The Alleged “Extraterritoriality” of the EU Financial Transaction Tax Proposal

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The EU proposal to introduce a financial transaction tax (FTT) is surrounded by many controversies. Since eleven Eurozone states decided to proceed through enhanced cooperation, a road that according to the treaties shall only be taken as a last resort, questions of legality have moved to the center of the debate. Critics, chief among them the Council’s own legal service, assert that the wide territorial scope of the tax is incompatible both with customary international law as well as the EU law provisions on enhanced cooperation (TFEU arts. 326-334). While the ECJ dismissed the corresponding U.K. challenge on April 30, 2014, it did so solely due to the premature character of the action without ruling or commenting on the merits of the case. This article argues that the allegations of extraterritoriality leveled against the so-called counterparty principle and the issuance principle of the proposal are unfounded. An examination of international tax law practice reveals that both are well-established triggers for taxation. Furthermore, there is no reason why the proposed FTT directive, which at its heart is only a harmonization measure, should be considered to infringe the EU law protections for enhanced cooperation. This is not to say that the FTT is indeed the best policy choice, but merely that the question what role the tax system should play in the regulatory overhaul is too important to be sidelined by questionable legal arguments.

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I. A Highly Controversial Proposal: Debates about Politics, Policy, and Legality

Right out of the gate, the EU proposal to introduce a financial transaction tax (FTT) has been surrounded by controversy. Although a preliminary consensus to find a way “how the financial sector could make a fair and substantial contribution”\(^1\) to the costs of the crisis seemed within reach on the political level in September 2009, during the G20 Pittsburgh Summit, exactly how to achieve this goal has eluded consensus among policymakers ever since.\(^2\) Indeed, it is striking that the International Monetary Fund (IMF), whose 2010 report to the G20 jumpstarted the policy discussion, expressly rejected the FTT, favoring instead the combined introduction of a bank levy (respectively financial sector contribution or FSC) and a so-called financial activities tax (FAT).\(^3\) Early statements by the European Commission, as well, appear rather critical not only about the prospects of achieving consensus on a global level, but also of the policy merits of an FTT.\(^4\) This is – although, admittedly, less explicitly then before – true even for the impact assessment accompanying the Commission’s own 2011 proposal for a directive to introduce a common system of FTT in the EU.\(^5\)

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\(^2\) See, e.g., G20, Toronto Summit Declaration, at ¶ 21 (June 27, 2010), available at http://www.g20.utoronto.ca/2010/g20_declaration_en.pdf (“We agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution, and reduce risks from the financial system. We recognized that there are a range of policy approaches to this end. Some countries are pursuing a financial levy. Other countries are pursuing different approaches.”).


\(^4\) See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Taxation of the Financial Sector, at 8, COM (2010) 549 final (Oct. 7, 2010) (“At this stage the Commission considers that there is greater potential for a Financial Activities Tax at EU-level.”).

A. From Global Initiative to an Experiment of Enhanced Cooperation

The proposal, unsurprisingly, proved deeply divisive and the unanimity required by art. 113 of the Treaty on the Functioning of the European Union (TFEU) ultimately unattainable, with the U.K. being the most vocal but by no means only opponent of a EU-only FTT. Nonetheless, some Member States, with the core economies Germany and France in the driver’s seat and the support of the European Parliament, kept on pushing ahead and by October 2012 eleven Eurozone states had submitted formal requests to the Commission to proceed through enhanced cooperation, TFEU art. 329(1) – a road that according to art. 20 of the Treaty on European Union (TEU) shall be taken only “as a last resort”. After having obtained consent by

new sources [sic] of European revenue, which may be tapped into by Member States as well as by EU’s own resources.”).


10 Austria, Belgium, France, Estonia, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.
the European Parliament on December 12, 2012, the authorization decision\textsuperscript{11} was adopted – with the Czech Republic, Luxemburg, Malta and the U.K. abstaining\textsuperscript{12} – by the Council at a meeting of the Economic and Financial Affairs Council (ECOFIN) on January 22, 2013. It was not until three weeks later, on February 14, 2013, that the Commission put forward its proposal for the directive to be enacted under enhanced cooperation.\textsuperscript{13}

\textbf{B. The Policy Rationales of the FTT}

As had been specifically requested by the participating Member States,\textsuperscript{14} the new proposal was based on and for the most part followed the lines of the Commission’s original 2011 proposal, albeit with some notable amendments and contentious additions.\textsuperscript{15} Accordingly, the 2013 proposal also reiterates the same objectives: (1) harmonizing the indirect taxation of financial transactions in order to avoid fragmentation in the internal market for financial services; (2) ensuring that financial institutions make a fair and substantial contribution to the costs of the crisis (as well as creating a level playing field with other sectors from a taxation point of view); and (3) creating appropriate disincentives for transactions that do not enhance the efficiency or stability of financial markets thereby complementing regulatory measures aimed at avoiding future financial crises.\textsuperscript{16}


\textsuperscript{14} See Council Authorization Decision, supra note 11, recital 6.


Notably, however, while the third, stability-driven rationale still features prominently in the official and even more so in the political\textsuperscript{17} statements, the policy rhetoric on this point has been significantly toned down – probably not least due to compelling as well as endless criticism\textsuperscript{18} that the FTT would in no way target the sources of systemic instability that lay at the heart of the financial crisis. In fact, in the Commission’s own 2013 impact assessment any disincentives are merely regarded as “welcome side effects”\textsuperscript{19} with the spotlight being essentially solely directed towards the “regulation” of high-frequency trading, an area of concern that although

\textsuperscript{17} See, e.g., Algirdas Šemeta, \textit{The Financial Transaction Tax: Europe Needs It}, 2012 \textit{World Commerce Review} 28 (“The financial transaction tax is also designed to encourage the financial sector to engage in more responsible activities, more geared towards the real economy. As such, it will complement the changes the Commission is proposing in the regulatory framework for a more stable and more responsible financial sector. Together the tax and regulatory measures should help prevent a crisis like the current one from ever happening again.”); Stamp Out Poverty, \textit{Financial Transaction Tax: Myth Busting} 8 (Mar. 2012), \url{http://www.stampoutpoverty.org/wp-content/uploads/2012/10/FTT-Myth-busting-FINAL.pdf} (claiming that “the FTT would reduce the amount of harmful economic activity that caused the crisis in the first place”).


subject to increasing public scrutiny\textsuperscript{20} barely, if at all, featured in any of the post-crisis reports. Notwithstanding any political posturing, the Commission instead acknowledges seeing “the overarching aim [in] ensuring that the financial sector makes a fair and substantial contribution to financing the costs of the crisis”\textsuperscript{21} while, at the same time, also emphasizing the significance of tax neutrality, i.e., a non-preferential and therefore non-distortive taxation of all actors, markets and products.\textsuperscript{22}

\textit{C. Towards a Debate About Legality}

As the political predetermination in favor of the FTT thus proved unswayable by policy arguments, the focus of the debate shifted more and more from the policy merits to the legality of proposal, particularly as regards the proposal’s alleged extraterritorial scope. On April 18, 2013 the U.K. government applied to the European Court of Justice (ECJ) to annul the Council decision authorizing enhanced cooperation, arguing that the adoption of the Commission’s FTT proposal would produce extraterritorial effects incompatible with customary international law as well as with the rules governing enhanced cooperation (TFEU arts. 326-334). On September 6, 2013 the Council’s own legal service in a confidential, but widely-reported opinion\textsuperscript{23} on the legality of the so-called counterparty principle of art. 4(1)(f) of the proposal essentially concurred with this assessment, as do almost all of the very few scholarly


\textsuperscript{21} 2013 Commission Impact Assessment, supra note 16, at 50.

\textsuperscript{22} \textit{Id.} at 12.

contributions that deal with this issue. In fact, the scholarly criticism is not only directed towards the counterparty principle of art. 4(1)(f), the sole mandate of the Council Legal Service, but also extends to the so-called issuance principle of art. 4(1)(g), which is one of the additions of the 2013 proposal.

The growing backlash forced the Commission to respond. It directly addressed the claimed illegality of the counterparty principle in a public technical note as well as in a longer confidential, but also leaked so-called non-paper – drafted in direct response to the Council Legal Service’s opinion –, arguing that art. 4(1)(f) of the proposal “is in conformity both with customary international law and EU primary law” and “does not entail any impermissible


25 But see Federico Fabbrini, Taxing and Spending in the Euro Zone: Legal and Political Challenges Related to the Adoption of the Financial Transaction Tax, 39 EUR. L. REV. 155, 170 (2014) (“The criticisms of the Council Legal Service do not appear convincing. First, the concern that the ‘counter-party’ principle results in an extra-territorial application of tax jurisdiction fails to notice that art.4(1)(f) of the Commission proposal valorizes a clear connecting factor: once a financial institution resident outside the FTT zone transacts with a financial institution resident within the FTT zone, it shall pay the FTT. This customarily occurs in tax legislation.”).

26 See Council Legal Service Opinion, supra note 23, at ¶ 3: “It is not intended to cover other issues or other provisions of the proposal.”


extraterritorial effects.” However, so far the Commission seems to cut a lonely figure. While the ECJ dismissed the U.K. challenge on April 30, 2014, it did so solely due to the premature character of the action, as the contested authorization decision is to be separated from the later implementation of the enhanced cooperation, without ruling or commenting on the merits of the allegations.

One can only speculate on the role this legal controversy and the corresponding as well as continuing legal uncertainty played in the marked slowdown of the legislative process. Originally slated for January 1, 2014, it now appears more open than ever whether the EU FTT will be introduced at all. However, not yet willing to admit defeat, in a joint statement on January 27, 2015 the ministers of ten of the eleven participating Member States renewed their May 2014 commitment to aim for implementation by January 1, 2016. The “big bang” approach favored by the Commission is abandoned and the harmonized framework is instead to be phased in incrementally on a step-by-step basis. Following the examples of the limited French and Italian FTTs, in a first step only “shares and some derivatives” will be subject to the tax. This lowest common denominator approach, which stands in distinct contrast to the

29 Commission Technical Note on Legality, supra note 26, at 1.
31 Curiously, Slovenia did not sign the 2014 statement but after a change in government signed the 2015 statement, while Greece, which signed the statement in 2014, did not sign in 2015, presumably due to the Greek general elections held just two days earlier.
35 Joint Statement 2014, supra note 33.
Commission’s neutrality-driven mantra of “all actors, all markets and all products”36, was probably seen as necessary to overcome not only the significant technical hurdles37 of the FTT, but also the pervasive legal challenges and uncertainties in a timely manner. Still, at least regarding the long run, the participating Member States claim to remain committed to the idea “that the tax should be based on the principle of the widest possible base . . . , while taking full consideration of . . . the risk of relocation of the financial sector.”38

D. But the Legal Challenges Are Unfounded

In view of these developments, this article argues that, contrary to the Council Legal Service’s assertions and the prevailing thinking in the literature, neither customary international law nor the EU law provisions on enhanced cooperation seem to impose any meaningful restrictions on the territorial reach of the EU FTT regime. In particular, both the counterparty principle of art. 4(1)(f) as well as the issuance principle of art. 4(1)(g) do not produce any extraterritorial effects incompatible with customary international law. Similar connecting factors have been used in the area of, especially income, tax law for decades. Indeed, it could even be a fertile exercise to try to put the acceptance of this widespread state practice in the realm of tax law into a broader context, thus serving to inform, e.g., the growing debate about the limits of extraterritorial financial regulation.39 Similarly, it also seems highly unlikely that the ECJ will


38 Joint Statement 2015, supra note 32.

interpret the provisions on enhanced cooperation as to impose meaningful additional requirements on what is essentially a harmonization measure. This is not to say that the author is convinced of the policy merits of the FTT, far from it, but only that this is a separate question. Correspondingly, it is perhaps unsurprising that upon closer examination, many of the arguments put forward by the Council Legal Service and the literature turn out to be more about policy and politics than law.

Providing the background to the ensuing analysis, section II goes on to offer some necessary details on the structure and drafting of the 2013 FTT proposal. Section III shows that the counterparty principle of art. 4(1)(f) is not a “novel”\(^\text{40}\) trigger for taxation and, in any case, does not produce “extraterritorial” effects incompatible with customary international law. As will be argued in section IV, the same is true with regard to the other connecting factor at issue, the issuance principle of art. 4(1)(g). Finally, section V remarks that seeing as the EU FTT proposal is not about introducing a European tax, but, at least conceptually, about the harmonization of national taxes,\(^\text{41}\) the TFEU provisions on enhanced cooperation should not be interpreted as to impose any significant limitations. Section VI concludes.

II. SOME BACKGROUND ON THE EU FTT PROPOSAL: THE CONCEPT OF “ESTABLISHMENT”

Pursuant to art. 3(1) of the proposal the FTT is supposed to apply to all financial transactions that fulfill the following conditions: (a) at least one party to the transaction is established in the territory of a participating Member State and (b) a financial institution established in the territory of a participating Member State is party to the transaction, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction. Said to be “based on the principle of the widest possible base,”\(^\text{42}\) the definitions of

\(^{40}\) A claim made in particular by Scott, supra note 24, at 1370-1374.

\(^{41}\) See, e.g., 2013 Proposal, supra note 13, recital 24 (reffering to “the objective of this Directive, namely to harmonise the essential features of a FTT within the participating Member States at Union level”).

\(^{42}\) Joint Statement 2015, supra note 32.
both what constitutes a “financial transaction,” laid down in art. 2(2),\textsuperscript{43} as well as what constitutes a “financial institution,” laid down in art. 2(8),\textsuperscript{44} are intentionally rather broad, so as not to “jeopardize achieving the aimed-at tax neutrality of the initiative.”\textsuperscript{45}

Such lack of any major substantive exclusions, however, also means that the scope of the FTT regime is essentially solely restricted by its territorial reach. This puts the concept of “establishment,” laid down in art. 4, center stage. Dissecting the different functions performed by art. 4 is thus key to understanding the structure of the proposal.

A. A “Broad-Based Residence Principle” as the Primary Sourcing Rule

Art. 4(1) provides seven conditions to define where a financial institution is to be considered established for the purposes of the directive. Initially, the provision thereby follows what the Commission has labelled a “broad-based residence principle”\textsuperscript{46}: with respect to the territorial scope of the directive “it does not matter where a transaction is carried out but who the trading partners are.”\textsuperscript{47} Meaning the tax would apply to all financial transactions entered into by resident financial institutions. This novel approach is supposed to increase the resilience of the tax against relocation.\textsuperscript{48} However, despite the label, a look at the sourcing rules shows that the proposed tax was never based on a pure residence approach. Pursuant to art. 4(1) a financial institution is deemed to be established in a participating Member State if it (a) has been authorized to act as financial institution by the authorities of that Member State, respectively (b) is authorized or otherwise entitled to operate as financial institution in regard to the territory of that Member State, (c) has its registered seat or (d) a permanent address or usual residence in that Member State, or (e) carried out the transaction through a branch in that Member State.

\textsuperscript{43} Certain types of transactions, in particular primary market transactions and transactions with the ECB or the Member States’ central banks, are, however, exempted from the tax via art. 3(4).
\textsuperscript{44} Art. 3(2) exempts certain entities from the tax when they engage in their specific function: namely, central counter parties, central securities depositories and managers of public debt. Note, however, that pursuant to art. 3(3) this does not preclude taxation of the counterparty.
\textsuperscript{45} 2013 Commission Impact Assessment, supra note 16, at 32 and 38.
\textsuperscript{46} \textit{Id.} at 39.
\textsuperscript{47} Commission Technical Fiche: The “Residence Principle” and the Territoriality of the Tax, at 1 (May 4, 2012),
In other words, the proposed directive combines traditional residence criteria with the authorization to trade, and thereby, at least implicitly, also incorporates elements of the so-called place of transaction principle.\footnote{See id. at 39.} The latter even serves as the primary connecting factor of the tax, since it is seen by the Commission as a rather robust criterion for catching transactions that serve clients in the participating Member States.\footnote{See id. at 18-19.}

B. The Different Role of the Counterparty Principle of Art. 4(1)(f)

A different role is played by the controversial counterparty principle of art. 4(1)(f), pursuant to which a financial institution is also deemed to be established in the territory of a participating Member State if it is a party (or is acting in the name of a party to the transaction) to a financial transaction with another financial institution established in that Member State pursuant to art. 4(1)(a)-(e), or with a non-financial party established in the territory of that Member State pursuant to art. 4(2). Meaning, even if it is neither authorized to trade nor has its seat, permanent address or a branch in that Member State, a financial institution is considered established in a participating Member State whenever its trading partner (whether financial or otherwise) is, for the purposes of the directive, considered established in that state.

On the face of it, for anybody versed in international tax law, it must indeed appear quite extraordinary – to say the least – to infer “residence,” which typically is used as a trigger for unlimited, and therefore often worldwide, tax liability, solely from the “residence” of the trading partner. However, this terminological peculiarity can be explained by the – admittedly convoluted – structure and drafting of the proposal.

Conceptually, the FTT is designed as a tax on financial transactions, not a tax on financial institutions, although only the latter are indeed primarily liable for the tax pursuant to art. 10(1). Hence, it is better understood as taxing financial markets as a whole rather than the “financial sector,” i.e., as an objective and not a personal tax.\footnote{See also Commission Services Opinion, supra note 27, at ¶ 20 (“Thus, FTT is an objective tax on a particular event – a “financial transaction” – and not on a certain person. In this sense, FTT can be considered as a form of an excise on the transactions concerned.”).} Art. 4(1)(a)-(e) and (2)(a)-(b) insofar essentially function as sourcing rules that establish when a financial transaction is to be considered to fall within the tax jurisdiction of the participating Member States. The parties to the transaction are merely used as the – hopefully more robust – medium of choice to sourcing
the transaction, i.e., as the primary method to determine whether a financial transaction “aim[s] at serving the economy of the FTT jurisdiction.” Accordingly, the provisions are more about locating the transaction than about locating the “tax residence” of the parties. Even more importantly, regarding this sourcing function it is considered sufficient if one of the parties (whether financial or otherwise) is deemed established in the participating Member States pursuant to art. 4(1)(a)-(e) or (2)(a)-(b). The tax jurisdiction attaches as soon as one of these conventional place of transaction- (art. 4(1)(a)-(b)) or residence-based (art. 4(1)(c)-(e) and (2)(a)-(b)) conditions is fulfilled by one of the parties.

The counterparty principle of art. 4(1)(f), on the other hand, is not a sourcing rule that establishes tax jurisdiction, for it does not create tax jurisdiction where it would not otherwise exist, but serves an entirely different function, the second function of art. 4: namely, allocating the taxing rights with regard to the transaction by defining the participating Member State(s) that has/have the right to tax the transaction. Pursuant to art. 10(1) the “FTT shall be payable to the tax authorities of the participating Member State in the territory of which the financial institution is deemed to be established.” Accordingly, by determining the state of “establishment” of the financial institution, art. 4(1) also determines which participating Member State(s) has/have the right to tax one and which or both sides of the transaction.

C. The Allocative Function of Art. 4(1)

The list of conditions laid down in art. 4(1) can insofar be seen to play a role similar to that of a – multilateral and FTT-specific – double taxation agreement between the participating Member States. This is because of art. 4(4), which solely for this purpose orders that “where more than one of the conditions in the lists set out in paragraphs 1 and 2 respectively is fulfilled, the first condition fulfilled from the start of the list in descending order shall be relevant for determining the participating Member State of establishment.” Thus, art. 4 – more specifically,

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53 See also Commission Services Opinion, supra note 27, at ¶ 23 (“Thus, Article 4(1) not only helps to determine whether a given financial transaction is subject to FTT at all under the Directive, but it also – and this is its key function – serves to identify the participating Member State that will have the right to tax the transaction.”).

54 This also explains why the counterparty principle is only laid down in art. 4(1), i.e., with regard to financial institutions, and not also in art. 4(2), i.e., with regard to other persons. As pursuant to art. 10(1) only financial institutions are primarily liable to the tax, there is no need to define the state of “establishment” of non-resident other persons purely for allocative purposes.
art. 4(1)(a)-(e) and (2)(a)-(b) – not only sets out the territorial scope of the FTT regime, i.e., which financial transactions are to be considered sourced in the participating Member States, but in its first paragraph also provides a binding hierarchy of connecting factors for allocating the right to tax that transaction between the participating Member States.

By way of example, whenever a financial institution, which has its registered seat in participating Member State A but is acting on an authorization by the authorities of participating Member State B, enters in a financial transaction, it will be deemed to be established solely in B and will thus be liable to pay FTT, at the rate specified by B’s national tax law – the EU directive only stipulates minimal tax rates –, to the tax authorities of B. If the institution transacts with another financial institution, which, e.g., because of a branch, is deemed established in participating Member State C, the transaction will also be liable to tax in C, at the rate specified in C’s national tax law. Each party to the transaction will have to pay FTT once, and only to its state of deemed establishment (subject to being held jointly and severally liable for the other financial institution pursuant to art. 10(3)). If, in an alternative scenario, the other financial institution is not deemed established in a participating Member State based on any of the traditional place of transaction- or residence-based criteria laid down in art. 4(1)(a)-(e), it will pursuant to the counterparty principle of art. 4(1)(f) for the purposes of this specific transaction nevertheless be deemed established in participating Member State B, its counterparty’s state of establishment. Consequently, the transaction will again be liable to FTT twice, one charge to be paid by each party to the transaction, but now to the same participating Member State.

In other words, the counterparty principle of art. 4(1)(f) is the mechanism by which the proposal tries to ensure that both legs of the transaction are subject to FTT, i.e., each financial transaction between financial institutions is liable to FTT twice. Strictly speaking, however, it never establishes tax jurisdiction over a transaction itself, but merely imposes a tax liability also on the foreign-based counterparty to the transaction which because of some other connecting factor is already considered to fall within the tax jurisdiction of the Member State.

D. The Issuance Principle of Art. 4(1)(g) and (2)(c) as Fallback Connecting Factor

Different from the counterparty principle, which given its purely allocative (and liability designation) function insofar must be considered the odd one out among the conditions listed in art. 4(1), the issuance principle laid down in art. 4(1)(g) (and (2)(c)) again serves both a sourcing as well as an allocative function. Pursuant to art. 4(1)(g) a financial institution is
deemed to be established in the territory of a participating Member State also if it is party (or is acting in the name of a party to the transaction) to a financial transaction in a structured product or relevant financial instrument issued within the territory of that Member State. Hence, the parties to a financial transaction, whether based in a non-participating or a non-EU State, are deemed established in a participating Member State solely by reason of trading in a financial instrument issued in that state.

Inserted in the 2013 proposal at the request of the participating Member States, this additional connecting factor for establishing tax jurisdiction was seen as the answer to the perceived need for extra measures “to avoid evasive actions, distortions and transfers to other jurisdictions”\(^55\), especially in a now regionally limited regime.\(^56\) The fact that the initiative was no longer an EU-wide project, however, was but merely a contributing factor. The European Parliament proposed supplementing the then still EU-wide original proposal “by elements of the issuance principle”\(^57\) already in May 2012. Hence, the often-heard assertion that the issuance principle essentially popped up out of nowhere only after the decision on enhanced cooperation was reached\(^58\) and thereby significantly altered the nature and reach of the initiative is at the least a bit misleading.

As the last condition in the hierarchical lists of art. 4(1) and (2), the issuance principle only serves the role of a fallback, i.e., it is only relevant if tax jurisdiction is not already established by one of the place of transaction- or residence-based connecting factors higher up the list. However, this does not mean that the issuance principle was introduced merely as an anti-avoidance measure,\(^59\) at least not in the classical anti-abuse sense\(^60\) of the word. Certainly it is meant “to improve the resilience of the system against relocation,”\(^61\) but it does so simply by serving as another connecting factor for identifying and sourcing all the financial transactions that pursuant to the Commission can be considered to typically “aim at serving the economy of

\(^{55}\) Council Authorization Decision, supra note 11, recital 6.  
\(^{57}\) European Parliament Legislative Resolution, supra note 9, amends. 7 and 17.  
\(^{58}\) See EUROPEAN UNION COMMITTEE, supra note 24, at ¶ 7 (“Importantly, it incorporated new anti-abuse provisions, including the very significant ‘issuance principle’, which had not been disclosed when the decision on enhanced cooperation was reached.”).  
\(^{59}\) Admittedly, however, the Commission itself refers to the issuance principle as an “anti-avoidance” measure, see 2013 Proposal, supra note 13, at 5.  
\(^{60}\) See the general anti-abuse rule in art. 13.  
\(^{61}\) 2013 Proposal, supra note 13, at 11.
Relocation risk is neither a prerequisite nor the sole raison d’être for the issuance principle. While expressly pointing towards “evasive actions . . . and transfers to other jurisdictions” in their requests for enhanced cooperation, the participating Member States were equally concerned with “the need to avoid . . . distortions” in their financial markets. The same is true for the European Parliament who originally introduced the principle into the legislative process in 2012: it viewed the issuance principle mainly as a means to avoid creating “competitive disadvantages” for FTT-zone financial institutions in trading financial instruments issued in the FTT-zone. In any case, all this goes to show that the addition of the issuance principle in art. 4(1)(f) and (2)(c) can hardly be considered “tantamount to the introduction of a new tax.”

In fact, the primary reason for the issuance principle’s low ranking in the hierarchy of the conditions listed in art. 4 has nothing to do with establishing tax jurisdiction, i.e., the sourcing function, but rather with the allocative function of art. 4. As mentioned in the Commission’s impact assessment to the 2013 proposal, it was discussed – and even favored by some Member States – to put the issuance principle first and thereby give it “priority over the other criteria so that the tax revenues from trading in products issued in a Member State would accrue to those countries in which the traded products . . . had actually been issued.” Such changing of the order was not rejected based on principle, but due to the notion that “the bailing out of financial institutions had primarily been undertaken by those Member States where the headquarters were located” and, hence, that state should be given the first right to tax.

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63 Highly critical therefore Englisch, Vella & Yevgenyeva, supra note 15, at 229 (“The issuance principle thus goes far beyond its anti-avoidance justification by bringing a host of transactions which are not avoidance-driven within the ambit of the tax.”).
64 See Council Authorization Decision, supra note 11, recital 6.
66 A claim made by Englisch, Vella & Yevgenyeva, supra note 15, at 229.
68 Id. at 41 (“All three approaches have their pros and cons.”).
69 Id. at 41.
70 Whether this assumed logic is indeed true as well as whether this is the appropriate criterion for allocating the revenues of a tax on financial transactions is of course open to debate. However, this very interesting question of what is the most sensible or logical hierarchy for allocating the right to tax, if there is such a thing,
Moreover, there was a concern that “due account would have to be taken of the evolving legislative and regulatory framework that will in future also allow a more flexible approach towards the place and country of issuance.”\textsuperscript{71}

So, while it might therefore be true that the EU FTT proposal uses not only a variety but essentially a combination of – at least elements of – all theoretically possible connecting factors,\textsuperscript{72} this fact alone says nothing about the viability of the EU FTT regime’s territorial scope or, more specifically, its assessment under customary international or European law.

\textbf{E. The Escape Clause of Art. 4(3) as a Jurisdictional “Safety Valve”?}

All of these connecting factors are expressly subject to the curious rule of art. 4(3). Pursuant to art. 4(3) a financial institution or other person will not be deemed to be established in a participating Member State pursuant to art. 4(1) or (2), “where the person liable for payment of FTT proves that there is no link between the economic substance of the transaction and the territory of any participating Member State.” The exact role this so-called escape clause, which was already included in the 2011 proposal (then art. 3(3)) and hence, in any case, cannot be considered a reaction to the addition of the issuance principle, is supposed to play is the object of much debate.

Those who lament the extraterritorial nature of the proposal see the provision as “crucial”\textsuperscript{73} for curbing the allegedly excessive extraterritorial effects, but due to the lack of any detail or binding guidelines, at the same time, also regard art. 4(3) as “totally unsatisfactory for that purpose.”\textsuperscript{74} The Commission, on the other hand, contends that far from being integral to

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\textsuperscript{71} 2013 Commission Impact Assessment, supra note 16, at 41.

\textsuperscript{72} See Englisch, Vella & Yevgenyeva, supra note 15, at 228; see also Diogo Ferraz Lemos Tavares, Notes on the Conditions for a Corrective Financial Transaction Tax, 42 INTERTAX 788, 798 (2014) (arguing expressly that “relocation risks should . . . be addressed through the use of different connecting elements, which must be set in a way that enables the FTT to reach any transaction remotely connected to the country”).

\textsuperscript{73} Englisch, Vella & Yevgenyeva, supra note 15, at 245.

\textsuperscript{74} Council Legal Service Opinion, supra note 23, at ¶ 25; see also Englisch, Vella & Yevgenyeva, supra note 15, at 245 (“It is manifestly inappropriate to refer to abstract concepts of international law where clear
defining the scope of the FTT regime the provision is merely intended to exclude tax liability “in very specific situations”\textsuperscript{75} respectively “under atypical circumstances.”\textsuperscript{76} Whether this escape clause or jurisdictional “safety valve”\textsuperscript{77} should be viewed as being of significance in assessing or even a prerequisite for the customary international law compatibility of the proposal’s triggers for taxation or, instead, serves a different role is a question that cannot be answered without first addressing the customary international law compatibility of the connecting factors as such.

III. THE COMPATIBILITY OF THE COUNTERPARTY PRINCIPLE, ART. 4(1)(F), WITH CUSTOMARY INTERNATIONAL LAW

The legality of the counterparty principle of art. 4(1)(f) is probably the principal point of contention and, in any case, was the sole mandate of the Council Legal Service. The Council Legal Service’s criticism is summarized in subsection A. Subsection B briefly comments on the general question whether the territoriality principle serves as a limit to legislative jurisdiction under customary international law, while subsection C shows that at least in the area of tax a (potential) overlap of jurisdiction is as such not incompatible with customary international law, regardless of whether one of the states has or claims to have a “more relevant interest”. Finally, by taking a look at actual international tax state practice subsection D goes on to demonstrate that the counterparty principle cannot be considered a “novel” trigger for taxation.

A. The Allegations of Extraterritoriality: Notions of “More Relevant Interest” and “Better Entitled”

In the Council Legal Service’s opinion, the counterparty principle of art. 4(1)(f) “does not stand the test of territorial connection”\textsuperscript{78} and hence “exceeds Member States’ jurisdiction for taxation under the norms of international customary law as they are understood by the Union.”\textsuperscript{79} It seems

\textsuperscript{75} Commission Services Opinion, supra note 27, at ¶ 37.
\textsuperscript{76} Id. at ¶ 35.
\textsuperscript{77} A term coined by Scott, supra note 24, at 1364-1370.
\textsuperscript{78} Council Legal Service Opinion, supra note 23, at ¶ 24.
\textsuperscript{79} Id. at ¶ 42.
to reach this sweeping conclusion largely based on the premise that “whether there is sufficient nexus to justify [taxation] . . . , and whether other States have not a more relevant interest in regulating the taxpayer’s conduct, is to be determined also in the light of the objectives pursued by the proposed legislation for a FTT,”80 an assertion which can also be found in the literature81 making the case of illegality.

None of the proposal’s objectives is, however, found to support the imposition of tax liability on financial institutions resident outside the FTT-zone.

Firstly and most importantly, with regard to a pure revenue-raising objective, the Council Legal Service contends that “it goes without saying that the raising of revenue by a Member State does not justify recourse to a remote nexus for taxation of foreign based persons thereby impinging on more relevant tax jurisdiction of other States over those persons or the activity involved.”82 Secondly, the same is said to apply to the notion that non-resident financial institutions could somehow be considered part of the financial sector that should make a fair and substantial contribution to the participating Member States’ budget.83 Bailouts and similar interventions were usually carried out by the financial institution’s home state, consequently, in the Legal Service’s view it were only that state actually providing the backstop which would

80 Id. at ¶ 19.
81 Englisch, Vella & Yevgenyeva, supra note 15, at 238-239. The literature cited therein, however, seems to support only another part of the proposition, namely that the reasonableness of a connecting factor may depend upon the subject-matter of the law, e.g., criminal law, civil law, tax law, commercial law, etc. Cf. CEDRIC RYNGAERT, JURISDICTION IN INTERNATIONAL LAW 212-214 (2008) (stating, while fleshing out his “new theory of jurisdiction in international law”, that an adoption of the German domestic Schutzzweck doctrine, which is said to demand that a jurisdictional assertion must serve the regulatory purpose of the particular legal provision, by the courts and regulators of other states “might, in due course, provide an impetus for the crystallization of the Schutzzweck doctrine as an objective doctrine of international law”, but that this is not yet the case); A. V. Lowe, The Problems of Extraterritorial Jurisdiction: Economic Sovereignty and the Search for a Solution, 34 INT’L & COMP. L. Q. 724, 735 (1985) (observing merely that “[w]hen some elements of any activity occur within a State, that State undoubtedly has some jurisdiction over it”, but “it by no means follows that the State can extend its jurisdiction without limit to control all the other elements which accompany the intraterritorial elements”, which, however, applied to the FTT directive seems better read to mean that the taxing state may be restricted in regulating or taxing also the other transactions or other aspects of the foreign financial institution, while separating the elements of the transaction seems at odds with the “‘focus’ of the legislation”).
82 Council Legal Service Opinion, supra note 23, at ¶ 20.
83 See also Englisch, Vella & Yevgenyeva, supra note 15, at 240-241.
be appropriate or at least “better entitled to claim such contribution.” Not at all veiling the underlying disagreement about policy, the FTT is, thirdly, essentially found and declared unfit to address the risk in or in any other way further the objective of enhancing the efficiency and stability of the financial markets. And finally, the general risk of relocation of financial transactions is not seen as being able to “justify in itself extraterritorial tax legislation,” as to do so “would not be in compliance with the proportionality principle” – however, whether this is supposed to refer to the proportionality principle of TEU art. 5(4) or, instead, claim the existence of such a principle with regard to the jurisdictional limits under customary international law is less clear.

**B. The “Territoriality Principle” as a Jurisdictional Limit under Customary International Law?**

Pursuant to TEU art. 3(5) bound to “contribute . . . to the strict observance and the development of international law”, it is the settled case-law of the ECJ that the EU, when exercising its powers, is bound to respect international law in its entirety, including in particular all principles of customary international law. This, of course, also applies to measures adopted under the

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84 Council Legal Service Opinion, *supra* note 23, at ¶ 21. However, the assertion that “a substantive part of the financial institutions and of the types of transactions that would be taxed under the provision have had no part whatsoever in the crisis and are not liable to contribute to any crisis in the future” goes much further and, essentially, would mean that a tax could only be levied from those financial institutions and those transactions that could be proven to be responsible for some past or future crisis – even if the financial institution were resident in a participating Member State.

85 *Id.* at ¶ 22; *see also* Vella, Fuest & Schmidt-Eisenlohr, *supra* note 18, at 619-620.

86 *Id.* at ¶ 23.

87 *Id.* at ¶ 23.


89 However, due to the inherently imprecise nature of customary international law the ECJ only applies a so-called “manifest error” test, see Case C-366/10, Air Transport Association of America and others v. Secretary of State for Energy and Climate Change and others, 2011 E.C.R. I-13755, at ¶ 110 (“However, since a principle of customary international law does not have the same degree of precision as a provision of an international agreement, judicial review must necessarily be limited to the question whether, in adopting the act in question, the institutions of the European Union made manifest errors of assessment concerning the conditions for applying those principles.” (citation omitted)).
framework of enhanced cooperation, as TFEU art. 326 expressly requires that “any enhanced cooperation shall comply with the Treaties and Union law.” What jurisdictional limits there are exactly under customary international law, however, is less clear.

The starting point of most endeavors that try to give an answer to that question is the 1927 decision of the Permanent Court of International Justice in the S.S. Lotus case, the only judgment of an international court to directly tackle prescriptive jurisdiction. The court said that while international law as it stood at the time clearly imposed a restriction on a state not to exercise its power in any form in the territory of another state, and that the state’s jurisdiction to enforce was, consequently, certainly territorial, it did “not, however, follow that international law prohibits a State from exercising jurisdiction in its own territory, in respect of any case which relates to acts which have taken place abroad.” The court, thus, drew a clear distinction between, what is now commonly referred to as, the jurisdiction to enforce and the jurisdiction to prescribe (or legislative jurisdiction), with only the former being bound by a strict territoriality principle. In contrast, with regard to the latter, the court reasoned that customary international law contained no “general prohibition to the effect that States may not extend the application of their laws and the jurisdiction of their courts to persons, property and acts outside their territory,” but instead “leaves them in this respect a wide measure of discretion which is only limited in certain cases by prohibitive rules; as regards other cases every State remains free to adopt the principles which it regards as best and most suitable.”

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91 JAMES CRAWFORD, BROWNLE’S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 478 (8th ed. 2012).

92 The court, of course, noted that such restriction was subject to “the existence of a permissive rule to the contrary”.


94 Id. at 19. Specifically with regard to fiscal legislative jurisdiction, see also ARNOLD A. KNECHTLE, BASIC PROBLEMS IN INTERNATIONAL FISCAL LAW 37 (W.E. Weisflog trans., 1979); JÉRÔME MONSENOEGO, TAXATION OF FOREIGN BUSINESS INCOME WITHIN THE EUROPEAN MARKET 54-60 (2012); KLAUS VOGEL, DER RÄUMLICHE ANWENDUNGSBEREICH DER VERWALTUNGSNORM: EINE UNTERSUCHUNG ÜBER DIE GRUNDLAGEN DES SOG. INTERNATIONALEN VERWALTUNGS- UND STEUERRECHTS [THE TERRITORIAL SCOPE
However, whether the approach mentioned in the *Lotus* judgment still represents the law as it stands today, or indeed did ever represent the law, remains a matter of debate.\(^{95}\) Undeniably, the restraint to draw any sort of limits for the jurisdiction to prescribe, and thus pay respect to the sovereignty of other states, has been heavily and frequently criticized in several separate or dissenting opinions\(^{96}\) written by judges of the International Court of Justice as well as by numerous legal scholars\(^{97}\). Indeed, at least within the scholarly literature today, it seems to be

\(^{95}\) Notably, even the *Lotus* court was evenly divided, 6-6, with the case being decided by the casting vote of the court’s president, and the weight that is to be attributed to the cited passages is heavily debated.

\(^{96}\) See, e.g., Fisheries (U.K. v. Nor.), Judgement, 1951 I.C.J. 116, 152 (Dec. 18) (individual opinion of Judge Alvarez) (arguing that while the principle that states have the right to do everything which is not expressly forbidden by international law might have been “formerly correct, in the days of absolute sovereignty,” it “is no longer so at the present day”); Legality of the Threat or Use of Nuclear Weapons, Advisory Opinion, 1996 I.C.J. 226, 394-396 (July 8) (dissenting opinion by Judge Shahabuddeen) (elucidating the general challenge to the *Lotus* dictum, but choosing to distinguish the case on the basis of the “apocalyptic” consequences of nuclear weapons); Arrest Warrant of 11 April 2000 (Dem. Rep. Congo v. Belg.), Judgement, 2002 I.C.J. 3, 43-44 (Feb. 14) (separate opinion of President Guillaume) (observing that in view of the emergence of vast amounts of treaty law “[t]he situation is different today, it seems to me – totally different”); *id.* at 78 (joint separate opinion of Judges Higgins, Kooijmans and Buergenthal) (stating that “the dictum represents the high water mark of laissez-faire in international relations, and an era that has been significantly overtaken by other tendencies”); *id.* at 168-169 (dissenting opinion of Judge Van den Wyngaert) (remarking that “[i]t has often been argued, not without reason, that the ‘Lotus’ test is too liberal and that, given the growing complexity of contemporary international intercourse, a more restrictive approach should be adopted today”).

the prevailing opinion that the territoriality principle serves to limit not just the jurisdiction to enforce, but also the jurisdiction to prescribe. A state may not assert its prescriptive jurisdiction to facts with no connection to its territory, unless such an exercise is supported by another permissive rule, as e.g., the so-called personality principle\(^98\) with regard to nationals of that state, the protective principle\(^99\) with regard to the vital interests of the state, or universal jurisdiction\(^100\) with regard to some fundamental norms of international law respectively some universally recognized criminal offenses. Accordingly, there must be a sufficient nexus – a genuine link\(^101\) – between the facts at hand, e.g., the conduct, thing or person concerned, and the territory of the state asserting jurisdiction.\(^102\)

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\(^98\) See, e.g., RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(2) (1987); see also Mann, supra note 97, at 24-30 (observing that because the U.S. practice of taxing citizens on a worldwide basis “appears to be undisputed and even free from criticism by diplomatic protests”, it seems no longer possible to condemn that practice as incompatible with customary international law, as he was inclined to do in his previous study 20 years earlier). For an overview of the criticism against using nationality as a jurisdictional basis for taxation, see RUTSEL SILVESTRE J. MARTHA, THE JURISDICTION TO TAX IN INTERNATIONAL LAW: THEORY AND PRACTICE OF LEGISLATIVE FISCAL JURISDICTION 66-88 (1989). For a recent critique of this U.S. practice, see Ruth Mason, Citizenship Taxation, 89 SOUTHERN CALIF. L. REV. (forthcoming 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2606744.


\(^100\) See, e.g., RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 404 (1987).

\(^101\) A phrase famously coined by respectively usually attributed to Mann, supra note 90, at 46 (“Since the doctrine of international jurisdiction is not at present concerned with exclusivity of jurisdiction, the legally relevant point of contact will have to be defined as indicating the State which has a close, rather than the closest, connection with the facts, a genuine link, a sufficiently strong interest.”). For somewhat similar concepts, cf. Nottebohm (Liech. v. Guat.), Judgement, 1955 I.C.J. 4, 24 (Apr. 6) (referring, with regard to the rules relating to nationality, to the notion of a “genuine connection”); Miller Bros. v. Maryland, 347 U.S. 340, 344-345 (1954) (ruling with regard to Maryland’s jurisdiction to impose use tax collection duties on a Delaware store that under the U.S. constitution “due process requires some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax”).

\(^102\) For a recent discussion of the continued relevance of the *Lotus* dicta and the notion of a “sufficient nexus” by an advocate general of the ECJ, see Opinion of Advocate General Jääskinen, Case C-507/13, U.K. v. Parliament and Council, http://curia.europa.eu/juris/liste.jsf?num=C-507/13, at ¶¶36-41 (“In my opinion the United Kingdom would simply be wrong if it sought to claim that only territorial jurisdiction to legislate is permitted under international law. On the other hand, if it were to accept, which appears to be the case, the
Be that as it may, this article argues that it is not necessary to find a definite answer to this general question of public international law in order to address the issue at hand. Instead, without trying to give a comprehensive account of or settle the controversy, it goes on to demonstrate that even if it were accepted that a state’s jurisdiction to prescribe is limited by the territoriality principle, neither the counterparty principle nor the issuance principle would be considered incompatible with customary international law. State practice in the area of tax law clearly shows that both frequently as well as seemingly without protest serve as triggers for taxation and, hence, seem to be regarded to provide a sufficient nexus between the facts at hand and the territory of the taxing state.

C. A (Potential) Overlap of Jurisdiction Is as Such Not Incompatible with Customary International Law

As a starting point, it should be pointed out that customary international law does not prohibit the occurrence of concurrent jurisdiction as such. Even further, and contrary to the abovementioned assertion of the Council Legal Service, there also exists no generally personality principle and even the effects doctrine as alternative bases for jurisdiction, it has failed to demonstrate that international law requires something more specific in terms of a ‘sufficient nexus’, and that this requirement was unfulfilled by the contested provision in the CRD IV Directive. In my opinion, the Lotus judgment established a kind of burden of proof rule, entailing that the link invoked by a State to justify its legislative jurisdiction will be sufficient, absent a rule of international law to the contrary. However, international law necessarily imposes some limits on the assertion of jurisdiction by States, so that any claim of universal jurisdiction needs to be based on a positive rule of international law.” (footnotes omitted)).

103 This seems to be uncontroversial, see, e.g., Opinion of Advocate General Darmon, Joined Cases C-89/85 et al., Ahlström Osakeyhtio and others v. Commission, 1988 E.C.R I-5214, at ¶ 49 (observing that “it is generally acknowledged that international law does not preclude concurrent jurisdiction”); Bundesfinanzhof [BFH] [Federal Tax Court] Dec. 18, 1963, Case I 230/61 S, 79 BFHE 57, at ¶ 20 (1963) (Ger.); MARTHA, supra note 98, at 145-151 (conceding that “[g]eneral international law knows of no norm which settles conflicts of legislative fiscal jurisdiction among States”); Maier, supra note 90, at 68-69 (stating that “[t]he resolution of claims of authority based on the various combinations of concurrent jurisdiction to which these principles give rise is found in an accommodation process operating outside the limits of formal international law”, namely “by the principle of international comity”); Mann, supra note 90, at 46 (observing that “the doctrine of international jurisdiction is not at present concerned with exclusivity of jurisdiction”); Klaus Vogel, Double Tax Treaties and Their Interpretation, 4 INT’L TAX & BUS. LAW. 1, 7-9 (1986); see also Staker, supra note 97, at 329-331 (discussing the possibility of a so-called foreign sovereign compulsion defense when one state’s legislation would require someone “outside its territory to do an act that would violate the criminal law of the place where the act would be done” [emphasis added]).
acknowledged notion that a state – despite the existence of a genuine territorial link – would be precluded from taxation because of another state having or claiming “a more relevant interest”\textsuperscript{104} to do so, regardless of one may want the latter to mean. Such a hierarchy of taxation rights for solving such jurisdictional overlap is nowhere to be found in customary international law.\textsuperscript{105}

1. The International Tax Law Approach to Dealing with Concurrent Jurisdiction

Quite the contrary, in international business today the overlapping of two or more fiscal jurisdictions seems to be the rule rather than the exception. Particularly in the area of income taxation, double (or multiple) taxation occurs all too frequently because the income is not only subject to tax in the taxpayer’s residence state, where he is taxed on the basis of his worldwide income, but also in the state of source, i.e., the state where the income arises.\textsuperscript{106} And this is only the textbook case; in practice, states may disagree about the taxpayer’s residence as well as the income’s source – the former of which might lead to unlimited tax liability of the taxpayer in multiple states and the latter to a limited taxation of the same income in multiple states.\textsuperscript{107} Although probably most prevalent in the income tax arena, this phenomenon is by no means restricted to income taxation, but similarly extends to, e.g., inheritance and gift, capital or transaction taxes, as well, to provide a recent and relevant example, the bank levies\textsuperscript{108} introduced by several European states.

\textsuperscript{104} Council Legal Service Opinion, supra note 23, at ¶ 19. See Englisch, Vella & Yevgenyeva, supra note 15, at 239, for a similar, but less explicit, assertion.

\textsuperscript{105} See, e.g., Vogel, supra note 94, at 351-353; Rutsel Silvestre J. Martha, Extraterritorial Taxation in International Law, in EXTRATERRITORIAL JURISDICTION IN THEORY AND PRACTICE 19, 21 (Karl M. Meessen ed., 1996) (stating “that general international law contains no conflict rules to regulate the preference in cases of concurrent jurisdiction”); see also Crawford, supra note 91, at 486 (observing that “[j]urisdiction is often concurrent and there is no hierarchy of bases for jurisdiction”).

\textsuperscript{106} See, e.g., Martha, supra note 98, at 143-144; Roy Rohatgi, Basic International Taxation, Volume 1: Principles of International Taxation 14-16 (2nd ed. 2005); Vogel, supra note 103, at 5-6.

\textsuperscript{107} See, e.g., Martha, supra note 98, at 141-143; Rohatgi, supra note 106, at 14-17; Vogel, supra note 103, at 6-7; see also Martha, supra note 105, at 21 (clarifying that international law does not “deal with the disparity between fiscal concepts, such as definitions of income, permanent establishment, residence, etc.”).

Many of such instances of concurrent fiscal jurisdiction, of course, are relieved or at least mitigated by way of the numerous – mostly bilateral – double taxation conventions (DTCs), which provide for an allocation of the taxation rights between the contracting states. None of the principles for allocating taxation rights found in the DTCs, i.e., treaty-based international law, however, amount themselves to customary international law, even though most DTCs, indeed, incorporate almost identical rules (essentially following the model conventions provided by the OECD and the U.N.). Instead, what states include in their DTCs respectively with whom they conclude DTCs at all remain primarily questions of the state’s (international) tax or trade policy. More often than not, this is thus about achieving reciprocity, legal certainty and coordination; or, in other words, overcoming the limitations of merely unilateral unharmonized regimes.

The unilateral regimes for double taxation relief found in the tax laws of most states, consequently, are governed by slightly different policy rationales. Residence states are willing to exercise restraint by, e.g., crediting foreign taxes or exempting certain foreign income in order to avoid the suffocating effect of unmitigated double taxation, and thereby not only ensure the international competitiveness of their residents and encourage international trade but also


110 See, e.g., Vogel, supra note 94, at 352-353; Qureshi, supra note 94, at 19; see also Mann, supra note 90, at 109 (stating that “although the international law of fiscal jurisdiction enjoys the unique and outstanding distinction of being regulated by a network of treaties, it is open to doubt whether they are expressive of, or exceptions to, the rules of customary international law”). For a different view with regard to the separate accounting method, however, see Chantal Thomas, Customary International Law and State Taxation of Corporate Income: The Case for the Separate Accounting Method, 14 Berkeley Int’l L. 99 (1996). But see Brian D. Lepard, Is the United States Obligated to Drive on the Right? A Multidisciplinary Inquiry into the Normative Authority of Contemporary International Law Using the Arm’s Length Standard as a Case Study, 10 Duke J. Comp. & Int’l L. 43, 154-177 (1999) (concluding that “the arm’s length standard should be regarded as having, at present, neither persuasive nor binding authority as a norm of customary international law”).


112 See Vogel, supra note 103, at 9-14, for a short overview of the development of DTCs.

satisfy notions of fairness and tax equity. A feeling that some foreign-sourced income may indeed have a “closer connection” to the other state might, of course, play a part in the design of the unilateral relief. But again, the provision of unilateral relief will usually be limited.

For an illuminating historical account of the discussions underlying the U.S. international tax regime in general and the U.S. foreign tax credit system, as “a rejection of the primacy of residence-based taxation” which had been “sold to the American people on fairness grounds”, see Michael J. Graetz & Micheal M. O’Hear, The “Original Intent” of U.S. International Taxation, 46 DUKE L. J. 1021, 1033-1054 (1997). Nonetheless, in practice, since the 1960s the policy debate has usually been framed in terms of two competing theories of (international) tax neutrality: capital export neutrality (“CEN”), i.e., achieving neutrality with regard to investing domestically or abroad, or capital import neutrality (“CIN”), i.e., achieving neutrality for all investors active on the same market. For the original formulation of these concepts and the start of the debate, see R. A. Musgrave, Criteria for Foreign Tax Credit, in TAXATION AND OPERATIONS ABROAD 83 (Tax Institute ed., 1960); Peggy Brewer Richman, Taxation of Foreign Investment Income: An Economic Analysis (1963) (discussing also the concept of national neutrality, which is based on a national welfare analysis and consequently treats foreign taxes merely as a cost of investing abroad); Peggy B. Musgrave, United States Taxation of Foreign Investment Income: Issues and Arguments 108-138 (1969); Richard Musgrave & Peggy Musgrave, Inter-Nation Equity, in MODERN FISCAL ISSUES: ESSAYS IN HONOR OF CARL S. SHOUP 63 (Richard M. Bird & John G. Head eds., 1972). See also Mihir A. Desai & James R. Hines, Jr., Old Rules and New Realities: Corporate Tax Policy in a Global Setting, 57 NAT’L TAX J. 937 (2004); Mihir A. Desai & James R. Hines, Jr., Evaluating International Tax Reform, 56 NAT’L TAX J. 487 (2003) (introducing two different kinds of tax neutrality as benchmarks for evaluating the desirability of international tax reforms: capital ownership neutrality or national ownership neutrality). For recent critiques of basing national tax policy decisions on a global welfare respectively worldwide economic efficiency standard, see, e.g., Daniel N. Shaviro, Fixing U.S. International Taxation 103-175 (2014); Michael J. Graetz, Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies, 54 TAX L. REV. 261 (2001).

See Robert J. Patrick, Jr., Rules for Determining Income and Expenses as Domestic or Foreign: General Report, 65b CAHIERS DE DROIT FISCAL INTERNATIONAL 15, 34 (1980) (“A weighing of the relative degree of economic connection of income also leads one country to accept another country’s exclusive or primary taxation of income having a certain degree of connection with the other country (e.g., real property located there). Examination of the national reports confirms the fact that the criteria for establishing the required degree of economic connection of an activity or property varies from country to country.”).

Only very few states strive to exempt all foreign-sourced income of resident taxpayers. Similarly, unilateral foreign tax credit regimes – whether operating on a worldwide, per country, type of income or similar basket approach – are typically limited, not only by capping the credit to the amount of domestic tax actually attributable to the foreign income, but often also with regard to what income can be considered foreign in the first place. See, e.g., 26 U.S.C. § 904 (2013) (U.S.); EStG §§ 34c-34d (Ger.); see generally Ault & Arnold, supra note 113, at 454-457. In this context, see also Martha, supra note 105, at 20 (observing “that no established universal rule of conventional or customary international law exists concerning the delimitation
by each state’s policy beliefs about what parts of the tax base are to be considered rightfully theirs to tax, and these beliefs might differ substantially from state to state.\textsuperscript{117} In other words, despite the emergence of many common features, there does not seem to be any evidence of a customary international law obligation on the residence state to provide unilateral double tax relief with regard to any specific form of income.\textsuperscript{118} French national tax law, by way of example, generally still does not provide for a credit of foreign taxes.\textsuperscript{119} Conversely, the decision by some states, the U.K. being a notable recent example, to move from a system of worldwide taxation towards a territorial system, by unilaterally exempting many forms of overseas profits (from corporation tax), also does not appear indicative of changing attitudes with regard to the allocation of fiscal jurisdiction under international law, but was again merely a deliberate policy choice: based in part on the well-known concerns about the easily manipulated, outdated and inherently elusive concept of corporate residence and with the clear

\textsuperscript{117} See KNECHTLE, supra note 94, at 62-67 (“[A]lthough attribution principles do exist in national fiscal law, it is in my view somewhat euphemistic to speak of attribution principles in international fiscal law also.”); VOGEL, supra note 94, at 116-117 (observing that the demise of the territoriality principle can also be seen by the vast differences of the definitions of domestic income provided in the tax laws of different states); Patrick, supra, note 115, at 15 (“There is an inextricable link between source concepts and the policy decision to tax certain income. It is not apparent in most cases whether the foreign/domestic characterization or the taxable/non-taxable decision came first. It is reasonable to suggest that notions of ‘domestic’ or ‘foreign’ income became convenient labels for designating activities that are or are not to be subject to tax and for recognizing the right of other countries to primary or exclusive taxing jurisdiction.”).

\textsuperscript{118} See, e.g., MONSENEGO, supra note 94, 61-62; Qureshi, supra note 94, at 19; Vogel, supra note 103, at 8 (“[I]nternational law can decrease the incidence of double taxation only through the introduction of rules establishing when a state must withdraw its tax claim. General international law does not as yet contain such rules. For the most part, only bilateral double tax treaties fulfill this role.”); see also Norr, supra note 94, at 438-439 (observing that a Swedish rule which did not even grant a deduction for foreign taxes paid, and hence resulted in full unmitigated double taxation, “was not considered to violate international law”). But see REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME 4-8 (2007) (arguing, albeit without providing any evidence except pointing towards the existence of the vast voluntary tax treaty network, that “preventing double taxation through a credit or exemption has become part of customary international law”).

\textsuperscript{119} See AULT & ARNOLD, supra note 113, at 452. Note, however, that most active foreign business income is exempted under French tax law.
goal of attracting multinational holding companies, reducing compliance costs and increasing the overall tax competitiveness of the U.K.\textsuperscript{120}

2. \textit{No Built-In Jurisdictional “Safety Valves” or Other Balancing of Interests in the Area of Tax Law as a Matter of Customary International Law}

All this goes to show is that, at least in the area of fiscal jurisdiction, customary international law does not require jurisdictional “safety valves” or some other built-in balancing of interests rule. The existence of a genuine link is a sufficient base – whether it is also necessary is, as described, a separate question – for a state to assert its jurisdiction to tax. This remains true even if the facts of the case are also genuinely linked to other jurisdictions. Hence, regardless of whether it may be considered part of customary international law that “elements of

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accommodation, mutuality, and proportionality should be duly taken into account,” this does not seem to impose any meaningful restrictions in the area of tax.\textsuperscript{122}

Admittedly, the existence of some form of balancing of interest rule for resolving jurisdictional overlaps has received strong endorsements in the international law sphere, particularly from U.S. scholars. One of the most prominent being the American Law Institute’s\textsuperscript{123} Restatement

\textsuperscript{121} Crawford, supra note 91, at 486. This and similar statements can usually be traced to a famous remark by Sir Gerald Fitzmaurice. See Barcelona Traction, Light and Power Company, Limited (Belg. v. Spain), Judgement, 1970 I.C.J. 64, at ¶ 70 (Feb. 5) (separate opinion of Judge Sir Gerald Fitzmaurice) (“It is true that, under present conditions, international law does not impose hard and fast rules on States delimiting spheres of national jurisdiction in such matters (and there are of course others—for instance in the fields of shipping, “anti-trust” legislation, etc.), but leaves to States a wide discretion in the matter. It does however (a) postulate the existence of limits—though in any given case it may be for the tribunal to indicate what these are for the purposes of that case; and (b) involve for every State an obligation to exercise moderation and restraint as to the extent of the jurisdiction assumed by its courts in cases having a foreign element, and to avoid undue encroachment on a jurisdiction more properly appertaining to, or more appropriately exercisable by, another State.”). It should be noted, however, that this statement refers solely to adjudicative, not legislative, jurisdiction in the area of bankruptcy law. For a critical in-depth analysis, see Ryngaert, supra note 81, at 142-182 (concluding that “the insufficiency of State practice and the absence of opinio juris with respect to the rule of reason . . . may inexorably lead to the conclusion that there is simply no clearly discernible norm of customary international law subjecting a State’s jurisdictional assertions to a reasonableness requirement.”).

\textsuperscript{122} See Crawford, supra note 91, at 486 (“[T]hese principles do not apply or do not apply very helpfully to (a) certain cases of concurrent jurisdiction . . . . In these areas special rules have been evolved . . . . Jurisdiction is often concurrent and there is no hierarchy of bases for jurisdiction.”)

\textsuperscript{123} It is important to note that the Restatement does not restate the official position of the U.S. government, but “represents the opinion of the American Law Institute as to the rules that an impartial tribunal would apply if charged with deciding a controversy in accordance with international law.” See Restatement (Third) of the Foreign Relations Law of the United States intro., at 3 (1987). Further, although a reasonableness analysis respectively some form of interest balancing has been undertaken by U.S. courts, the U.S. Supreme Court has at times declined to do so. See Hartford Fire Insurance Co. et al. v. California et al., 509 U.S. 764, 797-799 (1993). But see F. Hoffmann-La Roche Ltd. et al. v. Empagran S.A. et al., 542 U.S. 155, 168 (2004) (observing that “this approach is too complex to prove workable”, while using principles of comity in the construction of the statute). See generally Ryngaert, supra note 81, at 153-163; David B. Massey, How the American Law Institute Influences Customary Law: The Reasonableness Requirement of the Restatement of Foreign Relations Law, 22 Yale J. Int’l L. 419 (1997) (arguing “that the reasonableness requirement of Restatement (Third) section 403 did not reflect the state of customary international law when the treatise was published in 1987,” while conceding that “the reasonableness requirement nevertheless has been influential” and may contribute to such a requirement becoming customary international law in the future).
(Third) of the Foreign Relations Law of the United States (Restatement), which in § 403(1) lays down “reasonableness” as a general limitation on a state’s jurisdiction to prescribe: “Even when one of the bases for jurisdiction . . . is present, a state may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction would be unreasonable.”124 This reasonableness test in turn effectively involves an exercise of interest balancing, for pursuant to § 403(2) whether an assertion of jurisdiction is “unreasonable” is determined by “evaluating all relevant factors.”125

However, it should be pointed out that the reasonableness test of the Restatement is not intended to eliminate the concurrent exercise of jurisdiction by multiple states in all cases, far from it. In view of the factors in § 403(2) “exercise of jurisdiction by more than one state may be reasonable.”126 It is only when the “prescriptions by the two are in conflict” – which typically would not cover double taxation of the same facts127 – that there may be an “obligation” under § 403(3) to reevaluate and, essentially, work towards finding a solution. But the latter is merely a requirement in comity (“should”) “addressed primarily to the political departments of government,”128 not in law.129 Hence, even under the Restatement the “resolution of . . . legitimate assertions of concurrent jurisdiction must be found outside international law.”130

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124 See also Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], 2 BvR 457/78, Mar. 23, 1983, 63 BVerfGE 343, 369 (Ger.) (referring expressly to F. A. Mann and the necessity of sufficiently relevant points of contact, which have to satisfy a minimum of reasonableness).

125 See the non-exhaustive list of possible factors included in RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 403(2) (1987).


127 See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 403 cmt. e (1987) (stating that § 403(3) “does not apply where a person subject to regulation by two states can comply with the laws of both”).


129 For an overview of the discussions underlying this rule, see Harold G. Maier, Resolving Extraterritorial Conflicts, or “There and Back Again”, 25 VA. J. INT’L L. 7 (1984) (concluding that the “journey and the final product demonstrate that it is now recognized, by the Reporters and by the American Law Institute, that whatever the nature and degree of interest balancing required by U.S. law, there is no international or domestic legal limitation that only one nation may exercise jurisdiction in a situation where concurrent jurisdiction otherwise exists”). See also RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES pt. IV intro. note at 231 (1987) (“The courts appear to have considered these rules as a blend of international law and domestic law, including international ‘comity’ as part of that law.”).

130 Maier, supra note 90, at 69.
The case may be even stronger in the area of tax law, which is further illustrated in the tax-specific §§ 411-413 of the Restatement. While it is argued in the comment section to § 413 that, “in most contexts, recognition by the taxing state, in some form, of taxes paid to another state would be required by the principle of reasonableness, § 403,” ultimately the Restatement concedes that “states have been reluctant to admit an international obligation to avoid double taxation except on the basis of an agreement and in accordance with its terms.” Accordingly, the actual text of § 413 recognizes the existence of an obligation to give some form of double tax relief only “under United States law and agreements to which the United States is a party” and solely with regard to the income tax. So, even under U.S. law this does not extend to transaction taxes.

Consequently, Scott’s argument that the FTT proposal is “flawed” because it does not include built-in jurisdictional safety valves that, in her view, “may be necessary to ensure the reasonableness, and ultimately the legality” of the proposal seems itself flawed. Her line of reasoning is essentially based on the observation that in the area of financial and capital markets regulation the EU today often includes equivalence regimes as well as discretionary open-ended standards – which she together refers to as “jurisdictional safety valves” – “that are intended to prevent jurisdictional over-reach and to increase cooperation and avoid conflict with

132 Cf. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 413 reporters’ note 1 (1987) (“Transaction taxes . . . are regarded as expenses of carrying on business or owning property in the state and are at most allowed as deductions against income for purposes of income tax imposed by the state of nationality, domicile, or residence.”).
133 Scott, supra note 24, at 1380.
134 Id. at 1380.
135 Within the scope of a so-called equivalence mechanism certain EU rules, particular in the area of capital markets regulation, will be disapplied whenever the addressee of the rule is subject to a set of third country rules which have been determined (by the Commission) to be equivalent to those laid down in EU law. This approach has been developed as an alternative to the traditional choice between harmonization and regulatory competition. See generally Ethiopis Tafara & Robert J. Peterson, A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework, 48 HARV. INT’L L.J. 31 (2007); Howell E. Jackson, A System of Selective Substitutive Compliance, 48 HARV. INT’L L.J. (2007); Pierre-Hugues Verdier, Mutual Recognition in International Finance, 52 HARV. INT’L L.J. 55 (2011); Tzung-bor Wei, The Equivalence Approach to Securities Regulation, 27 NW. J. INT’L L. & BUS. 255 (2007).
other states.” \textsuperscript{136} The corresponding rules \textsuperscript{137} in the area of tax law, however, are the rules referred to above that – bilaterally or unilaterally – provide for double taxation relief by relinquishing some of the taxation rights. But neither DTCs nor the unilateral double tax relief regimes – the former of which might roughly correspond to regimes of mutual recognition, while the latter could be considered the tax counterparts of equivalence – are the result of obligations under customary international law.

Of course, one could argue that the FTT should draw its inspiration from the capital markets realm. Yet this fundamentally disregards that, regardless of any political rhetoric, the FTT’s key objective is simply to raise additional revenue;\textsuperscript{138} any stability-enhancing incentive effects are regarded purely as “welcome side effects.”\textsuperscript{139} Hence, equivalence considerations do not come to bear, since, as Scott herself concedes,\textsuperscript{140} for revenue-raising purposes taxation by non-participating states cannot be considered equivalent to taxation by the participating Member States themselves. And besides, there seems to be a good argument to be had that the (limited) disapplication mechanisms or “safety valves” found in the arena of financial and capital markets regulation, too, are not rooted in any rule of customary international law, but are based on reasons of EU law proportionality or, even more probable, again merely policy.

\textsuperscript{136} Scott, supra note 24, at 1379 and 1364-1370.

\textsuperscript{137} This only refers to “contingency”-based jurisdictional safety valves, i.e., those that lead to the disapplication of the rules by reason of the concurrent application of similar rules in other states. In contrast, “contextuality”-based safety valves, based on a case-by-case, discretionary assessment of the relevant authorities, seem ill-suited for comprehensive application in the area of tax law. See Scott, supra note 24, at 1364-1370.

\textsuperscript{138} See Evidence by Heinz Zourek, Director General, DG Taxation and Customs Union, European Commission, to the House of Lords European Union Sub-Committee on Economic and Financial Affairs (Oct. 2, 2013), available at http://www.parliament.uk/documents/lords-committees/eu-sub-com-a/FTTAliveanddeadly/FTTAliveanddeadlyEVFINAL.pdf (“It is a harmonised tax which should raise revenues; that is point number one, three, six and 10. Thereafter, there are some other considerations but its purpose is to raise revenues. We are departing from a point where we said that to raise revenues we would like to have the broadest possible tax base with the lowest possible rate, so that this would have the least effect in changing patterns and in favouring some transactions or products.”).

\textsuperscript{139} 2013 Commission Impact Assessment, supra note 16, at 11.

\textsuperscript{140} See Scott, supra note 24, at 1372 (“The absence of a safety valve in the form of an equivalence clause raises a suspicion that the Commission regards the FTT’s revenue-raising objective as paramount, as this is the only one of the proposal’s stated objectives that could not, in principle, be achieved as a result of equivalent action by other States.”).
Thus, in short, the assertion – expressly or implicitly – underlying many of the analyses that “impinging on [the] more relevant tax jurisdiction of other States over those persons or the activity involved”\textsuperscript{141} might as such make the imposition of FTT on foreign-based persons incompatible with international law seems to misrepresent the actual position of customary international law. There is no specific and binding order of precedence with regard to tax jurisdiction under customary international law. On the contrary, even under the territoriality principle, the only test is whether there is some kind of – genuine, relevant, or sufficient – nexus between the taxing state and the action or person subject to tax. The next subsection will show that the counterparty principle neither seems to be considered under the Restatement an “unreasonable”, nor is it indeed a “novel” trigger for establishing that nexus in the area of taxation.

D. Drawing Parallels: Far From a “Novel” Connecting Factor in the Area of Tax Law

Looking at international tax law practice, the revolt against the use of the counterparty principle for establishing the FTT liability of non-resident financial institutions appears almost baffling.

1. The Restatement on Transaction Taxes

One could easily argue that even the Restatement, which curiously is one of the most frequently cited treatises in the European debate, considers the counterparty principle a “reasonable” connecting factor for taxation, and that almost expressly so. Specifically with regard to transaction taxes, § 411(3)(b) stipulates that a state has jurisdiction to tax any “transaction that occurs, originates, or terminates in its territory or has some other substantial connection to that state,” and that pursuant to § 412(4) “without regard to the nationality, domicile, residence, or presence of the parties to such a transaction.” Under the Restatement the question thus effectively boils down to whether the connecting factors of art. 4 could be said to ascertain if a transaction “occurs, originates, or terminates . . . or has some other substantial connection” to a participating Member State.

As the exploration of art. 4’s inner structure in section II has shown, the counterparty principle of art. 4(1)(f), however, never actually assumes a sourcing rule function, but merely determines, in conjunction with art. 10(1), the recipient participating Member State as well as the person subject to the tax. The localization of any transaction is solely a matter of the connecting factors, i.e., the sourcing rules, laid down in art. 4(1)(a)-(e) and (g), (2). Hence, while the counterparty

\textsuperscript{141} Council Legal Service Opinion, supra note 23, at ¶ 20.
principle imposes FTT liability on foreign-based persons, it does so only with regard to transactions that because of another connecting factor already are considered to fall within the tax jurisdiction of a participating Member State. It is never used to establish tax jurisdiction over a transaction itself. Yet solely the latter seems to be of relevance – and subject to limitations – under the Restatement. No limitations are placed on making a non-resident counterparty liable to pay the tax on a transaction which “occurs, originates, or terminates in its territory or has some other substantial connection” and thus falls within the tax jurisdiction of the taxing state. This is reinforced by § 412(4): the fact that a counterparty does not itself fulfill any subjective connecting criteria is as such expressly regarded as irrelevant for the establishment of tax jurisdiction.

Further, under any sensible interpretation of the words, the factors referred to in art. 4(1)(a)-(e) and (g), (2) also seem to satisfy the territorial connection required by Restatement. Transferred into the financial markets realm, the seller respectively buyer might often be the only possible point of contact, in particular in electronic over-the-counter (OTC) transactions, to reasonably define where a transaction originates or terminates. This is especially true where the transaction is covered by the party’s authorization to act, art. 4(1)(a)-(b), or carried on through a branch in that state, art. 4(1)(e), but seems to be applicable also with regard to the connecting factors laid down in art. 4(1)(c) and (d). In any case, even the latter criteria would have to be considered to satisfy at least the “some other substantial connection” test.

The statement in § 412(4) does not argue against such interpretation: “without regard to the nationality, domicile, residence, or presence of the parties to such a transaction” merely means that a transaction may fall within a state’s tax jurisdiction regardless of any personal connection.

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142 See also Commission Services Opinion, supra note 27, at ¶¶ 27-33.

143 The issuance principle will be addressed separately in section 4.

144 See also Commission Services Opinion, supra note 27, at ¶ 25.

145 Cf. Mann, supra note 90, at 36-37 (“In many cases, however, it is very difficult to define the locality of an occurrence; much learning, acumen and even sophistry has been devoted to the problem in different connections. Yet a decision necessarily involving fine distinctions and based upon a review of steadily growing material is likely to rest on somewhat tenuous elements. Perhaps the most striking example is the well-known problem where a contract made by correspondence, teleprinter or telephone is concluded – a problem which, primarily for purposes of civil jurisdiction, is often of substantial importance. . . . In short, a test developed in wholly different economic, social and technical conditions and at a time when corporations did not yet play a predominant role in international life is unlikely to satisfy a generation which is suspicious of rigidity and, indeed, of principles.”).
not however, that such personal connection may not be used as a connecting factor for establishing jurisdiction to tax over the transaction in the first place. This can be derived from the interplay of the basic rule for transaction taxes in § 411(3)(b), which does not include this addendum, and the two-part application of the rule in § 412(3) and (4). Pursuant to § 412(3), which is a special rule for transfers of wealth, e.g., gift, estate, and inheritance taxes, a state is expressly given jurisdiction to tax such transfers “if the transfer is made by or to a national, resident, or domiciliary of the state,” effectively establishing something akin to the residence principle of art. 4(1)(c) and (d) as one of the connecting factors for the taxation of wealth transfers. The addition of the statement in the more general § 412(4) to the otherwise identical basic rule of § 411(3)(b) was merely supposed to clarify that, in general, jurisdiction to tax transactions was not similarly confined to the existence of a personal connection. This is expressly confirmed in the Reporters’ Notes to § 412:

“The distinction drawn in this section between a tax on transfer of wealth (Subsection (3)) and a tax on transactions (Subsection (4)) reflects their different jurisdictional bases. Gift, estate, and inheritance taxes, for example, frequently are imposed on the basis of the relationship of the transferor or transferee to the taxing state, regardless of the location of the property involved. On the other hand, states impose sales and excise taxes or customs duties on transactions in or touching the state, regardless of the relationship between the participants and the state. An excise or tariff, however, may be imposed on a person participating in a transaction by reason of that person’s relationship to the taxing state even though the transaction occurs outside the state’s territory.”

Accordingly, even under the relatively restrictive Restatement the connecting factors in art 4(1)(a)-(e), (2) are considered to provide a sufficient territorial link between the transaction and the state asserting jurisdiction, while, at the same time, placing no limitation on also making the non-resident counterparty in the transaction subject to (part of) the tax. Admittedly, the analyzed sections of the Restatement were not drafted with any particular reference to financial

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146 See Restatement (Third) of the Foreign Relations Law of the United States § 412 reporters’ note 8 (1987). Looking at the wording, one could argue that the FTT might also be characterized as a tax on the transfer of some form of wealth, but this seems neither necessary nor consistent with the common usage of the term. See, e.g., James Mirrlees et al., Tax by Design: The Mirrlees Review 347-349 (2011).

transaction taxes,\textsuperscript{148} neither, however, are they limited to VAT or similar consumption taxes, nor should it matter.\textsuperscript{149} Rather, the specific type of transaction tax should be irrelevant, as, again, even under the territorality principle customary international law is solely concerned with the existence of a territorial connection between the transaction and the taxing state. In other words, there is no evidence of limits specific to the taxation of financial transactions, but the objective connecting factors generally recognized for establishing tax jurisdiction over transactions should also apply to the FTT.

2. \textit{The “Counterparty Principle” as a Generally-Recognized Base for Establishing Limited Tax Liability in the Area of Income Tax}

In other areas of international tax law practice it is similarly far from unheard of to assert (limited) tax jurisdiction over foreign-based persons by reason of a contractual relationship, i.e., transacting, with one of the state’s residents.\textsuperscript{150} Indeed, this is one of the principal bases for establishing limited tax liability in the area of income tax. While such “counterparty principle” might only fit awkwardly within the categories of territorial connection as traditionally phrased in the general international law debate (i.e., conduct, presence, or even effects\textsuperscript{151}), this nonetheless seems to be a generally-recognized trigger for income taxation. Even under § 412(1)(b) of the Restatement a state is given jurisdiction to tax non-residents “with respect to income derived from or associated with presence or doing business [emphasis added] within that state.” A look at international tax law practice shows that the latter is, by no means, restricted to conduct respectively transactions physically occurring in the territory of the taxing state.

Many states assert jurisdiction to tax non-residents, or at least reserve their right to so, with respect to (some items of) income arising in their state. And their right to do so is internationally accepted, as, e.g., evidenced by art. 21(3), the fallback provision, of the 2011 U.N. Model

\textsuperscript{148} However, the Restatement makes an express reference to the former U.S. Interest Equalization Tax, which was a tax on the purchase of foreign securities. \textit{See Restatement (Third) of the Foreign Relations Law of the United States} § 412 reporters’ note 9 (1987).

\textsuperscript{149} Apparently dismissive of such a view, however, Englisch, Vella & Yevgenyeva, \textit{supra} note 15, at 241.

\textsuperscript{150} \textit{See also} Fabbrini, \textit{supra} note 24, at 170 (“[T]he concern that the ‘counter-party’ principle results in an extra-territorial application of tax jurisdiction fails to notice that art.4(1)(f) of the Commission proposal valorizes a clear connecting factor: once a financial institution resident outside the FTT zone transacts with a financial institution resident within the FTT zone, it shall pay the FTT. This customarily occurs in tax legislation.”).

Double Taxation Convention\(^{152}\), a model for the negotiation of DTCs between developed and developing countries. While the even more important OECD Model Tax Convention\(^{153}\) does not include a similar paragraph in its art. 21,\(^{154}\) a considerable number of Member\(^{155}\) and non-Member States\(^{156}\) have entered reservations in this regard and “wish to maintain [emphasis added] the right to tax income arising from sources within our own country.” This, as well as the numerous income-specific rules, is a clear testament to the fact that, in principle, under customary international law – meaning as long as there is no DTC to the contrary – states have jurisdiction to tax non-residents with regard to all income arising in their territory.\(^{157}\) So, the question comes down to what income can (reasonably) be considered to arise within their jurisdiction respectively how to determine the income’s source. Treaties oftentimes include express sourcing rules, at least for some categories of income. Yet it is important to note that the sourcing rules of DTCs serve an allocative respectively distributive function,\(^{158}\) i.e., they


\(^{154}\) This is consistent with the general approach taken by and the principal difference between these two models. See id. Introduction, at ¶ 3 (“The United Nations Model Convention generally favours retention of greater so-called ‘source country’ taxing rights under a tax treaty – the taxation rights of the host country of investment – as compared to those of the ‘residence country’ of the investor. This has long been regarded as an issue of special significance to developing countries, although it is a position that some developed countries also seek in their bilateral treaties.”).

\(^{155}\) OECD MODEL, supra note 153, Commentary on Article 21, at ¶ 13.

\(^{156}\) OECD MODEL, supra note 153, Non-OECD Economies’ Positions on the OECD Model Tax Convention, Positions on Article 21 (Other Income) and Its Commentary, at ¶ 1.

\(^{157}\) See also Mann, supra note 90, at 112 (stating that “[t]he State of the situs in which the income arises is entirely free to decide upon the type of tax it imposes,” for instance, “[i]t may tax the local income of non-resident aliens” as well as institute “a property tax or estate duty, i.e. something in the nature of a capital levy”).

\(^{158}\) See, e.g., OECD MODEL, supra note 153, Introduction, at ¶¶ 19-25.1; see also Vogel, supra note 103, at 22-23 (“Moreover, treaty rules do not ‘allocate’ jurisdiction to tax to the contracting states. States have original jurisdiction to tax, and by concluding tax treaties they agree to restrict their substantive tax law reciprocally. In situations in which an overlapping of substantive tax law is expected to occur, states which are parties to tax treaties decide which of them shall be bound to withdraw its tax claim. Tax treaties, in other words, do
facilitate double taxation relief, and are not meant to provide a definite answer to what sourcing rules states could as a matter of customary international law choose in their domestic law if they were unrestricted by tax treaties.\textsuperscript{159} Hence, the sourcing rules in DTCs more or less reflect the lowest common denominator of what the contracting states consider to be reasonable sourcing criteria.

Remarkably, despite this compromise character of DTC source rules, the counterparty principle features prominently in DTCs. It is even expressly suggested in the Commentary to the U.N. Model to be used for the purpose of its art. 21(3), and thus as the most general non-income specific source rule: “Income shall be deemed to arise in a Contracting State when the payer is a resident\textsuperscript{160} of that State.”\textsuperscript{161} Admittedly, this rule is qualified if the payment is borne by a permanent establishment,\textsuperscript{162} but this merely exemplifies the weight that – not as a matter of customary international law, but as a matter of policy and maybe comity – is placed on the permanent establishment principle\textsuperscript{163} for the allocation of taxation rights. In addition to being suggested for the purpose of the fallback art. 21 of the U.N. Model, the counterparty principle is also commonly used to determine the source of financial income. By way of example, pursuant to art. 11(5) of both Models,\textsuperscript{164} unless borne by a permanent establishment, interest is “deemed to arise in a Contracting State when the payer is a resident of that State,” and dividends

\begin{footnotes}
\textsuperscript{159} See also Klaus Vogel, \textit{Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part I)}, \textit{16 INTERTAX} 216, 223-229 (1988) (demonstrating that, although “authors take ‘source’ to be a natural, self-defining concept about which not much dissension or disagreement is possible,” a look at international tax law practice shows that “this is far from [the] truth”).

\textsuperscript{160} Again, the fact that pursuant to the relevant domestic laws the payer may be considered resident in more than one state is irrelevant within the present context of jurisdiction under customary international law. The reason why this multiple residence will be resolved under the tie-breaker rules of the DTC, i.e., art. 4(2) and (3), can be found in the allocative function of the DTCs, i.e., policy, and, consequently, has nothing to do with potential jurisdictional limits.

\textsuperscript{161} U.N. MODEL, supra note 152, Commentary on Article 21, at ¶ 9.

\textsuperscript{162} \textit{Id}.

\textsuperscript{163} See MIHAEL KOBETSKY, \textit{INTERNATIONAL TAXATION OF PERMANENT ESTABLISHMENTS: PRINCIPLES AND POLICY} (2011), for more background on the role and history of the permanent establishment principle.

\textsuperscript{164} See also Patrick, supra note 115, at 22. For a detailed commentary on the provision, see Werner Haslehner, \textit{Article 11: Interest, in KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS}, at ¶¶ 116-132 (Ekkehart Reimer & Alexander Rust eds., 4th ed. 2015).
\end{footnotes}
may be taxed in the distributing company’s state of residence pursuant to art. 10(2).  

While the same cannot be said with regard to the gains derived from the sale or other alienation of financial instruments, the exclusive tax jurisdiction of the seller’s residence state established by art. 13(5) of the OECD Model respectively art. 13(6) of the U.N. Model is again to be understood as a policy choice with regard to allocation, not as reflecting a restriction under customary international law on the buyer’s residence state. Consequently, it is not surprising that the U.N. Commentary speaks of “most members from developing countries” suggesting an alternative which reads, “Gains from the alienation of any property other than those gains mentioned in paragraphs 1, 2, 3 and 4 may be taxed in the Contracting States in which they arise according to the law of that State.” There is nothing to suggest that, from a customary international law perspective, the counterparty principle could not be used to determine also the source of such gains.

In any case, there is no reason why a state should not have jurisdiction to tax the underlying transaction as such, when under customary international law it would have (or had) jurisdiction to tax the income flowing from the instrument. This reasoning applies regardless of whether the foreign-based person acted as buyer or seller (or was otherwise connected to the transaction), simply because the FTT is an objective tax with the transaction as tax object, and not a personal tax. Hence, either way, the objective connection between the transaction and the counterparty’s residence state remains essentially the same.

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165 For a detailed commentary of the provision, see Werner Haslehner, *Article 10: Dividends, in Klaus Vogel on Double Taxation Conventions*, at ¶§ 36-63 (Ekkehart Reimer & Alexander Rust eds., 4th ed. 2015).

166 According to the OECD Model Commentary, a special kind of capital gain from the alienation of shares, namely from a redemption of the shares or similar, may be taxed as a “dividend” by the source state, *see OECD Model, supra* note 153, Commentary on Article 13, at ¶ 13. Whether this is indeed consistent with the text of Article 10(3) is subject to some debate. *See Josef Schuch & Erik Pinetz, The Definition of Dividends, Interest, Royalties and Capital Gains, in OECD Model Convention and Its Update 2014*, at 1 and 8-15 (Michael Lang et al. eds., 2015).

167 U.N. MODEL, supra note 152, Commentary on Article 13, at ¶ 18.

168 *Cf. Mann, supra* note 90, at 112 (“The State of the *situs* in which the income arises is entirely free to decide upon the type of tax it imposes. It may tax the local income of non-resident aliens. The tax may be a property tax or estate duty, i.e. something in the nature of a capital levy. No question of jurisdiction arises in this connection.” (footnotes omitted)).
All in all, the claims of the counterparty principle’s incompatibility with customary international law thus seem to have been greatly exaggerated and often based on objections that, at their heart, seem to be more about policy and politics than customary international law.

IV. THE COMPATIBILITY OF THE ISSUANCE PRINCIPLE, ART. 4(1)(G), WITH CUSTOMARY INTERNATIONAL LAW

A look at international tax law practice similarly reveals that the issuance principle, too, frequently serves as a trigger for establishing tax jurisdiction and seems to go largely unchallenged for doing so. Merely a fallback in the EU FTT proposal, the issuance principle is indeed the main connecting factor used not only by the 2012 French\(^{169}\) and the 2013 Italian\(^{170}\) FTT legislation, at least the former of which has therefore evoked similar objections by some EU FTT critics,\(^{171}\) but also by the U.K. Stamp Duty Reserve Tax (SDRT), which was introduced in 1986 to ensure that “paperless”, i.e., electronic and thus uncertificated,

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\(^{171}\) See Englisch & Krüger, supra note 24, at 517-519.
transactions would be subject to a tax equivalent to the centuries-old U.K. stamp duty.\footnote{172} Besides, it will be shown that the issuance principle and other legal connecting factors – acting essentially as formalized territorial links\footnote{173} – also feature prominently in other areas of tax law, and even beyond.

A. Drawing Parallels: the U.K. Stamp Duty Reserve Tax

Pursuant to Finance Act 1986 § 99 SDRT is applied to transfers of (chargeable) securities which have been issued by a body corporate incorporated in the U.K. or, alternatively, are registered in a U.K. register. Unlike than proposed for the EU FTT, SDRT is charged only on the transferee, not generally on both counterparties, and the principal charge is subject to an increasing number of exceptions, covering inter alia purchases by market makers and, since 2014, transfers of securities listed on so-called recognized growth markets\footnote{174}. The territorial scope of the tax, however, remains essentially without bounds. As expressly clarified by Finance Act 1996 § 187, SDRT is chargeable regardless of “whether the agreement, transfer, issue or appropriation in question is made or effected in the United Kingdom or elsewhere, and whether or not any party is resident or situate in any part of the United Kingdom.” Hence, issuance by a U.K.-incorporated company is evidently seen to constitute a territorial link sufficient for triggering the taxation of foreign-based persons, which interestingly are said to account for more than 40 per cent of SDRT revenue.\footnote{175}

Nonetheless, it has been submitted that the SDRT and the EU FTT were different in nature and that both would thus have to be distinguished.\footnote{176} The underlying reasoning is in large part again based on the assertion that the existence of a sufficient territorial link could “only be assessed

\footnote{172}{For additional background on the U.K. stamp duty and the SDRT, see HMRC, \textsc{Stamp Duty on Shares Manual}, \url{http://www.hmrc.gov.uk/manuals/stsmanual/}.}

\footnote{173}{Cf. Meessen, \textit{supra} note 97, at 228 (observing that “[t]he concept of territoriality is more elusive than it seems” and that “[a] less obvious variant of territorial links is provided by the persons actively involved since the notion of the nationality of corporations – the seat theory or the law of incorporation theory – refers to formalised territorial links”).}

\footnote{174}{See Finance Act 2014, § 115 and sch. 24 (U.K.).}


\footnote{176}{See Englisch & Krüger, \textit{supra} note 24, at 518-519; Englisch, Vella & Yevgenyeva, \textit{supra} note 15, at 243-244.}
in the light of the objectives of the legislation.”

 Allegedly, the U.K. SDRT was not introduced to ensure that tax revenue would continue to be raised from the transfer of chargeable securities, and insofar complement U.K. stamp duty, but was “clearly conceived as a tax on the use of domestic settlement and registration systems; more specifically, the CREST system operated by Euroclear.”

 Alternatively, the SDRT could be considered a “special indirect tax on capital” for which purpose the issuance principle could be seen to serve as an appropriate territorial link to the underlying investment.

 From a customary international law perspective, all of these arguments, however, seem beside the point. While it is true that most of the SDRT revenue is collected automatically through the CREST settlement system, and subsequently billed by the stockbroker, SDRT is triggered regardless of whether CREST, or indeed a stockbroker, is used or not.

 transactions are just as well subject to SDRT and have to be notified to the U.K. tax authorities by the party itself. The role of CREST in the collection process is merely one of convenience, or (enforcement) policy, not of jurisdictional concerns, in any case not regarding the jurisdiction to prescribe. The U.K. legislator simply took advantage of the major overhaul of the U.K. financial markets through the 1986 “big bang” deregulation, which inter alia entailed a change from face-to-face electronic, screen-based trading. Employing the electronic clearing

\[177\] Englisch, Vella & Yevgenyeva, supra note 15, at 241.

\[178\] Id. at 241.

\[179\] Englisch, Vella & Yevgenyeva, supra note 15, at 241. The authors point towards Stuart Adam, James Browne & Christopher Heady, Taxation in the UK, in DIMENSIONS OF TAX DESIGN: THE MIRRLEES REVIEW 1, 21 (Stuart Adam et al. eds., 2010); REGINALD S. NOCK, MONROE AND NOCK ON THE LAW OF STAMP DUTIES, at 4.021 and 4.025 (7th ed., 1989, loose-leaf). Particularly the former, however, derive such characterization from a purely economic understanding and analysis of what taxes affect capital investment in the economy. In other words, this does not seem at all specific to the U.K. SDRT but applies to all taxes on “transactions of securities and property” as well as “inheritance tax on bequests”.

\[180\] See Brondolo, supra note 37, at 9 (observing that “[t]he vast majority of stamp tax revenue is assessed and collected automatically from broker-dealers through the UK’s electronic securities settlement system: CREST”); Thornton Matheson, Taxing Financial Transactions: Issues and Evidence 33 (IMF, Working Paper No. WP/11/54, 2011) (stating that the U.K. stamp duty is “collected largely through the CREST central clearance system”).

system as the primary collection mechanism provided a cost-efficient way to levy the new tax. After all, even in today’s apparently globalized markets, the vast majority of companies still have their primary listing on a stock exchange in their country of incorporation. Correspondingly, it is no surprise that much of the EU FTT is anticipated to be automatically collected by utilizing market infrastructure players in the collection stage of the tax. All this, however, does not make the SDRT, or any general transaction tax for that matter, “a tax on the use of domestic electronic settlement and registration systems.” Indeed it would be more than strange if the U.K. government would have introduced a tax for the use of a private central securities depositary. Moreover, regardless of whether one wants to characterize the SDRT as a “special indirect tax on capital,” or whatever that is supposed to mean exactly, SDRT is triggered independent of any underlying change in investment by the mere transfer of ownership. Besides, such characterization of the SDRT cannot explain why SDRT is also payable with regard to securities issued by foreign-incorporated companies that are merely registered on a U.K. register. And if this is simply supposed to mean that the issuance principle can be considered to indicate a sufficient territorial link between the instrument, which securitizes the underlying investment, and the state of issuance, then the same logic would have to apply to the EU FTT.

Tellingly, although the issuance principle formed part of the U.K. application to the ECJ, even the U.K. government, namely Andrea Leadsom, then Economic Secretary to the Treasury, conceded as much in a letter to the House of Lords’ European Union Committee: the “use of the issuance principle was, for us, not the offensive element of the tax as such . . . , U.K. stamp

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182 Correspondingly, the U.K. SDRT is often lauded for its low compliance costs. See Brondolo, supra note 37, at 10 (reporting the administration cost “to be about 0.1 percent of the revenue collected”); Matheson, supra note 180, at 33 (using an absolute instead of a relative measure, reports that the U.K. stamp duty “costs 0.09 pence per pound sterling to collect”).


185 Incidentally, it should be noted that the CREST settlement service was launched only in 1996, ten years after the introduction of the SDRT.


duty takes this approach and we do not object to it in principle." The fact that the EU FTT will apply to more financial instruments and exempt fewer market players does not change that under customary international law the issuance principle is a generally accepted trigger for establishing tax jurisdiction.

B. Drawing Parallels: The Use of Legal Connecting Factors

International state practice shows that similar legal links seem generally accepted as connecting factors for asserting jurisdiction also in other areas of tax, and increasingly even beyond. Most prominently, states have long recognized that companies may be taxed on their worldwide income solely because they have been incorporated under the domestic laws of that state or have their registered office there, and that regardless of whether there is any substantive link between the business or its profits and the territory of the taxing state. Of course, this legal connecting factor may be rationalized as essentially representing the “nationality” of the corporate body or at least be a reasonable indicator of its residence, i.e., of a territorial connection. Yet then again, it is unclear why it should be a stretch to assume that the state of


189 See, e.g., RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 411 reporters’ note 2 (1987). Whether the choice of such an easily manipulated or even “meaningless” connecting factor is smart policy is another matter entirely. See, e.g., SHAVIRO, supra note 114, at 65-77; Graetz, supra note 114, at 320-323; Omri Marian, Jurisdiction to Tax Corporations, 54 B.C. L. REV. 1613 (2013).


191 See, e.g., MARTHA, supra note 98, at 73-88; see also Meessen, supra note 97, at 228 (observing that “[t]he concept of territoriality is more elusive than it seems” and that “[a] less obvious variant of territorial links is provided by the persons actively involved since the notion of the nationality of corporations – the seat theory or the law of incorporation theory – refers to formalised territorial links”).
incorporation’s transaction tax jurisdiction extends to cover all financial instruments issued by that company, regardless of any additional link to the taxing state’s economy or territory.

Limited tax liability of foreign-based persons, as well, is oftentimes triggered by purely legal links which insofar seem to be used to localize the underlying income source. Besides dividends, which when derived by foreigners are nonetheless frequently subject to tax in the company’s state of incorporation or legal seat,\textsuperscript{192} the legal system is often used to determine also the location of other rights that have been originally created, are registered under or are governed by the laws of that state.\textsuperscript{193} This may be particularly true with regard to royalties paid as consideration for the use of, or the right to use, protected intellectual property,\textsuperscript{194} but the underlying logic is by no means limited to that.\textsuperscript{195} Indeed, even the Restatement mentions that a state has jurisdiction not only with regard to shares and debt obligations issued by a resident company, but with regard to all “rights created or protected by the laws of the state.”\textsuperscript{196}

C. Are Derivatives Different?

Even the Commission in its 2013 impact assessment, however, fears that while the issuance principle as such “should not raise any legal concerns as regards extraterritoriality . . . , this might not hold for applying this principle to derivatives.”\textsuperscript{197} This concern, of course, refers not to derivatives themselves issued by a FTT-zone company, although OTC derivatives are nonetheless flatly excluded from the issuance principle, but only to “instruments that were derived from a security issued in one of the participating Member States,”\textsuperscript{198} yet actually

\textsuperscript{192} See, e.g., 26 U.S.C. § 861(a)(2)(A) (2013) (U.S.); ESTG § 49(1)(5)(a) (Ger.); see also Patrick, supra note 115, at 22-23.

\textsuperscript{193} See, e.g., ESTG § 49(1)(6) (Ger.).

\textsuperscript{194} See Patrick, supra note 115, at 23-24 (observing that with regard to royalties “[t]he most widely applied origin rules are the place of registration and the residence of the obligor”).

\textsuperscript{195} A curious example is provided by the so-called “passage of title” rule of U.S. law, under which the source of income from a sale has for a long time and for inventory and certain items of personal property is still determined by reference to where the title is passed pursuant to commercial law, i.e., a purely legal act. See Ray A. Knight & Lee G. Knight, Do the Foreign Tax Credit and the New Source of Income Rules Create the Potential for Double Taxation, 7 INT’L TAX & BUS. LAW. 249, 259-268 (1989); Johannes R. Krahmer, Federal Income Tax Treatment of International Sales of Goods: A Reevaluation of the Title-Passage Test, 17 TAX L. REV. 235 (1962); Vogel, supra note 159, at 225.

\textsuperscript{196} RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 412 cmt. f (1987).

\textsuperscript{197} 2013 Commission Impact Assessment, supra note 16, at 40.

\textsuperscript{198} Id. at 40.
“issued” by a non-FTT-zone company. Whether the latter is caught by the proposal in its current form may be doubted and, despite some ambiguity in the legislative documents,\(^{199}\) arts. 2(11) and 14 seem to argue against it.\(^{200}\)

The question if such a “look through” approach would be compatible with the jurisdictional limits under customary international law, again assuming there are any, nevertheless remains relevant with regard to possible changes to the proposal as well as to art. 14(1). Art. 14(1), which is drafted to complement and specify the general anti-abuse rule of art. 13, stipulates that “a depositary receipt or similar security issued with the essential purpose of avoiding tax on transactions in the underlying security issued in a participating Member State shall be considered issued in that participating Member State, in case a tax benefit would otherwise arise.”

However, at least from a customary international law standpoint the Commission’s concerns appear unfounded. Issues of practicality and enforcement may certainly abound (although there might be ways to overcome the latter), but such a legislative “look through” approach is neither unprecedented nor does it seem to exceed the jurisdictional competences of states under customary international law. Notably, both the French\(^{201}\) as well as the Italian\(^{202}\) FTT expressly apply to such depositary receipts regardless of the issuer’s place of establishment, e.g.,

\(^{199}\) The European Parliament wanted to expressly include derivatives agreements “where the reference or underlying instrument is issued by a legal entity that is registered in a [participating] Member State” as well as structured products “where the structured instrument is based on or backed by a significant proportion of assets or financial instruments and derivatives agreements with reference to financial instruments issued by a legal entity in a [participating] Member State”. See European Parliament Legislative Resolution, \textit{supra} note 9, amend. 18. However, these proposals have not been integrated in the 2013 proposal.

\(^{200}\) See also the discussion by Englisch, Vella & Yevgenyeva, \textit{supra} note 15, at 228-229.

\(^{201}\) See French FTT Guidance, \textit{supra} note 169, at ¶ 3.

\(^{202}\) See Decreto Ministeriale Economia e Finanze 21 febbraio 2013, Attuazione dei commi da 491 a 499 della legge n. 228/2012 (stabilita’ 2013) – imposta sulle transazioni finanziarie [Decree of the Ministry of Commerce and Finance of Feb. 21, 2013, Implementation of Paragraphs 491-499 of Law n. 228/2012 (Stability 2013) – Financial Transaction Tax], \textit{Gazzetta Ufficiale} [\textit{Official Gazette}] Feb. 28, 2013, n. 50, art. 2 (It.). An unofficial translation is available at http://www.agenziaentrate.gov.it/wps/file/Nsilib/Nsi/Home/CosaDeviFare/Versare/Imposta+sulle+transazioni+finanziarie/Normativa+e+prassi+Imposta+transazioni+finanziarie/FTT+Decree/DecretoFTT_11_3_2013_EN.pdf (“Additionally, the tax shall apply to the transfer of the ownership of securities representing equity investment, regardless of the place of residence of the issuer of the certificate and of the place where the contract has been concluded.”).
American depositary receipts issued by a U.S. institution, when they represent a French respectively Italian (equity) security that is covered by the tax, and that without recourse to any tax avoidance language. While the U.K. SDRT does not apply to the transfer of depositary receipts nor to contracts for difference, one of the major avenues to avoid the charge, a certain kind of derivative, namely call options on chargeable securities issued by U.K.-incorporated companies, is subject to SDRT, irrespective of whether the option was itself issued by the U.K.-incorporated company or under U.K. law. Incidentally, it also seems that trading in depositary receipts was not excluded due to concerns about legislative jurisdiction, but as a matter of enforcement expediency with regard to a relatively small market segment. Instead of the standard approach of taxing every transfer at a rate of 0.5 per cent, pursuant to Finance Act 1986 § 93(1) the initial transfer of chargeable securities to a depositary receipt issuer, as well as to a clearance service provider under § 96(1), is simply taxed at a higher rate of 1.5 per cent (often referred to as “season ticket” or “exit charge”).

Besides, a functionally similar “look through” approach is also adopted in other areas of international tax law. Pursuant to art. 13(4) of the OECD Model a state may tax gains derived from the alienation of shares (or similar interests) in any company, whether resident in any of the contracting states or not, if the relevant company derives more than 50 per cent of its value “directly or indirectly from immovable property situated in” that state. As expressly stated in the Commentary to the OECD Model, states are free to “reduce the percentage . . . that must be derived directly or indirectly from immovable property for the provision to apply” (and, curiously, may tax “the entire gain attributable to the shares to which it applies even where part of the value of the share is derived from property other than immovable property located in the source State,” a statement that is hardly, if at all, compatible with the limits that would apply under a strict territoriality principle). Of course, the “look through” as such can be easily explained by the desire to prevent the avoidance of situs state taxation through the setup of a

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203 The charge no longer applies when the shares are not transferred but instead issued to the clearance service or depositary receipt issuer, as this was held to be incompatible with the EU Capital Duty Directive as well as the EU treaties. See Case C-569/07, HSBC Holdings plc and Vidacos Nominees Ltd v. HRMC, 2009 E.C.R. I-9047; HSBC Holdings plc and The Bank of New York Mellon Corporation v. HRMC, [2012] UKFTT 163 (TC) (U.K.).

204 See OECD MODEL, supra note 153, Commentary on Article 13, at ¶ 28.5.

205 Id. at ¶ 28.6.

206 Id. at ¶ 28.4.
holding company structure. But there is no reason nor any evidence why the principle underlying art. 13(4) OECD Model should not be general in application. To give another example, the practice of some states to levy so-called secondary withholding taxes on dividends distributed by non-resident companies out of profits arising in the taxing state, although abandoned by the United States in 2004 and prohibited by art. 10(5) of both Models, was also never considered to violate any principles of customary international law.

Customary international law thus does not seem to place any limits on establishing tax jurisdiction over financial instruments by reference to the tax jurisdiction over the underlying asset or income source. The scale and breadth of the EU FTT may be unprecedented – with regard to covered products as well as market participants –, but that alone does not change the underlying principles of customary international law. Neither does the expected complexity of enforcement, which is bound by strict territoriality. Indeed, any different conclusion would

207 See U.N. MODEL, supra note 152, Commentary on Article 13, at ¶ 8.
209 But see Englisch, Vella & Yevgenyeva, supra note 15, at 239-242 (arguing that “the strict customary international law limits to extraterritorial enforcement of tax claims possibly render the issuance principle unreasonable”). However, while the sources cited indeed mention a similar argument, they do not necessarily seem to support this proposition as a matter of customary international law. Cf. Hannah L. Buxbaum, Territory, Territoriality, and the Resolution of Jurisdictional Conflict, 57 AM. J. COMP. L. 631, 665 (2009) (providing merely a description of the German competition law system, where the question of the application of the effects approach is intertwined with the issue of enforcement, which is contrasted to the U.S. approach, without any argument as to the position under customary public international law); Qureshi, supra note 94, at 21 (rejecting in fact the entire concept of reasonableness and the requirement of a “reasonable connection”, while asserting instead at page 17 that “[a] State may legislate whatever in fiscal matters, provided always that actual enforcement is intra-territorial” [second emphasis added]). In any case, the U.S. practice of taxing (non-resident) citizens on a worldwide basis seems to provide a clear indication that under customary international law legislative jurisdiction is not dependent upon the availability of obvious ways for enforcement. See also Bundesfinanzhof [BFH] [Federal Tax Court] Dec. 18, 1963, Case 1 230/61 S, 79 BFHE 57, at ¶ 18 (1963) (Ger.) (observing that there is no customary international law rule that would be violated by passing a hard to enforce tax law); Mann, supra note 97, at 34-38 (“Yet this must surely be due to some misunderstanding: the fact that a State has legislative jurisdiction does not authorize its enforcement abroad. There can be no question of the two jurisdictions necessarily coinciding. The international order could be gravely prejudiced if it were otherwise.”); Mann, supra note 90, at 127-129 (“It is in line with the difference in the nature of the problems that entirely different legal principles govern legislative and enforcement jurisdiction respectively.”).
seem to reflect a rather strange understanding of sovereignty, as a state’s jurisdiction to tax would by law be essentially subject to the financial ingenuity of the market.

V. SOME REMARKS ON ENHANCED COOPERATION (TFEU ARTS. 326-334)

Contrary to the critics, the “extraterritorial” scope of the FTT proposal also does not infringe the EU law protections for enhanced cooperation laid down in TFEU arts. 326-334. Admittedly, at first sight the FTT seems a rather peculiar use of enhanced cooperation. Labelled a harmonization measure, a minority of merely eleven EU Member States resorted to a rarely-used mechanism to implement one of the major (and most controversial) policy initiatives in the aftermath of the global financial crisis. Even the Commission was surprised to be asked to propose enhanced cooperation in the field of taxation, especially as the Member States preferred to proceed by intergovernmental agreements in other areas of the crisis response. Unsurprisingly, critics asserted that the


211 See Council Legal Service Opinion, supra note 23, at ¶¶ 26-42.

212 See 2013 Proposal, supra note 13, recital 3.

213 The two other uses of the enhanced cooperation procedure, namely on divorce law and the unitary patent, originally comprised 14 respectively 25 of the EU Member States.

214 See Evidence by Heinz Zourek, Director General, DG Taxation and Customs Union, European Commission, to the House of Lords European Union Sub-Committee on Economic and Financial Affairs (Oct. 2, 2013) (U.K.), available at http://www.parliament.uk/documents/lords-committees/eur-subs-com-a/FTTAliveanddeadly/FTTAliveanddeadlyEVFINAL.pdf (stating in response to question 11 that the Commission was “astonished” and taken “by surprise” to be asked to prepare a proposal for enhanced cooperation in the tax field).

proposal would be tantamount to “creating a new tax through an EU law”\textsuperscript{216} and giving “the Union tax collection competence.”\textsuperscript{217} And there is arguably an element of truth in that, as one may doubt whether the participating Member States would have been willing or capable to introduce a similarly broad and wide-ranging tax unilaterally; the French and Italian FTTs for instance are significantly narrower in scope.

Still, this does not change that at its heart the proposed EU directive is and would remain a harmonization measure and, consequently, only confining the harmonization to the participating Member States should be subject to the additional protections laid down in TFEU arts. 326-334, not, however, the imposition of the tax by the Member States as such (which, of course, would have to comply with the general protections of the TFEU).\textsuperscript{218} The ECJ in particular accepts that a harmonization measure may be taken preemptively “to prevent the heterogeneous development of national laws leading to further disparities which would be likely to create obstacles”\textsuperscript{219} to the functioning of the internal market. Such a facilitative and preventive use of enhanced cooperation moreover also seems consistent with the rationale underlying the procedure\textsuperscript{220} as well as the Union as a whole. After all, the EU was always meant to serve as a platform that, through (continued) integration, should enable its members to remain capable to act in an increasingly globalized world.\textsuperscript{221} And enhanced cooperation is intended to

\begin{footnotes}
\item[216] The Law Society of England and Wales, \textit{supra} note 210, at 3.
\item[217] Id. at 3.
\item[218] With regard to the latter, see Daniël S. Smit, \textit{The Financial Transaction Tax and the TFEU Freedoms, in TAXING THE FINANCIAL SECTOR: FINANCIAL TAXES, BANK LEVIES AND MORE} 121, 124-141 (Dennis Weber & Otto Marres eds., 2012) (“[I]n the author’s opinion, the FTT is likely to be compatible with the TFEU freedoms.”).
\item[220] See Fabbrini, \textit{supra} note 24, at 166-167, for a similar argument.
\item[221] \textit{See, e.g.,} JOSÉ MANUEL BARROSO, POLITICAL GUIDELINES FOR THE NEXT COMMISSION 13 (2009), \textit{available at} \url{http://ec.europa.eu/archives/commission_2010-2014/president/pdf/press_20090903_en.pdf} (“Europe’s raison d’être is to empower Europeans, to protect their rights and to foster social progress. In the age of globalisation, these tasks can no longer be fulfilled solely by national governments. The EU represents a real plus for Europeans as they try to build a better future, and allows them to shape the world we live in with confidence.”); José Manuel Durão Barroso, President of the European Commission. Speech by President Barroso at the European Forum Alpbach: European Ideas for Fair Globalisation (Aug. 31, 2013), \textit{available at} \url{http://europa.eu/rapid/press-release_SPEECH-13-664_en.pdf} (“Let me outline what these basic founding
allow some Member States to move faster and thereby establish a Europe of different speeds, while making sure that the cooperation stays embedded in the EU institutional framework instead of resorting to intergovernmental procedures.²²²

The proposed directive would in particular “respect the competences, rights and obligations” of the non-participating Member States as required by TFEU art. 327. As has been shown above, imposing a FTT charge on a financial institution resident in a non-participating Member State does not encroach upon any “primary competence”²²³ or right of the non-participating Member State recognized under international law. The same is true with regard to EU law, since there are no general limitations to the non-discriminatory exercise of the Member States’ fiscal jurisdiction under EU primary law. The ECJ has consistently held that EU primary law “does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation.”²²⁴ Consequently, the allegation that “financial transactions concluded by financial institutions in non participating Member States

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²²² See, e.g., Daniel Thym, “United in Diversity” – The Integration of Enhanced Cooperation into the European Constitutional Order, 6 GERMAN L. J. 1731, 1742-1747 (2005) (emphasizing that the enhanced cooperation mechanism is “integrated into the single legal and institutional framework of the European Union, thereby preserving its constitutional unity”, and even speculating that “some Member States may for example embark on the harmonization of tax law”); see also Daniel T. Murphy, Closer or Enhanced Cooperation: Amsterdam or Nice, 31 GA. J. INT’L & COMP. L. 265 (2003) (providing also a detailed account of how the substantive requirements have been “made less onerous” over time).

²²³ But see Council Legal Service Opinion, supra note 23, at ¶ 37.

would . . . contribute to the budget of participating Member States, whilst transactions by financial institutions resident in participant Member States would never contribute to the budget of another Member State” is as irrelevant, for it would be solely due to the non-participating Member State’s decision not to exercise its tax jurisdiction, as it is untrue: already today, a significant portion of the U.K. SDRT revenue is levied from non-U.K. residents.

The enhanced cooperation also does “not constitute a barrier to or discrimination in trade between Member States, nor . . . distort competition between them” (TFEU art. 326). There is no reason why the harmonization of a tax, even if done preemptively, should be considered an obstacle to trade, when the unilateral introduction of (non-discriminatory) national FTTs would arguably not. Mere disparities between national tax laws, as well as any disadvantages arising from the parallel exercise of tax competences by different Member States, do not as such constitute restrictions prohibited by the EU treaties.

225 Council Legal Service Opinion, supra note 23, at ¶ 37.

226 Note, however, that there is one case where the ECJ held that the imposition of a duty on a loan contracted in another Member State might constitute an obstacle to the free movement of capital, but that the duty was nonetheless not precluded by the EU treaties as it was “essential in order to prevent infringements of national tax law and regulations”, as provided by TFEU art. 65(1)(b), and the objective of the legislation was simply “to ensure equal tax treatment”, “irrespective of the nationality of the contracting parties or of the place where the loan is contracted”. See Case C-439/97, Sandoz GmbH v. Finanzlandesdirektion für Wien, Niederösterreich und Burgenland, 1999 E.C.R. I-7041, at ¶¶ 19-24. Yet whether this still represents the ECJ position today is doubted. See Case C-365/02, Lindfors, 2004 E.C.R. I-7183, at ¶ 34; Case C-387/01, Weigel and Weigel v. Finanzlandesdirektion für Vorarlberg, 2004 E.C.R. I-4981, at ¶ 55 (ruling that, “[g]iven the disparities in the [tax] legislation of the Member States”, “the Treaty offers no guarantee to a worker that transferring his activities to a Member State other than the one in which he previously resided will be neutral as regards taxation”); see generally BEN J.M. TERRA & PETER J. WATTEL, EUROPEAN TAX LAW 83-107 and 890 (6th ed. 2012) (“[T]he Court now seems to be firmly on a discrimination-based course of evaluating direct tax cases rather than on an obstacle-based track, as an obstacle-based disqualification of national measures makes little sense in direct tax matters: every tax is an obstacle, and the Treaties leave us clueless as to which connecting factor for asserting tax jurisdiction would be preferable over any other, possibly overlapping factor adopted by the other State.”).

Further, it does similarly not amount to discrimination that the “participating Member State will receive FTT twice when a transaction is entered into between a resident financial institution and a [non-resident] financial institution . . . , but only once when the transaction is between a resident financial institution and a financial institution resident in another participating Member State.”\textsuperscript{228} A financial transaction covered by the proposal is always subject to two charges of FTT – one on each counterparty –, if both counterparties are financial institutions. The different distribution of the revenue is merely a result of the allocative function of the criteria laid down in art. 4. And as the Commission rightly retorts, “the absence of such a mechanism in relations with non-participating Member States cannot be regarded as discrimination.”\textsuperscript{229} Indeed, the ECJ in its recent tax case-law consistently recognizes and highlights that Member States may implement measures to maintain a “balanced allocation”\textsuperscript{230} of the taxing rights. Viewed from this perspective, including the allocation mechanism directly in the EU level harmonization measure, and not leaving it to bilateral DTCs or the interplay of merely unilateral rules, should not arouse suspicions,\textsuperscript{231} but rather be considered a step in the right direction. Similarly, it is not discriminatory that financial institutions based in non-participating Member States may face different tax rates – art. 9(2) of the proposal only stipulates minimum rates – depending on

\textsuperscript{228} Council Legal Service Opinion, \textit{supra} note 23, at ¶ 29.

\textsuperscript{229} Commission Services Opinion, \textit{supra} note 27, at ¶ 62.

\textsuperscript{230} See Case C-337/08, X Holding BV v. Staatssecretaris van Financiën, 2010 ECR I-1215, at ¶ 27-33; see also Case C-311/08, Société de Gestion Industrielle SA v. Belg., 2010 ECR I-487, at ¶¶ 60-69; Case C-414/06, Lidl Belgium GmbH & Co KG v. Finanzamt Heilbronn, 2008 ECR I-3601, at ¶¶ 31-33; Case C-231/05, Oy AA, 2007 ECR I-6313, at ¶¶ 51-56; Case C-446/03, Marks & Spencer plc v. HM Inspector of Taxes, 2005 ECR I-10837, at ¶¶ 43-46.

\textsuperscript{231} Especially since, with regard to the Member States’ bilateral DTC network, the ECJ has rejected the notion that EU law would require a general most-favored nation treatment, where non-residents could claim treaty benefits granted under the DTC with another Member State. \textit{See} Case C-376/03, D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, 2005 ECR I-15821, at ¶¶ 49-63; Case C-374/04, Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue, 2006 ECR I-11673, at ¶¶ 84-94; \textit{see also} TERRA & WATTEL, \textit{supra} note 226, at 946-949; Peter J. Wattel, \textit{EC Law Does Not Require Most-Favoured Nation Treatment and a Disparity Is Not a Discrimination: D v. Inspecteur van de Belastingdienst}, 2005 \textit{BRITISH TAX REVIEW} [B.T.R.] 575.
where their counterparty is established respectively the instrument is issued, as this is again solely due to the remaining disparities between the Member States’ tax laws. 232

Nor does limiting the harmonization, and consequently the built-in mechanism for double taxation avoidance, to eleven Member States “undermine the internal market” or “distort competition” between the Member States, as also prohibited by TFEU art. 326. 233 Such “fragmentation” of the legal regime is an inherent element of any enhanced cooperation. 234 And establishing a harmonized system within the participating Member States does not introduce any distortions that go beyond such inherent “fragmentation” or the unilateral introduction of national FTTs, but if anything reduces distortions that would occur without such partial harmonization. The fact that the harmonization is undertaken preemptively cannot in any way lead to a different conclusion.

Lastly, although non-participating Member States may be required under Directive 2010/24/EU 235 to assist in the recovery of FTT and might incur costs in doing so, if they are unable to recover the costs from the taxpayer and did not specifically agree on reimbursement with the requesting Member State (see Directive 2010/24/EU art. 20), the proposed directive would not infringe TFEU art. 332. 236 These costs would not result from the “implementation of enhanced cooperation,” i.e., the establishment of a harmonized system of FTT, but from the obligations under the directives on mutual assistance respectively administrative cooperation. The obligations already apply, for instance, with regard to the new French and the Italian as well as any other European FTT; in other words, just as the participating Member States are required to assist in the recovery of the U.K. SDRT, 237 the non-

232 See also Commission Services Opinion, supra note 27, at ¶ 64.
233 But see Englisch, Vella & Yevgenyeva, supra note 15, at 249-250.
237 This analogy is rejected by Panayi, supra note 210, at 365. However, why such “comparison is not correct” remains unclear. It is particularly unclear why the fact that the FTT is supposed to be levied (primarily) from financial institutions and may at times be “entirely unrelated to the location of the companies whose shares
participating Member States will be required to assist in the recovery of the harmonized FTTs to be introduced by the participating Member States.

VI. CONCLUSION

The article has tried to show that the allegations of extraterritoriality leveled against the EU FTT proposal are unfounded. The territorial scope of the proposed charge is in conformity both with the jurisdictional limits under customary international law as well as with the EU law provisions on enhanced cooperation (TFEU arts. 326-334). Indeed, a look at international tax practice reveals that concepts similar to the counterparty principle of art. 4(1)(f) are by no means new to the area of tax. The same is true for the other point of contention, the issuance principle of art. 4(1)(g). Both hence cannot be regarded as “novel” triggers for taxation. Similarly, the fact that the proposal uses both of these generally accepted connecting factors in combination with a broad-based residence principle, and not one or the other in isolation, does not change that for the purposes of customary international law all charges of FTT under the proposal can generally be considered to be based on a sufficient genuine link.

Indeed, the widespread acceptance of both principles, which admittedly do not fit easily within the categories traditionally discussed under the territoriality principle, in the area of tax could serve to inform also the growing debate about the limits of extraterritorial financial regulation. States have always been willing to assert their tax jurisdiction when they considered the tax base to have some kind of tie to their economy or borders. And given the inherently extraterritorial nature of globalized financial markets, as well as the growing concern about interlinkages and interdependencies respectively the stability of the financial system as a whole, the same seems to be increasingly true for financial regulation. Especially with regard to market regulation, more and more states no longer shy away from imposing their standards, regardless of some other state potentially having “a more relevant interest.”

This does not mean that the introduction of the FTT is indeed good policy. On the contrary, there may be a strong case for arguing that the proposed tax not only does not address any of
the sources of systemic instability which lay at the heart of the financial crisis, but might – due to evasive actions as well as the inconsistent treatment of derivatives – even prove counterproductive by introducing new complexities and unwelcome distortions to the market. The revenue-raising objective might be better served by an incentive-neutral instrument such as the FAT proposed by the IMF,238 while concerns about systemic stability could be better addressed by redesigning the bank levy,239 or the FTT for that matter, to target the externalities associated with systemic risk, e.g., the susceptibility to runs240 due to the increasing reliance on – increasingly short-term – wholesale funding. Besides, a lot may already be gained by eliminating the existing distortions in our tax systems, in particular the bias in favor of debt-, which generally is tax deductible, over equity-financing, which is not.241 On the other hand, the

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239 This would be made easier by the fact that there is already a broad consensus about the bank levy. 26 EU Member States have recently agreed upon a harmonized framework for ex ante contributions to be paid to the Single Resolution Fund and both the U.K. and Sweden, who have not signed the intergovernmental agreement, also have a national bank levy. See Council Implementing Regulation (EU) 2015/81 of 15 December 2014 Specifying Uniform Conditions of Application of Regulation (EU) No. 806/2014 of the European Parliament and of the Council with Regard to Ex Ante Contributions to the Single Resolution Fund, 2015 O.J. (L 15) 1; Finance Act 2011, sch. 19 (U.K.).


troubles that might be caused by the introduction of the EU FTT also seem to be greatly exaggerated in the debate. In any case, this should be the focus of the debate instead of being pushed to the sidelines by questionable legal arguments. All the more so, since as of late the idea of introducing some form of FTT seems to gain new ground in the United States, again moving a bit closer to the original vision of a global tax.
