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The Right and the Good: Taxing Rights, Value Creation, and the Rhetoric of International Taxation

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The Right and the Good: Taxing Rights, Value Creation, and the Rhetoric of International Taxation

by

*David Elkins**

Abstract

A prominent theme in the discourse of international taxation is that taxing rights should follow wealth production. Examples of current attempts to implement such a proposition include the OECD's BEPS project and the frequently heard calls to adopt some form of international formulary apportionment. In considering the validity of this proposition, the Article will rely on the familiar dichotomy in moral philosophy between the right and the good. In the context of international taxation, the right involves a host country's deontological claim to receive a portion of the income produced within its borders. The good involves the claim that host countries need revenue from multinational enterprises (MNEs) to fund public goods. Although the literature often conflates these two claims, they are distinct and require separate analysis.

Within the realm of the right, we must make a further distinction between two different types of right-based claims. On the one hand, a host country may assert that MNEs who choose to operate in its territory take upon themselves an implicit contractual obligation to pay tax as delineated in the host country's laws. When the host country imposes

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an income tax, MNEs are in effect contractually obligated to pay the host country a percentage of the income generated by their economic activity in the host country. Alternatively, the host country may assert a neo-Lockean claim to a commensurate share of the wealth that its social capital—in the broadest possible sense of the term—helped to create.

Regarding the contractual claim, I argue that the terms of the contract are in almost all cases delineated by the host country's tax legislation. In effect the host country offers a standard-form contract to foreign entities, which then signify their assent by investing or otherwise operating in the host country's territory. Consequently, if the terms of the agreement are difficult to enforce, the most obvious response would be to adopt terms that are more easily enforceable. I posit that the reason host countries do not do so is because a stricter tax regime would make it difficult to compete for international investments against countries whose tax systems are easier to manipulate. In other words, the so-called "loopholes" are actually part and parcel of the implicit contractual arrangement between the host country and the MNE.

The neo-Lockean argument is that creation of wealth within a country's borders is effectively a joint project involving the exploitation of the MNE's resources along with the social capital—in the broadest sense of the term—of the host country. Under neo-Lockean theory, the host country is entitled to a share of the income commensurate with its contribution to the production of that wealth, and income tax is the means by which it asserts that right. Profit shifting by MNEs understates the wealth actually created within the host country's territory and prevents the host country from claiming its fair share of that income. I contend that this argument too does not succeed. First, from the mere fact that an MNE derives wealth from its operations in the territory of a certain country, it does not necessarily follow that the host country's social capital contributes in any meaningful way to the production of that wealth. Second, even when there is reliance upon the social capital of the host country, the MNE will in most cases pay for its exploitation of the host country's social capital via factor prices (particularly salaries and rent). Third, to the extent that the positive contribution of its social capital is not reflected in factor prices, the host country should be able effectively to impose tax on foreign entities. Its desire for more MNE tax revenue than it is capable of collecting in a competitive atmosphere constitutes at least

prima facia evidence that it wants more than its actual contribution to the creation of wealth.

Moving from the right to the good, it is often asserted that budgetary exigencies of host countries require that they collect taxes from MNEs and that without such revenue their ability to supply essential public good would be seriously curtailed. However, this utilitarian claim does nothing to support the proposition that taxing rights should follow the production of wealth. In allocating taxing rights under the umbrella of the good, it is needs and the capacity to meet those needs that should dictate taxing power. To which of any number countries the international tax regime should grant the power to tax a particular MNE's income in the name of the good would be a function of the extent to which granting the taxing power to any particular country would promote total human happiness. The location of wealth production is irrelevant from this perspective.

The Article concludes by considering why the principle that taxing rights should follow value creation has gained such prominence in the discourse on international taxation. I speculate that what actually motivates countries is a parochial concept of the good in which the welfare of their constituents takes precedence over the welfare of others. However, as it is difficult to seek international cooperation to implement such a principle, they instead attempt to justify their position in terms of an objective principle, even if that principle ultimately lacks a normative justification.

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I. Introduction

In the discourse of international taxation, it has become commonplace to assert that the international tax regime established in the wake of the First World War is ill-adapted to the needs of the modern era. Scholars and policy makers alike have averred that globalization has rendered the traditional norms obsolete and that the structure needs to be revised in view of the economic reality of the 21st century.[1] However, as much as it purports to be aware of the irrelevance of key elements in the 100-year-old structure, the literature overwhelmingly fails to question its underlying principles. Instead it tends to accept those principles dogmatically and simply suggest new ways of applying them in light of changed circumstances.

One of the principles of the traditional international tax regime is territoriality, the tenet that countries have the right to tax income derived from within their sovereign territory.[2] Originally described as economic allegiance on the basis of acquisition of wealth,[3] the principle of territoriality worked reasonably well as long as the means of production and the goods that they produced were primarily tangible and there existed substantial legal and practical barriers to the free movement of people, capital, and goods. While taxpayers have always sought to structure their activities so as to alleviate their tax burden, countries that

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1. *See* Michael J. Graetz, David R. Tillinghast Lecture, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 Tax L. Rev. 261 (2001); Edward D. Kleinbard, *Stateless Income*, 11 Fla. Tax Rev. 699 (2011) [hereinafter Kleinbard, *Stateless Income*]; Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 Tax L. Rev. 99 (2011) [hereinafter Kleinbard, *Lessons*]; *Action 1: Tax Challenges Arising from Digitalisation*, OECD, https://www.oecd.org/tax/beps/beps-actions/action1/ [https://perma.cc/2E4C-4WVV] (last visited Dec. 20, 2020).

2. Reuven S. Avi-Yonah, *International Tax as International Law*, 57 Tax L. Rev. 483, 490 (2004); Restatement (Third) of Foreign Relations Law of the United States § 402(1)(a) (Am. Law Inst. 1987).

3. G.W.J. Bruins et al., Econ. & Fin. Comm'n, League of Nations, Report on Double Taxation Submitted to the Financial Committee (1923), *reprinted in* Joint Comm. on Internal Rev. Tax'n, Legislative History of United States Tax Conventions, Volume 4: Model Tax Conventions 4003, 4027–29 (1962) [hereinafter League of Nations Report].

hosted international investment nevertheless had the capacity to tax effectively the wealth produced within their territory.

With the rise of the multinational enterprise (MNE), whose means of production are widely scattered and yet fully integrated and who can often move capital from one jurisdiction to another at the click of a button or the shuffling of some papers, host countries have found it increasingly difficult to impose an effective tax on MNEs operating within their territory. In particular, MNEs have proven extraordinarily adept at manipulating legal and accounting rules so as to understate the profits that they earn in the host country.[4] The methods that MNEs employ to accomplish this end are many and varied. Among the most common are paying deductible interest or royalties to related corporations in other jurisdictions, overpaying related foreign corporations for goods or services purchased from them, or undercharging related foreign corporations for goods or services it sells to them.[5] In one

4. Andres Báez Moreno & Yariv Brauner, *Taxing the Digital Economy Post BEPS . . . Seriously*, 58 Colum. J. Transnat'l L. 121 (2019); Steven A. Bank, *The Globalization of Corporate Tax Reform*, 40 Pepp. L. Rev. 1307, 1319 (2013); Ilan Benshalom, *How to Redistribute? A Critical Examination of Mechanisms to Promote Global Wealth Redistribution*, 64 U. Toronto L.J. 317, 338 (2014); Arthur J. Cockfield, *The Limits of the International Tax Regime as a Commitment Projector*, 33 Va. Tax Rev. 59, 89–90 (2013); J. Clifton Fleming, Jr. & Robert J. Peroni, *A Hitchhiker's Guide to Outbound International Tax Reform*, 18 Chap. L. Rev. 133, 138–39 (2014); Marc Morris, *United in Diversity, Divided by Sovereignty: Hybrid Financing, Thin Capitalization, and Tax Coordination in the European Union*, 31 Ariz. J. Int'l & Compar. L. 761, 763 (2014); Julie Roin, *Taxation Without Coordination*, 31 J. Legal Stud. S61, S70–S76 (2002); H. David Rosenbloom et al., *The Unruly World of Tax: A Proposal for an International Tax Cooperation Forum*, 15 Fla. Tax Rev. 57 (2014); Daniel Shaviro, *Money on the Table?: Responding to Cross-Border Tax Arbitrage*, 3 Chi. J. Int'l L. 317, 319–21 (2002); Marc D. Shepsman, Comment, *Buying FATCA Compliance: Overcoming Holdout Incentives to Prevent International Tax Arbitrage*, 36 Fordham Int'l L.J. 1767, 1769 (2013).

5. Ilan Benshalom, *Taxing the Financial Income of Multinational Enterprises by Employing a Hybrid Formulary and Arm's Length Allocation Method*, 28 Va. Tax Rev. 619, 627–28 (2009) [hereinafter Benshalom, *Taxing Financial Income*]; Jasmine M. Fisher, *Fairer Shores: Tax Havens, Tax Avoidance, and Corporate Social Responsibility*, 94 B.U. L. Rev. 337, 342–46 (2014); J. Clifton Fleming, Jr. et al., *Getting Serious About Cross-Border Earnings Stripping: Establishing an Analytical Framework*, 93 N.C. L. Rev. 673, 680–84

well-publicized example, Starbucks operated in the United Kingdom for a number of years, during which time it reported receipts amounting to several billion pounds and yet paid no income tax.[6] According to press reports, Starbucks used two primary means to divert its income outside of the relatively high-tax United Kingdom. First, it purchased coffee beans via a subsidiary in Switzerland, roasted them in the Netherlands, and resold them at a much higher price to its U.K. affiliate. Second, the U.K. affiliate paid a royalty to a related corporation in the Netherlands, which apparently then paid royalties to another related corporation in Switzerland. The high cost of the beans and the royalty payments reduced the taxable income of the U.K. operation to zero.[7]

(2015); Kleinbard, *Stateless Income, supra* note 1, at 703; Kleinbard, *Lessons, supra* note 1, at 112; Robert T. Kudrle & Lorraine Eden, *The Campaign Against Tax Havens: Will It Last? Will It Work?*, 9 Stan. J.L. Bus. & Fin. 37, 37–42 (2003); Henry Ordower, *Utopian Visions Toward a Grand Unified Global Income Tax*, 14 Fla. Tax Rev. 361, 363 (2013); Adam H. Rosenzweig, *Why Are There Tax Havens?*, 52 Wm. & Mary L. Rev. 923, 936–42 (2010).

6. *See* Vanessa Barford & Gerry Holt, *Google, Amazon, Starbucks: The Rise of "Tax Shaming,"* BBC News Mag. (May 21, 2013), http://www.bbc.com/news/magazine-20560359 [https://perma.cc/73M9-FWMW] (stating that Starbucks recorded "sales of £400m in the UK" in 2012); Catherine Boyle, *Multinationals Face Higher UK Tax After Storm of Criticism*, CNBC (Dec. 3, 2012), http://www.cnbc.com/id/100268782 [https://perma.cc/4A39-VX26]; Roxanne Escobales & Tracy McVeigh, *Starbucks Hit by UK Uncut Protests as Tax Row Boils Over*, Guardian (Dec. 8, 2012), http://www.theguardian.com/business/2012/dec/08/starbucks-uk-stores-protests-tax [https://perma.cc/TV7V-5DXP]; Juliette Garside, *Amazon UK Boycott Urged After Retailer Pays Just £4.2M in Tax*, Guardian (May 9, 2014), http://www.theguardian.com/business/2014/may/09/margaret-hodge-urges-boycott-amazon-uk-tax-starbucks [https://perma.cc/HSG3-BPFQ]; Mark Thompson, *UK to Tax Cheats: 'Wake Up and Smell the Coffee,'* CNN Money (Jan. 24, 2013), http://money.cnn.com/2013/01/24/news/economy/cameron-tax-trade [https://perma.cc/TYS7-4ME7]; Jia Lynn Yang, *The British Want to Stop Starbucks from Dodging Taxes. It Won't Work*, Wash. Post (Apr. 18, 2014), http://www.washingtonpost.com/blogs/wonkblog/wp/2014/04/18/the-british-want-to-stop-starbucks-from-dodging-taxes-it-wont-work [https://perma.cc/8TGU-VHMA].

7. Tom Bergin, *Special Report: How Starbucks Avoids UK Taxes*, Reuters (Oct. 15, 2012), http://uk.reuters.com/article/us-britain-starbucks-tax-idUSBRE89E0EX20121015.

Other MNEs engage in even more aggressive versions of this tax planning technique. For instance, consider Google's maneuver, known in the trade as a "Double Irish Dutch Sandwich."[8] Profits from Google's overseas operations, regardless of where its consumers are located, are booked in an Irish subsidiary. This subsidiary then pays a royalty to a Dutch subsidiary, which in turn pays a royalty to another subsidiary registered in Ireland but headquartered in Bermuda. Finally, the Irish/Bermudian subsidiary pays a royalty to a subsidiary both registered and headquartered in Bermuda. The purpose of the roundabout maneuver is to avoid withholding taxes—because Ireland and Holland are both members of the European Union, royalties between corporations resident in these two countries are exempt from withholding—as the income finds its way to Bermuda, a country that imposes no corporate income tax.[9]

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8. *See* Kleinbard, *Stateless Income*, *supra* note 1, at 706–13; Charles Duhigg & David Kocieniewski, *How Apple Sidesteps Billions in Taxes*, N.Y. Times (Apr. 28, 2012), https://nyti.ms/IM7vkK; Vanessa Houlder, *'Dutch Sandwich' Grows as Google Shifts €8.8 Billion to Bermuda*, CNBC (Oct. 10, 2013), http://www.cnbc.com/2013/10/10/dutch-sandwich-grows-as-google-shifts-88-billion-to-bermuda.html [https://perma.cc/B7TL-5JFN]; Toby Sterling & Tom Bergin, *Google Accounts Show 11 Billion Euros Moved via Low Tax 'Dutch Sandwich' in 2014*, Reuters (Feb. 19, 2016), http://www.reuters.com/article/us-google-tax-idUSKCN0VS1GP [https://perma.cc/L64R-MCN3].

9. The current Double Irish Dutch Sandwich is a modern incarnation of the original Dutch Sandwich, which was a prevalent tax-planning maneuver during the late 1980s and early 1990s. The Dutch Sandwich involved a U.S. corporation paying interest or royalties to a related corporation in the Netherlands, which in turn paid interest or royalties to a related corporation in the Netherland Antilles. Under the tax treaty between the United States and the Netherlands, the payments to the Dutch company were exempt from U.S. withholding tax. Under the tax treaty between the Netherlands and the Netherland Antilles, the payments to the Netherland Antilles corporation were exempt from Dutch withholding tax. The Netherland Antilles itself imposed no income tax. The Dutch Sandwich lasted from 1988 (when the United States terminated its own tax treaty with the Netherland Antilles, thus necessitating the diversion of payments via the Netherlands to avoid U.S. withholding tax) until 1994 (when a new tax treaty, drafted specifically to prevent this maneuver, between the United States and the Netherlands came into force). *See* Joseph Isenbergh & Bret Wells, International Taxation 221–22 (4th ed. 2020).

Practice has shown that it is extraordinarily difficult for host countries acting on their own to confront these and other tax planning techniques and to enforce their claim to a share of the wealth created within their borders.[10] As a consequence, governments, multinational organizations, and scholars have in recent decades begun exploring methods of international cooperation to ensure that host countries can effectively impose tax on MNEs operating within their territories. Perhaps the most radical among them is a scheme of formulary apportionment, under which an MNE's total profits would be allocated to the countries in which it operates in accordance with a formula that supposedly quantifies the extent of its operations in each country. Each host country would then be free to tax whatever income was allocated to it without regard to intrafirm transactions.[11] The OECD, which has hitherto refrained from endorsing formulary apportionment,[12] has

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10. *See, e.g.*, OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5—2015 Final Report* 12 (2015), https://dx.doi.org/10.1787/9789264241190-en [https://perma.cc/6W2C-9RMV].

11. *See, e.g.*, Reuven S. Avi-Yonah & Ilan Benshalom, *Formulary Apportionment—Myths and Prospects: Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative*, World Tax J., Oct. 2011, at 371; Reuven S. Avi-Yonah et al., *Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split*, 9 Fla. Tax Rev. 497 (2009); Ilan Benshalom, *The Quest to Tax Financial Income in a Global Economy: Emerging to an Allocation Phase*, 28 Va. Tax Rev. 165 (2008) [hereinafter Benshalom, *Quest*]; Benshalom, *Taxing Financial Income*, *supra* note 5, at 627; Ruud A. De Mooij et al., *An Assessment of Global Formula Apportionment* (IMF Working Paper No. 19/213, 2019), https://www.imf.org/en/Publications/WP/Issues/2019/10/11/An-Assessment-of-Global-Formula-Apportionment-48718 [https://perma.cc/WBW2-RZGZ]; J. Clifton Fleming, Jr. et al., *Formulary Apportionment in the U.S. International Income Tax System: Putting Lipstick on a Pig?*, 36 Mich. J. Int'l L. 1 (2014) [hereinafter Fleming, Jr. et al., *Formulary*] (discussing the proposal); Eric T. Laity, *The Competence of Nations and International Tax Law*, 19 Duke J. Compar. & Int'l L. 187, 239–42 (2009); Susan C. Morse, *Revisiting Global Formulary Apportionment*, 29 Va. Tax Rev. 593 (2010); Joann Martens Weiner, *Practical Aspects of Implementing Formulary Apportionment in the European Union*, 8 Fla. Tax Rev. 629 (2007).

12. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 38 (2017), https://doi.org/10.1787/tpg-2017-en [https://perma.cc/VE35-CATC] ("[T]he view of OECD member countries

nevertheless taken what some consider the first step toward adopting such an approach when, within the framework of its BEPS project, it recommended that MNEs be required to report how much of their income they earned in each jurisdiction ("country-by-country reporting").[13] Instead of formulary apportionment, the OECD has recommended or considered a number of other measures, including strengthening of the arm's length transfer price doctrine,[14] the imposition of effective worldwide taxation of income by home countries,[15] the

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continues to be that the arm's length principle should govern the evaluation of transfer prices among associated enterprises."). Although the OECD has not yet adopted formulary apportionment, it is currently considering a "unified approach" for taxing the digital economy. OECD, *Secretariat Proposal for a "Unified Approach" Under Pillar One: Public Consultation Document* (2019), https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf [https://perma.cc/YMK2-UPQ3].

13. OECD, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report* (2015), https://doi.org/10.1787/9789264241480-en [https://perma.cc/SM35-JEVM] [hereinafter OECD, *Action 13 Final Report*]; OECD, *Country-by-Country Reporting—Compilation of Peer Review Reports (Phase 1): Inclusive Framework on BEPS: Action 13* (2018), https://doi.org/10.1787/9789264300057-en [https://perma.cc/5E7Y-QX5X]; OECD, *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13* (2019), https://www.oecd.org/ctp/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf [https://perma.cc/6WK7-93VY].

14. OECD, *Action 13 Final Report*, *supra* note 13; *see also* Lorraine Eden, *The Arm's Length Standard Is Not the Problem*, 48 Tax Mgmt. Int'l J. (BNA) 499 (Oct. 11, 2019).

15. OECD, *Designing Effective Controlled Foreign Company Rules, Action 3—2015 Final Report* 13 (2015), https://doi.org/10.1787/9789264241152-en [https://perma.cc/74XM-ZN59] ("[I]f CFC rules effectively tax profits at a sufficiently high rate, they may . . . increase taxing opportunities in source jurisdictions by reducing or eliminating the tax incentives for multi-national enterprises (MNEs) to shift income into subsidiaries in low-tax jurisdictions."); Lorraine Eden, *Taxing Multinationals: The GloBE Proposal for a Global Minimum Tax*, 49 Tax Mgmt. Int'l J. (BNA) 11 (Jan. 10, 2020).

imposition of a global minimum tax,[16] and limiting the deduction of interest.[17]

All of these proposals are explicitly premised on the assumption that taxing rights should follow wealth creation, that is, that the international tax regime should be structured so that host countries can effectively tax the income that is generated within their territories.[18] The debate within the academic literature and in policy discussions at both the national and international levels focuses on how best to implement that principle.[19] All agree that the traditional rules, instituted a century

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16. OECD, *Global Anti-Base Erosion Proposal ("GloBE")—Pillar Two: Public Consultation Document* (2019), https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf [https://perma.cc/VH7H-WVAL].

17. OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4—2015 Final Report* (2015), https://doi.org/10.1787/9789264241176-en [https://perma.cc/K4XF-GTX4].

18. OECD, *Action Plan on Base Erosion and Profit Shifting* 20–21 (2013), https://www.oecd.org/ctp/BEPSActionPlan.pdf [https://perma.cc/P7ER-RT7N] [hereinafter OECD, *BEPS Action Plan*]; OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8–10—2015 Final Reports* (2015), https://dx.doi.org/10.1787/9789264241244-en [https://perma.cc/ZF4J-6KYZ]; OECD, *Tax Challenges Arising from Digitalisation—Interim Report 2018*, at 167 (2018), https://doi.org/10.1787/9789264293083-en [https://perma.cc/F285-54VY] ("The BEPS Project produced a substantial renovation of the international tax rules, underpinned by the principle that the location of taxable profits should be aligned with the location where economic activities and value creation take place."); OECD, *Harmful Tax Practices—2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5*, at 3 (2019), https://doi.org/10.1787/9789264311480-en [https://perma.cc/J76S-9WH9] ("Weaknesses in the current rules . . . requir[e] bold moves by policy makers to . . . ensure that profits are taxed where economic activities take place and value is created.").

19. *See, e.g.*, Robert Ackerman & Elizabeth Chorvat, *Modern Financial Theory and Transfer Pricing*, 10 Geo. Mason L. Rev. 637, 642 (2002) ("[Formulary apportionment] is often criticized because the allocation of profits should not necessarily track the placement of hard assets, employees and sales, as formulary apportionment would dictate. Rather, allocation should be based on the value of the economic realities brought by the participating related entities to the group." (footnotes omitted)); Jinyan Li et al., *Value Creation: A Constant Principle in a Changing World of International Taxation*, 67 Can. Tax J. 1107 (2019).

ago in a much different economic environment, have proven ineffective. The only question is what should replace them.

Left unaddressed in the current debate is the question of whether the principle itself—that taxing power should follow the creation of wealth—itself has any credence. Perhaps it too is a relic of a bygone era. Perhaps it never had any credence, and the rapid globalization of recent decades has served to expose that fact. Note that I am not referring here to the capacity of individual countries or even of the international community acting in concert successfully to implement the principle of territoriality given the challenges of globalization, digitalization, and so forth. One who laments the passing of territoriality as a practical option in light of the power of large MNEs to avoid taxation in the countries that host their investments implicitly agrees that effective taxation of domestic-source income is a valuable, albeit unachievable goal. The question that this Article will consider is deeper: whether allocation of taxing rights in accordance with wealth creation, assuming it could be achieved, is a goal that the international tax regime should pursue and, if it is not, why the idea that taxing rights should follow wealth creation plays such a central role in the international tax discourse.

In examining the principle that taxing power should follow wealth creation, this Article will rely upon the dichotomy, familiar in moral philosophy, between the right and the good.[20] In the context of international taxation, the right refers to a host country's deontological claim to receive a portion of the income produced within its borders.

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20. *See, e.g.*, IMMANUEL KANT, CRITIQUE OF PRACTICAL REASON 54 (Mary Gregor ed. & trans., Cambridge Univ. Press 1997) (1788) ("[T]he concept of good and evil must not be determined before the moral law (for which, as it would seem, this concept would have to be made the basis) but only (as was done here) after it and by means of it."); John Rawls, *The Priority of Right and Ideas of the Good*, 17 PHIL. & PUB. AFFS. 251 (1988); Timothy Hinton, *Kant and Aquinas on the Priority of the Good*, 55 REV. METAPHYSICS 825, 825 (2002) ("Aquinas treats the concept of the good as the starting point for moral philosophy. . . . Kant, on the other hand, famously rejects that doctrine entirely, insisting that the right must take precedence over the good."); Samuel Freeman, *Utilitarianism, Deontology, and the Priority of Right*, 23 PHIL. & PUB. AFFS. 313 (1994) (arguing that teleologists view the good as the starting point for moral principles, while deontologists give priority to the right); W. DAVID ROSS, THE RIGHT AND THE GOOD (Philip Stratton-Lake ed., 2002) (1930).

The good refers to the claim that host countries need revenue from MNEs to fund public goods. Although the literature often conflates these two claims, they are conceptually distinct and require separate analysis. I will argue that what actually motivates countries is not the right but rather a particular conception of the good in which the needs and desires of their own citizens and residents take precedence over those of other countries. However, for both political and psychological reasons they frame their position either in terms of the right or in terms of a more universal good, and this confusion pervades the academic literature as well.

Within the realm of the right, we must make a further distinction between two different types of right-based claims. A host country may assert that MNEs who choose to operate within its territory take upon themselves an implicit contractual obligation to pay tax as delineated in the host country's laws. When the host country imposes an income tax, MNEs are, in effect, contractually obligated to pay the host country a percentage of the income generated by their economic activity in the host country. Alternatively, the host country may assert a neo-Lockean claim to a commensurate share of the wealth that its social capital—in the broadest sense of the term—helped to create. Part II will discuss the contractual claim. Part III will consider the neo-Lockean claim.

Part IV will consider the good. It will sketch and then examine an argument leading from the proposition that tax revenues are necessary for the promotion of human welfare to the supposed conclusion that one of the pillars of the international tax regime should be the enabling of host countries to impose an effective income tax on MNEs.

Part V will summarize the findings and offer speculation as to why unsubstantiated claims based upon the right or upon a universal good have nevertheless attained such prominence in the discourse on international taxation.

II. Contractual Rights

The basis of a contractual right is the contract itself. The fact that one freely agreed to the terms of the contract is both necessary and sufficient to obligate one to honor those terms.[21] The rights and

21. The obligation to abide by the terms of an agreement into which one enters has a venerable history in moral philosophical thought. *See, e.g.*,

obligations under a contractual claim are independent of the underlying justice or fairness of the terms of that contract, in the sense that one who argues for enforcing the contractual terms need not demonstrate that it would have been appropriate to impose the obligation in the absence of a contract (of course, this does not mean that it is appropriate to enforce contractual terms that are unfair or unjust, or that agreements entered into under conditions of duress, fraud, and so forth are valid. It means simply that the source of the claim is the contract itself and not any underlying natural, pre-contractual, or property right). For example, if I contract to purchase 1,000 widgets at $100 per unit, then I am obliged to pay the vendor $100,000. The vendor's claim for payment derives from the contract itself, not from the vendor's underlying property right in the widgets.[22] Contrast this contractual claim to the claim that the owner of the widgets would have against me had I taken the widgets without her consent. Here the owner's claim against me effectively derives from her property rights in the widgets, not from any agreement on my part to pay for them.[23] To further clarify the distinction, note that where the right is contractual, I am obliged to pay even if I change my mind and decide that I do not want the widgets. Clearly, in such a case the source of that obligation is the contract itself. The owner of the widgets has no underlying, pre-contractual, or natural right to receive payment.[24]

In the context of international taxation, MNEs who choose to operate within a country's borders can be seen as implicitly agreeing to pay the taxes imposed by the host country. Thus, if the host country imposes an income tax, MNEs who invest in that country implicitly take upon themselves something akin to a contractual obligation to pay the government of the host country a given percentage of the profits that

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Thomas Hobbes, Leviathan, Parts I and II, at 112–19, 144–46, 162–63, 165–66 (Liberal Arts Press 1958) (1651); Immanuel Kant, Groundwork of the Metaphysics of Morals 89–90, 97 (H.J. Paton trans., Harper & Row 1964) (1785).

22. For a discussion of the distinction between claims whose validity derives from actual agreement and claims for which the fact that one would have agreed is evidence of their validity, see Ronald Dworkin, *The Original Position*, 40 U. Chi. L. Rev. 500, 500–09 (1973).

23. True, in some instances, a person may have both a contractual and non-contractual right to payment. Here, however, we are concerned with the contractual claim only.

24. *See generally* Randy E. Barnett, *A Consent Theory of Contract*, 86 Colum. L. Rev. 269 (1986).

they earn from their economic activity within its territory. Having taken upon themselves such an obligation, they then have a moral duty to honor the terms of that agreement.

The primary obstacle facing host countries in their attempt to enforce their rights vis-à-vis the MNE is not that MNEs violate their tax laws. Rarely are MNEs charged with tax evasion.[25] Rather, the primary challenge facing host countries is that MNEs are adept at avoiding tax by stripping income out of the host country and into tax havens or, more generally, into jurisdictions with more hospitable tax regimes. The contract argument that we are considering here is that by doing so, the MNE is in violation of its implied contractual obligation to pay the host country a percentage of the income that it earned by virtue of its operations within the host country's territory. Moreover, since practice has shown that host countries operating on their own are hard-pressed to enforce their implied contractual right vis-à-vis the MNE, there is a need for international cooperation, and the goal of such international cooperation should be to enable host countries to tax the wealth derived from their territory.

It is crucial to emphasize that the claim we are currently examining does not rely upon any natural right of the host country to share in the wealth created within its territory or upon its contribution to the creation of that wealth, but strictly from the implicit agreement between itself and the MNE. True, it is reasonable to assume that no MNE would agree to take upon itself such an obligation unless it expected that the benefit from operating within the host country's territory would exceed

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25. *See, e.g.*, Ilan Benshalom, *The New Poor at Our Gates: Global Justice Implications for International Trade and Tax Law*, 85 N.Y.U. L. Rev. 1, 44–45 (2010); Rajeev Syal, *Amazon, Google and Starbucks Accused of Diverting UK Profits*, Guardian (Nov. 12, 2012), https://www.theguardian.com/business/2012/nov/12/amazon-google-starbucks-diverting-uk-profits [https://perma.cc/S2CK-FTBW] (Parliamentary committee chair Margaret Hodge charged Starbucks, which was under investigation for paying almost no income tax to the United Kingdom despite its supposedly profitable business operations in that country: "We're not accusing you of being illegal, we are accusing you of being immoral[.]"); *cf. Ten Reasons to Defend the Corporation Tax*, Tax Just. Network 17 (2015), https://www.taxjustice.net/wp-content/uploads/2013/04/Ten_Reasons_Full_Report.pdf [https://perma.cc/54CT-8R6P] ("The best that can be said for most of this activity is that it has **not been shown** to be illegal. That is not at all the same as saying it's 'perfectly legal.'").

the expected tax burden. Nevertheless, the moral claim to tax MNE income under the argument being addressed in this Part is not grounded in the underlying sovereignty or in any benefit that the MNE may derive by operating within the host country's territory, but rather in the terms of the implied contract itself.[26] The question that we now need to consider is whether or not this claim is sound.

In almost all instances, the terms of the asserted contractual arrangement between the host country and the MNE are delineated in the legislation of the host country.[27] From the perspective of the contract-based argument, the host country effectively offers a standard-form—although extraordinarily long and complicated—contract to foreign entities, which then signify their assent to the terms contained therein by investing or otherwise operating in the host country's territory.[28]

Consequently, if the terms of agreement are difficult to enforce, the most obvious response would be to adopt terms that are more easily enforceable. For instance, if experience shows that MNEs can easily manipulate their taxable income by deducting interest or royalties, then local legislation could prohibit the deduction of these types of payments or could specify statutorily the amount of interest and royalties that are deductible, instead of leaving it to the vague standard of arm's length transfer prices.[29] Alternatively, it could impose tax—at the same rate that it imposes on the corporation operating in its midst—on the foreign recipients of those payments along with a withholding requirement to assist it in enforcing collection. In such a case, every dollar deducted

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26. These alternative claims will be addressed in Part III, *infra*.

27. I am not distinguishing here among statutory provisions, regulations, formal and informal administrative procedures, case law, and so forth. The word "legislation" in the text includes the entire body of the host country's tax law and practice, in the broadest sense of the term.

28. In some instances, particularly in the case of large MNE investments, the terms of taxation are negotiated directly between the MNE and the government of the host country. The analysis in this Part applies to such arrangements as well.

29. *See, e.g.*, Morse, *supra* note 11, at 598; Julie Roin, *Can the Income Tax Be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 Tax L. Rev. 169, 171 (2008); Elena R. Tsaneva, *Transfer Pricing in the World of Services and Intangibles—A New Challenge to Preserving the Corporate Tax Base*, 9 UCLA J. Int'l L. & Foreign Aff. 323, 325–26 (2004); Bret Wells & Cym Lowell, *Tax Base Erosion: Reformation of Section 482's Arm's Length Standard*, 15 Fla. Tax Rev. 737 (2014).

by the corporation operating within its territory would be a dollar taxable in the hands of the recipient. The host country would be indifferent to the amount of the payment.

True, doing either of these may violate the terms of treaties to which the host country is a signatory.[30] However, the treaty is a contractual arrangement to which the host country agreed. Assuming that the host country is a rational actor, the reason it signed the treaty is that it expected the benefits it would reap from the treaty to outweigh the costs.[31] Moreover, if in retrospect this expectation turns out to be unfounded, the host country can always abrogate the treaty or seek to renegotiate its terms.[32] It seems a bit ingenuous for a country to sign a treaty, remain a party to it, and then remonstrate that the terms of that treaty make it difficult to implement its tax laws. Interestingly, the tax treaty network forms the basis of current international cooperation in the field of taxation.[33] If treaty obligations really do constitute a significant obstacle to enacting more easily enforceable tax legislation, then

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30. For example, prohibiting the deduction of interest and royalties would run afoul of Article 7(2) of the OECD Model Income Tax Treaty, imposing tax on the foreign recipient of royalties would violate Article 12(1) of the treaty, and imposing tax on the foreign recipient of interest at a rate higher than 10% is impermissible under Article 11(2) of the treaty. OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, arts. 7(2), 11(2) & 12(1) (2017), https://doi.org/10.1787/mtc_cond-2017-en [https://perma.cc/K4R5-9UA6] [hereinafter OECD Model Tax Convention]; *see also* U.S. Model Income Tax Convention, arts. 7(2), 11(2) & 12(1) (2016), https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf [https://perma.cc/W2T3-K2EF] (similar to the OECD treaty, except under Article 11(2), the maximum rate of tax on interest is 15%); U.N. Model Double Taxation Convention Between Developed and Developing Countries, arts. 7(2), 11(2), & 12(2) (2017), https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf [https://perma.cc/TR8H-4CUA] (similar to the OECD and U.S. models, except that the tax rate on interest and royalties under Articles 11(2) and 12(2) is to be established through bilateral negotiations).

31. *Cf.* Tsilly Dagan, International Tax Policy: Between Competition and Cooperation 166–80 (2018).

32. *See, e.g.*, OECD Model Tax Convention, *supra* note 30, art. 32 ("Either Contracting State may terminate the Convention . . . by giving notice of termination at least six months before the end of any calendar year. . . .").

33. *See, e.g.*, Reuven S. Avi-Yonah et al., U.S. International Taxation: Cases and Materials 1 (3d ed. 2011).

it would seem no small paradox that international cooperation actually impedes enforcement of the terms of the implied contract between host countries and MNEs operating in their territory.

If it is difficult to prevent MNEs from understating their profits from operations in the host country, then perhaps the solution is to choose a tax base other than profits.[34] After all, why use a contract term that is difficult to supervise? Instead of taxing profits, the host country could impose tax on gross receipts or upon some other matrix that is more difficult to manipulate.[35] Recall that we are currently considering not the host country's natural or neo-Lockean claim to a share of the profits generated within its territory but rather its moral claim of entitlement to the terms of the contract as implicitly agreed between it and the MNE.[36]

Thus, the question that arises is: Why do countries not adopt terms of reference that are easy to enforce and that enable them to collect the amount of tax that they wish to collect from MNEs? I would posit that the reason they do not do so is that such a tax regime would make it difficult for them to compete for international investment against other countries whose tax systems are easier to manipulate. For example, denying a deduction for interest and royalties paid by local enterprises to foreign entities is the functional equivalent of raising the tax rate on the local enterprise's earnings by the ratio of its pre-royalty-and-interest profits to its post-royalty-and-interest profits. Assume that a local enterprise generates profits of $1 billion before paying royalties and that it pays a related foreign corporation a royalty of $800 million. A 15% income tax that does not a permit deduction of royalties is the functional equivalent of a 75% income tax that permits such a

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34. *See, e.g.*, David Elkins, *The Case Against Income Taxation of Multinational Enterprises*, 36 Va. Tax Rev. 143 (2017).

35. Consider, for instance, the contractual terms that the owners of a shopping mall are likely to offer prospective tenants. They might simply ask for a fixed rent. If they want to make the payments, at least partially, a function of the success of the tenants, they might ask for a percentage of total receipts and then perhaps institute a mechanism for verifying those receipts. It is highly unlikely that they would ask for a percentage of profits, in part because lessees could easily avoid the rent, e.g., by paying large salaries to their shareholders. If the owners of the mall did ask for a percentage of the profit, they would almost certainly include in the contract explicit limitations on the deduction of payments to related parties.

36. The neo-Lockean claim will be considered in Part III, *infra*.

deduction.[37] It is reasonable to assume that a country imposing a 75% income tax on post-royalty profits would find it difficult to compete for international investments against countries offering a much lower rate. The same reasoning would apply to any other attempt to tighten up the tax regime that a country imposes on MNEs. Imposing a withholding tax on payments of royalties or interest to nonresidents could have the same effect as denying a deduction for the local enterprise paying the royalty or interest.[38] Restricting the deduction of various payments made by the local enterprise would raise the effective tax burden on that enterprise, although to a lesser extent than denying the deductions. Similar problems arise with regard to other aspects of a country's internal international tax regime. For example, imposing tax on the worldwide income of MNEs that are managed and controlled or have their home offices in the country would discourage MNEs from establishing home offices in the country's territory.[39]

Consider for instance the case of the famous (or infamous) treaty between the United States and the Netherland Antilles. From the 1950s until 1984, foreigners lending to U.S. corporations could avoid tax on the interest they received by routing the loan through an Antilles subsidiary of the U.S. corporate parent. The way that the transaction was structured was that the foreign entity would lend money to the Antilles subsidiary, which would then lend the money at substantially the same

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37. 15% × $1 billion = 75% × $200 million. In terms of the formula cited two sentences earlier in the text, the 75% tax rate is equal to the 15% tax rate times the ratio of the corporation's pre-royalty income ($1 billion) to its post-royalty income ($200 million): 0.75 = 0.15 (1,000,000,000/200,000,000).

38. Whether or not it would, and the extent to which it would, could depend, among other factors, upon the tax regime to which the foreign recipient is subject. For example, if the foreign recipient is subject to income tax at a rate not less than that prevailing in the host country and is entitled to a full credit for taxes paid to the host country, it might be indifferent to the imposition of tax. However, if that were the case, the MNE would have no tax incentive to make the royalty payment in the first place.

39. *See, e.g.*, J. Clifton Fleming, Jr. et al., *Defending Worldwide Taxation with a Shareholder-Based Definition of Corporate Residence*, 2016 BYU L. Rev. 1681, 1693; Gary Clyde Hufbauer & Ariel Assa, U.S. Taxation of Foreign Income 116 (2007); Omri Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. Rev. 1613, 1620–22, 1657 (2013); George K. Yin, Letter to the Editor, *Stopping Corporate Inversions Sensibly and Legally*, 144 Tax Notes 1087 (Sept. 1, 2014).

interest rate to the U.S. parent. Under the terms of the treaty, the Antilles subsidiary was exempt from U.S. taxation on the interest. Although it was ostensibly subject to Antilles tax, the Antilles subsidiary was entitled, under domestic Antilles tax law, to deduct the interest it paid to the foreign entity, meaning that its taxable income was close to zero. Finally, the Antilles did not impose any withholding tax on interest payments from its corporations to foreign corporations.[40]

The question that immediately arises is why the U.S. government, which for three decades was well aware of what was happening, allowed it to continue. Seeing how its treaty with the Netherland Antilles was exploited to avoid U.S. income tax on interest payments originating in the United States, it could simply have abrogated the treaty. Alternatively, the IRS could have challenged this structure on the grounds that the Antilles subsidiary was merely a conduit and therefore should be ignored or be denied treaty benefits.[41] However, for 30 years the government tacitly approved of this structure. The reason it did so was that shutting down the tax shelter would have made it more expensive for foreigners to lend money to U.S. corporations. As U.S. corporations were dependent upon foreign funds, preventing the "abuse" of this "loophole" would have been detrimental to U.S. economic interests.[42] In 1984, the Code was amended and portfolio interest received by foreigners was formally exempted from U.S. taxation.[43] At that point, it was no longer necessary to recognize what was known as the Antilles sandwich, and the IRS finally got around to challenging the structure.[44] Simultaneously, the United States proposed adding a Limitation of Benefits to its treaty with the Netherland Antilles in order to deny treaty benefits from Antilles corporations whose beneficial owners were not residents of the Antilles. When the Antilles refused, the United States simply terminated the treaty.[45]

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40. Isenbergh & Wells, *supra* note 9, at 209–11.

41. *See, e.g.*, *Aiken Indus., Inc. v. Comm'r*, 56 T.C. 925 (1971), *acq.*, 1972–2 C.B. 1.

42. Isenbergh & Wells, *supra* note 9, at 208–09.

43. I.R.C. §§ 871(h), 881(c).

44. Rev. Rul. 84–152, 1984–2 C.B. 381; Rev. Rul. 84–153, 1984–2 C.B. 383; *N. Ind. Pub. Serv. Co. v. Comm'r*, 115 F.3d 506 (7th Cir. 1997), *aff'g* 105 T.C. 341 (1995).

45. *See generally* Frith Crandall, *The Termination of the United States-Netherlands Antilles Tax Treaty: What Were the Costs of Ending Treaty*

The Antilles sandwich is a blatant case of a host country permitting foreigners to exploit what appears to be a loophole in its tax regime because closing the loophole and imposing tax on the actual domestic-source earnings of those foreigners would discourage them from investing in the host country (in this case—from lending to U.S. corporations). However, it is not an isolated case; rather it is symptomatic of a much more general rule. Host countries are often well aware of the loopholes that MNEs exploit to understate their taxable income.[46] Moreover, those loopholes can usually be closed at the stroke of a legislative pen. The tax base, the source rules, deductibility, residence, and so forth are all dictated by the host country's statutory framework.

Thus, the supposed loopholes that prevent host countries from collecting more tax from MNEs operating in their territory are in fact part and parcel of the contractual arrangement between the host country and the MNE. Recall again that the argument we are currently considering is that the source of a host country's claim to collect tax from an MNE operating in its territory is the implied contract whose terms are no more and no less than that the MNE must respect the host country's tax regime. If the host country employs terms of reference that are easily manipulable—and particularly if it continues to employ those terms after becoming aware of their manipulability—then from a contractual perspective the only reasonable conclusion that one can arrive at is that those are the terms it is actually offering and that the MNE is implicitly accepting. An argument that the MNE is then obliged to ignore the manipulability inherent in the terms of reference adopted by the host country itself when designing its own tax regime is bound to fail. So too must fail the argument that a host country is entitled to call for international cooperation to enable it to enforce a contractual right against MNEs who exploit the inherent manipulability of its tax laws.

Shopping?, 9 Nw. J. Int'l L. & Bus. 355 (1988); Mark B. Schoeller, *The Termination of the United States-Netherlands Antilles Income Tax Convention: A Failure of U.S. Tax Policy*, 10 U. Pa. J. Int'l Bus. L. 493 (1988).

46. Even if they are not aware of the exact details of particular tax planning strategies, they usually know which provisions of their domestic tax law (including treaty provisions that function as part of their domestic law) are likely to facilitate MNE tax avoidance.

III. Neo-Lockean Rights

A. The Neo-Lockean Claim

An alternative claim of host country entitlement derives from the proposition that those who contribute to the creation of wealth have a natural right to a commensurate portion of the wealth that they help create.[47] From this perspective, the income tax that host countries demand from MNEs operating within their territory is a manifestation of the host country's neo-Lockean claim to a share of the profits generated by what is effectively a joint economic venture, a cooperative exploitation of the resources of the MNE and the social capital of the host country.[48] "Social

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47. This claim is often couched in term of benefit theory. *See, e.g.*, William B. Barker, *International Tax Reform Should Begin at Home: Replace the Corporate Income Tax with a Territorial Expenditure Tax*, 30 Nw. J. Int'l L. & Bus. 647, 665 (2010) ("The exchange or benefit principle of taxation is the primary theory that underlies source-based international taxation."); J. Clifton Fleming, Jr. et al., *Designing a U.S. Exemption System for Foreign Income When the Treasury Is Empty*, 13 Fla. Tax Rev. 397, 401 (2012) ("[E]very country has a normative claim, based on a benefits-received rationale, to tax income earned by foreigners within its borders[.]" (footnote omitted)); J. Clifton Fleming, Jr. et al., *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 Fla. Tax Rev. 299, 307 n.13 (2001) ("[T]he U.S. tax regime that applies to the U.S.-source income of nonresidents. . . . is often rationalized as a benefit-based charge imposed by the source country."); Lawrence Lokken, *The Sources of Income from International Uses and Dispositions of Intellectual Property,* 36 Tax L. Rev. 233, 239−40 (1981); Stephen E. Shay et al., David R. Tillinghast Lecture, *"What's Source Got to Do With It?" Source Rules and U.S. International Taxation*, 56 Tax L. Rev. 81, 90−91 (2002); Herwig J. Schlunk, *How I Learned to Stop Worrying and Love Double Taxation*, 79 Notre Dame L. Rev. 127, 129−30 (2003); *cf.* Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 Law & Pol'y Int'l Bus. 145, 203 (1998) (recognizing, although not agreeing with, the common assertion that "benefit theory underlies source taxation").

48. The Neo-Lockeanism referred to in the text is one interpretation of Locke's credo that when labor (which belongs to the individual) is combined with a part of the natural work (which belongs to mankind in common), then the resultant product belongs exclusively to the individual. John Locke, *Concerning the True Original Extent and End of Civil Government*, *in* Two Treatises of Government § 27 (Bettesworth 5th ed. 1728) (1689),

capital" in this context is a broad term that describes all aspects of a country that are relevant for its capacity to serve as a substructure for producing wealth. It includes the country's territory, weather, and geopolitical situation along with its political, economic, and social institutions and traditions. Particularly relevant for our discussion is that a country's social capital is the embodiment of all those factors that a rational foreign investor would take into consideration when deciding whether or not to invest in the country.

An ostensibly similar claim is that MNEs should share in the cost of actual government outlays from which they, along with the local

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https://www.google.com/books/edition/Two_Treatises_of_Government_in_the_Forme/BpZmAAAAcAAJ?hl=en&gbpv=0 [https://perma.cc/5D9L-EWSW] ("Whatsoever then he removes out of the State that Nature hath provided, and left it in, he hath mixed his *Labour* with, and joined to it something that is his own, and thereby makes it his *Property*. It being by him removed from the common State Nature hath placed it in, it hath by this *Labour* something annexed to it, that excludes the common Right of other Men. For this *Labour* being the unquestionable Property of the Labourer, no Man but he can have a Right to what that is once joined to. . . ."). The neo-Lockean interpretation is that the product belongs to all those whose resources contributed to its creation, in proportion to their contribution. According to this interpretation, the reason that Locke assigned all of the rights in the product to the individual who contributed the labor was that he was discussing an era of abundance in which there were enough natural resources, particularly land, to satisfy everyone's needs. Under such circumstances the economic value of unimproved land or other resources in their natural state would be zero or close to zero. *Id*. § 33 ("Nor was this *Appropriation* of any parcel of *Land*, by improving it, any prejudice to any other Man, since there was still enough, and as good left; and more than the yet unprovided could use."). A proportional assignment of rights would indeed result in the one contributing the labor receiving full rights in the product. *Id*. § 40 ("I think it will be but a very modest Computation to say, that, of the *Products* of the Earth useful to the Life of Man 9/10 are the *Effects of Labour*: Nay, if we will rightly estimate things, as they come to our Use, and cast up the several Expences about them, what in them is purely owing to *Nature*, and what to *Labour*, we shall find, that in most of them 99/100 are wholly to be put on the account of *Labour*."). Needless to say, we are no longer in such an era of abundance, and today there is competition for almost every natural resource. Even in their natural state, resources therefore have economic value. When one combines one's labor with a natural resource, the product rightfully belongs to the labor and to the (rightful) owner of the material resource in proportion to their contribution.

population, benefit.[49] However, focusing on social capital is more accurate than focusing on government expenditures. First, not all social capital involves government outlay. If the climate of the country is conducive to creating wealth, the host country has as strong a neo-Lockean claim to share in that wealth as it would have had were its contribution to wealth creation manifested in its superior infrastructure. In either case it owns the relevant factor of production and is ostensibly entitled to a portion, commensurate with its relative contribution, of the wealth created. Second, some government expenditure is undertaken in order to overcome negative social capital. For example, if a country faces a threat of invasion, it will likely be a less attractive investment venue than is an otherwise similar country that is not under such threat. By maintaining a large and expensive military force as a deterrent, the country in question may be able to create a functional equivalence vis-à-vis other countries with smaller military budgets but not under immediate military threat. If the contribution of these countries to the creation of

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49. *See, e.g.*, William B. Barker, *Optimal International Taxation and Tax Competition: Overcoming the Contradictions*, 22 Nw. J. Int'l L. & Bus. 161, 188 (2002) ("There should be no obligation on the part of a nonresident to pay taxes without the provisions of demonstrable government services."); Graetz, *supra* note 1, at 298 ("The idea that the source country has a fair claim to the income produced within its borders is also grounded in the view that foreigners, whose activities reach some minimum threshold, should contribute to the costs of services provided by the host government, including, for example, the costs of roads and other infrastructure, police and fire protection, the system for enforcement of laws, education, and the like."); Robert A. Green, *The Future of Source-Based Taxation of the Income of Multinational Enterprises*, 79 Cornell L. Rev. 18, 84 (1993) ("A benefits tax would be based on the costs that the taxpaying corporation imposes on the public sector, including the costs of the public goods and services that the corporation uses."); Shay et al., *supra* note 47, at 90 ("A nonresident who invests in or carries on a U.S. business profits from U.S. government activities that create and foster general public safety, national security, a fair legal system, a transparent and safe financial infrastructure, a healthy and educated workforce, transportation and communication infrastructure, legal protection of intellectual property licensed or sold in the United States by the nonresident, and redistributive assistance to the poor that contributes to a stable social order." Conspicuous by the absence are any benefits that do not derive from direct government expenditure); Kaufman, *supra* note 47, at 185 ("Under a strict benefit rule, the country in which a product is produced could impose a charge for the government goods and services benefitting the producer. . . .").

wealth in their territories is similar, those with a larger military expenditure do not appear to have a neo-Lockean claim to impose a higher tax burden on MNEs operating in their midst than do the others. While MNEs certainly benefit from the military expenditure in the sense that their operations in the country in question are safer and less risky than those that would have been in the absence of such expenditure, it is equally true that MNEs operating in competing venues benefit from the safety accorded by an absence of any direct military threat. Another way of phrasing the same idea is that the threatened country's geopolitical situation is a negative factor in its ability to contribute to wealth production. Its military expenditures simply neutralize the negative factor. The same line of reasoning will apply to expenditures undertaken for the purpose of overcoming the threat of hurricanes or typhoons, of halting the process of desertification, or of stemming the spread of endemic diseases.

In order to rely on government expenditure to ground neo-Lockean rights vis-à-vis the profit of MNEs, we would need to distinguish between government expenditures that provide a positive benefit and those that overcome a negative factor. This would require the establishment of a necessarily arbitrary baseline. (Is the threat of invasion a negative factor or is the absence of such a threat a positive factor?) We would then need to bring into account any incidence in which a country failed to overcome a negative factor, i.e., any attribute below the baseline, as a negative government expenditure, equal to the amount that the government would have had to expend in order to overcome that negative factor. Thus, for example, if a country would need to spend $100*x* to protect itself during an annual, potentially devastating hurricane season but in fact spends only $60*x*, then—assuming that absence of hurricanes is the baseline—we would need to view government expenditures in this field not as $60*x*, but as negative $40*x*. Moreover, consistency would demand that we consider positive factors requiring no budgetary outlay as effectively incurring a constructive expense.

Therefore, this Part will focus not on government expenditures but rather on the larger picture of social capital, in the broadest sense of the term, and on the contribution of that social capital, whatever its source, to the creation of wealth.

The line of reasoning that we are exploring considers income tax imposed on foreign MNEs to be the means by which the host country actualizes its natural, neo-Lockean claim to a proportionate share of the profits produced from the joint enterprise to which it is a party. Implementation of such a claim requires that the taxable income reported

by the MNE reflect the actual total wealth created by the joint enterprise. Without an accurate computation of the wealth created by the joint enterprise, the host country's ability to enforce its claim to a fair share of the wealth is severely hampered. Thus, goes the neo-Lockean argument, the use of profit shifting techniques to reduce taxable income violates the natural property rights of the host country and effectively constitutes a misappropriation by the MNE of profits from the joint enterprise.

B. Analyzing the Neo-Lockean Claim: Presence

The argument that the host country has a neo-Lockean claim to share in the wealth produced within its territory rests upon the implicit proposition that all production of wealth within a country's borders relies to a meaningful extent upon the host country's social capital. This proposition is far from axiomatic. Consider the following hypotheticals:

> (a) While walking through a park, I come up with a commercially valuable idea. I then sell this idea or otherwise derive income from it.

Even though the idea that generated the income originated in the park, the owner of the park does not appear to have a neo-Lockean claim to a proportion of my new-found wealth. The reason, I would posit, is that the park—and by extension, the owner of the park—contributed little if anything to the birth of the idea. True, the owner of the park might have had a claim to some of my income had he, say, posted a sign at the entrance stating that he is entitled to a stated percentage of the profits from any idea generated in the park. Of course, enforcing such a claim would be extraordinarily difficult, but let us ignore that issue for a moment. Even if the claim is enforceable, it is a contractual claim, not a neo-Lockean claim: it derives not from ownership of the park but rather from the contractual obligation that I took upon myself when I entered the park.[50]

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50. Part II, *supra*, discussed a host country's contractual claim to tax MNE income. The focus of the current Part is the host country's neo-Lockean claim.

> (b) A number of colleagues and I meet regularly in the park to exchange ideas. Over time we develop a commercially valuable idea, which we then sell or from which we otherwise derive income.

I would argue that in this case, too, the owner of the park does not have a neo-Lockean claim to a proportion of the income and for the same reason as in scenario (a): the park is peripheral to the germination of the idea. We could have met anywhere. The fact that we met in that particular park is not a significant factor in the creation of wealth. At best, the owner would have a natural claim to fair use value of the park. He would not have a claim to share in the wealth that happened to have been created in his park.

Moving now from the analogy to the referent:

> (c) An MNE establishes a research or a production facility in an undeveloped portion of a country. Its employees, supplies, and so forth are all brought in from outside the country, and the product of the facility is exported from the host country.

Assuming that the facility is profitable, wealth is indeed created within the host country's territory. However, unless the host country's contribution to the creation of wealth consists of more than its simply allowing the facility to operate within its territory, it has little discernable neo-Lockean claim to a portion of the MNE's income. As with scenario (b), the host country will at best have a claim to fair market rent for the use of the land. As the MNE presumably pays fair market rent to the owner of the land—whether a private party or the state itself—it would have no further neo-Lockean obligation toward the host country.

In other words, the fact that an MNE derives income from operating in a country does not in and of itself imbue the host country with a neo-Lockean right to a portion of that wealth. A neo-Lockean claim requires more.

C. Analyzing the Neo-Lockean Claim: Factor Prices

Let us therefore consider circumstances in which the contribution of the host country to the creation of wealth consists of more than simply allowing the MNE to operate in its territory.

> (d) Like scenario (c), except that instead of bringing in employees from abroad, the MNE hires local employees. To strengthen the host country's case, assume that the facility conducts cutting edge research, that the host country has an exquisite post-secondary public education system, and that the MNE hires the best and the brightest graduates to work in its facility. Furthermore, assume the host country has a strong cultural work ethic that encourages cooperation and creativity. As a consequence, the employees are able to create intellectual property with tremendous market value.

In this scenario—as opposed to scenarios (a), (b), and (c) above—the host country's purported claim to a share in the income is not based merely upon the fact that wealth was produced within its territory. Here, the MNE is heavily dependent upon the host country's social capital. The host country would accordingly appear to have a relatively strong neo-Lockean claim to a portion of the wealth created. Nevertheless, a closer examination will demonstrate that this claim, too, is unfounded.

While it is true that the MNE benefits from the host country's education system, the talents of its residents, and its cultural norms, it is equally true that the MNE pays for those benefits via the salaries that it pays its employees. These salaries presumably reflect the education that they received, the talents that they possess, and their work ethic. Requiring the MNE then to share its profits with the government of the host country would effectively be charging it twice for the same benefit. In other words, it is not enough to demonstrate that the MNE relies upon the social capital of the country in the production of its income. It is also necessary to demonstrate that the MNE does not pay full market price for the use of that social capital through factor prices.[51] Note that in scenario (d), the host country may well have a neo-Lockean claim vis-à-vis the employees. Their income-producing ability derives at least in part from the social capital—the education system and the cultural norms—of the host country, and the host country could actualize this claim by, for instance, imposing an income tax on the salaries of those employees. However, the host

51. Instances in which factor prices do not fully reflect the benefits of the country's social capital are discussed in Subpart D, *infra*.

country does not appear to have a legitimate neo-Lockean claim to a percentage of the profits of the MNE.

Another couple of examples will perhaps help to elucidate the matter.

> (e) Like scenario (d), except that the host country provides no public higher education. All post-secondary education is provided by for-profit colleges.

Do the colleges have a neo-Lockean claim vis-à-vis the MNE to a portion of its profits? Clearly, they do not. At most they would have a claim vis-à-vis their graduates to a share of their income, but even here, if they received fair market tuition, then they would presumably have no further claim upon those to whom they provided an education. From a neo-Lockean perspective, it is of no concern to the MNE who provided and who financed the education of the employees that it hires: the government, private firms, charitable organizations, and so forth. Once the MNE pays its employees full market value for the services that they render, any neo-Lockean claim of those who provided those employees with the skills, the temperament, and the other attributes that enabled them to contribute as they do to the production of wealth must be directed toward the employees themselves, not toward those who hire them.

> (f) An MNE establishes a research or production facility in Country *A*, close to its border with Country *B*. All of its employees are residents of Country *B* and commute to the facility. As in scenario (d), Country *B* provides its residents with free and exceptional post-secondary education, and Country *B*'s cultural norms encourage creativity and cooperation. As a consequence, the employees are able to create intellectual property with tremendous market value.

Consider first the position of Country *B*. Although the social capital of Country *B* in scenario (f) is as necessary to the production of the MNE's profit as is the social capital of the host country in scenario (d), I am unaware of any argument in the academic literature or in any national or international policy proposal that Country *B* should have the right to tax the profits of the MNE. The reason seems quite clear. Although the MNE relies upon Country *B*'s social capital, Country *B*'s

contribution to the production of wealth is embodied in the services that its residents render to the joint project and for which they presumably receive fair market value. Country *B* can and often does claim the right to tax its residents on the salaries that they earn from working abroad, and as we have seen, this can perhaps be viewed as an appropriate means of asserting its neo-Lockean rights in the wealth that its social capital helped produce. However, both logic and international usage agree that Country *B* in scenario (f) has no neo-Lockean claim to a share in the MNE's residual profit after the MNE pays fair market salaries. Such being the case, it is difficult to assert that the host country in scenario (d) has any claim to share in those profits by virtue of the local employees hired by the MNE.

A similar line of reasoning applies to other elements of the host country's social capital. It is usually advantageous to operate in a country with stable economic, political, and social institutions. Operating in a country that is close to sources of raw materials, that is located along major shipping lines, and that has easy access to markets for manufactured goods can contribute to the success of an MNE's economic venture. However, these advantages will be reflected in factor prices, particularly in the price of land. When an MNE rents real estate in a stable, developed, geopolitically well-situated country, it will almost certainly pay more than it would in an unstable, undeveloped, geopolitically disadvantaged country. Its profits are those that remain after accounting for such expenses. Having paid full market value for access to those advantages via rent and other factor prices, the MNE would seem to have no neo-Lockean obligation to share its residual profits with the host country.

Returning to scenario (f), consider now the position of Country *A*. The fact that it adjoins and has an open border with Country *B* (and that as a consequence those operating near that border can hire skilled workers from Country *B*) is an element of Country *A*'s social capital that contributes to the production of wealth by the MNE. Nevertheless, it would not appear that these factors imbue Country *A* with a neo-Lockean right to share in the MNE's profits. As already noted, the rent paid by the MNE for the privilege of operating near that border will presumably reflect that advantage. As with Country *B* and its resident employees, it would seem that Country *A* has a strong neo-Lockean claim to tax the rent received by its resident landowners from the MNE. However, Country *A*'s proximity to and friendly relationship with Country *B* does not appear to present a strong case for taxing the profit earned by the MNE after paying that rent. Paying full market rent for

use of the land and then sharing its residual profits with Country *A* would again seem to be a case of paying twice for the same thing.

D. Analyzing the Neo-Lockean Claim: Uncompensated Contribution

Our discussion of factor prices and their effect upon the host country's neo-Lockean right to tax the MNE's profits has hitherto rested upon the implicit assumption that the contribution of the host country's social capital to the creation of wealth within its territory is fully captured by factor prices, particularly wages and rent. There is strong empirical evidence to support this assumption. Studies have shown that in the international arena, the incidence of corporate tax falls primarily upon domestic employees and domestic landowners.[52] If true, this finding would seem to indicate that the advantages of investing in a country are indeed fully reflected in the factor prices paid by the MNE to suppliers of services (including the use of land).

Nevertheless, it is not unreasonable to posit that, in many instances, factor prices will not capture all of the advantages of a country's social capital. True, economic theory dictates that where there are advantages not so reflected, the host country will attract additional investment and this additional investment will drive up factor prices to the point where they fully reflect all of the advantages of investing in that country.[53] However, markets are not completely efficient (for example, there may not be a sufficient number of international actors capable of exploiting the opportunities available in a particular country),[54] so it is possible that some advantages attributable

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52. *See, e.g.*, Reuven Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 Harv. L. Rev. 1573, 1647 (2000) [hereinafter Avi-Yonah, *Crisis*]; Reuven S. Avi-Yonah, *Bridging the North/South Divide: International Redistribution and Tax Competition*, 26 Mich. J. Int'l L. 371, 380 (2004); Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 Geo. L.J. 543, 553 (2001).

53. At that point, investors will be indifferent to investing in that country as opposed to alternative venues.

54. *See, e.g.*, *69 of the Richest 100 Entities on the Planet Are Corporations, Not Governments, Figures Show*, Global Justice Now (Oct. 17, 2018), https://www.globaljustice.org.uk/news/2018/oct/17/69-richest-100-entities-planet-are-corporations-not-governments-figures-show [https://perma.cc/Z9Y3-JYTF].

to the host country's social capital will not be fully reflected in factor prices. This uncompensated contribution of a host country's social capital to the creation of wealth could ground a legitimate claim for neo-Lockean taxing rights.

The question that now arises is how, in such a case, to quantify this uncompensated contribution (i.e., the contribution of the host country's social capital that is not reflected in factor prices). The allocation of taxing rights in accordance with wealth creation does not do so. First, there is a difference between wealth creation and MNE profit. The wealth created by an economic enterprise is equal to the combined income of all the factors of production: employees, lessors, lenders, licensors, equity investors, and so forth. Profit is that portion of the wealth created that is left over after paying those who own or control the non-equity factors of production. Thus, one venue may generate a significant amount of wealth, most of which is captured by local factors of productions, leaving few residual profits for equity owners. Another venue may produce relatively little wealth, but because less of that wealth is captured by local factors of production, the residual profits earned by the MNE may be higher. In other words, the first produces greater wealth, the second produces more MNE profit. Second, the proposed formula does not successfully distinguish between the uncompensated contribution of the host country's social capital and the contribution of resources belonging to the MNE. It is certainly possible to imagine two venues in which the MNE profits (after deducting the cost of local factors of production) are similar but where in one the uncompensated contribution of the host country's social capital is considerably greater than in the other. The first host country has a neo-Lockean claim to a much greater share of the MNE's profits than does the second. The mantra of allocating taxing rights in accordance with where wealth is created cannot make that distinction.

Is there a practical way to quantify the uncompensated contribution of a host country's social capital to the production of wealth and then enable it to impose a tax that would effectively enforce its legitimate neo-Lockean claim? I will argue that there is such a method, but that it involves abandoning international efforts to coordinate tax systems and, instead, promoting competition for international investment. Furthermore, I will argue that the nature of international taxation means that, perhaps counterintuitively, it is considerably easier to implement a neo-Lockean tax structure in the international arena than it is in the purely domestic arena.

E. Quantifying the Contribution of Social Capital: The Domestic Arena

To fully elucidate the argument, this Subpart will begin with a brief discussion of the problems that we might encounter were we to attempt to design a domestic tax in accordance with neo-Lockean principles. It will then apply the findings of that discussion to the international arena.

As in the international arena, so too in the domestic setting, the production of wealth results from the confluence of private and public resources. When earning income, individuals and firms rely not only upon their own efforts but also upon the country's social capital, and the wealth that they produce is effectively the result of a joint enterprise between them and the society in which they operate.[55] From a neo-Lockean perspective the wealth so produced—the wages, the profits, the rents, and so forth—belongs to those who contributed to its production, each in proportion to the value of its contribution. The individual or the firm is entitled to a portion of the wealth, and the state—representing the claims of its constituents to their share of the income attributable to social capital—is also entitled to a portion of the wealth.[56] Income tax, from this perspective, is the means by which the state claims its fair share of that wealth. An income tax of x% would reflect the idea that $(100-x)$% of a taxpayer's income is traceable to her own efforts and that x% of that income is traceable to her exploitation of social capital.

The practical problem with applying this model is quantifying the relative value of public resources that are exploited in the production of wealth (i.e., determining the value of x). On the one extreme, it could be argued that the contribution of public resources is equal to the

55. *See* Yoseph Edrey, *Constitutional Review and Tax Law: An Analytical Framework*, 56 Am. U. L. Rev. 1187, 1211–24 (2007).

56. President Obama implicitly relied upon such a neo-Lockean argument in a widely quoted and highly controversial 2012 campaign speech, in which he stated, "If you've got a business—you didn't build that." Eugene Kiely, *"You Didn't Build That," Uncut and Unedited*, FactCheck.Org (July 23, 2012), https://www.factcheck.org/2012/07/you-didnt-build-that-uncut-and-unedited/ [https://perma.cc/8S8V-59RE]; *see also* Kent Hoover, *4 Reasons Why "You Didn't Build That" Still Haunts Obama*, Bus. J. (July 20, 2012), https://www.bizjournals.com/bizjournals/washingtonbureau/2012/07/20/4-reasons-why-you-didnt-build-that.html [https://perma.cc/6FKA-QEF5].

difference between the wealth that an individual or firm actually earns and the wealth that it could have produced in a Hobbesian state of nature. In most instances, the difference is so great that we would allocate almost the entire income to the state, and the result would be confiscatory rates of tax.[57] On the other extreme, one could note that without private labor, private capital, and private entrepreneurship, the capacity of the state to produce wealth would be extremely curtailed, perhaps limited to selling the natural resources it owns.[58] The fact is that, in general, the wealth produced in modern industrialized societies results from a synergy

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57. *See, e.g.*, Barbara H. Fried, *The Puzzling Case for Proportionate Taxation*, 2 Chap. L. Rev. 157, 176–77 (1999) ("One *could* take this view of our implicit (Lockean) social contract, pursuant to which all the gains that, say, Wayne Gretsky [sic] realizes by moving from being Wayne Gretsky alone on a desert island, thinking of inventing a game called hockey if he could ever find ice, eleven other players, and an audience to pay to watch, to being Wayne Gretsky in late twentieth-century America earning $20 million a year, are thrown into a common pool for division. . . ."). In critiquing Rawls's theory of justice, Nozick notes that because Rawls describes justice as the fair distribution of the benefits of social cooperation, his theory of justice should apply only to the difference between what an individual would have in the absence of social cooperation and what the individual is able to obtain in a state of social cooperation. Nevertheless, Rawls proceeds to ignore the distinction and applies his theory to the totality of what individuals have in a state of social cooperation. Nozick considers and rejects the argument that due to the tremendous benefits of social cooperation, the noncooperative shares are so small that they can be discounted. Robert Nozick, Anarchy, State, and Utopia 183–85 (1974).

58. The derivation of a country's right to the natural resources it controls is unclear. Interestingly, in this context Rawls appears even more deferential to property rights than Locke. Rawls wrote that a state has exclusive rights to the natural resources located within its territory and is under no obligation to share with other nations the wealth derivable from those resources. John Rawls, The Law of Peoples with "The Idea of Public Reason Revisited" 117 (1999). Although for Locke the acquisition of ownership in a physical object requires combining labor with a part of the natural world so that ownership of the labor can flow into the object (Locke, *supra* note 48, at § 27), Rawls recognized a state's exclusive rights to the resources in its territory even in their natural state, i.e., before the state adds even one iota of economic value. Moreover, whereas Locke was careful to add the proviso that the laborer leaves for others "enough, and as good" as he took for himself (*Id.* § 33), Rawls added no such proviso. According to Rawls, a state may

between private and public resources. Attempting to determine accurately the relative contribution of public and private resources to the production of wealth in a purely domestic setting is likely to prove an exercise in futility.

The question of how to adjudicate competing neo-Lockean claims in the domestic setting arises not only with regard to the proper measure of compensating the public for its contribution to the production of wealth. Any time the owners of different means of production combine their resources to produce value, the question of how to determine appropriate shares will arise. For example, combining *A*'s labor, *B*'s capital, and *C*'s entrepreneurship might produce wealth that is greater than the sum of what they could earn acting on their own. However, a well-functioning market economy offers a mechanism to adjudicate competing claims.[59] Suppose a private firm claims that its contribution to the production of wealth in a particular joint enterprise is equal to $*x* or *y*% of the profits.[60] To test the claim, it can simply offer its services to the market. If others agree to contract with it on those terms, then it would appear that the firm's claim has merit. If no one takes it up on its offer, this would constitute at least prima facie evidence that its claim is exaggerated and that its contribution to the production of wealth is less than it claims.

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legitimately claim exclusive rights to extremely rare and consequently extremely valuable resources.

59. Of course, the caveat "well-functioning" is significant. Because of factors such as fraud, duress, and imbalance of negotiation power (monopolies, oligopolies, and so forth), the agreed upon division may not properly reflect the actual contribution of each factor of production.

60. Note that a contributor's share is not necessarily a proportional share of the wealth created. Workers, lenders, and lessors of tangible property tend to receive a more-or-less fixed payment for their contribution, while the reward for entrepreneurs, capital investors, licensors of intellectual property, and those working on a contingency basis is usually more dependent upon the success of the enterprise. In other words, risk-taking is also a factor of production, without which wealth cannot be created, and those who invest their capital or their labor without any guarantee of the compensation that they will receive have a neo-Lockean right to a portion of the production commensurate with the contribution of risk-taking relative to other factors of production. Again, in a properly functioning market economy, the contribution of risk-taking, as with the contribution of other factors of production, will be reflected in ex ante contractual arrangements.

The problem we encounter when we attempt to quantify the contribution of social capital in the domestic setting is that no such mechanism is available. By definition, public goods are non-excludible, meaning that it is impossible to prevent those who refuse to pay for the good from benefiting from it.[61] The non-excludability of public goods precludes our using the market to determine who benefits from the good and how much they benefit from it: because public goods are non-excludible, the state cannot attach a price tag to the good and observe who if anyone agrees to pay the price in exchange for the good. In other words, while the market provides us with the means of determining the extent to which private goods contribute to the production of wealth, there is no objective measure of the extent to which public goods contribute to the production of wealth.[62]

F. Quantifying the Contribution of Social Capital: The International Arena

In the international context, the situation is fundamentally different. A host country has the capacity, if it wishes, to prevent foreigners from benefiting from its social capital. The excludability of a country's social capital in the international arena means that, from the perspective of international investors, social capital is effectively a private good, owned by the constituents of the host country and managed by its government

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61. *See, e.g.*, N. Gregory Mankiw, Principles of Economics 225–27 (5th ed. 2008).

62. Any attempt to design a neo-Lockean domestic tax regime will necessarily rely upon arbitrary and almost certainly inaccurate assumptions. For example, one could estimate that x% of a person's income is attributable to public resources and that $(100-x)$% is attributable to private resources and consequently impose upon an across-the-board x% flat-rate income tax. However, not only is x% clearly an arbitrary determination, it is undoubtedly also the case that some individuals and firms rely more heavily than do others on public goods for the generation of their income. Moreover, certain public goods may actually be detrimental to the economic interests of some individuals or firms. For example, consider the effect of a good public transportation system on the economic interests of those who manufacture, import, and sell automobiles. They would likely earn more in the absence of this public good. In other words, the contribution of this particular public good to their capacity to create wealth—and consequently the state's neo-Lockean claim to a portion of the income—may be negative.

on their behalf. The state can demand payment in exchange for access to its social capital and deny access to those who refuse to pay. Those who are willing to pay the tax demanded by the host country are granted access to the country's territory and are able to exploit its social capital. Those who are unwilling to pay the tax are excluded.

The fact that, from the perspective of non-residents, access to a country's social capital is an excludible good means that, in the international arena, the market mechanism can serve as an effective tool in quantifying the contribution of the host country's social capital to the production of wealth and consequently the host country's commensurate share in the wealth produced within its territory. If the tax burden imposed on potential foreign investors is less than the contribution of the country's social capital to the creation of wealth, then the tax will not deter foreign investment: the after-tax income that non-residents will derive from investing in the country will be greater than the after-tax income available in alternative venues. Consequently, if the tax does deter foreign investment, this state of affairs would constitute strong prima facie evidence that the potential contribution of the host country's social capital to the production of wealth within its borders is less than the tax burden. The highest tax burden that a country can successfully impose and still attract foreign investment is at the very least a good approximation of the contribution of its social capital to the creation of wealth within its borders.

When considering the tax burden and its effect upon foreign investment—and consequently the evidence it provides regarding the contribution of the country's social capital to the production of wealth within its borders—there are two important caveats that need to be emphasized. The first caveat is that any contribution of the host country's social capital to the creation of wealth that is captured by factor prices will almost certainly reduce the amount of tax that the host country can impose. Where the entire contribution is captured by factor prices, any tax imposed by the host country will create a serious impediment for foreign investors. Therefore, the amount of tax that a country can successfully impose is limited in practice to the uncompensated contribution of its social capital.[63] Stated differently, where investments in a country produce economic rents, the host country can impose a

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63. As defined above, the uncompensated contribution of its social capital is the contribution of its social capital not reflected in economic rent available to foreign investors.

corporate tax up to the amount of that rent without affecting the amount of investment that it attracts.[64]

From a broader perspective, we can say that at least three factors contribute to the wealth produced by foreign investment: the resources of the foreign investor, the private resources of local service providers (workers, lessors, and so forth), and the host country's social capital. In some instances, the wages, rents, and other payments to local service providers will capture the entirety of the second two categories. The host country will then be able to claim its share by taxing the income of those service providers. In other instances, factor prices will not capture the entire contribution of the host country's social capital, and the host country will be able to claim some of its share by taxing the foreign investor itself (in addition to taxing the income of the service providers). In any case, assuming that both the domestic and the international markets are operating efficiently and that governments design their international tax regimes so as to maximize the welfare of their constituents, the total amount received by the host country and its constituents will approximate their total contribution to the creation of wealth. As noted earlier, the proper division of spoils between the government of the host country and its residents is a matter of speculation as there is no market for government services in the domestic arena. Nevertheless, whatever the local tax rate, the sum of the after-tax income of the service providers along with the tax collected by the government of the host country (both from the foreign investor and from its own residents) should equal the combined contribution of the host country and its constituents to the creation of wealth.

The discourse of international taxation generally focuses on only two elements of this broad picture: the income generated by the foreign investor and the tax collected by the host country from the foreign investor. If the latter is small relative to the former, the literature

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64. Joseph Bankman et al., *Collecting the Rent: The Global Battle to Capture MNE Profits*, 72 Tax L. Rev. 197 (2019) (stating host countries can impose tax up to the amount of the rent without affecting MNE investment). Factor prices are determined by supply and demand. If there is no reduction in the amount of investment, there will be no reduction in the demand for those services and consequently no reduction in their market price, and the incidence of the corporate tax will fall on the corporation itself. *See generally* David Elkins, Corporate Taxation: Structure, Functions, and Flaws 11–15 (2d ed. 2018).

tends to view this as a violation of the host country's right to a fair share of the wealth produced within its territory. This view is too narrow. As we have seen, in a competitive environment the total amount received by both the government and the residents of the host country will likely equal their combined contribution to the creation of wealth. How they distribute this amount among themselves is an issue of domestic politics: a high rate of domestic tax will allocate more to the government while a low rate of domestic tax will allocate more to the domestic service providers. This domestic allocation is of no concern to the foreign investor. Having paid to the host country and its constituents their fair share of the wealth generated by the joint venture—and in an efficient international economy, the total amount received by local factors of production and the host country will properly reflect their combined contribution to the creation of wealth—what remains should faithfully represent the contribution of the foreign investor's own resources to the creation of wealth.

The second caveat is that the tax burden imposed upon nonresidents is a function not only of the formal rates of tax but also of the way that the legislature, the administrative agencies, and the courts of the host country compute the tax base and the degree to which the host country aggressively enforces its tax laws. For example, an income tax imposed at a relatively high rate but that is more lenient with regard to the deductions permissible in computing taxable income may be less burdensome than an income tax with lower rates but that is stricter with regard to permissible deductions. In a competitive market for international investments and international investment venues, investors will respond not to the formal tax rates but to the effective tax burden. Thus, if a country's tax laws effectively permit MNEs to reduce their taxable income by deducting payments to related corporations in other jurisdictions, MNEs will certainly take those provisions of the local tax code into consideration when they weigh the cost and benefits of investing in that country. A country has every right to tighten up its tax code to prevent profit shifting. It has every right to abandon income as a tax base altogether and impose tax on some other, less manipulable base instead. If its tax base is narrower than it would like, but it finds it too difficult or inconvenient to broaden the base, it has every right to compensate by raising the rate of tax that it imposes on international investors. However, in a competitive international market, the tax that a country is in fact capable of collecting is likely an accurate representation of its contribution to the creation of wealth.

IV. The Good

As in the previous two Parts, I will begin here by constructing an argument—this time, based on a conception not of the right but of the good—for allocating taxation rights according to where wealth is created. I will then proceed to examine whether the argument is sound.

Most countries are dependent upon tax revenue to supply essential public services and to finance social insurance and social welfare.[65] Without such revenue, the well-being of their residents (particularly those most dependent upon government services) would suffer. Furthermore, a curtailment of tax-financed services could lead to social unrest, political extremism, and possibly international conflict. Maintaining a steady stream of tax revenue is necessary in order to forestall such threats to human welfare.[66]

One important potential source of tax revenue is international investment. Particularly today, when the percentage of global income generated collectively by MNEs is so high,[67] the taxation potential is significant. However, the globalization of the late 20th and early 21st centuries, while facilitating such international investment, has made it

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65. Only countries with significant marketable natural resources and relatively small populations can function without tax revenues. For example, Kuwait has a very large public sector (74% of all citizens are employed by the government), with 90% of its revenues deriving from petroleum. *Middle East: Kuwait*, CIA World Factbook, https://www.cia.gov/the-world-factbook/countries/kuwait/#economy [https://perma.cc/ZP25-79C4] (last visited Jan. 18, 2021).

66. *See*, *e.g.*, OECD, *BEPS Action Plan*, *supra* note 18, at 8; Avi-Yonah, *Crisis*, *supra* note 52, at 1632–48 (analyzing governmental budgetary needs and concluding that "both developed and developing countries need tax revenue"); Tracy A. Kaye, *The Gentle Art of Corporate Seduction: Tax Incentives in the United States and the European Union*, 57 U. Kan. L. Rev. 93, 114–19 (2008); Ivan O. Ozai, *Tax Competition and the Ethics of Burden Sharing*, 42 Fordham Int'l L.J. 61, 68 (2018).

67. In 2018, the world's 500 largest companies generated $32.76 trillion in revenue and $2.15 trillion in profits. *Global 500*, Fortune, https://fortune.com/global500/2019/ [https://perma.cc/D3BY-RUS8] (last visited Dec. 23, 2020). During 2019, the total value of all goods and services produced in the world was $87.8 trillion. *World Development Indicators Database*, World Bank 4 (2019), https://databank.worldbank.org/data/download/GDP.pdf [https://perma.cc/82GC-M5SV].

increasingly difficult for countries to collect tax from MNEs operating in their territories.[68] Tax competition means that in order to continue to attract investment, host countries are forced to reduce the rate of tax that they impose on the income of MNEs. Furthermore, even with a reduced tax rate, host countries often discover that the tax base itself has shrunk as MNEs avail themselves of opportunities —enhanced by the growing digitalization of the economy—artificially to shift their income out of the reach of the host country's taxing authority and into jurisdictions that impose little or no income tax.[69]

Practice has shown that, acting independently, host countries tend to be unsuccessful at protecting their key interest in maintaining a steady stream of tax revenue from MNEs operating in their territories. Cooperation among states is therefore necessary in order to allow them to collect more tax than they currently can. Ideally, host countries would like to replicate what they would have been able to collect in a long gone world in which competition did not drive down tax rates and MNEs were not able to shift their profits from one jurisdiction to another with relative impunity.[70] With regard to the former, even the most optimistic realize that a return to the corporate tax rates that prevailed in most developed countries before the 1990s is unlikely to occur.[71] Therefore, their limited goal is to mitigate to the extent possible the corrosive effects of international tax competition and prevent a debilitating race to the bottom in which all host countries lose. With regard to income shifting, some observers have set for themselves loftier goals. For example, those who propose a universal formulary apportionment argue that adopting such a proposal would practically eliminate the capacity of MNEs to

68. OECD, *BEPS Action Plan*, *supra* note 18, at 7–8.

69. See the sources cited in note 5, *supra*.

70. Roin, *supra* note 52, at 553 ("Advocates of tax harmonization appear to regard any departure from the level and distribution of the tax burden set in the noncompetitive world as unduly low.").

71. As late as the late 1980s, corporate tax rates of 60% or higher were not uncommon. For example, Finland had a corporate tax rate of 61.8% in 1985; Sweden had a corporate tax rate of 60.1% in 1989; and West Germany had a corporate tax rate of 60% until 1989. *OECD Corporate Tax Income Rates, 1981–2013*, Tax Found. (Dec. 18, 2013), http://taxfoundation.org/article/oecd-corporate-income-tax-rates-1981-2013 [https://perma.cc/92TY-QHUE].

shift profits artificially among jurisdictions.[72] Critics of formulary apportionment argue that it is no less immune to manipulation than is the traditional arm's length pricing method.[73]

The more wealth created by MNE investment in a given country, the more damage (in absolute terms) these byproducts of globalization inflict. In other words, the difference between the tax revenue a country collects from MNEs and the revenue it would have collected in the absence of tax competition is likely to be greater (in absolute terms) for countries in whose territory MNE investment produces a large amount of wealth than it is for those countries that host little MNE investment. If the goal of international tax cooperation is to mitigate to the extent possible the corrosive effects of tax competition and profit shifting on the taxes that host countries can collect from MNEs operating within their territories, it follows that the structure should be designed so as to assist those countries in whose territory wealth is created to tax that wealth.

Although various elements of this argument—that countries need revenue to supply public services, that globalization and tax competition make it difficult for them to impose effective taxation, that international cooperation can mitigate or reverse this trend, that those countries in which wealth is created should have the capacity to tax that wealth, and so forth—are prevalent in the literature, I am unaware of any comprehensive presentation of the argument as sketched above leading from the need for revenue to the proposition that taxing power should follow wealth creation. Nevertheless, I submit that any argument relying upon the good (as opposed to the right) for allocating taxing power to those countries in which wealth is actually created would need

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72. *See, e.g.*, Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 Va. Tax Rev. 89, 159 (1995); Benshalom, *Taxing Financial Income, supra* note 5, at 629–30, 638–39; Benshalom, *Quest, supra* note 11, at 167; Rachel J. Greenburg, *Taking a Byte out of International Tax Evasion: Combating Base Erosion and Profit Shifting*, 19 Chap. L. Rev. 307, 328 (2016).

73. *See, e.g.*, Fleming, Jr. et al., *Formulary*, *supra* note 11, at 39–41, 53; J. Clifton Fleming, Jr. et al., *Worse Than Exemption*, 59 Emory L.J. 79, 128–30 (2009); Greenburg, *supra* note 72, at 328; Wells & Lowell, *supra* note 29, at 790–91; Roin, *supra* note 29, at 174; Bret Wells, *International Tax Reform by Means of Corporate Integration*, 20 Fla. Tax Rev. 70, 103–04 (2016).

to follow very similar lines. Consequently, the rest of this Part will take the above argument as prototypical and will consider whether it is sound.

One critique of the argument is that countries that host MNE investments, and subsequently in whose territory wealth is created, are not necessarily the same as those that would have hosted the investments in the absence of tax competition. By its very nature, tax competition enables some countries to attract investment that otherwise would have gone elsewhere. In such a case, it is the latter, not the former, that suffer the effects of tax competition. The former are actually net beneficiaries of tax competition, enjoying both whatever tax revenue that they are able to collect from the MNE and—often more important—the positive spill-over effects of hosting MNE investment.[74] Consequently, if the purpose of the international tax regime is, at least to some extent, to compensate countries whose tax revenues suffer due to tax competition, then designing a set of rules that allocates taxing rights according to where wealth is in fact created compensates those countries that most benefit from tax competition and does little or nothing for those countries that are most harmed by it.[75]

A much more fundamental flaw in the argument is that there is no necessary connection between the concept of the good that the international tax regime is supposedly attempting to promote and the proposition that taxing power should follow wealth creation. Schematically, the utilitarian argument sketched above relies upon a number of tacit premises: (1) the proper role of tax regimes is to maximize human welfare; (2) increasing the amount of tax currently paid by MNEs would better promote human welfare; and (3) international cooperation would increase the amount of taxes that MNEs pay. From these premises, the argument purports to arrive at the conclusion that nations should cooperate to assist those countries in which wealth is created to tax that wealth.

Does this conclusion follow from the premises? A reasonable conclusion that can be drawn from these three premises is that it is

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74. *See, e.g.*, Yoram Margalioth, *Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries*, 23 Va. Tax Rev. 161, 176–80 (2003).

75. Of course, any attempt to compensate countries that lost investments because of tax competition would require a counterfactual determination of where investments would have flowed in the absence of such competition.

appropriate for countries to cooperate to create an international tax regime in which MNEs pay more tax than they do now.[76] However, the premises do not support the distributive claim that the right to tax an MNE's profits should be allocated to those countries in which the MNE conducts its operations, nor do they support the claim that, among those countries in which the MNE does operate, taxing rights should be allocated in accordance with wealth creation. If the goal of the international tax regime is to promote overall human welfare, then taxing rights should be allocated, not in accordance with where MNE wealth is created but rather in a manner consistent with that goal.[77] For example, assume that (a) an MNE creates wealth within the territory of Country *A* and (b) Country *B*'s receipt of tax revenues would promote human welfare to a greater extent than would the receipt of tax revenues by Country *A*. Proceeding from the premises stated above, the international tax regime should grant the taxing power to Country *B*, not to Country *A*.

The fact that in this example Country *B* is the appropriate possessor of taxing rights does not mean merely that there exist circumstances in which it is appropriate to grant the taxing power to a country other than the one in which wealth is created. The conclusion is much stronger than that. When allocating taxing rights within the framework of an international tax regime whose goal is to maximize human

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76. I do not mean to imply that the premises are uncontroversial. They are not. With regard to the first, a deontological view would consider the right rather than the good of promoting human welfare as the appropriate focus of taxation in general and of international taxation in particular. *See* Parts II and III, *supra*. One could also imagine a good other than promoting human welfare as forming the basis of a tax regime or that promoting human welfare is only one of a number of appropriate goals of the tax regime. With regard to the second premise, one would need to consider not only the contribution to human welfare of the additional tax-financed services but also the contribution to human welfare of the private goods that the funds currently finance and the macroeconomic effects of such a tax increase. This analysis, in turn, is dependent upon macroeconomic modeling (to determine the overall effects of a tax increase) and the social welfare function (to determine which of the various outcomes predicted by such modeling is preferable). The third premise relies upon predictions of how international cooperation would play out in practice.

77. A more radical approach would be for an international body to impose tax on cross-border activity and to distribute the revenue in accordance with a welfare-enhancing algorithm.

welfare, the location of wealth production is simply not a relevant factor. The only criterion that would be taken into account is the effect of the allocation on aggregate human welfare.

Assume that the designers of such an international tax regime are faced with the decision of how to allocate the power to tax a particular MNE's income. One option is to allocate the taxing power to the least developed countries on the grounds that the needs of their residents are the most immediate and the most intense. Another is to allocate the taxing power to the more developed countries on the grounds that their more efficient bureaucracies are better capable of turning tax revenue into public goods.[78] Proper allocation of the taxing power would require, *inter alia*, predicting the effects of different tax structures on the welfare of the various countries' residents and agreeing on a social welfare function to rank the alternative scenarios. For example, if it were determined that granting taxing power to relatively wealthy countries would raise aggregate human happiness but that granting taxing power to the poorest countries would reduce the number of people living in absolute poverty, a classic Utilitarian social welfare function would prefer the former[79] while a Rawlsian social welfare function would prefer the latter.[80] Nevertheless, however they make such empirical and normative determinations, the designers of an international tax regime commissioned

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78. For discussions of distributive justice when those who are already better off have a greater capacity to turn resources into utility, see NOZICK, *supra* note 57, at 41; HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 14 (1938).

79. JOHN STUART MILL, UTILITARIANISM 50 (1948) (1863).

80. The global Rawlsianism referred in the text is a conceptual globalization of Rawls's difference principle, according to which social and economic inequalities are to be arranged to the benefit of the least advantaged. JOHN RAWLS, A THEORY OF JUSTICE 266 (rev. ed., 1999). Significantly, Rawls himself refused to extend his difference principle to the international arena and held that it is applicable only within the bounds of a society. RAWLS, *supra* note 58, at 116. Some social philosophers have castigated Rawls's apparent inconsistency and argued that place of birth is no less arbitrary than social position or natural talents and cannot therefore form the basis for claims to distributive shares. *See, e.g.*, CHARLES BEITZ, POLITICAL THEORY AND INTERNATIONAL RELATIONS (1979); KOK-CHOR TAN, JUSTICE WITHOUT BORDERS: COSMOPOLITANISM, NATIONALISM AND PATRIOTISM (2004). In this Article, I do not take a position for or against cosmopolitanism but merely raise it as a possible moral basis for modeling a cooperative international tax regime.

with best promoting human welfare would properly give no weight to the venue in which the MNE in question derived its income.

V. Conclusions: What's Really Going On?

The good that countries in fact pursue in their international tax policies does not conform to a global Utilitarianism in which the pleasure or pain of each individual carries equal weight and the goal is to maximize the total quantity of human happiness,[81] to a global Rawlsianism in which the goal is to maximize the amount of primary goods available to the least well-off stratum of humanity,[82] or to any other universalizable good. The good that countries seek is the parochial good of maximizing the welfare of their own constituents.[83] Taxing MNEs serves that good because countries can thereby provide for the needs of their constituents without having to impose upon them the cost of doing so.[84] In other words, countries need tax revenues, and MNEs have the capacity to help meet that need.

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81. Mill, *supra* note 79.

82. *See supra* note 80.

83. Note that "the good" in moral philosophy is that to which one attaches value and the pursuit of which one considers a worthwhile goal. The good is not necessarily universalizable or non-egotistical. In fact, the good sought by different individuals or societies are often incompatible. For example, if one views acquisition of power as the good, then the pursuit of that good will almost certainly conflict with the pursuit by others of their good (whether that good is promoting their own power or simply being free from the power of others). *See, e.g.*, Robert L. Holmes, Basic Moral Philosophy 57–58 (4th ed. 2007).

84. Taxing foreigners was once castigated as a cynical exploitation of those who have no say in the political process. *See*, *e.g.*, League of Nations Report, *supra* note 3, at 4044 ("A survey of the whole field of recent taxation shows how completely the Governments are dominated by the desire to tax the foreigner."); Shay et al., *supra* note 47, at 89. One of the better-known adages of tax politics is attributed to Senator Russell B. Long: "Don't tax you. Don't tax me. Tax that fellow behind that tree." Robert Mann, Legacy to Power: Senator Russell Long of Louisiana 333 (2003). An alternative version concludes, "[t]ax that fellow across the sea." Greg Rushford, *Tax the Foreign Fellows*, Rushford Rep. Archives (June 2003), http://www.rushfordreport.com/2003/6_2003_Players.htm [https://perma.cc/E2H5-QG3K].

When justifying their desire to impose tax on MNE profits and particularly when seeking international cooperation to help them do so, host countries may intuit that the fact that they have budgetary needs and that MNEs have the wherewithal to contribute toward satisfying those needs may not be sufficiently cogent. It does not create a sense of moral urgency, nor does it instill a sense of injustice that, by avoiding taxation, MNEs are denying host countries their due. It perhaps sounds too much like the statement widely attributed to Willie Sutton who, when asked why he robbed banks, purportedly replied, "because that's where the money is."[85] The fact that host countries need money and that MNEs have money may not constitute a morally compelling argument for eliciting a transfer of funds from the latter to the former.

Furthermore, as we have seen, reliance on need as the normative basis of attempts to tax MNE profits opens the door for other countries, particularly poorer countries that attract little or no MNE investment, to claim that they are the proper recipients of MNE tax revenue. Consequently, in order to justify their own claim to tax MNE profits and their call for international cooperation to enforce that claim, host countries need more than simply a demonstration that the money they collect would promote the welfare of their own residents. They need either to prove that allocating taxing power to host countries would promote a universal good—as opposed to a parochial good—or to present a right-based claim.[86]

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85. Robert M. Yoder, *Someday They'll Get Slick Willie Sutton*, Saturday Evening Post 17 (Jan. 20, 1951); *I Rob Banks Because That's Where the Money Is*, Quote Investigator (Feb. 10, 2013), https://quoteinvestigator.com/2013/02/10/where-money-is/#note-5417-1 [https://perma.cc/CYC4-EHWZ].

86. True, the argument that countries are justified in demanding that MNEs pay tax on their profits simply because they need money is occasionally raised in both the academic literature and in papers issued by multinational organizations. *See, e.g.*, Avi-Yonah, *Crisis supra* note 52. Nevertheless, such an argument is almost always raised within the context of a call to limit tax competition. The attraction of the need-based argument in this context is that it is at least ostensibly universalizable: the claim is that competition harms all countries and all therefore have a common interest in limiting competition. The universal good of improving overall human welfare serves as a banner under which all can supposedly gather. However, when it comes to dividing the tax pie, there is no such alignment of interests. Each country naturally desires more for itself. *Cf.* Rawls, *supra* note 80, at 4 (Individuals have a commonality of interest in

I would suggest that the right-based claim upon which host countries rely is a function of this conundrum. They cannot rely upon a universal good (such as the maximization of human happiness) because then taxing rights would be allocated not according to where MNEs earn their profits but rather according to where tax revenues would best serve the good that the international tax regime was supposedly charged with promoting. Such an allocation would not conform to the parochial good (maximizing the welfare of their own residents) that the host countries actually want to promote. In other words, arguments based on a parochial good are unpersuasive, while arguments based on a universal good are ineffective. Thus, host countries have little option but to present a right-based argument, under which they have the exclusive or primary right to share in the wealth created by MNEs operating within their territory.

I am not suggesting that host countries who are trying to protect their tax base—along with the transnational organizations and the scholars who support that goal—consciously go through this thought process before they raise right-based arguments. What I am saying is that while their actual motive is the furthering of a parochial good, when they are called upon to justify their claim—to others and possibly also to themselves—they are in practice forced to rely on a right-based argument. It is possible that they internalize the right-based claim to the point that they actually believe that it justifies their position (after all, most people prefer to believe that the positions they hold are morally justifiable and not simply a case of promoting self-interest). However, my argument is neither descriptive nor psychological but normative. Justifying the exclusive or nearly exclusive right to tax the profits of MNEs operating in their territories requires host countries to assert a right-based claim. Presuming that the right is prior to the good,[87] their claim would trump any needs-based claim from other countries to receive a share of that tax revenue.

Despite their superficial attraction, rights-based arguments are ultimately no more successful in justifying allocation of taxing rights in accordance with wealth creation than are arguments based on the promotion of a universal good. We considered two types of rights-based arguments. The first rests upon the MNEs' implicit contractual obligation

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promoting social cooperation but a divergence of interests in distributing the benefits of that cooperation.).

87. *See*, *e.g.*, Kant, *supra* note 20; Rawls, *supra* note 20.

to pay the taxes imposed by the law of the host country. The problem with this argument is that MNEs are rarely if ever accused of tax evasion. The usual charge laid against them is they artificially reduce their taxable income by legally exploiting "loopholes" in the host countries' tax laws.[88] Thus, host countries could frustrate undesired MNE tax avoidance—reduce its impact if not eliminate it entirely—by the simple expedient of changing their tax law. For example, they could deny deductions for interest and royalties; they could impose a tax on the foreign recipients of interest and royalties; or they could abandon the income tax and opt for a less manipulable tax base. The reason that they refrain from such measures is their fear that doing so would deter international investment as MNEs seek more lenient tax regimes elsewhere. In other words, the "leaky" tax regime that foreign investors face is in fact the regime that host countries implicitly offer and that those foreign investors implicitly accept. A demand that they ignore the opportunities available to reduce their tax liability is a demand that they do more than they agreed.

The second rights-based claim is neo-Lockean. Under this argument, host countries are entitled to tax MNE profits derived from their territory because of the contribution of their social capital to the creation of the wealth. The problem with this argument is that host countries do not need international cooperation in order to enforce their neo-Lockean rights. The position of a host country vis-à-vis foreign investors is comparable to that of the owner of a private resource in a domestic market economy. In a competitive atmosphere, the tax that they are able to impose and collect without deterring investment should equal—or, at the least, constitute a good approximation of—the uncompensated contribution of their social capital to the creation of wealth. If due to competitive pressure, a country is incapable of imposing any tax, this indicates that the entire contribution of the host country's social capital has been captured by local factors of production and that it is they who are the appropriate targets of the host country's neo-Lockean claim. If there is any uncompensated contribution of the host country's social capital, it should be able to impose a tax up to that amount without deterring international investment.

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88. For a critique of the concept of loopholes in the tax discourse, see Heather M. Field, *A Taxonomy for Tax Loopholes*, 55 Hous. L. Rev. 545 (2018).

As legitimate as the desire for additional revenue is from the perspective of host countries, the attempt to organize a cooperative international tax regime that would allow host countries to collect more than they can in a competitive atmosphere cannot be supported by either contractual or neo-Lockean right-based arguments. Moreover, there is no rational reason to prefer needs-based claims of host countries—particularly after they have satisfied their neo-Lockean claims by means of the tax that they are actually able to collect in a competitive atmosphere—over the needs-based claims of other countries.

In conclusion, if there is to be a cooperative international tax regime—and for the purpose of this Article, I refrain from expressing an opinion with regard to the desirability of such a regime—one could legitimately argue for an allocation of taxing rights on the basis of needs, efficiency, or some other value. There appears to be little normative basis for adopting the principle that taxing rights should follow wealth production.