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THE THEORY OF TAXATION, WITH REFERENCE TO NATIONALITY, RESIDENCE AND PROPERTY.

Can we define the principles and distinguish the cases for making respectively the residence of persons and the situation of the property possessed by them a ground for the incidence of public charges? That question meets us in the problems of national taxation, as between state and state, and in those of general and local taxation within a state, while in the former class of problems there also occurs the question whether the nationality of the state affords a ground for taxing those who possess it or exempting those who do not. My attention was called to the matter in its international aspect, in which I propose here to discuss it first and most fully, afterwards noticing the other.

I. Taxation considered Internationally.

At its meeting at Cambridge in 1895 the Institute of International Law determined to take up the question *Des doubles impositions dans les rapports internationaux, notamment en matière de droits de mutation par décès*. Questions so taken up are referred to committees which study them in conjunction with reporters, whose reports serve as the basis of the discussions in the full body of the Institute. This question has not yet come on for discussion in the full body, but the progress made by the committee in preparing it may be seen in the *Annuaire de l'Institut de Droit International*, vol. 16, pp. 118, 310 and vol. 17, pp. 148, 301. With my single exception the members of the committee answered in the negative the question put by the reporter: "Is it equitable that the same property should be subjected at the same time to taxes of the same order in different countries, because the domicile or the nationality of the deceased differed from the situation of the property, or for any other reason?" And there was no exception to the opinion that immovable pro-

perty ought to pay taxes assessed on it in the country of its situation, without reference to any question of domicile, residence or nationality. But beyond these propositions there was great divergence.

As might be expected from a body not of economists or financiers but of lawyers, the subject was generally treated from the point of view of the right of a state to make laws for persons or property. Yet from that point of view the objection to double taxation cannot be fully sustained, as one member, M. Lehr, pointed out: vol. 16, p. 126, *note*. For while a state has the exclusive right to determine the ownership and employment of property situated within it, it has also the right to make laws for its subjects always and everywhere, subject to the condition that they cannot be enforced by any penalties, whether on person or on property, except within its own territory. The legal argument therefore will not protect subjects from being taxed by their own state in respect of their foreign property, at the same time that they have to pay the taxes assessed on it where it is situated. Probably M. Lehr's concurrence in pronouncing double taxation inequitable must be taken as little more than formal; if not, and in any case as to the other members, it would be interesting to know on what other foundation the opinion rested. But little else can be discovered except undeveloped allusions to the regrettable effect that very high taxation, imposed by a state without regard to taxes imposed elsewhere, may have on international relations. And one member, M. Stoerk, apprehended such regrettable effect on international relations much less from double taxation than from entering on the difficult path of distinguishing the situations of different kinds of movable property, instead of submitting them all to a single taxation on the basis either of domicile or of nationality (vol 16, p. 132). That path however is the one which most members of the committee enter on, though without unanimity as to the rules to be established, while a few support exclusive taxation of the entire mass of movables on one or other of the two bases just mentioned.

For my part, reflection has confirmed me in the view of which I submitted a short and rough sketch three years ago to the committee of the Institute of International Law.

In framing a system of taxation we consider what may be described as the *normal man*, the man who lives in the country of which he is politically a citizen, and who has all his property and carries on all his avocations there. The system established with a view to that man may combine direct and indirect taxation in any way,

and the principle on which it is based may be that of proportioning the burden to the pecuniary means of the individual, or that of equality of sacrifice in any of the forms which seek practically to embody that principle, or indeed any other. Then the question for us will be *whether any special consideration, as compared with the normal man, can be claimed by aliens, by citizens or other residents deriving means from foreign sources, or by non-resident owners of property.* The existence of such a question is mentioned by several writers on political economy, but they do not express themselves at any length on it. The fullest discussion of it which I have found is contained in the following passage from Professor Sidgwick's *Principles of Political Economy*, 2nd edition, p. 562.

"It seems clearly just that aliens residing or possessing property in any country should pay something towards the expenses of its government; and if so, unless aliens are to be fined as such, it is clearly just that they should pay proportionally less to their own government; and the only satisfactory way of determining the ratio in which their contribution ought to be divided between the two governments is by regarding it as a price paid for services rendered. An Englishman residing in France is much less concerned than a Frenchman with French expenditure on armaments, but he has as much interest as a Frenchman has in the expenditure for maintaining internal order and promoting well-being in France; and he is also benefited by this latter outlay if, without residing in France, he merely holds property there. It seems therefore most proper that at least a rough division should be made of the taxes ordinarily paid by an English capitalist into three parts; one part to be paid by him to the English government, wherever he may reside or hold property; another to the government of the country in which he resides; while the third should be proportioned to the property that he enjoys under the protection of his own, or any other, state."

There is no difficulty in granting that, if any of the classes of persons which have been contrasted above with the normal man is entitled to special consideration, that consideration must be reached by regarding the contribution of the class as a price for services rendered, the persons who combine fewer of the qualities of citizen, resident and owner of property paying less than those who combine more, because less service is rendered to them. It remains to enquire whether any such ground of less service really exists for the consideration claimed. The assertion that it exists appears at first sight to conflict with the doctrine now prevailing, which I would certainly not impugn, that the benefits received from government by different persons cannot be arithmetically compared in any way, whether in proportion to their property or otherwise, and that therefore government must be regarded as a common concern, to which those interested in it

must contribute on some other basis than that of benefit received. It is however conceivable that that doctrine may apply only within the class "normal man," and that there may be classes as between which, or as between them and normal men, it will not apply. In order that this should be so, I submit that some department or activity of government must be shown which is not a common concern to the normal man and the special class; something which the special class could dispense with, or which might be conducted on a smaller scale if there were no people but the special class. If what goes on would have to go on in any case and on the same scale for the sake of the special class as for that of the normal man, the benefit felt by them respectively from it, or the loss that would be felt by them respectively if the activity or expense in question were stopped or diminished, is not arithmetically comparable. We are then within the range of the arguments by which the prevailing doctrine is supported. We are asked to apply a yard measure to feelings, which we cannot do. It is therefore necessary to enquire whether any singling out of something which might be dispensed with is possible in the cases of the special classes concerned.

Let us first take aliens as a class. The resident alien is concerned in common with the resident citizen in the security of the country from external enemies and internal crime and disturbance. He is further concerned as a resident in whatever conduces to its amenity as a well governed country partaking in progressive civilisation, and I will venture to add in the maintenance of its greatness and empire, since these conduce both to its amenity and to the field which it supplies for the employment of his faculties and means. All that he is not concerned in is any armament undertaken for offence or aggression, and no government will admit that any part of its armaments have that object. M. Lehr, as a member of the committee of the Institute of International Law on our subject, has argued thus :

"On arrive à cette absurdité qu'un état prétend se faire payer un impôt parce qu'un étranger vient y dépenser sa fortune, au grand bénéfice des nationaux. L'assimilation de l'étranger aux indigènes quant à l'impôt ne se justifie que si au fait de la résidence se joint l'exercice d'une industrie ou profession lucrative, et encore y aurait-il certaines réserves ou distinctions à faire. Pour moi, la seule règle conforme aux principes du droit international est que l'étranger ne soit passible d'un impôt que sur les biens, rentes, pensions ou allocations qu'il possède dans le pays, à l'exclusion des biens ou droits de nature quelconque qu'il possède dans son pays d'origine ou dans une tierce contrée."—*Annuaire de l'Institut de Droit International*, vol. 16, p. 127.

Here we must note the admission that the exercise of a

lucrative industry or profession may render an alien justly liable to taxation, it is not said whether generally or only on the profit made by the industry or profession. But surely the expense which goes to make lucrative employment possible must be reckoned against those for whom it is made possible, whether or not they avail themselves of the opportunities which are provided for them in the country which they seek. If taxation of the non-resident citizen, which M. Lehr justifies, is to be defended on any but the bare legal ground that we have a right to tax him, the insufficiency of which as a reason for actually taxing him was well exposed by Burke when we tried to tax our American colonists, the ground for it must be found in the advantages which belong to him as a citizen ; and I might ask my valued colleague whether the omission to use the advantages which belong to you is a better plea for the resident alien than for the non-resident citizen. In sum, I fail to see why foreign nationality should give a claim for special consideration to any who fall within the circumstances in which taxation is imposed on the normal man, and I think that the general practice of the world bears me out.

Property and residence remain to be discussed, and since we may be sure that the government of the country in which property is situated will not excuse it from taxation on the ground that its owner is an absentee, the only practical question is whether foreign property should be reckoned among the pecuniary means on which its owner ought to be taxed in the country in which he resides. The property which from the economical point of view can be localised as being in a given country includes, without attempting an exhaustive enumeration, land and mortgages on land, the public funds of the government or of local authorities, the profits from business carried on in the country, and the shares and securities of companies belonging to it. So much is clear in principle ; for all these, and the industry engaged in creating or working them, are protected by the government of the country no less than land, and the capital engaged in them is employed in the country. Difficult questions arise in the application of the principle ; as for instance, in some cases, as to the exact locality at which transactions ranging over different countries result in a net business profit. And sometimes legal considerations become inevitably mixed up with economical ones, as for instance when we have to determine the degree of importance which ought to be attached to the fact that a company derives its corporate existence from the law of a given country, as compared with that due to the localities at which its transactions take place. But the

principle is broad enough and at the same time definite enough to serve as the foundation for legislation. It must unavoidably be taken as the basis for the taxation of property in the country where it is deemed to be situated, and there can be no greater difficulty in taking it as the basis for the exemption of a resident's foreign property from taxation, if that should be thought right. I do not therefore attach so much importance as my valued colleague M. Stoerk to the international difficulties which, as above mentioned, he fears from the attempt to fix the situation of different kinds of movable property.

From the total of property which admits of being localised we must for our present purpose make one great deduction, that of land or immovable property. It is the established practice of the world not to tax any one, whether citizen or resident alien, on his foreign land; and our own fiscal system fully recognises this exemption, both for the income tax and for the death duties, and both for truly foreign land and that situated in British colonies or possessions. The origin of the difference thus made between land and movables must be sought in notions, and those feudal notions, of sovereignty. It belongs to what I have referred to as the legal argument on our subject, and yet during the last half century even the legal distinctions between movables and immovables for international purposes have been greatly weakened, while from the economic point of view it would seem that any difference between them is not in principle but only in the greater facility of localisation. In that opinion I am glad to have the support of Mr. Leonard Courtney who, in the discussions in the House of Commons on the Finance Bill of 1894, declared that he saw no reason to maintain the distinction between foreign real and personal property for the death duties; both might be treated on the ground of domicile. However, the exemption of foreign land from taxation must be accepted as a fact, and it is an infectious fact, for its anomalous character tends to confuse the ideas, and this must be ranked among the causes of the efforts made from time to time to extend the exemption more or less widely into the domain of foreign movable property. Especially is this the case among those who do not realise that, strictly speaking, property is never taxed; that persons are the only possible subjects of taxation, and that the question of the means in respect of which they ought to be taxed has little to do with that of the legal authority under which those means, considered in themselves, are placed. The exemption of land situated out of the country supplies a reason the more for carefully apply-

ing economic considerations, including those of justice as economic considerations do include them, to the large field which remains, the taxation of residents in respect of movable property held by them out of the country.

It may be well to begin with a short statement of the mode in which the British Parliament has dealt with the matter, not trying to follow the words or the arrangement of the acts. Income tax is payable by persons of all descriptions on the income derived from any property, real or personal, that can be localised in the United Kingdom, including foreign public annuities payable in the United Kingdom and any business or avocation carried on within it. In respect of any movable property, business or avocation to be localised elsewhere, the income tax acts do not concern themselves with domicile, which may be described as a certain technical definition of residence, but affect those who are regular residents in the common understanding of the term, or who in fact reside in the United Kingdom for more than half the year even for some temporary purpose, and those as soon as they arrive who intend to establish their residence in the country. All these are equally affected although aliens, and no one else is affected although a subject. And the persons affected are liable to the tax on the income received by them in the United Kingdom from the sources in question. In some cases arrangements may be made for receiving abroad the income originating abroad, but this is not easy to ordinary persons, so there will be little error if we say that residents in the United Kingdom pay income tax on their income from all sources except land outside it. Next, the legacy duty, or that on the shares of an intestate's estate, is only payable when the deceased was domiciled in the United Kingdom, but then it is payable on all the movable property which after the payment of his debts he has left in any part of the world. For the succession duty, other than on land in the United Kingdom which is always subject to it, or than land out of the United Kingdom which is never subject to it, the principal test is whether the property, without regard to its situation, is held in trust under the law of some part of the United Kingdom. Thus we are introduced to a consideration belonging rather to the legal than to the economic argument, but few settlors would have established such a trust as brings movable property under the succession duty unless they were resident or domiciled in England, Scotland or Ireland. The estate duty falls on all property of any description in the United Kingdom, whatever the nationality or domicile of the deceased, as was the case with the old probate and adminis-

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tration duties except that these did not fall on land. And it falls on movable property out of the United Kingdom whenever the legacy or succession duty falls on it, or would do so but for the relationship of the person to whom it passes, with the alleviation that the amount of any duty payable in respect of it in the country of its situation is deducted from the valuation of the property if that country is a truly foreign one, but, under the condition of reciprocity, from the estate duty if that country is a British colony or possession. The alleviation in the latter case, the only real one, was introduced during the passage of the Finance Act 1894 through Parliament, in deference to colonial remonstrances, and therefore did not represent the independent opinion of the British government. So far as it extends, it is a premium on the investment of home capital in the British empire rather than in truly foreign countries.

From the foregoing sketch it appears that the same principle runs through our whole system of direct taxation, as might be expected from the fact that death duties may be regarded as capitalised income tax, and that, therefore, the deceased person whose domicile is so influential in the death duties is in effect paying a deferred quota. It may be expressed as the taxation of all descriptions of persons in respect of their property capable of being localised in the territory for which the system exists, and of residents, whether subjects or aliens, in respect of their movable property outside that territory, the plea of double taxation not being admitted in principle as an excuse. A different system is embodied in the Bavarian law of 18th August, 1879, of which Art 7 runs thus :—

“Immovables and the rights which are assimilated to them are not taxed if their locality is out of Bavaria. Other property out of Bavaria possessed by a deceased person who at the time of his death was a Bavarian or domiciled in Bavaria is taxed when it passes to a person residing in Bavaria, and when no duty, or a duty less than that prescribed by the present law, is imposed on it in the foreign state. In the latter case, the payment of the duty being proved, it is deducted from the duty imposed in Bavaria.”—*Annuaire de l'I. de D. I.*, vol. 16, p. 119.

It will be seen that the conditions relating to the deceased do not differ from those in England by any admission of foreign nationality as a ground of exemption, but by making Bavarian nationality a ground of taxation equally with a Bavarian domicile. There is, however, added the condition that the recipient of the succession shall be resident in Bavaria, and then the alleviation of double taxation, which in the United Kingdom is limited to the

British Empire and by the condition of reciprocity, is extended to all countries without that condition.

We are now ready to consider what economic justice requires in the case of a resident deriving his means in all or in part from foreign sources, and for that purpose, if the doctrine laid down earlier in this article is correct, to consider whether there are any departments or activities of government which might be dispensed with altogether, or might be carried on upon a smaller scale, if no interests were taken into account but those of residents or those of owners of property respectively. Now it is not only the police and judicial institutions which immediately surround the person of one man or the property of another that contribute to the amenity and opportunities of the former or to the protection of either. Nor is it only the police and judicature of a country in their largest extent which have this effect, but all public expenditure which tends to raise and civilise the people of the country tends to make crime and tumult less frequent, even though its proximate application may be to popular education, poor relief, or so much of sanitation as is necessary for civilised habits of life. If the general condition of the country were less satisfactory the protection which it would be necessary to apply immediately to persons and property would be more elaborate and costly. In speaking of the case of aliens it has been pointed out how the armaments of a state concern all the residents, and they help in the protection of property by furnishing a supplement to the police, necessary though it is commonly sufficient to keep it in the background, and enhance the value of property by increasing the security and therefore the general prosperity of the country. There are indeed some items of public expenditure which may appear to concern persons only and not property, such as those on sanitation for protection against disease, on museums and libraries, and any others of which the object is some form of personal enjoyment or higher instruction. But items of this kind form an insignificant part of all national budgets, and if any justification is needed for making no allowance on account of them, it will be amply found in the escape of non-residents from indirect taxation, the effect of which is that the double taxation paid by the owner of foreign property is never equal to the total which would be paid by two normal men, of whom one resided in the one country with the total means of the absentee owner, and the other in the other country with the means there possessed by that owner. Items of the opposite character, that may even

have the appearance of concerning property but not persons, it would be hard to find.

The conclusion is that the principle of the English system is the correct one. The person who suffers double taxation has necessitated, as far as in him lay, the duplication of government establishments. If he has not taken and could not take advantage of both, that is due to the circumstances in which he has been placed by his own action, holding property in a country in which he does not reside. To discuss whether he feels a total amount of benefit corresponding to the double taxation which he pays would be like discussing whether the rich or the poor feel most benefit from government. The question would be insoluble and irrelevant. He has made the government of each country as a whole a matter of common concern to him and to the ordinary subjects of that government, and there is no reason in the true theory of taxation for discriminating between him and the normal man contemplated in that theory.

II. General and Local Taxation.

In considering the questions arising between general and local taxation within any state we meet with a kind of public expenditure which does not occur in the budget of a nation, namely that which maintains or augments the value of particular property, and has no such tendency to maintain or improve the general condition of the country as to affect the general value of property in it. It is immaterial for the present purpose whether such expenditure concerns particular property only, as by draining it, embanking it, or improving the immediate means of approach, or whether it also concerns the population of a particular locality, as the expenditure at watering places in order to increase their amenity, or that on communications extending over a certain area which increases the facilities for business in that area. In either case the cost must be borne locally, and there is a practical necessity for assessing it on real property. It has always been found impossible to devise an equitable local income tax, the interests of individuals being continually connected with several localities in the same state, and indeed, so far from real property bearing an unfair burden by the assessment on it of all such cost as is now under consideration, the true doubt is whether, when the residents are benefited, they will not, through the enhancement of rents, have to bear the whole of the assessment on the

property occupied by them. The owners reap the profit arising from the aptitude of the place which has encouraged the expenditure.

There remains the expenditure which only maintains or augments the value of property through maintaining or improving the general condition of the country, and therefore affects all the property in it. This, whether it be raised and expended nationally or locally, is the expenditure which we have been considering with reference to taxation in its international aspect. All that has been said about its being a common concern to residents in a country and owners of property in it resident in another country applies equally to show that it is a common concern to all the people of the country, no matter in what local districts they may reside or their property may be situated.

We are apt to be under an illusion about this, because so many important branches of public expenditure have been local from their commencement that it is difficult not to imagine that their connection with localities has not been dictated by something in their nature. But the view here taken appears to be sanctioned by the best authorities who have given thought to the subject. Professor Bastable says :

“A final point is the relation of central and local finance, which has been already referred to. The true point of view is, I think, that which regards all taxation, imperial and local, as levied for the public advantage, and as forming one solid mass of public burdens. In considering its equitable distribution, however, assignment has to be made of the special local taxes levied for the sole benefit of the locality to its account. In the same way imperial expenditure, even though administered by central authorities, if it is solely for the advantage of a locality, should be charged to that locality. It is of course true that very few services are of purely local advantage, but this holds good quite as well of expenditure from local rates, which should therefore be treated in the same way.” (Note to the memorandum supplied by Sir Robert Giffen to the Royal Commission on the financial relations between Great Britain and Ireland; Parliamentary Papers 1896, vol. 33, p. 185.)

And Mr. Goschen, speaking of “the general allegation that the owners and occupiers of rateable property together pay more than their share of local and imperial taxation,” added “I say of imperial as well as of local taxation, because these two classes should be treated as one when such an argument is in view.” In the House of Commons, April 3rd, 1871; Reports and Speeches on Local Taxation by Mr. Goschen, p. 202.

That imperial and local expenditure, other than that part of

the latter which was distinguished at the beginning of this section, must be treated as one when the just distribution of the burden is considered, may not have been true in the remote times when counties and even parishes were in a great degree foreign to one another. And now that it has become true by the moral and material unification of the kingdom, the large part allowed to local action in our constitutional system still finds a good defence in two axioms which will readily be appreciated by anyone who will think of such subjects as elementary education and poor relief. One is that good administration cannot be expected without the assistance of local bodies familiar with details and circumstances, and the other is that local bodies will be extravagant in the expenditure of money wholly supplied to them by a central authority. But the decentralised administration required by these axioms reacts on the proof that the imperial and local expenditure must in economic justice be treated as one mass, for that proof will only hold if the several services for which the expenditure provides are everywhere administered on a uniform scale, suited to the requirements of the country as a whole. If anywhere they are administered more liberally than on that scale, it would be difficult to deny either that, so far as liberality can be distinguished from extravagance, there is a special benefit to the locality for which it ought to pay, or that, so far as the greater expenditure is extravagant, there is in the locality a fault for which it ought to pay. The problem is how to combine national liability, in recognition of the common benefit received by the nation from the normal services, with local liability, as a means towards good administration and a corrective for varying administration. Perhaps the ideal system would be that, for the services which Parliament made incumbent on the localities or left to them a sum should be assigned from the national revenue to each locality proportioned to its population or to some reasonable combination of tests, that sum however not being quite sufficient, so that in the local taxation still necessary an inducement should remain to economy and good management. The system of grants in aid, that is, providing from the national revenue aliquot parts of certain local expenditures, may be regarded as a rougher means of arriving at a somewhat similar end. The part of the total charge left in either way to be borne locally is not in justice a burden on real property alone, but we are again met by the impossibility of devising an equitable local income tax. It would therefore seem best not to pursue further an unattainable ideal of fairness, but to

aim at connecting the incidence of the local charge as closely as possible with the control of its expenditure, in order that the object sought in making any part of the total charge local, namely good administration, may not be defeated. At this point, however, we pass out of the domain of politico-economic into that of purely political considerations, and we must stop.

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