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The Renaissance of the Benefit Principle for the 21th Century International Tax Reform

Eva Escribano López (Universidad Carlos III de Madrid) · Thursday, January 30th, 2020

The benefit principle is widely known as a traditional justification for the imposition of taxes. Broadly speaking, it has customarily implied that taxpayers ought to contribute to government in proportion to the benefits obtained from government institutions and programs[1]. Today, the usefulness of the traditional version of the benefit principle appears to be confined to those taxes that are paid as a direct consideration for citizen use of government property, facilities and services (e.g. highway tolls, tuition fees or charges for administrative concessions or licenses). In these scenarios, the very reason why citizens are compelled to pay taxes in the first place is precisely the fact that they are directly benefiting from a government activity, while the own amount of the tax due is commonly directly correlated to the cost borne by government to provide such benefit. Beyond these very limited cases, the truth is that the configuration of the vast majority of taxes appear to completely disregard benefit considerations and instead rely on other principles such as ability to pay, which demands taxpayers with an equal ability to pay to be subject to the same amount of tax.

The question that now arises is whether this old tax policy principle should be rescued from oblivion and further play some role in the tax policy discussions currently going on in the international arena, most notably those concerning the proposals on the taxation of the digital economy.

The response from the most prominent international policymakers (i.e. OECD and EU) appears to be negative at first glance. At least, there is no express reference to the benefit principle whatsoever in any of their relevant reports or drafts on the topic. Yet, we have the feeling that the spirit of this tax policy guideline is somehow present in these documents and we may have found an explanation for this. While it is evident that both international organizations have placed among their most urgent priorities the re-establishment of the link between taxation and the location of actual economic activities[2], they have failed to provide any sound tax policy reason(s) why tax bases ought to be allocated wherever economic activities are taking place. In this context, the old benefit principle is able to provide a consistent theoretical foundation for this claim: taxpayers ought to be subject to tax wherever they perform their economic activities insofar as such performance automatically makes them potential beneficiaries of the host State´s public infrastructures and services. This being so, we could conclude that the benefit principle may be regarded as the hidden dogma underlying the most recent demands of the OECD and EU States on the ongoing international tax reform.

Beyond these considerations, we believe that the benefit principle may still be of value today. Indeed, we proposed somewhere else a revised version of this old principle (the "presumptive benefit principle")[3] with a very specific content and targeted use[4]. In this sense, this principle would be useful to guide the determination of the members of the community that ought to contribute to the financial support of a government, thus justifying the imposition of a tax burden on persons who find themselves in a position to effectively or potentially benefit from the relevant public goods, services and infrastructures provided by the State concerned. The reason is obvious: it seems only fair that those presumably enjoying the benefits funded by a State should contribute to their financial support. This being said, this principle should ideally underlie the tax rules that ultimately identify the taxpayers that would become subject to a State´s tax jurisdiction. This is, tax connecting factors such as domestic tax residence tests or the permanent establishment concept.

Tax rules based on the aforementioned principle should merely rely on a presumption of access to benefits rather than on the case-by-case demonstration of the effective use and enjoyment of the State´s public services by the taxpayer as this last exercise would simply be unrealistic. This approach intends to overcome a notable challenge posed by the benefit principle (this is, the difficulties to establish the effective enjoyment of public benefits) while ensuring it still plays a role in the identification of the community of taxpayers of a State. This way, these rules ought to confide in certain indicators whose presence in the territory concerned is visible and easily ascertainable and further allows us to assume that the taxpayer is in a position to access the State´s services and infrastructures. Clearly, as we anticipated above, the performance of a physical economic activity may be regarded as a valid indicator for these purposes.

At this point, the question may arise as to whether the presumptive benefit principle would be able to provide a theoretical justification for the taxation of profits derived from digital enterprises in the States where their customers or users are located. In other words, does the mere access to a market of customers or users (albeit remotely) by these enterprises makes them potential beneficiaries of the market State´s public infrastructures and services? We believe the response to this question should be positive for two main reasons[5]. Firstly, the existence of a potential market of well-educated, healthy and prosperous customers is clearly not a random spontaneous event, but rather the consequence of diverse circumstances including, *inter alia*, their efforts, the socio-economic context in which they operate and a number of policies and services promoted (and defrayed) by their government over the years to foster their general well-being, access to education and healthcare, economic prosperity, labor protection, etc. Secondly, a framework that is conducive to remote transactions with the aforementioned market of customers is equally the result of the proper functioning of public infrastructures (telecommunications, supply of energy), services (postal service, waste disposal, reliable judicial system) and policies (protection of IP rights or customers´ rights)[6].

To sum up, States willing to follow the (presumptive) benefit principle in their respective tax policies would need to rethink their tax connecting factors to ensure that taxpayers who may be presumably in the position to access their public benefits ultimately pay their share in their territories. Such access may be assumed in two main scenarios. First and foremost, in cases where the taxpayer is performing a physical economic activity in the territory concerned, a situation that may be measured by a number of factors (e.g. assets and labour). In this regard, it would be interesting to explore, for example, the revision of domestic corporate tax residence tests in the light of this[7]. Secondly, such assumption could equally be made in cases where the taxpayer has access to local customers or users, albeit through remote means. Accordingly, the introduction of a new remote-sales PE[8] with a high quantitative threshold could be an option to consider. It is

undeniable, though, that the number of benefits within the reach of the taxpayer and the extent of its presumable enjoyment are expected to be much more limited in this latter scenario, a fact that should be taken into account by the relevant State when the time comes to rethink its own tax rules.

[1] A comprehensive study of this principle and its historical evolution may be found in Dodge, J.M. (2004): Does the new benefit principle (or the partnership theory) of income taxation mandate an income tax at both the individual and corporate levels? (FSU College of Law, Public Law and Legal Theory Research Paper n. 118, p. 1-29).

[2] OECD (2013), BEPS report, p. 15, 20 and 51 and EU Commission (2015): A fair and efficient corporate taxation in the European Union, p. 6 and 8-10. This mantra also made its way towards the explanatory memoranda of the draft directives on the proposal for a digital services tax and the significant digital presence permanent establishment.

[3] Escribano, E. (2019), *Jurisdiction to tax corporate income pursuant to the presumptive benefit principle: a critical analysis of structural paradigms underlying corporate income taxation and proposals for reform* (Alphen aan den Rijn: Wolters Kluwer), §2.02. The most relevant precedents of this new suggested approach are mainly Schanz´s "economic allegiance" theory (Schanz, G. (1892), Zur Frage der Steuerpflicht (FinanzArchiv, vol. 9, band II, p. 372-373), the Musgraves` "inter-nation equity" principle (Musgrave, P.B.; Musgrave, R.A. (1972), Inter-nation equity, in Bird, R.; Head, J.G. (eds.), *Modern fiscal issues: essays in honor of C.S. Shoup* (Toronto: Toronto University Press)) and Dodge´s "partnership theory" (or "economic version of the benefit principle") (Dodge, J.M. (2005), Theories of tax justice: ruminations on the benefit, partnership and ability-to-pay principles (Tax Law Review, vol. 58, n. 4), p. 444 et seq) among others.

[4] The benefit principle would not play any role in what regards, for example, the extent of the tax liability in income taxes (i.e. the calculation of the tax base and the decision on the relevant tax rate) since the ability to pay principle is better equipped to deal with this.

[5] See Escribano, supra n. 3, at. §2.02[B] [2] [b]

[6] Pinto, D. (2003), *E-commerce and source-based income taxation* (Amsterdam: International Bureau of Fiscal Documentation) p. 21-23 and Hongler, P.; Pistone, P. (2015), Blueprints for a new PE nexus to tax business income in the era of the digital economy (IBFD White papers), p. 22.

[7] Escribano, supra n. 3, at §4.02 [B] [3] [b] and Couzin, R. (2002), *Corporate residence and international taxation* (Amsterdam: International Bureau of Fiscal Documentation), p. 262-263.

[8] Avi-Yonah, R. (1997), International taxation of electronic commerce (Tax Law Review, vol. 52), McLure, C.E. (Jr.) (2000), Source-based taxation and alternatives to the concept of permanent establishment, in VVAA: *2000 World Tax Conference Report* (Toronto: Canadian Tax Foundation), Schön, W. (2009), International tax coordination for a second-best word (part I) (World Tax Journal, vol. 1, n. 1), p. 92 and 99-104, Avi-Yonah, R.; Halabi, O. (2014): A model treaty for the age of BEPS (University of Michigan Public Law and Legal Theory Research Paper series, n. 411), Gadžo, S. (2016), Nexus requirements for taxation of non-residents' business income : a normative evaluation in the context of the global economy (Amsterdam: International Bureau of Fiscal Documentation), p. 320-322 and Escribano, supra n. 3, at §4.02 [C] [3].

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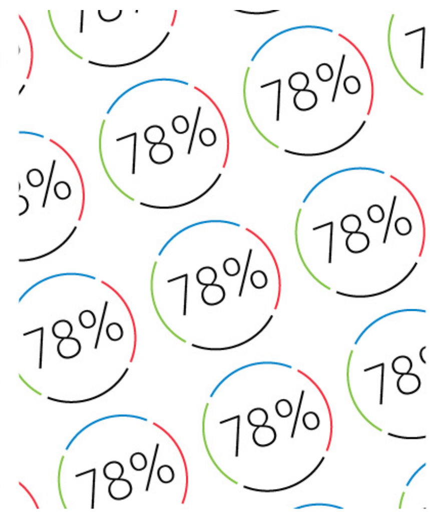

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