capital, and the rents for shareholders.[262] For all intents and purposes, it will hardly be expected that the introduction of a CFC regime will attract opposition from other states. Hence, the lack of objection from states does not constitute acquiescence in the creation of a norm of customary international law.

Indeed, current trends in the international tax field do not lend credence to the view that the CFC regime has crystallized as a norm of customary international law.[263] One such recent development is the OECD Base Erosion and Profit Shifting Project (BEPS Project). The BEPS Project was tasked with developing recommendations regarding the design of rules relating to CFC regimes.[264] The recommendations were

261. Rosenbloom, *supra* note 216. *See also* Diane Ring, *International Tax Relations: Theory and Implications*, 60 TAX L. REV. 83 (2007) (discussing potential adverse effects from failing to anticipate other countries' tax views or the interactions of their tax rules with a state's tax rules).

262. *See generally* Kimberly A. Clausing, *In Search of Corporate Tax Incidence*, 65 TAX L. REV. 433 (2012); Arnold C. Harberger, *The Incidence of the Corporation Income Tax*, 70 J. POL. ECON. 215 (1962); William C. Randolph, *International Burdens of the Corporate Income Tax* (Cong. Budget Office, Working Paper No. 2006-09, 2006), https://cbo.gov/sites/default/files/cbofiles/ftpdocs/75xx/doc7503/2006-09.pdf; Jennifer C. Gravelle, *Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis* (Cong. Budget Office, Working Paper 2010-03, 2010), https://www.cbo.gov/sites/default/files/111th-congress-2009-2010/workingpaper/05-2010-working_paper-corp_tax_incidence-review_of_gen_eq_estimates_0.pdf/; William A. Klein, *The Incidence of the Corporation Income Tax: A Lawyer's View of a Problem in Economics*, 1965 WIS. L. REV. 576 (1965).

263. OECD, *supra* note 233.

264. *Id.* at 9.

contained in a 2015 final report.[265] One of the goals of the BEPS Project was to encourage states without a CFC regime to implement their recommended design and states with existing CFC regimes to adapt their regimes to the recommended design.[266] Yet the 2015 final report states that the recommendations are not minimum standards but have been designed to ensure that jurisdictions that choose to implement them would have rules that effectively prevent taxpayers from shifting income into foreign subsidiaries.[267] If the CFC regime had become part of customary international law, the BEPS Project, which seeks to have all states implement a CFC regime, would not have made the decision to implement a CFC regime dependent solely upon the choice and preferences of states.

C. *The Skeptic's Answer to Avi-Yonah's Hypothetical Question*

Tax advisors for a transition economy or developing country may undoubtedly be constrained in their advice relating to the fashioning of rules for international taxation. But that feeling of constraint does not arise out of a sense of legal duty to comply with an international obligation (i.e., *opinio juris*).[268] Rather, as indicated in the fact pattern, that developing country or transition economy wishes to attract foreign investment. The government of that country may well decide to implement rules that are contrary to the single tax principle and the benefits principle and still comply with all of its public international law obligations. The consequence would not be a violation of a norm of customary international law, but instead a loss of foreign direct investment (FDI). As stated above, public international law does not eschew double taxation or double non-taxation if the domestic laws of states comply with their international obligations. In practice, however, states often conduct their tax affairs in a manner that attracts FDI or some other similar economic benefit without any sense of a legal obligation. It is, therefore, possible that a state may refuse to conform and not violate international law. That state may lose FDI, as illustrated by the following few examples.

As of 2018, Vodafone Group PLC is slated for an international arbitration with the Indian government over what may be considered a violation of the single tax principle and the benefits principle. The

265. *Id.*

266. *Id.* at 11.

267. *Id.*

268. This is, however, subject to obligations contained in international conventions, including tax and nontax treaties, as discussed above.

Supreme Court of India has held that India is neither the source nor resident country. Thus, by implication, India's decision to impose a tax on a so-called indirect transfer violates the single tax and the benefits principles.[269] Under the benefits principle, India does not have a valid tax rate to apply pursuant to the single tax principle. Yet, following the Supreme Court decision, the Indian government amended the tax legislation with retrospective effect to enable it to sidestep the Supreme Court decision and to claim back taxes from Vodafone Group PLC.[270] The main backlash India has received from foreign investors and multinationals is that its unpredictable tax regime repels foreign investors and causes foreign direct investments in India to fail. India has not yet been challenged before an international tribunal for violating norms of customary international law in relation to international tax.

In other examples, Mexico was made to revise its transfer pricing in order to join the OECD.[271] Avi-Yonah draws on this example to support his claim that states are constrained in their ability to freely choose their international tax design.[272] There is, however, no indication that Mexico complied with this directive because it considered that it was legally bound to do so under customary international law.[273] Indeed, the decision by Mexico to embrace the OECD transfer pricing rules was not done out of opinio juris any more than the EU VAT directive was.[274] It is well accepted that international organizations such as the OECD and EU have internal regulations that states must comply with to be admitted as members.[275]

Another example cited by Avi-Yonah in support of his argument concerns Bolivia.[276] The Bolivian government abandoned a cash flow corporate tax (CFT) in favor of a conventional corporate income tax,

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269. PTI, *India may not accept arbitration orders annulling Cairn, Vodafone tax demands*, FIN. EXPRESS (May 22, 2018), https://www.financialexpress.com/industry/india-may-not-accept-arbitration-orders-annulling-cairn-vodafone-tax-demands/1176818/.

270. *Vodafone Seeks Arbitration in India Tax Dispute*, BBC NEWS (May 8, 2014), http://www.bbc.com/news/business-27321208; Sean McLain, *Vodafone Wins Tax Case in India*, WALL ST. J. (Oct. 8, 2015), http://www.wsj.com/articles/vodafone-wins-tax-case-in-india-1444315869/; *India reminds Vodafone to pay $2 billion in taxes*, MARKETWATCH (Feb. 16, 2016), http://www.marketwatch.com/story/india-reminds-vodafone-to-pay-2-billion-in-taxes-2016-02-16-104854835#:izd9C5Dws_kVrA/.

271. AVI-YONAH, *supra* note 158, 4.

272. *Id.*

273. *Id.*

274. For more on the EU Directive on the implementation of the VAT, see BEN J.M. TERRA & JULIE KAJUS, INTRODUCTION TO VALUE ADDED TAX IN THE EC AFTER 1992: WITH AN INTEGRATED TEXT OF EC VAT DIRECTIVES AND THE DIRECTIVE ON THE ABOLITION OF FISCAL FRONTIERS 3–9 (1992).

275. *Id.*

276. AVI-YONAH, *supra* note 158, at 4.

because it was concerned that the non-creditability of the CFT would affect the flow of U.S. investment to Bolivia.[277] Thus, the decision of the Bolivian government was born out of policy considerations other than opinio juris. Indeed, the arena of tax policy and state practice is bedeviled with a host of policy reasons that influence states to adopt one tax policy or another. These policy reasons, although potentially accompanied by a sense of a legal obligation, are usually adopted for their own sake and with no sense of legal obligation.

IV. Conclusion

This Article attempts to situate the international tax system within public international law by reviewing the sources of public international law as contained in Article 38 of the Statute of the ICJ. With respect to treaty law as a source of public international law, the Article shows that the existence of over 3,000 bilateral tax treaties and a multilateral tax treaty supports an international tax system that is grounded in treaty law. Further, it demonstrates that there are uncertainties about an international tax system that is founded upon customary international law. This is because widespread state tax practice may not necessarily constitute customary international law if there is an absence of opinio juris. Thus, the widespread implementation of the VAT in more than 160 countries does not indicate a new rule of customary international tax law if the countries introduced the VAT without opinio juris. However, as general principles of law recognized by nations, the international tax system may find some grounding in public international law. The Article identified some principles of law that have already been determined by courts as constituting general principles of law recognized by nations. Additionally, the Article identified some principles that are likely to be recognized by a court as constituting such general principles of law. In the end, the Article concludes that the international tax system is largely treaty-based. It is therefore not surprising that some have described Avi-Yonah's claim that customary international law supports the international tax system as "mysterious" and "imaginary,"[278] and astonishing, controversial and unsubstantiated.[279]

277. Charles E. McLure Jr. & George R. Zodrow, *The Economic Case for Foreign Tax Credits for Cash Flow Taxes*, NAT'L TAX J. 1, 2 (1998).

278. Rosenbloom, *supra* note 216, at 154, 166.

279. Qureshi, *supra* note 163, at 199-200.