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Giorgio Beretta, PhD\*

## ‘FIXING’ THE SOCIAL CONTRACT: A BLUEPRINT FOR INDIVIDUAL TAX REFORM\*\*

*In the face of population ageing and demographic decline, nowadays all countries compete for an increasingly valuable asset: human capital. Indeed, the drain of human capital from one country to another concerns not only highly-skilled individuals seeking job opportunities abroad, but also pensioners relocating to sunnier and more tax-friendly jurisdictions. Absent global action, the risk of uncoordinated and unilateral measures taken by countries to increase and protect their own tax base, with adverse effects both from the inter-nation and the intra-nation equity perspective, is very concrete. So far, however, neither the OECD nor the European Union have developed specific policies or measures in the domain of individual taxation. Arguing that scope of reform exists also in this field, the article explores various policies and measures as a blueprint for individual taxation reform, with the double aim to curb tax competition among countries and fix the crumbling social contract.*

Key words: *Human capital. – Individual taxation. – Migration. – Social contract. – Tax policy.*

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\* Researcher, [gberetta@liuc.it](mailto:gberetta@liuc.it); [giorgio.beretta90@gmail.com](mailto:giorgio.beretta90@gmail.com).

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*‘Society is indeed a contract ... As the ends of such a partnership cannot be obtained in many generations, it becomes a partnership not only between those who are living, but between those who are living, those who are dead, and those who are to be born.’*

(Burke 1790)

*‘It is no longer the call to ‘Give me your tired, your poor, your huddled masses’; now we ask for your alert, your privileged, your brainy, your talented. Our machines can do the menial work. Today the emphasis is on technical skill, sophisticated training and adaptability to modern society.’*

(Perkins 1966, 617)

*‘A place in the sun and a tax-free pension’*

(Somerset Webb 2015)

## 1. INTRODUCTION

The launch and subsequent delivery of the broad and multifaceted Base Erosion and Profit Sharing (BEPS) 15 Action Points in 2013–2015 undoubtedly marked a turning point for international taxation (on BEPS, see Christians, Shay 2017; Brauner 2014). After BEPS, in fact, no one can seriously hold the traditional view of a completely sovereign autonomy of countries in tax matters (for a discussion, see Rocha, Christians 2017). As a matter of fact, major theoretical developments in tax policies are now achieved not only through political and legal processes undertaken at the national level, but also in a multilateral setting and with the increased participation of non-governmental actors.<sup>1</sup> In the past the OECD has been and, certainly still is, the major organization to act as a central hub for shaping international tax policies (see, especially, Cockfield 2005).

The action spearheaded by the OECD and undertaken by all countries participating to the Inclusive Framework on BEPS,<sup>2</sup> however, has narrowly focused on closing tax loopholes exploited by multinational

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<sup>1</sup> An example of the increasing intervention of non-governmental actors in a global tax governance is given by the Platform for Collaboration on Tax, launched in April 2016 by the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the United Nations (UN), and the World Bank Group (WBG).

<sup>2</sup> The OECD/G20 Inclusive Framework on BEPS was established in 2016 as a means to ensure interested countries and jurisdictions, including developing economies, can participate on an equal footing in the development of standards on BEPS-related issues, while reviewing and monitoring the implementation of the OECD/G20 BEPS

enterprises (MNEs) and has sought to establish a new international tax order in the field of corporate taxation only (see, especially, Christians 2016).<sup>3</sup> Remarkably, no action has so far been taken at the international level in the realm of individual taxation. The same has indeed occurred in the European Union (EU), where the fight against Harmful Tax Competition (HTC), since the establishment of the Code of Conduct Group in 1997, has only revolved around the identification and elimination of preferential tax regimes designed for companies and other legal entities.<sup>4</sup>

Such dearth of action is rather surprising given that, although revenue losses for national governments due to international tax evasion and avoidance are far greater in the corporate sector, the number and extent of threats arising in the field of individual taxation are by no means negligible.<sup>5</sup>

The author indeed posits that three distinct challenges – each of which is somehow referred to in the three passages quoted in the epigraph – deserve, in particular, closer attention. The first challenge is related to the threat posed to the social contract by the combined effects of population ageing and demographic decline in nearly all developed countries, which contribute to a widening divide across generations and urge governments all around the world to search for additional sources of revenue. The second challenge is related to the phenomenon of the brain drain, which sees countries fiercely competing among themselves for increasingly valuable assets such as human capital and poaching one another's pool of talented individuals. The third challenge is related to the increasingly large wave of pensioners who migrate from one country to another in search of a milder climate and often a more tax-friendly environment, which causes a revenue drain in the country where pension income was built up and/or from which it is paid out.

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Project. As to October 2019, over 130 countries and jurisdictions are collaborating on the implementation of the BEPS 15 Action Points.

<sup>3</sup> Notably, in pursuit of the BEPS goals, countries have committed to implementing four minimum standards, respectively concerning measures on Harmful Tax Practices (HTPs) (Action 5), on Tax Treaty Abuse (Action 6), on Country-by-Country (CbC) Reporting (Action 13), and on a Mutual Agreement Procedure (MAP) (Action 14), all of which, however, relate only to corporate taxation (see OECD/G20, 2019a).

<sup>4</sup> This in spite of the fact that the Preamble of the Resolution on a Code of Conduct, of 1 December 1997, explicitly contemplated the possibility to tackle HTC practices also with regard to 'special tax arrangements for employees' (see European Commission 1998, 1). A similar plea was then reiterated by the Commission in its 2012 Communication titled 'An Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion', but it did not actually lead to the enactment of any measure in this field (see European Commission 2012a, 7).

<sup>5</sup> Notably, revenue losses for governments due to BEPS practices by MNEs are conservatively estimated by the OECD at around 4–10% of global corporate income tax revenues or USD 100–240 billion annually (see OECD 2019a).

While all these three challenges indeed point to the need to undertake global action in the field of individual taxation, with a discussion of each of them provided in the following, in terms of proposals, the article mostly focuses on migration of pensioners and cross-border taxation of pension income. Despite such a narrow context, the author submits that the proposed policies and measures may offer valuable suggestions for rethinking individual taxation on a more general scale.

The article is organized as follows. Section 2 provides background information on the increasing challenges faced by the implicit social contract, which underpins the Welfare State currently adopted by nearly all developed countries. In particular, the discussion centres around the threats posed by a widening divide across different generations. Section 3 traces the main causes and consequences of the brain drain and the battle for human capital which is fiercely being waged by countries worldwide. Section 4 describes the phenomenon of migrating pensioners as well as the main features of the different pension taxation regimes. Section 5 deals with taxation of pension income on an international plane, with focus on the treatment currently provided under the OECD Model. Exploration of the tax treatment of pension income at the international level is used for individualizing possible policies and measures to be enacted in the field of individual taxation. This task is undertaken in Section 6, where a blueprint for individual tax reform is laid down, and pros and cons of each proposed measure are closely compared. Section 7 concludes.

## 2. THE SOCIAL CONTRACT UNDER THREAT AND THE WIDENING INTERGENERATIONAL DIVIDE

We are arguably entering an age of increasing global instability and social disillusion, both of which may be seen as prominent hallmarks of the end of the globalization thrust and the beginning of an opposite ‘deglobalization’ era (see, especially, van Bergeijk 2019; James 2017). The symptoms of a growing instability and disillusion are variably expressed in politics, society and the economy, in so far as all these areas are experiencing a surge of nationalist and protectionist movements, fuelled by popular grievance and general distrust of elites (see, in this regard, Lagarde 2019). In the aftermath of the financial crisis of 2008, it has in fact become common for people, especially the middle-class in developed countries, to have declining perceptions of well-being and trust in the future,<sup>6</sup> whereas the global wealthiest one percent has gained

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<sup>6</sup> According to OECD (2019b, 13), due to nearly stagnating wages, growing lifestyle costs and housing prices, rising job insecurity in the middle of fast-transforming labour markets, ‘today the middle class looks increasingly like a boat in rocky waters’.

enormously throughout the past decades (for different perspectives in this regard, see Smith *et al.* 2019; Piketty 2013).

Rising inequality – both at the national and international level – is certainly a major source of government and individual concerns (see, for example, Wilkinson, Pickett 2019; Stiglitz 2015), as indeed those worries are further exacerbated by gloomy forecasts of employment conditions in the near future due to the rapid pace at which epochal phenomena such as automation (see, for a discussion, Baldwin 2019; Ford 2015) and population ageing<sup>7</sup> are occurring.

The Welfare State, adopted after World War II by nearly all developed countries, since it is seen as a valuable weapon against inequalities in society, is currently under tight scrutiny.<sup>8</sup> This is largely due to the social contract implicitly agreed upon between generations, which underpins the Welfare State and, arguably, contributes to holding a society together (for a perspective on the situation in this regard in the United Kingdom, see House of Commons 2016, 8–23).

The intuitive idea of such an intergenerational social contract is that the redistributive mechanism underpinning the Welfare State justifies the obligation of the current productive generations to finance the health, pension and care services of the older generations, by arguing that future generations will provide the same kinds of benefits once the current generations retire (see Hammer, Istenič, Vargha 2018, 22). In this way, the Welfare State facilitates solidarity across different generations or age cohorts, via financial transfers to the old, mainly in the form of pensions, and to the young, mainly in the form of education, both of which are funded principally by taxing the current working-age population (see Resolution Foundation 2018, 25–27).

But there is a catch. In principle, everyone is to pay in during their working life, drawing down in early years and retirement, for a broadly neutral lifetime result. However, the amount of transfers and benefits provided in return may well change over time, as indeed do tax rates and the size of generations that are contributing or withdrawing. As a result, over their lifetime span, different generations can end up with net gains or net losses, a circumstance that is very much capable of skewing the redistributive mechanism underpinning the Welfare State (see Gardiner 2016, 7).

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<sup>7</sup> Tellingly, by 2020, for the first time in history, there will be more people on the planet over the age of 65 than under five (see He, Goodkind, Kowal 2016, 3).

<sup>8</sup> As early as 2000, Avi-Yonah (2000, 1578) warned that ‘globalization leads to a more pressing need for revenues at the same time that it limits governments’ ability to collect those revenues. This dilemma threatens to undercut the social consensus about the value of the Welfare State that underlies modern industrialized societies and to create a backlash against the globalization that produces too many overall benefits’.

Presently, there is in fact a widespread consensus that the social contract is not being honoured for today's younger generations and that, in particular, the Baby Boom generation, commonly identified as individuals born between 1945 and 1965, are receiving a net gain over later coming generations, such as those of the Generation X, i.e. individuals born between 1965 and 1980, and the Millennials, composed of those born between 1980 and 2000.<sup>9</sup>

Worries on this matter concentrate, in particular, on this latter age cohort. Tellingly, the Resolution Foundation (see Gardiner 2016, 5) has revealed gloomy economic forecasts for those belonging to that generation, signalling that Millennials are 'the first generation that has so far earned less than the one before at every age' and warning that, if productivity growth remains as low as now, 'Millennials are at risk of becoming the first ever generation to record lower lifetime earnings than their predecessors'.<sup>10</sup> On a similar strain, European Commission (2017, 12) has flagged increased concerns that today's young people in the EU and their children may actually end up worse off than their parents. Concerns also surround the future pensions of current workers, whose social sustainability is indeed put under a severe test, in so far as it is not clear whether the amount of the present contributions will provide adequate living conditions for tomorrow's retirees (see, especially, Scarpetta, Blundell-Wignall 2015). On a broader perspective, there is also a risk that a growing intergenerational divide would widen inequalities and wealth gaps existing in society, therefore the overall importance of inheritances and private transfers between generations is expected to grow (see Resolution Foundation 2018, 114–117).<sup>11</sup>

Such dire prospects for today's younger generations are indeed the ultimate fruit of various ongoing trends in society and the economy. The

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<sup>9</sup> This classification of generations follows Willetts 2010. One should caution, however, that defining different generations inevitably entails an element of arbitrary choice, as long as, for instance, those individuals born immediately before a generational dividing line may well dispute their implicit association with those born 20 years earlier, for example, but not with those born only one year later.

<sup>10</sup> Such gloomy prospects, however, are contested by others (see, for example, Ganesch 2016), who point out, for instance, that economists indeed 'cannot account for the dazzling consumer gains that come with technology and competition multiplied by the passage of time', perhaps embodied at best by 'all the facilities now inherent to a smartphone' which 'would have cost a teenager in 1980 a king's ransom in separate, clunky machines'.

<sup>11</sup> See also Bangham (2018, 3–6), pleading for the elimination of the UK current inheritance tax and its replacement with a lifetime receipts tax to be levied on recipients with fewer exemptions, a lower tax-free allowance and lower tax rates, whose revenues are to support a GBP 10,000 'citizen's inheritance' – a restricted-use asset endowment for all young adults, from the age of 25, to sustain skills, entrepreneurship, housing and pension savings.

first challenge is related to population ageing, due to a combination of an increased life expectancy and a decreasing trend in birth rates in nearly all developed countries,<sup>12</sup> both phenomena that indeed are expected to intensify in the coming decades, so that a growing demand for health, pension and care services will have to be sustained by the fiscal revenues extracted by a shrinking working-age population, thus increasing the so-called ‘dependency ratio’, measuring the number of pensioners per working age person (see Resolution Foundation 2018, 87–89).<sup>13</sup> Next, it comes the inequality challenge, with an increasing share of wealth globally owned by older generations, who have managed to shield their income and assets from the financial crisis of 2008 better than the younger generations (see Gardiner 2016, 23–25). The third challenge is related to poor job prospects for the young, who, mainly due to fast-paced automation, experiences increasing challenges in finding an employment, at a time when overall job quality, particularly in terms of work stability and benefits provided, has been reduced dramatically (see, especially, OECD 2019c).

As a result, a new divide is ripping society apart and it is based on age, in so far as when a person was born increasingly matters in determining their present and future living standards.<sup>14</sup> This situation, of course, generates significant backlashes – often depicted even in terms of ‘intergenerational warfare’ (see, most notably, Willetts 2019; Pickard 2019) – across generations and in society, further fuelled by a misleading propaganda on both sides (see, especially, Sternberg 2019; Bristow 2019). Older generations are thus depicted as a gerontocracy of the early-retiring and asset-rich, in contrast to precariously housed and insecurely employed younger generations,<sup>15</sup> whereas the latter are accused of living frivolously and have even been caricatured for consuming avocado toast (!) and

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<sup>12</sup> Indeed, as revealed by He, Goodkind, Kowal (2016, 15), birth rates in all countries, with the exception of African ones, are already below the so-called ‘population replacement level’, which is the number of children per woman needed to sustain population replacement.

<sup>13</sup> Against this backdrop, it may be contended (see, for example, European Commission 2018a) that an ageing population eventually favours private expenditure on a whole new set of goods and services, from connected health devices to age-friendly universities, all of which contributing to the flourishing of the so-called ‘silver economy’.

<sup>14</sup> Evidence of such growing divide between the old and the young became apparent with the Brexit referendum, which indeed showed that British politics is deeply polarized by age, with a substantial majority of older people voting for leaving the EU, while a large majority of younger generations voting for remaining in the Union (see Norris 2018). It should also be noted that, as their own population grows older, the political weight in all developed countries becomes increasingly tipped in favour of older generations.

<sup>15</sup> For instance, the New York Times columnist Thomas Friedman (Friedman 2010) has gloriously railed against ‘a Grasshopper Generation’, one that ‘has eaten through all that abundance like hungry locusts’, whereas David Willetts (Willetts 2010),

priced coffee, instead of working and saving for the future as, supposedly, former generations did (see Levin 2017).

### 3. BRAIN DRAIN, TALENT AND THE INTERNATIONAL BATTLE FOR HUMAN CAPITAL

New kinds of wars are being waged by many countries all around the world for hoarding an increasingly valuable asset: human capital.<sup>16</sup> Human capital can broadly be described as all the wealth of knowledge, skills, competences and attributes – which, overall, might be labelled as ‘super talent’<sup>17</sup> – that a few of individuals are endowed with and that facilitate the creation of personal, social and economic prosperity, being all of these preconditions for the flourishing of the 21st century ‘knowledge society’ (for a conceptualization, see Drucker 1993). As a proxy for all these endowments, educational attainments of those individuals are generally used.<sup>18</sup>

Amid those international wars and battles (see, in this regard, Brücker *et al.* 2012), countries’ victories and losses against one another are measured by means of inbound and outbound flows, i.e. by looking at the overall number and quality of the endowments of individuals permanently moving in or out the territory of the given country. Indeed, this two-way flow is neither necessarily nor under all circumstances well-balanced. Quite the contrary, such flow can be one-way. If this ‘human capital’ exchange is overall positive, i.e. more highly-skilled individuals are moving in rather than out, the country has a ‘profit’ or, more appropriately, a ‘brain gain’. On the other hand, if for a given country the

chair of the UK Resolution Foundation, has claimed that ‘the Baby Boomers took their children’s future’.

<sup>16</sup> Although the origins of the expression can be traced as back as to Adam Smith (1723–1790), the modern usage of the term ‘human capital’ is generally attributed to Gary S. Becker (1930–2014), especially in regard to his influential book *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education*, first published in 1964.

<sup>17</sup> According to Shachar, Hirschl (2013, 72), ‘[t]he desire to be great, to make a lasting mark, is as old as civilization itself. Today, it is no longer measured exclusively by the size of a nation’s armed forces, the height of its pyramids, the luxury of its palaces, or even the wealth of its natural resources. Governments in high-income countries and emerging economies alike have come to subscribe to the view that something else is required in order to secure a position in the pantheon of excellence: it is the ability to draw human capital, to become an “IQ magnet”, that counts’.

<sup>18</sup> In this connection, however, it should be noted that the category that is used to qualify an individual as highly-skilled is related to the possession of tertiary education, an element that by itself is very crude, in so far as it includes in this category even individuals with (only) practical and technical education degrees. For an overview about education classification at the international level, see UNESCO 2012.



said balance is overall negative, i.e. more highly-skilled individuals are moving out rather than in, it faces a ‘loss’ or, more appropriately, a ‘brain drain’ (see Boeri 2012, 1).

The expression ‘brain drain’ was first coined by the British Royal Society (see Royal Society 1963) to narrowly describe the outflow of scientists and technologists from the United Kingdom to both the United States and Canada in the 1950s and early 1960s.<sup>19</sup> However, presently, the term is more broadly used to illustrate the departure of highly-skilled individuals – thus, not necessarily scientists or technologists – from their own countries to others where usually wages and life conditions are more favourable overall, or are at least perceived as such.<sup>20</sup> As a break-down of this compound expression suggests, the word ‘brain’ refers to the wealth of knowledge, skills, competences and attributes with which the emigrating individuals are believed to be endowed. The word ‘drain’ implies that the rate of those leaving a country is far greater than the normal or desirable level of departures from a country. The link between these two words means that the departure of the most talented and highly-skilled individuals from a country actually occurs at an appreciable rate (see Giannoccolo 2009, 2).

Brain drain is indeed the source of major concerns for governments and policy makers in the countries of origin (see, for example, *The Italian Insider* 2019; Filipovic 2019), which especially complain about efficiency losses to their economy or, even, about the shortage of talented people in specific economic sectors (e.g. in the healthcare or education sector), in so far as those nations blame the country of arrival for poaching their own base of talented individuals, whose education and training were often financed by means of fiscal revenues, so that an export of its ‘human capital’ effectively becomes a sunk investment for the country of origin.<sup>21</sup>

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<sup>19</sup> If the emigrant is an unskilled individual, then one could perhaps speak about ‘muscle drain’ rather than ‘brain drain’ (see Pomp 1985, 250, 260 and 286).

<sup>20</sup> Compare the definition of ‘brain drain’ contained in the Cambridge English Dictionary (‘the situation in which large numbers of educated and very skilled people leave their own country to live and work in another one where pay and conditions are better’) with the narrower one included in the Collins English Dictionary (‘the movement of a large number of scientists or academics away from their own country to other countries where the conditions and salaries are better’). For their own account, EU institutions (European Commission 2019) define ‘brain drain’ as ‘the loss suffered by a country as a result of the emigration of a (highly) qualified person’.

<sup>21</sup> Tellingly, a 2019 report prepared by the Westminster Foundation for Democracy (2019, 23) for the UK government estimates that the ‘sunk’ cost of education of emigrants from a country such as Serbia in a single year is more than the total annual earnings from the IT services exported by that country. On the other hand, it could be contended (see Boeri 2012, 9) that ‘selective immigration policies increase individual incentives to invest in human capital in the sending countries, so that the impact of migration on human capital formation in the country of origin may not be so strong’.

Although the general thrust of the conventional view is that the emigration of human capital is detrimental to a country, the actual validity of such a statement is open to discussion, as it is related to an empirical question whose answer varies from case to case (see, especially, Kapur, McHale 2005; Commander, Kangasniemi, Winters 2004). Moreover, literature also points out that, to the extent that the brain drain allocates human capital resources more efficiently, such phenomenon is likely to benefit more people globally (see Sykes 1992, 1). From another perspective, it is also contended that the brain drain is nothing more than the free exchange occurring across country borders, in as much as goods and services flow in and out a country (see, in this regard, Carens 1987),<sup>22</sup> which states professing a liberal creed certainly cannot obstruct, at least if they have committed to respect fundamental human rights such as freedom of movement, which is even enshrined in several international charters and declarations.<sup>23</sup> Lastly, there are additional phenomena related to brain drain, such as remittance, diasporas and returns, whose net effects on the country of origin are difficult to assess (for a discussion, see Faini 2017; Wei, Balasubramanyam, 2006; Dustmann, Fadlon, Weiss, 2011).

Various reasons can be traced at the roots of the brain drain phenomenon. The main determinant of the brain drain is generally recognized as being the wage differentials existing between countries, which may function as either a push or pull factor for both inbound and outbound migration patterns (see, especially, Borjas 2001). Another traditional factor encouraging migration is related to cross-country unemployment differentials (see, especially, Piracha, Vadean 2009). The quality of public institutions and standards of living may also help explain the decision of an individual to migrate from one country to another (see, especially, Cooray, Schneider 2016). Other non-financial benefits could equally motivate talented and highly-skilled individuals to move from a country, such as the existence of centres of excellence in a specific economic sector in the country of arrival: in a sense, ‘brains’ go where other ‘brains’ are (see Tesón 2008, 902).<sup>24</sup> Intended as such, the brain drain – like any other economic phenomenon – is governed by the law of supply and demand and by the law of comparative advantages (see Tesón 2008, 902).

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<sup>22</sup> Many authors (see, for example, Freeman 2006; Pritchett 2006), however, criticize that the current wave of globalization includes ‘everything but labour.’

<sup>23</sup> See e.g. Universal Declaration of Human Rights (10 December 1948), Art. 13 (2); International Covenant on Civil and Political Rights (16 December 1966), Art. 12 (2); European Convention on Human Rights (4 November 1950), Art. 2 (2) Prot. No. 4. An alternative, although nowadays minoritarian, view instead regards emigration as a privilege to be granted by the country of origin, rather than a right to which each individual is entitled (for a discussion, see Risse 2012, 152–166).

<sup>24</sup> For a discussion about ‘brain hubs in the United States, i.e. innovation clusters where the average GDP and patents for new technologies are higher, see Moretti (2012, 82–88).

The patterns of ‘brain’ migration also vary. Brain drain may affect developing countries in favour of developed countries, such as non-OECD countries in favour of OECD countries (see, especially, Docquier, Lohest, Marfouk 2007). However, the phenomenon does also occur among OECD countries, as the experience of outward individual movements in developed nations like Italy and New Zealand conspicuously demonstrates (see Brücker *et al.* 2012, 43–47). Further, brain drain can be caused by a reversal of social and economic conditions or unexpected political decisions occurring within a country, which, apparently, is the case of the brain drain that is greatly feared after the Brexit vote in the United Kingdom (see Fazackerley 2018). Lastly, it should be duly considered that migration patterns are likely to change over time, as demonstrated by the history of Europe during the 20th century, when it went from an emigration to an immigration continent, (see Hatton, Williamson 1994, 533–539).

The brain drain phenomenon is a tangible reality also within the EU, where the free movement of workers is one of the four economic freedoms to which Union citizens are entitled and it is a right guaranteed by Article 45 of the Treaty on the Functioning of the European Union (TFEU).<sup>25</sup> In the EU, reasons at the roots of the brain drain relate, mostly, to wage and employment differentials across the Member States as well as different EU regions. While migration patterns mainly followed an East to West route, from countries of the former Soviet bloc – all joining the EU in 2004 and in 2007 – to Western EU-founding Member States during the first decades of the 2000s, the past few years have instead signalled a clear increase of emigration rates from the South to the North of the Old Continent, especially those involving highly-skilled individuals.<sup>26</sup>

Quite intuitively, individual migration patterns also have a significant impact on fiscal revenues. Emigration of individuals, especially

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<sup>25</sup> Notably, Article 45 TFEU stipulates that ‘freedom of movement for workers shall be secured within the Union’, which entails, *inter alia*, the right ‘to move freely within the territory of Member States’. EU law, in fact, guarantees both the right of an individual to leave his Member State of origin and the right to enter and live in another Member State. Therefore, freedom of movement of workers is related to the emigration country as well as to the immigration country, both of which are indeed precluded from hindering cross-border movements and discriminating workers based on their different nationality. However, in so far as tax systems and economic rights arising from the Welfare State of the various Member States differ, the economic consequences of an individual’s decision to move from one country to another may well be discouraging, which is an issue that the Commission has long committed to tackling but has failed to address so far (see European Commission 2010).

<sup>26</sup> For a more detailed description of past, present, and future trends concerning migration of highly-skilled individuals within the EU, see European Commission 2018b. On labour migration from Eastern to Western Europe in the past decade, see Atoyán *et al.* 2016.

those talented and highly-skilled, who presumably earn an above average salary, erodes the tax base and dampens fiscal revenue in the country of origin. The situation is exactly opposite for the country of arrival, as it later sees an increase in its own tax base and fiscal revenues (with specific regard to individuals moving from India to the United States, see the economics analysis by Desai *et al.* 2009). It is no wonder, therefore, that some measures of control – particularly, in the form of taxes to compensate or promote development in the ‘losing’ country, i.e. the country of the ‘brain’ departure<sup>27</sup> – have long been proposed as a way to restore global or inter-country ‘fairness’ (see, especially, Bhagwati 1976; Brauner 2010).

Similar considerations apply to the current situation within the EU, where Member States should arguably endeavour to harmonise their own fiscal policies rather than fiercely competing against each other as they actually are (see, in this regard, Alcini, Gros 2019), as clearly shown by the increased number of special tax regimes for incoming individuals enacted by Member States in recent years (for a discussion of these regimes, see Beretta 2019a; Beretta 2019b; Beretta 2017; Arginelli, Avella 2017; Ribes Ribes 2017; Bader, Seiler 2015; Cassiano Neves 2010; van Zantbeek 2010; Roxburgh 2006).

From a tax policy perspective, what is particularly worrying of this growing trend is that countries seem to design these special tax regimes before even understanding the real nature of their own social and economic troubles, thus ending up granting tax benefits to individuals based on rather objectionable – if not constitutionally flawed – criteria (see Kostić 2019a).<sup>28</sup>

#### 4. PENSIONERS ON THE MOVE: RETIRING ACROSS BORDERS

If there is a word that perhaps should be retired nowadays, it would be ‘retirement’ (see Ezra 2019). Just as individual working lives have changed dramatically over the past several decades, so has the conventional wisdom about retirement. Notably, time and again experts advise to

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<sup>27</sup> Measures in this regard may be taken by the country of origin, the country of arrival or, even, adopted as the result of international cooperation (for a discussion, see Kapur, McHale 2005).

<sup>28</sup> Reportedly (see Tax Foundation 2019), as from 1 August 2019, Poland introduced a blunt exemption from income tax for all Poles aged below 26 and earning less than a given annual salary (approximately EUR 22,500) as a measure to induce Polish youth to remain in its territory. For its own account, starting in 2019, Portugal (see República Portuguesa 2019) introduced a special tax regime (called ‘*Programa Regressar*’), providing a 50% reduction of employment income tax, which is specifically designed to encourage the return of former residents who have fled the country in the last years. Indeed, in this as in other cases, one may well question the *differentia specifica* that may justify providing a special tax treatment based solely on the odd criteria such the age or the former residence of an individual (see Kostić 2019a).

prepare for the 100-year life (see, in this regard, Gratton, Scott 2016), in which the three traditional stages of life – education, work and leisure – are going to be subverted.<sup>29</sup> And indeed, anecdotal evidence indicates that droves of people are already ‘unretiring’ and going back to work (see Cavendish 2019, 71–99; Harding 2018; Span 2018), being that such a decision is favoured by the shrinking of the working-age population, due to declining fertility rates in nearly all developed countries (see He, Goodkind, Kowal 2016, 15).

The circumstances that such that pensioners are, generally, not only healthier but also wealthier; as a matter of fact, the two major sources of private wealth, i.e. illiquid and liquid assets such as houses and pensions, are steadily in their hands – has also brought emigration within the financial reach of many of them (see Gardiner 2016, 33–39). Moving, therefore, is no longer necessarily a young person’s game.<sup>30</sup> Indeed, statistics show that an increasing number of pensioners are retiring in countries other than the ones in which they spent their entire or a substantial part of their working life, staying there for at least a considerable part of the year (see, for example, Cruccu 2018; *KeepTalkingGreece* 2018; Tilbrook 2018; Gehring 2017; ONS 2017; *The Economist* 2017).

Although there is very little research into migration patterns of the elderly population and, indeed, the exercising of the right to free movement across the EU by ‘economically inactive’ citizens, who have reached their retirement age has received scant attention so far,<sup>31</sup> for those individuals the decision to migrate seems to be favoured by a general loosening of occupational and social ties that normally bind an individual to a certain place of residence during their entire working life (see, in this regard, Pyte, Rahmonov 2019). In the EU, cross-border mobility of pensioners is further encouraged by the obligation imposed by EU law upon Member States to eliminate national restrictions that

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<sup>29</sup> Notably, the three stages of life, i.e. education, work and leisure, were first laid down by Harold Entwistle in *Education, Work and Leisure* (Routledge 1970).

<sup>30</sup> Against this background, Young (2017, 3, 16, 40) contends that ‘people moving across state lines are young’, since ‘people move not because they are cold and calculating but because of where their opportunities lie’, which, according to that author, is more likely to materialize when a person is still relatively young and is trying to establish a career. Conversely, the propensity to move supposedly decreases when a person reaches the peak of their career, due to a variety of factors, such as growing family responsibilities and the accumulation of human, social and cultural capital in the place where the person has settled.

<sup>31</sup> Nevertheless, one recent groundwork study (see Gehring 2019) has pinpointed three main reasons for a retiree to cross country borders: (1) increased free time and the absence of work obligations, (2) availability of budget flights for most destinations as well as the possibility to rely on distance-shortening technologies such as videocalls, and (3) in the EU, the right to free movement across Member States.

impede or discourage the provision of pension portability without objective justification or that are not proportionate to their own aims.<sup>32</sup>

Although, in principle, the brain drain phenomenon only pertains to highly-skilled individuals of working age, the outbound flow of pensioners – indeed, a ‘drain’, and hence a parallel with the brain drain phenomenon may be established – is also a source of concern for governments and policy makers, in so far as it generates a loss of fiscal revenues for the country of origin and a corresponding gain for the country of arrival, a circumstance that induces countries to tightly compete in offering those individuals the most favourable tax and non-tax conditions (in general, with regard to the fiscal effects of migration by an individual from one country to another, see Beretta 2019a; Betten 1998).

Furthermore, even from a purely intra-country perspective, emigration of pensioners undermines the effectiveness of deferred taxation of pension income and leads those countries to shift the fiscal burden on the young, thus impairing intergenerational fairness (see Redonda *et al.* 2019; Xu 2015, 75–77). Given that private pensions are among the most significant financial assets currently held in the household sector, the importance of pensions as a source of revenue for countries is quite obvious and, indeed, it is expected to also remain significant in the near future (see Gardiner 2016, 33–39).

The background of this discourse is that pay-as-you-go (PAYG) regimes, in the form of compulsory contributions, are still a relevant part of pension regimes, in many countries, as well as in most EU Member States, the most common among those schemes being the EET system (Exemption for the individual contributions, Exemption of the savings and capital market returns accumulated in the pension fund, and Taxation upon disbursement of pension wealth once an individual retires).<sup>33</sup> Under

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<sup>32</sup> Indeed, the Commission issued a communication on the elimination of tax obstacles to cross-border provision of occupational pensions in 2001, followed by an update in 2003, and launched several infringement proceedings against a number of Member States in the subsequent years (see European Commission 2001a; European Commission 2001b; European Commission 2003). Among the infringement proceeding launched by the Commission over the years, it is worth pointing out the case against Denmark, which resulted in a decision rendered against that Member State by the Court of Justice of the European Union in 2007 (CJEU, case C-150/04, *Commission of the European Communities v. Kingdom of Denmark*, ECLI:EU:C:2007:69). The lack of pension portability and double taxation of cross-border pension have long been identified as a significant obstacle to cross-border movements and a factor of lost income for EU citizens (for a discussion, see Williams 2001; Gutmann 2001). More recently, a regulation on a pan-European Personal Pension Product (PEPP) was passed by the European Parliament in 2019 (see European Parliament 2019).

<sup>33</sup> There are indeed various types of old-age pensions and all are generally underpinned by three tiers of retirement income, i.e. public, occupational and private, whose quantitative significance however varies markedly across countries as well as

such scheme, pensions become taxable for the first time when benefits start being paid out. Alternatives to the EET system are the ETT system (Exempt contributions, Taxed investment income and capital gains of the pension fund, Taxed benefits) and the TEE system (Taxed contributions, Exempt investment income and capital gains of the pension fund, Exempt benefits), although other combinations are also possible.<sup>34</sup>

While in a closed economy setting the aforementioned pension taxation regime works quite smoothly, the migration of a retired person from one country to another instead creates havoc in such a scheme, in so far as the emigrating person pays no taxes in the country of origin, despite the employment activity and the income thereof to which pension contributions can be traced having generally been made in that country (see Starink 2016, 6–13).

As such, the cross-border aspects of private pensions is characterized primarily by a potential conflict between two distinct elements: (1) the ability of an individual to accrue a pension without impediments during the contribution and accumulation phases, regardless of where one person works or lives, and (2) the tax claim by the country of origin over payments made from pensions accrued under favourable tax provisions upon disbursement (see Kavelaars 2007).

The quasi-contractual argument that lies behind such a claim is evident: the emigrating pensioner has received a tax benefit from his country of origin and, therefore, has a duty – a moral one, at least – to pay it back to the country from which he departs (see Brokelind, Axmin 2017, 261). As a matter of fact, the flow of pensioners and, accordingly, of pension income between two countries could very well not be reciprocal and, in some cases, may represent a relatively substantial net outflow for the country of origin of these elderly migrants (see Staats 2015).

Indeed, this quasi-contractual argument gains further traction if the pension income goes untaxed not only in the country of origin but also in the country of arrival, effectively achieving international double non-taxation. Notably, this situation occurs where the emigrating pensioner

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between individuals within a country. Notably, in order to render their pension systems more sustainable over time, countries generally motivate employers and employees to support occupational and private retirements savings with various forms of tax preferences or direct subsidies. For an overview of the current and prospective pension systems at the international level, see OECD 2017a.

<sup>34</sup> According to Dilnot, Johnson (1993, 2), ‘three main transactions constitute most private pension schemes and it is these transactions which are the possible occasions for taxation: (1) contributions into the scheme, from employer or employee, (2) income derived from the investment of contributions, and (3) payment of retirement benefits from the accumulated fund’. For a discussion of the various pension taxation regimes in the EU, see Brokelind 2014, which concludes that ‘cross-border workers may have a lot to lose compared to non-migrant workers, just because of a lack of simplicity in mixing the systems’.

moves from an EET country to a TEE country, in so far as the differences between the pension taxation regimes that are in place in the two countries in question ultimately lead to double non-taxation of the particular income.<sup>35</sup> Indeed, double non-taxation of pensions may also occur if a tax treaty is in place between the country of origin and the country of arrival and such a treaty follows the OECD Model, but the latter country provides for an exemption or simply does not actually tax the relevant pension income (see Beretta 2019b). This situation can be best understood by reviewing the current regime for taxation of pension income under double tax treaties, which is done in the next section.

## 5. TAXATION OF PENSION INCOME UNDER TAX TREATIES

Under the current version of the OECD Model Convention on Income and on Capital (2017), pension income from past private employment is addressed in Article 18. This article provides for a single – for some, indeed, ‘deceptively simple’ (see Brown 2019, para. 1.1.1.)<sup>36</sup> – taxation rule, stipulating that pension and similar remuneration, paid in consideration of past private employment, are taxable only in the state of the individual recipient.<sup>37</sup>

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<sup>35</sup> Notably, double taxation and non-taxation as a result of an individual moving across state borders were dealt with at a seminar during the 2008 IFA Congress in Brussels (see De Broe, Neyt 2009). For an analysis of similar issues in the EU, see European Commission 2016.

<sup>36</sup> Notably, according to Brown (2019, para. 1.1.1.), such ‘deceptively simplicity’ is related to the fact that Article 18 of the OECD Model ‘provides no definition and, of course, no source rule. In fact, unlike most of the other distributive rules in tax treaties, the provision is not limited to pensions that arise in one state and are paid to a resident of the other state’. Lacking a tax treaty definition, pursuant to Article 3 (2) of the OECD Model, the term ‘pension’ must be interpreted in accordance with the domestic law of the jurisdiction imposing the tax, unless the context requires differently. Furthermore, as long as the OECD Model does not include a specific provision regarding social security benefits or annuities, it might be doubtful whether, in a concrete situation, those items of income fall under Article 18 or not (see, most recently: CJEU, case C-372/18, *Ministre de l’Action et des Comptes publics v. Mr and Mrs Raymond Dreyer*, ECLI:EU:C:2019:206, concerning the actual characterization of contributions paid by an individual resident in France to a Swiss social security scheme). Moreover, since Article 18 of the OECD Model provides for no taxation by the source state, it also does not contain any source rule. Accordingly, the allocation rule contained in Article 18 is not limited geographically, which means that all payments that fall within the definitional scope of Article 18 are governed by such rule, without any regard to where those payments actually ‘arise’.

<sup>37</sup> Article 18 of the UN Model indeed contains two alternative provisions, i.e. (A) and (B), for taxation of pension income from past private employment. Notably, these two alternatives reflect very distant tax policies. The first alternative (A) includes a general rule that follows the corresponding OECD Model provision. The second alternative (B), instead, ensures taxation by the state of residence of the recipient and the state of which



As an allocation rule, Article 18 closely follows the residence principle. The taxing rights of the source state are therefore completely disregarded. On the other hand, pursuant to Article 19 (2) of the OECD Model, pension income from past government employment is taxable only in the source country, which is identified as the country where the government services were in fact rendered.<sup>38</sup> Importantly, the OECD Model and double tax treaties in general focus only on the actual disbursement of pension income, disregarding the contribution and accumulation phases.

Historically, taxing rights over private pension income shifted from the source country to the residence country at time of the drafting of the 1946 London Model, under the sponsorship of the League of Nations.<sup>39</sup> The main reason for the overhaul is related to the fact that the same shift occurred for taxation of income from movable capital and that private pensions were ultimately regarded as just a form of income from capital.<sup>40</sup> The new allocation of taxing rights among the source and residence countries indeed gained further confirmation in all subsequent updates of the OECD Model<sup>41</sup> and, eventually, the rule was upheld by ensuing discussions which took place inside the various Working Party Committees through the years.<sup>42</sup>

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the payer is a resident. It is worth noting that both alternatives provide for exclusive taxation of social security payments by the source state.

<sup>38</sup> Blank, Ismer (2015, 252–253) indeed suggest bluntly deleting this provision from the OECD Model, in so far as they argue that ‘the paying state principle’, on which this provision is based, creates a lot of complexities as well as opportunities for tax arbitrage and that, furthermore, a great deal of simplification could be achieved by providing a single rule that applies to all pensions, from both private and government past employment. Along the same lines, see Lang (2007).

<sup>39</sup> Although it is not entirely clear what was the reason taxing rights over private pension income were allocated to the source state instead of the residence state prior to 1946, it should be noted that the 1927 League of Nations Draft Convention also proposed to extend the treatment that had applied only to public pensions – i.e. taxation by the state from which payment was made – to also include private pensions. The Commentaries to Article 8 of the 1927 Draft Convention (League of Nations 1927, 16 [4130]), in fact, explained this decision by stating that ‘it appeared both right and practical that all pensions should be made subject to the same rules’. As it happened, the treatment of private pensions provided under the 1927 Draft Convention had little effect on the drafting of actual tax treaties between countries (see Brown 2019, para. 1.2.1.1.).

<sup>40</sup> See League of Nations (1946, 28 [4348]) reasoning that ‘[i]n the London Draft, private pensions and life annuities are made taxable in the country of fiscal domicile of the creditor, as in the case of interest from debts’. For a discussion, see Starink (2016, 8).

<sup>41</sup> As recalled by Brown (2019, para. 1.2.2.), in truth, the United Kingdom made an attempt to add a subject-to-tax test to the provision that would have been then included in the 1963 OECD Draft, but it only gained the support of the United States.

<sup>42</sup> See OECD (1973, 6) pointing out that ‘the article as it stands does not seem to have given rise to difficulties’.

Despite, as a rule, exclusive source-based taxation displays a number of strengths,<sup>43</sup> four broad justifications are usually found for providing exclusive residence-based taxation of pension income from past private employment. Notably, those reasons relate to:

(1) the ability-to-pay principle, as its concrete assessment depends on the worldwide income of the individual taxpayer and it is assumed that personal and family circumstances of the pensioner are better evaluated by the residence state, which, therefore, is also able to ensure personal income taxation of the individual taxpayer on a net basis.<sup>44</sup> On the other hand, taxation of pensions at source is likely to result in excessive taxation, especially if the source state imposes a final withholding tax on the gross amount of pension payments;<sup>45</sup>

(2) the need to fund expenses associated with an aging population, especially for health, pension and care services available to pensioners, whose costs are to be borne by the residence state (see Kavelaars 2007; Blum 1999, 656–657);<sup>46</sup>

(3) easiness of tax administration by the competent authorities, as long as significant hurdles might arise in the case of individuals who have worked in more than one state, changed residence during their career, or

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<sup>43</sup> Notably, the main advantage of exclusive source-based taxation is related to the existence of a clear causal link between pension and private employment income, which implies that it is reasonable to tax pensions, as a manifestation of income subject to a suspensive condition, in the very same country where employment income is also taxed. See UN Model Tax Commentary on Article 18 (2017), para. 11. Noteworthy, exclusive source-based taxation is provided under the multilateral Nordic Convention. See Denmark-Faroe Islands-Finland-Iceland-Norway-Sweden Income and Capital Tax Convention (Nordic Convention) (1996) (as amended through 2008), Art. 18 (1).

<sup>44</sup> OECD Model Commentary on Article 18 (2017), para. 17. The Commentaries on Article 18 were amended in the 2005 Update of the OECD Model, following discussions among representatives of Member States at the OECD level (see OECD, 2003). Notably, similar considerations can be found also in the case-law of the CJEU (see e.g. CJEU, case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, ECLI:EU:C:1995:31, para. 32).

<sup>45</sup> It should be noted, however, that in *Hirvonen* (CJEU, case C-632/13, *Skatteverket v. Hilikka Hirvonen*, ECLI:EU:C:2015:765, para. 49) the CJEU ruled that the refusal by the source state to grant non-resident taxpayers, who obtain the majority of their income from the source state and who have opted for the taxation at source regime, the same personal deductions as those granted to resident taxpayers under the ordinary taxation regime, does not constitute, by itself, a discrimination contrary to EU law, in particular where the non-resident taxpayers are not subject to an overall tax burden greater than that placed on resident taxpayers.

<sup>46</sup> In this connection, Kemmeren (2001, 32) draws a distinction between the production of income and its consumption, arguing that payment of consumption taxes provide sufficient compensation for the public services offered to emigrated taxpayers in the new country of residence. This argument, however, is rejected by other scholars (see, especially, Starink 2016, 12).

derived pensions from funds established in a state other than the one in which they worked;<sup>47</sup>

(4) simplification of tax compliance obligations for individual taxpayers, since exclusive residence-based taxation enables emigrated individuals to deal with income tax rules and tax authorities of only one country.<sup>48</sup>

Although exclusive residence-based taxation, as the relevant taxing rule, is mandated by Article 18 of the OECD Model and, as seen, a series of justifications for its adoption can be found, actual tax treaty practice shows that allocating taxing rights to the source state is equally possible.

Notably, a study conducted by the IBFD in 2014 (see Wijnen, de Goede 2014) highlighted that, up until 2013, out of 1,811 tax treaties included in the survey, seven tax treaties concluded between two OECD countries provided for exclusive source-based taxation, whereas 25 of them allocated non-exclusive taxing rights to the source state, limited to a certain percentage, ranging between 10% and 25%. As for tax treaties concluded between an OECD and UN country, 44 tax treaties provided for exclusive source-based taxation, whereas 31 of them allocated non-exclusive taxing rights to the source state, limited to a certain percentage, ranging between 10% and 25%.

The tendency to attribute at least some private pension income taxing rights to the source state is indeed growing, in particular among pension-exporting nations like the northern countries in the EU. Denmark, for instance, terminated its tax treaties with France and Spain in 2009, after repetitive failures to negotiate some form of source-based taxation of private pension income with those countries.<sup>49</sup>

Along the same lines, recent tax treaties concluded between the Netherlands, on the one hand, and respectively, Ireland and Germany, on the other, the latter of which came into effect in 2016 (in contrast, the Dutch-Irish income tax treaty is not yet in force), provide for source state taxation of private pensions exceeding, respectively, EUR 25,000 and EUR 15,000 per annum.<sup>50</sup>

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<sup>47</sup> OECD Model Commentary on Article 18 (2017), paras. 19–19.2.

<sup>48</sup> OECD Model Commentary on Article 18 (2017), para. 20.

<sup>49</sup> Notably, the income tax treaties with Spain and France were terminated by Denmark, effective 1 January 2009. See Dyppele 2011, reporting that ‘from a Danish perspective, it is crucial that future treaties contain provisions resulting in a more balanced allocation of rights to tax pension income ... As neither France nor Spain seems to show consideration for the Danish taxation of pensions as a whole and conclude a new treaty with a provision in line with this view, the Minister does not expect new treaties to be entered into in the near future’.

<sup>50</sup> Ireland-Netherlands Income and Capital Tax Treaty (signed on 13 June 2019, not yet in force), Art. 17 (2); Germany-Netherlands Income Tax Treaty (1 Jan. 2016), Art. 17 (2).

Exclusive residence-based taxation, compounded with the adoption of an EET taxation system of private pensions by most countries, ultimately leads to a ‘fairness dilemma’. On the one hand, by bilaterally agreeing to such a regime, the country of origin in fact forgoes all its potential fiscal revenues. On the other hand, the emigrating pensioner is effectively double-taxed if the country of origin tries to close the tax income gap by, for instance, taxing pension contributions, whereas the country of arrival, following the treaty, also taxes the pension benefits upon receipt by the individual (see Genser, Holzmann 2016, 10–15). Indeed, in the EU, this situation is further complicated by the encroachment of the freedom of movement across different Member States to which all EU citizens – including ‘economically inactive’ ones such as pensioners – are entitled.<sup>51</sup>

Nevertheless, as a result of the growing willingness and capacity of pensioners to move across country borders, maintaining an exclusive residence-based taxation for income from private pensions in double tax treaties has become increasingly problematic.<sup>52</sup> Indeed, if, at time when exclusive residence-based taxation was conceived, the amounts of pensions paid cross-border were relatively small in relation to other types of cross-border payments such as dividends, interest and royalties, so that the costs for the source state of giving up its own taxing rights were not seen that great, this is no longer the case in the current political, social and economic landscape (see Brown 2019, para. 1.1.1).

To add to this problem, in a few cases the residence state provides for a blunt exemption or simply does not tax the relevant pension income.<sup>53</sup> This situation occurs in Portugal, which has a special tax

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<sup>51</sup> Indeed, as clarified by the CJEU, first, in *Pusa* (CJEU, case C-224/02, Heikki Antero Pusa v. Osuuspankkien Keskinäinen Vakuutusyhtiö, ECLI:EU:C:2004:273, para. 18) and then in *Turpeinen* (CJEU, case C-520/04, Pirkko Marjatta Turpeinen, ECLI:EU:C:2006:703, paras. 13–23), the exercising of an economic activity is no longer a requirement for an emigrant to have treaty standing, as the combination of Union citizenship and the right of residence avails the ‘economically inactive’ citizen of a right to national treatment in the state of destination and of a right of non-restriction in the state of origin. See also CJEU, case C-300/15, Charles Kohll and Sylvie Kohll-Schlesser v. Directeur de l’administration des contributions directes, ECLI:EU:C:2016:361, para. 28.

<sup>52</sup> See OECD Model Commentary on Article 18 (2017), stipulating that ‘[t]he globalisation of the economy and the development of international communications and transportation have considerably increased the international mobility of individuals, both for work-related and personal reasons. This has significantly increased the importance of cross-border issues arising from the interaction of the different pension arrangements which exist in various States and which were primarily designed on the basis of purely domestic policy considerations. As these issues often affect large numbers of individuals, it is desirable to address them in tax conventions so as to remove obstacles to the international movement of persons, and employees in particular’. For a discussion of movements of pensioners across country borders inside the EU, see Del Sol, Rocca 2017.

<sup>53</sup> Granting an exemption to foreign-source pensions does not necessarily imply the complete forfeiture of fiscal revenues, in so far as a country may well expect an

regime providing for a 10-year exemption for foreign-source pension income.<sup>54</sup> Repeated failures to negotiate a new tax treatment for private pensions by Finland with the Portuguese tax authorities led the Scandinavian state to terminate the income tax treaty with Portugal as from 1 January 2019 (see Ambagtsheer-Pakarinen 2018).

Indeed, the number of variations on and deviations from any of the standard models, or even the alternatives included in the Commentaries to the OECD and UN Models, as well as the circumstance that countries are normally prone to negotiate ‘bespoke’ provisions combining multiple provisions from the Commentaries on Article 18, or ignore them altogether, indicate the existence of scope for reforming the current tax treatment of pension income under double tax treaties (see Brown 2019, para. 1.1.1).

## 6. A BLUEPRINT FOR INDIVIDUAL TAX REFORM

### 6.1. Rethinking individual taxation for the 21<sup>st</sup> century challenges

There are indeed good reasons to believe that international wars and battles for human capital will intensify in the next few decades. Fast-paced automation combined with the increasing specialization of developed countries in human capital-intensive activities are, in fact, expected to spur the general demand for labour by highly-skilled individuals and, thus, also the extent of the brain drain phenomenon. Also, population ageing along with the growing willingness and capability of pensioners to move across borders are predicted to impose tight budget constraints and, thus, put additional pressure on the Welfare State of most developed countries. Ultimately, the aforementioned two phenomena might be in correlation, in so far as challenges related to an ageing population spur the general demand for workers, especially highly-skilled individuals, from abroad.

Uncontrolled flows of people across borders, being either highly-skilled or elderly individuals, could well increase the extent of strategic tax competition among countries, thus draining the brain and fiscal resources of many nations (see Dagan 2018, 59; Rixen 2011, 449). This

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increase in collected revenues through indirect taxation. This is indeed the case of Portugal which, reportedly, experienced a sharp increase of new residents in the last years, largely due to its preferential tax regime for foreign-source pensions (see Wise 2019). As stated, Kemmeren (2001, 32) takes the view that payment of consumption taxes by the emigrated individual in the country of arrival offers sufficient compensation for the public services provided by that country to those individual.

<sup>54</sup> Código do Imposto sobre o Rendimento das Pessoas Singulares (CIRPS) [Portuguese Individual Income Tax Code], Arts. 16 (8–12), 72 (6) and 81 (4–6). For a discussion of the Portuguese special tax regime, see Cassiano Neves 2010.

is even truer inside the EU, given the freedom of movement that workers and Union citizens are entitled to under EU law. As a result of such cross-border movements, wealth gaps between those who leave and those who remain – the former not necessarily being the younger, the latter not necessarily being the older – are also likely to widen.

Against this background, the author submits that a coordination strategy to address the current disarray existing in the realm of individual taxation at the international level is highly desirable and that the allocation rules as provided under current double tax treaties, not only for corporate but also for individual taxpayers, should be duly reconsidered.<sup>55</sup> Accordingly, in the following, various policies and measures that might constitute a blueprint for individual tax reform are analysed and their respective pros and cons are in turn evaluated. Importantly, the ensuing discussion mostly focuses on Article 18 of the OECD Model and taxation of cross-border pension income from past private employment, the author arguing that such an examination might offer valuable suggestions for rethinking individual taxation on a more general scale. Also worth noting is that the following sections only deal with how the taxing rights between the source and the residence state, i.e. the country of origin and the country of arrival in case of migration of an individual from one country to another, could be allocated, without further discussing how the proceeds resulting from such allocation should be used by the countries concerned. As a further word of caution, given that each of the proposed policies and measures warrants an article of its own, only the main elements and arguments of each are hereinafter delineated.

## 6.2. Extended residence-based taxation

A first measure to address the current challenges encountered in the field of individual taxation may consist in granting taxing rights to the country of origin of the emigrants, being either highly-skilled or elderly individuals, over income received by those persons while abroad.<sup>56</sup> Notably, the possible strategies that the country of origin may implement in order to protect its own tax base against tax-induced migration of individuals can essentially be divided into three broad categories: (1) exit taxes, (2) extended tax liabilities, and (3) recaptures of previously enjoyed benefits, deductions or deferrals (see De Broe 2002, 23).

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<sup>55</sup> For a thoughtful examination and some reconsideration of allocation rules for employment income under tax treaties, in particular with regard to Article 15 of the OECD and UN Models, see Kostić 2019b.

<sup>56</sup> As a matter of international law (see Norr 1961, 432), countries are free to assert jurisdiction over the worldwide income of an individual abroad, provided that a ‘minimum connection’ or ‘nexus’ exists between the country and the individual or the income concerned.

‘Exit taxes’ or ‘departure taxes’ can be summarily described as taxes that the country of origin levies upon a person when they cease to be its resident. It is worth nothing that becoming a resident of the other Contracting State under a tax treaty’s tie-breaker rule is, in most circumstances, equated to an expatriation. The primary purpose of an exit tax is to ensure that, following the change of residence by a taxpayer, the income accrued while that person was a resident does not escape taxation altogether because of the excluded or limited taxing rights permitted to the source state (i.e. the country of arrival) under its domestic law or by virtue of tax treaty obligations.

As regards their theoretical design, two main types of exit taxes can be distinguished: namely ‘general’ and ‘limited’ exit taxes. General exit taxes are fiscal liabilities imposed on all accrued-but-not-yet-realized income (e.g. capital gains) of the emigrated individual. Limited exit taxes are instead imposed on accrued-but-not-yet-realized items of income from certain types of property, such as income from the alienation of a substantial shareholding.

Exit taxes are quite problematic. By imposing an exit tax, a state might in fact be found in breach of its tax treaty obligations. Indeed, an exit tax in regard to pension rights imposed by the Netherlands was found inconsistent with its tax treaty obligations, which, pursuant to Article 18 of the OECD Model, attributed taxing rights on pension income exclusively to the state of residence of the individual recipient.<sup>57</sup> Exit taxes might also be troublesome in relation to obligations deriving from EU law, in so far as those measures amount to illegitimate restrictions on one or more of the four freedoms (for an introduction to this topic, see Helminen 2019, Chapter 2). Since they are immediately charged to the emigrated individual, exit taxes also present complications in cases of temporary migrations, i.e. where an individual moves from one country to another and remains therein only for a few years, to the extent that the individual taxpayer, once returned, is not able to recover the tax paid to the country of origin upon emigration.<sup>58</sup>

The second type of defensive measures is related to ‘extended’ tax liabilities or ‘trailing’ taxes. These are taxes that are levied on income that is not otherwise subject to the country of origin’s source rules, accrued to an individual within a given period following his change of residence

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<sup>57</sup> See: Hoge Raad, BNB 2009/263, 19 June 2009. However, in a more recent decision (see Hoge Raad, BNB 17/186, 14 July 2017), the Dutch Supreme Court held to be compliant with the country’s treaty obligations the law enacted by the Dutch government in response to the 2009 Supreme Court decision, prescribing a ‘conservatory assessment’ limited to the tax-exempt pension contributions accrued to an individual until emigration. For a comment, see Pötgens, Kool (2018).

<sup>58</sup> See Helminen (2002, 234), submitting that ‘a mere temporary emigration of a Finnish national should not trigger limited tax liability in Finland. Only emigration, which may be regarded as final, should trigger limited tax liability’.

(generally, five to 10 years).<sup>59</sup> Following the imposition of a trailing tax, based on an idiosyncratic definition of residence (see Oldman, Pomp 1979, 31), the emigrated individual remains liable for tax on their worldwide income in the country of origin, both on income derived from assets owned at the time of departure and on income accrued to them thereafter. In contrast to an exit tax, a trailing tax is not assessed at the time of the transfer of residence, but only subsequently, i.e. when the individual actually receives the income thereof.

Indeed, the scholarly proposal to change the order of the tie-breaker rules for individual residence purposes currently used in the OECD Model, by primarily assigning residence to the country where the individual taxpayer has their ‘centre of vital interests’ rather than ‘a permanent home available to him’, as is presently the case, can be seen as a sort of extended tax liability or trailing tax also (see Brauner 2010, 250). Further, the use, by a country, of citizenship as the main personal connecting factor for income tax purposes, to the extent that by doing so such country succeeds in taxing its expatriated citizens, leads to the same effects.<sup>60</sup> Ultimately, citizenship may also be used, even if not as the main personal connecting factor, in the context of extended liability provisions, by countries having a residence-based tax system (this is the case of Finland, Hungary and Sweden).<sup>61</sup> While these kinds of constraints to tax-driven expatriation are usually unilateral, nothing prevents a specific provision allowing citizenship-based taxation to be inserted in a double tax treaty. France has followed this route in its double tax treaties with Andorra and Monaco.<sup>62</sup>

<sup>59</sup> Notably, a Dutch ten-years trailing tax, although in the field of inheritance tax, was at stake in *van Hilten* (CJEU, case C-513/03, Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen, ECLI:EU:C:2006:131).

<sup>60</sup> However, it should be noted that at the present, the United States is one of the few countries that still uses citizenship as the main personal connecting factor (for an overview, see Holm 2014). The only other country that uses citizenship as the main personal connection factor, Eritrea, was in fact condemned by both the UN and the EU for the practice of imposing a 2% levy, named ‘Diaspora Tax’ or ‘Recovery and Rehabilitation Tax’, on its citizens permanently living abroad. See: United Nations, Resolution 2023, UN Doc. S/RES/2023, 5 December 2011; European Parliament, Resolution on the Situation in Eritrea, 2016/2568(RSP), 10 March 2016. Past practices by other states (most notably, Mexico and Philippines) to levy income tax based on citizenship were, indeed, largely unsuccessful, mainly due to the difficulties encountered by those countries in enforcing tax obligations on their expatriated citizens (see Pomp 2015).

<sup>61</sup> *Tuloverolaki* 1992 [Finnish Income Tax Act], Sec. 11; *Inkomstskattelag* 1999 [Swedish Income Tax Act], Sec. 7; *Személyi jövedelemadóról szóló 1995. évi CXVII. törvény* 1995 [Hungarian Law on Individual Income Tax], Sec. 3 (2) (a).

<sup>62</sup> France-Monaco Income Tax Treaty (18 May 1963), Art. 7; Andorra-France Income Tax Treaty (2 April 2013), Art. 25 (1) (d). For a discussion of the provisions contained in these two treaties, see Kallergis (2015).



As a potential alternative or in addition to the aforementioned measures, the country of origin may decide to recapture or ‘claw-back’ benefits, deductions or deferrals previously granted to an individual upon emigration. In this way, the country of origin essentially aims to safeguard its latent taxing rights over an emigrant’s income.<sup>63</sup> However, claw-back provisions imposed on income such as pensions are highly problematic, in so far as those measures frequently generate a liquidity shortage for the emigrated individual, who might not have readily or entirely available cash needed to pay the tax assessment concerned. Arguably, such kinds of income recaptures should therefore at least contemplate payment in instalments. Notably, with respect to pension income, a proportionate method of tax remittance might take the form of a withholding on monthly pension payments.<sup>64</sup>

Whether any of the measures discussed above is included in a blueprint for a given tax reform, the establishment of some procedural rules would also be needed. In particular, it would be useful to provide for an effective exchange of information and adequate tax collection mechanism between countries. While imposing a tax on its emigrated individuals, a country is in fact confronted with two kinds of hurdles. First, it must obtain accurate information about the emigrated individual’s income in order to assess their tax liabilities and, second, it must collect the amount of tax owed.<sup>65</sup> Indeed, an exchange of tax information can also be useful for the country of arrival, as long as a specific obligation is imposed upon such country to take into account the tax charged by the other state while levying its own taxes on the individual taxpayer.<sup>66</sup>

### 6.3. Subject-to-tax rule(s)

As it is known, under international tax law states are under no obligation to prevent either double taxation or non-taxation, unless specific provisions to that effect are inserted in a double tax treaty. Subject-to-tax rules fulfil precisely this function, by ensuring that income

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<sup>63</sup> In a sense, previously enjoyed deductions represent a sort of ‘tax loan’, which must be recouped at a later date. See: Opinion of Advocate General Stix-Hackl, case C-150/04, *Commission of the European Communities v. Kingdom of Denmark*, ECLI:EU:C:2006:357, para. 68.

<sup>64</sup> Interestingly, in their proposal for a ‘brain drain tax’, Bhagwati, Dellalfar (1973, 96) suggested the tax be collected for 10 years following migration or, preferably, through lifetime payments.

<sup>65</sup> Those kinds of procedural rules are set forth, respectively, in Articles 26 and 27 of the OECD and UN Models.

<sup>66</sup> Noteworthy, such an obligation exists in the EU for exit taxes levied on emigrated corporate taxpayers after the first Anti-Tax Avoidance Directive (ATAD) entered into force in July 2016. See: Council Directive (EU) 2016/1164 of 12 July 2016 laying down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, Art. 5 (5), OJ L 193/1 of 19/6/2016.

is taxed at least by one of the two Contracting States (see Rust 2015, 1624 paras. 34). Seen from this perspective, subject-to-tax rules provide a concrete example of how the single tax principle, i.e. the principle stipulating that the same income is to be taxed once and only once, can act as a coordination mechanism to turn the international tax regime into a more comprehensive one.<sup>67</sup>

The idea underlying subject-to-tax rules is anything but new (for a discussion, see Burgstaller, Schilcher 2004; Lampe 1999). Although not generally recommending that states include subject-to-tax rules in their double tax treaties,<sup>68</sup> the Commentaries to the OECD and UN Models in fact mention time and again the possibility for countries of bilaterally agreeing on a rule according to which the tax relief to be granted by one Contracting State is contingent upon the income being subject to tax in the other Contracting State.<sup>69</sup> It is worth noting that a subject-to-tax rule is also included in the Global anti-Base Erosion (GloBE) proposal unveiled by the OECD in early 2019, which essentially aims to ensure that internationally operating businesses pay a minimum level or ‘fair share’ of taxes (see OECD/G20 2019b; OECD/G20 2019a).

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<sup>67</sup> For a theoretical concept of the single tax principle as a cornerstone of the international tax regime, see Avi-Yonah (2007, 8–10). Gil García (2019) argues that ‘single taxation is not pursued by tax treaties but is, rather, a consequence when specific provisions are implemented’, such as subject-to-tax rules, whereas Shaviro (2015, 6) points out that the single tax principle can be seen as ‘an often useful coordinating device’.

<sup>68</sup> Until 2014, the Commentaries to Article 1 on the OECD Model in fact stipulated that ‘[g]eneral subject-to-tax provisions provide that treaty benefits in the State of source are granted only if the income in question is subject to tax in the State of residence. This corresponds basically to the aim of tax treaties, namely, to avoid double taxation. For a number of reasons, however, the Model Convention does not recommend such a general provision’. OECD Model Tax Convention Commentary on Article 1 (2014), para. 15. The quoted passages were deleted during the 2017 Update of the OECD Model (see OECD 2017b, 47). It is also worth recalling that the BEPS Action 6 Final Report proposed to add new provisions to Article 11 (Interest), Article 12 (Royalties) and Article 21 (Other Income) of the OECD Model, stipulating that interest, royalties or other income arising in a Contracting State and beneficially owned by a resident of the other Contracting State ‘may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident is subject to a special tax regime’ (see OECD/G20 2015, 98). The provisions in question would essentially allow taxation by the source country when there is a preferential tax regime in the residence state and this is defined in the relevant tax treaty. However, the proposed new provisions were not included in any of the aforementioned articles during the 2017 Update of the OECD Model.

<sup>69</sup> See e.g. OECD Model Tax Convention Commentary on Article 13 (2017), para. 21, stipulating that ‘[a]s capital gains are not taxed by all States, it may be considered reasonable to avoid only actual double taxation of capital gains. Therefore, Contracting States are free to supplement their bilateral convention in such a way that a State has to forego its right to tax conferred on it by the domestic laws only if the other State on which the right to tax is conferred by the Convention makes use thereof’. See also UN Model Tax Convention Commentary on Article 13 (2017), para. 4.

The forms and wordings of subject-to-tax rules contained in the various double tax treaties concluded by countries are indeed manifold. According to relevant literature, one criterion for categorizing such rules is whether the subject-to-tax rule only applies to a certain item of income – thus, resulting in a ‘specific’ subject-to-tax rule – or whether it applies to all categories of income covered by a double tax treaty – thus, resulting in a ‘general’ subject-to-tax rule (see Burgstaller, Schilcher 2004).

A specific subject-to-tax rule is envisaged in the Commentaries to Article 18 of the OECD Model (reproduced in the Commentaries to Article 18 of the UN Model), allowing source taxation of pension payments where the residence state does not subject to tax these payments ‘under the ordinary rules of its tax law’.<sup>70</sup> The adoption of a general subject-to-tax rule by EU Member States in their double tax treaties was instead proposed by the European Commission in its 2012 Recommendation on Aggressive Tax Planning.<sup>71</sup> Moreover, a general subject-to-tax rule is laid down in Article 26 (2) of the multilateral Nordic Convention.<sup>72</sup> A mechanism ultimately resulting in a similar effect to that of a general subject-to-tax rule – commonly called a ‘switch-over clause’<sup>73</sup> – is also envisaged in paragraph 4 of Article 23 (A) of the OECD Model and is related to the exemption method used by the residence state, which is prevented from exempting items of income from tax whether those incomes have not been taxed in the source state.<sup>74</sup>

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<sup>70</sup> OECD Model Tax Convention Commentary on Article 18 (2017), para. 15. Notably, the subject-to-tax rule on pension income was added to the OECD Commentaries following the 2003 Discussion Draft on Tax Treaty Issues Arising from Cross-Border Pensions (see OECD 2003, 6).

<sup>71</sup> See European Commission 2012b. Dourado (2015, 50–51) submits that ‘in the current EU context of tax competition and lack of will to harmonize, it is very unlikely that EU Member States would adopt such a subject-to-tax clause, especially regarding intended gaps, aimed at promoting investment abroad or investment in developing countries. Moreover, EU Member States may also be resistant to adopting a general subject-to-tax clause geographically limited to the EU territory. Taking into account free movement of capital, subject-to-tax clauses should ideally be adopted universally or at least in the OECD context, in order to avoid diversion of investment to those States that do not adopt those rules’. Remarkably, thus far, all these predictions have been fulfilled. For a critical analysis of the subject-to-tax rule recommended by the European Commission in 2012, see Marchgraber 2014.

<sup>72</sup> Convention between the Nordic Countries for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital (23 September 1996, as amended through 2018), Art. 26 (2).

<sup>73</sup> See e.g. van Horzen, De Groot (2018), discussing the switch-over clauses included in the EU anti-BEPS rules.

<sup>74</sup> See also OECD Model Tax Convention Commentary on Article 18 (2017), para. 35. By contrast, Rust (2015, 1655 para. 102) considers that the relevant provision ‘does not constitute a subject-to-tax clause’.

In actual tax treaty practice, general subject-to-tax rules can be found in several bilateral treaties, such as those signed by Italy with France and Germany or by Austria with Malta and the United Kingdom.<sup>75</sup> Specific subject-to-tax rules concerning pension income from past private employment can also be found in many double tax treaties, for instance those between Cyprus and Switzerland, Denmark and the United Kingdom, Estonia and Serbia, or France and Switzerland.<sup>76</sup>

Although, as stated, subject-to-tax rules are nothing new under the sun and, indeed, can be found in various double tax treaties, no internationally agreed standard has evolved yet. A blueprint for individual tax reform including such measures could thus offer a valuable framework for harmonizing their interpretation and application. It is worth noting that subject-to-tax rules might be particularly useful to address in situations where pension income from past private employment is not taxed in the resident state of the emigrated retiree due to the operation of a preferential tax regime.<sup>77</sup>

However, it should be noted that a subject-to-tax rule, by itself, is not able to tackle situations in which pension income is actually taxed by the residence state, but a preferential tax rate applies.<sup>78</sup> In fact, even the exact meaning of the term ‘subject-to-tax’ is far from clear and, thus, the answer to this question is very much open to different interpretations, especially in borderline situations.<sup>79</sup> What if, for instance, no preferential regime exists for pension income in the residence state, but such country is a TEE state and therefore it simply does not levy any tax upon

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<sup>75</sup> 1989 Protocol of the France – Italy Income and Capital Tax Treaty (5 October 1989), Point 15; Protocol of the Germany – Italy Income and Capital Tax Treaty (18 Oct. 1989), Point 18 (b); Austria – United Kingdom Income Tax Treaty (30 April 1969, as amended through 2009), Art. 2 (2); Austria – Malta Income and Capital Tax Treaty (29 May 1978), Art. 2 (5).

<sup>76</sup> 2014 Protocol Cyprus – Switzerland Income and Capital Tax Treaty (25 July 2014), Point 4 (b); Denmark – United Kingdom Income Tax Treaty (11 November 1990, as amended through 1996), Art. 18 (1); Estonia – Serbia Income Tax Treaty (24 September 2009), Art. 18 (2); France – Switzerland Income and Capital Tax Treaty (9 September 1966, as amended through 2014), Art. 20 (2).

<sup>77</sup> As recalled in section 5 above, this is the case of foreign-source pensions in Portugal.

<sup>78</sup> For instance, as from 2019, Italy has introduced a special tax regime for incoming pensioners to which a 7% substitute tax of the income tax apply (see Beretta 2019b).

<sup>79</sup> See Lang (2004, 111), also noting that ‘in some languages, the term ‘subject to tax’ means the same as ‘liable to tax’, thus adding further confusion to the interpretation and application of the expression in question’. The general subject-to-tax rule included in the recommendation issued by the European Commission in 2012 was surprisingly short. It only stipulated that ‘an item of income should be considered to be subject to tax where it is treated as taxable by the jurisdiction concerned and is not exempt from tax, nor benefits from a full tax credit or zero-rate taxation’ (see European Commission 2012b).

disbursement of pension income? Or, even, what if the amount of pension income is below the minimum taxable amount in the residence state so that no actual tax liability arises? Or, further, what if a substitute tax rather than the statutory income tax applies to pension income, so that such levy might be excluded from the scope of a double tax treaty pursuant to Article 2 of the OECD Model?<sup>80</sup> Shall the subject-to-tax rule operate also in those situations? Moreover, in addition to the specific case of an emigrated pensioner, a subject-to-tax rule fails to entirely address the brain drain issue, since no financial compensation is provided to the country of origin of the highly-skilled emigrant if the income that he receives once in the country of arrival is subject to tax therein.

#### 6.4. Exclusive source-based taxation

One may imagine addressing the challenges arising in the field of individual taxation by means of changes to the relevant allocation rules currently provided under double tax treaties. Notably, with regard to pension income from past private employment, this would imply abandoning exclusive residence-based taxation in favour of exclusive source-based taxation.<sup>81</sup>

A proposal to that effect was recently advanced by Genser and Holzmann. Notably, the two authors implore for a coordinated shift from EET to TEE (or TTE) taxation of pension income, since they regard the latter taxation system of pension income better suited for a world of increasingly mobile individuals, than the EET, adopted by most countries (see Genser, Holzmann 2016, 16–23).<sup>82</sup> In their opinion, universal or widespread adoption of TEE (or TTE) taxation of pension income – in their word ‘front-load taxation’ instead of ‘back-loaded taxation’ – would prevent revenue losses for the country of origin when the individual taxpayer emigrates, as the income will have already been taxed at the time it was earned, and would also avoid double taxation, as the residence state would be required to exempt the income in question.<sup>83</sup> As an

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<sup>80</sup> As it might occur in the case of the substitute tax that applies to incoming pensioners in Italy as of 1 January 2019.

<sup>81</sup> A model provision to that effect is indeed included in the Commentaries to the OECD Model. See OECD Model Tax Convention Commentary on Article 18 (2017), para. 15. It is worth noting that exclusive source-based taxation is also provided under the multilateral Nordic Convention. See the Convention between the Nordic Countries for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital (23 September 1996, as amended through 2018), Art. 18 (1).

<sup>82</sup> See also Schindel, Atchabahian (2005, 40), noting that ‘from the point of view of inter-nation equity and efficiency, exclusive or predominant taxation at source is shaping up as the most reasonable basis of taxation’.

<sup>83</sup> A tax levied by the country of origin over the income of the emigrated individual also emerged from international discussion as the most feasible version of the Bhagwati brain drain tax (see Oldman, Pomp 1979, 246–247).

alternative, they also propose that pension taxation by the source state be deferred until the relevant income is effectively disbursed, so that the tax becomes due only at time of disbursement of the monthly pension benefits (see Genser, Holzmann 2016, 20–21).

The most important advantage of applying the TEE (or TTE) rather than the EET system is that cross-border movements of pensioners from one country to another no longer distort inter-country equity. Pension income is, in fact, taxed already at time when contributions to pension systems are not deductible from employment income in the country of origin, so that no recouping of income tax relief is required to restore equity between different jurisdictions once the individual taxpayer leaves their country of origin. A second advantage is related to the administration of the TEE (or TTE) system in contrast to the EET one, in so far as the former method requires no control of correct deductions for pension savings and since, if the TTE system is applied, old-age pension contributions and pension savings do not reduce the income tax base in the country where the relevant income is built up. The third advantage is related to the fact that, since old-age pension benefits to pensioners are tax-free, for the emigrated taxpayers filing income tax returns in the country of origin is not a requirement, even if pension income is received from several sources, possibly located in different countries. Accordingly, there is no need to establish any source rule either.<sup>84</sup>

Exclusive source-based taxation, however, will only work if countries universally adopt the TEE (or TTE) system. If this is not the case, bilateral tax treaty negotiations will be complicated furthermore by the fact that resident pensioners will receive pension benefits from different source countries, so situations may arise where a country that suffered a tax revenue loss from preferential treatment accorded during the contribution and accumulation phases of pension income, is not the source country paying out the pension income and, is therefore, not part of the negotiation process with the residence state. In fact, a consistent solution to this dilemma would require establishing some form of multilateral consent. In this regard, however, the claim made by Genser, Holzmann (2016, 24) that a pan-European decision to move from a EET to a TEE (or TTE) system of taxation of pension income would put pressure on non-European countries to replicate such an approach, so as to avoid revenue shortfalls and double taxation, does not seem sufficiently grounded.

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<sup>84</sup> There are indeed three different possible source rules for pensions, i.e. their source may be located: (1) where the fund paying pension income is established, (2) in the state in which employment services were rendered, or (3) in the state in which deductions in respect of the pension have been claimed. See OECD Model Tax Convention Commentary on Article 18 (2017), para. 19.1; UN Model Tax Convention Commentary on Article 18 (2017), para. 13.

It should also be taken into account that exclusive, rather than shared, taxing rights attributed to the source state are likely to bring additional pressure on national governments during tax treaty negotiations (see Starink 2016, 11).<sup>85</sup> A solution to this shortcoming might then be found in granting the source state shared – as opposed to exclusive – taxing rights with the residence state, regarding pension income. This practically implies limited source-based taxation, meaning that the source tax cannot exceed a specified rate, while the residence state is obliged to credit the tax levied by the source state, as similarly provided for dividends and interest, respectively, in Articles 10 and 11 of the OECD and UN Models. And yet, even this solution presents some hurdles, since limited source-based taxation might not actually be sufficient to fully compensate the country of origin for the fiscal revenues forgone as a consequence of the emigration of an individual taxpayer.<sup>86</sup>

### 6.5. Compensation tax

An alternative to the aforementioned measures may be to leave the current allocation rule (taxing rights over pension income vested solely to the residence state) unchanged, but to provide at least some fiscal compensation to the source state, which should be identified as the country from which pension income payments are made. The ground idea is that the country of arrival is to levy a tax on pension income to fully or partially compensate the country of origin for the revenues forgone following the expatriation of the individual taxpayer, being either a highly-skilled or an elderly individual. Indeed, although abandoned in later versions of the proposal, as it was found difficult to actually enforce, the original Bhagwati tax proposal envisioned a surtax imposed by the country of arrival (see Bhagwati 1972, 44).

A proposal featuring a sort of compensation tax to address the brain drain phenomenon was also advanced more recently in Lister (2017). The key feature of the proposal contained therein is to resort to a tax credit – roughly akin to the foreign tax credit currently available to US citizens living and working abroad<sup>87</sup> – as a means to compensate the countries of origin experiencing a revenue loss following the departure of highly-skilled individuals from their own territory.<sup>88</sup> Specifically, it is proposed

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<sup>85</sup> However, Brauner (2010, 163) contends that a ‘brain drain tax’ can also be implemented by countries bilaterally, through purposive changes to existing double tax treaties.

<sup>86</sup> A model provision to that effect is included in the Commentaries to the OECD Model. See OECD Model Tax Convention Commentary on Article 18 (2017), para. 15.

<sup>87</sup> Internal Revenue Code (IRC), Title 26, Sub. A, Ch. 1, Subch N, Part III, Subpart A, Sections 901–909.

<sup>88</sup> Lister (2017, 75) defines highly-skilled individuals as those who, cumulatively: (1) have received higher education or skills training, (2) whose training or education was

that the country of origin levy an income tax over employment income earned abroad by its emigrated highly-skilled individuals and that the resulting fiscal proceeds, collected by the country of arrival, are credited against employment taxes due in that country, whereas the remainder is returned to the countries of origin of the emigrated individuals, thereby compensating – at least to a degree – those latter countries for the sunk investment made in human capital that has left its territory. Lister (2017, 76) further stipulates that the levying of the compensation tax is to last long enough to fully compensate the country of origin for the lost investment in the highly-skilled individual.

Cases in point can be found in actual tax treaty practice by countries. It is worth noting that under Article 9 of the 2015 Protocol to the double tax treaty concluded between France and Germany, the resident state of the individual recipient of the pension paid out under the statutory social insurance schemes is entailed to tax the income in question, but it must pay back to the state in which the payments arise a ‘compensation amount’ corresponding to the tax which that state would have charged under its tax laws.<sup>89</sup>

The main advantage of the aforementioned proposal is that it aligns the interests of both the countries concerned, since it provides for shared allocation of taxing rights between the residence and source states and, therefore it also allows shared allocation of tax revenues between the country of origin and the country of arrival. This is consistent with the fact that, arguably, both countries have a legitimate claim to tax the income of the emigrated individual. Another, related advantage is that countries no longer have to strive for exclusive source-based taxation as a means to tackle tax-induced emigration of individual taxpayers from their own territory. Indeed, this very circumstance is likely to significantly smooth tax treaty negotiations between countries. In the context of the brain drain from a developing to a developed country, the further advantage of this proposal is related to the fact that the compensation tax builds upon the administrative capabilities of the developed country (see Lister 2017, 82).

The major concern related to the proposal under discussion are the nature and characteristics of such a ‘compensation tax’. If, in fact, the proposed compensation tax is designed to apply separately and on top of income taxes levied by the residence state (i.e. the country of arrival), it might not actually be considered as an income tax covered by a double tax treaty, pursuant to Article 2 of the OECD and UN Models, with the

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largely or completely publicly funded, and (3) have left their own country to work in another within a defined number of years after completing their education or training.

<sup>89</sup> 2015 Protocol of the France – Germany Income and Capital Tax Treaty (21 July 1959, as amended through 2015), Art. 9, introducing a new Art. 13c in the text of the Convention.



consequence that the double taxation relief mechanisms provided in the relevant double tax treaty would not apply. Such a compensation tax might be considered as a sort of ‘extraordinary tax’, i.e. a levy imposed for a limited period – particularly, until the country of origin is fully compensated for the lost investment in the highly-skilled individual – and for certain reasons, provided various circumstances are also met.<sup>90</sup> Another important disadvantage is related to the fact that the implementation of the proposal requires quite a smooth system through which the collected tax is passed on by the emigrated individual’s country of arrival to their country of origin. A further drawback is related to the circumstance that an emigrated individual will be at a disadvantage vis-à-vis an individual resident in the country in the same personal and economic circumstances. As such, the compensation tax seems to run contrary to the general obligation of non-discrimination, which is enshrined both in tax treaties pursuant to Article 24 (1) of the OECD Model and at the EU level in Article 18 TFEU, to the extent that taxation of incoming individuals equates to taxation of foreigners by the country of arrival.<sup>91</sup> However, probably the major source of concern is that the actual implementation of the proposal seems utopian at best, since the country of arrival would not only miss out on fiscal revenues, but it would also have to help collect those proceeds, all for the sole benefit of the emigrated individual’s country of origin.<sup>92</sup>

## 6.6. Global minimum tax

The GloBE proposal unveiled by the OECD in early 2019 envisages an international tax regime where MNEs are required to pay, at least, a minimum level of taxes. This practically ensures that a ‘global minimum

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<sup>90</sup> ‘Extraordinary taxes’ are also considered in the Commentaries to the OECD and UN Models. Notably, it is stipulated therein that Article 2 ‘does not mention ‘ordinary taxes’ or ‘extraordinary taxes’. Normally, it might be considered justifiable to include extraordinary taxes in a Model Convention, but experience has shown that such taxes are generally imposed in very special circumstances. In addition, it would be difficult to define them. They may be extraordinary for various reasons; their imposition, the manner in which they are levied, their rates, their objects, etc. This being so, it seems preferable not to include extraordinary taxes in the Article. But, as it is not intended to exclude extraordinary taxes from all conventions, ordinary taxes have not been mentioned either. The Contracting States are thus free to restrict the convention’s field of application to ordinary taxes, to extend it to extraordinary taxes, or even to establish special provisions’. See OECD Model Tax Convention Commentary on Article 2 (2017), para. 4. For a discussion, see Ismer, Blank (2015, 15 para. 28).

<sup>91</sup> Based on paragraph 6 of Article 24 of the OECD Model, the prohibition of discrimination, ‘notwithstanding the provisions of Article 2’, applies to ‘taxes of every kind and description’, consequently, in principle, also to a ‘compensation levy’ that is not covered by a double tax treaty.

<sup>92</sup> As admitted by the same proponent of the ‘compensation tax’ against brain drain illustrated in this section (see Lister 2017, 83).

tax' is ultimately paid by MNEs. A 'global minimum tax' in the field individual taxation may eventually be introduced, mimicking in a way developments occurring in the corporate sector at the international tax level.

A 'global minimum tax' in the individual sector would in fact display a number of strengths. Probably the most important advantage is related to the fact that its worldwide implementation by countries would provide a unique opportunity for meaningful multilateralism, although it does not seem equally feasible to entrust the administration and collection of such global minimum tax to a 'World Tax Organization'<sup>93</sup>, as it was notably stipulated under a version of the Bhagwati tax proposal, which assigned such a task to the UN.<sup>94</sup>

A first concern with regard to a global minimum tax is related to its nature and characteristics. In this sense, similar considerations to those presented above with regard to a compensation tax apply. In addition to the issue of devising a robust enough effective tax rate, there is also the issue of establishing the category of persons to be subject to the tax as well as the rules and principles governing the calculation of the tax base. To put it into a perspective: should a global minimum tax be imposed only on highly-skilled and/or elderly individuals or, also on all/other categories of emigrated taxpayers? Notably, what about emigration of individuals from one country to another for a short period – say, two or three years – such as it may occur in the case of academics and students? In fact, the individual motives for a person to reside abroad could also change over time. Furthermore, as regards the calculation of the tax base, should the income tax rules of the country of arrival or those of the country of origin apply? An autonomous set of rules for calculating the tax base could also ultimately be laid down. Another set of concerns is related to the actual implementation of such a global minimum tax. Even if an adequate consensus is built around it and a multilateral framework is then established, implementing such a tax is by no means straightforward, to the extent that this would require a change of bilateral tax treaties. In this sense, it seems far more practical to amend current tax treaties through a multilateral convention. The experience of the BEPS Multilateral Convention (MLI) can provide useful insights in this regard (see OECD

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<sup>93</sup> A first plea for a supervising 'World Tax Organization' was famously made by Tanzi (1999). Questioning the actual feasibility of a 'World Tax Organization' as a means to achieve international tax coordination, see Schön (2009), who considers that 'a realistic outlook will be the ongoing use of bilateral treaties, including some regional multilateral conventions which would extend the number of participants but would not change the traditional character of this instrument as such'.

<sup>94</sup> Oldman, Pomp (1979, 44–58), however, also suggest that the United Nations might only promulgate a set of guidelines for the imposition of an 'international brain drain tax', or 'IBDT', by individual countries.

2017c). However, this would again involve a demanding process, involving modification thousands of existing bilateral treaties on the basis of a complex set of options to accommodate many different possible combinations of treaty partner preferences, as a quick glance at the OECD MLI Matching Database clearly shows (see OECD 2019d).

## 7. CONCLUSIONS

After BEPS, the idea of tax sovereignty, i.e. that national governments have a non-exclusive right to shape their own tax policies completely independently of one another, seems a distant memory at best. In the post-BEPS world, the unconditional sovereign autonomy of countries over tax matters is, in fact, no longer conceivable.

It is unclear, however, whether the new international tax order that the OECD has long envisaged will ultimately lead to more cooperation or, rather, it will bring more competition among countries. A meaningful cooperation would indeed require building-up a global consensus, based on which a tax level playing field would be established among countries. Without such a global consensus, an international tax order would be difficult to shape, since countries would compete against each other in a global strategic game, based on volatile preferences reflecting their political and economic bargaining power rather than on a sound framework of jointly established principles and rules.

If the ultimate outcome of the action undertaken by the OECD is hard to predict, it is clear that the consequences of non-action at the international level are quite dire, in so far as an increasing number of countries would likely introduce unilateral measures to preserve their own tax base. Indeed, several decentralized actions by countries might ultimately produce the dissolution of any sort of international tax regime. Specifically, with regard to migration of individual taxpayers from one country to another, in the absence of any form of cooperation at the international level, bilateral negotiations would likely be stalled and, perhaps, even rolled back by the intrinsic antagonism of the countries concerned, as a result of their opposing budgetary interests.

This would certainly be detrimental not only from an inter-country perspective, but also from an intra-country point of view. As a matter of fact, in the current political, social and economic landscape, welfare-enhancing objectives can only be achieved if the international and national level are considered simultaneously and, possibly, aligned. The author therefore posits that if a new and fairer social contract is to be established at the national level, the terms and the course of the international tax

order should also be more clearly articulated among countries. In this sense, the various policies and measures explored in this article might eventually kick-off discussions on establishing such an international tax order.

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