2. The Principle of Territoriality

2.1. The Principle of Territoriality in General International Law

2.1.1. Territoriality and Nationality

Though sovereign a state and its jurisdiction are subject to international law.[283] Regarding sovereignty and jurisdiction, both terms carry different meanings. In its most common usage, sovereignty denotes the collection of rights of a state in its capacity as the entity allowed to exercise control over its territory and to represent its territory and its people on an international plane.[284] Sovereignty thereby indicates supreme authority and independence from any other authority.[285]

Sovereignty must not be confused with jurisdiction which is an aspect of a state's sovereignty.[286] Jurisdiction denotes a state's power to exercise, i.e. its judicial, legislative, and executive competence.[287] International law provides various principles regulating how jurisdiction may be exercised. The two most important ones in the field of tax law are the principle of territoriality and the principle of nationality.[288] Historically, the principle of nationality predated the principle of territoriality as a jurisdictional basis. In early stages of human development, community was built on the basis of religion, ethnicity, or nationality[289], and territorial borders were not yet (fully) established.[290] Given the steady manifestation of territorial borders and the increasing mobility of people,[291] the principle of nationality was partly replaced by the principle of territoriality. From the 14th century onwards, territoriality gained significant importance and evolved as a fundamental

283 *Doehring*, Völkerrecht: Ein Lehrbuch (1999) para 122.

284 *Crawford*, Brownlie's Principles of Public International Law (2012) 448.

285 *Oppenheim*, International Law. A Treatise, Volume 1 (2018) 126 § 123.

286 *Crawford*, Brownlie's Principles of Public International Law (2012) 456; *Mann*, Further Studies in International Law (1990) 4.

287 *Crawford*, Brownlie's Principles of Public International Law (2012) 456; *Beale*, The Jurisdiction of a Sovereign State, Harvard Law Review 1923, 241 et seq; *Meng*, Extraterrritoriale Jurisdiction im öffentlichen Wirtschaftsrecht (1994) 1 et seqq; *Vranes*, Trade and Environment: Fundamental Issues in International and WTO Law (2006) 104 and *Martha*, The Jurisdiction to Tax in International Law (1989) 15: "*[…] jurisdiction is an attribute of sovereignty, and based thereon a sovereign (i.e. a State) may exercise jurisdiction*".

288 Besides territoriality and nationality, also other principles (e.g. the protective principle or the universality principle) governing jurisdiction exist.

289 *Kassan*, Extraterritorial Jurisdiction in the Ancient World, American Journal of International Law 1935, 240. See also *Borchard*, The Diplomatic Protection of Citizens Abroad (1928) 3 et seqq; *Ryngaert*, Jurisdiction in international law (2015) 51.

290 *Ryngaert*, Jurisdiction in international law (2015) 50; *Monsenego*, Taxation of Foreign Business Income within the European Internal Market (2011) Chapter 2.2.2.1.; *Simma/Müller*, Exercise and limits of jurisdiction, in *Crawford/Koksenniemi*, The Cambridge Companion to International Law (2012) 141 et seq.

291 *Shaw*, Territory in International Law, Netherlands Yearbook of International Law 1982, 62; *Gottmann*, The Significance of Territory (1973) 3 et seq.

principle in international law.[292] In current state practice, both principles are applied depending on the specific field and purpose of the law.[293]

In (general) international law, the principle of territoriality delineates a state's jurisdiction and supreme authority over its territory, including all persons and objects connected to it.[294] "Territory" thereby denotes the geographical scope of a state's jurisdiction.[295] Since all states are exclusively competent to exercise state power within their territory,[296] a state may not enforce state power in another state's territory (without permission).[297] By contrast, the principle of nationality reflects the idea of a special relationship of rights and duties between a state and its nationals conferring the powers to the state to regulate its nationals' regardless of any territorial constraints. Hence, the principle of nationality allows for jurisdiction over nationals wherever they are.[298] In international law, the conditions for granting nationality are determined by the state itself[299] and may be conferred to both natural persons and legal persons.[300]

2.1.2. Parallel Jurisdiction

Owed to the coexistence of the nationality principle and the territoriality principle, states may establish jurisdiction over the same person, object, or event based on different principles, i.e. in the lack of a common agreement on which principle is

292 *Shaw*, Netherlands Yearbook of International Law 1982, 62; *Gottmann*, The Significance of Territory (1973) 3 et seq. See also *Jennings* (The Acquisition of Territory in International Law (1963) 2): "*The mission and purpose of traditional international law has been the delimitation of the exercise of sovereign power on a territorial basis*".

293 E.g. voting rights and diplomatic protection are often based on the concept of nationality. In contrast, tax law – as will be illustrated in Chapter 2.2.3.1. – is strongly based on the principle of territoriality (see *Weber*, Tax Avoidance and the EC Treaty Freedoms (2005) 111; *Kokott*, Chapter 2: The 'Genuine Link' Requirement for Source Taxation in Public International Law, in *Haslehner* et al (eds), Tax and the Digital Economy Challenges and Proposals for Reform (2019) 15).

294 *Ipsen*, Völkerrecht (1990) § 23 para 3; *Monsenego*, Taxation of Foreign Business Income within the European Internal Market (2011) Chapter 2.2.2.1.; *Lehner*, Das Territorialitätsprinzip im Licht des Europarechts, in *Gocke/Gosch/Lang* (eds), Festschrift Franz Wassermeyer (2005) 242; *Kelsen* (Principles of International Law (2003) 209) defines territory as the "*space within which a state is authorised by general international law to perform all acts provided for by its national law or […] the space within which according to general international law the organs determined by a national legal order are authorized to execute this order*".

295 *Gottmann*, The Significance of Territory (1973) 2.

296 *Stuyt*, The General Principles of Law as Applied by International Tribunals to Disputes on Attribution and Exercise of State Jurisdiction (1946) 2; PCIJ 7.9.1927, *Lotus*, Ser A no 10, 18, 19.

297 *Ipsen*, Völkerrecht (1990) § 23 para 6; *Beale*, Harvard Law Review 1923, 245.

298 *Stuyt*, The General Principles of Law as Applied by International Tribunals to Disputes on Attribution and Exercise of State Jurisdiction (1946) 96; *Crawford*, Brownlie's Principles of Public International Law (2012) 459 and 486; *Friedrich*, Gibt es eine völkerrechtliche Grenze für die Höhe der Besteuerung? (1972) 5; *Hackworth*, International Law (1941) 84; *Dahm/Delbrück/Wolfrum*, Völkerrecht Band I/1 (1989) 318.

299 ICJ 6.4.1955, *Nottebohm Case*, 23; *Simma/Müller*, Exercise and limits of jurisdiction, in *Crawford/Koksenniemi*, The Cambridge Companiaon to International Law (2012) 142.

300 *Stuyt*, The General Principles of Law as Applied by International Tribunals to Disputes on Attribution and Exercise of State Jurisdiction (1946) 97.

to be applied in a certain situation, a parallel exercise of power over the same situations by two or several states may arise.[301]

Some scholars discussed whether territorial jurisdiction should be given primacy over the principle of nationality in order to resolve conflicts of dual jurisdictions.[302] Whether international law establishes a hierarchy between these principles is controversial.[303] It has been contended that international law neither requires nor hinders the removal of a double exercise of state power.[304] Furthermore, no consistent state practice exists that gives primacy to the one or the other principle.[305] A preference for one principle might also depend on the specific subject matter. For example, in the area of diplomatic protection, a state's territorial jurisdiction is usually restricted in favor of the state of nationality[306] while, in other matters, states tend to give primacy to territoriality.[307] It also appears that establishing a hierarchy between different principles of exercising jurisdiction fails to resolve all conflicts of jurisdictions.[308] Even if states apply the same principle, a parallel exercise of state power may occur.[309] For instance, when two states

301 Tax law is a perfect example of an overlap of jurisdictions resulting from the prescription of different links for taxation: While the majority of states tax income on the basis of a territorial connection, e.g. the taxpayer's residence, the US taxes income on the basis of nationality (*Weber*, Tax Avoidance and the EC Treaty Freedoms (2005) 111; *Kokott*, Chapter 2: The 'Genuine Link' Requirement for Source Taxation in Public International Law, in *Haslehner* et al (eds), Tax and the Digital Economy Challenges and Proposals for Reform (2019) 15). Such a parallel exercise of taxing power based on different principles results in double taxation.

302 For an overview of the arguments see *Ryngaert*, Jurisdiction in international law (2015) 36 and 143, who concludes that no such hierarchy exists. See also Separate Opinion of Judge Guillaume, ICJ 14.2.2002, *Arrest Warrant*, 43 para 15: "*The adoption of the United Nations Charter proclaiming the sovereign equality of States, and the appearance on the international scene of new States, born of decolonization, have strengthened the territorial principle*".

303 Negating the existence of a hierarchy: *Simma/Müller*, Exercise and limits of jurisdiction, in *Crawford/Koksenniemi*, The Cambridge Companion to International Law (2012) 151; *Ryngaert*, Jurisdiction in international law (2015) 142: "*[S]tates can rely on a variety of jurisdictional grounds regarding one and the same situation […] The system of jurisdiction […] is, accordingly, a concurrent one*". See also *Kokott*, Das Steuerrecht der Europäischen Union (2018) § 5 m.no. 14.

304 *Simma/Müller*, Exercise and limits of jurisdiction, in *Crawford/Koksenniemi*, The Cambridge Companion to International Law (2012) 150 et seq. See also *Meessen*, Extraterritorial Jurisdiction in Theory and Practice (1996) 84, who argues the freedom granted to states in the *Lotus* case "*implies the logical impossibility of setting priorities among conflicting sovereign prerogatives*".

305 *Meessen*, Antitrust Jurisdiction under Customary International Law, American Journal of International Law 1984, 801.

306 *Borchard*, The Diplomatic Protection of Citizens Abroad (1928) 346.

307 For an analysis of the development of the preference of territoriality in the field of protecting trading interests, see, e.g. *Lowe*, Blocking Extraterritorial Jurisdiction: The British Protection of Trading Interests Act, American Journal of International Law 1981, 257 et seqq.

308 *Simma/Müller*, Exercise and limits of jurisdiction, in *Crawford/Koksenniemi*, The Cambridge Companion to International Law (2012) 151; *Ryngaert*, Jurisdiction in international law (2015) 142: "*[S]tates can rely on a variety of jurisdictional grounds regarding one and the same situation […] The system of jurisdiction […] is, accordingly, a concurrent one*".

309 *Ryngaert*, Jurisdiction in international law (2015) 144. An example in the area of taxation would be an exercise of taxing power on the basis of residence or source which are both forms of territorial connections. Commonly, the state of residence would tax the worldwide income of a its resident while part of that income might be taxed in the state where the source of income is located. Although both states follow the principle of territoriality, a dual exercise of state power over the same income may occur.

follow the principle of territoriality, each may exercise its jurisdiction by use of different links to their territory. Moreover, overlaps may also occur if two states use the same principle and the same link, e.g. situations of dual residence or dual nationality.

2.1.3. Prescriptive and Enforcement Jurisdiction

The limits of state power, particularly those established by the principle of territoriality, were most prominently outlined in the decision of the PCIJ, the predecessor of the International Court of Justice (ICJ), in the *Lotus* case.[310] In this case, the PCIJ explicitly differentiated between jurisdiction to prescribe, i.e. a state's right to legislate, and jurisdiction to enforce, i.e. a state's right to enforce its law and national court decisions, e.g. by making investigations or arrestments.[311, 312]

The case concerned a criminal trial that was the outcome of the collision between two ships, the French S.S. Lotus and the Turkish S.S. Bozkurt, that caused several deaths. As a consequence, the PCIJ was asked whether Turkey had jurisdiction to punish the French officer. The bedrock of the PCIJ's reasoning was the idea that "*whatever is not explicitly prohibited by international law is permitted*" ('Lotus Principle').[313] That is, a state is, in principle, independent and enjoys complete sovereignty unless international law provides restrictions. When outlining the restrictions, the PCIJ distinguished between prescriptive jurisdiction and enforcement jurisdiction. The court held that a state's jurisdiction to prescribe law is only limited "*in certain cases*",[314] and states are thus generally free to prescribe laws outside their territory.[315] Conversely, a state's jurisdiction to enforce is limited by the principle of territoriality. Territoriality prevents states from exercising jurisdiction outside its territory unless international law provides special permission.[316] Thus, the PCIJ considers the principle of territoriality to be a prohibition

310 PCIJ 7.9.1927, *Lotus,* Ser A no 10, 19.

311 *Behrens*, The extraterritorial reach of EU competition law revisited: The "effects doctrine" before the ECJ, Discussion Paper, Europa-Kolleg Hamburg, Institute for European Integration No. 3/16 (2016) 4; *Beckman/Grundy-War/Forbes*, Acts of Piracy in the Malacca and Singapore Straits (1994) 6. See also *Gerontas*, Columbia Journal of European Law 2013, 430.

312 In the context of taxation, prescriptive jurisdiction refers to the power to create tax law (see *Martha*, The Jurisdiction to Tax in International Law (1989) 64) while enforcement refers to committing state acts. Enforcement may take the form of acts of coercion or those acts that result in such acts, e.g. investigations, tax assessment, and execution proceedings are means of enforcement (*Knechtle*, Basic Problems in International Fiscal Law (1979) 40 et seq).

313 *Weil*, The Court Cannot Conclude Definitively … Non Liquet Revisited, Columbia Journal of Transnational Law 1998, 112; see also Advisory Opinion, *Nationality Decrees in Tunis and Morocco*, PCIJ Reports, Series B No 4, 23-4 (1923): "*[J]urisdiction which in prinicple, belongs solely to the state, is limited by rules of international law*". Critically *An Hertogen*, Letting Lotus Bloom, European Journal of International Law 2015, 901 et seqq.

314 See *Qureshi*, The public International Law of Taxation: Text, Cases and Materials (1994) 29.

315 The court was criticized for not establishing a general prohibition for exercising jurisdiction to prescribe extraterritorial in literature, see, e.g. *Ryngaert*, Jurisdiction in International Law: United States and European Perspektives (2007) 38 et seq.

316 PCIJ 7.9.1927, *Lotus,* Ser A no 10, 19.

to enforce law in another state's territory.[317] A state cannot take actions to enforce its law on foreign territory without consent of the foreign state or without international law permitting such action.[318] In lack of a permission, state actions are effective only within the state's territory,[319] but states are free to exercise prescriptive jurisdiction across borders.

The decision of the PCIJ is controversial. Most states as well as the prevailing view in literature take a different approach when it comes to the relationship between international law and jurisdiction. Following their approach, states are generally not allowed to exercise jurisdiction unless a permissive rule, such as territoriality or nationality, allow such an exercise.[320]

2.1.4. Limitations to Prescriptive Jurisdiction

2.1.4.1. The Genuine Link

While the territorial limitation to enforcement jurisdiction is rather undisputed, the existence of restrictions to prescriptive jurisdiction is debated. Despite the freedom that the PCIJ grants states in their jurisdiction to prescribe in *Lotus*, states usually endeavor to limit their legislative jurisdiction to circumstances in which a territorial or personal connection, i.e. a "*genuine link*" or nexus, to the subject matter becomes evident.[321] Since *Nottebohm*, it has increasingly been contested that international law requires a certain connection to a state in order to also render prescriptive jurisdiction permissible.[322] Despite the relativity of the ICJ's remarks on the existence of a genuine link criterion (see Chapter 2.1.4.2.), proponents of a genuine link requirement often refer to the principles of sovereign equality and non-intervention. Accordingly, a genuine link criterion is con-

317 *Lehner*, Das Territorialitätsprinzip im Licht des Europarechts, in *Gocke/Gosch/Lang* (eds), Festschrift Franz Wassermeyer (2005) 244 et seq; *An Hertogen*, European Journal of International Law 2015, 907 et seq; *Gadzo*, The Principle of 'Nexus' or 'Genuine Link' as a Keystone of International Income Tax Law: A Reappraisal, Intertax 2018, 197; *Heber/Sternberg*, The Extraterritorial Reach of the German Progression Clause in Income Tax Law in the Light of International Law, Intertax 2017, 257; *Crawford*, Brownlie's Principles of Public International Law (2012) 478.

318 *Gerontas*, Columbia Journal of European Law 2013, 430.

319 *Kegel/Hohenveldern*, Hastings International and Comparative Law Review 1982, 247; *Schön*, Bulletin for International Taxation 2015, 284; *Becker*, Bulletin for International Taxation 2016, 190.

320 *Ryngaert*, Jurisdiction in International Law (2015) 29; *Gerontas*, Columbia Journal of European Law 2013, 430.

321 *Ipsen*, Völkerrecht (1990) § 23 para 97.

322 *Dahm/Delbrück/Wolfrum*, Völkerrecht Band I/1 (1989) 320 et seq; *Ipsen*, Völkerrecht (1990) § 23 para 97;*Englisch/Vella/Yevgenyeva*, The Financial Transaction Tax Proposal Under the Enhanced Cooperation Procedure: Legal and Practical Considerations, British Tax Review 2013, 238 et seq; *Martha*, The Jurisdiction to Tax in International Law (1989) 46; *Schön*, Persons and Territories: on the International Allocation of Taxing Rights, British Tax Review 2010, 554 et se; *Schön*, Bulletin for International Taxation, 2015, 280; *Crawford*, Brownlie's Principles of Public International Law (2012) 486; *Lang/Paterno*, Die Vermeidung der Doppelbesteuerung in der föderalen Struktur Österreichs, Spectrum der Rechtswissenschaft 2011, 82. A different view was taken by *Monsenego*, Taxation of Foreign Business Income within the European Internal Market (2012) Chapters 2.2.3.-2.2.5.

sidered necessary when exercising jurisdiction by two states leads to a conflict of interests or when one state is harmed by another state's jurisdiction.[323] Whether a state is harmed by another state's jurisdiction is a subjective category and thus difficult to prove.[324]

2.1.4.2. The Genuine Link in the Case Law of the ICJ: Nottebohm and Barcelona Traction

Supporters of the "genuine link" criterion refer to the decision of the ICJ in *Nottebohm*.[325] Despite the support in literature of a general restriction of jurisdiction to matters where a genuine link criterion is evident, the case of *Nottebohm* is highly specific for several reasons and may, arguably, not give rise to a generalization of the genuine link criterion.

Nottebohm was born in Germany and moved to Guatemala in 1905 where he lived as a permanent resident without ever acquiring Guatemalan nationality. After the beginning of the Second World War, *Nottebohm* successfully applied for nationality in Liechtenstein and consequently lost his German nationality in 1939. In 1941, Guatemala sided with the Allies and declared war on Germany. In spite of his Liechtenstein nationality, the Guatemalan Government treated *Nottebohm* as a German national and took measures against the person and property of *Nottebohm*. The Liechtenstein Government brought proceedings against Guatemala before the ICJ arguing that Guatemala ignored *Nottebohm's* Liechtenstein nationality, thus treating him unjust.[326] The ICJ did not share the opinion of Liechtenstein. Although states are generally free to determine the criteria to obtain their nationality, such nationality must not be recognized by other states when a genuine link is missing:[327]

> According to the practice of States, […] nationality is a legal bond having as its basis a social fact of attachment, a genuine connection of existence, interests and sentiments, together with the existence of reciprocal rights and duties.

Since the genuine link between *Nottebohm* and Liechtenstein was missing, the court found that Guatemala was under no obligation to recognize *Nottebohm's* Liechtenstein-based nationality.[328]

The remarks of the ICJ in *Nottebohm* are rather vague. The case did not concern nationality in general but the specific field of diplomatic protection. This was

323 *Ryngaert*, Jurisdiction in international law (2015) 36.
324 See *Ryngaert*, Jurisdiction in international law (2015) 41, who submits that a state's protest might serve as indication for such harm.
325 *Becker*, IGH v.6.4.1955 – Nottebohm: Zu den minimalen Standards völkerrechtlich relevanter Staatsangehörigkeit, in *Menzel/Pierlings/Hoffmann* (eds), Völkerrechtsprechung (2005) 152.
326 ICJ 6.4.1955, *Nottebohm Case*.
327 ICJ 6.4.1955, *Nottebohm Case*, 23.
328 ICJ 6.4.1955, *Nottebohm Case*, 26.

even emphasized by the ICJ that further explicated that the genuine link test originates from arbitrations concerning conflicts of diplomatic protection of dual nationality.[329] In the area of diplomatic protection, nationality takes a pivotal role. While a state commonly yields its right to exercise jurisdiction over nationals in favor of another state's territorial jurisdiction, jurisdiction over nationals is reasserted in the area of diplomatic protection, e.g. when injury is done to a national.[330] Diplomatic protection commonly concerns situations where two states claim jurisdiction, i.e. either on a territorial or – from the perspective of the state requesting diplomatic protection – a nationality basis, but follow conflicting interests.[331] Diplomatic protection requires a state to reconcile its territorial jurisdiction with another state's right to protect its nationals abroad.[332] Since nationality is a concept of a state's national law rather than a concept of international law,[333] the state itself is exclusively competent to lay down the criteria for conferring nationality. This also gave rise to the underlying problem in *Nottebohm*: The Liechtenstein-based nationality was an artificial construction merely aimed at enabling *Nottebohm* to rely on diplomatic protection and avoid the negative consequences resulting from the German nationality.[334] Therefore, the ICJ did not want to obligate Guatemala to waive its territorial sovereignty due to an artificially created right to diplomatic protection. More precisely, the ICJ did not deny Liechtenstein the right to freely decide on which grounds it may grant nationality. Rather, it merely found that Guatemala is not forced to recognize the Liechtenstein nationality for the purposes of diplomatic protection in the concrete case of *Nottebohm*.[335]

Also the subsequent decision in *Barcelona Traction*[336] concerning the diplomatic protection of a corporation provides no convincing foundation for a generalization of the genuine link criterion. *Barcelona Traction* was incorporated in Canada where it also had its headquarters and operated in Spain. The majority of its

329 ICJ 6.4.1955, *Nottebohm Case*, 22.

330 *Borchard*, The Diplomatic Protection of Citizens Abroad (1928) 346; *Ipsen*, Völkerrecht (1990) § 46 para 4.

331 Commenting the decision in *Nottebohm*, *Ryngaert* (Jurisdiction in International Law (2015) 43) highlights the principle of non-intervention that "*may require that States only exercise jurisdiction when they do not intervene in the internal affairs of other States*". On page 155, the author further clarifies that the principle of non-intervention is to be understood as precluding only enforcement jurisdiction but not prescriptive jurisdiction.

332 *Borchard*, The Diplomatic Protection of Citizens Abroad (1928) 347. In some circumstances, the right of diplomatic protection can also be exercised by a state of which the protected person is not a national. See *Ipsen*, Völkerrecht (1990) § 24 para 35.

333 See, in that regard, ICJ 5.2.1970, *Barcelona Traction*, para 78, 45; PCIJ advisory opinion, 8.11.1921, *Tunis and Marocco National Decrees*, para 40.

334 See, in that regard, also *Lang/Paterno*, Spectrum der Rechtswissenschaft 2011, 81. *Kunz* (The Nottebohm Judgment, American Journal of International Law 1960, 555) also mentions that the ICJ's decision may be affected by the fact that Nottebohm had been a German national and politically an adherent of the Hitlerite.

335 *Lang/Paterno*, Spectrum der Rechtswissenschaft 2011, 82.

336 ICJ 5.2.1970, *Barcelona Traction.*

shareholders were Belgians. Belgium wanted to exercise diplomatic protection for the company vis-à-vis Spain. Spain contended that Belgium had no standing because Barcelona Traction was a Canadian company. The crucial question in *Barcelona Traction* was whether a state (Belgium) can exercise diplomatic protection if the national's state (Canada) did not have the capacity to do so. Concerning the submission that Canada did not have the capacity to grant diplomatic protection, the ICJ remarked on the decision *Nottebohm* and explicitly denied an analogy of the reasoning in *Nottebohm* due to differences in "*legal and factual aspects*" in *Barcelona Traction*:[337]

> […] in the particular field of the diplomatic protection of corporate entities, no absolute test of the 'genuine connection' has found general acceptance […] In this connection reference has been made to the Nottebohm case […] However, given both the legal and factual aspects of protection in the present case the Court is of the opinion that there can be no analogy with the issues raised or the decision given in that case.

After describing the connection between *Barcelona Traction* and Canada, the ICJ explicitly confirmed that "*a close and permanent connection has been established*".[338] The ICJ clarified that the links between the company and Canada were manifold and further pointed out that the Canadian nationality of *Barcelona Traction* was generally recognized[339] which is why Canada still had the capacity to grant diplomatic protection.

Similar to the case of *Nottebohm*, the decision in *Barcelona Traction* did not concern the question of whether the principle of nationality was satisfied with the links between *Barcelona Traction* and Canada.[340] Rather, the ICJ merely determined the requirements for granting diplomatic protection: [341]

> [When] allocating corporate entities to States for purposes of diplomatic protection, international law is based, but only to a limited extent, on an analogy with the rules governing the nationality of individuals. The traditional rule attributes the right of diplomatic protection of a corporate entity to the State under the laws of which it is incorporated […] This notwithstanding, further or different links are at times said to be required in order that a right of diplomatic protection should exist.

To conclude, a rule of international law that requires a genuine link in order to generally render state actions legitimate can neither be deduced from the ICJ's decision in *Nottebohm* nor from the decision in *Barcelona Traction*. Even if the cases are understood as establishing a genuine link criterion, it should be recalled that both cases concerned the principle of nationality in the particular field of

337 ICJ 5.2.1970, *Barcelona Traction*, page 42 para 70.
338 ICJ 5.2.1970, *Barcelona Traction,* page 42 para 71.
339 ICJ 5.2.1970, *Barcelona Traction*, 42 para 73: "*[…] the Canadian nationality of the company has received general recognition*".
340 So also *Mann*, Studies in International Law, American Journal of International Law 1973, 269 and fn 39.
341 ICJ 5.2.1970, *Barcelona Traction*, 3 para 70.

diplomatic protection; drawing conclusions for the principle of territoriality thus appears to be difficult. Further, recourse to a genuine link criterion might arguably be limited to situations where a state's jurisdiction interferes with another state's interest.[342] Thus, granting nationality without any link to a person was not per se declared a violation of general international law by the ICJ nor otherwise prohibited. It was the conflict of interests by two states with both being in the position to claim jurisdiction which opened up the debate on a criterion in the form of a genuine link.

2.1.4.3. Requirements of Customary Law

Customary law can be described as a "*generalization of the practice of states*"[343] with the reason for generalization being that a practice "*is fit to be accepted, and is in truth generally accepted, as law*".[344] Customary law evolves from general and consistent state practice and an "opinio juris", i.e. the sense of being bound.[345] The practice must be consistent and continuous but not used by all states.[346] Sources of custom include, i.e. the opinions of government legal advisers, official manuals on legal questions, legislation, international and national case law, recitals in treaties, and other international instruments.[347] Despite this, customary law is of a highly relative nature. Even when a rule qualifies as customary law, states persistently objecting to a rule of customary law are not bound by it.[348]

In order for the genuine link criterion to be customary law, the above conditions must be met. The existence of such a criterion depends on the specific rule and field of law. Admittedly, proving that a rule qualifies as customary law is difficult. Besides providing evidence of state practice, the primary challenge is to prove a state considers itself to also be bound by its practice.

2.2. The Principle of Territoriality in Tax Law

2.2.1. The Meaning of Territoriality in Taxation

In the context of tax law, the meaning attached to territoriality may differ from the meaning under general international law. The meaning of territoriality in

342 See *Beale*, Harvard Law Review 1923, 241: "*If it is legally wrong for a sovereign to exercise his will, it must be so because that infringes the rights of other sovereigns*".
343 Opinion Judge *Read,* 18.12.1951, *Fisheries (UK v Norway)*, 191.
344 *Crawford*, Brownlie's Principles of Public International Law (2012) 23.
345 *Chantal*, Customary International Law and State Taxation of Corporate Income: The Case for the Separate Accounting Method, Berkeley Journal of International Law 1996, 114; *Avi-Yonah*, International Tax as International Law (2007) 5; *Kadens/Young*, How Customary is Customary International Law?, William & Mary Law Review 2013, 888; *Scoville*, Finding Customary International Law, Iowa Law Review 2016, 1895.
346 *Chantal,* Berkeley Journal of International Law 1996, 115; *Avi-Yonah*, Altera, the Arm's Length Standard, and Customary International Tax Law, Michigan Journal of International Law (2017) 3 et seq.
347 *Crawford*, Brownlie's Principles of Public International Law (2012) 24.
348 *Crawford*, Brownlie's Principles of Public International Law (2012) 28.

taxation may be strongly shaped by the systematics of direct taxation and the different principles of taxation. It is therefore important to not confuse territoriality as used in tax law literature with the principle of territoriality as used in *general* international law.[349]

Following the understanding of territoriality in general international law, territorial taxation denotes taxation of income or subjects providing a link to the territory of a state. Under this notion, territorial taxation includes taxation of income linked to a state's territory as well as taxation triggered by a person's domicile or physical presence in a territory. In the area of direct taxation, a differentiation between taxation triggered by a connection to the tax subject, i.e. taxpayer, or to the tax object, i.e. the income, is often drawn.[350] Likewise, the expression subjective territoriality is used to indicate taxation on the basis of a territorial connection to the taxpayer, such as residence, and objective territoriality to denote taxation with regard to the territorial link to the taxable income.[351]

Different from the meaning of territoriality under general international law, the prevailing view in tax law literature considers territoriality to be a counterpart to taxation based on personality.[352] Taxation in accordance with the principle of territoriality denotes taxation triggered by a link of taxable income to a state's territory as opposed to taxation based on a connection to the tax *subject*. Under this notion, territoriality is only referred to as the limitation to tax income linked to a state's territory[353] while jurisdiction linked to the tax subject, e.g. taxation of residents, is excluded from that meaning. More precisely, territoriality as a principle in taxation might be used in two contexts: domestic law (worldwide taxation and territorial taxation) and double taxation conventions (residence taxation and source taxation).

In almost all income tax systems, taxation is triggered by a link either to the tax subject or the tax object. This emergence becomes understandable when considering various theories on the justification to tax and the debate on the appropriate links to "allocate taxing rights" in the historical context of double tax treaties.

349 *Knechtle*, Basic Problems in International Fiscal Law (1979) 36 fn 88; *Wassermeyer*, Die beschränkte Steuerpflicht, in *Vogel* (ed), Grundfragen des Internationalen Steuerrechts (1985) 52; *Koblenzer*, Grundlagen der „beschränkten Steuerpflicht", Betriebs-Berater 1996, 933; *Schindel/Atchabahian*, General Report, in Cahiers de Droit Fiscal International (2005) 29; *Marres*, The Principle of Territoriality and Cross-Border Loss Compensation, Intertax 2011, 934.

350 *Pistone*, The Impact of Community Law on Tax Treaties (2002) 177; *Marres*, Intertax 2011, 113.

351 *Koblenzer*, Betriebs-Berater 1996, 934.

352 *Herzfeld*, Probleme des internationalen Steuerrechts unter besonderer Berücksichtigung des Territorialitaetsproblems und des Qualifikationsproblems (1932) 428 et seq; *Koblenzer*, Betriebs-Berater 1996, 934.

353 E.g. *Musgrave*, Who should tax, where, and what?, in *McLure* (ed), Tax assignment in federal countries (1993) 7; *Vogel*, Worldwide vs. source taxation of income – A review and re-evaluation of arguments, Intertax 1988, 221; *Flick*, Methoden zur Ausschaltung der internationalen Doppelbesteuerung bei den direkten Steuern: Eine rechtsvergleichende systematische Übersicht, entwickelt an den deutschen Doppelbesteuerungsmaßnahmen, Finanz Archiv 1961, 101; *Marres*, Intertax 2011, 113.

Considering the current design of national tax systems and bilateral tax treaties is fundamental for understanding the connotation of territoriality in the specific field of tax law and the differences to the meaning under general international law.

2.2.2. Theories on Taxation

2.2.2.1. Contracts, Costs and Benefits

In early times, taxes were only levied for exceptional purposes, such as war. The change from an exceptional tax to a continuous tax is partly owed to an increase of state expenditure resulting from an expansion of state activities.[354] The focus of a state's responsibilities switched from mere repression and prevention, e.g. from war or force majeure, to "developmental" and "constructive" activities or, in other words, the functions of the state moved from merely "preventing evil" to "improving life".[355] Alongside these developments in the functions of a state, different theories of taxation evolved.

The political theory of the Middle Ages considered taxation to be justified in light of a state's responsibilities to provide services for the individual. Theories of taxation were based on the philosophical idea of society in the "social contract".[356] Following this approach, the reasons and measures of taxation are in accordance with the principles of an exchange between the individual and the government. Thus, tax payments are made in exchange for services provided by the state.[357] This took two forms: The cost theory and the benefit theory with the latter being a key element in modern theories of income taxation.[358]

The benefit theory was the prevailing tax principle in the 18th and 19th centuries, particularly in England.[359] *Hobbes*, one of the early proponents of the benefit theory, considered the core function of a state to be protection with taxes being the price for peace.[360] He equated "equality of taxes" with "equality of the depth" that every man owed for his protection, further arguing "*the debt which a poor man oweth them that defend his life is the same which a rich man oweth for the*

354 *Seligman*, Double Taxation and International Fiscal Cooperation (1928) 4; *Westphal-Conn*, Die Steuersysteme und Staatseinnahmen sämmtlicher Staaten Europa's und die Steuerreformgesetze in Oesterreich (1886) 4.

355 *Seligman*, Double Taxation and International Fiscal Cooperation (1928) 9 et seq. See also *Vogel*, The American Journal of Jurisprudence (1988) 25.

356 *Willoughby*, The ethical basis of political authority (1930) 151.

357 *Luttmer/Singhal*, Tax Morale, The Journal of Economic Perspectives 2014, 157.

358 According to the cost of service theory, taxes should be paid in accordance with the cost of the service performed by the state. Everyone would finance the services he obtained from governments from his own resources. The flipside of the cost of service theory (as well as of the benefit principle) is that it puts a heavier burden on the poor than on the wealthier classes since the ratio between revenue and expenditure would put the former in a worse position with regard to their ability to pay. See *Seligman*, The Income Tax (1911) 11; *Westphal-Conn*, Die Steuersysteme und Staatseinnahmen sämmtlicher Staaten Europa's und die Steuerreformgesetze in Oesterreich (1886) 4.

359 *Cooper*, The Benefit Theorie of Taxation, Australian Tax Forum 1994, 431.

360 *Hobbes*, Elementa philosophica de cive (1782) 228. See also *Hobbes*, The Leviathan (1651) 213.