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Re-Imagining Tax Justice in a Globalised World

TSILLY DAGAN

In this chapter I explain why designing a country's tax policy with the elasticity of taxpayers' choices of residency in mind, although a rational welfare-maximising move by the state as a whole, and possibly even for its immobile as well as mobile constituents, is a policy that may not be justified under a liberal-egalitarian social contract.

I discuss two polar views of the social contract. One endorses the state with the coercive power to promote the joint interests of its constituents. The other views the coercive power of the state as a way to fulfil the collective will of its constituents as a society of equals, in order to promote who they are as people. If states' coercive power is based on equal respect and concern, a policy that undercuts such equality might not be justified. The state thus faces a dilemma: taking into account the increased electivity of taxation (by some) could undermine the normative foundations of the power of the state to tax. Ignoring such increased electivity, on the other hand, may limit the potential of *some* individuals and the state as a whole to flourish.

I. Introduction

Income taxation is considered a key tool (the *optimal* tool, some even argue) for promoting justice. Under canonical thinking, the monopolistic coercive power of the state could and should be used in order to promote justice. This belief in the power of tax to promote justice is based, however, on the assumption of a closed economy, where sovereign power reigns and the state has both the will and the power to impose and enforce its taxation.

This assumption of a closed economy, in turn, is challenged under globalisation. Globalisation is transforming the state-citizen relationship by increasingly turning states into market actors who compete for residents (individuals as well as businesses), for factors of production, and for tax revenues. Instead of powerful

sovereigns with the capacity to make and enforce mandatory rules, impose taxes and set redistribution, states are increasingly becoming actors in a competitive global market, where their ability to govern is affected by supply and demand. With the rise of mobility among residents and factors of production, the state increasingly functions as a regime that is to a large extent elective (at least for some), where certain individuals and businesses have the ability to choose from a broad range of legal jurisdictions. This electivity applies only to a limited set of the countries' constituents and resources, thus creating a new rift within the state: between the mobile (important among them are the rich and talented) and the immobile.

This new competitive market reality dramatically weakens states' ability to promote their goals through taxation, and presents them with fundamental dilemmas. Competition among states pushes them to lower the 'prices' (ie taxes) they charge, and, moreover, to 'price discriminate' among taxpayers, allowing them to collect lower taxes from the mobile segments of society, in order to stay competitive and maximise welfare. Thus, the question arises: are there domestic limitations on states, as competitive actors, in terms of justice? Should domestic taxation be based solely on the ability of states to collect whatever taxes they can, from whoever cannot avoid them, much like firms in a competitive market? Or should there be any limitations on income taxation even in a competitive world? This question is especially acute in a world where taxes become elective only *for some*,[1] while for others – those with limited mobility and limited ability to pick and choose among jurisdictions – taxation is still a coercive measure. Should taxation – in order to be defensible, let alone to be fair – comply with some basic requirements of justice and, if so, what are such requirements?

In this chapter I present the dilemma faced by sovereign states' taxation systems in a competitive world: between maximising the combined welfare of their constituents through market-inspired mechanisms on the one hand and maintaining a society of equals on the other hand. Each of these (extreme) options not only entails different consequences for states, their constituents, and the relationships among them, but is also based on a very different rationale for the state.

On the one hand, where states embrace market measures and choose to tax some of their constituents more leniently based on their elasticity (ie to grant mobile taxpayers with reduced tax liability in order to encourage them to stay), they might face serious consequences in terms of the stability and fairness of their social contract. This may be justified under a utilitarian perception of the state – one that sees the interaction between the state and its constituents, and among the constituents themselves, as strictly based on maximising their combined self-interests. This marketised version of the state – which is based on the supply and demand for states' services, and on the attractiveness of potential taxpayers

[1] The ability to move one's activities, or parts thereof, is not equally distributed among taxpayers. Taxpayers with international activities (eg foreign consumers), opportunities to operate overseas or more modular components within their operations will be better able to opt out of the system if they so wish.

– highlights citizens' independence, stresses their ability to exit and forms a thin conception of citizenship.

On the other hand, where states embrace equality – pursuing equal concern and respect – they must, as I explain below, look beyond maximising material resources, and should not let demand considerations take over. While under this rationale the state respects equality, it may entail considerable costs in terms of welfare, and – if not properly designed – undermine the autonomy of mobile residents.

The practical dilemma, too, is considerable. In the extreme case, sovereign states would present mobile taxpayers with a dichotomous choice: join us (and subject yourselves to our tax regime in its entirety) or exit (and we will be happy to host your business on a non-membership basis). Or, alternatively, they can choose to commodify their membership and subject it to the rules of the market, thus undermining their state-citizen relationship.

This chapter will continue as follows: Section II will discuss the shift in income taxation from benefit taxation to viewing taxation as part of one's civic identity, delinked from the value of the goods and services one receives from the state, and describe the different rationales for each. Section III wonders whether globalisation and tax competition – by highlighting mobility and fragmentation – brought with it a hybrid idea of taxation 'benefits taxes *for some*'. Finally, Section IV presents the sovereign state's dilemma – juxtaposing the two ideal types of state-taxpayers' relationships: a market-inspired version of the state (an 'exit based state') and a community of equals (a 'loyalty based state') and asking whether a choice between the two is inevitable (or even desirable).

II. Income Taxation: From Benefit Taxation to Ability to Pay

Taxation is anchored in the sovereign power of the state. It facilitates social cooperation within the state – by collecting the resources necessary for its operation,[2] and, at the same time, it operates thanks to the states' coercive power. Coercion is essential as – at least within a sizeable population – we cannot trust only the goodwill of individuals to pursue (even) their mutual interest.

> The only way to provide that assurance is through some form of law, with centralized authority to determine the rules and a centralized monopoly of the power of enforcement. This is needed even in a community most of whose members are attached to a common ideal of justice, both in order to provide terms of coordination and **because it doesn't take many defectors to make such a system unravel**.[3]

[2] D de Cogan, *Tax Law, State-Building and the Constitution* (Oxford, Hart Publishing, 2020) 7 (describing the prominence of tax in constructing states and social relations within them).

[3] T Nagel, 'The problem of global justice' in *Secular Philosophy and the Religious Temperament: Essays 2002-2008* (Oxford, OUP, 2010) 64 (emphasis added).

This raises a delicate question, which is at the core of our discussion as to 'the appropriate relation of the individual to the collectivity, through the institutions of the state.'[4] As Murphy and Nagel explain:

> A state has a near monopoly of force within its territory, and it has the authority to coerce individuals to comply with decisions arrived at by some non-unanimous collective choice procedure. What are the legitimate aims for which such power may be used, **and what, if anything, limits the way it may legitimately be exercised over individuals?** These are questions about what we may be said to owe to our fellow citizens, and what kind of sovereignty we should retain over ourselves, free from the authority of the state, even when we are members of it and subject to its control in certain respects. Those questions define the issue of political legitimacy.[5]

There are two very distinct ways to think about the coercive power of the state. One could think of it as a way for individuals to promote their joint interests. Under this view external coercive power is necessary where individuals cannot achieve this goal due to collective action problems. Alternatively, we could think of the coercive power of the state as a way to fulfil the collective will of its constituents as a society of equals in order to promote who they are as people.

Each justification for the state's coercive power dictates a different set of goals for income taxation. If coercion is only a way to more effectively promote the collective self-interest of states' constituents, tax policy should focus on the instruments that would maximise the collective welfare pie. If, on the other hand, coercion is necessary in order to promote the collective will of states' constituents, it demands a richer account not only of distributive justice, but also of horizontal equity; not only of maximising welfare but also on equal concern and respect – as will be explored below.

The evolution of income taxation seems to reflect a shift in the perception of the state. In the past, taxation was implicitly perceived to be a cost that a person paid for the public goods he consumed, and the rationale of benefit taxation was widely supported.[6] Under the benefit principle the tax relationship between the state and its constituents was limited to a deal, a quid-pro-quo, a 'cash nexus' as Ajay Mehrorta describes it in the American context of the nineteenth century.[7]

> Citizenship itself was reduced to a commodity. The benefits principle seemed to subordinate the social aspects of the social contract. For a subsequent group of theorists and political activists, such an impoverished vision of taxes and community would be unacceptable. But during the last decades of the nineteenth century few doubted this logic and characterization of taxes.[8]

[4] L Murphy and T Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford, OUP, 2002) 41.

[5] ibid (emphasis added).

[6] Hobbes famously supported paying taxes in proportion to what people consume in society: 'But when the impositions are laid upon those things which men consume, every man payeth equally for what he useth.' T Hobbes, *Leviathan: Book II* (revised edition, Broadview Press Canada, 2010) 295. See AK Mehrotra, *Making the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation 1877–1929* (Cambridge, CUP, 2013) 64.

[7] See ibid.

[8] ibid.

Payment according to the benefits one receives from the state can make a lot of sense. It aligns the costs of government with the preferences of its constituents (assuming these could be accurately measured), it prevents the government from spending money on goals that are of no interest for its constituents and it provides a simple (some would say simplistic) utility-maximising version of the social contract. Especially for those who perceive of their own resources as 'naturally' belonging to them, benefit taxation provides an intuitive and easy to support rationale for taxation. When providing quid-pro-quo in public services, the government does not deprive constituents of their resources but rather serves their interests in solving their collective action problems in promoting such interests.

The justification for taxation in political theory evolved, however, from this initial (Hobbesian) justification of taxes as a payment for the public goods that taxpayers consume (ie benefit taxation) into a concept of state-imposed allocation of the fiscal costs of the budget, irrespective of such benefits.[9] In modern times, it is commonly assumed that tax should be de-linked from the benefits that a person receives from the state.

Under this version of the social contract, states' constituents subject themselves to the coercive powers of their states (only) in order to be able to effectively pursue their collective will. This creates a unique political interdependency where individuals are simultaneously 'subjects in law's empire and citizens in law's republic'.[10] This unique combination of coercive power and co-authorship, of relinquishing one's power in order to pursue the collective will of himself along with others, brings with it unique duties, as states' coercive powers must '… be justified to their co-authors'.[11] In Nagel's words:

> adherence to … [political institutions] is not voluntary: Emigration aside, one is not permitted to declare oneself not a member of one's society and hence not subject to its rules, and other members may coerce one's compliance if one tries to refuse. An institution that one has no choice about joining must offer terms of membership that meet a higher standard.[12]

'The state', claims Nagel, 'makes unique demands on the will of its members … and those exceptional demands bring with them exceptional obligations, the positive obligations of justice'.[13] Importantly, according to Cohen and Sable, 'not just any justification will do … the justification must treat each person … in whose name the coercion is exercised – as an equal'.[14] The reason for this is that 'states not only foster cooperation by coercively enforcing rules but implicate the will of those subject to their coercive authority by making, in the name of all, regulations

[9] K Vogel, 'The Justification for Taxation: A Forgotten Question' (1988) 33 *American Journal of Jurisprudence* 19, 24–33.

[10] J Cohen and C Sabel, 'Extram Republicam Nulla Justitia?' (2006) 34 *Philosophy and Public Affairs* 147, 148.

[11] ibid 160.

[12] T Nagel, 'The Problem of Global Justice' (2005) 33 *Philosophy and Public Affairs* 113, 133.

[13] ibid 130.

[14] Cohen and Sable (n 10) 160.

that apply to them all'.[15] Will-implication is significant since 'it is impermissible to speak in someone's name … unless that person … is … given equal consideration in making the regulations'.[16] Regulations made by the state must therefore be justified to their co-authors.[17]

Or, as Ronald Dworkin, expresses it:

> A political community that exercises dominion over its own citizens, and demands from them allegiance and obedience to its laws, must take up an impartial, objective attitude toward them all, and each of its citizens must vote, and its officials must enact laws and form governmental policies, with that responsibility in mind. Equal concern … is the special and indispensable virtue of sovereigns.[18]

Under this conception of the social contract, equal respect and concern is thus an inherent part of the power of the state to tax. Hence, taxes should be allocated among taxpayers as equal members in a political community. Underlying this approach is the idea that the state has grown so distinct and meaningful that it is no longer feasible (since it is extremely hard to measure how much one benefits from the state) and, more importantly, it is no longer appropriate, to base people's tax obligation on the benefits they receive from the state, as they are not merely consumers of public goods, but rather equal members in a political community. The duty to pay taxes cannot thus be based on the benefits one gets from the state but rather on a sense of membership and a civic obligation.[19] Though the exact level of this obligation is debatable, a widespread belief seems to have been entrenched that taxpayers should pay their fair share (Mill's 'equal sacrifice'[20]) in financing the public fisc based on their being equal members of the political community.[21]

Under a closed economy, tax law seemed like an optimal domain for implementing the social contract between states and their constituents and, in particular, a locus for states to apply their norms of justice. Globalisation and the tax competition it entailed seem to have changed this reality, and challenge the common

[15] ibid.

[16] ibid.

[17] ibid.

[18] R Dworkin, *Sovereign Virtue: The Theory and Practice of Equality* (Harvard, Harvard University Press, 2000) 6.

[19] See Murphy and Nagel (n 4) 16 and 19, who note that '[m]any have thought that fairness in taxation requires that taxpayers contribute in proportion to the benefit they derive from government' and criticise the benefit principle as being 'inconsistent with every significant theory of social and economic justice'.

[20] The idea of equal sacrifice is attributed to JS Mill, *The Principles of Political Economy with Some of Their Applications to Social Philosophy* (Boston, CC Little & J Brown 1848) *354* ('all are thought to have done their part fairly when each has contributed according to his means, that is has made an equal sacrifice for the common object'). But see Murphy and Nagel (n 4) 20–25, opposing equal sacrifice, indeed vertical equity, on the basis that justice of tax burdens cannot be separated from the justice of the pattern of government expenditure.

[21] Discussion of what are the exact attributes subject to such equality in tax law, especially under mobility and fragmentation, is the subject of Section IV of this chapter.

beliefs underlying our tax system. The next section will explain how the decentralised structure of international taxation affects the interaction between sovereign states and their constituents. Specifically, it will argue that competition brings with it a unique hybrid that distinguishes between parts of the constituents who pay taxes according to their ability and others who pay according to their benefit. In other words, the current international tax regime brings back benefit taxes, but only *for some*.

III. States under Competition: Benefit Taxation *For Some*

Under globalisation, taxpayers are increasingly mobile. This enables them to choose from among alternative jurisdictions to relocate their places of residence, investments and business activities. States often encourage such mobility by offering certain privileges and incentives to desirable potential residents and investors. Residents-in-demand relocate to more appealing jurisdictions, as states lure away investors, as well as sought-after residents. With this intensified mobility, sovereign states have found themselves in a new position: once defined by their coercive powers and control over their citizenry and territory, they now often need to lure residents and investments away from competing sovereigns, as they fight to keep their own desirable taxpayers.

By providing taxpayers with a viable alternative, tax (and often other regulatory) competition between states has effectively changed the role of the state. The state can no longer necessarily be perceived as making compulsory taxation demands on its subjects in order to promote the collective goals of a given group of constituents but, rather, it increasingly solicits investments in order to facilitate increased economic activity and bids for prospective residents in an attempt to build the best possible team. Tax rates and rules as well as other legal rules have become part of the considerations for the globally mobile when weighing their residency and investment options. Hence, they have become, to a large extent, the currency of state competition.

Under competition, tax has increasingly become a price taxpayers are willing to pay for residing, investing and conducting their business in an attractive state as opposed to a civic obligation they should fulfil as members in a political community. Moreover, under competition, tax rates and public policies have become subject, to a considerable extent, to the rules of supply and demand of the market among states. In its extreme version, tax competition changes taxation from a mandatory regime to a regime that is basically elective or, to be more precise, elective *for some* – ie those that can and will move elsewhere for more favourable tax and public services. Thus, in conditions of tax competition, if and when they obey the rules of the competitive market of tax competition, states increasingly resemble

business actors that offer goods and services that will appeal to (and keep) investors and residents, including attractive taxing and spending deals.[22]

Under the rules of this market, policymakers target the most valuable taxpayers and those most likely to move for tax reasons. They pursue taxpayers that will bring with them the most benefits to the state, such as spillover of technological and managerial skills, investments and simply talent. In terms of tax policies, this means offering the public goods and services that are most attractive to such constituents and lowering taxes for the most mobile.

In short, competitive sovereignty focuses on assembling the most attractive 'team' of constituents by offering the most attractive public services deals at an attractive price. This is very different from sovereignty that seeks to provide the best possible public services to a set group of constituents who share common goals and projects, and that wields the power and legitimacy to accomplish this using coercive measures so as to prevent collective action problems and to promote its collective will.

A. Unbundled Sovereignty

Mobility of residents and their resources – and the accompanying marketisation of the government-constituent relationships it entails – are only the tip of the iceberg. No less significant and too often overlooked is the ability of (certain) individuals and businesses to unbundle and then reassemble packages of sovereign goods tailored to their specific needs. In the current market of states, individuals and businesses are able not only to shop for their jurisdiction of choice but also to buy 'a-la-carte' fractions of regimes of different state sovereignties. This fragmentation of sovereignty occurs in many areas of state regulation, but tax – formerly the quintessential tight, all-encompassing coercive legal regime – seems particularly vulnerable to such tailoring by skilled tax planners.

The conditions that can trigger the application (or non-application) of tax laws in different jurisdictions vary widely, which has produced a fragmented international tax landscape with a diversity of mix-and-match components: differing residency rules; a wide assortment of source rules; conflicting rules for allowing deductions; differing tax and withholding rates; and a vast number of tax treaties between different jurisdictions. Even under the increasingly tightening international tax regime, sophisticated and well-advised taxpayers can and do still assemble these diverse components into a tax regime that is favourable to them and does not necessarily overlap with any of the regimes governing their other affairs.

Tax planners employ a host of techniques to de facto opt-out of a tax jurisdiction, without actually moving their human clients' residency or, in extreme cases, even their activities. Tax planners often incorporate subsidiaries or trusts

[22] For the classic theory for such regulatory competition in local government, see C M Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *The Journal of Political Economy* 416.

in tax havens to reduce the taxation of their income or defer it to when the profits are repatriated, if at all. They siphon off income through beneficial tax treaties to and from low-tax jurisdictions, thereby avoiding taxation at source, as well as a host of other techniques to reduce the total tax liability of individuals and their businesses.[23] As a result, tax-planning taxpayers can often simultaneously reside in one jurisdiction (and consume its publicly provided goods and services); incorporate in another (and thus enjoy its corporate governance); do business in a third (and use the local court and banking systems), invest in an industrial plant in a fourth (and reap the benefits of publicly provided services such as an educated workforce and a developed transportation system); register its IP (and/or move its R&D activity over there) in a fifth; and be subject to the tax rates, if any, of a sixth jurisdiction.

The reason such arrangements are possible is that different factors trigger the application of different duties and rights, including tax obligations. Some rights and duties apply to residents (and the factors that make one a resident also vary across jurisdictions), while others apply to property owners, consumers, investors, or citizens of certain states. Many of these rights and duties are related to a person's permanent place of residence, place of abode or key place of business. Others are tied to citizenship, to the location of one's property, to one's (even temporary) presence or to specific actions within the state's jurisdiction.[24]

In contrast to the classic mobility story, which tends to be constructed around a market of states offering take-it-or-leave-it package deals of legal rules, public services and taxes, the fragmentation perspective highlights the electivity and flexibility of these packages. Instead of looking at individuals' and businesses' ability to shift their choice of jurisdiction en bloc by moving their residency to a new jurisdiction, fragmentation stresses the leeway to mix-and-match legal jurisdictions. The fragmentation of the state-citizen relationship and the fact that individuals and businesses are not exclusively connected to a single state but, rather, interact simultaneously with many states on various planes, mean that this relationship cannot, and does not, necessarily bundle together all of the dimensions of the potential interaction between taxpayers and states. This reality impacts the strategies used by taxpayers as well as states, and for better or worse, alters the meanings of such interactions. Whereas absent this jurisdictional fragmentation, the optional strategies for residents are essentially either voice (using their political power to shape state policy) or exit (relocating to a jurisdiction that offers a more favourable regulatory package), they now have an option that will maximise their benefits: to *diversify* their state-related interactions. Thus, in this market for public goods, *some* people can choose not only between jurisdictions in their entirety but also among different combinations of fractions of these jurisdictions. This feature of fragmentation has a liberating effect *for some* constituents – who can now better

[23] For some more detail, see T Dagan, *International Tax Policy: Between Competition and Cooperation* (Cambridge, CUP, 2018) ch 2 and references there.

[24] T Dagan, 'The Global Market for Tax and Legal Rules' (2017) 148 *Florida Tax Review* 168–170.

tailor their interaction with the state to match their needs and preferences. But, at the same time, if successful, it could have a rather dramatic impact on what membership in a state means for taxpayers who have the opportunity to unbundle states' sovereignty as well as what such membership means for those with limited such capacity.

States face hard choices in this reality of electivity under fragmentation. Fragmented competition occurs in multiple markets simultaneously. Hence, trade-offs between various aspects of their public services are much harder to pull off. In other words, a state's advantageous geographical location, excellent school system, or strong legal tradition will not necessarily compensate for a high corporate tax rate or strict deduction rules, as residents and businesses can often simply choose to opt out of the less desirable restrictions. Sadly, fragmentation, and the creative tax planning it facilitates, also allows taxpayers to free ride some of the public goods which states offer. While states can vow to collect taxes and make significant efforts in this direction, enforcement is a challenge. Where a state cannot collect the taxes from individuals and businesses that find ways to avoid them by tax planning, the fact of the matter is that states cannot ensure the participation of all taxpayers in the financing of public goods and services.

To be sure, states have come up with a variety of mechanisms in order to apply and enforce their rules on 'their' residents: a worldwide tax base; CFC rules for the corporations owned by their residents; and restrictive regimes for overseas trusts. States vigorously try to fight (and increasingly succeed in fighting) tax evasion and tax planning, by using GAAR rules, or by cooperating with other states.[25] But it seems as if we are still quite far from a state where rich and mobile taxpayers actually pay taxes at rates that are similar to those with less opportunity to opt out of the system.

B. Benefit Taxes *for Some*

Because of competitive pressure and the considerable difficulty for states to enforce their rules on mobile taxpayers, they are pressured to offer mobile constituents – or those with better planning opportunities – with either significant tax benefits or increased leeway in planning their world-wide tax operations. The rational choice for a state in a competitive market is a regime that is a hybrid between ability to pay and benefit taxation. *For some* taxpayers – the ones with lower ability or a smaller inclination to move – coercive world-wide taxation of their income would

[25] See eg European Commission, 'Council Directive 2011/16/EU on Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC', 9; OECD, *Action Plan on Base Erosion and Profit Shifting* (Paris, OECD Publishing, 2013) 15, available at https://doi.org/10.1787/9789264202719-en (accessed 7 January 2020); OECD, *CRS by jurisdiction*, available at https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction/ (accessed 7 January 2020); for a description of some of the recent cooperative accords see also Dagan, *International Tax Policy* (n 23) ch 5.

make sense. Yet for others – those with available alternatives – a regime which is more lenient, at times even elective, is the more beneficial option in terms of tax revenues.[26] In other words, tax competition brings back benefits taxes in a unique version: benefit taxes *for some*.[27]

In more detail: by adjusting their policies to match them with the varying degrees of elasticity among their constituents, states could increase the tax revenues they collect. Assuming the marginal cost of providing much of the public services to such mobile taxpayers is zero, or close to zero, elasticity-based taxation could result in net gain for the state. Any taxes thus collected would be used to serve the entire population– not only the mobile residents who will pay lower taxes would benefit, but also immobile constituents (as whatever taxes collected will increase the collective revenues). Where, on the other hand, elasticity is low – as in the case of immobile taxpayers – there is no reason for the state not to collect higher taxes, as long as the incentive of taxpayers to work is intact. The bottom line is that in order to maximise the welfare pie, tax should be imposed in inverse relation to how elastic taxpayers are.[28] This means that the most inelastic (ie immobile taxpayers and the ones unable to opt out) should pay the highest (coercive) taxes, while the ones with the greatest elasticity should get a more lenient treatment.

When viewed from a strictly utilitarian perspective the choice of a flexible regime – adjusting rates and rules to the elasticity of taxpayers' choices in order to attract as much revenues and benefits as possible – may seem like an almost inevitable move by states. But is it? Is the state free to choose among these strategies? Or are there any limitations on the state when considering these options? The rest of this chapter will focus on justice and ask whether providing elastic taxpayers with tax benefits is justified.

IV. Benefit Taxes *For Some*: Between Two Ideals of the State

Under taxpayers' electivity (or lack thereof) among jurisdictions, the question arises whether catering to their electivity, granting them privileges in order to

[26] Some taxpayers are sometimes lured into countries which offer them residency combined with attractive tax deals. Interestingly, though, taxpayers may not have to actually relocate in order to attain better tax treatment. Some of them get preferable treatment by tax planning, eg by operating via offshore corporations and trusts.

[27] While tax benefits to certain groups of residents are available at the domestic level as well, global competition among states adds a considerable dimension to the preferable treatment of some taxpayers – stressing mobility and cross-border planning ability.

[28] True, if the mobile are also the rich (which is often the case) inequality between mobile and immobile constituents would likely increase. However, if – faced with increased taxation – the mobile leave, the result will be levelling down both the gaps between remaining (less mobile) constituents, along with a reduction in the national welfare pie.

attract (or keep) them, is justified under the social contract. The answer to this question depends on the rationale for the social contract in each state.[29] Does the social contract follow a utilitarian ideal of maximising our collective interests (the market-inspired ideal)? Or is it about creating a community of equals (the membership ideal)?

In a different world this choice might have been one of domestic political processes within states – free to shape their unique contracts, allowing constituents that prefer alternative arrangements to opt for them in a different jurisdiction. Under competition, however – and especially the imperfect competition among jurisdictions we currently observe – we are presented with a significant dilemma. Under current competition only *some* residents have a real choice of opting for a different jurisdiction. Others have no real alternative as (foreign) states are under no obligation to welcome newcomers and, thus, social contracts in their countries of origin are non-negotiable for them. In other words, under competition, only certain people have a choice: those who are both willing to exit and who are most attractive in the eyes of other states.

When choice is limited *for some* taxpayers, both the utilitarian ideal and the membership ideal raise considerable challenges. The utilitarian ideal caters to the needs of the mobile segments of society, supports their independence and maximises the national welfare pie. Such a model, however, may undermine equal respect and concern for the immobile factors of society, that is, the people that have no or lesser choice among jurisdictions. The membership-based ideal, on the other hand, supports equal respect and concern for immobile taxpayers, but at a cost to collective welfare, *and* it forces mobile taxpayers to make a binary choice between staying and leaving – thus undermining their self-determination and disrespecting their choice of a life plan that is not necessarily tied to a single jurisdiction.

A. Utilitarian Ideal of the State

If our social contract is about the joint promotion of the combined self-interests of all of the state's constituents, and assuming we focus on material resources, the fact that *some* taxpayers (the mobile and fragmented, in our case) pay less taxes, should not bother us, as long as the state's welfare pie grows, and the slice each of us gets is no smaller than under the alternative (ie if we tried to impose higher taxes on the mobile). Surely, it would not have been in our best interest to attempt to tax the mobile if the result would have been their opting out of the state's system which would result in a net loss.

[29] Whether or not there are justice considerations that (should) limit the ability of the state to choose between a 'thin' social contract, under which the state merely promotes the collective interests of its constituents, or a 'thick' social contract, which focuses on equal respect and concern, depends on the alternatives available for the constituents. Assuming that there is a variety of other states of all shapes and kinds and that people are, in practice, free to choose among them, I believe states should be free to choose among such alternatives.

As explained above, under the utilitarian ideal, states under competition must offer attractive 'deals' for mobile taxpayers. Just like firms on the market, the 'price' they charge for their public goods and services must be competitive and thus subject to the elasticities of the supply and demand curves of the market. Mobile taxpayers, and taxpayers that prefer to diversify their membership and split their lives between a number of jurisdictions may benefit from such policies, as such policies enable them to live their lives without fully committing to (and paying the taxes of) a single jurisdiction. If, on the other hand, their country of residence demands that they pay full taxes (and assuming such a demand is enforceable), they would be forced to either obey or exit. This welfare-maximising policy (ie calibrating taxes to such elasticities), while supporting the independence of taxpayers in high demand, undermines equality. Not only does it limit the ability of the state to redistribute income (and perhaps even increase economic gaps),[30] it also – as explained below – undermines equal respect and concern.

B. An Equality-based Ideal of the State

If the basis for our entrusting the state with our collective power is not only the need to coerce us to cooperate in the promotion of our own self-interests, but also to implicate our will as co-authors, then the limitation it (should) impose on our tax system is more stringent. In speaking on our behalf, the state has a duty not only to serve our material interests but also to treat us all with equal respect and concern. The tax system has an important role in shaping our political communities. Under this ideal of the state it has a role in supporting a community of equals. Under global competition, in particular, it also has a role in determining who belongs to us and what rights and duties such inclusion may involve.

C. The Market-based Ideal Undermines Equality

The global demand for certain people is a result of their willingness to exit (or their ability to fragment their interaction with the state) and their use value in the eyes of competing jurisdictions (ie how attractive they are for other jurisdictions). These features are often based on taxpayers' age, their talents, their family status and fortune, even their language and vocational skills. It is thus often attributes that are beyond individuals' control (or choices that are a crucial part of their identity) that make them more or less attractive for other jurisdictions – and thus enable them (and not others who lack such options) to choose among alternative jurisdictions.

Should these features be the basis for favouring them (or discriminating against others) if we are to equally respect all constituents for tax purposes? Favouring the

[30] If the rich are also the ones most mobile. See Dagan, *International Tax Policy* (n 23) 36–37.

ones that can opt out, I believe, treats the others unequally. If the state is to build a political community of equals, a person's option value – her 'net worth' elsewhere – cannot be a reason for her paying lower rates of taxation. If taxes are part of our civic duties, if they are – like voting – a sign of our membership in an egalitarian community of equals, we can certainly decide to exit, but we should not be allowed to base our share of contributing to the country's fisc on how credible our threat of exit is.

Both constituents' readiness to opt out and their use value are criteria, the consideration of which in the tax context challenge justice (in the sense of equal respect and concern). Favouring the mobile – like favouring the tall, or the handsome or the smart – undermines equality based on attributes that the immobile are simply unlucky to have. The fact that one is luckier than others to have options to move elsewhere, or to shift their income to another jurisdiction, should not be taken into account if we were to treat all of our constituents with equal respect and concern for who they are.[31] If mobility provides its holders with privileges that others do not enjoy it becomes the new status. The consideration of attributes that subject some of us to heavier duties than others based on attributes that are beyond their control undermines, I believe, our social contract understood as equal respect and concern.

Finally, operating under the threat of exit – keeping our relationships with our co-citizens on a tentative basis – allows mobile taxpayers to argue or even imply that they will stay if the price were right but threaten to leave if it were not, and even more so – allows them to contribute less to the public fisc *because* they have other options available elsewhere (which other taxpayers don't necessary enjoy). This, I believe, does not treat immobile constituents with equal concern and respect. Instead, it presents them with an ultimatum: a take-it-or-leave-it deal. Such an ultimatum and equal respect and concern are contradictory in terms. As Elizabeth Anderson, in her famous critique of the nature of equality argues '[democratic] equality … regards two people as equal when each accepts the obligation to justify their actions by principles acceptable to the other, and in which they take mutual consultation, reciprocation, and recognition for granted'.[32] Ultimatums inherently disrespect this ideal.

When equality is undermined, the justification of the state in imposing its coercive power declines with it. Under the social contract we agree to endorse the state with our collective power only because we trust it to treat us equally. Treating some of us better than others, simply because of attributes they were lucky enough to have – their threat power, in particular – is simply not under the mandate of

[31] See eg K Lippert-Rasmussen, 'Justice and Bad Luck' in *The Stanford Encyclopedia of Philosophy*, Summer 2018 Edition, available at https://plato.stanford.edu/archives/sum2018/entries/justice-bad-luck/ (accessed 7 January 2020).

[32] E Anderson, 'What Is the Point of Equality?' (1999) 109(2) *Ethics* 297, 303.

the state. And using market power as a criterion for our civic duties challenges the social contract on which state coercion (at least today) is based.[33]

D. Why Ignoring Elasticity Also Undermines Equality

On the other hand, as explained above, mobility and fragmentation are not only a result of how attractive one is in other jurisdictions, it is also a result of one's personal desires, dreams, unique features and life plans. Think, for example, of a renowned scientist or a famed athlete who seeks an opportunity to pursue her professional career under the auspices of the world's leading research institute or finest league. Subjecting them to the full scope of taxation at their country of origin pushes them to choose between their old allegiances and new ones. Despite the fact that subjecting mobile taxpayers to residence-based taxation might disrespect their choices to be citizens of the world, and their desire not to commit to a single jurisdiction, it does not undermine state power in ways similar to the alternative (of taxing in inverse relation to one's elasticities). The reason is that with elasticity comes the (real) choice of exit. Exit, although different than voice, still allows mobile individuals to effectively resist the coercive power of the state by emigrating. This, I believe is a lesser infringement on their autonomy and hence on the legitimacy of the coercive power of the state.

And yet, the question remains whether exit is good enough an answer in order to maintain equal concern and respect. After all, shouldn't mobile residents too have a claim to stay part of their country of residence *and* be able to live a cosmopolitan-style life? Hence, shouldn't they be able to argue that they would like to stay *and* have the state respect their wish to split their allegiances among different jurisdictions, instead of pushing them to leave (or stay)? I believe the answer to this claim by mobile taxpayers is both yes and no. Taxpayers' split allegiance should be respected in order to allow them to run their lives as they wish, without pressuring them to leave. But such taxpayers should *not* be allowed to pay only for the public services that they actually consume. Hence, ability to pay residence-based taxation should be sustained, in order to protect an equality-based social contract. At the same time, such taxpayers should be allowed to credit any foreign taxes they pay (so as not to impose double taxation on those wishing to split their lives between jurisdictions). This logic, alleviating some of the excess burden imposed on mobile taxpayers without allowing them to pay only for the public services they actually consume, may also demand a more nuanced understanding of residency

[33] If we were to think of a different structure of the international order – if, for example, we could set states under a classic Tiebout model, with unlimited mobility, and opportunities for individuals to join and establish political communities freely and without limitations – we could, theoretically think of alternative communities of equals who decide, for example, to limit public goods and services (and the need for coercive power) to a bare minimum. This, obviously, is currently utopian (due to limited mobility of some) if at all desirable.

where individuals are entitled to split their taxes between various jurisdictions. This could be achieved, perhaps, by adopting a 'number of days' or other split of residency among various jurisdictions,[34] or by allowing taxpayers to split their entire world-wide income tax base between different states according to their level of allegiance.[35]

But even if policies for the prevention of double taxation succeed in ameliorating the equality concern of the mobile, without undermining the equality of the immobile, they still don't eliminate tax competition and with it the incentive which high overall taxes provide for mobile residents to exit.

E. The Sovereign's Tax Dilemma

This is the crux of the sovereign's dilemma: states under competition must decide whether to consider their taxpayers' mobility in determining their tax liability. If they choose to ignore the varying elasticities of their constituents (ie subject all of their constituents to similar rules and rates of taxation, irrespective of how elastic their choices of residence are), they may lose the ones that are most mobile and wealthy. If, on the other hand, they choose to give weight to taxpayers' varying elasticities – they risk undermining equal respect and concern for the immobile ones. Moreover, not only considering mobility, but also allowing fragmentation may undermine equal respect and concern for the immobile. Ignoring mobility and curtailing fragmentation may provide the immobile with equal respect and concern, but disrespect the mobile. Credits for foreign taxes may resolve some of the issues, and yet, residence-based taxation with or without a credit comes at a cost to the collective welfare pie, by pushing taxpayers subject to increased taxes to leave.

The significance of this choice for state governance in tax matters cannot be overstated: it juxtaposes two very different ideal types of state-taxpayers' relationships: a market-inspired version of the state ('exit-based state') and a community

[34] Thus, a resident splitting her life between country A (10% tax, where she spends 100 days each year) and country B (40% tax, where she spends the rest of the year) and producing income in country C (15% tax), should pay taxes on her entire ability to countries A and B (at a 100:265 ratio) and get a credit for the 15% country C taxes.

[35] This scheme echoes Seligman's famous contribution in the 1923 league of nations report. Seligman was part of a panel of four tax experts that were nominated to study the issue of double taxation. The experts weighed the relative strengths of the various allegiances – political ties, temporary residency, permanent residency, location of wealth – and concluded what has become widely accepted ever since: that a state is justified in taxing income where the taxpayer owes it a certain degree of economic allegiance. Similarly to the case described in this chapter, the approach expressed in the experts' report recognised the possibility that taxpayers may have multiple allegiances. Hence, the report's recommendations are premised on the assumption that allegiances can be shared among states as well as ranked or proportioned. For a review of the report's conclusion and a critical analysis, see Dagan, *International Tax Policy* (n 23) 44–45.

of equals ('loyalty-based state'). Under the first, states surrender to the rules of the market, and operate more like a profit maximising organisation, which optimises the tax revenues (and other benefits) they can collect from current and potential residents. To do that they must give considerable weight to the elasticities of taxpayers' choice of jurisdiction. The result is that exit power prevails over voice and loyalty. Under the second, the state ignores such elasticities in the name of equal respect and concern and reinforces a loyalty-based taxation where one's belongingness to the state dominates her taxation, pushing her to make binary choices between staying of leaving.

In between these two extremes – strict exit and strict loyalty – lies the third component in Albert Hirschman's prescription formulation: Voice.[36] Allowing *all* constituents to have a say in the political negotiations of a tax system that provides them with a welfare system that avoids leaving *some* people behind and allows them freedom to pursue their life plans within the state and beyond it. This, of course, is the great challenge for states under the current international tax regime: how to preserve the benefits of globalisation and avoid its harms without incurring the faults and injustices of the market on the one hand and the constraints of restrictive loyalty on the other. Whether this justice-based taxation can be achieved is left unanswered.

V. Conclusion

Competition has dramatically undermined the state's centralised monopolisation of the power of taxation and thus altered the relationships of states with their constituents. Mobility, the relocation options it opened up, and the opportunities for fragmentation of one's attributes and activities have allowed *some* taxpayers to opt for lower taxes. This has put states in a serious dilemma: how should states deal with these options? The answer, I have argued, involves meaningful choices: between playing by the rules of the market for states – focusing on maximising collective welfare on the one hand *and* practicing equal concern and respect by subjecting mobile and immobile taxpayers alike to tax rules that ignore elasticities. Both options have their costs. The first undermines equality. The second undermines collective welfare, and (potentially) the autonomy of *some* taxpayers to choose to split their lives among various jurisdictions. Whether a system that achieves a reasonable compromise of both can be achieved is left unanswered.

[36] AO Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard, Harvard University Press, 1970).