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The Global Market for Tax and Legal Rules

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The Global Market for Tax and Legal Rules

by

*Tsilly Dagan**

Abstract

The canonical literature in law and economics argues that tax laws are more efficient than other areas of law (such as private law) in redistributing income. Focusing on two basic features of globalization—marketization of the state-constituent relationship and the fragmentation of sovereignty—the Article challenges this conventional wisdom.

In the globalized economy, (some) people and businesses can pick and choose the laws applicable to their activities: they can reside in one jurisdiction, do business in another, register their IP in a third, invest under the rules of a fourth, and pay taxes, if any, in a fifth. Thus, in determining which rule is a better platform for efficient redistribution,

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states should look beyond their domestic dynamics and respond to the elasticity of taxpayers' choices among jurisdictions. Tax rules, with the many opportunities they offer to (particularly well-off) taxpayers to opt out of the taxing jurisdiction, lose their a priori advantage over nontax rules as a framework of redistribution.

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Introduction

In a recent article in the *New York Times*, entitled "For the Wealthiest, a Private Tax System That Saves Them Billions," the following argument was made:

> [T]he very richest Americans have financed a sophisticated and astonishingly effective apparatus for shielding their fortunes. Some call it the "income defense industry," consisting of a high-priced phalanx of lawyers, estate planners, lobbyists and antitax activists who exploit and defend a dizzying array of tax maneuvers, virtually none of them available to taxpayers of more modest means. . . . [T]he wealthy have used their influence to steadily whittle away at the government's ability to tax them. The effect has been to create a kind of private tax system, catering to only several thousand Americans.[1]

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1. Noam Scheiber & Patricia Cohen, *For the Wealthiest, a Private Tax System That Saves Them Billions*, N.Y. Times (Dec. 29, 2015), https://www.nytimes.com/2015/12/30/business/economy/for-the-wealthiest-private-tax-system-saves-them-billions.html?mcubz=3&_r=0.

Although taxpayers have always avoided taxes, the current era of globalization has made it easier for some to achieve this goal. The decentralized international regime, where states compete for residents, investments, and businesses, is particularly amenable to the use of loopholes, especially by the ultra-rich.[2] The marketized and fragmentized nature of the competition between states, which allows (some) taxpayers to essentially design their own tax system by picking and choosing from among specific rules, has produced unprecedented opportunities for avoiding taxes through legal planning. Thus, despite growing inequality and renewed interest in policies aimed at reducing the gap between the rich and the poor, the ability of the former to avoid taxation seriously undermines the ability of states to redistribute via tax rules.[3]

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2. For a recent elaborate description of the tactics used to shield private wealth from taxation and other legal obligations see Brooke Harrington, Capital Without Borders: Wealth Managers and the One Percent (2016), describing the craft of focusing on the role of wealth managers.

3. Gabriel Zucman, The Hidden Wealth of Nations: The Scourge of Tax Havens 3–4 (2015), recently estimated the size of tax evasion and concluded the following:

> [D]espite some progress in curtailing it in recent years, tax evasion is doing just fine. There has, in fact, never been as much wealth in tax havens as today. On a global scale, 8% of the financial wealth of households is held in tax havens. According to the latest available information, in the spring of 2015 foreign wealth held in Switzerland reached $2.3 trillion. Since April 2009, when countries of the G20 held a summit in London and decreed the "end of banking secrecy," the amount of money in Switzerland has increased by 18%. For all the world's tax havens combined, the increase is even higher, close to 25%. And we are only talking about individuals here.
>
> Corporations also use tax havens. Corporate filings show that US companies are shifting profits to Bermuda, Luxembourg, and similar countries on a massive and growing scale. Fifty-five percent of all the foreign profits of US firms are now kept in such havens. Since multinationals usually try to operate within the letter—if not the spirit—of the law, this profit shifting is better described as "tax avoidance" rather than outright fraud. But its cost is enormous—$130

My claim is that this reality challenges the conventional view of the tax and transfer system as the most efficient way to attain redistribution. I show that the electivity of legal regimes under globalization (i.e., the ability of individuals and businesses to choose the laws applicable to them or to avoid application of a particular legal regime altogether) radically diminishes the effectiveness of redistribution through the tax system. This, I argue, makes other rules an attractive avenue for redistribution.

One of the fundamental debates in the literature is how a state can best redistribute income among its subjects. The canonical preference for the tax and transfer system argues that tax laws are more efficient than other areas of law in redistributing income;[4] some assert, in contrast, that redistribution can be efficiently achieved in many other legal spheres, particularly private law.[5] The objection to redistribution through nontax rules is grounded in two key arguments. First, nontax rules are arguably both over-inclusive and under-inclusive. Unlike tax and transfer rules, which directly target income, nontax rules cannot be as precisely tailored to the redistribution goal. Second, unlike other areas of law (such as private law), tax laws do not create what is known as a "double distortion" problem.[6] Although all laws that redistribute income involve a labor-leisure distortion, nontax rules (or "legal rules" as they have been termed) arguably entail additional distortions. And since tax laws redistribute income in a less costly way than other legal instruments, redistribution via the tax and transfer system provides more resources to the poor, the argument goes. Thus, for example, whereas high taxes will distort people's incentives to work rather than engage in leisurely activities, tort rules favoring poor fishermen over rich yacht owners will distort the latter's incentives not only to produce income rather than engage in leisure but also to take the optimal level of precaution.[7]

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billion a year for US firms alone—and since equity ownership is very concentrated, it essentially benefits only the wealthiest among us.

4. *See infra* Part I.

5. *See infra* notes 11–15 and accompanying text.

6. Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. Legal Stud. 667 (1994).

7. For a discussion of Kaplow and Shavell's example involving damage by a yacht to a fishing boat, see *infra* notes 102–103 and accompanying text.

Together, these two arguments form the canonical claim for redistribution via tax and transfer rules and against redistribution in the framework of other areas of law.[8]

Contrary to conventional wisdom, the Article asserts that global tax competition shakes the case against using nontax rules for redistribution.[9] The electivity of legal regimes currently impacts tax more than it does other areas of law. This raises doubts about the tenets of the over-inclusiveness and under-inclusiveness argument and undermines the double-distortion argument against using nontax rules to effect redistribution.

Globalization has transformed the state-citizen relationship by turning states into market players competing for residents (individuals and 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 shaped by supply and demand. With the increased mobility of residents and factors of production, the state no longer functions as a regime that imposes whatever rules it deems necessary but as a regime that is elective to a large extent. Consequently, individuals and businesses have the ability to choose from a broad range of legal regimes, while states are pressured to offer competitive deals of desired public goods and services (including competitive regulation) at an attractive price. Redistribution has thus become a price that some states can afford to impose on high-ability individuals and businesses. This competitive market reality dramatically weakens states' ability to redistribute, by pushing them to lower the "prices" they charge.

Moreover, individuals and businesses are not limited to shopping for one "pre-packaged" legal regime under the sovereignty of a single state, but they can also buy, à la carte, fractions of regimes under the sovereignty of different states. In other words, the state-subject relationship has not only been marketized but also fragmented: individuals and

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8. *See, e.g.*, Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance,* 56 Tax L. Rev. 157, 177–78 (2003).

9. In this Article, I will distinguish between regulations that govern the relationship between an individual and the state (which I will refer to as tax rules) and rules that apply to interpersonal relationships (which I will refer to as nontax rules).

businesses can detach their residency from the location of their investments, manufacturing plants, and any other business activities and subject each to separate jurisdictions. Even more significant for the purposes of this Article is that they do not have to actually physically relocate themselves or their resources and activities in order to be subject to rules of another jurisdiction, nor do they have to comply with all the rules of any particular jurisdiction as a package deal. Rather, in many cases, they can bind themselves to specific rules of a certain jurisdiction (and avoid the rules of another jurisdiction) by way of choice-of-law rules. Therefore, the public goods and services as well as the rules, in and of themselves, are market choices for taxpayers. The result is that as a practical matter, wealthy individuals and businesses can, to some degree, put together their own legal regime and thereby minimize the price they pay for each of its components. From a state's perspective, the price it charges for each of the unbundled rules, products, and services it offers (including the redistributive component of that price) must be competitive relative to the prices charged by other states for the same products and services.

Under the conventional approach, selecting the most effective legal tool for redistribution is a matter of internal optimization for the closed-economy state. Under the current fragmented and competitive global regime, however, redistribution has become a process of price-setting by a competitive actor (the state) seeking to optimize the (redistributive) price it charges for the legal rules it offers. In this market reality, the best tool for redistribution is the rule for which the highest price can be charged. Thus, given the electivity of taxpayers' choice of jurisdiction, the price (i.e., the redistributive component) of each individual tax or nontax rule should be determined by the elasticity of taxpayers' choice of jurisdiction—i.e., how variations in these prices will impact that choice. Elasticity, the Article will explain, is a function of the availability of alternative choices in other jurisdictions *as well as* the costs of opting for these alternatives.

In the framework of the Article's discussion, two considerations will be offered for determining the optimal rules for attaining redistribution. The first is a given rule's opting-out potential.[10] The different areas of law vary in their criteria for the applicability of their rules. Choice-of-law

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10. For a similar consideration in the domestic context, see David Gamage, *How Should Governments Promote Distributive Justice?: A Framework for Analyzing the Optimal Choice of Tax Instruments*, 68 Tax L. Rev. 1 (2014).

rules, which govern the applicability of legal jurisdictions, make opting in and opting out of jurisdictions more or less costly. Some choice-of-law rules are easily contended with (or evaded). For example, the rules relating to contracts essentially enable individuals to freely choose which rule will apply to their contractual relationships. Other rules, such as those applying to property law, tend to more closely bind to a specific territorial location (e.g., the locus of the asset) and are therefore costlier to plan around. Consequently, such rules are better mechanisms for achieving redistribution, provided that the cost of redistribution does not push individuals to move their factors of production (e.g., their investments in land) to another—more welcoming—location. In short, the effectiveness of rules as a means of redistribution is negatively correlated with how costly it is to avoid them. All other things being equal, then, for any given rule, a state can impose a redistributive price that reflects the cost of opting out of that rule. Accordingly, assuming a country seeks to redistribute income, it would be more efficient to do so through rules that are costlier to avoid.[11]

Despite the efforts made by many states to counter international tax planning, tax laws are still highly susceptible to jurisdiction shopping. If other legal areas are less elastic in terms of the opting-out potential they offer (which is a question to be determined empirically about each jurisdiction), they could facilitate more efficient redistribution. Again, the best legal field (tax or nontax) for applying redistributive rules is the one that entails the highest shifting-away costs (adjusted for the costs of distortions). Thus, for example, whereas a yacht owner could relatively easily earn her income tax free in Bermuda even without relocating there, assuming she wishes to explore sites beyond Bermuda, she may be less able to avoid redistribution via, say, tort laws, where jurisdiction is determined according to the "place where the damage occurred" rule.

Alongside opting-out potential, another factor that emerges as relevant under the global paradigm set out in this Article is the extent of legal rule convergence across national borders. Even if an individual can easily make herself subject to the rules of a new jurisdiction, she has no incentive to do so if its rules are identical to those of her current jurisdiction. Some fields of law are more harmonized across national borders than others. The more harmonized a given legal field, the narrower the alternatives for individuals and entities shopping for lax rules. This phenomenon makes some legal areas better candidates than others for

11. This recalls the explanation for why taxes are more efficient as to products with inelastic demand.

implementing redistributive schemes. To illustrate, if tort laws in every jurisdiction were to impose on yacht owners an enhanced duty of compensation towards fishermen, avoiding those laws might be impossible. This would make them a better legal area for implementing redistribution. Similarly, if tax rules and rates were to be globally harmonized, tax-planning opportunities would decrease dramatically. And, indeed, private law tends to be more harmonized, as a general rule, than other areas of law, particularly tax law; as a result, nontax private laws are less impacted by competition in terms of their ability to achieve redistribution.

Combined, the multiplicity of legal jurisdictions and the ability of individuals and businesses to select from amongst them dramatically alter the determination of the best framework for redistribution: tax and transfer rules or nontax (i.e., private law) rules. Since all types of rules are elective to some degree, policymakers must consider the competing legal jurisdictions when deciding on the optimal legal tool for redistribution. When other jurisdictions offer superior legal products, the relative elasticity of the different rules—that is, how likely taxpayers are to opt out of a certain jurisdiction due to the level of redistribution it imposes—becomes a key consideration. Since tax laws seem to offer relatively high elasticity to taxpayers in opting for a preferred regime, they are not necessarily any better for redistributing income than other legal fields; in many cases, they are actually worse.

Moreover, the costs of opting out and the available opportunities vary among individuals and businesses. Globalization and the planning opportunities it facilitates make certain individuals and businesses far more able than others to avoid domestic rules. As a result, not only are certain rules costlier to opt out of than others, but sometimes they are easier to opt out of for some individuals and businesses than for others. Since those with tax-planning capabilities are often the prime targets of redistribution schemes, tax's comparative advantage in targeting the relevant audience no longer justifies the dominance of tax law in the redistribution business.

It is important to note that this Article does not argue that the relative electivity of tax and nontax rules is in any sense an inherent feature of either field. Rather, it takes the reality of choice-of-law rules and tax rules, as well as the existing level of legal convergence and tax-planning, as givens. Accordingly, no normative prescription is offered for the optimal redistribution mechanism. Rather, the Article presents a framework for thinking about redistribution in a globalized economy. As opposed to the traditional canon, this framework includes no fixed axioms. It instead requires that national policymakers carefully analyze

the competitive global market for sovereign goods, consider the elasticity of the demand for the various instruments, and set their redistributive "prices" to maximize their revenue. The outcome will then point to the optimal vehicle for redistribution: tax rules, nontax rules, or a combination of both. In contrast to the conventional approach, there is no a priori favoring of tax rules as tools of redistribution.

The Article proceeds as follows: Part I summarizes the canonical argument for the superiority of tax rules over nontax rules in redistributing income, presenting in brief also some of the critiques of this argument. Part II sets the stage for a new paradigm for analyzing tax rules and nontax rules as tools of redistribution in the transnational era. It explains how globalization and the intensified mobility of people, businesses, and resources facilitate the marketization and fragmentation of sovereignty, two processes that play a central role in the transformation of legal rules into market choices. Part III then presents the proposed paradigm and the factors it identifies as determinative of which rules are better candidates than others for redistribution. In the course of this discussion, the opting-out potential, the effect of harmonization in particular legal fields, and the problem of targeting the right audience are examined. Part IV concludes.

I. The Canon

The classic economic argument is that the tax and transfer system is the best available framework for advancing redistribution. This argument is in response to suggestions for redistribution via nontax rules. Thus, for example, distributive concerns were raised as the normative basis for certain property rules,[12] tort law,[13] contract law,[14] intellectual

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12. *See, e.g.*, Joseph William Singer, Entitlement: The Paradoxes of Property (2000); Gregory S. Alexander, *The Social-Obligation Norm in American Property Law*, 94 Cornell L. Rev. 745 (2009); Hanoch Dagan, *Takings and Distributive Justice*, 85 Va. L. Rev. 741 (1999).

13. Tsachi Keren-Paz, Torts, Egalitarianism and Distributive Justice (2007); Gregory C. Keating, *Rawlsian Fairness and Regime Choice in the Law of Accidents*, 72 Fordham L. Rev. 1857 (2004) (symposium on Rawls and the law).

14. Aditi Bagchi, *Distributive Justice and Contract*, *in* Philosophical Foundations of Contract Law 193 (Gregory Klass et al. eds., 2014);

property law,[15] and bankruptcy law.[16] The classic economic argument sees such areas as inferior for redistribution both because they entail more costs than tax rules *and* because they yield a lower level of redistribution.

The persuasive "double distortion" argument stresses that although tax rules and private law rules both distort the incentive to work when they redistribute income, redistribution through the latter adds another layer of inefficiency, namely, the adoption of less efficient legal rules.[17] Thus, for example, under this argument, when tort rules for compensating the injured victims of car accidents take into account the victims' and injurers' relative levels of income, they not only distort people's incentives for work rather than leisure (like tax laws would) but also impact their decisions to drive more or less, or whether or not

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Anthony T. Kronman, *Contract Law and Distributive Justice*, 89 Yale L.J. 472 (1980).

15. Oren Bracha & Talha Syed, *Beyond Efficiency: Consequence-Sensitive Theories of Copyright*, 29 Berkeley Tech. L.J. 229, 274 (2014); Molly Shaffer Van Houweling, *Distributive Values in Copyright*, 83 Tex. L. Rev. 1535 (2005).

16. Sefa M. Franken, *Cross-Border Insolvency Law: A Comparative Institutional Analysis*, 34 Oxford J. Legal Stud. 97 (2014); Ronald J. Mann, *Bankruptcy and the Entitlements of the Government: Whose Money Is It Anyway?*, 70 N.Y.U. L. Rev. 993 (1995); John A. E. Pottow, *Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to "Local Interests"*, 104 Mich. L. Rev. 1899 (2006).

17. *See, e.g.*, Louis Kaplow & Steven Shavell, Fairness Versus Welfare 34 (2002) (noting that "redistribution through legal rules entails both the inefficiency of redistribution generally (due to adverse effects on work incentives) and the additional cost involved in adopting less efficient legal rules"). It should be noted that although Kaplow and Shavell use in their model an optimal labor income tax as the tool of redistribution, they do not seem to limit their conclusion to labor income taxation. Thus, they remark, "[i]t should be apparent that our result does not depend on the nature of the activity . . . , the form of the legal rule, the income tax system, or the distribution of ability." Kaplow & Shavell, *supra* note 6, at 679. They further specifically note that "[o]ne can think of the labor-leisure distortion as exemplifying any distortion that results from a general redistributive tax." *Id.* at 679 n.22. In any event, their argument was used in the literature as an authority for the general dominance of income taxation as a redistributive mechanism over nontax rules. *See infra* notes 20–24.

to take certain precautions. Therefore, even if nontax rules are equally effective in redistributing income, they achieve this result at a higher efficiency cost.

Moreover, it is argued, nontax rules are inferior tools of redistribution not only because of the extra costs they impose on the system, but also because they have a lower redistributive capacity.[18] For example, in contractual settings, market players can preempt redistributive legal rules by contracting around them.[19] Thus, if the law imposes a standard that favors low-income parties (say, by setting minimal habitability standards for rental housing), the result might be simply an increase in the price of such services for these parties, thereby harming rather than assisting them.

Another key problem with redistribution by way of nontax laws, it is claimed, is that the scope of the redistribution tends to be both under-inclusive and over-inclusive.[20] Unlike tax and transfer rules, which directly target income, other nontax rules cannot be as precisely tailored to the redistribution goal. Thus, the tort rule that compensates victims of car accidents by comparing the victim's and injurer's respective levels of income redistributes solely among people who happen to be involved in car accidents. Similarly, rules that impose standards or criteria that approximate income without directly measuring it (e.g., that assume landlords are always richer than renters) could increase costs for rich and poor landlords alike.[21]

In sum, conventional wisdom holds that tax rules are less costly and more effective than other rules in redistributing income. Thus, under the prevailing economic approach, it makes no sense to redistribute income via inferior, nontax rules, for society would be limited in its capacity to redistribute its resources and thereby harm those most in need of redistribution.

Much criticism has been leveled at this traditional argument against redistribution through private law rules. Some critics seek to show

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18. *See, e.g.*, A. Mitchell Polinsky, An Introduction to Law and Economics 125–27 (2d ed. 1989); *see also* Kaplow & Shavell, *supra* note 6.

19. *See* Polinsky, *supra* note 18.

20. *See, e.g.*, *id.* at 132.

21. Daphna Lewinsohn-Zamir, *In Defense of Redistribution Through Private Law*, 91 Minn. L. Rev. 326, 335–36 (2006).

that nontax rules could be effective under certain circumstances;[22] others have claimed that nontax rules do not distort incentives[23] or that tax rules also entail inefficiencies.[24] Based on behavioral analysis, Christine Jolls has argued that individuals' disincentives to work under redistributive legal rules are different from the disincentives under equally redistributive taxation.[25] David Gamage has focused on tax gaming strategies that are unique to income tax rules in asserting that the combination of

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22. Consider, for example, Ronen Avraham, David Fortus, and Kyle Logue (*Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell*, 89 Iowa L. Rev. 1125 [2004]), who argue that due to heterogeneity among taxpayers in their caretaking skills and income-generating abilities, there is no simple way to determine whether an income-sensitive tort rule would alter an individual's care standards or work habits or to what degree. Tomer Blumkin and Yoram Margalioth (*On the Limits of Redistributive Taxation: Establishing a Case for Equity-Informed Legal Rules*, 25 Va. Tax Rev. 1 [2005]) argue that pecuniary transfers may be inappropriate in some circumstances (e.g., racial discrimination). John R. Brooks II, Brian D. Galle, and Brendan S. Maher (*Cross-Subsidies: Government's Hidden Pocketbook*, 106 Geo. L.J. (forthcoming 2018), https://ssrn.com/abstract=3050674) argue that "cross-subsidies can be more efficient than taxes, especially when they are used to redistribute wealth on grounds other than income, such as the ACA's transfer from men to women." For arguments supporting redistribution through legal rules that precede Kaplow and Shavell, see Bruce Ackerman, *Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies and Income Redistribution Policy*, 80 Yale L.J. 1093, 1121–22 (1971); Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 Md. L. Rev. 563, 613 (1982).

23. Chris William Sanchirico, *Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. Legal Stud. 797, 805–06 (2000) (noting that due to taxpayer diversity, it can be efficient to give equity a little consideration in order to avoid distortionary taxation).

24. Avraham, Fortus & Logue, *supra* note 22, at 1151; Blumkin & Margalioth, *supra* note 22, at 3 (pointing to prohibitive administrative costs).

25. Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 Vand. L. Rev. 1653, 1656 (1998) (noting, for example, that uncertain events, such as incurring tort liability, are often processed very differently from certain events, because they may be charged to different "mental accounts").

a variety of different policy tools (including some legal tools) could be more efficient in promoting distribution than using any single (tax) mechanism.[26] Zachary Liscow recently put forth the convincing argument that equity-informed design of legal rules (e.g., initial allocation of entitlements to the lesser-off) could be superior to taxation and extended the notion of equity beyond redistribution based on income (e.g., compensating pollutees who develop asthma even if their income does not decrease).[27] Another line of criticism challenges the particular consequentialist theory underlying Kaplow and Shavell's economic analysis.[28]

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26. Gamage, *supra* note 10.

27. Zachary Liscow, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 Yale L.J. 2478 (2014). Hence, some legal rules (such as those allocating clean air property rights to the poor) may reduce the amount of (labor-leisure distortive) taxation and be more efficient in redistributing:

> One may conceptualize the shift from the negligence rule to strict liability as a transfer of an entitlement. Transferring the property right essentially leads to a free reduction in the distortion from taxation. The social planner is choosing who has the right to clean air, poor residents or rich polluters. The social planner is choosing who has the right to clean air, poor residents or rich polluters. My argument is simply that the social planner should not distribute that right to those who are already advantaged. The social planner should distribute that right to the disadvantaged. In other words, advantaging the poor in defining a tort is a way of transferring assets to them. This is perhaps better defined as distribution rather than redistribution—indeed, perfect, costless, equity-informed distribution. It beats the one-third rule for the distortion caused by taxes. In fact, it beats taxes infinitely, with a distortion of one-third for taxes versus no distortion for adopting the equity-informed rule described here.

Id. at 2487.

28. *See* Lewinsohn-Zamir, *supra* note 21, at 328–32 (arguing for an objective theory of human well-being in lieu of simplistic preference satisfaction and suggesting that the benefit people derive from resources depends on complex factors, including the source of those resources).

With this as background, the next Part sets the groundwork for the analytical framework that I offer as a challenge to the canonical claims.

II. Setting the Stage

The traditional conception of states implied in the canonical analysis is that they are powerful sovereigns operating in a closed economy, with the capacity to make and enforce mandatory rules, impose taxes, and set redistribution. Under global competition, however, the relationship between states and their constituents has changed from a compulsory regime, where the state imposes rules on the subjects, to a generally elective marketplace, with states instead compelled to offer competitively priced deals of goods, services, and, as in the context of our discussion, rules. Redistribution is now a price some states are able to charge of high-ability individuals and businesses. The marketplace competition for residents and resources reduces states' ability to redistribute and thereby sets the upper limit on redistribution. Moreover, as explained, electivity not only marketizes but also fragmentizes the relationship between states and their subjects by de facto allowing individuals and businesses to pick and choose among the rules of different regimes. Thus, competition exists not only between states providing take-it-or-leave-it packages but also across the many rules (and public goods and services) that individuals and businesses can choose from separately. While marketization dramatically undermines states' ability to redistribute, fragmentation impacts which mechanism is optimal for redistribution. In what follows, I contend that not only in setting the level of redistribution but also in designing the optimal tools of redistribution, states should abide by the market rules rather than limit themselves to minimizing internal distortions.

A. Marketization

State rules do not seem like a consumer good. Setting state legal policy is traditionally viewed as the domain of national sovereigns. Thus, the traditional perspective envisions states as ruled by sovereigns with exclusive legislative powers, aiming (ideally) to maximize welfare and justly (re)distribute it while reinforcing the underlying normative values shared by the state's constituents. This is, presumably, how the canonical view depicted the world, which implicitly assumes a closed

economy where states can and should make the legal rules. From this perspective, it is indeed understandable why a state should select the least distortive rule in pursuing its objectives.

Under globalization, however, this reality is undergoing significant change. Taxpayers—both individuals and businesses—are becoming increasingly mobile and, therefore, can select from alternative jurisdictions to which they can relocate their places of residence and business activities. For example, in recent years, many ultra-rich individuals have expatriated in order to avoid high taxes, shifting not only their residence but also their citizenship to another jurisdiction.[29] States often encourage such mobility by offering desirable incoming residents certain privileges and incentives.[30] Residents-on-demand relocate to more appealing jurisdictions: states lure away foreign medical experts, Olympic athletes, potential investors, and young productive individuals to salvage their collapsing social security systems.[31] Multinational enterprises (MNEs) are also, of course, mobile. They can incorporate and sometimes even re-incorporate[32] in their jurisdiction of choice and move

29. Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. Rev. 443, 490 (2007).

30. *See, e.g.*, Louis T. Wells, Jr. & Nancy J. Allen, *Tax Holidays to Attract Foreign Direct Investment: Lessons from Two Experiments*, *in* Using Tax Incentives to Compete for Foreign Investment: Are They Worth the Costs? 1, 27–32 (Foreign Inv. Advisory Serv. 2001); Alex Easson & Eric M. Zolt, *Tax Incentives* 15–18 (World Bank 2003), http://siteresources.worldbank.org/INTTPA/Resources/EassonZoltPaper.pdf.

31. *See* Ayelet Shachar, *Picking Winners: Olympic Citizenship and the Global Race for Talent*, 120 Yale L.J. 2088 (2011); Ayelet Shachar, *The Race for Talent: Highly Skilled Migrants and Competitive Immigration Regimes*, 81 N.Y.U. L. Rev. 148 (2006).

32. The question of corporate reincorporation's sensitivity to tax considerations was highly debated in the United States in the context of corporate inversions, particularly in the pharma industry. See, notably, Edward D. Kleinbard, *Competitiveness Has Nothing to Do With It*, 144 Tax Notes 1055 (Sept. 1, 2014) (arguing that inversions are not motivated by tax disadvantages of U.S. corporations), and recently, Michael S. Knoll, *Taxation, Competitiveness, and Inversions: A Belated Response to Kleinbard*, 155 Tax Notes 619 (May 1, 2017) (reviewing the [limited] available empirical literature and concluding that the data available is inconclusive at best, and does not support Kleinbard's position; most of it, Knoll argues, supports the opposite view).

their production, marketing, and R&D activities to more favorable locations.[33] In addition, enterprises in demand are strongly encouraged

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33. For a recent review of the empirical research on the effect of host and residence tax on the location decisions of corporations and their subsidiaries, which supports this prediction, see Peter H. Egger and Michael Stimmelmayr, *Taxation and the Multinational Firm* 6–7 (CESifo Working Paper Series No. 6384, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2941448. For an extensive discussion of the electivity of corporate residency under U.S. laws and the problems in measuring it, see Daniel Shaviro, *The Rising Tax-Electivity of U.S. Corporate Residence*, 64 Tax L. Rev. 377, 403 (2010) (David R. Tillinghast Lecture) ("In gauging the electivity of U.S. corporate residence, the key issue is whether its nontax advantages to those who would choose it if they were tax-indifferent are low enough that any significant associated tax cost would lead to opting out. Unfortunately, this is hard to measure directly. . . ."). But consider Eric J. Allen and Susan C. Morse (*Tax-Haven Incorporation for U.S.-Headquartered Firms: No Exodus Yet*, 66 Nat'l Tax J. 395, 406–09 (2013)), who demonstrate that, despite their ability to choose between foreign and U.S. incorporation, U.S.-headquartered corporations that engage in international activities are, in fact, usually formed in the United States. As Michael Knoll notes, however,

> [T]he authors [Allen and Morse] do find that those U.S.-headquartered IPO companies that incorporate in tax havens have relatively more foreign income than those that incorporate in the United States. They interpret that result as suggesting that the companies that incorporate in tax havens expect to have larger tax benefits than would other companies from incorporating in a tax haven. Presumably, if U.S. incorporation was as tax-efficient as tax haven incorporation . . . companies with larger foreign earnings should be no more likely than other companies to incorporate in tax havens.

Knoll, *supra* note 32 (footnotes omitted). See also J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Defending Worldwide Taxation with a Shareholder-Based Definition of Corporate Residence*, 2016 B.Y.U. L. Rev. 1681, 1686 n.13 ("Studies have shown that despite the few legal limitations on the power to choose between foreign and U.S. incorporation, U.S. headquartered corporations that engage in international activities are, in fact, usually formed in a U.S. jurisdiction. Nevertheless, it is clear that if the relevant decision makers determine that the tax benefits of foreign incorporation are sufficiently attractive, they have substantial freedom to elect foreign incorporation, particularly for foreign-headquartered subsidiaries." [citations omitted]); *see also*

by host states to relocate. States compete for the production facilities of MNEs (as they provide jobs and spillover of know-how),[34] for their headquarters and R&D centers (in the belief that they create positive externalities),[35] and even for their formal incorporation (for the registration fees and (albeit sometimes minimal) tax revenues).[36]

For the mobile, the legal rules that apply to a certain jurisdiction as well as the applicable tax rules and rates are important considerations when weighing residency options and where to locate economic activities.[37] Hence, for states, tax rules and rates have become, to a large extent, the currency of competition.[38] This puts states in an unfamiliar position: no longer do they impose compulsory tax and regulatory requirements on their subjects solely to advance the collective goals of a given group. Rather, the policymaking process has gradually been transformed by competition, with the state increasingly operating as a recruiter of

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Michael P. Devereux & Rachel Griffith, *The Impact of Corporate Taxation on the Location of Capital: A Review*, 9 Swedish Econ. Pol'y Rev. 79 (2002); Johannes Voget, *Relocation of Headquarters and International Taxation*, 95 J. Pub. Econ. 1067 (2011).

34. *See, e.g.*, E. Borensztein, J. De Gregorio & J-W. Lee, *How Does Foreign Direct Investment Affect Economic Growth?*, 45 J. Int'l Econ. 115 (1998); Holger Görg, *Productivity Spillovers from Multinational Companies*, *in* Perspectives on Irish Productivity 240 (Ciarán Aylward & Ronnie O'Toole eds., 2007).

35. *See, e.g.*, Jan I. Haaland & Ian Wooton, *International Competition for Multinational Investment*, 101 Scandinavian J. Econ. 631 (1999).

36. Ronen Palan, Richard Murphy & Christian Chavagneux, Tax Havens: How Globalization Really Works 36–38 (2010); *see also* Wolfgang Schön, *Playing Different Games? Regulatory Competition in Tax and Company Law Compared*, 42 Common Mkt. L. Rev. 331 (2005).

37. Corporations may be more responsive for such considerations than individuals *See* Schön, *supra* note 36, at 3 ("Enterprises will choose the location, which promises the highest return on investment, taking into account not only the specific costs of the operation but also the regulatory climate and the provision of public goods."). For the U.S. context, see Fleming, Peroni & Shay, *supra* note 33, at 1686 ("U.S. law effectively gives those decision makers significant discretion in determining the residence of corporations engaged in international activities."); *see also* Devereux & Griffith, *supra* note 33, at 81. But individuals as well may consider their residency for tax purposes and use tax planning tools.

38. John Douglas Wilson, *Theories of Tax Competition*, 52 Nat'l Tax J. 269, 298 (1999).

investments and residents from across the globe. If we zoom out to the international level, we find that the once all-powerful sovereign is in fact but one of two hundred or so sovereigns competing with one another for investments, residents, and business activities. Thus, competition has—to a large extent—turned states into market players offering their goods and services to potential "customers." Individuals and businesses, for their part, compare the costs of shifting their residency or economic activities to the potential costs (or gains) of being located in the new jurisdiction under consideration.[39] The lower the costs of shifting jurisdictions and the higher the "price" of redistribution in the current location, the more likely they are to relocate.[40]

The ability of states to redistribute is crucially dependent on how mobile their residents are. Thus, a key aspect of any discussion of redistribution in a global world is the extent to which people and businesses are mobile.[41] The greater their mobility, the lower the costs of

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39. For a classic description of competition for public goods, see Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. Pol. Econ. 416 (1956) (offering a competition-based theory for efficient provision of public goods in the local government context); *see also* Schön, *supra* note 36; Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. Econ. Literature 1120 (1999).

40. A similar argument has been made in the context of the U.S. federal system in Brian Galle, *Is Local Consumer Protection Law a Better Redistributive Mechanism than the Tax System?*, 65 N.Y.U. Ann. Surv. Am. L. 525, 526–27 (2010) (arguing that "at least under existing legal arrangements, local redistributive taxes create distortions and deadweight losses that local tort laws do not. . . . As a result, sellers can easily avoid redistributive taxation, but cannot escape redistributive tort law without surrendering the market entirely. In jurisdictions where escaping redistribution is easy, redistribution is difficult, and the accompanying economic costs are correspondingly high."). Similarly, those on the receiving end of the redistribution will seek the location with the highest rewards. *See* Roderick M. Hills, Jr., *Poverty, Residency, and Federalism: States' Duty of Impartiality Toward Newcomers*, 1999 Sup. Ct. Rev. 277.

41. The literature is divided on how mobile taxpayers actually are. Thus, for example, Peter Diamond and Emmanuel Saez (*The Case for Progressive Tax: From Basic Research to Policy Recommendations*, 25 J. Econ. Persp. 165, 171 [2011]) assume low mobility and, hence, arrive at an optimal top tax rate of 73%. Tomer Blumkin, Efraim Sadka, and Yotam Shem-Tov (*International Tax Competition: Zero Tax Rate at the Top Re-Established* (CESifo, Working Paper No. 3820, 2012), http://www.cesifo-group.de/DocDL

redistribution people and businesses can expect. The need to factor in the opportunities available elsewhere to residents and investors in setting state policy significantly restricts states' ability to redistribute income.[42]

Mobility does not, however, mean that some redistribution is impossible to achieve. Several factors serve as counterweights to competition's downward pressure on redistribution.[43] One central factor is the actual costs of relocation for individuals and businesses. People have to bear the costs of shifting their residences, families, cultural ties, and jobs and switching their domestic loyalties. Businesses may face costs related to moving their physical activities and workers and applying for new permits. A second important factor is the specific market power of a jurisdiction. If a jurisdiction offers an attractive residential environment, particular loyalties (e.g., a strong sentiment in favor of a specific residential location due to historical, cultural, or national ties), a unique commitment to the welfare of fellow members of the community,[44]

/cesifo1_wp3820.pdf) assume high mobility and arrive at an optimal top tax rate of 0%.

42. This is particularly acute given that there tends to be (although there not always is) a correlation between wealth and mobility. The wealthiest people (as well as their capital) are often the most mobile people. Therefore, broad-brush rules seeking to treat the mobile more leniently will tend to limit redistribution via tax laws. Since redistribution targets the wealthiest, mobility limits states' ability to redistribute. Taxing the mobile-rich might push them away; taxing the less mobile (and not as rich) will yield less efficient redistribution.

43. *See, e.g.*, Vivek H. Dehejia & Philipp Genschel, *Tax Competition in the European Union*, 27 Pol. & Soc'y 403, 409 (1999) (applying Nash equilibrium concepts to tax competition); Thomas Plümper, Vera E. Troeger & Hannes Winner, *Why Is There No Race to the Bottom in Capital Taxation?*, 53 Int'l Stud. Q. 761, 764 (2009) ("No doubt, the prediction of zero capital tax rates was not in line with reality when it was first formulated and it did not come true since."); Sijbren Cnossen, *Tax Policy in the European Union: A Review of Issues and Options* 15 (CESifo, Working Paper No. 758, 2002), http://www.cesifo-group.de/DocDL/758.pdf (noting that taxes on labor are not highly affected by tax competition because of issues such as language barriers).

44. *See* Alberto Alesina & Paola Giuliano, *Preferences for Redistribution* (Nat'l Bureau of Econ. Research, Working Paper No. 14825, 2009), http://www.nber.org/papers/w14825.pdf.

natural resources, network externalities, or any other comparative advantage (e.g., superior corporate governance[45]), it should be able to allow for more redistribution. Such factors may well explain how states continue to collect above-zero taxes and allow for a certain level of redistribution even under the current conditions of global competition.[46] The analysis in Part III will, accordingly, assume some redistribution to be feasible even in a competitive global setting.

With mobility in the background, states weigh the benefits of redistribution relative to the potential costs of driving away wealthy residents and businesses with excessive redistribution. Competition among states has constructed a market in which states offer public goods for a price, namely, the taxes paid to them for being under their jurisdiction.[47] Market forces determine, to a large degree, investment flows, relocation decisions, and states' ability to collect taxes. In this setting, sovereign states are suppliers, while individuals and businesses shop around for investment opportunities and packages of public goods. Under such a market regime, states should adopt policies that reflect their comparative advantage relative to other states in the market, so as to attract and retain mobile individuals, businesses, and factors of production.

Yet mobility per se does not seem to entail differences between tax and nontax rules, at least insofar as we presume people's decisions to relocate themselves or their activities to be indifferent to whether their income is redistributed via tax or nontax rules.[48] Assuming that the

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45. *See, e.g.*, Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 Va. L. Rev. 1649 (2015) (noting that the bundling of tax with place of incorporation enabled the United States to collect taxes due to MNEs' preference for Delaware corporate laws).

46. U.S. federal laws and local tax laws have evolved so as to limit location-specific rents, especially for businesses operating in more than one jurisdiction, thereby making redistribution via local tax rules relatively inefficient. *See* Galle, *supra* note 40, at 534–37 and references cited therein.

47. Tiebout, *supra* note 39.

48. It could be argued that people's perceptions, biases, and attitudes influence their inclination to either comply with a specific regime or seek an alternative jurisdiction. These inclinations may vary across different legal fields. If, even under similar levels of redistribution, people—due to behavioral factors—have a stronger preference for exiting a jurisdiction in one legal

decision to relocate is affected by the overall level of redistribution and not by the rule by which it is achieved, mobility in itself does not justify preferring tax rules to nontax rules or vice versa. The ability of individuals and businesses to relocate and opt for a preferable "package" of public goods and services at a better price is only one part of the picture. The other part, elaborated on below, is the ability of individuals and businesses to unbundle and reassemble these packages tailored to their specific requirements.

B. Fragmentation

Electivity, which is the ability of individuals and businesses to choose the legal regime that applies to them, not only marketizes the relationship between states and their subjects by allowing the latter to shop for their jurisdiction of choice, but also allows them to unbundle the packages of goods and services offered by different states. Indeed, in this market, individuals and businesses can buy à-la-carte fractions of regulatory regimes under different state sovereignties. As a result, they can reside in one jurisdiction (and consume its police protection, parks, and clean air), do business in another (and use the local court and banking systems), invest in a plant in a third (and reap the benefits of its publicly educated workforce), vote in a fourth, and pay taxes, if any, in a fifth.

The reason this is possible is that different factors trigger the application of different duties and rights. Some rights and duties are extended to residents; 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,[49] or, simply,

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field (e.g., tax law) than in another legal field (e.g., tort law), the latter becomes more resilient and can, hence, implement higher levels of redistribution. People's preferences may vary due to the saliency of the rules at hand, their level of sympathy with a rule's objectives, or their different risk-taking attitudes. *See* Jolls, *supra* note 25, at 1669 (stressing risk and separate mental accounting as diversifying factors).

49. For example, the right to work is often dependent on one's residency status. Residency may also determine the right to marry and adopt, the right to receive social security benefits, and the right to education and medical treatment.

place of abode,[50] or key place of business.[51] Others are connected to citizenship,[52] to the location of one's property,[53] to one's (even temporary) presence or specific actions within the state's jurisdiction,[54] or to a specific

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50. The rules of many jurisdictions, like tax treaties, view one's place of abode to be a significant factor in determining residency for tax purposes. See, e.g., N.Y. Tax Law § 605(b) (LexisNexis 2017); OECD Model Tax Convention on Income and on Capital: Condensed Version, July 15, 2014, art. 4. Property law in the United Kingdom also uses usual place of abode, Income Tax Act 2007, c. 3, §§ 874(1)(d), 971(2).

51. The insolvency rules of many countries apply to the assets of MNEs whose center of main interests is located within their territory. *See* Franken, *supra* note 16, at 98. Additionally,

> [t]he EC Insolvency Regulation first introduced the concept of 'centre of main interests' as a connecting factor, which concept was later adopted by the UNCITRAL [U.N. Commission on International Trade Law] Model Law. Both the EC Insolvency Regulation and the Model Law presume that in the case of a company or legal person, the place of the registered office shall be the centre of main interests in the absence of proof to the contrary.

Id. at 102 n.12. Many countries define corporations' central management and control matters for tax purposes (e.g., UK, Canada, France, Germany, Italy, and Japan). *See* Reuven S. Avi-Yonah, Nicola Sartori & Omri Marian, Global Perspectives on Income Taxation Law 133–34 (2011) (providing definitions of corporate residency for tax purposes in the G7).

52. For example, the right to vote or to be elected. *See* T. Alexander Aleinikoff & Douglas Klusmeyer, Citizenship Policies for an Age of Migration 42 (2002).

53. Many tax incentives are determined by the location of the property. *See* Edward L. Glaeser, *The Economics of Location-Based Tax Incentives* (Harvard Inst. of Econ. Research, Discussion Paper No. 1932, 2001).

54. U.S. securities laws will generally apply only to securities sold on a U.S. exchange or to companies with a significant economic presence in the country. *See* Chris Brummer, *Post-American Securities Regulation*, 98 Cal. L. Rev. 327, 336 (2010). Antitrust laws apply to those doing business within a jurisdiction and may apply where the activity of a foreign person affects competition in domestic markets. *See* Hannah L. Buxbaum & Ralf Michaels, *Jurisdiction and Choice of Law in International Antitrust Law—A US Perspective*, *in* International Antitrust Litigation: Conflict of Laws and

registry (such as the registration of a corporation as incorporated in the given state,[55] of a financial instrument,[56] of a vessel, or of a vehicle[57]).

Globalization allows people and businesses to detach these factors from one another. In some cases, this involves relocating actual resources, while in others, it is merely a matter of signing specific documents or doing some paperwork. Thus, capital can move separately from its owner, IP can shift separately from the technology it manufactures, production can be separated from sales, and corporations can be separated from their stakeholders. Indeed, people no longer have to reside or even be physically present where they do business; the corporate structure enables businesses to set up residency in any number of locations; people can own property, open bank accounts, invest, and consume in various locations simultaneously. As a result, they can establish residency or be physically present in the location that offers them the residency package most compatible with their preferences, while, at the same time, invest, do business, or even consume in other locations.

On the supply-side, states, for their part, compete for residents, resources, and tax revenues according to their specific needs (which can vary) by offering attractive regulatory packages. Thus, a state competing for investments may offer a regulatory environment that is attractive to potential investors, tailoring the costs and benefits of its packages of public goods and services to fit the specific interests of investors. These packages (e.g., legal protection, favorable banking rules, and low taxation) should be connected to (and thus triggered by) specific features of the investment or the investor (e.g., capital ownership, active business investment, or the provision of jobs). In contrast, when a state competes for residents, what they require (and, hence,

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Coordination 225 (Jürgen Basedow et al. eds., 2012). In the vast majority of taxing jurisdictions, nonresidents are taxed only on income sourced within the country. *See* Reuven S. Avi-Yonah, International Tax as International Law: An Analysis of the International Tax Regime 64–90 (2007).

55. The corporate governance rules of the jurisdiction apply to corporations incorporated within the jurisdiction. *See, e.g.*, Talley, *supra* note 45.

56. Securities regulation in the U.S. applies to corporations listed in a public securities market. *See id.* at 1699.

57. Many states require the registration of motor vehicles and boats. *See, e.g.*, California Veh. Code § 4001 et seq. (Westlaw, Oct. 2017); Marshall Islands Maritime Act, 1990, § 201 et seq., https://www.lowtax.net/information/marshall-islands/maritime_act.pdf.

the packages designed to attract them) probably differs (e.g., quality education, personal security, and stronger environmental standards). States enjoy different comparative advantages, and prices for the packages they offer are set accordingly: a state that is known for its attractive residential environment can charge higher taxes. A state with a desirable corporate governance regime can impose higher taxes.[58] A state that captures the financial markets can implement stricter regulation.[59] A state in dire need of direct foreign investments might have to relax its labor or environmental regulation.[60]

Competition among jurisdictions is not simply a matter of an all-inclusive state competing with other states for the entire faculty of individuals and businesses (i.e., their residency, their business activities, their intellectual property, their savings, and their consumption). Rather, the competition occurs simultaneously in a number of parallel markets: the market for residents, the market for capital, the market for

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58. *See* Talley, *supra* note 45, at 1652 (arguing that the U.S. could charge relatively high corporate taxes since it has bundled its tax system with its corporate governance regime); *see also* Schön, *supra* note 36, at 336–37 (discussing the unbundled "price" of company laws).

59. Thus, for example, the U.S. used the comparative advantages of its capital markets to successfully promote the Foreign Account Tax Compliance Act. *See* Joshua D. Blank & Ruth Mason, *Exporting FATCA*, 142 Tax Notes 1245 (Mar. 17, 2014).

60. *See* Dan L. Burk, *Law as a Network Standard*, 8 Yale J.L. & Tech. 63, 66 (2006).

> Local law comprises an important component of each jurisdiction's competitive package. Regulation with economic effects may be tailored to foster and attract certain industries. For example, environmental regulations may be eased in order to lower the operating costs of favored industries. Patent and copyright laws may be strengthened in order to maximize the economic return to industries that innovate. Corporate and partnership laws may be designed to accommodate investment and control structures amenable to certain industries. Indeed, development of desirable law "products" may be even more important to attract and retain high-value businesses activity than it is to attract and retain high-value individuals.

Id.

production sites, the market for jobs, etc. Hence, particular services, public goods, and legal rules have to be individually priced.

Of particular importance for the purposes of this Article is that much of the picking and choosing on the part of consumers can be conducted through sophisticated legal planning. Whether in the context of shopping for the best corporate governance laws,[61] bankruptcy laws,[62] admiralty laws,[63] the optimal tax jurisdiction,[64] or the most convenient banking laws,[65] the bottom line is that individuals and businesses can use choice-of-law mechanisms offered by the competing states to make themselves subject to a new jurisdiction rather than to actually relocate.[66]

Tax rules are no different in this respect. International tax laws are famous for the variety in the conditions that determine their

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61. *See, e.g.*, Schön, *supra* note 36.

62. Franken, *supra* note 16.

63. *See, e.g.*, John Hare, *Shopping for the Best Admiralty Bargain: Competing Jurisdictions in Admiralty Claims with Particular Emphasis on Forum Shopping Motivated by Domestic and International Differences in Regimes for the Limitation of Liability*, *in* Jurisdiction and Forum Selection in International Maritime Law: Essays in Honor of Robert Force 137, 138 (Martin Davies ed., 2005).

64. The selection of one's tax jurisdiction is made by using treaty shopping techniques and tax haven planning, for example. *See* OECD, *Addressing Base Erosion and Profit Shifting* (2013), http://www.oecd-ilibrary.org/docserver/download/2313151e.pdf?expires=1508373054&id=id&accname=ocid194682&checksum=B45EAEEF389E857A11F464B0363B22C1 [hereinafter BEPS Report].

65. For generations, Swiss banks were famous for their secrecy rules. *See* Bradley J. Bondi, *Don't Tread on Me: Has the United States Government's Quest for Customer Records from UBS Sounded the Death Knell for Swiss Bank Secrecy Laws?*, 30 Nw. J. Int'l L. & Bus. 1, 1 (2010). This reputation was seriously damaged recently. *See* Blank & Mason, *supra* note 59 and references therein.

66. Moreover, there is often significant coordination between the supply and demand sides of these markets. States and the potential "consumers" of their rules can often negotiate the terms of the "deal." For example, states adapt their regulations to the needs of a large enough group of investors, allow some leeway in specific regulation, or amend laws due to pressure from interest groups to make the jurisdiction more amenable to their preferences.

application. While residency is key, it too can be determined by very different requirements in different jurisdictions;[67] the location of property also plays an important role in the application of tax laws, as does the place of active business. And yet, because states compete for residents, investments, and businesses, they often offer taxpayers of other countries tax havens in return for their residency, investments, and even fractions of their tax payments at times. The outcome is—again—a fragmented international tax landscape where taxpayers can assemble the tax regime of their choice by combining the residency rules of one jurisdiction, the source rules of another, the deductions allowed in a third, the tax rates of a fourth, and the withholding rates set in treaties between some of these jurisdictions. Hence, taxpayers (at least those states seek to attract) can assemble the different components of their optimal tax regime from legal jurisdictions that do not necessarily correlate with those governing their other affairs.[68]

What is important in our context is that the choice of legal jurisdiction (tax or nontax) does not hold for every aspect of one's life. That is to say, individuals and businesses do not have to comply with all of the rules of any particular jurisdiction as a package deal. As a practical matter, a wealthy individual can, to some degree, assemble her regime of choice and minimize the price she pays for it. In contrast to the classic mobility story, which tends to describe a market of states offering take-it-or-leave-it package deals of legal rules, services, and taxes, the fragmentation perspective highlights the electivity and flexibility of these packages. Instead of looking at people's and businesses' ability to shift their choice of jurisdiction en bloc by moving their residency to a new jurisdiction, the analysis here stresses their 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 the state-constituent relationship cannot, and does not, necessarily bundle together all of the dimensions of the potential interaction between taxpayers and states. This reality impacts the

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67. Schön, *supra* note 36, at 342–44 (comparing incorporation versus real seat requirements for corporate residency).

68. *But see id.* at 336 (describing tax competition as competition between bundled goods, whereas company law competition is over only one particular good).

strategies used by individuals and businesses as well as states. Whereas absent this jurisdictional fragmentation, the potential strategies for individuals and businesses are essentially either voice (using their political power to shape state policy) or exit (relocating to a jurisdiction that offers a more favorable regulatory "package"),[69] they now have another option that will maximize their benefits: to diversify their state-related interactions. Thus, in the market for legal rules, people can choose not only between jurisdictions in their entirety but also different fractional combinations thereof.

States must also adapt their strategies to the reality of electivity under fragmentation. They must internalize that they (should) operate as competitive players in multiple markets and should rethink, accordingly, their optimal market strategies. Should they cooperate with competitors? Should they offer newly bundled packages of public goods and services? Should they price discriminate between different potential consumers? A complete analysis of these possible strategies is far beyond the scope of this Article. However, it is important to note one aspect of this fragmented market regime, which is central to the rest of my analysis: the considerations in selecting the most effective means for redistribution have dramatically changed. From internal maximization, this has become a matter of determining the optimal market strategy for a supplier of goods (the state) competing for clientele. Hence, a new paradigm emerges for analyzing the preferability of tax rules versus nontax rules as tools for redistribution, which I now turn to in Part III.

III. A Paradigm Shift

The canonical argument for tax rules as the best means of redistribution and the prevailing critiques of this view all take a closed-economy, national-level perspective. In the era of globalization, however, redistribution is no longer the internal optimization problem depicted by the traditional view. Since states are now subject to the rules of the fragmented global market, their ability to redistribute and the optimal mechanism for redistribution are determined by each state's respective position as a competitive actor in this market. This perspective shakes

69. Albert O. Hirschman, Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States (1970).

the underlying tenets of the traditional argument, in that it conceives of legal rules as market choices in and of themselves. If legal regimes are seen as market choices for taxpayers, redistribution can be understood as a price states can charge for using the regime they offer. As with any market product, the price individuals and businesses will be willing to pay in terms of redistribution depends on how elastic their demand for the product is. Therefore, in the global market, states can no longer pursue monopolistic gains through their tax systems and must, instead, assess the alternative products offered by other jurisdictions and set their prices accordingly.

As explained, competition curtails the ability of states to redistribute in many respects. And yet, a certain level of redistribution remains feasible even under the current conditions of heightened competition for residents and intensified resource mobility, due to the comparative advantages a state can offer relative to its competitors and the costs of relocating or shifting certain resources to new jurisdictions. Assuming states are interested in redistribution, the original debate resurfaces, namely, whether it is tax rules or nontax rules that are the more efficient means of redistribution.

From the perspective of the new paradigm I propose, the answer cannot be determined by looking solely or even primarily at the different distortions caused by tax rules and nontax rules in a closed economy. In the marketized and fragmented global economy, the instruments themselves (both nontax and tax) are—to a certain degree—market products. As such, their relative ability to redistribute—i.e., their redistributive price—should be determined according to the global forces of supply and demand rather than by weighing internal distortions.

As part of their strategy as market players, in setting the price (i.e., the redistributive level) of a certain legal regime, state policymakers must assess the extent to which taxpayers' choice of jurisdiction is elastic with respect to changes in that price. The highest redistributive outcome, I argue, could be achieved by imposing a higher price on the least elastic instrument.[70] The more inelastic taxpayers' choice, the less inclined or able they will be to shift to another jurisdiction. Elasticity, I

70. A similar argument has been made in the context of the U.S. federal system in Galle, *supra* note 40, at 532–33 (arguing, in the local jurisdiction context, that tort rules may be a more effective second-best mechanism for states to seize local rents than tax rules due to the laxer constitutional

explain below, is determined by the availability of superior options in other jurisdictions *and* the costs of opting for those options. Available alternatives and the costs of opting out vary across legal instruments: hence, the redistributive price of tort rules, for example, should be, and in fact probably can be, different from the price of property rules or tax rules.

This does not mean that Kaplow and Shavell's double-distortion claim is invalid. What it does mean is that it is far from being the only or even most compelling consideration in determining how to redistribute. Their analysis, in focusing on distortions, misses a crucial point: that individuals and businesses can choose from competing jurisdictions. Where people can more easily opt out of tax rules than nontax rules, the latter may prove to be more, rather than less, efficient in redistributing income. An extreme example would be a market in which the demand for tax rules is completely elastic—and, hence, any redistributive price a state sets on its tax rules would drive taxpayers to the tax "products" of other states—but a certain nontax rule is completely inelastic, meaning taxpayers would be willing to pay any price (up to their entire amount of profits in the given jurisdiction) to use that rule. Hence, a state could impose the maximum redistributive price via the nontax rule but not via its tax rules. The additional distortion created by nontax rules should certainly be taken into account when calculating the costs of offering a specific legal regime. However, although the gain for this state by redistributing through the nontax rule would be diminished due to the efficiency losses entailed by suboptimal legal rules, the result—in terms of redistribution—would still be superior to what would result from using tax rules.

The discussion in the rest of the Article focuses on the competitive aspect of legal jurisdictions and, in particular, on a fundamental element of the "how to redistribute" dilemma, which the traditional analysis obscures: the relative elasticity of the various alternatives (in particular, tax rules as opposed to nontax rules) for redistribution under conditions of competition. I seek to provide the theoretical infrastructure for shifting the paradigm of analysis from the conventional statist perspective to a global, competitive framework suited to the contemporary transnational reality. I assume that despite the general competitive pressure (due to the mobility of people and resources) to reduce redistribution,

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restraints on states, which allow firms to enjoy local rents without paying local taxes).

some level of redistribution is still possible, and I consider which legal fields are better at achieving redistribution, given the electivity of the global market for legal regimes.

In the next two sections, I discuss two critical divergences across the various legal fields that render some better than others as avenues of redistribution. The first is found in the differing relative costs of opting out of a jurisdiction under the legal field's choice-of-law rules; the second divergence is in the extent of harmonization of various legal fields across national borders. Notably, tax rules do not rank high in either of these aspects, making them a more problematic redistribution framework than nontax rules in a globalized economy. In the first two parts of this analysis, I assume that individuals and businesses are homogenous in their ability to opt out. The third section relaxes this assumption in exploring another traditional concern regarding the comparative ability of tax and nontax rules to target the relevant audience: inclusiveness. This remains a valid, indeed important, consideration in our transnational world. But, again, it does not necessarily weigh in favor of tax laws, as opposed to nontax laws, for redistribution in conditions of global competition.

A. The Costs of Jurisdiction Shopping

The multiplicity of alternative legal jurisdictions in the global regime has meant an increase in choices for individuals and businesses seeking to reduce their costs of redistribution. Complete exit from a jurisdiction is obviously one way to reduce these costs. It is not, however, the only alternative. Often, people and businesses can avoid the costs of redistribution in a legal regime without completely exiting it and, instead, strategically plan around the application of the laws of that regime.

Choice-of-law rules are what determine the applicability of a certain legal regime to a certain person, business, or transaction—the rules of the game, as it were. These laws determine which state's laws apply to a specific case or set of circumstances.[71] Choice-of-law rules vary across the different legal fields (and, to a lesser degree, across different jurisdictions). Although different states will tend to have similar

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71. Dicey, Morris & Collins on The Conflict of Laws 55 (Lord Collins of Mapesbury et al. eds., 15th ed. 2012).

choice-of-law rules[72] (some because they were transplanted[73] and others due to explicit efforts to harmonize choice-of-law rules to prevent forum shopping[74]), different areas of law (e.g., torts, contract law, property law, consumer-protection law, and, of course, tax law) systematically use different criteria to determine their applicability to particular legal relationships, including, for example, the location of the dangerous activity; the place where the tort was committed (*lex loci delicti*); the place where the damage occurred (*lex loci damni*)*;* the location of the land (*lex situs*); the place where the asset was supposed to be transferred; place of residence; the location of the business activity in question; and even the choice expressed by the contractual parties.[75] The variety of these rules allows individuals and businesses a certain leeway in selecting the rules that will apply to them and their activities, irrespective of their other coordinates (i.e., their place of residence and/or the location of their activities). If residents and businesses can strategically choose their legal jurisdiction, they can ensure that the rules of a foreign jurisdiction apply to them without actually relocating themselves or their activities or changing the location of their investments.

The rules determining applicable jurisdiction can be easier or harder to opt out of. While some require people to actually shift the territorial location of various components of their lives and activities (e.g.,

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72. Of particular importance are the EU regulations that have created significant harmonization amongst European countries: Commission Regulation 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome 1), 2008 O.J. (L 177) 6 [hereinafter Rome I]; Commission Regulation 864/2007 of the European Parliament and of the Council of 11 July 2007 on the Law Applicable to Non-Contractual Obligations (Rome II), 2007 O.J. (L 199) 40 [hereinafter Rome II]. *See also* Die Übersetzung berücksichtigt die Änderung(en) des Gesetzes durch Artikel 17 des Gesetzes v. 20.11.2015, (BGBl. I S. 2010) (Article 3, Introductory Act to the Civil Code Introductory Act to the Civil Code, ch. 1, 2, include the explicit instruction of the German Civil Code that German law will prevail only where no European norm exists).

73. Peter Hay, Patrick J. Borchers & Symeon C. Symeonides, Conflict of Laws 849*,* 877, 1230 (5th ed. 2010).

74. Dicey, Morris & Collins, *supra* note 71, at 55.

75. For a general review of the various choice-of-law rules, see *id*. For some specific examples, see the main text that follows.

the location of the land they own, their factory plant, their store or branch, or the place where their products are marketed or used) in order to become subject to the jurisdiction of a particular regime, other rules mandate only particular legal actions (e.g., signing a contract that explicitly states the parties' choice of jurisdiction, denoting a certain country as the location of the transfer of an asset, or registering a sailing vessel under the flag of the country of choice). While the rules of application of some legal jurisdictions represent real-world choices (such as the residence of an individual or the location of real property), others represent choices by operation of law (e.g., the place of incorporation or IP registration). Indeed, the prevailing choice-of-law rules diverge widely in the criteria they set for determining jurisdiction across the different fields of law (and, hence, in the costs of avoiding an unwanted regime). For example, in property cases involving real estate, courts almost universally apply the *lex situs* (the law of the jurisdiction in which the property is situated);[76] thus, in order to completely avoid the property rules of a certain jurisdiction, one cannot own any real property situated there. Where other tangible assets (i.e., non-land property) are concerned, courts may retroactively apply the law of a jurisdiction in which the asset is not actually located. In such cases, then, avoiding the *lex situs* rule may be slightly easier than in the case of real-estate property, for the asset can be claimed to have a more significant connection to a jurisdiction in which it is not physically located.[77]

So far as tort choice-of-law rules are concerned, European rules tend to focus on the state in which the damage occurred,[78] whereas U.S.

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76. Einführungsgesetz zum Bürgerlichen Gesetzbuche [EGBGB] [Introductory Act to the Civil Code], art. 43, *translation at* https://www.gesetze-im-internet.de/englisch_bgbeg/index.html (Ger.); Dicey, Morris & Collins, *supra* note 71, at 1330; Hay, Borchers & Symeonides, *supra* note 73, at 1231.

77. *See, e.g.*, Einführungsgesetz zum Bürgerlichen Gesetzbuche [EGBGB] [Introductory Act to the Civil Code], art. 46, *translation at* https://www.gesetze-im-internet.de/englisch_bgbeg/index.html (Ger.); Hay, Borchers & Symeonides, *supra* note 73, at 1254.

78. Rome II, *supra* note 72, art. 4(1); Dicey, Morris & Collins, *supra* note 71, at 2210. This is regardless of the country or countries in which indirect consequences of the event may occur. There are, however, two major exceptions: (1) When the defendant and claimant are both habitually resident in the same country at the time when the damage occurs, it is the law of that

rules look to the location of the most significant relationship[79] but allow for certain exceptions, such as the jurisdiction in which both parties reside. Hence, avoiding a particular tort rule in the United States entails not only actually refraining from causing injury in that specific jurisdiction but also taking extra precautions not to harm residents of one's own jurisdiction. Another example is product liability, which, in the European Union (EU), is subject mostly to the law of the habitual residence of the injured person at the time the damage occurred, provided that the product is marketed in that country.[80] Accordingly, to avoid the application of a particular rule, a manufacturer must also generally keep her product out of the undesired jurisdiction's market. Lastly, in the case of trusts, as in the contractual context, the parties usually are able to designate their preferred jurisdiction.[81] The rules of any given jurisdiction can generally be avoided, therefore, by simply stating the parties' choice of applicable law. Yet, in a contractual context, if a considerable power gap exists between the contracting parties—which redistributive rules may, in fact, target in particular—courts may be led to retroactively overrule the parties' consent to the governing jurisdiction.[82] It may thus be harder to contract around certain rules in such circumstances.

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country that applies. (2) When the event is manifestly more closely connected with a different country (e.g., deriving from a preexisting relationship between the parties, such as a contract), it is the law of that country that applies. The European rule is of universal application: that is, the relevant law is applied whether or not it is the law of a member state.

79. Restatement (Second) of Conflict of Laws § 145 (Am. Law Inst. 1971). This was interpreted to follow a specific list of indicators, such as place of injury (particularly in cases of conduct-regulation rules), location of the injurious act, residency of the litigants, and central location of their relationships. *Id.*; *see also* Hay, Borchers & Symeonides, *supra* note 73, at 853.

80. Rome II, *supra* note 72, art. 5(1)(a); Dicey, Morris & Collins, *supra* note 71, at 2220. Otherwise, the law of the country in which the product was purchased is the determining factor or the law of the country in which the damage occurred, if the product is marketed there.

81. *See* Lionel Smith, *Stateless Trusts*, *in* The Worlds of the Trust 89 (Lionel Smith ed., 2013).

82. For example, in cases where the court retroactively finds such jurisdiction to be falsely applied (*see, e.g.*, Rome I, *supra* note 72, art. 3(3);

What emerges from this (clearly brief) review of choice-of-law rules is that the more lax the requirements for opting out of a given regime, the lower the costs of avoiding its rules, and the more easily wealthy individuals and businesses can get around a redistributive scheme if implemented through those rules. To take this to the extreme, if under the variety of existing regimes, individuals could pick the law of their choice irrespective of where they reside or where their activities actually take place, redistribution would be impossible (or would be entirely dependent on individual goodwill) because people with high incomes would have no particular reason to opt for rules that entail redistributing their wealth to others. In other words, the potential of rules to effectively redistribute negatively correlates with how costly it is to avoid them. All other things being equal, with any rule, a state can impose a redistributive toll that is equal to the cost of opting out of the rule.

States, of course, must be aware of the limits mobility places on their ability to redistribute through any law, for excessive redistributive costs could drive away current residents and investors as well as scare off newcomers. My analysis, however, assumes some redistribution to be feasible, even given mobility, and explores the question of the best vehicle for implementing redistribution. If individuals and businesses enjoy sufficient benefits that make it worthwhile for them to remain in a certain state's market even with a certain level of redistribution (though they would obviously prefer to avoid the toll of redistribution if they could), that state, in order to efficiently redistribute, should prefer rules that are costlier to avoid.[83] For the ability to opt out of a legal regime adds to the range of choices

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Restatement (Second) of Conflict of Laws § 187 (Am. Law Inst. 1971); Dicey, Morris & Collins, *supra* note 71, at 1801) or that applying such jurisdiction is against the laws (or policy) of a country whose laws would have applied absent such consent (*see, e.g.*, Rome I*, supra* note 72, art. 9(2); Restatement (Second) of Conflict of Laws § 187(2) (Am. Law Inst. 1971); Dicey, Morris & Collins, *supra* note 71, at 1802; Hay, Borchers & Symeonides, *supra* note 73, at 1099–101).

83. Galle, *supra* note 40, at 538 (arguing that in the U.S. federal context, which limits state-level redistributive taxation, "[l]ocal non-tax redistribution is more efficient than local taxation because it affords greater opportunities for location-specific rents").

available to people and businesses: in addition to their choice between (redistributively taxed) work and (untaxed) leisure and choices that distort the activities governed by the legal rules stressed by Kaplow and Shavell (such as taking excessive precautions), opting out offers a choice between (redistributive) domestic rules and (non-redistributive) foreign rules. As explained, regardless of their efficiency in a closed economy, rules can be easier or harder to avoid depending on the relevant choice-of-law mechanisms. The more easily a rule can be avoided, the less efficient it is as a tool of redistribution.[84] Hence, the ease with which a regime can be avoided is an important factor when weighing the relative efficiency of tax laws and nontax laws for the purpose of redistribution.

Tax law used to be the quintessential example of a legal regime that "covers all bases." Traditionally, tax rules applied both on a territorial basis (to all income-producing activities "sourced" within a jurisdiction) *and* on a personal basis (i.e., to the worldwide income produced by a state's citizens and, sometimes, even its residents). This presumably enabled states to tax local residents, foreign investors, and people with a business connection to the taxing jurisdiction. Arguably, this wide-ranging applicability of national tax laws enabled states to use their coercive power to impose duties to pay redistributive taxes without giving taxpayers any option to opt out (beyond abstaining from producing income altogether).

In the era of globalization, however, tax laws have become notorious for being virtually elective (or, more precisely, elective for some) due to the ability of (some) taxpayers to plan around them. Tax laws may be more elective than other legal rules. One reason for such increased electivity is that taxpayers are able to avoid income taxation. Despite efforts to curtail tax avoidance through national as well as international efforts,[85] tax avoidance in cases of cross-border income still seems to be a substantial problem In the United States, for example, although higher-income taxpayers do pay the larger share of income tax, and notwithstanding the Foreign Account Tax Compliance Act (FATCA), the

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84. Put differently, when rules become a product of choice for their subjects, efficient taxes should be imposed on products with inelastic demand.

85. For a brief description of these efforts, see Tsilly Dagan, International Tax Policy: Between Competition and Cooperation ch. 5 (forthcoming 2018).

state faces a challenge in collecting taxes from its residents' overseas operations.[86] Globalization seriously exacerbates tax avoidance, because

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86. Commissioner Douglas H. Shulman noted the problem of high-wealth individuals:

> This fall, the IRS created a Global High Wealth Industry Group to centralize and focus IRS compliance expertise involving high wealth individuals and their related entities—which can often have an international component. Tax agencies around the world . . . have also formed high wealth groups.
>
> Now, high wealth individuals are not your typical Form 1040 filers with a W-2, some 1099 income, and maybe a Schedule C enclosed with their return. Their tax picture is much more complicated and nuanced.
>
> For a variety of reasons—including valid business reasons—many high wealth individuals make use of sophisticated financial, business, and investment arrangements with complicated legal structures and tax consequences. Many of these arrangements are entirely above board. Others mask aggressive tax strategies.
>
> And there are other tax considerations regarding high wealth individuals, including international sourcing of income and tax residency, and offshore structures and bank accounts, to name just a few.
>
> So what's our game plan here? At least initially, we will be looking at individuals with tens of millions of dollars of assets or income. Going forward, we will take a unified look at the entire web of business entities controlled by a high wealth individual, which will enable us to better assess the risk such arrangements pose to tax compliance and the integrity of our tax system.

IR-News Rel. 2009–116, 2009 IRB LEXIS 720, at *11–12. Additionally, according to the Honorable J. Russell George:

> The Congress, the Department of the Treasury, and the IRS are concerned about the International Tax Gap—that is, taxes owed, but not collected on time, from a U.S. or nonresident person whose cross-border income is subject to U.S. taxation. The IRS has not estimated the size of the International Tax Gap, but non-IRS estimates range from $40 billion to

the variety of taxing regimes and the "gaps and frictions"[87] among them provide a great deal more opportunities for such planning. To be sure, tax avoidance is not a uniquely cross-border problem, and the challenges it presents for the canonical argument against the use of legal rules for redistribution can be found in an entirely domestic setting as well. As David Gamage recently demonstrated, the ability to "game" the system can and does diverge between tax and legal rules in the domestic context. Thus, Gamage convincingly explains that the ability to reduce taxable income creates a distortion unique to income tax laws that does not necessarily affect legal rules in the same way (at least when redistribution via legal rules is not directly connected to one's level of taxable income). Hence, the unique ability of taxpayers to game income tax laws could affect the efficiency of these rules in redistributing income.[88]

Globalization and tax competition add yet another *qualitative* (and not only quantitative) dimension to *these* planning opportunities.[89]

> $123 billion annually. While there might be overlap between the overall IRS Tax Gap estimate and the International Tax Gap estimate, it is unlikely that the $450 billion Tax Gap estimate includes the entire International Tax Gap. The primary reason for this is that identifying hidden income within international activity is very difficult and time-consuming.

Problems at the Internal Revenue Service: Closing the Tax Gap and Preventing Identity Theft: Hearing Before the Subcomm. on Gov't Org., Efficiency & Fin. Mgmt. of the H. Comm. on Oversight and Gov't Reform, 112th Cong. 55 (2012) (statement of the Hon. J. Russell George, Treas. Inspector Gen. for Tax Admin.). For a summary of the distribution of income and taxes and average tax rates, see JOINT COMM. ON TAX'N, 113TH CONG., JCX-25-14, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2014 (2014).

87. OECD, *Action Plan on Base Erosion and Profit Shifting* 11 (2013), http://www.oecd.org/ctp/BEPSActionPlan.pdf.

88. Gamage, *supra* note 10, considered tax avoidance and tax planning at the domestic level focusing on the closed-economy aspects of the tax-gaming problem. *Id.*

89. Gordon and Nielsen have likewise argued in the context of the choice between different tax instruments that a value-added tax and a cash-flow income tax have similar behavioral and distributional consequences where tax evasion possibilities are ignored, but "the available means of tax evasion under each can be very different. Under a VAT, avoidance occurs through cross-border shopping, whereas under an income tax it can occur through shifting taxable income abroad." Roger H. Gordon & Soren Bo Nielsen, *Tax*

Under the current global competitive regime the ability of taxpayers to reduce their tax liability is no longer an imperfection of an existing system as it is in the entirely domestic setting, where such loopholes can—at least theoretically—be eliminated (or ameliorated) by the state with stricter enforcement or a more careful design of its existing income tax laws.[90] Rather, tax competition has made the electivity of tax rules and their fragmentation an *inherent* aspect of the international tax system, which is now typified by a *deliberate* use by states of their tax rules as properties in their inter-state competition. As explained above, under competition, taxpayers can (often with the encouragement of some countries) unbundle states' taxing regimes and combine them into their own tax regime; many states take advantage of this feature; some even make it their business by allowing foreign taxpayers to "park" their residency, or other features, under their jurisdiction in order to save on their costs of public services or even to help these foreigners avoid their taxes elsewhere.[91] This characteristic of the globalized tax regime generates a

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Evasion in an Open Economy: Value-Added Vs. Income Taxation, 66 J. Pub. Econ. 173, 173 (1997). Given evasion, they show that "a country would make use of both taxes in order to minimize the efficiency costs of evasion activity" (*id.* at abstract), and "the less vulnerable one of these taxes is to evasion, the larger its tax rate should be relative to the other tax rate" *(id.* at 176). Gamage has extended this argument to the context of legal rules, convincingly arguing for the use of multiple instruments (i.e., tax and nontax rules) for redistribution. Gamage, *supra* note 10.

90. Obviously, however, desirable countries may be able to better bundle residency with tax liability. *See* Reuven S. Avi-Yonah, *And Yet It Moves: Taxation and Labor Mobility in the Twenty-First Century*, 67 Tax L. Rev. 169 (2014) [hereinafter Avi-Yonah, *And Yet It Moves*] (arguing that individual U.S. residents and citizens cannot escape the income tax on dividends, interest, and capital gains by moving their capital overseas but without moving their residency). The recent FATCA legislation illustrates the powerful ability of a desirable country—like the U.S.—to more effectively control opting out.

91. See Ronen Palan. *Tax Havens and the Commercialization of State Sovereignty*. 56 Int'l Org. 151, 152 (2002), https://doi.org/10.1162/002081802753485160 ("[T]ax havens are like the sovereign equivalent of parking lot proprietors: they could not care less about the business of their customers, only that they pay for parking their vehicles there."); Omri Marian, *The State Administration of International Tax Avoidance*, 7 Harv. Bus. L. Rev. 1, 1 (2017) (documenting a process in which Luxembourg's tax administration consciously and systematically assisted taxpayers to avoid taxes in other jurisdictions, terming it "an intentional "beggar thy neighbor" behavior,

new level of tax modularity that is no longer entirely the object of states' anti-avoidance efforts. It thus dramatically bolsters the effect of tax avoidance and with it upsets the purported advantage of tax law as a tool of redistribution.

The reality is, therefore, that residency and source of income, although still the official criteria for tax liability, are extensively bypassed by tax planners, who use a host of techniques to de facto opt out of a jurisdiction without actually relocating their clients' residency or activities. Tax planners prominently incorporate subsidiaries in tax havens to defer the taxation of their income (such as worldwide royalties or service income) to when the profits are repatriated, if at all.[92] They siphon off income through beneficial tax treaties to and from low-tax jurisdictions, thereby avoiding taxation at source.[93] They use hybrid entities to

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aimed at attracting revenue generated by successful investments in other jurisdictions, without attracting actual investments").

92. Anecdotal data on investments through famous tax havens is telling:

> [B]y searching through the IMF Co-ordinated Direct Investment Survey (CDIS), it emerges that in 2010 Barbados, Bermuda and the British Virgin Islands received more FDIs (combined 5.11% of global FDIs) than Germany (4.77%) or Japan (3.76%). During the same year, these three jurisdictions made more investments into the world (combined 4.54%) than Germany (4.28%). On a country-by-country position, in 2010 the British Virgin Islands were the second largest investor into China (14%) after Hong Kong (45%) and before the United States (4%). For the same year, Bermuda appears as the third largest investor in Chile (10%). Similar data exists in relation to other countries, for example Mauritius is the top investor country into India (24%), the British Virgin Islands (12%), Bermuda (7%) and the Bahamas (6%) are among the top five investors into Russia.

BEPS Report, *supra* note 64, at 17.

93. This technique is explained in the BEPS Report:

> [T]he fact that the owner of the income-producing asset (*e.g.* funds or IP) is located in a low-tax jurisdiction means that in most cases where income is derived from other countries the taxing rights of the source State will not be limited by

take advantage of a deduction in a high-tax jurisdiction, while avoiding taxation in the jurisdiction where the income was produced,[94] or even to take advantage of deductions twice,[95] and they use transfer pricing to allocate revenues to low-tax jurisdictions (e.g., by setting transaction prices between related entities to increase taxable income in low-tax jurisdictions and increase deductions in high-tax jurisdictions). Tax planners also employ earning stripping to erode the tax base in the country where the income was produced[96] and construct creative derivatives

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> any double tax treaty. The interposition of a conduit company located in a State that has a treaty with the source State may allow the taxpayer to claim the benefits of the treaty, thus reducing or eliminating tax at source. Further, if the State of the conduit company applies no withholding tax on certain outbound payments under its domestic law or has itself a treaty with the State of the owner of the income-producing asset that provides for the elimination of withholding tax at source, the income can be repatriated to the owner of the income-producing asset without any tax at source. Taxation of the income from the funds or IP in the State of the conduit company does not take place, since the income will be offset by a corresponding deduction for the payments to the owner of the income-producing asset in the low-tax jurisdiction.

Id. at 41.

94. If, for example, a subsidiary is considered transparent in Jurisdiction *A* but opaque in Jurisdiction *B*, payments (e.g., interest payments or royalties) from *B* to *A* will be deductible in *A* (thus reducing taxable income and tax liability in *A*) but not considered income in *B*. Interestingly states' tax laws practice unbundling here as well. Thus, for example, the U.S. "check-the-box" regulations (Reg. § 301.7701–1 *et seq*.), allow U.S. entities to effectively design their opaque, versus flow-through, tax treatment. These regulations are an example of how the U.S. facilitates unbundling: entities can thereby enjoy corporate status for their corporate governance purposes while benefiting from partnership status for tax purposes, or vice versa.

95. By attributing the deductions to an entity that could be jointly considered for tax purposes with two different entities in two different countries.

96. This typically involves "setting up a finance operation in a low-tax country . . . to fund the activities of the other group companies." BEPS Report, *supra* note 64, at 43. The outcome "is that the payments are deducted

that are viewed as loans in one country and as equity investment in another.[97] Moreover, they oftentimes use a combination of these techniques,[98] amongst others, to reduce the total tax liability of individuals and businesses without any need for residency or prime business relocation. It is important to note, of course, that not all of these tax-planning techniques are available to all taxpayers. In particular, it is important to distinguish between individuals, who are the key target of redistribution policies, and corporations, which enjoy far broader leeway in their tax planning. That said, however, individuals on the very high-end (those classified by Commissioner Shulman as high-wealth individuals[99]) can and do operate through corporations as well other entities (e.g., trusts) and, hence, may also benefit from the loopholes generally available to corporations.[100] The ability of individuals and businesses to engage in

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against the taxable profits of the high-taxed operating companies while taxed favourably or not being taxed at all at the level of the recipient thus allowing for a reduction of the total tax burden." *Id.*

97. If, for example, Country *A* classifies a transaction an equity investment (and, hence, the payments as dividend distributions) and Country *B* classifies the same transaction a loan (and the payments as interest), then payments from *B* to *A* will be considered interest (and, hence, deductible in Country *B*), while considered dividends in Country *A*. If Country *A* exempts dividend income or accords it preferential treatment, there is a tax gain.

98. Google's "Double Irish Dutch Sandwich" is a good example of such a combined structure: Google's worldwide income is channeled to an Irish subsidiary, thus reducing Google's income in high-tax jurisdictions because the fees paid are deductible at source. The Irish subsidiary's income is then reduced by royalty payments to another subsidiary—Google BV, a Dutch corporation—thereby enabling Google to benefit from the exemption from withholding taxes within the EU. Google BV's income is stripped using almost identical royalty payments to a Bermuda company. The Netherlands imposes no withholding taxes, and Bermuda is famous for not taxing income. The result is a near zero tax on Google's income from customers in Europe, the Middle East, and Africa. For a detailed description, see Edward D. Kleinbard, *Stateless Income*, 11 Fla. Tax Rev. 699, 706–13 (2011).

99. *See* IR-News Rel. 2009–116, *supra* note 86, at *11–13.

100. Harrington, *supra* note 2, provides an insider look into the tools of the trade of the prosperous industry of wealth managers. For their tactics and techniques in the tax area, see *id.* 151–159. Mitt Romney's offshore corporations, for example, made headlines in 2012 during his presidential campaign. *See* Mark Maremont, *Romney's Unorthodox IRA*, Wall St. J., Jan. 19, 2012, at A1. In the U.S., especially post-FATCA, it has been argued that the

tax planning differs across countries. For the individuals and businesses that can make use of international tax planning, the costs of opting out of a tax jurisdiction could be lower than the costs of relocating.

As described, nontax areas of law tend to vary in the criteria for their application, which may be less elastic than those applied by tax laws. Consider, for example, a choice-of-law rule that ties the jurisdiction of certain rules to where the damage in question transpired, to the center of the debtor's main interests, to where the labor in question occurs, or to where the property in question is physically located. Although people or businesses could certainly shift the damage-prone activity, the labor-intensive plant, the ownership of property, or even the center of their main interests to another location, this could be relatively costlier than planning tax liability. Hence, nontax rules could be better candidates for tools of redistribution, at least insofar as they do not completely drive people and businesses out of the jurisdiction.[101]

Take, for example, Kaplow and Shavell's example of yachts owned by the wealthy that cause damage to fishing boats:

> Suppose, for example, that a policy analyst is considering what tort damages rule should apply to accidents in which yachts owned exclusively by the rich collide with small fishing boats owned by fishermen with low incomes. The analyst will conclude for familiar reasons that, under the efficient legal rule—that which

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opportunities to tax avoid and evade seem to have become much costlier. *See, e.g.*, Avi-Yonah, *And Yet It Moves*, *supra* note 90. Opportunities are still available, however, for offshore tax planning. For a catalogue of some of these available options, see David S. Miller, Unintended Consequences: How U.S. Tax Law Encourages Investment in Offshore Tax Havens (Oct. 4, 2010) (unpublished manuscript), http://ssrn.com/abstract=1684716; *see also* Gabriel Zucman, *The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors?*, 128 Q.J. Econ. 1321, 1322 (2013) (estimating that around eight percent of the global financial wealth of households is in tax havens, three-quarters of which goes unrecorded).

101. Gamage used a similar argument, focusing on marginal amounts of redistribution, to argue for the use of multiple (including legal) instruments for redistribution: "In light of the tax smoothing-principle, the question must be whether adjusting the tax system or the design of legal rules is relatively more efficient at promoting marginal amounts of distribution." Gamage, *supra* note 10, at 75 n.286.

> minimizes the total of accident costs and prevention costs—damages should equal harm. But, if damages are raised somewhat, the incentives of rich yacht owners to take precautions might be distorted only slightly, whereas the distribution of income might be favorably affected because the fishermen would receive higher payments from the rich yacht owners. Should the analyst therefore endorse such an inefficient legal rule because it redistributes income from the rich to those whose incomes are low?[102]

Kaplow and Shavell answer this question in the negative, because redistribution would be more efficiently achieved through income tax rules: "[W]hen inefficient legal rules are employed to redistribute income, there is not only a distortion of work effort; there is also the cost directly associated with the inefficiency of the legal rule (such as insufficient or excessive precaution to avoid accidents)."[103] This, however, holds if, and only if, we assume a closed economy, where yacht owners cannot shift their tax liability to another jurisdiction.[104] When the currently available tax-planning options are taken into account, the Kaplow and Shavell analysis misses a crucial point: that income tax rules may be easier to opt out of than tort rules. Thus, if yacht owners can plan their activities so that the vast majority of their income is not being taxed in their country of physical presence, while the applicable tort rules are determined according to the place where injury occurred, setting higher compensation for damage caused by yacht owners to local fishermen may well yield more efficient income redistribution.

As another example, think of cross-border bankruptcy rules. Although many scholars argue that bankruptcy rules should be designed to promote the efficient resolution of financial distress, the rules in many countries include distributive components as well.[105] Thus, in many

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102. Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. Legal Stud. 821, 822 (2000).

103. *Id.* at 823–24.

104. See Gamage, *supra* note 10, for possible examples of tax planning even under the assumption of a closed economy.

105. *See* Pottow, *supra* note 16, at 1902 ("[D]espite the protestations of many scholars who insist (with some merit) that the principal focus of

countries, employees' claims enjoy priority over the claims of other creditors.[106] Assuming such bankruptcy rules apply on a universal basis in the "home" jurisdiction of the debtor,[107] debtors will not be able to avoid the "home" country redistributive policies without actually relocating the center of their main interests.[108] Although redistribution via bankruptcy rules may, indeed, entail an increased efficiency cost due to the distortion of the efficient solution, it may still be superior to imposing higher taxes, assuming taxpayers can avoid such taxes through tax planning.

In sum, tax laws not only distort taxpayers' labor-leisure choices, as assumed by the traditional view, but they also impact taxpayers' choice of tax jurisdiction. Importantly, in addition to affecting people's choice of residence and where individuals and businesses locate their economic activities, the ability to strategically select a tax jurisdiction has translated into significant and prominently used tax-planning mechanisms, which conceivably reduce tax liabilities.[109] If, indeed, tax planning

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a bankruptcy law should be the efficient resolution of financial distress, the bankruptcy laws on the books in myriad jurisdictions around the globe unabashedly contain a panoply of redistributive provisions.").

106. *See* Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 Mich. L. Rev. 2177, 2197 (2000) ("Under the laws of the United States, Canada, Germany, Israel, Australia, Switzerland, England, and Egypt, employees receive priority behind secured claims and administrative expenses. In Japan, the Netherlands, and Argentina the same is true, although employees also recover behind at least one tax authority.").

107. The U.N. Commission on International Trade Law (UNCITRAL) Model Law, for example, ascribes predominant jurisdictional power to the country of the "centre of the debtor's main interests." UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, at art. 16(3), U.N. Sales No. E.14.V.2 (2014), https://www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf.

108. If, on the other hand, the local bankruptcy rule is a territorial one—that is, applying only to the property located within the country—debtors may be able to enjoy laxer redistributive rules by shifting part of their assets to other, more welcoming, jurisdictions. Asset-shifting may well be easier for debtors to do than relocating their home, but still could be costlier than tax planning.

109. Empirical evidence as to the level of tax planning and amount of forgone tax is hard to find. At the U.S. domestic level, a number of studies have shown large and quick responses of reported incomes along the tax avoidance margin at the top of the distribution. According to Diamond and Saez,

considerably decreases tax revenues, this could be a good argument for considering redistribution via nontax rules. To be sure, there is no reason to assume that nontax rules could not be similarly avoided through creative legal structures, nor does the fact that tax and nontax rules are both susceptible to manipulation render this point irrelevant. Policymakers should assess which rules—tax or nontax—are costlier to avoid. The relative elasticity of different rules in terms of opting-out potential is key to determining the preferable framework for implementing redistributive policies in conditions of global competition. Generally speaking, the legal areas that are less elastic in terms of individuals' ability to opt out of their governing rules could facilitate more efficient redistribution.

> [I]n the United States, realized capital gains surged in 1986 in anticipation of the increase in the capital gains tax rate after the Tax Reform Act of 1986. Similarly, exercises of stock options surged in 1992 before the 1993 top rate increase took place. The Tax Reform Act of 1986 also led to a shift from corporate to individual income as it became more advantageous to be organized as a business taxed solely at the individual level rather than as a corporation taxed first at the corporate level. The paper Gruber and Saez (2002) is often cited for its substantial taxable income elasticity estimate ($e = 0.57$) at the top of the distribution. However, its authors also found a small elasticity ($e = 0.17$) for income before any deductions, even at the top of the distribution.

Diamond & Saez, *supra* note 41, at 172 (citations omitted). Diamond and Saez further emphasize, "[N]o compelling study to date has shown substantial responses along the real economic responses margin among top earners" and thus stress that tax avoidance should be dealt with by limiting tax planning possibilities rather than by altering redistribution policies. *Id.* If—as I suspect—combating tax avoidance is extremely hard to do given the multiplicity of tax regimes worldwide, then the ability to tax plan has a crucial impact on the levels of redistribution that tax laws can offer. Commissioner Shulman's statement indicates the existence of this problem to a certain extent among the ultra-rich. IR-News Rel. 2009–116, *supra* note 86. The BEPS Report, although cautious not to draw any strong conclusions as to the existence of empirical proof of base erosion and profit shifting, asserts that "[t]here are several studies and data indicating that there is increased segregation between the location where actual business activities and investment take place and the location where profits are reported for tax purposes." BEPS Report, *supra* note 64, at 15.

In short, the best legal area for applying redistributive rules is where the costs of shifting away from the regime are the highest.

B. The Availability of Different Legal Regimes

This Article's focus on jurisdictional competition brings to light another significant factor in determining whether tax rules or nontax rules are more efficient mechanisms for redistributing income: the extent of rule convergence across national borders.

The more globally harmonized a legal area or rule, the fewer alternatives that are available to individuals and businesses in shopping around for the most favorable rule. Hence, when a certain area of law is characterized by similar rules across jurisdictions, it is less vulnerable to inter-jurisdictional competition. When harmonized legal rules have redistributive consequences, they are less susceptible to opting out by the wealthy and, therefore, conceivably more effective at redistribution.

Take, for example, bankruptcy rules that, as explained above, are often set with specific distributive concerns in mind (e.g., granting priority to employees under the assumption that they are worse off than other creditors). Pushing the bankrupt individual or entity to opt for a different regime would not achieve anything for the other creditors if the laws in other jurisdictions set similar rules. Another example would be yacht owners' liability: if the same standard of compensation applies across jurisdictions, opting out of the rules of one regime for those of another—even assuming this to be relatively easy to do—would offer no benefit to someone seeking to avoid this compensation standard.

Does greater convergence facilitate more redistribution? If the harmonized regime entails redistributive demands, it certainly may. In the absence of a more favorable foreign alternative to their own regime, states should be able to impose more redistribution through widely harmonized rules, since this redistribution will not be avoidable through opting out. If, however, the generally accepted rule were non-redistributive (say, a rule that favors non-employees as creditors), it would make it even harder for a single state to use this rule as a tool of redistribution, for it would then be singling itself out as a less favorable regime for employers. It would, therefore, not only push potential creditors to other, preferable regimes but would also lose any network gains it had secured in the past from converging its regime with the regimes of other states.

So what are the facts? Are legal regimes harmonized across jurisdictions? Despite extensive talk about legal harmonization, it seems that in many legal areas, a globally harmonized substantive regime is

not widespread. Yet some areas of law are, in fact, more harmonized than others. For example, there have been successful harmonization efforts in patent law, with multilateral negotiations leading to the 1994 TRIPS agreement, which had been preceded by the Patent Cooperation Treaty of 1970.[110] Similarly, there has been intensive supra-national legislation in the area of cultural property, with a de facto harmonization of the rules of transfer for such property across national borders and its restitution when stolen or otherwise unlawfully transferred.[111] Efforts to harmonize consumer protection laws have also met with significant success, particularly within the EU, in a cooperative process that culminated in the 2005 Unfair Commercial Practices Directive.[112] This

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110. *See, e.g.*, Robert C. Bird, *The America Invents Act, Patent Priority, and Supplemental Examination*, *in* The Changing Face of US Patent Law and Its Impact on Business Strategy 63, 72 (Daniel R. Cahoy & Lynda J. Oswald eds., 2013).

111. *See, e.g.*, Convention for the Protection of Cultural Property in the Event of Armed Conflict art. 4.3, May 14, 1954, S. Treaty Doc. No. 106-1, 249 U.N.T.S. 215 (the parties agree to respect cultural property located within their territory as well as within the territory of other Contracting Parties); Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property, Nov. 14, 1970, 823 U.N.T.S. 231 (aiming to protect cultural property against theft and looting and to emphasize the restitution of such items); Council Directive 93/7/EEC on the Return of Cultural Objects Unlawfully Removed from the Territory of a Member State, 1993 O.J. (L 74) 74; Council Regulation (EEC) No. 3911/92 of 9 December 1992 on the Export of Cultural Goods, 1992 O.J. (L 395) 1 (aimed at protecting from and prohibiting removal of cultural objects and monitoring their return, alongside the protection of free trade among the Member States); *see also* Victoria J. Vitrano, *Protecting Cultural Objects in an Internal Border-Free EC: The EC Directive and Regulation for the Protection and Return of Cultural Objects*, 17 Fordham Int'l L.J. 1164, 1167, 1169 (1994). *But see* Amnon Lehavi, *Unbundling Harmonization: Public Versus Private Law Strategies to Globalize Property*, 15 Chi. J. Int'l L. 452 (2015) (arguing that outside cultural property rules of conflicts between original owners and purchasers of stolen property still diverge considerably across jurisdictions).

112. Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 Concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market and Amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council, 2005 O.J. (L 149) 22.

Directive regulates all marketing activities designed to induce consumers to purchase goods or services and prohibits misleading advertisement, false claims, deceptive pricing, etc., in this marketing.[113] Success beyond the EU was limited.[114] Government and quasi-government reform efforts to regulate cross-border insolvencies have also abounded, although apparently not with great success.[115] The EU has in fact emerged as a key leader in harmonization efforts, though endeavors beyond the EU have been only mildly successful. Specifically, the EU Charter allows EU legislative institutions to review domestic legislation and impose positive harmonization on EU member states,[116] and some EU directives have had some success at harmonizing specific areas.[117] Proposals by groups of experts, such as the 2009 Draft of Frame of Common Reference,[118] have led to considerable progress in harmonizing certain

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113. Hugh Collins, *Harmonisation by Example: European Laws Against Unfair Commercial Practices*, 73 Mod. L. Rev. 89 (2010).

114. Despite UN efforts to provide guidelines for state legislation (G.A. Res. 39/248, United Nations Guidelines for Consumer Protection (April 16, 1985)), calls for international cooperation and regional agreements, and significant efforts on the part of the Organization of American States to facilitate harmonization, this has yet to be achieved. *See* Diego P. Fernandez Arroyo, *Current Approaches Towards Harmonization of Consumer Private International Law in the Americas*, 58 Int'l & Comp. L.Q. 411 (2009).

115. Pottow, *supra* note 16, describes the UNCITRAL Model Law on Cross-Border Insolvency and efforts on the part of the World Bank and INSOL to promulgate a Legislative Guide for "best practices" bankruptcy codes.

116. *See* Lehavi, *supra* note 111.

117. *See, e.g.*, Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on Combating Late Payment in Commercial Transactions, 2011 O.J. (L 48) 1 (aimed at combating late payments in this field, promoting the proper functioning of the internal market, and fostering competition of undertakings, particularly in small- and medium-sized enterprises); Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings 2000 O.J. (L 160) 1 (aimed at setting solutions to insolvency proceedings regarding debtors with operations in more than one EU Member State); Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements, 2002 43 O.J. (L 168) 43 (prohibiting states from imposing format requirements on the creation, validity, enforceability, or admissibility of evidence for any financial collateral arrangement).

118. Study Grp. on a European Civil Code & Research Grp. on EC Private Law (Acquis Group), Principles, Definitions and Model Rules of

property concepts as well as contract laws. It is as yet unclear, however, whether this will become European law. Interestingly, albeit perhaps not entirely surprisingly, when regimes are successfully harmonized, they do not necessarily promote redistribution. In many cases, in fact, harmonization has the reverse effect: it privileges capital owners.

Tax laws, in particular, are infamous for their lack of harmonization or even coordination, despite the relentless calls of prominent policymakers and scholars to strive for such cooperation.[119] Although scholars claim to have identified common trends among tax laws, with some even going so far as to assert that an international tax regime with converging rules already exists, tax rates, levels of redistribution, as well as specific loopholes and exemptions vary considerably across the different tax jurisdictions. This is no mere coincidence; efforts to harmonize tax regimes on a global scale have been met by objections from sovereign states protective of their right to set their tax rates and design their tax structures.

Regimes differ not only in their tax rates. They diverge also in how they define different sources of income;[120] in their criteria for determining the geographical location of certain types of income;[121] in the deductions they allow;[122] and the taxes they withhold;[123] in how and whether they characterize an entity as opaque or transparent for tax

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European Private Law: Draft Common Frame of Reference (DCFR) Outline Edition (Christian von Bar et al. eds., 2009), http://ec.europa.eu/justice/policies/civil/docs/dcfr_outline_edition_en.pdf.

119. *See, e.g.*, Avi-Yonah, *supra* note 54; Yariv Brauner, *An International Tax Regime in Crystallization*, 56 Tax L. Rev. 259 (2003).

120. Note, for example, the differences in defining dividend income between regimes that adhere to form (which tend to focus on the formalities of the instrument paying the "dividend," i.e., whether a stock or a bond) and those regimes that focus on substance (i.e., on the rights and duties of the owner of the instrument), as well as the differences between loans and leasing transactions in other jurisdictions.

121. Whether, for example, interest income is located where the payer resides, where the activity financed by the loan takes place, or elsewhere.

122. Some jurisdictions, for example, are more generous in allowing interest deductions, thus facilitating "income stripping."

123. Michael Burda, *Comments*, *in* Public Finance and Public Policy in the New Century 89, 90 (Sijbren Cnossen & Hans-Werner Sinn eds., 2003).

purposes;[124] in the rules they use to determine the price of transactions (their transfer pricing rules);[125] and in their mechanisms for alleviating double taxation. These divergences have spawned ample opportunities for arbitrage, which is used extensively by tax planners to minimize the combined tax burden for taxpayers in all countries.[126]

In sum, in the absence of harmonization, there is no unambiguous answer to the question of whether tax laws or nontax laws are the more efficient means of redistribution. At the very least, the low level of harmonization in tax, on the one hand, and the relatively greater harmonization in other legal areas, on the other, mean that tax laws cannot be presumed a priori to be more effective at facilitating redistribution.

C. Targeted Audience

The first two sections of this Part implicitly assumed that individuals and businesses are homogenous in terms of opting-out ability and the options available to them in different jurisdictions. In reality, however, they differ in both their opting-out costs and their ranges of options. This section puts aside the homogeneity assumption and returns to another canonical argument for tax law as an instrument of redistribution: its comparative advantage in targeting the relevant audience. The discussion below explains that in a global world, the targeting consideration has ceased to support the dominance of tax law for redistribution.

The costs of opting out and the spectrum of available opportunities vary not only across legal fields but also within them among the individuals and businesses subject to each field. Some individuals and businesses are more flexible in terms of ability to conform to the relevant criteria (e.g., place of residency, location of bank account, place of

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124. The United States, for example, allows most taxpayers to characterize their entities on their own (by using check-the-box regulations). *See* Reg. § 301.7701–1 to—3. Other countries apply various criteria for determining which is which.

125. Lorraine Eden, *Taxes, Transfer Pricing, and the Multinational Enterprise*, *in* The Oxford Handbook of International Business 591 (Alan M. Rugman & Thomas L. Brewer eds., 2001).

126. Consider, for example, a transaction that is regarded a leasing transaction in one country (thus providing depreciation deductions to the lessor) but a loan financing the purchase of an asset in another country (thus providing depreciation deduction in that other country to the lessee/debtor).

doing business, place of incorporation, and location of IP registration). Thus, the costs of meeting the technical requirements of opting out of a jurisdiction may be lower for them. For example, spending a required amount of time overseas every year is easier for a professional tennis player than for a person who holds a regular job; conducting some of its business activities abroad is less costly for a MNE than for a local convenience store; and offshoring its IP is easier for an internet-based company than for a local entertainer.

Furthermore, some individuals and businesses are more flexible than others in terms of planning their activities to bypass less favorable rules of certain jurisdictions. For example, capital owners can increase their opting-out capacity by investing not only in real property (and thereby become subject to property rules) but also in capital markets (and thereby become subject to the market regulations). Some businesses can choose whether to be subject to certain environmental rules by self-producing or to avoid those rules by outsourcing production to others. Software developers can sell their products directly to consumers in some countries and sell software-developing services in others. And some large businesses may find it worthwhile to invest in tax planning, while others may find the initial costs of such planning (e.g., paying for incorporating overseas or tax counsel) prohibitive.

The bottom line, then, is that individuals and businesses vary to a large degree in the relative costs to them of opting out. This variance in demand among consumers is, of course, expected with any demand curve. It raises no particular distributive problems when the curve is based on variances in consumers' preferences and is randomly spread. If, however, demand for a certain legal rule is higher among the lesser off, a distributive problem may arise as it would be a poor choice as a tool of redistribution. The primary audience for that rule would be the lesser-off, who would then bear the bulk of the price of redistribution, while the better-off—the targeted audience—would simply avoid the rule.

The traditional literature frames this issue as a matter of inclusiveness, asking whether or not a certain rule applies to the right group of people. Tax rules are conventionally considered the better targeting device not only because they apply to all taxpayers, but also because their application is calibrated by taxpayers' differing abilities to pay. In contrast, nontax rules are traditionally considered both over-inclusive and under-inclusive compared to tax rules. Accordingly, it has been argued that "the income tax system affects the entire population and, by its nature, treats individuals on the basis of their income. By contrast, the influence of legal rules often is confined to the small fraction of

individuals who find themselves involved in legal disputes."[127] Hence, individuals who should be on the paying side of redistribution are often not captured by the nontax rule (for example, a wealthy individual not involved in a car accident will not be subject to redistribution via tort law). At the same time, certain rules, because they only approximate wealth, apply to individuals who are not necessarily wealthy (for example, rules that require rental property to be habitable could apply to poor as well as rich landlords).

This analysis treats the issue of inclusiveness as a domestic matter that is under the exclusive control of national policymakers. However, the ability of these policymakers to capture the appropriate target group (i.e., the well-off) through an optimally inclusive mechanism is—again—limited by the competitive market forces in the global setting and, more specifically, by the relative ability of certain individuals and businesses to bypass the mechanism. If the ability to tax plan is not equally or even randomly distributed across taxpayers—i.e., if wealthier individuals and businesses are, specifically, better able to take advantage of opting-out opportunities—the inclusiveness issue ceases to be a domestic problem to be addressed top-down by the state with regard to a certain group of individuals and businesses. Instead, it is a matter of optimally setting local prices in order to maximize redistributive "profit" in a competitive market—in this context, by actually raising the prices of the instruments that *the rich* are less likely to opt out of. Hence, policymakers should design redistributive instruments while taking into account the relative abilities of the rich and poor to avoid them. Other things being equal, the lesser the ability of the well-off to avoid a given rule, the better an instrument it is for redistribution.

Despite their reputation for accurate targeting in a closed economy, tax rules in fact discriminate among taxpayers based on their ability to reduce their taxes through tax planning, which is directly related to their wealth.[128] Tax-planning ability is not distributed equally across all taxpayers even in a closed economy,[129] and this inequality dramatically intensifies in the global setting. Some taxpayers (e.g., those who earn

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127. Kaplow & Shavell, *supra* note 102, at 823.

128. For evidence that elasticity is likely to be higher for top earners than for middle income earners, possibly due to tax avoidance, see Jon Gruber & Emmanuel Saez, *The Elasticity of Taxable Income: Evidence and Implications*, 84 J. Pub. Econ. 1 (2002).

129. Gamage, *supra* note 10.

income overseas, capital owners, those with more mobile income,[130] and MNEs that are able to use transfer pricing and interest and royalties deductions to shift taxable income across national borders[131]) are better able than others to plan so as to reduce their tax liability.[132] Thus, many well-off taxpayers who would pay high taxes under an optimally inclusive system are able to avoid taxation. The applicability of tax laws, too, then, is often confined to the small fraction of individuals who find themselves paying high taxes.[133]

In other words, not only nontax rules are under-inclusive; in a global world, tax rules also under-include when they tax only some of the better-off. Because wealthy individuals are often more likely to be able to take advantage of low-tax jurisdictions (because a larger portion of their income is from (mobile) capital and because they are more willing to invest in costly tax planning) and because global businesses are better able to plan their activities to reduce their taxes (by using transfer prices, offshore entities, and tax treaties), tax laws are no longer necessarily the best targeting mechanism for redistribution. In order to

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130. The increased mobility of capital compared to labor income has been the basic assumption of international tax policy in the past decades, implying increased ability to tax plan (and favorable treatment by governments). *See, e.g.*, Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 Harv. L. Rev. 1573 (2000) [hereinafter Avi-Yonah, *Globalization*] (describing the shift from taxing capital to taxing labor and its threatening effect on the welfare state).

131. See, for example, Jost H. Heckemeyer & Michael Overesch, *Multinationals' Profit Response to Tax Differentials: Effect Size and Shifting Channels* (Zentrum für Europäishche Wirtschaftsforschung, Discussion Paper No. 13-045, 2013), http://ftp.zew.de/pub/zew-docs/dp/dp13045.pdf, highlighting the role of transfer pricing in MNEs' profit-shifting capacity (the existence of which they describe as unquestionable).

132. But note that Avi-Yonah argues that capital should not be taxed at lower rates than other income because of the significant limitations on the ability of individual U.S. taxpayers (as opposed to corporations) to avoid tax by moving their capital overseas. Moreover, he argues, if we focus on those taxpayers that pay the bulk of the income tax (i.e., the upper-middle class and the wealthy), the data suggest that their ability to legally avoid taxation by expatriation is not significantly less than their ability to evade it by moving capital. Avi-Yonah, *And Yet It Moves*, *supra* note 90.

133. *See id.*

determine which tool better targets for redistribution purposes—tax or nontax rules—the extent to which they are under-inclusive must, thus, be carefully compared.

One key factor in making tax planning a more serious problem in the international setting is the active part played by states in facilitating such tax planning for the rich. The variance in level of mobility and tax-planning ability across taxpayers makes tax a central arena of interstate competition and enhances states' ability to price-discriminate among individuals and businesses based on their tax-planning ability. Hence, states often have to sacrifice the distributive goal for tax revenues.[134] An optimal revenue-raising policy for a state is to impose higher taxes on taxpayers whose choices regarding their tax jurisdiction are less elastic. However, immobile taxpayers and those reluctant to engage in tax planning are usually not those who should pay higher taxes. If states end up taxing those less inclined to tax plan, and if the latter are often amongst the lesser-off, then tax laws—in being disproportionately imposed on the lesser-off[135]—could also be over-inclusive and not just under-inclusive and, therefore, are (again) not a priori preferable to nontax laws on the redistributive front in an open economy.

The question that remains, then, is whether nontax rules can do a better job than tax rules at targeting the relevant audience. Answering this obviously requires careful analysis of the expected (and/or observed) results of promoting redistribution through the two types of rules. One advantage of nontax rules in this respect may, in fact, emerge as relating to the fact that tax rules target income. This could seem surprising given the conventional claim regarding nontax rules that their failure to directly target income is their central flaw as tools of redistribution: "legal rules often are very imprecise tools for redistribution because there tends to be substantial income variation within groups of plaintiffs and groups of defendants."[136] However, the fact that nontax laws often do not actually measure income in carrying out redistribution could mean they are more efficient redistributive tools than tax rules in the globalized world. As noted above, David Gamage has convincingly

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134. *See, e.g.*, Tsilly Dagan, *The Tragic Choices of Tax Policy in a Globalized Economy*, *in* Tax, Law and Development 57 (Yariv Brauner & Miranda Stewart eds., 2013).

135. *See* Avi-Yonah, *Globalization*, *supra* note 130.

136. Kaplow & Shavell, *supra* note 102, at 823.

demonstrated this in the closed economy context.[137] The international context seriously exacerbates the problem. Using taxable income as the criterion for redistribution opens up the door to a variety of strategies for reducing taxable income or simply shifting it away to other jurisdictions, but without significantly impacting taxpayers' ability to pay (e.g., earning stripping, transfer pricing, and tax arbitrage). By contrast, in using criteria that only *approximate* ability to pay without actually measuring it (e.g., that a taxpayer is an employer, yacht owner, landowner, or banker) in order to calibrate the sources of the redistribution, nontax rules may be able to thwart (or at least constrain) tax planning and do a better job at redistributing.[138]

By using different rules as tools of redistribution, policymakers could target different segments of the population. In presuming a closed-economy setting, the conventional account rightfully concluded that tax laws target individuals and businesses for redistribution purposes better than nontax rules. Yet globalization and the tax planning it facilitates have radically altered the economic setting by making some individuals and businesses much more capable than others of bypassing domestic rules. Not only are certain rules costlier to opt out

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137. Gamage, *supra* note 10; *see also supra* note 88 and accompanying text.

138. Liscow interestingly notes another advantage to equity-sensitive legal rules that are not based on actual income measurement but on an approximation regarding the group of people who typically tend to fall on one side of a legal rule or another. Liscow, *supra* note 27. Using the example of air pollution, he argues:

> In order to achieve this costless distribution of wealth, the legislature can see that, *as a group*, the polluters are wealthier than the ollutes and then alter the legal rule accordingly. Because the rule is established for a group, and no individual faces an effective tax rate on the basis of having more income, there is no Kaplow-Shavell-type tax, since one's taxes or costs do not go up when one receives more income. Under these assumptions, this legal rule is effectively a lump sum tax and transfer. Such taxes are completely nondistortionary.

Id. at 2490 (emphasis added).

of than others, therefore, but sometimes, with regard to the very same rule, some individuals and businesses will opt out with greater ease than others.

Before concluding, I would like to stress again that the argument made in this Article is not that tax rules and nontax rules have inherent comparative abilities to redistribute but that choice-of-law rules, tax planning, fragmented legal regimes, and the existing level of legal convergence are a given reality. Focusing on the possible strategies of taxpayers, the analysis thus looked at the static dimension of tax as well as inter-jurisdiction competition.

A number of possible ways of improving the redistributive ability of certain rules emerge from my analysis, in particular, raising the price of opting out or promoting harmonization. One option would be to tie the choice of redistributive laws to immobile factors by, for example, setting redistributive rules controlling immobile property or imposing distinct taxes on, say, yachts entering the given jurisdiction. Note, however, that these rules would differ from the broad-based income tax rules envisioned by the canonical view. The beauty of the Kaplow and Shavell argument (and its weakness in the era of globalization), I contend, is its reliance on a notion of tax as an all-inclusive mechanism that applies to the entire faculty (ability to pay) of an individual or business, irrespective of its source. However, once the economy has opened up and people are allowed to earn a part of their income outside of their home countries, income tax laws become susceptible to cross-border planning. Thus, from a policy perspective, a need for a trade-off emerges: if we impose increased and differential tax rates on immobile income and resources, we are essentially abandoning the notion of an all-inclusive income tax law. If we continue to focus on making tax law all-inclusive, the question of electivity resurfaces—i.e., whether tax rules or nontax rules are more elastic.

Another dynamic effect of improving the ability of certain areas of law to redistribute should be considered: individuals and businesses are expected to be more inclined to engage in activities that better allow for jurisdiction planning. In line with the Kaplow and Shavell analysis, we could expect an increased distortion of economic activity: some taxpayers might prefer to reduce their redistribution-intensive activities and explore, instead, less progressive avenues of economic activity or more tax-planning-friendly activities. The inefficiencies created by the distortive shift away from redistributive activities must be weighed against any benefits from redistribution.

A number of factors can account for the current state of affairs, in which there are significant variations in both the opting-out potential of regimes and the level of cross-jurisdiction harmonization. It is likely no coincidence that the traditional attempts to redistribute centered on tax laws, due, amongst other things, to private law's general inclination to stress bilateral justice between parties and, possibly, its traditional development in the courts rather than through legislation. It is also no coincidence that tax-planning efforts have focused on tax laws because of their central role in collecting payment on the redistributive "price." It is thus certainly possible that once redistribution becomes an important component of any given private law doctrine (say, nuisance law or consumer law), more of the tax-planning efforts will be directed at avoiding that law rather than tax laws. However, as things currently stand, international tax rules are emblematic of rule elasticity.

One final point should be emphasized. As far as state redistribution policy is concerned, this is likely only the tip of the iceberg in terms of the long-term strategic considerations involved. The analysis in this Article has assumed that the only change in legal policy that a state can initiate is to incorporate redistributive functions into a rule or remove them. States can obviously do much more than this. Specifically, they can attempt to strategically plan their choice-of-law rules so as to make them more cumbersome to avoid. Notably, whatever rules they select to advance redistribution could affect (and trigger reciprocal responses from) other states in their policy choices, resulting in a strategic game that should be played with caution.[139] Moreover, states might seek to cooperate (or defect from cooperation) with other states towards the harmonization of their substantive tax and nontax legal regimes. The possible consequences of such cooperation are far from clear. If anything is to be learned from previous attempts to cooperate on tax matters, tax harmonization is extremely difficult to achieve (if at all desirable). In any event, cooperative efforts towards harmonization should also be carefully assessed and factored-in when determining the optimal framework for redistribution. While a full analysis of the strategic aspects of such policies is beyond the scope of this Article, the insights from the analysis here can hopefully serve as a starting point.

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139. For a strategic analysis of international tax laws, see Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. Int'l L. & Pol'y 939 (2000).

Conclusion

Globalization has changed the modes and conditions of redistribution. It has constricted states' redistributive capacity and has forced them to devise new strategies for contending with the creative ways taxpayers avoid taxes.

Mobility, a prominent feature of globalization, sets the upper limit on states' ability to redistribute. Mobility of people—namely, their ability to relocate to a new jurisdiction—has decreased the effectivity of personal-based taxation. Excessively high taxes can drive too many people to shift their residency to a more lax tax jurisdiction, to the detriment of both national welfare and redistribution goals. Mobility of resources—namely, investors' ability to shift their investments to more favorable jurisdictions—impacts the effectivity of source-based taxation: excessive taxation can discourage investments and thereby shrink the national welfare pie.

And yet, my assumption throughout this Article has been that a certain level of redistribution remains feasible even under the current conditions of increased human and resource mobility and competition among jurisdictions. Thus, assuming states are interested in redistribution, the question that arises is whether the more efficient way to redistribute is through tax laws or nontax laws.

The response offered by Kaplow and Shavell and others, which has become the canon on the issue of redistribution, is that tax laws are inherently superior to nontax laws as tools for redistributing income, due to the double distortion yielded by redistribution via nontax laws. According to this approach, moreover, nontax rules are both under- and over-inclusive and, therefore, inferior to tax law, with its all-encompassing scope. But contrary to this conventional wisdom, I have argued here that the globalized economy renders this paradigm obsolete in our transnational world, where tax laws are not innately superior to nontax laws. There are a number of considerations to be taken into account by states when deciding which set of rules more efficiently redistributes. None of these considerations, it was shown, points to any unequivocal advantage to tax laws over nontax laws for redistribution purposes.

The first factor that should be considered is the extent to which any rule, tax or nontax, is amenable to choice-of-law planning. Specifically, policymakers should evaluate the ability of local residents and investors to opt for a less progressive set of rules offered by a foreign jurisdiction (short of relocating either their residence or economic activity).

The field of law in which it is most costly to move to a more attractive jurisdiction will be—I submit—the sphere in which redistribution is most efficiently achieved. Notably, unlike in the closed economy context of the traditional view, tax and nontax rules both entail opting-out opportunities. Hence, tax laws offer no a priori advantage in this respect. Moreover, the ample leeway available to taxpayers in choosing a favorable tax jurisdiction through international tax planning may be indicative of a disadvantage to tax laws.

The second factor is that the ability of a state's constituents to avoid redistribution by making themselves subject to the law of another jurisdiction depends not only on how easy it is to take advantage of the relevant choice-of-law rules but also on whether there are actually alternative regimes that offer less redistribution. When the relevant redistributive laws (e.g., giving preferential treatment to fishermen versus wealthy yacht owners) are universally harmonized, it is more difficult, if not virtually impossible, to plan around them. Hence, all other things being equal, such a (harmonized) legal area will be a better site for redistribution. And since tax laws do not tend to be any more harmonized than other areas of law, there is no a priori advantage to using them to redistribute.

Another consideration that was raised in the literature and discussed here is the extent of inclusivity. Nontax rules are admittedly over-inclusive as well as under-inclusive. However, in the global economy, tax rules, too, are under-inclusive, due to the ability of some taxpayers to avoid domestic taxation using tax-planning strategies. Thus, many well-off taxpayers who would pay high taxes under an optimally inclusive system are able to avoid taxation. Immobile taxpayers and those reluctant or unable to engage in tax planning find themselves subject to increased taxation, although they are not necessarily those who *should* pay higher taxes. In other words, tax laws may also be over-inclusive, and not just under-inclusive, and are therefore not necessarily preferable on the redistributive front in an open economy.

The underlying insight is that even if we accept the superiority of tax rules over nontax rules in a closed economy, no a priori argument can be made for their superiority in the global open-economy context. Rather, policymakers must empirically investigate the alternatives available to taxpayers in other jurisdictions in order to reach the best solution.

In sum, in the current global economy, both tax and nontax rules yield targeted forum-shopping opportunities and, therefore, room to bypass state redistributive schemes. The optimal strategy for an individual state—given the alternative legal regimes currently available to its

constituents—would be to promote redistribution through the (tax or nontax) rules that are the least avoidable by the wealthiest individuals and businesses. Put differently, with any given (tax or nontax) rule, a state can impose redistribution whose cost to its constituents equals the cost of shifting to the rules of an alternative regime. Accordingly, in an open economy, the efficiency of redistributing under any rule should be determined by the availability of alternative legal "products" and their comparative "prices."