Vokhid Urinov

Taxation of Foreign-Source Income of Resident Individuals

A Structural Enforcement through Automatic Exchange of Tax Information

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Taxation of Foreign-Source Income of Resident Individuals

Why this book?

The 21st century is characterized by unprecedented economic and technological globalization. An increasingly free cross-border flow of goods, services, capital and workforces has led to a greater integration of economies across the world. These developments have also posed some challenges to national tax systems. A seemingly simple rule most countries have adopted and maintained for decades that residents ought to pay taxes on their worldwide income now has to prove its feasibility in the face of these new realities. There is an open question as to how to administer this residence-based tax regime in a world in which states' administrative capacities are highly restricted to their national borders while their residents increasingly trade, invest and provide services across borders.

This book aims to introduce a new way of exploring an old but increasingly important topic in income taxation: the enforcement of taxes on the foreign-source income of resident individuals. Central to this discussion is the emerging "automatic exchange of information" (AEOI) system. The author explores the emerging AEOI Standard among governments as a potential mechanism to address the issues and attempts to provide much-needed historical research, conceptual clarification and theoretical support of AEOI. The author also analyses the need for a fair international legal framework for AEOI and discusses he particularities and challenges associated with establishing such a framework.

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Preface

Law plays a significant role in society. One of the most fundamental roles of law is to ensure a fair, safe and sufficiently progressive society in which every person lives his or her life happily and in harmony with others.[1] In order to promote this collective project, governments employ certain measures that allow them to observe, detect and sanction breaches of law, all of which are collectively known as law enforcement measures. The existence of these enforcement measures is critical for ensuring the rule of law.[2] The very existence of these enforcement measures is also what distinguishes law from other norms (e.g. customs, traditions, morality or other rules of conduct), for without them, the law would be no more than a moral prescription.[3]

There are some significant shortcomings and problems in respect of modern income tax laws. There is a clear mismatch between what the national income tax laws generally stipulate and their enforceability. The basic premise is that, according to these tax laws, a state's jurisdiction to tax the income of its residents is not effectively limited to its territorial borders.[4] Generally, a state may tax the income of its residents from all sources, including those earned within and outside of its borders.[5] For instance, if an individual taxpayer resident in country A receives employment income from a domestic source, dividends from a company located in country B and interest from deposits in a bank located in country C during the year, the taxpayer is generally required to aggregate all of these amounts as his or her total income for the year and declare it to tax authorities of country A in which they reside. This is true despite the fact that some of these items of income – in this case, the dividends and the interest – originated in other countries and may have already been taxed there. However, the person pays tax on such foreign-source income in their country of residence only to the extent that the foreign taxes paid on the income are lower than the residence country's

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1. *See* J. Locke, *Second Treatise of Government* p. 103 (Hackett Publishing 1980). Locke argues that the person who "exceeds the power given him by the law … may be opposed, as any other man, who by force invades the right of another".
2. A.D. Woozley, *The Existence of Rules*, 1 Journal Noûs 1 (1967).
3. C. Johnson, *Moral and Legal Obligation*, 72 Journal of Philosophy 12, p. 315 (1975).
4. League of Nations Economics and Finance Commission, *Report on Double Taxation* (League of Nations 1923).
5. Id.

tax that would otherwise be payable on the income, thereby neutralizing the effect of potential double taxation or tax arbitrage.[6]

Today, an overwhelming majority of countries operate under this regime when taxing the income of their residents – at least individual residents.[7] This tax regime is commonly known as the "residence-based" or "worldwide-based" income tax system. However, one of the biggest challenges of the residence-based income tax regime since its very inception has been its enforceability, particularly in relation to foreign-source income.[8] The main

6. An important corollary of this system is the potential double taxation of the resident taxpayer's foreign-source income. If the resident taxpayer has incurred any income tax on the foreign-source income in the country where it was earned, the taxpayer is generally provided a foreign tax credit for such taxes, thereby mitigating double taxation on the foreign-source income. An ultimate result of the foreign tax mechanism is that the resident taxpayer's overall tax burden on foreign and domestic-source income would generally be the same, to the extent that the foreign taxes paid on the income were lower than that of the residence country; otherwise, the taxpayer's overall tax burden on the foreign-source income would be that of the source country. Typically, when levying tax on the foreign-source income of its residents, the residence country allows a foreign tax credit or an itemized deduction for those foreign taxes. Thus, the amount of the foreign tax paid is normally deductible from the amount of tax that is payable on such income to the residence country. As a result, the resident taxpayer is liable to pay the difference between tax rates that are applicable in the residence and source countries to the residence country, to the extent that the foreign tax paid is lower than the residence country's tax otherwise payable. Provided that the tax rates in the source country of the income and the residence country of the taxpayer are comparable, the taxpayer may not owe any tax on the respective foreign-source income to his or her residence country, but he or she is still required to declare that income. An overall result of the foreign tax credit system is that the residence country's tax rate in effect applies to all income of the taxpayer, regardless of where it is earned, either domestically or abroad. *See OECD Model Tax Convention on Income and on Capital* art. 23 (21 Nov. 2017), Treaties & Models IBFD; *United Nations Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2011), Treaties & Models IBFD; K. Holmes, *International Tax Policy and Double Tax Treaties: An Introduction to Principles and Application* pp. 1-22 (IBFD 2007), Books IBFD; and A. Miller & L. Oats, *Principles of International Taxation* (Tottel Publishing 2009).

7. *See* Deloitte, *Country Taxation and Investment Guides*, sec. 3 (Business Taxation) and sec. 6 (Tax on Individuals) (Deloitte 2014). These guides provide a summary of the tax systems of over 150 countries worldwide and Guides are available at https://dits.deloitte.com/#TaxGuides (accessed 14 Apr. 2019). *See also* K. Vogel, *Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments: Part 1*, 16 Intertax 8/9, p. 25 (1988).

8. R. Gordon, *Can Capital Income Taxes Survive in Open Economies?* p. 1159 (National Bureau of Economic Research 1990). Gordon notes that income from savings invested outside the country is virtually impossible for a government to monitor, and individuals can therefore evade tax on such savings with very little risk of being caught by the tax authorities of their residence countries. *See also* K. Wagner, *US Taxation of Foreign*

questions are of how a state can feasibly enforce tax on the foreign-source income of its residents when its administrative capacity is inherently limited to its territory and, more importantly, how a state can possibly establish whether its residents earn foreign-source income.

In a purely domestic context, states heavily rely on a third-party tax information reporting mechanism in order to administer their income tax systems.[9] Under this mechanism, the government obtains information about a particular taxpayer's income situation from a third party, which often happens to have either an employer-employee, investee-investor or debtor-creditor relationship with the taxpayer. Consequently, the government often already has information about the taxpayer's income situation regardless of whether the taxpayer reports the income. In certain cases, the third parties collect income taxes at source and remit them to the government on behalf of the taxpayers.

However, as a fundamental principle of international law, a state cannot exercise such tax administrative measures in the territory of another state.[10] This means that the state's typical domestic tax enforcement measures, such as third-party tax information reporting and third-party tax withholding requirements, have no force of law in another state's territory. A centuries-old but still rigorously applied common law doctrine, known as the "revenue

Income: The Use of Tax Havens in a Changing Tax Environment, 18 Southern Illinois University Law Journal 2, p. 634 (1994). Wagner points out that non-compliance is an option to most taxpayers with foreign-source income because of their tax authorities' inability to collect information about foreign financial transactions. *See also* P. Baker, *The Transnational Enforcement of Tax Liabilities*, British Tax Review 5, pp. 313-318 (1993); and J. Dubin, *The Causes and Consequences of Income Tax Noncompliance* (Springer Science + Business Media 2012).

9. J. Alm, J. Deskins & M. McKee, *Third-Party Income Reporting and Income Tax Compliance*, Georgia State University Experimental Economics Center Working Paper 06-35 (2006); OECD Center for Tax Policy and Administration, *Third Party Reporting Arrangements and Pre-filled Tax Returns: The Danish and Swedish Approaches* (OECD 2008); and OECD Center for Tax Policy and Administration, *Using Third Party Information Reports to Assist Taxpayers Meet their Return Filing Obligations – Country Experiences With the Use of Pre-populated Personal Tax Returns* (OECD 2006).

10. *See* L. Oppenheim, *International Law: A Treatise*, vol. 2, pp. 386-458 (Longmans, Green and Co 1944). The territorial authority is an important aspect of public international law. Oppenheim argues that a state may not exercise an act of administration or jurisdiction in foreign territory without permission and that, as all persons within the territory of a state fall under its territorial authority, each state normally has jurisdiction – legislative, curial, and executive – over them. *See also* A. Qureshi, *The Public International Law of Taxation: Text, Cases and Materials*, 1st ed., p. 308 (Graham & Trotman 1994).

rule", confirms this position.[11] The doctrine holds that a tax claim is generally unenforceable in a country outside that in which the claim has arisen.[12]

As a result of these principles and practices, states have been forced to cope with the administrative and enforcement challenges pertaining to the foreign-source income of resident taxpayers, often by means of treaty mechanisms called "exchange of information" and "assistance in the collection of taxes". According to the first concept, states agree to obtain and reciprocally exchange information that is foreseeably relevant to the administration or enforcement of their domestic laws concerning taxes (exchange of information on request).[13] With the latter concept, they also lend assistance to each other in their collection of taxes;[14] however, to be able to invoke these tax treaty mechanisms, the states have to be fairly specific in their treaty requests for assistance with regard to whom the information relates or against whom the revenue claim is being enforced. In reality, states often cannot be sufficiently specific in their requests for assistance, as they often do not have very basic information as to which of their residents are earning foreign-source income. In other words, the existing exchange-of-information mechanisms under tax treaties require the requesting state to provide the requested treaty state with the very information that the former often does not have and, in fact, needs itself. Therefore, in most cases, the

11. The revenue rule has been around for centuries and, as such, has become firmly embedded in case law. The earliest reported case referencing the revenue rule was decided in 1729 in England in *Attorney General v. Lutwydge*. In this case, Lord Chief Baron Pengelly held that "[b]efore the union this court had no jurisdiction of the revenues in Scotland, and therefore the question is, whether the statute is not exclusive of us, since it is giving a farther jurisdiction to them who had it exclusive of us before". The revenue rule was further reinforced in 1775 in *Holman v. Johnson*. In this English case, Lord Mansfield wrote that "no country ever takes notice of the revenue laws of another" (*see* UK: Trial Court, 1729, (1729) 145 Eng. Rep. 674 (Ex. Div.) *Attorney Gen. v. Lutwydge*). The revenue rule was further reinforced in 1775 in *Holman v. Johnson*. In this English case, Lord Mansfield wrote that "no country ever takes notice of the revenue laws of another" (*see* UK: Trial Court, 1775, (1775) 98 Eng. Rep. 1120- 1121, *Holman v. Johnson*).

12. The doctrine allows a state and its administrative bodies to decline enforcing foreign tax laws and judgments. *See* Anonymous, *International Enforcement of Tax Claims*, 50 Columbia Law Review 4, pp. 490-504 (1950); and B. Mallinak, *The Revenue Rule: a Common Law Doctrine for the Twenty-First Century*, 16 Duke Journal of Comparative and International Law 79 (2006).

13. *OECD Model Tax Convention on Income and on Capital* art. 26 (30 July 1963), Treaties & Models IBFD [hereinafter OECD Model Tax Convention (1963)]; and *United Nations Model Double Taxation Convention between Developed and Developing Countries* art. 26 (1 Jan. 1980), Treaties & Models IBFD [hereinafter UN Model Tax Convention (1980)].

14. Art. 27 OECD Model Tax Convention (1963); and art. 27 UN Model Tax Convention (1980).

existing mechanisms for the exchange of tax information under tax treaties, i.e. exchange of information on request, have not been of much use.

After all, in administering their tax laws on the foreign-source income of their residents, states have had no option but to rely largely on information provided by the taxpayers themselves and their honesty. However, the reality is that if taxpayers know that the government has no capacity to know or verify the accuracy of income pertaining to them, they tend to misreport or not report their information at all.[15]

There have been some misguided attempts to address these shortcomings. Given that the administration of a residence-based tax system depends enormously on governments' ability to access extraterritorial information and because their access to such information through resident taxpayers' self-disclosure or mechanisms available under tax treaties is severely limited, they have turned their focus to other options, the mode and implications of which are questionable.

First, there is the issue of stolen extraterritorial tax information. In the recent past, several notable cases have occurred in which people have stolen large volumes of confidential information from foreign banks relating to non-resident customers and shared it with relevant governments, often for ransom. For example, in the summer of 2007, a computer technician of a Lichtenstein bank offered the German tax authorities CDs containing data that he had stolen from the bank.[16] The CDs contained confidential information on thousands of German and non-German residents suspected of holding millions of euro in allegedly undeclared offshore accounts with the Lichtenstein bank. The German government paid the informant roughly EUR 5 million in remuneration and shared some of that information that was relevant to the residents of other countries to the fiscal authorities of

15. *See* M. Allingham & A. Sandmo, *Income Tax Evasion: a Theoretical Analysis*, 1 Journal of Public Economics 3/4, pp. 323-338 (1972); J. Roth, J. Scholz & A. Witte, *Taxpayer Compliance* p. 82 (University of Pennsylvania Press 1989); and H. Kelvin et al., *Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark*, Econometrica 3, p. 689 (2011). The latter authors note that one possible explanation for higher rates of tax non-compliance or underreporting of taxable income is the lower probablity of detection associated with some types income.
16. Spiegel, *Liechtenstein's Shadowy Informant: Tax Whistleblower Sold Data to the US*, Spiegel (25 Feb. 2008), available at http://www.spiegel.de/international/business/liechtenstein-s-shadowy-informant-tax-whistleblower-sold-data-to-the-us-a-537640.html (accessed 14 Apr. 2019).

said countries.[17] This was one of the biggest tax evasion investigations by the fiscal authorities of many countries on their resident taxpayers.[18]

A similar event occurred in the United States, where a former executive of a Swiss bank, UBS, offered the US Internal Revenue Service confidential data stolen from the bank. The data revealed the identities of thousands of high net worth US residents suspected of holding undeclared accounts with UBS. The informant received a landmark USD 104 million reward from the Whistle-blower Office of the US Internal Revenue Service. This whistle-blowing deal opened up one of the biggest tax evasion scandals in US history.[19]

Another similar event involved a global bank, HSBC. At the end of 2008, a former employee of the Geneva office of HSBC, Hervé Falciani, offered the French government confidential bank data concerning approximately 130,000 foreign customers of HSBC. France's then-Minister of Finance, Christine Lagarde, shared the list with other countries, including Germany, Greece, Italy and the United States. Because of the strength of the information provided, HSBC was forced to pay a USD 1.9 billion settlement to the United States. One peculiarity of this case is that Falciani systematically refused rewards for the supplied data.[20]

In April 2013, an unidentified informant provided the tax authorities in the German state of Rhineland-Palatinate with a computer disc containing 40,000 records of information on more than 10,000 German residents holding secret accounts in Swiss banks.[21] Sources revealed that the authorities paid the informant EUR 4 million in remuneration for the data.[22]

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17. C. Dougherty & M. Landler, *Tax Scandal in Germany Fans Complaints of Inequity*, The New York Times (18 Feb. 2008), available at http://www.nytimes.com/2008/02/18/business/worldbusiness/18tax.html?pagewanted=all (last accessed 14 Apr. 2019).
18. M. Esterl, G. Simpson & D. Crawford, *Stolen Data Spur Tax Probes*, The Wall Street Journal (19 Feb. 2008).
19. D. Hilzenrath, *For American Who Blew Whistle, Only Reward May Be a Jail Sentence*, The Washington Post (20 Aug. 2009), available at http://articles.washingtonpost.com/2009-08-20/business/36769607_1_ubs-probe-whistleblower-reward-national-whistleblowers-center (accessed 14 Apr. 2019).
20. M. Hesse, *Swiss Bank Leaker: 'Money Is Easy to Hide'*, Spiegel (16 July 2013), available at http://www.spiegel.de/international/business/interview-hsbc-swiss-bank-whistleblower-herve-falciani-on-tax-evasion-a-911279.html (accessed 14 Apr. 2019).
21. *See* M. Bartsch, *Swiss Bank Data: German Tax Officials Launch Nationwide Raids*, Spiegel (16 Apr. 2013), available at http://www.spiegel.de/international/business/germany-raids-200-suspected-tax-evaders-in-nationwide-hunt-a-894693.html (accessed 14 Apr. 2019). *See also* the TV news report on France 24, *German tax authorities pay €4 million for CD of Swiss bank details*, available at http://www.youtube.com/watch?v=JVSniNw4PyE (accessed 14 Apr. 2019).
22. Id.

As beneficiaries of such data, some countries have begun to openly encourage, legitimize and reward such data theft by means of statutory measures.[23] They offer large monetary rewards and protection from possible retaliation to persons who have reasonably reliable information about the abusive taxpayer behaviour of fellow residents and who come forward to provide such information to tax authorities. These laws and programmes are commonly known as "whistle-blower" laws.[24] The Tax Relief and Health Care Act of the United States,[25] the Public Interest Disclosure Act of the United Kingdom and the Offshore Tax Informant Program of Canada are examples of such laws and programmes.[26]

Second, there is the issue of massive tax information leaks. For the past few years, the tax world has also witnessed a number of massive financial data leaks around the globe. For example, on 3 April 2013, the Washington, D.C.-based International Consortium for Investigative Journalism (ICIJ) announced that it had received the world's largest financial data leak. The leak included over 2.5 million files disclosing the identities and secret financial dealings of more than 70,000 taxpayers and 120,000 offshore corporations and trusts involving tax havens.[27] The records detailed the offshore holdings of people and companies in more than 170 countries and territories.[28] This unprecedented information leak provided an opportunity to look into the secret world of tax havens and their use by wealthy individuals and

23. F. Lipman, *Whistleblowers: Incentives, Disincentives, and Protection Strategie*s (Wiley 2011).
24. E.A. Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the "Tax Gap",* 24 Akron Tax Journal 1, p. 3 (2008), available at https://ideaexchange.uakron.edu/cgi/viewcontent.cgi?article=1135&context=akrontaxjournal) (accessed 14 Apr. 2019); and P. Latimer & A. Brown, *Whistleblower Laws: International Best Practice*, 31 University of New South Wales Law Journal 3, pp. 766-768 (2008).
25. On 20 December 2006, the United States adopted US: Tax Relief and Health Care Act, 2006, vol. 152. For more information, *see* http://www.irs.gov/uac/Whistleblower-Informant-Award (accessed 14 Apr. 2019).
26. The Public Interest Disclosure Act of the United Kingdom came into force on 2 July 1999. The Act protects workers that disclose information about malpractice at their workplace or former workplace, provided that certain conditions are met. *See* D. Pyper, *Whistleblowing and Gagging Clauses: the Public Interest Disclosure Act 1998* (House Of Commons 2014). *See also* the Canadian Offshore Tax Informant Program, introduced with the 2013 Federal Budget on 21 March 2013. Launched as part of the Canada Revenue Agency's efforts to fight international tax evasion and aggressive tax avoidance, the programme allows the Canada Revenue Agency to give financial awards to individuals who provide information related to major international tax non-compliance that leads to the collection of owed taxes.
27. R. Gerard et al., *Secret Files Expose Offshore's Global Impact*, International Consortium of Investigative Journalists (2 Apr. 2013), available at https://www.icij.org/offshore/secret-files-expose-offshores-global-impact (accessed 14 Apr. 2019).
28. Id.

companies.[29] It also provided the tax authorities of many governments with crucial information for enforcing tax laws on these foreign-held assets of their resident taxpayers.[30]

Recently, in April 2016, the ICIJ released another set of financial data, commonly known as the "Panama Papers", which revealed the secret offshore financial dealings of some of the world's wealthy people. The leak consisted of 11.5 million confidential financial and legal documents from the Panama-based law firm Mossack Fonseca, including detailed information on more than 14,000 clients and more than 214,000 offshore entities connected to people in more than 200 countries and territories. The data included emails, financial spreadsheets, passports and corporate records revealing the owners of bank accounts and companies in 21 offshore jurisdictions, from the United States to Singapore to the British Virgin Islands, and covered nearly 40 years.[31] The ICIJ made the records freely available in bulk in a publicly searchable online database.[32] In the same month in which it was released, tax authorities from 28 countries met in Paris to develop a joint strategy for collaborative action based on the revelations.[33]

Third, there is the emergence of domestic laws with extraterritorial scope. In March 2010, the United States enacted a law called the Foreign Account Tax Compliance Act (FATCA), prescribing an extraterritorial and unilateral obligation for all financial institutions around the world to routinely report tax information on their US customers to the US tax authorities.[34] The law attempts to impose, for the first time, significant tax compliance obligations on almost all financial institutions around the world that maintain a business relationship, in one way or another, with US resident taxpayers. FATCA requires these foreign financial institutions to register with the US Internal Revenue Service and carry out (i) regular due diligence; (ii) reporting; and

29. For further details on the topic, *see* A.J. Cockfield, *Big Data and Tax Haven Secrecy*, 18 Florida Tax Review 8, p. 2 (2016).
30. R. Gerard & M.W. Guevara, *Tax Authorities Move on Leaked Offshore Documents*, International Consortium of Investigative Journalists (9 May 2013), available at https://www.icij.org/offshore/tax-authorities-move-leaked-offshore-documents (accessed 15 Dec. 2016).
31. B. Obermayer et al., *Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption*, International Consortium of Investigative Journalists (3 Apr. 2016), available at https://www.icij.org/investigations/panama-papers/20160403-panama-papers-global-overview/ (accessed 19 Apr. 2019).
32. *See* https://offshoreleaks.icij.org/.
33. M.M. Hamilton, *Global Joint Investigation To Be Proposed at Special Tax Meeting*, International Consortium of Investigative Journalists (12 Apr. 2016), available at https://panamapapers.icij.org/20160412-global-tax-officials-meeting.html (accessed 14 Apr. 2019).
34. US: Foreign Account Tax Compliance Act (2010). The law has been incorporated into the new sections §1471-1474 of US: Internal Revenue Code (1986).

(iii) tax withholding obligations vis-à-vis the US government concerning their customers who happen to be US persons. This controversial US law was the result of some revealed cases of abuse of the existing US income tax regime by US citizens and Swiss financial institutions.[35]

All of these representative cases are indicative of the long-endured shortcomings of the administration and enforcement of the modern residence-based income tax system, particularly with respect to the foreign-source income of resident taxpayers. They confirm that something is not quite working with this income tax system, or with the current international income tax regime as a whole.

Increasing economic globalization has given this problem greater policy prominence. Today's global financial system makes it increasingly easy for people to make, hold and manage investments outside their countries of residence. According to a study conducted by Global Financial Integrity, offshore deposits reached USD 10 trillion in 2010.[36] The largest recipients of these non-resident deposits were the Cayman Islands, the United States and the United Kingdom, each of which held over USD 1.5 trillion in private foreign deposits.[37] The study also found that such deposits by non-residents have been growing at a compound rate of 9% annually over the last decade.[38] These assets are typically controlled through offshore companies, foundations and trusts. They are often multi-layered, making it extremely difficult to track down their ultimate owners and their countries of residence. According to the Tax Justice Network, somewhere between USD 190 billion and USD 255 billion is lost in taxes every year by governments worldwide, solely as a result of governments' lack of knowledge on the offshore assets of their residents.[39] What is more troubling is that, in most cases, these foreign-held assets and foreign-source income do not even yield tax to host countries. This is largely due to the increasing tax competition between states to attract foreign capital and investment.[40] This means that a large

35. US: Department of Justice, *United States Asks Court to Enforce Summons for UBS Swiss Bank Account Records* (2009).
36. A. Hollingshead, *Privately Held, Non-Resident Deposits in Secrecy Jurisdictions*, Global Financial Integrity (19 Mar. 2010), available at: http://www.gfintegrity.org/report/briefing-paper-secrecy-jurisdiction-deposits/ (accessed 14 Apr. 2019).
37. M. Allingham & A. Sandmo, *Income Tax Evasion: a Theoretical Analysis*, 1 Journal of Public Economics 3/4 (1972).
38. M. Bartsch, *Swiss Bank Data: German Tax Officials Launch Nationwide Raids*, Spiegel (16 Apr. 2013).
39. Tax Justice Network, *Tax Us If You Can* p. 10 (Tax Justice Network 2012).
40. R. Palan, R. Murphy & C. Chavagneux, *Tax Havens: How Globalization Really Works* (NY Cornell University Press 2010).

volume of foreign-source income never incurs tax, either in the residence or the source country.

The problem appears to be that even though states claim that they treat and tax the domestic and foreign-source income of their resident individuals pari passu and despite the fact that the volume of cross-border investments by resident individuals has grown substantially over the past few years, states do not have a feasible mechanism to enforce tax laws over the foreign-source income of their resident individuals.

The author begins his discourse with this initial analysis and hypothesis and conducts a comprehensive study of the tax enforcement mechanisms generally available for states, domestic laws, double taxation treaties, tax information exchange agreements and other multilateral legal instruments that focus on cooperation in the field of tax. He then explores the possibility and challenges of establishing such an enforcement mechanism, emphasizing the newly emerging regime in international taxation: automatic exchange of tax information between states.

Overall, this research provides a historical account, rationale and theoretical basis for establishing a structural tax enforcement mechanism on the foreign-source income of resident individuals and assesses the perspectives and challenges of establishing such a mechanism.

Chapter 1

Concept and Sources of Tax Information

This chapter explores the concepts and sources of tax information in modern income taxation. It also discusses some fundamental issues with the current administration and enforcement of the residence-based income tax system that are caused by tax authorities' lack of access to extra-territorial information. The analysis in this chapter suggests that the time is ripe to address these issues.

1.1. Income tax systems and the concept of tax information

1.1.1. Income tax systems in the world

International tax policy requires certain benchmarks for sovereigns to assert their jurisdiction to tax income.[41] One possible, relatively common and easily justifiable benchmark, as it was used in most other areas of law, is the "territorial" benchmark.[42] According to the territorial jurisdiction doctrine, a state's geographical borders are considered the beginning and end of its power to exercise authority. However, the benchmarks of jurisdiction adopted under income tax law and policy are fairly unique. These benchmarks are the source of income, the citizenship or the residence of the income earner, or a combination of these three.[43] These jurisdictional benchmarks are either narrower or broader than the territorial benchmark, but not necessarily the same.

41. R. Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Kluwer Law and Taxation Publishers 1989).
42. C. Nine, *Global Justice and Territory* (Oxford University Press 2012); M. Vagias & J. Dugard, *The Territorial Jurisdiction of the International Criminal Court* (Cambridge University Press 2014).
43. R. Avi-Yonah, N. Sartori & O. Marian, *Global Perspectives on Income Taxation Law* p. 151 (Oxford University Press 2011).

1.1.1.1. Citizenship as a benchmark for income taxation

Under the citizenship-based income tax system, a state levies tax on its citizens' worldwide income regardless of where these citizens live or reside.[44] Thus, the citizenship-based tax system emphasizes a person's political, legal, psychological and sometimes symbolic connections rather than their physical, economic or social connections to the state. Today, there are a handful of countries in the world that tax the worldwide income of their citizens based on this benchmark. The most notable examples for the citizenship-based income tax system are the United States and Eritrea.

The citizenship-based tax system is often subject to debate by scholars and policymakers due to its nature, outcomes and administrative challenges.[45] One often-quoted justification for the legitimacy of the citizenship-based tax system regards potential benefits, protections or privileges that a state may afford to its citizens. According to the proponents of this regime, the state is justified to tax its citizens based on these reasons alone.[46] However, critics of the regime emphasize how relatively few legal rights may flow from the mere holding of citizenship status, especially in cases in which a citizen lives in another country for a considerable period or even permanently and may not plan or intend to return to the country of their citizenship.[47]

One of the advantages of taxing individuals based on their citizenship, however, is its administrative simplicity, as opposed to administering a residence-based income tax system, which involves factually complex rules for determining an individual's residency (*see* section 1.1.1.3. for a discussion on residence-based income tax). However, jurisdictions that use citizenship as a benchmark for tax jurisdiction also tax non-citizens based on residence and source principles. Thus, the citizenship-based tax system is complex and difficult to rationalize. The relevance of citizenship-based income tax systems is that a state that operates under a citizenship-based income tax

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44. J. Christie, *Citizenship as a Jurisdictional Basis for Taxation: Section 911 and the Foreign Source Income Experience,* 8 Brook. J. Int'l L. 1, p. 110 (1982).
45. R.S. Avi-Yonah, *The Case against Taxing Citizens*, University of Michigan Law & Economics, Empirical Legal Studies Center Paper No. 10-009, p. 11 (2010); and B. Schneider, *The End of Taxation Without End: A New Tax Regime for US Expatriates*, 32 Virginia Tax Review 1 (2012).
46. US: Supreme Court, 5 May 1924, *Cook v. Tait*, [1924] 265 US 47. *See also* P.H. Schuck, *Citizenship in Federal Systems*, 48 American Journal of Comparative Law 2, p. 207 (2000).
47. A.M. Bickel, *The Morality of Consent* pp. 33-36 (Yale University Press 1975); and L. Swanson, *U.S. Citizenship Based Taxation: Unique or Outrageous?*, Wolters Kluwer Global Tax News (16 Dec. 2013), available at http://www.tax-news.com/articles/US_Citizenship_Based_Taxation_Unique_or_Outrageous____571149.html#sthash.RoTlADye.dpuf (accessed 14 Apr. 2019).

system imposes tax on citizens on their worldwide income and consequently may require extra-territorial information in order to enforce tax, especially on the citizens' foreign-source income.

1.1.1.2. Source of income as a benchmark for income taxation

Another benchmark used in determining tax jurisdiction is based on the "source" principle. Under the source principle, a state asserts its jurisdiction to tax income based on the place where the income is earned. Therefore, a state that uses the source principle levies taxes only on profits arising in or derived from carrying on a trade, business or income from employment within its territory regardless of the residence or citizenship status of the income earner.[48] This system is also referred to as a "territorial income taxation system".[49] Today, jurisdictions such as Hong Kong, Malaysia, Panama and Singapore operate under the source-based or territorial income tax system.[50]

One unique feature of source-based income taxation is that if a resident taxpayer is engaged in an economic activity both domestically and abroad, the state does not levy tax on the resident's foreign-source income. In doing so, the state assumes that the foreign-source income of its resident has been subject to tax in the host country. Another element that must be noted about source-based taxation is that tax treaties that are consistent with the purpose of eliminating double taxation and used as a mechanism for allocating taxing rights between countries may limit the rights of source countries to tax income that may, according to general principles, be considered sourced in that country. Consequently, there are many circumstances in which income may be considered to have its source in a particular country, but that country's right to tax it may be limited under tax treaties.[51]

48. For a general theoretical discussion of the territorial tax system, *see* K. Vogel, *Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part II)*, 16 Intertax 10 (1988); and K. Vogel, *Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part III)*, 16 Intertax 11 (1988).
49. C. Fleming, R. Peroni & S. Shay, *Some Perspectives From the United States on the Worldwide Taxation vs. Territorial Taxation Debate,* 3 Journal of the Australasian Tax Teachers Association 2 (2008); and T. Ihori, *Capital Income Taxation in a World Economy: A Territorial System Versus A Residence System*, 101 The Economic Journal 407 (1991).
50. APCSIT, *Taxation of Foreign Source Income in Selected Countries* (Canada Advisory Panel on Canada's System of International Taxation 2008). *See also* E. Kleinbard, *Throw Territorial Taxation From the Train*, 46 Tax Notes International 1 (2007).
51. P. Harris, *Taxation of Residents on Foreign Source Income*, in *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* pp. 109-171 (A. Trepelkov, H. Tonino & D. Halka eds., United Nations 2013).

Generally, the source-based tax system is justified by the premise that the country that provides the source and opportunity to earn income or profits should have the right to tax it. There are also specific doctrines that attempt to justify the source-based income tax system. One of such doctrines is that of capital import neutrality (CIN).[52] CIN holds that all investments within a country should face a similar tax burden, regardless of whether they belong to a domestic or foreign investor. This proposition suggests that states should refrain from taxing their residents on their foreign-source income. The rationale is that taxing residents on their foreign-source income may put them at a competitive disadvantage compared to their counterparts in the host country because the former carry two levels of tax burden, i.e. residence and host-country taxes, while the latter carries only the domestic tax burden. The CIN doctrine argues that relieving the foreign-source income from taxation allows these residents to have a similar tax burden to their competitors in the host country, leading to an optimal outcome, i.e. CIN.

One of the challenges of source-based taxation is determining the source of income. In practice, the manner of determining the source of income is generally based on the nature of income and the transactions that give rise to such income.[53] For example, income from the performance of services is generally treated as arising where the services are rendered. Financing income is generally treated as arising where the user of the finances resides. Income related to the use of immovable property (e.g. rent) is generally treated as arising where the property is situated. Income related to the use of intangible property (e.g. royalties) is generally treated as arising where the property is used. Yet, it is often a daunting task to attribute some types of income to a particular place or source. E-commerce is an obvious example, in light of certain characteristics of which the application of source-based taxation in its traditional form may be rendered problematic.[54]

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52. T. Horst, *A Note on the Optimal Taxation of International Investment Income*, 94 The Quarterly Journal of Economics 4, pp. 796-798 (1980).

53. HK: The Government of Hong Kong Special Administrative Region, Inland Revenue Department, *A Simple Guide on The Territorial Source Principle of Taxation* (2011), available at https://www.ird.gov.hk/eng/paf/bus_pft_tsp.htm (accessed 14 Apr. 2019), provides an illustrative example of the challenges associated with determining the source of income under the source-based income tax system.

54. D. Pinto, *E-commerce and Source-based Income Taxation* (IBFD 2003), Books IBFD. Pinto argues that source-based taxation is theoretically justifiable for income that arises from international transactions, which are conducted in an e-commerce environment. However, the thesis also argues that the way in which the source of income is defined needs to be reconceptualized because the application of source-based taxation under traditional principles may be rendered problematic in light of certain characteristics of e-commerce that are significant from a tax perspective.

The source-based income tax system has a number of limitations. One limitation associated with a pure source-based tax system is that an individual taxpayer may reside – and thereby benefit from public goods and services – in country A, but may earn all of their income from country B. In this case, even though country A incurs the costs of providing public goods and services to the resident, the resident does not pay income tax to this country. This may unfairly shift the tax burden of maintaining public goods and services to resident taxpayers whose income is mainly from domestic sources. Under the source-based tax system, residents also have a strong incentive to move their business and investments to jurisdictions where the applicable tax rates are lower than at home. This, in turn, may cause capital flight and encourage countries to engage in the international tax competition "race to the bottom" between countries.[55]

Section 1.1.1.4. provides more insight into other aspects of source-based taxation, but for the purpose of the analysis here, it is sufficient to note that the administration of the source-based tax system has less dependence on extra-territorial information. This is largely due to the fact that a state that operates under this system actually does not tax the foreign-source income of its residents.

1.1.1.3. Residence as a benchmark for income taxation

An alternative to the citizenship-based and source-based income tax systems is the residence-based income tax system. Under this tax system, a person's residence is considered to be the primary factor used by the state to establish its tax jurisdiction, and the state is entitled to tax its residents on their worldwide income.[56] Therefore, the residence-based tax system is also referred to as a "worldwide income system".

According to common practice, one of the main determinants of an individual's residence for tax purposes is either social or economic ties to the state (e.g. the person's physical presence in a state for a particular period during the year, normally 183 days, in the form of gainful employment, maintaining an abode, family ties, etc.). For its legitimacy, the residence-based tax

55. OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publishing, 1998), available at https://www.oecd-ilibrary.org/taxation/harmful-tax-competition_9789264162945-en (accessed 20 Aug. 2019).
56. L. Badler, *The Residence Concept and Taxation of Foreign Income*, 51 Columbia Law Review 3 (1951).

system receives strong theoretical support from the capital export neutrality (CEN), economic allegiance, benefit and ability-to-pay theories.

The CEN doctrine holds that a resident's decision on whether to carry out business or investment activity domestically or abroad should not be distorted by locational tax factors or rates.[57] It is argued that the residence-based tax regime supports this neutrality by maintaining the same tax burden for domestic and foreign-source income of resident taxpayers so that the resident taxpayer is neither encouraged nor discouraged by tax factors when making locational decisions.

The residence-based income tax system also receives theoretical support from the economic allegiance theory. It is one of the theories that has influenced the shape of contemporary income taxation.[58] The theory starts with the proposition that the purpose of income taxation is to finance government services and that a government has no recognizable jurisdiction to tax unless there is an appropriate and sufficient economic factor connecting it to the taxpayer. In order to determine the true economic connection, the founders of the economic allegiance theory posed three fundamental questions: Where is the wealth really produced? Where is it owned? Where it is disposed of?[59] Based on the answers to these questions, the source of the income and the residence of the income earner were chosen as the two main elements of connection.[60] The fact to ascertain was where the true and primary economic interests of the individual actually reside. Here, the benefit theory comes into play. The benefit theory extends the economic allegiance doctrine. It argues that if a person is resident in a particular jurisdiction, which is determined largely by reference to the person's physical, economic and social ties to that jurisdiction over a substantial period, it is most likely that the person is benefiting from public goods and services provided by that jurisdiction. The enjoyment of the benefits and services requires the person

57. R. Musgrave, *The Theory of Public Finance: a Study in Public Economy* pp. 145-150 (McGraw-Hill 1959); and P. Musgrave, *United States Taxation of Foreign Investment Income: Issues and Arguments* Law (Harvard University 1969).
58. L. Murphy & T. Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press 2004).
59. League of Nations Economics and Finance Commission, *Report on Double Taxation submitted to the Financial Committee Economic and Financial Commission*, pp. 22-23 (League of Nations 1923).
60. The economic allegiance doctrine was developed by four renowned economists, namely Gijsbert W.J. Bruins (the Netherlands), Luigi Einaudi (Italy), Edwin R. Seligman (United States) and Sir Josiah Stamps (United Kingdom). *See* League of Nations, *Double Taxation and Tax Evasion: Report and Resolutions Submitted by the Technical Experts to the Financial Committee of the League of Nations* (League of Nations 1923).

to contribute to the financing of these benefits in that jurisdiction.[61] However, it is recognized that the residence state may depend on the "source" state's assistance in administering its tax laws, either because the source state has relevant information or because it is in a better position to tax the income. Therefore, the source state also has the right to tax the income, but its right should be limited to a mutually agreed percentage.[62]

The benefit theory has a minor deficiency: it may imply that only those who are able to and, in fact, do pay taxes must be entitled to enjoy the benefits and protections provided by government. This brings us to the ability-to-pay doctrine. This doctrine addresses the question of how to distribute the overall tax burden among the members of society. It holds that a total tax burden of government services shall be distributed among its relevant taxpayers according to their capacity to bear it.[63] Thus, the doctrine places an increased tax burden on taxpayers with higher income, and a lesser or no tax burden on those segments of society with low income. Given that the amount of income tax payable is determined based on a percentage of one's income, no income means no tax liability. Today, most countries have adopted these principles in their income tax systems: they tax their individual residents (i.e. the persons who benefit from public goods and services offered by the government) on their worldwide income, but do so through a progressive income tax system (i.e. residents who earn less pay less tax, while residents who earn more pay disproportionally more tax).

Finally, it must be noted that states that operate under the residence-based income tax system do not restrict their tax jurisdiction only to residents. They also impose tax on non-residents, but only on income earned within their territory. The states often administer this income tax system by imposing an obligation on their own residents to withhold tax on income payments

61. The benefit doctrine is essentially an extended form of the economic allegiance doctrine. Its main premise is that tax must be seen as a payment for services and goods rendered by the government to persons. *See* J. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles*, 58 Tax L. Rev. 4 (2004).

62. League of Nations Economics and Finance Commission, *supra* n. 19, at pp. 40-42.

63. The earlier proponents of the ability-to-pay doctrine were Adam Smith and John Stuart Mills. Smith argues that "[s]ubjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities". *See* A. Smith, *The Wealth of Nations* (Random House 1937/1976). Later on, Mills developed this idea into the "equal sacrifice" doctrine. The equal sacrifice doctrine argues that the tax contribution of each person towards the expenses of the government must be determined in such a way that he/she shall feel that they benefit neither more nor less from his share of the payment than every other person experiences from his/hers. *See* J.S. Mills, *Principles of Political Economy With Some of Their Applications to Social Philosophy*, vol. V (John W. Parker 1848).

that they make to non-residents. In this sense, the residence-based income tax system reflects, in itself, the characteristics of both source and residence-based tax systems.

Because residents are taxed on their worldwide income, the proper administration of the residence-based income tax system depends heavily on tax authorities' ability to access extra-territorial information.

1.1.1.4. Income tax systems and international double taxation

One of the biggest challenges of different states adopting different benchmarks of tax jurisdiction, particularly states employing both the worldwide income-based approach for residents and the source-based approach for non-residents, is international double taxation. In the absence of a compromise between the country of source and the country of residence to deal with their overlapping income tax claims, it is quite possible that a person who engages in a cross-border economic activity may end up with a liability to pay taxes on the same income to more than one country: first to the country where the income is earned, by virtue of the source principle, and second to the country where the person resides, by virtue of the residence principle.

One of the main reasons for the development of double tax conventions (DTCs) is to mitigate this international double taxation problem.[64] In order to resolve this problem, tax treaties allocate taxing rights over various types of income between the source and residence countries according to which one of these countries will have primary rights, while the other will have residual rights to tax the income.

DTCs approach the issue of international double taxation by employing two methods. First, the country where the individual or entity is resident will bear the burden of eliminating double taxation by instituting either a foreign tax credit or by merely exempting foreign-source income from taxation altogether.[65] Generally, this applies to income from cross-border business employment. Second, the source country will considerably limit both the extent of its jurisdiction to tax income as it arises at the source, as well as

64. P. Harris, *Taxation of Residents on Foreign Source Income* pp. 12-28 (United Nations 2013).
65. *OECD Model Tax Convention on Income and on Capital* arts. 23A and 23B (21 Nov. 2017), Treaties & Models IBFD. *See also* R. Deutsch, R. Arkwright & D. Chiew, *Principles and Practice of Double Taxation Agreements* pp. 30-61 (BNA International Inc 2008).

the rate of tax that is ultimately imposed where tax jurisdiction is retained. This typically applies to dividends, interest income, rent and royalties.

Under the foreign tax credit mechanism, the country allows its resident taxpayers to deduct the amount of foreign taxes incurred on the income from tax on this income that would otherwise be payable to the country. To the extent that the amount of foreign tax incurred is less than the amount of income tax otherwise payable to the residence country, the resident taxpayer is required to pay the difference to the residence country. On the other hand, when the amount of income tax paid to the source country is comparable to the amount of tax otherwise payable to the residence country, the taxpayer does not owe any tax on the income to the country of residence. If the amount of income tax paid to the host country is higher than the amount of tax otherwise payable to the residence country, the latter does not tax the income, but it also does not compensate its residents for the excessive foreign taxes.[66] An ultimate result of the foreign tax credit system is that the resident's overall tax burden on foreign-source income would be the higher of the source and residence countries' taxes. Thus, when properly implemented and enforced, the foreign tax credit mechanism would eliminate any tax advantage for resident individuals earning income in low-tax jurisdictions.

1.1.1.5. Predominance of the residence-based income tax system

Today, an overwhelming majority of states operate under the residence-based income tax system.[67] They tax their residents on their worldwide income while allowing foreign tax credits for the taxes paid on their foreign-source income to the country of source. They also impose tax on non-residents, but based on the source principle.

66. The US income tax law allowed compensation for its foreign-source-income-earning taxpayers for the excessive foreign tax for a while after it had introduced the foreign tax credit system in 1918. However, a few years later, it amended the law (i.e. an amendment to sec. 904(a) of the US Internal Revenue Code) so that no foreign tax credit is allowed for the taxes paid in the host country above the US tax liability. *See* R. Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* pp. 157-158 (Cambridge University Press 2007).

67. *See* the sections on business taxation and tax on individuals in the Deloitte Country Taxation and Investment Guides for 2017. The Guides provide the brief and most up-to-date summaries of the tax systems of over 150 countries worldwide. The Guides can be downloaded at https://dits.deloitte.com/#TaxGuides (accessed 14 Apr. 2019). (The guides provide that all countries tax their residents on their worldwide income.) *See also* K. Vogel, *Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part I)*, 16 Intertax 8/9, p. 225 (1988).

As discussed in section 1.1.1.3., this tax system has a strong theoretical basis. First, the residence-based taxation system is mutually inclusive. Its existence does not exclude source-based taxation. In fact, its foreign tax credit mechanism accommodates, or at least does not undermine, source-based taxation. In fact, through this mechanism, the residence-based tax system admits the source country's tax jurisdiction in its own territory. Second, the residence-based tax system promises a better conceptual mechanism for the increasingly globalized world in which people trade, invest or render services cross-border without departing their country of residence. Third, there is also a question of consistency between (i) the residence-based and source-based tax systems; and (ii) the ability-to-pay doctrine. One difficulty with this principle is that one's ability-to-pay tax cannot be accurately established without taking into consideration his or her income from all sources (i.e. domestic and foreign).[68] However, under the pure source-based income tax system, the taxpayer's ability to pay income tax is measured only in reference to his or her income earned within the country. Having no domestic-source income does not mean that the resident is not able to pay taxes; he or she may earn all his or her income from foreign sources. If the resident earns income largely or exclusively from foreign sources, notwithstanding the benefits they have received in the country of residence and despite their overall economic ability to pay taxes, they unfairly escape paying taxes in the country of residence. On the other hand, the person's ability to pay tax under the residence-based tax system is determined by taking into consideration their worldwide income, which better reflects their ability to pay taxes.

Overall, the residence-based income tax system appears to be a more equitable, fair and all-inclusive tax system. However, one of the biggest challenges of the system is its enforceability, which will be discussed in section 1.1.2.

1.1.2. Concept and types of tax information

As Greenaway once eloquently testified, there are two mutually inclusive elements for the effective enforcement of income taxes: tax jurisdiction and tax information.[69] Tax jurisdiction is a legitimate authority to prescribe and

68. *See* D.R. Tillinghast, *Tax Aspects of International Transactions* p. 3 (M. Bender 1984). The modern proponents of the doctrine claim that the ability-to-pay or equal sacrifice doctrine cannot be accurately established without taking into consideration the income of the taxpayer from all sources (i.e. domestic and foreign). Tillinghast argues that in the international context, the ability to pay is meaningless until one has identified the persons or the enterprises whose wealth is to be taken into account.
69. T. Greenaway, *Worldwide Taxation, Worldwide Enforcement*, Tax Notes International 54, p. 759 (2009).

collect taxes.[70] Tax information, on the other hand, is a type of information that enables tax authorities of the state to carry out this mandate. Greenaway argued that jurisdiction to tax without tax information is useless; tax enforcement will be real only when both elements are combined.[71]

Income tax is generally assessed on a yearly basis on the net accretion to one's wealth during the year before consumption, but after deducting certain eligible expenses.[72] Thus, income tax systems can work properly only when taxpayers make reasonable and truthful disclosure of their income and deductible expenses to the tax authorities. Without such disclosure, the state would have great difficulty in fully enforcing its income tax laws.

However, there is a fundamental challenge associated with attaining such disclosure. By nature, people disclose information to others only when they perceive it to be in their own interest to do so, or at least when the outcome of the disclosure would be neutral to their interest; otherwise, they generally tend to hold it back. It also is naïve to believe that people enjoy giving out their hard-earned income to the government. In their attempts to understand the roots of tax avoidance and evasion, Slemrod and Bakija noted that "it is not any one individual's interest to contribute voluntarily to the government's coffers. Each citizen has a very strong incentive to ride free on the contributions of others, since one's own individual contribution is just a drop in the bucket and does not materially affect what one gets from the government".[73]

Thus, in the absence of certain enforcement mechanisms, it is not in the taxpayer's immediate self-interest to voluntarily disclose information on their income. This requires some sort of mechanism that ensures reasonable visibility of resident individuals' income positions to the government.

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70. R. Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* pp. 54-66 (Kluwer Law and Taxation Publishers 1989).
71. T. Greenaway, *Worldwide Taxation, Worldwide Enforcement*, 54 Tax Notes International 9, p. 759 (2009).
72. Generally, the modern concept of income was shaped in the 1920s and 1930s by the American economists Robert M. Haig and Henry C. Simons. They defined the income as "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question". *See* R.M. Haig, *The Concept of Income – Economic and Legal Aspects*, in *The Federal Income Tax* pp. 1-28 (R.M. Haig ed., Columbia University Press 1921); and H. Simons, *Personal income taxation: The definition of income as a problem of fiscal policy* p. 49 (Chicago University Press 1938).
73. J. Slemrod & J. Bakija, *Taxing Ourselves: a Citizen's Guide to the Debate Over Taxes* p. 145 (MIT Press 2004).

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