

**SPRING 2018**  
NEW YORK UNIVERSITY  
SCHOOL OF LAW

“Taxation and Democracy”  
**Wolfgang Schön**  
Max Planck Institute

**April 24, 2018**  
Vanderbilt Hall – 208  
Time: 4:00 – 5:50 p.m.  
Week 13

## **SCHEDULE FOR 2018 NYU TAX POLICY COLLOQUIUM**

(All sessions meet from 4:00-5:50 pm in Vanderbilt 208, NYU Law School)

1. Tuesday, January 16 – Greg Leiserson, Washington Center for Equitable Growth. “Removing the Free Lunch from Dynamic Scores: Reconciling the Scoring Perspective with the Optimal Tax Perspective.”
2. Tuesday, January 23 – Peter Dietsch, University of Montreal Philosophy Department. “Tax Competition and Global Background Justice.”
3. Tuesday, January 30 – Andrew Hayashi, University of Virginia Law School. “Countercyclical Tax Bases.”
4. Tuesday, February 6 – Gerald Auten, U.S. Treasury Department. “Income Inequality in the United States: Using Tax Data to Measure Long-Term Trends.”
5. Tuesday, February 13 – Vanessa Williamson, Brookings Institution. “How the Taxpaying Experience Obscures Low-Income Taxpayers and Shapes Attitudes about Progressivity”
6. Tuesday, February 27 – Jacob Goldin, Stanford Law School. “Tax Benefit Complexity and Take-up: Lessons from the Earned Income Tax Credit”
7. Tuesday, March 6 – Lisa Philipps, Osgoode Hall Law School. “Gendering the Analysis of Tax Expenditures.”
8. Tuesday, March 20 – Lisa De Simone, Stanford Graduate School of Business. “Repatriation Taxes and Foreign Cash Holdings: The Impact of Anticipated Tax Reform”
9. Tuesday, March 27 – Damon Jones, University of Chicago Harris School of Public Policy. “How Do Distributions from Retirement Accounts Respond to Early Withdrawal Penalties? Evidence from Administrative Tax Returns.”
10. Tuesday, April 3 – Ajay Mehrotra, American Bar Foundation and Northwestern University School of Law. “T.S. Adams and the Beginning of the Value-Added Tax.”
11. Tuesday, April 10 – Jason Furman, Harvard Kennedy School. “Should Policymakers Care Whether Inequality Is Helpful or Harmful For Growth?”
12. Tuesday, April 17 – Emily Satterthwaite, University of Toronto Law School. “Electing into a Value-Added Tax: Survey Evidence from Ontario Micro-Entrepreneurs.”
13. Tuesday, April 24 – Wolfgang Schon, Max Planck Institute. “Taxation and Democracy.”
14. Tuesday, May 1 – Mitchell Kane, NYU Law School. “Collecting the Rent: The Global Battle to Capture MNE Profits”

## Taxation and Democracy

Wolfgang Schön\*

PRELIMINARY DRAFT: DON'T CIRCULATE!

### **Abstract**

*Political economy assumes that taxation and democracy interact beneficially when there exists “congruence” or “equivalence” among those who vote on the tax, those who pay the tax, and those who benefit from the tax. Yet this only holds true when we look at the community of taxpayers as an aggregate, not at the position of the individual taxpayer. Individuals might regard democratic decision-making as a tool for the majority to exploit the minority. They might also perceive powerful special interest groups to extract preferential tax treatment to the detriment of other constituencies.*

*In the international situation, the notion of “congruence” or “equivalence” comes under additional strain. Why do most countries allow citizens abroad to vote without being subject to tax while resident aliens are subject to tax without the right to vote? In recent years, tax competition has exerted even more pressure on democratic discourse: Is the “exit” option for individuals a source of irritation for democratic tax legislation or is it rather a useful device to protect the individual against being overtaxed? To what extent shall outside investors take into account the redistributive policies of States? These issues do not only challenge the traditional balance of taxation and democracy. They also challenge our views on how we perceive the State and how we define the community of taxpayers as agents of social justice. In tax law, the borderline between “us” and “them” has to be addressed as unlimited tax liability involves a notion of solidarity that is hard to capture in a globalized world.*

*Against this background, this article explores the constitutional framework of taxation and democracy in a comparative fashion. It presents two major pathways for the protection of the individual in fiscal matters: protection by “content” (material tax principles) and protection by “consent” (voting rights) as they have evolved since the days of Hobbes and Locke. While the United Kingdom and the United States largely rely on the protective value of democratic consent, countries in Europe and in Latin America have resorted to hard-wired constitutional constraints on tax legislation, ensuring a high-degree of judicial review by constitutional courts. This constitutional framework comes under increased pressure once a country opens itself to the globalized world. It remains to be seen to what extent material principles – like the principle of equality – are in the position to restrain a country’s engagement in international tax competition.*

\* Director, Max Planck Institute for Tax Law and Public Finance, Honorary Professor, Munich University, Global Professor of Tax Law, NYU School of Law. This article is an enlarged version of the author’s “Max Weber Lecture” given at the European University Institute on 11 October 2017; it has further been presented at the conference on tax competition celebrating the 75<sup>th</sup> Anniversary of the Tax Institute at the University of Cologne in October 2017 and at the Tax Policy Colloquium at NYU Law School in April 2018.

## I. Introduction

### 1. “No taxation without representation”

“No taxation without representation”. This world-famous battle-cry stemming from the American War of Independence against British oppression springs to mind immediately when we start thinking about the relationship between taxation and democracy. Taxation, being the most prominent and most extensive intrusion of the State’s power into the sphere of the individual, shall be legitimized by the people’s consent. To phrase it differently: The mandatory character of the tax shall be mitigated by the voluntary dimension of (parliamentary) representation. Similar demands have been raised in manifold historical situations – the agreement on the Magna Charta in 1215<sup>1</sup> and the enactment of the Bill of Rights after the Glorious Revolution in 1689<sup>2</sup> have successfully limited the taxing power of the Kings of England. The convention of the *États Généraux* in 1789 – the first time after 1615 - was the starting point of the French Revolution, driven by the Monarch’s need to gain approval of his fiscal plans by the three Estates of the Kingdom<sup>3</sup>. In Germany, the ascent of constitutional monarchy during the 19<sup>th</sup> century circled to a large extent around the fiscal and budgetary power game between the rulers and the propertied classes<sup>4,5</sup>.

Today, the link between democratic decision-making and the fiscal powers of the State is taken for granted and enshrined in most constitutions of the world. In the United States, only Congress has the power to establish federal taxes. More specifically, the time-honored Origination Clause provides that “All Bills for raising Revenue shall originate in the House of Representatives”. Since 1787, neither the President nor the U.S. Senate have been entitled to initiate the legislative process - in order to rest legislative power in fiscal matters with the institution closest to the American people<sup>6</sup>. Two years later, in 1789, the French Declaration of Human and Civil Rights established the rule that

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<sup>1</sup> Magna Carta, para 12 s.1: “No scutage not aid shall be imposed on our kingdom, unless by common counsel of our kingdom (...)”.

<sup>2</sup> English Bill of Rights 1689: An Act Declaring the Rights and Liberties of the Subject and Settling the Succession of the Crown: “That levying money for or to the use of the Crown by pretence of prerogative, without grant of Parliament, for longer time, or in other manner than the same is or shall be granted, is illegal.”

<sup>3</sup> Tocqueville, L’ancien régime et la république.

<sup>4</sup> Heun, Staatshaushalt und Staatsleitung, 1989.

<sup>5</sup> As to the issue of whether fiscal issues drive democracy-building in a similar fashion in today’s developing world see the review by *Martin/Prasad*, Taxes and Fiscal Sociology, 40 Annual Review of Sociology (2014) p.331 (337 et seq.).

<sup>6</sup> *Medina*, The Origination Clause in the American Constitution: A Comparative Survey, 23 Tulsa Law Review (1987) p.165 et seq.; *Zotti/Schmitz*, The Origination Clause: Meaning, Precedent, and Theory from the 12th to 21st Century, in: 3 British Journal of American Legal Studies (2012) p.71 et seq.

*“Chaque citoyen a le droit, par lui-même ou par ses représentants, de constater la nécessité de la contribution publique, de la consentir librement, d’en suivre l’emploi et d’en déterminer la quotité, l’assiette, le recouvrement et la durée »<sup>7</sup>.*

The French constitutions of the revolutionary age stuck to these principles which safely survived the restorative periods of the early 19<sup>th</sup> century<sup>8</sup>. In a similar vein, but in a more hesitant fashion, the German Empire’s first draft constitution of 1849, the « *Paulskirchenverfassung* », opted for shared legislation of the King and the Chambers of Parliament in fiscal matters<sup>9</sup>.

The 20th century has seen the rise of nearly uniform constitutional language around the world confirming the people’s ultimate power in the area of taxation. But it is worth noting that the foundation of the principle of democracy in the area of taxation runs deeper than the generally accepted notion that all acts of state vis-a-vis the individual citizen shall be covered by a legal basis and that this legal basis shall be traced back to a voluntary act by the people itself or their elected representatives. First of all, it is widely accepted that in fiscal matters, formal legislation by Parliament itself is required to lay out the substantive elements of tax law<sup>10</sup>. This power must not be delegated to other institutions, e.g. the executive branch of government. In a paradigmatic fashion, Art.127 par.1 of the 1999 Swiss Constitution provides that

*“the design of taxes, in particular the definition of taxable persons, the object of the tax and the measurement of the tax base, has to be set by the legislator itself, at least with regard to its main features”<sup>11</sup>.*

This principle has been the subject of extensive debate in China’s People’s Congress, addressing existing practice of Chinese administrative bodies to introduce new levies by themselves. According to the new wording of China’s Legislation Law as amended in 2015,

*“The establishment of any category of tax, determination of tax rates, tax collection administration, and other basic taxation rules”<sup>12</sup>*

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<sup>7</sup> Declaration of Human and Civil Rights, Art.14; the wording was changed in 1793 for “*Tous les citoyens ont le droit de concourir à l’établissement des contributions, d’en surveiller l’emploi, et de s’en faire rendre compte.*”

<sup>8</sup> Titel V, Art.1 French Constitution of 1793: “*Les contributions publiques seront délibérées et fixées chaque année par le Corps législatif, et ne pourront subsister au-delà du dernier jour de la session suivante, si elles n’ont pas été expressément renouvelées.*”

<sup>9</sup> Kempny, *Die Staatsfinanzierung nach der Paulskirchenverfassung* (Tübingen: Mohr Siebeck), 2011, p.55.

<sup>10</sup> To give a few examples: § 43 Constitution of the Kingdom of Denmark; § 61 Constitution of Finland; Art.34 Constitution of France; Art.99 par.1 Constitution of the Grand-Dukedom of Luxemburg; Art.106 par.2 Constitution of Portugal; for a recent case on Art.23 of the Constitution of Italy see Constitutional Court of Italy, judgment of 15 April 2015, Case 83/2015.

<sup>11</sup> For a comparison between the German and the Swiss understanding of this principle see: *Waldhoff, Verfassungsrechtliche Vorgaben für die Steuergesetzgebung im Vergleich Deutschland – Schweiz*, (München: C.H.Beck) 1997, p.110 et seq.

<sup>12</sup> Art.8 par.6 Legislation Law of the PRC.

have to be determined by the legislator itself.

Secondly, the power of the democratically elected legislature to tax is complemented by the power of the same legislature to pass the State's budget. This ensures that both the revenue side and the expenditure side of the public sector are under the control of the people and their representatives respectively. Parliament holds – to use a phrase from U.S. constitutional practice dating back to *Madison's* contributions to the *Federalist*<sup>13</sup> – the “power of the purse”.

This constitutional framework seems to support the view that the interaction between taxation and democracy is – from a theoretical point of view – in good order. The citizens have the right to vote in elections. Elected representatives will implement the will of the people when it comes to levying taxes and when it comes to the expenditure of the revenue raised by these taxes. People will enjoy the benefits from public goods and redistributive measures as agreed upon in the democratic process.

## 2. The “principle of congruence” and its challenges

Yet this apparent untroubled picture is subject to serious challenges. These challenges result from the fact that the underlying framework of taxation in democratic communities is less solid than one might think. The argument runs as follows:

- Political economy tells us that the starting point for any healthy relationship between taxation and democracy is “congruence”<sup>14</sup> or “equivalence”<sup>15</sup> as regards the people who vote on the tax, the people who pay the tax and the people who benefit from the tax. In any simple model, this will be true for the community in question as an aggregate. But for the individual taxpayer within any given community, this relationship will typically not hold. Due to the fact that taxation is not a simple *quid pro quo* for an individual benefit like a user's fee or a social security contribution, but an “unrequited”<sup>16</sup> financing tool for public goods and redistributive measures, asymmetric effects will be not the exception but the rule. Some taxpayers will win, others will lose. Public goods will be enjoyed with different intensity by the members of the community of taxpayers. Redistribution by its very definition re-allocates wealth between taxpayers. Thus, any tax, which might conceptually be labeled a voluntary transfer at the aggregate level, can be characterized as a mandatory taking at the individual

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<sup>13</sup> *Madison*, Federalist Papers, No.58.

<sup>14</sup> *Oates*, Fiscal Federalism (Cheltenham: Elgar) 1972, p.35 et seq.; *Blankart*, Öffentliche Finanzen in der Demokratie, 8<sup>th</sup> Ed. (Vahlen) 2011.

<sup>15</sup> *Olson*, The Strategic Principle of “Fiscal Equivalence”: The Division of Responsibilities among Different Levels of Government, 59 American Economic Review (1969) p.479 et seq. (483); *idem*, Toward a More General Theory of Governmental Structure 76 American Economic Review (1986) p.120 et seq. with respect to the community financing and enjoying a public good.

<sup>16</sup> See the definition of tax in: OECD, Revenue Statistics 1965 – 2016, 2017, p.11: “Taxes are defined as compulsory, unrequited payments to general government”.

level<sup>17</sup>. This leads to the question of whether the individual taxpayer has to accept any burden imposed on him on the basis of democratic procedures – financing public goods he is not interested in or implementing redistributive effects to his detriment.

- The situation becomes even more difficult when we relax the assumption that there exists congruence between voters, taxpayers and beneficiaries. Take income taxation: Voting rights are regularly attached to citizenship. But taxability goes far beyond citizenship and hits both foreign nationals who are resident in the taxing jurisdiction (as regards their worldwide income) and also foreign residents doing business in a jurisdiction (as regards their local income). Is there a justification for taxation of non-voters? Surely this cannot be built on democratic consensus in a formal sense. On the other hand, most countries do not tax their own nationals when these live abroad – the mavericks being the United States and Eritrea who to this day adhere to citizenship taxation<sup>18</sup>.
  
- Last but not least, the relevant communities of voters, taxpayers and beneficiaries do not remain stable. Taxpayers may leave a country and move to another tax jurisdiction. This can result in a shift of public revenue between these countries. Tax competition will evolve and put pressure on local policymakers. There is a long-standing political and scholarly debate on the claim that today's democratic decision-making gets distorted by influential outsiders, in particular multinational companies, but also by wealthy individuals<sup>19</sup>. For these constituencies, the exit option substitutes for voice<sup>20</sup>. The widely used parlance of citizens and companies "voting with their feet" (going back to a seminal article by *Charles Tiebout* from the 1950s<sup>21</sup>) points directly to the impact of cross-border movements on the democratic process.

### 3. Two stories from the literature

It is interesting to see that this interaction between taxation and democratic principles has come to the fore again in two narratives presented by economists and political scientists in recent years. The publications in question are *Acemoglu/Robinson's "Economic Origins of Dictatorship and Democracy"* (2006) and *Dani Rodrik's "The Globalization Paradox"* (2011). The common trait of these two publications seems to be that each presents a "narrative" according to which the interaction between taxation and democracy lies at the heart of major political developments and challenges.

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<sup>17</sup> *Epstein*, *Taxation in a Lockean World*, 4 *Social Philosophy & Policy* (1986) p.49 et seq.

<sup>18</sup> See below

<sup>19</sup> See below

<sup>20</sup> *Hirschman*, *Exit, Voice, and Loyalty*, 1970, p.21 et seq.

<sup>21</sup> *Tiebout*, *A pure theory of local expenditures*, 64 *Journal of Political Economy* (1956) p.416 – 424.

### a) *Acemoglu/Robinson*: Democracy as a tool for redistributive taxation

In their magisterial study “Economic Origins of Dictatorship and Democracy”<sup>22</sup>, economists *Daron Acemoglu* and *James A. Robinson* present a general model for the transformation of a society from dictatorship towards democracy. The starting point of their findings is the assumption that in any given country we find a conflict between the ruling elite (“the rich”) and the citizens (“the poor”) about the allocation of wealth within the society. The people press for redistribution from the top to the bottom, while the elite tries to defend its vested rights. To quote from their exposition:

*“To facilitate the initial exposition of our ideas, it is useful to conceive of society as consisting of two groups – the elites and the citizens – in which the latter are more numerous. Our framework emphasizes that social choices are inherently conflictual. For example, if elites are the relatively rich individuals – for short, the rich – they will be opposed to redistributive taxation; whereas the citizens, who will be relatively poor – for short, the poor – will be in favor of taxation that would redistribute resources to them. More generally, politics or social choices that benefit the elites will be different from those that benefit the citizens. This conflict of social choices and policies is a central theme of our approach.”*<sup>23</sup>

According to their theory<sup>24</sup>, over time the rich will share some of their wealth with the poor in order to fend off threats of a revolution. But the ordinary citizens will not be persuaded by those informal and revocable transfers in the long run and will demand credible commitments for the future. The strongest device for a credible commitment is – after all - constitutional change<sup>25</sup>. Against this background, a move towards a democratic constitution involving substantial influence of the whole citizenry of a nation on the legislature. This will grant the majority of voters the power to implement a distributive tax system for the foreseeable future. The concomitant extension of the franchise throughout the 19<sup>th</sup> century and the rise of the (progressive) income tax during the same period are regarded to be but one example for this relationship described under this model<sup>26</sup>. In this world, democratic procedures – it seems – are not primarily safeguards for the individual or the people (conceptualized as a homogeneous aggregate of taxpayers) against some autocratic regime. They work rather as a tool for the (poor) majority within a society to appropriate the wealth of the (rich) minority<sup>27</sup>.

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<sup>22</sup> Cambridge University Press, 2006.

<sup>23</sup> *Supra*, p.15.

<sup>24</sup> For a similar account see: *Mukand/Rodrik*, The Political Economy of Liberal Democracy, March 2017, extending the *Acemoglu/Robinson* model to majority-minority conflicts under ethnic, religious and similar cleavages not related to wealth.

<sup>25</sup> Under the assumption that the political elite has an incentive to observe the limitations set by the constitution. This leads to specific requirements of “self-enforcement” of constitutional norms (*Fearon*, Self-Enforcing Democracy, 126 *Quarterly Journal of Economics* (2011) p.1661 et seq.; *Weingast*, The Political Foundations of Democracy and the Rule of Law, 91 *American Political Science Review* (1997) p.245 et seq. (251 et seq.)

<sup>26</sup> *Kiser/Karceski*, Political Economy of Taxation, 20 *Annual Review of Political Science* (2017) p.75 (79);

<sup>27</sup> Major studies in the field of comparative fiscal history pleading for a cautious case-by-case approach include: *Steinmo/Tolbert*, Do Institutions Really Matter? Taxation in Industrialized Democracies, 31 *Comparative*

## **b) Rodrik: Globalization as a threat for democracy**

“The Globalization Paradox” by *Dani Rodrik* looks into the future of the democratic nation-state in the context of globalization, in particular with respect to the impact of free trade and free capital flows. It builds on a broad tradition of research on regulatory competition – including tax competition – and describes the pressures on local policymakers which arise from their willingness to exploit the benefits of a global market on the one hand while retaining full sovereignty in legislative matters on the other hand<sup>28</sup>. His analysis results in what he calls the “trilemma of globalization”: It says that

*“democracy, national sovereignty and global economic integration are mutually incompatible: we can combine any two of the three, but never have all three simultaneously and in full”.*

For *Rodrik*, the ongoing worldwide race to the bottom for corporate tax rates is just one clear example of policymaking being stuck between the demands of a globalized market for capital (generating outside investment) and domestic policy goals of redistribution, environmental protection and other public policy goals. States – this is his thesis – have to decide: They can retain state sovereignty and democratic decision-making – then they have to lock themselves in and withdraw from the globalized economy. Or they try to exercise state sovereignty in a globalized world – then the people will not be able to sustain full democratic control of domestic policies. Or they shift democratic institutions and decision-making to a higher level – then they have to leave the sovereign nation-state behind and go for “global government”.

Anybody who has witnessed tax policy in America, Europe and around the globe in recent years is fully aware of the enormous pressure tax competition exerts on national tax legislation – going far beyond the corporate tax straight into the world of personal taxation of high net-worth individuals and mobile high-skilled labor<sup>29</sup>. The outcome seems to be a new form of “tax privilege” for the high-end members of the society who have found a way to leave behind the constraints of democratic decision-making<sup>30</sup>.

## **4. The research question**

Both the discussion of the theoretical model – congruence of voters, taxpayers and beneficiaries – and the presentation of historical accounts – different narratives on the role of taxation in democratic societies – show that democracy and taxation do not align as easily as the household rhyme of “taxation and representation” suggests. There are conflicts, which –

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Political Studies (1998) p.165 – 187; *Scheve/Stasavage*, *Taxing the Rich* (New York: Russell Sage Foundation/Princeton and Oxford: Princeton University Press), 2016, p.12 et seq.

<sup>28</sup> For the state of the art of economic research in this area see: *Keen/Konrad*, *The Theory of International Tax Competition and Coordination*, in: *Auerbach/Feldstein* (Ed.), *Handbook of Public Economics*, Vol.5 (2013) p.257 – 328.

<sup>29</sup> *Schön*, *Tax Competition in Europe*, 2003.

<sup>30</sup> *Dagan*, *International Tax Policy Between Competition and Cooperation*, 2018, p.12 et seq.

from a normative point of view – might need to be addressed by constitutional constraints. This goes both ways: On the one hand, in the *Acemoglu/Robinson* world, the rich minority might seek protection against fiscal expropriation by the poor majority. On the other hand, in the *Rodrik* world, the poor majority will try to resist the option of the rich minority to gain fiscal privilege in the name of tax competition.

Some constitutions and constitutional court practice have established such limitations (with varying success) – in Germany, Switzerland and other countries of continental Europe, but also in Latin America. In other countries – most notably the United Kingdom but to a large extent also the United States, Australia and Canada – the citizens seem to put their trust primarily in the democratic process.

- Against this background, the first part of this article is devoted to the constitutional options to diminish distortions and moderate conflicts arising under conditions of democracy from the fact that taxation is – after all – a statutory obligation on individual persons to make mandatory payments for which they cannot expect any individual consideration. For this purpose, the article presents a comparison of the major tools of taxpayer protection offered by theory and adopted by constitutional practice.
- The second part of this article focuses on the international dimension of taxation and democracy, starting out with a critical assessment of mismatches between taxability and voting rights which flow from the fact that most countries have resorted to taxation on the basis of mere residence and/or economic presence as opposed to taxation on the basis of citizenship.

This analysis will be complemented by a concise view on the impact of international tax competition on the domestic political process and its constitutional framework.

## **II. The protection of the individual in tax**

### **1. “Content” versus “Consent”**

A closer look at the historical and theoretical development of taxation in modern times reveals one decisive feature up front:

- One can think of taxation from the top to the bottom, taking the State and its fiscal needs as a given and trying to formulate material principles guiding fiscal policies, thus establishing a substantive framework for taxpayer protection. This is what I call taxpayer protection by “content”.
- One can also think of taxation from the bottom to the top, requiring the involvement of citizens at all stages, making the mere existence of taxation dependent on democratic procedures and voluntary acts by the citizenry. This is what I call taxpayer protection by “consent”.

Without claiming to be comprehensive, it seems fair to say that we can relate both concepts to the two leading political philosophers of 17<sup>th</sup> century's England: *Thomas Hobbes* and *John Locke*. *Hobbes'* work is the starting point for the evolution of protection by content while *Locke's* theory of taxation is systematically built on taxpayer's consent<sup>31</sup>. We can then – with a huge grain of salt - draw a line through some centuries of tax policy leading to today's constitutional conflicts.

## 2. Protection by content – The evolution of tax principles

In *Thomas Hobbes'* “*Leviathan*”<sup>32</sup>, the State is not a democratic State. It may be built on some mythical social contract but it does not require ongoing legislation – nor even confirmation - by a representative legislature to exercise its power. The Monarch's sovereignty is absolute and the people have to obey. Taxes are levied without any voluntary decision-making on the side of the taxpayers. If one accepts the fundamental necessity to establish a government to secure internal and external peace, it follows logically, that one also accepts the fundamental necessity to provide funds for the sovereign power, and this justifies taxation *eo ipso*<sup>33</sup>.

The sovereign power in *Hobbes'* world is not constrained by democratic institutions, but it is constrained by the material requirement

*“that Justice be equally administered to all degrees of the People; that is, that as well the rich, and mighty, as poor and obscure persons, may be righted of the injuries done them. (...) For in this consisteth Equity; to which, as being a Precept of the Law of Nature, a Sovereign is as much subject, as any of the meanest of his People.”*<sup>34</sup>

This prevailing role of the principle of equality – still today the “virtue of sovereigns”<sup>35</sup> - has consequences for taxation:

*“To Equall Justice, appertaineth also the Equall imposition of Taxes; the Equality whereof dependeth not on the Equality of riches, but on the Equality of the debt, that every man oweth to the Common-wealth for his defence. (...) For the Impositions, that are layd on the People by the Sovereign Power, are nothing else but the Wages, due to them that hold the publique Sword, to defend private men in the exercise of severall Trades, and Callings. (...) Which considered, the Equality of Imposition, consisteth rather in the Equality of that which is consumed, than of the riches of the persons that consume the same. (...) But when the Impositions, are layd upon those things which men consume, every man payeth Equally for what he useth.”*

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<sup>31</sup> For an overview on „The Concept of Taxation and the Age of Enlightenment“ see *Frecknall-Hughes*, in: *Tiley* (Ed.), *Studies in the History of Tax Law*, Vol.2 (Oxford and Portland: Hart), 2007, p.253 et seq.

<sup>32</sup> *Hobbes*, *Leviathan*, 1651 (ed. By *Flathman/Johnston* (New York – London: W.W.Norton), 1997.

<sup>33</sup> *Von Stein*, *Lehrbuch der Finanzwissenschaft* (Leipzig: Brockhaus), 1875, p.302 et seq.

<sup>34</sup> *Hobbes* supra Chapt. XXX [180], p.175.

<sup>35</sup> *Dworkin*, *Sovereign Virtue*, 2000, Introduction, p.6.

Equality of taxation (according to Hobbes on the basis of “benefit”) – this is a material standard tax lawyers know quite well and apply to this day. For *Hobbes* this requirement is built on equal justice being part of natural law (and there has been a lot of debate by modern-day scholars as to the reasons why this approach has led him to propose a tax on consumption<sup>36</sup>).

Throughout the 18<sup>th</sup> century, the evolution and refinement of this material tax principle abounds. When *Vauban* presented the highly innovative “*Dîme Royale*” in 1707, he both confirmed the fundamental obligation of all subjects of the State to contribute to the King’s funds and the allocation of this burden in proportion to the income or the industry of the taxpayers<sup>37</sup>. Moving fast forward, it suffices to take a short look at *Adam Smith*’s enormously influential “four canons of taxation” which reconfirmed in 1776 the paramount principle of equality of taxation – citing both a benefit-related and a means-related perspective<sup>38</sup>. This material benchmark is complemented by his three procedural canons on the “certainty”, the “convenience” and the “economy” of taxation which jointly demand the tax burden to be foreseeable, easy to comply with and cheap as regards administrative costs. Again, taxpayer protection is of high importance but we find no mention of democratic procedures in this part of his work<sup>39</sup>. Rather, these tax principles seem to work well under any form of government, oscillating between prescripts of natural law, economic justifications and prudential maxims for a Monarch who intends to rule both effectively and efficiently.

Beyond theoretical thinking, the principle of equality gained enormous political momentum throughout the 18<sup>th</sup> century. It became a highly controversial issue during the bitter fight of the rising bourgeoisie against fiscal privileges for the nobility and for the church. This omnipresent source of social conflict made world history in the run-up to the French Revolution. The French constitutions of the revolutionary age used unambiguous language in prohibiting any form of tax privilege for individuals and social classes<sup>40</sup>. This abolition of any personal tax exemptions was later copied by constitutional texts throughout Europe, including Germany’s

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<sup>36</sup> *Jackson*, Thomas Hobbes’ Theory of Taxation, 21 Political Studies (1973) p.175 et seq.

<sup>37</sup> *Vauban*, La Dîme Royale, 1707, Maximes Fondamentales de ce Systeme: “De cette nécessité, il résulte: Premièrement, une obligation naturelle aux sujet de toutes conditions, de contribuer à proportion de leur revenue ou de leur industrie, sans qu’aucun d’eux s’en puisse raisonnablement dispenser”.

<sup>38</sup> *Supra*, Chap.XXX [181], p.175: “*The subject of every state ought to contribute towards the support of the government as early as possible in proportion to their respective abilities that is in proportion to the revenue which they respectively enjoy under the protection of the State. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation*”.

<sup>39</sup> But see his remarks on the status of the American colonies (*Smith supra* p. ).

<sup>40</sup> Title I French Constitution of 1793.

Art.134 of the Constitution of the Weimar Republic<sup>41</sup>. An explicit ban on tax privilege can still be found in some of today's constitutions, e.g. those of Belgium and Luxemburg<sup>42</sup>.

But the fight for equality in taxation went beyond the abolition of unjustified privilege for certain individuals and social classes. In his "Principles of Political Economy" published in 1849, *John Stuart Mill* highlighted the fundamental nature of the principle of equality in the tax area as "it ought to be so in all affairs of government". The tax system as a whole was meant to be shaped by this notion. Two major sub-principles of tax equality stand out to this day: Equality according to the benefits received from the State, and equality according to the individual capacity to contribute to the common good<sup>43</sup>. The most prominent manifestation of the latter dimension of the principle of equality in fiscal matters is the "ability-to-pay" principle, which rose to worldwide recognition throughout the 19<sup>th</sup> and the 20<sup>th</sup> century, widely replacing the "contractarian" view of tax as a consideration for a benefit received<sup>44</sup>. Today, many constitutions around the world – in particular in some European countries and in Latin America – explicitly require tax legislation to be in line with the principle that taxation should relate to the ability-to-pay of the taxpayer, transforming *Adam Smith's* recipe for practical tax legislation into hard-wired law<sup>45</sup>.

### 3. Protection by consent – taxation as a voluntary payment

As said before, a different line of thinking links the justification of taxation to the consent of the taxpayer. Enjoying good government and having good tax principles is not enough. Let's quote from *John Locke's* "Second Treatise on Government":

*"§ 140: It is true, governments cannot be supported without great charge, and it is fit every one who enjoys his share of the protection, should pay out of his estate his proportion for the maintenance of it. But still it must be with his own consent, i.e. the consent of the majority, giving it either by themselves, or their representatives chosen by them: for if any one shall claim power to lay and levy taxes on the people by his own authority, and without such consent of the people, he thereby invades the fundamental law of property, and subverts the end*

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<sup>41</sup> Art.134 WRV provided that taxes had to be levied "*ohne Unterschied*" in order to prohibit any tax privilege for specific social classes or individuals.

<sup>42</sup> Art.172 Constitution of the Kingdom of Belgium; Art.101 Constitution of the Grand Duchy of Luxemburg; see also Art.127 par.2 Swiss Constitution.

<sup>43</sup> *Musgrave*, Public Finance

<sup>44</sup> For its history in 19<sup>th</sup> century England see: *Daunton*, *Trusting Leviathan: The Politics of Taxation in Britain 1799 – 1914* (CUP) 2001, p.136 et seq.; for its history in the United States see: *Ajay K. Mehrotra*, *Making of the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation, 1877 – 1929*, CUP, 2013, p.96 et seq.; for its history in Germany see: *Birk*, *Das Leistungsfähigkeitsprinzip als Maßstab der Steuernormen*, 1983; a comparative analysis has been provided by *Scheve/Stasavage* supra p.26 et seq.; this article cannot discuss the material aspects, in particular the fundamental vagueness and uncertainty of the concept of „ability-to-pay“ (see: *Kay/King*, *The British Tax System*, 5<sup>th</sup> Ed., 1990, p.89 et seq.; *Gassner/Lang*, ).

<sup>45</sup> Art.53 par.1 Italian Constitution; Art.31 par.1 Constitution of the Kingdom of Spain; Art.127 par.2 Swiss Constitution; Art.145 par.3 no.1 Constitution of Brazil.

*of government: for what property have I in that which another may by right take, when he pleases, to himself.*<sup>46</sup>

Reading *Locke* from the perspective of modern political economy, one is interested in the question why he so easily conflates individual consent by the taxpayer, whose property is taken, and democratic consensus as afforded by a majority of the voters. The reason may lie in the fact that for *Locke*, the conflict between minority and majority which seems so salient today could be assumed away to a large extent. Firstly, he was only willing to allocate voting rights to persons if and to the extent to which they actually paid taxes. In his view, a part of the people is allowed to participate in legislation solely “in proportion to the assistance which it affords to the public”<sup>47</sup>. In *Locke’s* time, this greatly reduced the number of citizens entitled to participate in political decision-making<sup>48</sup>. Secondly, this smallish set looked rather homogeneous to him: It was the landed gentry<sup>49</sup>. These landowners – we can fairly assume – showed concurring political preferences and the will of the majority of this class represented pretty accurately the interest of all its members. The potential for conflict as to the allocation of the tax burden and the way revenue was spent was substantially smaller among such a well-connected class of landowners than in modern day’s anonymous and diverse democracies<sup>50</sup>.

The concept that voting rights shall be granted in proportion to the amount of tax paid by a citizen to the state carries major implications for policy-making, in particular for the level of redistribution but also for the size of the public sector and the quantity and quality of public goods being provided by the state<sup>51</sup>. Against this background it comes as no surprise that the 19<sup>th</sup> century has seen a constant fight about the enlargement of the franchise – from the land-owning nobility to the urban bourgeoisie, and – at a later stage - from the capitalist businessmen to their employees<sup>52</sup>. At the Philadelphia Constitutional Convention in 1787, the issue of multiple voting rights according to wealth was seriously discussed. In the end, *Madison* convinced the framers of the U.S. Constitution that a Senate representing the

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<sup>46</sup> *Locke*, The Second Treatise of Government, 1689 § 140, in: *Sigmund* (Ed.), The selected political writings of John Locke (New York – London: W. W. Norton), 2005, p.79 et seq.;

<sup>47</sup> *Supra*, § 158, p.87.

<sup>48</sup> Customs and excises on goods were not regarded as „taxes“ in this sense which meant that the fiscal burden on the common man was largely outside the picture.

<sup>49</sup> Discourse VII. Of Taxes; *Andrew*, Possessive Individualism and Locke’s Doctrine on Taxation, 21 *The Good Society* (2012) p.151 et seq.; *idem*, Locke on Consent, Taxation and Representation 62 *Theoria* (2015) p.15 et seq.; for a more progressive reading of Locke’s writings see: *Leviner*, The Normative Underpinnings of Taxation, in: *Brennan/Brown/Jones* (Ed.), *Beyond Economic Efficiency in United States Tax Law* (New York: Wolters Kluwer), 2013, p.27 et seq.

<sup>50</sup> In *Locke’s* time leading economists believed that not only direct taxes on land but all other taxes would ultimately fall on the landowners (critical *Hume*, Of Taxes, in: *Hume*, *Essays, Moral, Political, and Literary*, Part II, Essay VIII).

<sup>51</sup> The „contractual“ character of tax payments in this period was reinforced by widespread „earmarking“ of contributions to a specific purpose (*Kiser/Karceski supra p.82*).

<sup>52</sup> *Daunton supra*, p.148 et seq.

aristocracy of his time – the “landed proprietors”<sup>53</sup> – will sufficiently serve as a limiting factor to the taxing power of the House of Representatives<sup>54</sup>. In “De la Démocratie en Amérique”, *Alexis de Tocqueville* strongly supported in 1835 to limit voting rights to the middle classes who would look for parsimony and efficiency in public spending<sup>55</sup>. Even *John Stuart Mill* – a staunch supporter of broad equality in fiscal matters - not only pleaded in 1861 for a restriction of voting rights to those who actually pay the tax – he also wanted to take away any electoral rights from those who live on public (church) welfare<sup>56</sup>. In practice, the function of graduated voting power was fulfilled in the United Kingdom by the constitutional status of the House of Lords. This body only lost its right to veto “money bills” passed by the House of Commons in 1911 following a political crisis after the Lords had voted down in 1910 the Government’s Budget in full.

At that time, this conflict had also become practically visible within Germany: From 1849 until 1918 the impact of votes on the elections for the Prussian House of Representatives was built on the “*Dreiklassenwahlrecht*” which provided for three separate ballots, each of them dedicated to the election of one third of the Members of the House. As each ballot was allocated to one out of three classes of taxpayers – each of them providing one third of the overall tax revenue - it granted multiple voting power to the rich. At the same time, elections of the Imperial Diet, which was established after German unification in 1871 and virtually held no taxing powers, followed the “one man – one vote” rule. A male Prussian would have different voting power depending on which assembly he was voting for. And it will not surprise anyone that the Social Democrats turned out to hold a much larger faction in the Imperial Diet than in the Prussian House of Representatives<sup>57</sup>.

In our time, concepts like the Prussian “*Dreiklassenwahlrecht*” are widely ridiculed as an atavistic remnant from bygone days of feudalism and class struggle. Today, equal voting rights are accepted as self-evident results of social and moral assumptions about the equal value of human beings<sup>58</sup>. But one should not overlook that this result stems from “inbred value judgment rather than logic”<sup>59</sup>. From the standpoint of political economy, these bygone institutional constraints made sense insofar as they tried to forge a compromise between the

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<sup>53</sup> Notes of the Secret Debates of the Federal Convention of 1787, Taken by the Late Hon Robert Yates, Chief Justice of the State of New York, and One of the Delegates from That State to the Said Convention.

<sup>54</sup> *Chomsky*, Requiem for the American Dream: The 10 Principles of Concentration of Wealth and Power, 2017, 1<sup>st</sup> Principle.

<sup>55</sup> *De Tocqueville*, De la Démocratie en Amérique, 1835, Deuxième Partie, Chapitre V, „Des Charges Publiques sous l’Empire de la Démocratie Américaine“.

<sup>56</sup> *Mill*, Considerations on Representative Government, 1861, chapters 8 and 15.

<sup>57</sup> *Ritter/Niehus*, Wahlgeschichtliches Arbeitsbuch: Materialien zur Statistik des Kaiserreiches 1871 – 1918, München, 1980; *Kühne*, Handbuch der Wahlen zum preußischen Abgeordnetenhaus 1867 – 1918, 1994.

<sup>58</sup> For a theoretical critique see: *Ganghof*, Does public reason requires super-majoritarian democracy? Liberty, equality, and history in the justification of political institutions, 12 Politics, Philosophy & Economics (2012) p.179 – 196.

<sup>59</sup> *R.Musgrave*, The Theory of Public Finance: A Study in Political Economy (New York – Toronto – London: McGraw Hill), 1959, p.118; in a similar vein *Hayek*, The Constitution of Liberty: Definitive Edition, Collected Works, Vol. XVII, p.166 et seq.

necessity to engage in collective action for the common good on the one hand and the goal to avoid exploitation of the wealthy minority by a rent-seeking majority following the *Ace-moglu/Robinson* model. To make the point more generally: The more taxation moves from individual consent to aggregate consent, the more we have to think about substantive constitutional constraints against exploitation.

Taking these issues seriously, the founding father of modern political economy and public choice, the Swedish scholar *Knut Wicksell* pleaded in 1896 (in his book “Finanztheoretische Untersuchungen”<sup>60</sup>) for a supermajority requirement in budgetary and fiscal matters. He proposed that no fiscally relevant action should be taken unless there was (nearly) unanimous consent among the representatives of the different social constituencies. His work laid the conceptual foundations for the public choice approach championed since the 1960s by *James Buchanan* and his school.

It is interesting to learn that *Wicksell* did not put much trust in any material principles of taxation, in particular the concept of equality, as tools of taxpayer protection. From his perspective, once broad consensus among the people’s representatives had been reached, the delineation of the tax base and the shaping of the tax rate could have any form. Moreover, the allocation of the tax burden would also take into account the asymmetric distribution of benefits received by the taxpayers financed from the tax revenue which rendered the concept of tax equality even more precarious<sup>61</sup>. *Wicksell* therefore had a rather critical view of concepts like tax justice which seemed to him vague and subjective<sup>62</sup>. In his world of (near) unanimity, consent fully substitutes for content.

20<sup>th</sup> century history has seen different theoretical and practical attempts to establish alternative models of consent-oriented rules for taxpayer protection<sup>63</sup>. *Friedrich-August von Hayek* proposed a division of competence between an “upper house” responsible for defining the tax base in the long run and a “lower house” setting the tax rate and the budget on an annual basis<sup>64</sup>. In the United States, the (in) famous Proposition 13 of the Californian Tax Revolution in 1978 created the requirement of a supermajority for the introduction of new taxes in California<sup>65</sup>. And at the Federal level, the presidential model of democratic government which makes successful tax legislation dependent on agreement between the two

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<sup>60</sup> *Wicksell*, Finanztheoretische Untersuchungen nebst Darstellung und Kritik des Steuerwesens Schwedens, 1896, p.110 et seq.

<sup>61</sup> *Supra* p.113.

<sup>62</sup> See his remarks on majority votes when existing public commitments have to be funded: “*Da folglich die Beschlussfassung hier immer ein positives Ergebnis herbeiführen muss, kann dieselbe, wenn über die Deckung solcher Ausgaben überhaupt abgestimmt werden muss, nicht wohl anders als nach einfacher Majorität geschehen, wobei es ebenso wünschenswert ist, dass die Majorität in der Verteilung der betreffenden Bürden von Gefühlen der Gerechtigkeit und Billigkeit geleitet sei, wie es schwierig ist, hierüber in einer für alle Fälle zutreffenden Weise etwas auszusagen*“ (p.118).

<sup>63</sup> *Buchanan supra*, p.202 et seq.

<sup>64</sup> *Hayek*, Law, Legislation and Liberty, Vol.3, 1979, p.

<sup>65</sup> For a critical assessment see: *Gamage*, Coping through California's Budget Crises in Light of Proposition 13 and California's Fiscal Constitution, in: PROPOSITION 13 AT 30, Jack Citrin & Isaac Martin, eds., 2009.

chambers of the U.S. Congress and the President, helps to protect the tax system against highly volatile attacks<sup>66</sup>.

Sometimes procedural help comes from a different angle: In Germany legislation in income tax matters and VAT matters requires a majority of votes both in the *Bundestag* and in the *Bundesrat* (representing the governments of the *Länder*). While this veto position was meant to protect revenue interests of the sub-national states, it has effectively contributed largely to taxpayer protection in general by fending off major increases of the existing tax burden, particularly in times when the two decision-making bodies (*Bundestag* and *Bundesrat*) were controlled by different political parties<sup>67</sup>.

To put these anecdotal case studies in general terms: The more “veto players” the institutional set-up of a fiscal constitution involves, the less leeway exists to increase the level of taxation<sup>68</sup>.

#### 4. Democracy, separation of powers and the prospect of a “government shutdown”

The obligation to pay tax as such – this is the main difference between the *Hobbesian* and the *Lockean* approach to taxation – arises either from the mere fact that the taxpayer is a subject of the State – irrespective of the form of government in place - or it is built on the individual consent given by the taxpayer or his group of peers on a voluntary basis. What happens if one tries to embrace both views simultaneously<sup>69</sup>? The resulting conflict became topical in the 19<sup>th</sup> century. Its contrasting theoretical solutions can be found in the writings of two influential public intellectuals of the time: *John Stuart Mill* in England and *Friedrich Julius Stahl* in Germany.

In his “Principles of Political Economy” of 1848, starting out from a rather *Hobbesian* approach, *Mill* emphasized the general but equal obligations of all citizens towards their State. Their contribution should not reflect any benefit received but an equal sacrifice towards the common good<sup>70</sup>. In a similar vein and only two years earlier, *Friedrich Julius Stahl* expressed his concurring view in different words when he laid out that being a subject of the State justifies in full being subject to taxation. The very essence of the State leads consequentially to

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<sup>67</sup> *Ganghof*

<sup>68</sup> *Kiser/Karceski* supra p.82 – 83; *Gould/Baker*, Democracy and Taxation, 5 Annual Review of Political Science (2002) p.87 – 110 (100 et seq.); another trajectory of research has tried to show that proportional election systems rather than majoritarian election systems produce representative bodies furthering re-distribution (for references see: *Gould/Baker* supra p.93.

<sup>69</sup> *Epstein* supra, p.51 et seq.

<sup>70</sup> *Mill*, Principles of Political Economy, 1848 (*Winch* (Ed.) Pelican Classics, 1970), chapter 11 § 2: “Government must be regarded as so pre-eminently a concern of all, that to determine who are most interested in it is of no real importance. If a person or class of persons receive so small a share of the benefit as makes it necessary to raise that question, there is something else than taxation which is amiss, and the thing to be done is to remedy the defect, instead of recognizing it and making it a ground for demanding less taxes.”; similar *McCulloch*, A Treatise on the Principles and Practical Influence of Taxation and The Funding System, 1845, p.1 et seq.

taxation – not as a quasi-contractual consideration but as an obligation arising from the individual’s membership in the Nation.<sup>71</sup>

How does this relate to the fact that both *Mill* and *Stahl* accepted the existence of parliamentary powers in fiscal matters? In order to align the conflict between the widely accepted notion that the State as such deserves to be financed by its citizens *a priori*, and the interest of the citizens to get involved in the decision-making, *John Stuart Mill* – in his “Considerations on Representative Government” allocates to the Executive the power to shape the fiscal affairs of the State in the first place. It’s up to the King of England to deliver the first shot. Parliament, on the other side, is not allowed to make amendments to the budget or to pursue its own policies by budgetary means. This reduces the tax competence of Parliament to a mere veto power<sup>72</sup>. Political practice in the United Kingdom shows, that the underlying constitutional issue, whether Parliament has the power to bring about – to borrow from modern parlance – a “government shutdown”, has been left open in England to this day as any outright rejection of the Government’s budget proposal would simply be regarded as a vote of non-confidence, leading to a general election in due course<sup>73</sup>. In the United States however, the option of a “government shutdown” provoked by Congress has been regarded as part and parcel of the fiscal constitution for centuries<sup>74</sup>. It was used forcefully under both the Clinton and the Obama Administration and was only narrowly averted by the Trump Administration in 2017 and 2018.

For *Stahl*, who sought to preserve the Prussian Monarch’s prerogative, even the notion of a parliamentary veto right endangered the stability of the State as such. When speaking in the Prussian First Chamber in 1849 on constitutional reform<sup>75</sup>, he fervently dismissed the proposal that Parliament should have the power to reject the King’s annual budget proposal – including tax legislation - altogether. A Parliament-driven government shutdown would not only jeopardize central functions of the State, it would lead to “*Demokratismus*”<sup>76</sup>, which was bound to destroy the finely-tuned separation and balance of powers within the State.

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<sup>71</sup> *Stahl*, Rechts- und Staatslehre auf der Grundlage christlicher Weltanschauung, Bd.II/2 (Heidelberg) 1846, § 121, p.419 et seq.: “*Der Rechtsgrund der Steuern, der Grund, daß der Staat befugt ist sie aufzulegen, die Unterthanen sie zu entrichten, ist auch hier schlechthin der Unterthanenschaft. Wie solcher Geldaufwand im Wesen und Zweck des Staates mit Nothwendigkeit liegt, so müssen auch seine Glieder ihn aufbringen. Die Nation gibt als ein geistiges Ganzes die Mittel für ihren Beruf als Staat, und jeder Einzelne muß geben, weil er Glied der Nation ist. Verwerflich ist auch hier der Rechtsgrund, daß die Unterthanen die Steuern als Aequivalent für den Schutz ihres Vermögens geben, gleich als Subjekte außer der Nation und dem Staate, mit diesen einen Kontrakt schließend. (...).*”

<sup>72</sup> *Mill*, chapter 5.

<sup>73</sup> But see: *Talbot*, Budget 2015 could see a government shutdown in the UK, *The Conversation*, 28<sup>th</sup> October 2013 ([www.theconversation.com](http://www.theconversation.com)).

<sup>74</sup> *Young*, American Exceptionalism and Government Shutdowns: A Comparative Constitutional Reflection on the 2013 Lapse in Appropriations, 94 *Boston University Law Review* (2014) p.991 et seq.; for a German perspective on this concept see: *Heun*, Das Budgetrecht im Regierungssystem der USA, 1989.

<sup>75</sup> *Stahl*, Das Steuerverweigerungsrecht: Rede des Dr. Stahl, Abgeordneten für Angermünde, Ober- und Niederbarmin, Prenzlau, Templin, in der fünfundfünfzigsten Sitzung der preußischen Ersten Kammer am 16. Oktober 1849.

<sup>76</sup> *Supra* p.14.

For *Stahl*, parliamentary powers in the field of taxation only enabled the people's representatives to have a word on incremental increases of the annual tax revenue, in particular the introduction of new types of taxes, but not to force their will on other branches of the government. In his view, the budgetary powers of the Parliament were not meant to question the *Raison d'État* as such. The *Lockean* notion practiced in England and supported by *Mill*, that Parliament may decline any financial contributions demanded by the King, was explicitly rejected by *Stahl* as an atavistic remnant of medieval customs, under which different Estates (landowners, urban burgers etc.) negotiated individually with the King their respective contributions for the King's outlays in his political and military ventures<sup>77</sup>.

*Stahl's* theoretical question became highly topical in the 1860s when the King of Prussia and the Prussian House of Representatives disagreed on costly military reform<sup>78</sup>. *Otto von Bismarck*, the then Prussian Prime Minister, deplored what he named a "constitutional gap"<sup>79</sup> and argued for this to be filled by the Royal Prerogative, "as the life of the State cannot stand still for a single moment", and sealed the outcome with a crackdown on the aspiring liberal movement in Prussia. This move set the stage for more than 150 years. Under today's fiscal constitution of the Federal Republic of Germany, *Bismarck's* plea that the "State Engine" has to be kept going, has not lost its force. Art.111 of the German Basic Law empowers the Federal Administration to move on without a formally confirmed budget on a provisional basis in order to keep the executive branch capable of acting. Moreover, existing tax laws remain in force *pro futuro* unless they are formally suspended by the legislator. Against this background, the German Constitutional Court has emphasized the necessity to fund the "political, economic and social interest of the State" and obliged the executive branch and the legislative branch to cooperate for this common goal<sup>80</sup>. The majority view among constitutional scholars seems to be that the *Bundestag's* power to bring down any government by vote of non-confidence seems to have anyway reduced the room for long-lasting conflict in budgetary matters<sup>81</sup>. A similar constitutional framework applies in France and in other countries on the European Continent<sup>82</sup>.

## 5. Majority decision versus individual consent

For writers like *Hobbes*, *Mill* or *Stahl*, the obligation to pay taxes is primarily built on the taxpayer being a "subject" of the state. The answer to the question of whom this state represents and who is in charge of government is of a secondary nature and has changed over time. While *Hobbes* would see the respective "Sovereign Power" as the apex for any obligation to pay tax, *Stahl* would recast the focal point of this obligation as the "Nation" and *Mill* as the "Social Union" for which government exists. Since the days of the French Revolution,

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<sup>77</sup> *Supra* p.10 et seq.

<sup>78</sup> *Friauf*, Der Staatshaushaltsplan im Spannungsfeld zwischen Parlament und Regierung, Vol.1 (Bad Homburg – Berlin – Zürich: Gehlen), 1968, p.223 et seq.

<sup>79</sup> As to the „Lückentheorie“ see:

<sup>80</sup> Bundesverfassungsgericht, judgment of 25 May 1977 2 BvE 1/74, C.I.5.b).

<sup>81</sup> *Heun* in: *Dreier* (Ed.), Grundgesetz-Kommentar, 2nd Ed., 200x, Art.111 Grundgesetz para 1.

<sup>82</sup>

the “People” as such – in German parlance the “*Staatsvolk*” – have taken over as the source of legitimacy for the exercise of the State’s powers. In the end, the Monarch or any ruling elite gave way to the entirety of the citizens acting under the rules of democratic decision-making.

This replacement of the Monarch by the People which we witness throughout the 19<sup>th</sup> and 20<sup>th</sup> century lends to the interaction between taxation and democracy a specific twist. Following *Montesquieu’s* and *Rousseau’s* dialectic view of the members of a nation being both the “objects” of the state’s powers and the “subjects” of government<sup>83</sup>, the taxpayer sees himself in both camps: being part of the taxing power and being subject to its execution. At first glance, this dialectic perspective makes us believe that the age-old contrast between the *Hobbesian* and the *Lockean* view goes away once full democratic government has arrived. Under the new rules, no tax will be levied, which is not built on the consensus of the people. In *Rousseau’s* own terms: “The individual does not need any guarantees towards the state as the body will not do harm to its members.”<sup>84</sup>

Taking a closer look, it turns out that the replacement of autocratic government by democratic government does not change the nature of the problem at all. *Georg Jellinek*, one of Germany’s most astute constitutional lawyers at the turn of the 20<sup>th</sup> century, clarified that the (fiscal) decisions taken by the People acting as a homogeneous “organ” of the State in the sense of *Rousseau*, bear no conceptual relationship to the individual consent of a taxpayer or his peer group as required in the *Lockean* world<sup>85</sup>. At the level of the State we have to switch from the “bottom-up” perspective of individual consent to the “top-down” perspective of a government run by a collective body, namely the People or their representatives as an aggregate. For the decision-making of these representatives, the introduction of the majoritarian rule is clearly inevitable. It is either practically necessary in order to avoid complete standstill of the government or – to apply *Rousseau’s* optimistic line of thinking – because it helps to establish the *volonté générale* at a higher level<sup>86</sup>.

But this brings up the underlying paradox: The minority is subject to a majority decision which they have not voted for but which they have to accept as being their own<sup>87</sup>. It is quite telling that a political philosopher who grew up in France but was exposed to democracy in America – *Alexis de Tocqueville* – became the most prominent critic of the “tyranny of the majority” in democratic systems in the 19<sup>th</sup> century. In his view, the majority of voters, lacking any personal financial means and taxing capacity, would not only plead for large-scale redistribution but also for a major increase in public spending on the whole<sup>88</sup>. The raw fact that the majority of voters have an incentive to exploit the minority cannot be superseded

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<sup>83</sup> *Rousseau*

<sup>84</sup> *Rousseau*, *Contrat Social*

<sup>85</sup> *Jellinek*, *Allgemeine Staatslehre*

<sup>86</sup> *Rousseau*, *Contrat Social*

<sup>87</sup> *Murswiek*, *Paradoxa der Demokratie*, in: *Juristenzeitung* 72 (2017) p.53 (55 et seq.).

<sup>88</sup> *Tocqueville* *supra*.

by dialectic idealism in the sense of *Rousseau*. In the same vein a prominent German constitutional theorist, *Johann Kaspar Bluntschli*, wrote in 1881:

*“Rousseau wiederholt hier den Irrtum des Hobbes und kommt wie dieser zu einer absoluten Staatsgewalt. Freilich bekennt er sich als Freund der gemeinen Bürgerfreiheit, während Hobbes die Herrschaft des einen über alle begünstigt. Aber der Absolutismus seines als Souverän proklamierten Demos ist für die Freiheit der Individuen nicht weniger gefährlich als der Absolutismus des Monarchen bei Hobbes. Ob meine Eigenart von dem Unverstande der Menge unterdrückt oder von der Willkür eines Despoten gefesselt werde, ist für meine Freiheit gleich verderblich; und wenn auch die Demokratie Rousseaus der gemeinen Freiheit aller nicht so abgeneigt ist wie die Despotie des absoluten Fürsten, so ist jene doch stärker als diese und es wird schwieriger, ihrer rohen Übermacht zu widerstehen.”<sup>89</sup>*

One hundred years later, *James Buchanan*, when discussing the alternative between the utopian principle of unanimity as proposed by *Wicksell* and a simple and practical majority rule in fiscal matters, accepted majoritarian rule in order to overcome transaction costs and collective action issues but he phrased his concerns about minority protection in equally strong words:

*“Indeed, it may be suggested that commonly observed majoritarian rule can best be modeled as if it embodies no effective constraint on the exercise of government powers at all”<sup>90</sup>.*

His conclusion is clear: Majority rule requires additional constitutional constraints in order to protect the individual<sup>91</sup>.

For this purpose, the material principle of equality stands out as a major feature of taxpayer protection: Democracy works better than dictatorship when it comes to the decision on public goods, redistribution and their funding - as the majority of voters will tax themselves while the dictator doesn't tax himself<sup>92</sup>. And within a democratic environment, voting works better as a means of collective decision-making if the principle of equality in tax matters ensures that there is equal cost for everyone for financing the collective good<sup>93</sup>. It makes sure that majority decisions cannot go too far to the detriment of the outvoted minority<sup>94</sup>. But

<sup>89</sup> *Bluntschli*, *Geschichte der Neueren Staatswissenschaft: Allgemeines Staatsrecht und Politik Seit dem 16. Jahrhundert bis zur Gegenwart* (München – Leipzig: Oldenbourg) 1881, p.349.

<sup>90</sup> *Buchanan*, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press) 1980, p.7 (emphasis by Buchanan).

<sup>91</sup> *Supra*, p.187 et seq.; see also *Schön*, *Grundrechtsschutz gegen den demokratischen Steuerstaat*, *Jahrbuch des öffentlichen Rechts* 2016; *Delmotte*, *The political economics of tax exemptions: Tax uniformity as a constitutional principle*, 2017.

<sup>92</sup> *Olson*, *Dictatorship, Democracy, and Development*, 87 *American Political Science Review* (1993) p.567 et seq. (570 et seq.); in Germany, *Adolf Hitler* was the last individual to be awarded a tax-exempt status.

<sup>93</sup> *Bowen*, *The Interpretation of Voting in the Allocation of Economic Resources*, 58 *Quarterly Journal of Economics* (1943) p.27 et seq. (46 et seq.).

<sup>94</sup> It is interesting to note that in *Federalist 21* (1787) *Alexander Hamilton* pleaded for consumption taxes rather than personal taxes to fund the Federal Budget as excise taxes are conceptually applied in a broad manner, leave the decision to consume to the taxpayer and cannot therefore serve as a means to expropriate specific taxpayers or groups of taxpayers: *“It is a signal advantage of taxes on articles of consumption, that they contain in their own nature a security against excess. . . . If duties are too high they lessen the consumption—the collection is eluded; and the product to the treasury is not so great as when they are confined within proper and*

there is one additional concept that has to be clarified when it comes to the interaction between the taxing State and the individual: the concept of private property.

## 6. The property problem

It is fair to say that one of the main differences between the content-oriented framework and the consent-driven theory of taxation lies in their basic assumptions as to the role of private property pre-empting the relationship between the state and the taxpayer. Again, *Hobbes* and *Locke* stand out as protagonists of opposing views. While *Locke* in his aforementioned quote deduces the necessity of taxpayer consent from the protection of private property vis-à-vis the state<sup>95</sup>, *Hobbes* is of the opinion that property rights can only work between citizens but not towards the sovereign power:

*“Every man has indeed a Propriety that excludes the Right of every other Subject: And he has it onely from the Sovereign Power; without the protection whereof, every other man should have equall Right to the same. But if the Right of the Sovereign also be excluded, he cannot performe the office they have put him into; which is, to defend them both from forraign enemies, and from the injuries of one another; and consequently there is no longer a Commonwealth.”*<sup>96</sup>

It is visible from this quotation that *Hobbes* regards the property of individuals to rest on the overarching dominion of the state. One hundred years later, Germany’s most prominent counselor in fiscal matters in the 18<sup>th</sup> century, *Johann Heinrich Gottlob von Justi*, established a similar line of thinking. His “System des Finanzwesens”, published in 1766, started out from the assumption that the State or the Regent are entitled to all wealth located on the State’s territory, either being “direct” property of the State (like a domain) or “indirect” property owned and administrated by the citizens<sup>97</sup>. Under this theory of the State, there is no conceptual foundation for making taxation dependent on individual or aggregate consent of taxpayers. It must be sufficient to accept that the state has to fulfill its functions and that the necessary funding has to be allocated to the citizens in an equitable and economic fashion. In 1846, *Friedrich Julius Stahl* transposed this view into 19<sup>th</sup> century Germany<sup>98</sup>. Again,

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*moderate bounds. This forms a complete barrier against any material oppression of the citizens, by taxes of this class, and is itself a natural limitation of the power of imposing them.”* In a similar vein, *Hayek* proposed that progressive taxes should only be admissible to the extent that the majority of voters finds itself in the highest tax bracket (The Constitution of Liberty, 1960, p. ).

<sup>95</sup> *Snape/Frecknall-Hughes*, John Locke: Property, Tax and the Private Sphere, in: *Harris/de Cogan* (Ed.), Studies in the History of Tax Law, Vol.8 (Oxford and Portland: Hart), 2017, p.1 et seq.

<sup>96</sup> *Supra* chapt.XXIX [169], p.164.

<sup>97</sup> *Von Justi*, System des Finanzwesens, nach vernünftigen aus dem Endzweck der bürgerlichen Gesellschaften und aus der Natur aller Quellen der Einkünfte des Staats hergeleiteten Grundsätzen und Regeln ausführlich abgehandelt (Halle: Rengerische Buchhandlung) 1766, §§ 114 et seq.

<sup>98</sup> *Supra*, § 121 p.420: „Dem ersteren Prinzip gemäß sind die Steuern vor Allem von der vermögenserzeugenden Societät zu entnehmen, und ist die erste Rücksicht derselben der harmonische Zustand der Erwerbszweige und der Genußmöglichkeit. Es giebt nämlich ein Nationalvermögen oder sociales Vermögen, das nicht Summe des Vermögens der Einzelnen ist, sondern nur im Ganzen besteht, das ursprünglich und allein der Societät ist als ein ungesondertes oder auch ungebildetes, zum Theil als bloße Möglichkeit des bestimmten Vermögens, das erst zum Vermögenger gesonderten Einzelnen wird und in ihrem Besitz erst bestimmte Gestalt erhält. (...) Der Staat

the *Hobbesian* assumption, that the State's right to tax is not dependent on consent, and the assumption, that individual wealth forms part of societal wealth available for public use, come together. Unlike in the *Lockean* world, property as such is not a pre-constitutional entitlement preceding the existence of the State and negatively affected by any tax but requires the existence of the state and its emanations to come into being.

It is interesting to note that this state-oriented view as regards the lack of protection of private property vis-à-vis the tax legislator unites conservative theorists of the State like *Stahl* and progressive socialist thinkers in one camp. One might even say that the socialist governments of the 20<sup>th</sup> century could build their tax policy on the remnants of a conservative theory, which had immunized the fiscal State against individual concerns<sup>99</sup>. During and in the aftermath of World War I, the enormous rise of the overall and average tax burden in industrialized countries as described by *Joseph Schumpeter* as early as 1919 in his seminal article on the "Crisis of the Taxing State"<sup>100</sup> blew away all concerns as to the outreach of the taxing powers towards the individual taxpayer<sup>101</sup>. In this unruly post-war world, *Schumpeter* uttered a fervent plea for upper limits on taxation which was not founded on theoretical or legal concepts of individual entitlements or constitutional constraints but on the sheer practical necessity to leave private business some space to breathe – in the interest of the Nation as a whole<sup>102</sup>. After World War II, the optimistic notion of the State as a central planner and as a social engineer emboldened legislators to apply ever higher tax rates on personal income and wealth in most Western countries in order to achieve distributive goals and a steep increase of the public sector<sup>103</sup>. Old-style libertarians like *Hayek* were regarded as outsiders while social planners like *Richard Musgrave* held center stage.

The most coherent recent attempt to address the unresolved issue of tax versus property has been presented by *Liam Murphy* and *Thomas Nagel* in 2002 in their study on the "Myth of Ownership". In this book, they try to embed taxation solidly in the context of ownership. From their point of view, private property is not conceivable without the State and its functions and cannot be conceptualized outside the social context. Taxation is necessary to keep the State afloat and therefore taxation is justified. "Pretax income" - so they say -

*"has no independent moral significance. It does not define something to which the taxpayer has a prepolitical or natural right, and which the government expropriates from the individual in levying taxes on it. All the normative questions about what taxes are justified and what*

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*nimmt die Steuer von der Societät und ihrem Vermögen, und daher von jedem Einzelnen, in wieweit er an dem Letztern, d. i. an der Möglichkeit des Erwerbs und des Genusses, participirt. "*

<sup>99</sup> *Schön*, Steuergesetzgebung zwischen Markt und Grundgesetz, in: FS Kirchhof, 2003.

<sup>100</sup> *Schumpeter*, Die Krise des Steuerstaats, 1919, abgedruckt in: *Hickel* (Hrsg.), „Rudolf Goldscheid/Joseph Schumpeter: Die Finanzkrise des Steuerstaats; Beiträge zur politischen Ökonomie der Staatsfinanzen (Frankfurt: edition suhrkamp) 1976, p.329 et seq.

<sup>101</sup> The thesis that major increases in the overall tax burden – including high tax rates on high-income earners – are correlated to war efforts and the need to deliver a sacrifice fairly „compensating“ for the loss of life and health by others it at the centre of *Scheve/Stasavage* supra p.76 et seq. and p.135 et seq.

<sup>102</sup> Supra p.345 et seq.; see also *Isensee*, Steuerstaat als Staatsform, Festschrift Hans-Peter Ipsen, 1977, p.

<sup>103</sup>

*taxes are unjustified should be interpreted instead as questions about how the system should define those property rights that arise through the various transactions – employment, bequest, contract, investment, buying and selling – that are subject to taxation”.*<sup>104</sup>

It follows easily from this exposition that individual “consent” carries less weight when it comes to the question of whether taxation should exist and how it should be apportioned:

*“Of course, virtually no one really believes that all taxation is illegitimate because it takes what belongs to us without our consent.”*<sup>105</sup>

Thus, the main thrust of *Murphy’s* and *Nagel’s* book circles around issues of “content” – standards of justice, fairness, efficiency and equity. The authors do not dwell on the fundamental alternative between individual consent or majority rule, and the implementation of democratic procedures in tax matters is outside the scope of the book. To the contrary, given the concrete (and in their view: disappointing) experience with the political process in the U.S., the authors seem to regard both capitalism and democracy as major obstacles to tax justice and try to conceive of a way to change the mindset of voters in order to persuade them of an enlightened and egalitarian social ideal in fiscal policy:

*“The development of a **conception of justice compatible with capitalism and realizable under democracy** is a formidable intellectual task. It would require more than simply letting the demands of justice yield to pressure from the other two. But the spread of such a conception so that it becomes part of the habit of thought of most of those who live in the capitalist liberal democracies is a problem of a different kind. The moral ideas that do the work of legitimation have to be graspable and intuitively appealing, not just correct.”*<sup>106</sup>

Taking a look at today’s constitutional practice, the age-old tension between taxation and private property has not been solved in a substantial manner anywhere. While it is true that in many jurisdictions, constitutions contain provisions prohibiting “expropriating” or “confiscatory” taxation<sup>107</sup>, these are rather vague, limited to extreme cases, and therefore hardly play a practical role<sup>108</sup>. The debate on the interaction between tax and private property only gained short-lived practical relevance in Germany, when in 1995 the Constitutional Court ruled the existing net wealth tax to be unconstitutional<sup>109</sup>. This primary and rather unsurprising finding, which addressed arbitrary valuation methods, was simply based on the general rule of equal treatment. Going beyond this result, the judges – led by judge and professor

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<sup>104</sup> *Murphy/Nagel*, *The Myth of Ownership*, Oxford University Press, 2002, p.74.

<sup>105</sup> *Supra*, p.35:

<sup>106</sup> *Supra*, p.188

<sup>107</sup> E. g. in Art.31 par.1 Constitution of the Kingdom of Spain and in Art.150 par.4 Constitution of Brazil.

<sup>108</sup> This holds also true for the „Takings Clause“ under the Fifth Amendment of the U. S. Constitution; for the opposing view see *Epstein*, *Takings: Private Property and the Power of the Eminent Domain*, 1985, p.283 – 305.

<sup>109</sup> BVerfGE 93

*Paul Kirchhof*<sup>110</sup> - admonished (in an *obiter dictum*) the legislator to ensure that both the substance and the proceeds from the use of private property should remain with the taxpayer to a substantial extent – the tax burden should not exceed an equal share of the overall proceeds<sup>111</sup>. In a famous dissenting vote, Justice *Ernst-Wolfgang Böckenförde* rejected this notion that private property could block the traditional sovereign power of the State to reallocate wealth among its citizens by means of taxation<sup>112</sup>. Only a decade later, in 2006, the judges of the Constitutional Court explicitly retreated from their far-reaching earlier statements and abandoned this highly debated concept of a “half-income” limitation<sup>113</sup>.

The main reason why we find hardly any useful constitutional benchmark for the borderline between private benefit and public interest in the tax world is rooted in the fact that we do not have any useful constitutional limitations to the public sector as a whole<sup>114</sup>. It is not only up to the democratically elected legislature to establish taxes, in particular to define the tax base and to set the tax rate. It is also within the scope of parliamentary powers to set the public policies of the State, which in turn require financial contributions by the citizens. This relationship has not been overlooked in the past and many constitutions require in general terms that taxes must only be levied for “general welfare”<sup>115</sup> or “public purposes”<sup>116</sup>. But not much guidance comes out of such general terms. And there was only one constitution – to my knowledge – which seriously tried to introduce the additional material requirement that taxes can only be levied if the envisaged public benefit surpasses the private benefits derived otherwise: The Constitution of Pennsylvania enacted in 1776<sup>117</sup>:

*„Sec. 41. No public tax, custom or contribution shall be imposed upon, or paid by the people of this state, except by a law for that purpose: And before any law be made for raising it, the purpose for which any tax is to be raised ought to appear clearly to the legislature to be of more service to the community than the money would be, if not collected; which being well observed, taxes can never be burthens.“*

This rule never gained any traction in the real world. But the visible lack of any meaningful constitutional constraints on the size and scope of the State’s activities forces us to accept that constitutional law does not set any “absolute” limits to the taxing State and assigns the task of taxpayer protection to “relative” concepts ensuring the equality of taxpayers, which even a high-tax jurisdiction can be asked to comply with<sup>118</sup>.

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<sup>110</sup> *Kirchhof*

<sup>111</sup> BVerfGE 93

<sup>112</sup> BVerfGE 93

<sup>113</sup> BVerfGE

<sup>114</sup> *Klaus Vogel*

<sup>115</sup> Art.1 sec.8 U.S. Constitution.

<sup>116</sup> Art.20 French Constitution of 1793

<sup>117</sup> Sec. 41 Constitution of Pennsylvania, 1776.

<sup>118</sup> *Buchanan*, supra, p.195.

## 7. Community, solidarity and progressive taxation

In political and constitutional discourse, the absolutistic notion that the State or the Sovereign is the “true owner” of all assets belonging to its citizens has been replaced over time by the concepts of community and solidarity. The citizenry of a State has been named a “social union”<sup>119</sup>, an “organism”<sup>120</sup>, whose members are expected to show responsibility for each other and who are willing to “sacrifice” their personal wealth (to a limited extent) for the general good. This social model of the State and of society is particularly important in the context of redistribution as a major goal of taxation<sup>121</sup>.

The concept of taxation as a means of redistribution finds its origin in *d’Alembert’s* “Essai sur les Elemens de Philosophie”<sup>122</sup> and in *Rousseau’s* “Discours”<sup>123</sup> where they pleaded for a tax-free threshold for the poor in order to allow for their basic needs and a progressive tax system for the rich. This notion gained ground in the 19<sup>th</sup> century on the basis that the State and its functions are strongly related to the “Nation” as a rather homogeneous and coherent social entity<sup>124</sup>. 19<sup>th</sup> century socialist philosophers – including *Karl Marx* - happily joined the bandwagon and pressed for high progressive taxes as a means of class struggle<sup>125</sup>. From the perspective of German mainstream thinking the notion of the social-welfare state as a framework for a redistributive tax system has been most prominently developed in the late 19<sup>th</sup> century by public finance theorist *Adolph Wagner*. In his “Finanzwissenschaft”<sup>126</sup> he laid susary evil”. For him, the State represents the “highest form of human co-existence”, the “highest form of a compulsory community” as opposed to what he called a contractarian and “*Smithian*” perception of the State.

In the United States, public finance scholars at the turn of the 19<sup>th</sup> century took both *Mill’s* and *Wagner’s* theories home from their studies in Europe and pressed for progressive taxation on the basis of solidarity among the citizens of a state<sup>127</sup>. In the work of *Seligman* and *Ely*, one can clearly see how the *Hobbesian* concept of being a subject of the (absolute) state

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<sup>119</sup> *Mill*

<sup>120</sup> *Wagner*

<sup>121</sup> *Dagan* supra p.20 et seq.

<sup>122</sup> *D’Alembert*, Essai sur les elemens de philosophie, in: *Jean D’Alembert*, Melanges de littérature, d’histoire, et de philosophie, vol.5, 4th ed., Amsterdam : Zacharie Chatelain & Fils, 1767, p.94 – 96 ; I owe this reference to *Epple*, *D’Alembert philosophe engage : Inegalite, frontieres, et la societe des gens de lettres et des grands*, unpublished manuscript, 2017.

<sup>123</sup> *Rousseau*

<sup>124</sup> *Lorenz von Stein* supra, p.

<sup>125</sup> *Marx/Engels*, Das kommunistische Manifest, 1848, chapt.II.; this text is still regarded “seminal” for modern tax sociology (*Martin/Prasad*, Taxes and Fiscal Sociology, 40 Annual Review of Sociology (2014) p.331 (332)); for the introduction of the concept „social justice“ to the Dutch tax system throughout the 19<sup>th</sup> century see: *Gribnau/Vording*, The Birth of Tax as a Legal Discipline, in: p.55 et seq.

<sup>126</sup> *Wagner*, Finanzwissenschaft (Leipzig – Heidelberg: ) 1883, § 27, p.45 et seq.; see also *Wagner*, Lehr- und Handbuch des Politischen Ökonomie, Vol.IV/2, Finanzwissenschaft, 2nd Ed. 1890, § 82, p.207 et seq.

<sup>127</sup> *Mehrotra* supra ; *Seligman*, Progressive Taxation in Theory and Practice, 1908; *idem*, The Income Tax, 9 Political Science Quarterly (1894) p.610

morphed into the concept of solidarity owed to other members of that state. The *Lockean* contractarian view is clearly dismissed while the concept of tax as a “sacrifice” enters center stage.

*“It is now generally agreed that we pay taxes not because the state protects us, or because we get any benefits from the state, but simply because the state is a part of us. The duty of supporting and protecting is born with us. In a civilized society the state is as necessary to the individual as the air he breathes; unless he reverts to stateless savagery and anarchy he cannot live beyond his own confines. (...) We pay taxes not because we get benefits from the state, but because it is as much our duty to support the state as to support ourselves or our family.”<sup>128</sup>*

*“Man, as a human being, owes services to his fellows, and one of the first of these is to support government, which makes civilization possible. Only an anarchist can take any other view. To the ordinary man it appears right that he should be called upon to give not only his property for the promotion of common interests, but even his life, if need be.”<sup>129</sup>*

Yet the introduction of the concept of solidarity brings up the fundamental necessity to define the composition and to delineate the outer borders of the community towards which a taxpayer owes solidarity<sup>130</sup>. History has seen manifold social groups large and small, which have claimed solidarity from its members. One could mention families, local municipalities, religious groups, social classes, and ethnical communities but also the Nation as a whole. The latter concept gained particular strength in the 19<sup>th</sup> century when the conceptual divide between the Nation and the State was largely assumed away<sup>131</sup>. From this starting point it seemed easy to bring about “congruence” between those who vote, those who pay and those who benefit from the government’s activities. But can we still build a tax system on the assumption that the simple fact of being a citizen of a State leads to a fundamental obligation of solidarity towards all other citizens of the same State<sup>132</sup>?

It is interesting to learn that major representatives of contemporary political philosophy including *John Rawls* have not yet fully abandoned this notion of a “special” mutual bond between the citizens of a State or a Nation. In *“The Law of Peoples”*, published in 1998, *Rawls* starts out from the assumption that the common agency of the State requires “common sympathies” in a sense propagated by *Mill* when he described the nation as a “social union”

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<sup>128</sup> *Seligman*, *Essays in Taxation*, 1895, p.72.

<sup>129</sup> *Ely*, *Taxation in American States and Cities*, 1888, p.13.

<sup>130</sup> *Walzer*, *Spheres of Justice*, 1983, p.31: *“The idea of distributive justice presupposes a bounded world within which distributions take place: a group of people committed to dividing, exchanging and sharing goods, first of all among themselves”*

<sup>131</sup> *Critical Volkman* p.118 et seq.; for a modern analysis of the problem see: *Gans*, *Citizenship and Nationhood*, in: *Shachar/Bauböck/Bloemraad/Vink* (Ed.), *The Oxford Handbook of Citizenship* (OUP) 2017, p.107 et seq.

<sup>132</sup> For a recent account see: *Kirchhof*, *Der Bürger in Zugehörigkeit und Verantwortung*, in: *Isensee/Kirchhof* (Ed.), *Handbuch des Staatsrechts*, Vol.XII, (Heidelberg: C.F.Müller), 3rd Ed. 2014, § 283 para 1 et seq.

in the early 19<sup>th</sup> century<sup>133</sup>. Moreover, *Rawls* rejects the view that the arbitrary character of citizenship – acquired by birth under random circumstances - undermines the very necessity of drawing this line between insiders and outsiders<sup>134</sup>. His followers – most prominently *Thomas Nagel*<sup>135</sup> – have strongly supported this view that the concept of “distributive justice” is still linked to the concept of “membership” in the state:

*“Every state has the boundaries and population it has for all sorts of accidental and historical reasons; but given that it exercises sovereign power over its citizens and in their name, those citizens have a duty of justice toward one another through the legal, social, and economic institutions that sovereign power makes possible. This duty is sui generis, and is not owed to everyone in the world, such as a duty of humanity. Justice is something we owe through our shared institutions only to those with whom we stand in a strong political relation. It is, in the standard terminology, an associative obligation.”*<sup>136</sup>

According to these writers there is – as *David Miller* has put it – still more to the State than mere “coercion” of subjects by a single authority or their “cooperative practice” in public and economic affairs. A “common identity” is what complements the other two points and contributes to the notion of mutual solidarity in any given state<sup>137</sup>.

Many constitutions stress this mutual obligation of taxpayers – starting with the French constitutions of the revolutionary age<sup>138</sup> and ending with the current Constitution of the People’s Republic of China<sup>139</sup>. But is unclear to what extent this notion of solidarity goes beyond the common interest in maintaining a smoothly functioning Government and the self-evident rule that citizens have to obey the laws issued by the legislature. Taking mutual sacrifice as a starting point, a fair number of constitutions – like the constitutions of Brazil, Italy, Spain and Switzerland - give an answer to this question as they explicitly provide for progressive taxation as a matter of principle<sup>140</sup>. Under German constitutional law, this approach is implicitly related to the concept of the “social-welfare state” laid down in Art.20 par.1 of the Basic Law, which obliges the legislator to level factual inequality and to pursue public

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<sup>133</sup> *Rawls*, *The Law of Peoples*, Harvard University Press, 1999, p.23; for a critical assessment of this position see: *Nussbaum*, *Frontiers of Justice*, 2006, p.224 et seq. (in particular at p.245).

<sup>134</sup> *Rawls supra* p.38.

<sup>135</sup> For a critical view see: *Cohen/Sabel*, *Extra Rempublicam Nulla Salus?*, 34 *Philosophy and Public Affairs* (2006) p.147 (158 et seq.).

<sup>136</sup> *Nagel*, p.121; see also p.125: “Beyond the basic humanitarian duties, further requirements of equal treatment depend on a strong condition of associative responsibility, that such responsibility is created by the specific and contingent relations such as fellow citizenship.” And see p.127: “It is only from such a system, and from our fellow members through its institutions, that we can claim a right to democracy, equal citizenship, nondiscrimination, equality of opportunity, and the amelioration through public policy of unfairness in the distribution of social and economic goods.”

<sup>137</sup> *Miller*, *Justice for Earthlings*, 2013, p. 142 et seq. (“Justice and Boundaries”), p.161 et seq.

<sup>138</sup> Art.101 of the Revolutionary Constitution of 1793: « *Nul citoyen n'est dispensé de l'honorable obligation de contribuer aux charges publiques.* ».

<sup>139</sup> Art.65 Constitution of the People’s Republic of China: “It is the duty of the citizens of the People’s Republic of China to pay taxes in accordance with the law”.

<sup>140</sup> Italy, Switzerland, Spain.

welfare. Building on this concept of the “social-welfare state”, in a recent dissenting vote on the constitutionality of inheritance taxation, three judges of the German Constitutional Court emphasized a constitutional requirement to implement a meaningful minimum of redistribution under the German tax system<sup>141</sup>.

## 8. Democratic discourse

The notion of the State as an organism, the requirement for the citizenry to contribute to the common good and the high rank attributed to the sovereignty of Parliament lead to the question of whether it is possible to overcome the conflict between the majority and the minority by democratic means. In other words: Is it possible that the minority accepts the outcome of a majoritarian vote as the true expression of the general will of the people? Starting from *Rousseau’s* optimistic assumptions as to the creation of the *volonté générale* he was forced to assume that the defeated minority simply “got it wrong”<sup>142</sup>, that it had a false perception of reality and a misunderstanding of the best solution and should be educated to accept it. In today’s world one would refer to *Habermas’* model of democratic decision-making as a procedurally organized discourse of arguments, which is meant to lead to sufficiently justified outcomes<sup>143</sup>. Against this background, a group of German constitutional lawyers led by *Oliver Lepsius*<sup>144</sup> and *Christoph Möllers*<sup>145</sup> have rejected the jurisprudence of the German Constitutional Court on hard-wired constraints on the work of the tax legislator in order to retain leeway for such parliamentary deliberation and compromise. This view is complemented by *Jeremy Waldron’s* more fundamental critique of judicial review of legislation, given the weak democratic foundations of judicial power<sup>146</sup>.

But is taxation really about democratic discourse? It is interesting to learn that *Knut Wicksell*, the afore-mentioned founding father of modern political economy, clarified as early as in 1896, that it makes a big difference whether factions within a democratic legislature disagree as regards their personal opinions or as regards their personal interests<sup>147</sup>. Differences of opinion – e.g. how best to attain a common goal like environmental protection or a reform of the educational system – can by and large be addressed by discourse and solved by majority vote. Differences of interest – e.g. regarding the level of wealth redistribution

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<sup>141</sup> *Baer, Geier, Masing, Abweichende Meinung,*

<sup>142</sup> *Rousseau, Social Contract, 1762, Vol.4, chapter 2 ; for a skeptical view on the wisdom of majority rule see Hayek supra p.176.*

<sup>143</sup> *Habermas, Faktizität und Geltung: Beiträge zur Diskurstheorie des Rechts und des demokratischen Rechtsstaats (Suhrkamp 1992) chapter VII; see also Dryzek, Discursive Democracy: Politics, Policy, and Political Science (Cambridge University Press), 1990; Bohman, Public Deliberation (MIT Press) 1996; for a critical view on this concept in the context of European decision-making see: Scharpf, De-constitutionalisation and majority rule: A democratic vision for Europe, 23 European Law Journal (2017) p.315 (327 et seq.).*

<sup>144</sup> *Lepsius*

<sup>145</sup> *Möllers*

<sup>146</sup> *Waldron, The Core of the Case Against Judicial Review, 115 Yale Law Journal (2006) p.1346 et seq.; Waldron, Judicial Review of Legislation, in: Marmor (Ed.), The Routledge Companion to Philosophy of Law, p.434 et seq.*

<sup>147</sup> *Supra p.111.*

within a society – are harder to manage and it would seem rather naïve to regard the outcome of a majority vote as a simple exercise in philosophical deliberations around a “common good” – given that nobody acts under a “veil of ignorance”<sup>148</sup>. This is one of the reasons why *Wicksell* pleaded for (nearly) unanimous consensus: He wanted to weed out those proposals, which do not seem to carry enough weight to be regarded as clear outflows of the common good. As this is a utopian approach, one has to think about material constraints to majority voting in fiscal matters.

## 9. Constitutional safeguards

### a) The English approach

To what extent does this situation require additional constitutional constraints to democratic tax legislation? The English approach traditionally rejects the notion of hard-wired substantive limitations to parliamentary legislation in the area of taxation.

Nevertheless, the 19<sup>th</sup> century saw a strong current among tax experts in Britain that some general “principles” of taxation had to be recognized as unwritten compulsory constitutional constraints in fiscal affairs. As historian *Chantal Stebbings* has shown, the then growing impact of the central government’s powers in the area of tax administration was heavily criticized by contemporaries. In particular the introduction of inquisitorial procedures and the shift of tax collection from local lay commissioners to central authorities were regarded to be “unconstitutional”. The main argument was that these intrusions into the taxpayer’s sphere were not covered by the “real” or “true” consent of the taxpayer<sup>149</sup>.

This argument ran into the problem that it insinuated a double meaning for the word “consent”. According to the critics, the approval of the Government’s action by a majority of Members of Parliament would not be sufficient to substitute for “real” consent by the taxpayers. But this double notion of consent did not meet with much favor as the paramount Sovereignty of Parliament had been widely accepted in England at this point in time. Moreover, given that there was and is no written constitution under English law, it was hard to transform the constitutional resentment of a fair number of taxpayers against modern intrusions of the taxing State into hard-wired obstacles to legislation.

Taking a closer look, one cannot help but state that the institutional framework of the United Kingdom seems to adhere to the counterfactual fiction that Parliament is not identical and not synchronized with the government and that it is the foremost obligation of Parliament to protect the interest of the citizenry vis-à-vis the Queen and Her Government. This *Lockean* theory of the Parliament’s role has been preserved in some time-honored customs like the introductory preamble to the annual UK Finance Act, which to this day clarifies the

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<sup>148</sup> *Schön*, Grundrechtsschutz gegen den demokratischen Steuerstaat, JöR 2016.

<sup>149</sup> *Stebbing*s, Consent and Constitutionality in Nineteenth-Century English Taxation, in: *Tiley* (Ed.), *Studies in the History of Tax Law*, Vol.3 (Oxford and Portland: Hart), 2009, p.293 et seq. (312 et seq., 320 et seq.).

voluntary character of any tax as a gift by the people to the Monarch<sup>150</sup>. Moreover, some major taxes like the income tax have to be formally re-confirmed under each annual Finance Act for the following fiscal year, otherwise they might simply expire<sup>151</sup>. But this traditional language cannot conceal the political fact that the British Parliament has the power to set its own political agenda and to pursue its will with full force – as several governments have shown in the course of the 20<sup>th</sup> century.

Therefore, it remains a puzzle why there has never been in England a political or legal movement to limit the taxing power of Parliament by means of constitutional law, given the fact that for more than 100 years the sovereignty of the House of Commons in fiscal matters has been more or less completely unrestrained. The reason might lie not only in the lack of a written constitution and a strong belief in Parliament's sovereign power, but also in historical, social and political peculiarities of the United Kingdom where political parties and voters have been more cautious of increasing the tax burden and empowering the state than on the Continent. As early as 1912, German economist *Adolph Wagner* was amazed by the fact that the leading political parties in Britain consistently competed in general elections by offering tax reductions<sup>152</sup>. From a broader perspective, Cambridge historian *Martin Daunt* has shown that during the time period between the Napoleonic Wars and the First World War, the share of the public sector in the overall economy in Britain gradually went down as opposed to developments on the Continent<sup>153</sup>. Thus, it may well be that in England, during that formative period, taxpayer protection was effectively ensured by the political process and widely shared economic principles, not by hard and fast constitutional rules.

But as history has also shown, the United Kingdom – along with the United States – has seen the highest volatility as regards the top marginal tax rate on personal income during the 20<sup>th</sup> century<sup>154</sup>. Political scientists have traced this imbalance back to the the “highly unstable tax structure” brought about by the “centralized single-member, first-past-the-post electoral system”<sup>155</sup>. On this basis, the post-war years have seen an unprecedented tax burden on the British economy for many decades before both conservative (*Margaret Thatcher*) and labour-led (*Tony Blair*) governments reconfirmed the British consensus to reduce rather than to increase the tax burden of the people. Once a truly left-leaning government comes to

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<sup>150</sup> “*WE, Your Majesty's most dutiful and loyal subjects, the Commons of the United Kingdom in Parliament assembled, towards raising the necessary supplies to defray Your Majesty's public expenses, and making an addition to the public revenue, have freely and voluntarily resolved to give and to grant unto Your Majesty the several duties hereinafter mentioned; and do therefore most humbly beseech Your Majesty that it may be enacted, and be it enacted by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:*”

<sup>151</sup> Part 1 no.1 Finance Act 2017: “*Income tax is charged for the tax year 2017-18.*”; see also Art.100 Constitution of the Grande Dukedom of Luxemburg;

<sup>152</sup> *Wagner/Deite*, Finanzwissenschaft, Vol.III. Spezielle Steuerlehre, 2<sup>nd</sup> Ed., 1912, §108, p.7 et seq.

<sup>153</sup> *supra*, p.65.

<sup>154</sup> See the statistical findings in: *Scheve/Stasavage supra* p.57.

<sup>155</sup> *Steinmo/Tolbert supra* p.171.

power in England, there will be hardly any constitutional constraints to their willingness to move to a new fiscal paradigm.

## b) The U.S. approach

The United States is a special case. While many areas of public policy have been subject to constitutional debate and “judicial activism” at the level of the Supreme Court, we find a high degree of judicial deference to the political decisions taken by Congress and State legislatures in fiscal matters<sup>156</sup>. Chief Justice *Marshall*’s famous dictum that “the power to tax is the power to destroy”<sup>157</sup> might have been mitigated by later findings – most prominently by *Oliver Wendell Holmes*<sup>158</sup> – but the Justices of the Supreme Court have never developed as strong material limitations to tax legislation as their counterparts in continental Europe, e. g. under the Equal Protection Clause<sup>159</sup> or the Takings Clause<sup>160</sup>. Even the Uniformity Clause which forces the Federal legislator to ensure equal treatment among taxpayers from different States has never been developed into an overarching principle of tax equality<sup>161</sup>.

The most prominent hard-wired constraint to federal and state tax legislation stems from the division of fiscal competences between the States and the Federation, which the Supreme Court has employed to limit federal and state taxing powers on many occasions<sup>162</sup>. To give two examples: At the end of the 19<sup>th</sup> century the Supreme Court declared a federal progressive income tax unconstitutional as it did not comply with the constitutional requirement to “apportion” the tax burden equally among the States<sup>163</sup>, and the U.S. Constitution had to be changed by the Sixteenth Amendment in 1913 to provide a legal basis for today’s federal income tax. State legislators, on the other hand, have to comply with constitutional limitations of their competences as well, in particular under the “dormant commerce clause”

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<sup>156</sup> *Bittker*, Constitutional Limits on the Taxing Power of the Federal Government, 41 *The Tax Lawyer* (1987) p.3 – 12; *Ackerman*, Taxation and the Constitution, 99 *Columbia Law Review* (1999) p.1 et seq.

<sup>157</sup> *McCulloch v. Maryland* 17 U. S. 316 (427).

<sup>158</sup> *Panhandle Oil Company v. Knox* 277 U.S. 218 (1928) at p.223: „*The power to tax is not the power to destroy while this Court sits.*“

<sup>159</sup> See the U. S. Supreme Court’s recent statement in *Armour v. City of Indianapolis* 132 S.Ct. (2012) 2073 per Justice Breyer: „*And we have repeatedly pointed out that “[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes.*“ *Regan v. Taxation With Representation of Wash.*, 461 U. S. 540, 547 (1983); see also *Fitzgerald v. Racing Assn. of Central Iowa*, 539 U. S. 103, 107–108 (2003); *Nordlinger v. Hahn*, 505 U.S. 1, 11 (1992); *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U. S. 356, 359 (1973); *Madden v. Kentucky*, 309 U. S. 83, 87–88 (1940); *Citizens’ Telephone Co. of Grand Rapids v. Fuller*, 229 U. S. 322, 329 (1913).“; for a comparative account of the principle of equality in the United States and in Germany see: *Barker*, The Three Faces of Equality: Constitutional Requirements in Taxation, 57 *Case Western Reserve Law Review* (2006) p.1 – 53.

<sup>160</sup> *Brushaber v. Union Pacific R.R.* (1916) 240 U.S. 1 (24 – 25); *Kades*, Drawing the Line Between Takings and Taxation: The Continuous Burdens Principle, and Its Broader Application, 97 *Northwestern University Law Review* (2002) p.189; for a more forceful use of the takings clause in fiscal matters see *Epstein supra*.

<sup>161</sup> *Bittker supra* (citing *Knowlton v. Moore* U.S. 41 (1900) which declared a progressive inheritance tax to comply with the Uniformity Clause).

<sup>162</sup> *Ackerman supra* (regarding the constitutional limitations on “direct” Federal taxes).

<sup>163</sup> *Pollock v. Farmers’ Loan & Trust Company*, 157 U.S. 429

which has been employed to strike down tax legislation in a multitude of cases<sup>164</sup>. One might fairly say that the constitutional allocation of taxing powers between the Federation and the States establishes some indirect safeguards for the taxpayers as well, but this seems to be rather a collateral effect and not an outright goal of this constitutional framework.

Overall, one gets the impression that similar to the institutional set-up in the United Kingdom, under the U.S. Constitution, Congress regards itself to be a representative body defending taxpayers against the executive branch. When Chief Justice *Marshall* declared the power to tax to be “the power to destroy” in 1819 he simultaneously expressed an optimistic view as to this dimension of representative democracy:

*„The people of a State, therefore, give to their Government a right of taxing themselves and their property, and as the exigencies of Government cannot be limited, they prescribe no limits to the exercise of this right, resting confidently on the interest of the legislator and on the influence of the constituent over their representative to guard them against its abuse.“<sup>165</sup>*

This approach makes the political process but also specific instruments like a “government shutdown” much more important than substantive limitations to the State’s power to tax its own citizens. And it may well be – as recent studies have tried to show - that in the United States there exists a relatively stable antipathy among the electorate against “taxing the rich”<sup>166</sup>. But even in the United States some scholars have expressed doubts as to the long-term viability of these political arrangements<sup>167</sup>. They propose that basic principles in taxation should be linked to individual rights and liberties under the Constitution. This is the direction constitutional law has tried to take in Germany and many other European and Latin American countries.

### **c) The German approach**

German constitutional thinking does not start from the assumption that the fiscal powers of the *Bundestag* act as a shield against the executive branch’s fiscal outreach. Rather, the *Bundestag* is in full control of the Government – the Federal Chancellor and the Cabinet being responsible to and dependent on the trust of the Parliament. Tax legislation, once it has been established, will remain in force until the *Bundestag* decides to amend and change its text, but there is no need to re-introduce the legal basis for taxation each and every year. Parliament is seen as the supreme source of stately power and not as a counterweight to the exercise of stately power by the other branches of government.

Against this background it is interesting to note that in the context of the German tradition, constitutional protection of the individual taxpayer has emerged as a fundamental element

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<sup>164</sup> *Knoll/Mason*, The Economic Foundation of the Dormant Commerce Clause, 102 Virginia Law Review (2017) p.309 et seq.

<sup>165</sup> *McCulloch v. Maryland* supra p.428.

<sup>166</sup> *Scheve/Stasavage* supra p.210 et seq.; *Scheve/Stasavage*, Wealth Inequality and Democracy, 20 Annual Review of Political Science (2017) p.451 – 468 (p.463 – 464).

<sup>167</sup> *Supra*

of the finely-tuned balance between the individual and the State. In Germany, Parliament – or: The People - have assumed the role of the Monarch, and it is one of the basic features of Germany’s constitution, that citizens have to be protected against overreaching fiscal claims by relying on the fundamental rights enshrined in the Basic Law – notwithstanding the fact that the People’s representative is the source of fiscal legislation.

In this context, the application of the fundamental rights in the area of taxation is meant to fulfil two purposes: It is meant to protect minorities against the overwhelming interest of the majority and against self-serving coalitions between different stakeholder groups within the citizenry. It is also meant to strike down illegitimate tax benefits awarded to powerful pressure groups – building on the earlier tradition of banning fiscal privilege. In such a system, the material principle of equality complements democratic decision-making. It fights tax privilege for the rich as well as special charges on individual economic actors and groups<sup>168</sup>.

It is not possible to address all constitutional facets and implications of tax equality in this article<sup>169</sup>. It is not even clear to what extent redistribution of wealth by tax means simply follows from the principle of equality or whether it requires specific implementation and justification at a separate level<sup>170</sup>. But one thing is clear: The principle of equality does not pre-ordain the structure and the scope of any tax system. It leaves a lot of leeway to the legislator to decide on the types of taxes, the definition of the tax base and the setting of the tax rates.

One of the most relevant aspects of this constitutional framework concerns the progressivity of tax rates in the area of the income tax, the net wealth tax or the inheritance tax - the issue of “vertical equality”. To what extent does the principle of equal treatment prohibit steep surges as regards the tax rate? In Europe, there exists some constitutional jurisprudence in this area. In France, a special income tax rate of 75 % on income exceeding 1 million € was declared unconstitutional in 2012 by the *Conseil Constitutionnel* but a later version got green light in 2013<sup>171</sup>. Nevertheless, while the *Conseil Constitutionnel* validated the marginal tax rate of 75 %, the *Conseil* hit the brakes as some items of financial income were subject to an overall tax burden of more than 90 % which it found to violate the “ability-to-pay principle” enshrined in the French Constitution<sup>172</sup>. In Switzerland, as early as 1973 the Federal Tribunal found some elements of a cantonal wealth tax unconstitutional as progressivity was used to an extent which applied marginal tax rates of up to 250 % to certain tax brackets<sup>173</sup>. The German Constitutional Court raised the issue in 2006 in a general fashion (when it discarded the “half-income limitation” under the Basic Law’s property clause) and admonished the

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<sup>168</sup> Schön, FS Spindler, 2011

<sup>169</sup> Musgrave supra, chapter 4, p.61 et seq., and chapter 5, p.90 et seq.

<sup>170</sup> Osterloh-Konrad, Zur Legitimation steuerlicher Umverteilung, Steuer und Wirtschaft (2017) p.305 et seq.

<sup>171</sup> Decision no 2012-662 DC du 29 Décembre 2012 para 12 – 22.

<sup>172</sup> Decision no 2013-684 DC du 29 Décembre 2013 para 31 – 33.

<sup>173</sup> Schweizer Bundesgericht, Urteil v. 20<sup>th</sup> July 1973 BGE 99, p.638 (656).

legislator not to introduce overly steep progressivity for income taxation<sup>174</sup>. The issue may reach the courts in Germany quite soon again as the newly formed German coalition government has agreed to scrap the so-called “solidarity surcharge”<sup>175</sup> on the income tax for 90 % of taxpayers. It will remain in force only for the upper 10 % - a strange and novel application of the notion of “solidarity”<sup>176</sup>.

On the other hand, the issue of special tax benefits – privilege – has not gone away since the days of the French Revolution. As current political practice shows, tax privilege today takes the form of intended or unintended “tax incentives”, most prominently tax breaks for business income or business assets. From a constitutional background this leads to the problem of the legitimacy of pursuing non-tax goals in fiscal legislation: The most prominent case in recent years, where the overall problem became highly visible, concerned inheritance taxation as reformed in 2008. This legislation combined two main deficiencies where material principles of taxation and the legitimating power of democracy clash<sup>177</sup>. On the one hand, the *Bundestag* decided to establish generous tax-free thresholds which exempted 90 % of the country’s citizens and rendered inheritance taxation to become a residual tax. On the other hand, rich business-owners (in particular family businesses), being a formidable pressure group in German politics, succeeded in lobbying for large-scale tax exemptions for business owners. In the end, neither the large majority of low-wealth voters nor the special-interest group of super-rich business owners contributed a meaningful amount to the revenue from inheritance tax, which fell upon a small residual constituency of high-income professionals owning investment assets but not business assets.

Following the principle of equal treatment, the Constitutional Court urged in 2014 the German legislator to limit the extent of tax breaks for business gradually but the Court did not dare to challenge the underlying policies in a fundamental fashion<sup>178</sup>.

This jurisprudence shows both the glory and the weakness of constitutional constraints as applied to democratic tax legislation. It sets general standards but it cannot (and should not) fully pre-empt parliamentary decision-making. So far the experience has been a mixed one: it has prevented excessive tax legislation and arbitrary distinctions to a certain degree but it was not able to fend off powerful majorities and minorities in all respects.

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<sup>174</sup> Bundesverfassungsgericht

<sup>175</sup> The solidarity surcharge („*Solidaritätszuschlag*“) had been introduced in 1990 to finance the cost of German re-unification. It has remained in place for more than 25 years. Multiple attempts to have it struck down by the Constitutional Court have failed so far.

<sup>176</sup> „Ein neuer Aufbruch für Europa - Eine neue Dynamik für Deutschland - Ein neuer Zusammenhalt für unser Land: Koalitionsvertrag zwischen CDU, CSU und SPD - 19. Legislaturperiode“, February 2018, p.68

<sup>177</sup> Schön, *Wieviel Erbschaft gehört dem Staat?*, Frankfurter Allgemeine Zeitung 2015.

<sup>178</sup> Bundesverfassungsgericht

### III. Tax, citizenship, and residence – the international dimension

#### 1. Residence taxation and the “mismatches” between taxation and representation

Given the amount of theoretical thinking and political argument that has been devoted to the interaction between taxation, democracy and citizenship one should assume that citizenship is a prominent element in designing tax laws around the world, in particular with respect to its international dimension. This line of thinking is corroborated by international customary law, which does not constrain a country’s right to tax its own citizens wherever they live<sup>179</sup>. Reality looks different: Citizenship has become largely irrelevant for (international) tax policy and has been replaced by concepts of residence and territoriality<sup>180</sup>. To be more specific: Under most income tax laws, only (but all) residents are subject to worldwide taxation irrespective of their nationality while non-residents are only taxable with respect to their income sourced in the taxing jurisdiction<sup>181</sup>. Solely the United States<sup>182</sup> and Eritrea<sup>183</sup> strictly (but not exclusively) adhere to worldwide taxability on the basis of nationality. Similar frameworks have emerged for other types of direct taxes like net wealth taxation and inheritance taxation, although the notion of nationality plays a somewhat bigger role with respect to the latter one. Given the fact that migration and globalization have led to a substantial number of people living outside their country of citizenship it has become a natural and widely observed pattern that personal taxability has become disconnected from citizenship both in the legal sense and as an economic and social reality. Indirect taxes like the nearly omnipresent value added tax and specific consumption taxes never carried any link to the citizenship of suppliers or consumers as a personal quality – these taxes are traditionally levied on the basis of the territorially delineated consumption of goods and services.

The first conclusion we can draw from this fiscal framework is that in the international situation the notion of “congruence” or “equivalence” of the people who pay the tax, who vote on the tax and who benefit from the tax does not hold. Citizens of a country might live abroad and are largely free of tax in their home country but still retain the right to vote. Vice versa, many people live in countries as resident aliens where they are subject to unlimited tax liability without having any say in the way revenue is raised and spent (but they may

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<sup>179</sup> Schön, *Persons and Territories*, British Tax Review, 2010.

<sup>180</sup> For „accidental Americans“, even the compatibility of citizenship taxation with international customary law has been challenged recently (*Christians*, *A Global Perspective on Citizenship-Based Taxation*, 38 Michigan Journal of International Law (2017) p.193 (226 et seq.).

<sup>181</sup> Ault/Arnold, *Comparative Income Taxation*, 3<sup>rd</sup> Ed. (Kluwer) 2010, p.431 et seq.

<sup>182</sup> Treas. Reg. § 1.1-1(a)(1) (2015) (“Section 1 of the Code imposes an income tax on the income of every individual who is a citizen or resident of the United States”); id. § 1.1(b) (“All citizens of the United States, whether resident, ... are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States”).

<sup>183</sup> This practice has been criticized by the UN Security Council as Eritrea uses “extortion, threats of violence, fraud and other illicit means” to enforce their “diaspora tax” (Resolution 2023 (2011) adopted at its 6674<sup>th</sup> meeting, on 5<sup>th</sup> December 2011, para 11).

benefit from it). The outcome is a “mismatch between territorial and membership boundaries”<sup>184</sup>. Both the “outbound” and the “inbound” situation deserve a closer look.

## 2. Citizens abroad – representation without taxation?

The first issue concerns out-of-country voting. Is it possible – or even legitimate – to link voting rights for citizens to taxability in the country of citizenship? This is not a problem for a country like the United States, as U.S. citizens are both subject to unlimited tax liability and entitled to vote in U.S. federal elections wherever they live<sup>185</sup>. But countries, which do not exercise their right to tax their expatriate citizens, have to address the question of whether these expatriates should have voting rights or not.

State practice varies hugely in this area. In a 2011 report<sup>186</sup>, the *European Commission for Democracy through Law* (“Venice Commission”) laid out that there is no uniform model in place. Many countries sustain voting rights without limitation irrespective of residence (France, Portugal or Switzerland). Other countries award the franchise only to people living inside their home country and grant exceptions from this rule specifically to foreign-based diplomatic and military personnel (Ireland, Israel). Most countries apply some middle-of-the-road concept. In Germany voting rights typically expire 25 years after taking foreign residence, and the United Kingdom applies a similar statute of limitation of 15 years – as many British citizens learned the hard way when they were denied a vote in the *Brexit Referendum* in June 2016, a measure upheld by British courts<sup>187</sup>.

The most interesting feature of this issue lies in the fact that while the overall political momentum goes into the direction of a generous admission of out-of-country voting<sup>188</sup>, the courts have sustained legal constraints on expatriate voting rights all over the place. Neither the European Court of Human Rights<sup>189</sup> nor the European Court of Justice<sup>190</sup> have forced their Member States to extend voting rights to citizens living abroad, and the same has been confirmed by domestic courts<sup>191</sup>. It has been largely accepted that there must be some

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<sup>184</sup> *Bauböck*, Political Membership and Democratic Boundaries, in: *Shachar/Bauböck/Bloemraad/Vink* (Ed.), *The Oxford Handbook of Citizenship* (OUP) 2017, p.60 et seq.

<sup>185</sup> For a recent account and critical assessment of U.S. worldwide taxation on the basis of citizenship see: *Mason*, *Citizenship Taxation*, 89 *Southern California Law Review* (2016) p.169 et seq.

<sup>186</sup> *European Commission for Democracy through Law (Venice Commission)*, Report on Out-of-Country Voting, adopted by the Council for Democratic Elections at its 37th meeting (Venice, 16 June 2011) and by the Venice Commission at its 87th plenary session (Venice, 17 – 18 June 2011) on the basis of comments by Ms Josette Durrieu (Expert, France) and Mr László Trócsányi, Substitute Member, Hungary).

<sup>187</sup> *Shindler and MacLennan v. Chancellor of the Duchy of Lancaster and Secretary of State for Foreign and Commonwealth Affairs* [2016] EWHC 957, *Divisional Court* 28 April 2016.

<sup>188</sup> *Supra* (Venice Commission), para 92; *Bauböck supra* p.70; *Bauböck*, Stakeholder Citizenship and Transnational Political Participation: A Normative Evaluation of External Voting, 75 *Fordham Law Review* (2007) p.2393 et seq. (p.2399 et seq.).

<sup>189</sup> *Doyle v The United Kingdom* (2007) 45 EHRR SE3; *Shindler v The United Kingdom* (2013) 58 EHRR 9; for a critical assessment of this jurisprudence see *Lappin*, *The Right to Vote for Non-Resident Citizens in Europe*, 65 *International and Comparative Law Quarterly* (2016) p.859 et seq.

<sup>190</sup> Case 300/04 *Eman and Sevinger* (2006) ECR I-8055 para 54 – 55.

<sup>191</sup> *R (Preston) v. The Lord President of the Council* (2012) EWCA Civ 1378.

leeway for national legislators to decide when the link between a person and his home country has become so tenuous and weak that he or she is not sufficiently affected by and knowledgeable about the political decisions taken at home.

The most recent *cause célèbre* in this field is *Frank v. Canada (Attorney General)*, a case currently pending with the Supreme Court of Canada on this country's 1993 elimination of expatriate voting rights (becoming effective five years after a citizen's emigration). In 2015, in a judgment of the Court of Appeal for Ontario<sup>192</sup>, the majority of judges rejected the view that this limitation infringes upon Art.3 of the "Canadian Charter of Rights and Freedoms", which grants each Canadian citizen the right to vote. Their reasoning goes directly back to the contractarian views of the State as promoted by *Locke* and *Rousseau*:

"(5) ... *The electorate submits to the laws because it has had a voice in making them. This is the social contract that gives the laws its legitimacy. (6) Permitting all non-resident citizens to vote would allow them to participate in making laws that affect Canadian residents on a daily basis, but have little to no practical consequence for their own daily lives. **This would erode the social contract and undermine the legitimacy of the laws.***"

"(74) *Adding a layer to citizenship, residence and physical presence can have an important influence on the rights and obligations of Canadians. For instance, residence is a requirement for entitlement to full health coverage and social assistance in Ontario. Similarly, only resident citizens can be compelled to serve on a jury. **Residents, whether citizens or not, pay the full array of taxes that support government programs.** Most important, only residents are regularly required to obey domestic Canadian laws. (...).*"

In a dissenting vote, this line of reasoning was heavily criticized by one judge, mostly with regard to the fact that the main point of the "social contract" had never been made by Parliament when the law was enacted in 1993<sup>193</sup>. Moreover – the dissenting judge explicitly wrote – a theory that was developed around 200 years ago by *Rousseau* and *John Stuart Mill* didn't seem to capture the modern and ever-expanding notion of enfranchisement as an outflow of equality and inclusiveness<sup>194</sup>.

Be this as it may – the question remains whether it makes sense to enable those who do not pay the tax to decide on its levying and on its spending. One might even ask whether constitutional principles are infringed upon if citizens living abroad gain a decisive vote in fiscal matters<sup>195</sup>?

Weighing the options, it makes sense to accept the current state of the art. Firstly, also for resident citizens, their right to vote does not depend on their current financial contributions to the public coffers (as was the case to a large extent in the 19<sup>th</sup> century)<sup>196</sup>. Moreover, in a modern democracy, parliamentary elections are not only about taxing and spending but they

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<sup>192</sup> *Frank v. Canada (Attorney General)* 2015 ONCA 536.

<sup>193</sup> *Laskin J.A. (dissenting)* at 196 et seq.

<sup>194</sup> *Supra* para 235.

<sup>195</sup> *López-Guerra, Should Expatriates Vote?*, 13 *Journal of Political Philosophy* (2005) p.216 et seq.

<sup>196</sup> *Bauböck supra* p.2413; *Lappin supra* p.881.

affect many more long-term aspects of social, economic and political life. A citizen resident abroad who doesn't pay tax on a current basis still has the fundamental right to return to the country in the future and might be affected by other decisions taken today by the institutions acting on behalf of his country of citizenship – matters of foreign policy, international trade, military activities etc. These foreign resident citizens are – to quote *Bauböck* – “stakeholders in the future of the political community”. As long as one cannot exclude that foreign resident citizens have to bear the effect of these decisions in the long run it seems legitimate (but not mandatory) to award them the right to vote in domestic elections.

### 3. Resident aliens – taxation without representation?

#### a) Why tax foreigners?

The complementary feature of the international tax order is the light-heartedness, which most countries apply when they tax foreign nationals who are resident within their jurisdiction. Unlike taxpayers living outside a jurisdiction, those resident aliens are not only liable to tax with their territorially sourced income and local assets but with their worldwide income and net wealth. A New York lawyer who has been assigned to a German law firm for two years will find out that she has to pay tax in Germany not only on her income generated in Germany but also on her income derived from sources in third countries or her home jurisdiction. This is state of the art in most countries, confirmed by a multitude of double taxation treaties (see Art.4 par.1 and par.2 OECD Model Tax Convention) and hardly constrained by international customary law<sup>197</sup>.

This leads us back to where we started out. Why are people obliged to pay tax? Assuming firstly that the State as such is justified and has to be funded and assuming secondly that the State is entitled to exercise its jurisdiction over all persons and assets present on its territory, the resident alien will not have any right to reject the tax claim out of hand. Territorial “raw force” is still very much alive in this case. As *Ely* put it back in 1888:

*“The element of might also undoubtedly enters into taxation, and the mere fact that a foreigner is so situated that he can be forced to contribute to the expenses of government is at times held to be sufficient reason for placing a tax upon him.”*<sup>198</sup>

While this statement is certainly true to this day as regards the constraints applied to the taxation of foreigners under international customary law<sup>199</sup> one still has to think about material justifications for taxation under philosophical and constitutional aspects. Why should – to borrow from *Jeremy Waldron* – a resident alien regard a country to be “my country” in terms of fiscal sacrifice<sup>200</sup>? And how should domestic tax law address – as *Daniel Shaviro* has put it – the fundamental necessity to distinguish between “us” and “them” when it comes to

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<sup>197</sup> *Ault/Arnold supra* (note x).

<sup>198</sup> *Ely supra* p.9.

<sup>199</sup> International law only requires some “genuine link” between the taxpayer and the taxing state which is easily given when the state

<sup>200</sup> *Waldron, Special Ties and Natural Duties*, 22 *Philosophy & Public Affairs* (1993), p.3 (at p.5 et seq.).

delineate the body of “potential community members”<sup>201</sup>, who deserve to be subjected to taxation of worldwide income. Taking account of international legislative practice, *Shaviro* expresses no doubt that resident aliens belong to that group<sup>202</sup>. But he also exposes the ambiguous character of this mixed blessing conferred upon alien residents - who are awarded by the legislator the honor to be taxed more harshly than foreigners residing abroad.

In this respect, it is interesting to learn how unlimited taxation of resident aliens has developed over time<sup>203</sup>. During the 19<sup>th</sup> century, taxability was typically linked to nationality in the same vein as military service which could only be expected from nationals<sup>204</sup>. Foreigners were taxable on their locally derived income and assets but could become subject to unlimited liability after a certain period of time. This primary orientation on citizenship was still present in 1923, when the famous “Four Economists” (led by *Seligman*), in their highly influential report on international tax policy for the League of Nations, pointed out that

*“when we deal with the question of personality, we are confronted by the original idea of personal political allegiance or nationality”*<sup>205</sup>.

In a similar vein, Art.134 of the 1919 Constitution of the Weimar Republic provided that

*“all citizens, without any difference, are obliged to contribute to the public weal according to their means”*.

But this traditional approach, which linked taxability to nationality, was soon regarded as overly narrow and misleading<sup>206</sup>. One did not see any reason why resident foreigners, who benefit from public goods in their country of residence and who compete with local citizens in the economy should not bear the full burden of the public financial needs<sup>207</sup>. Against this background, taxation of residents was more and more modeled on the tax treatment of citizens<sup>208</sup>. Since the 1920s, citizenship taxation retreated to the background internationally and residence taxation took center stage. A review of the literature shows that the old paradigm has been destroyed so thoroughly that renowned scholars both inside<sup>209</sup> and outside<sup>210</sup> the

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<sup>201</sup> *Shaviro*, Taxing Potential Community Members, 70 Tax Law Review (2016) p.75 (at 89 et seq.)

<sup>202</sup> *Supra* p.75 and 91 et seq.

<sup>203</sup> *Schön*, Persons and Territories: on the International Allocation of Taxing Rights, in: British Tax Review (2010) p.22 et seq (23 et seq.).

<sup>204</sup> *Isay*

<sup>205</sup> League of Nations Economic and Financial Commission (Bruins, Einaudi, Seligman and Stamp), Report on Double Taxation: Document E.F.S. 73 F 19; April 5, 1923, Part II 1 a.

<sup>206</sup> *Anschütz*, Die Verfassung des Deutschen Reichs vom 11. August 1919, 14<sup>th</sup> Ed. Berlin 1933, Art.134 WRV par.1; *Colquhoun v. Brooks* (1889) 2 TC p.490 et seq. (499).

<sup>207</sup> Deutscher Juristentag 1925.

<sup>208</sup> *Edwin R. Seligman*, Essays in Taxation (Norwood Mass. USA: Norwood Press, 1905) p.117; *Bühler*, Prinzipien des Internationalen Steuerrechts (Amsterdam: IBFD) 1964, p.161 et seq.

<sup>209</sup> *Zelinsky*, Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile, 96 Iowa Law Review (2011) p.1289 ( at p.1291).

<sup>210</sup> *Vann*, International Aspects of Income Tax, in: Thuronyi (Ed.), Tax Law Design and Drafting (Washington D. C.: IMF, 1998) Vol.2 p.718 et seq (at 729 – 734).

United States now seem to regard citizenship as a “proxy” for residence in tax matters, thus turning the historical trajectory on its head.

Unlike most current writers, those scholars, who in the 19<sup>th</sup> century advocated the move away from a “contractual” and benefit-oriented approach to taxation towards an approach shaped by “membership” and sacrifice, clearly struggled with the fault line between taxation of citizens and taxation of resident aliens. *Ely*, who strongly dismissed the libertarian “contractual” view of taxation in the case of citizens, maintained it grudgingly for resident aliens:

*“Taxes on foreigners are justified on the ground that they must **derive some benefit from the existence of the government** taxing them, and in so far such taxes may be regarded as a payment for protection, **for it cannot be held that the duties of citizenship devolve upon foreigners.**”<sup>211</sup>*

The justification to tax aliens who are resident in a jurisdiction is indeed rather strong when applying the “benefit principle” which qualifies a tax as a consideration for the enjoyment of public goods<sup>212</sup>. It is less straightforward when one characterizes a tax as a sacrifice for the sake of a community to which the taxpayer belongs. If we were of the opinion that solidarity is only conceivable and enforceable within the community of citizens in a formal sense, alien residents could opt out or demand lower and other charges with good reasons. They might reject the application of a progressive tax rate on their overall income. Only if and insofar as they enjoy the output of domestic institutions – including benefits provided by the “welfare state” - they could be asked to pay their fair share<sup>213</sup>. But this is not a view that can be traced back to “patriotic affect and allegiance” within a “Nation”<sup>214</sup> as the traditional view would require.

This leads us to the question of whether one should – in the 21<sup>st</sup> century - move forward and re-conceptualize “solidarity” for fiscal purposes rather on the basis of territorial cohabitation than on the basis of political membership. From the perspective of political philosophy, this question has been put forcefully by *David Miller*:

*“If we speak of ‘countries’ as the sites of distributive justice, what does ‘country’ actually mean? Does it refer to a geographical territory, a nation, a state, or all of these at once?”<sup>215</sup>*

To my knowledge, this question hasn’t been examined and answered conclusively in the past. Rather, both the political and the territorial element have been conflated. When *Rawls* discussed this matter in *“The Law of Peoples”*, he seems to have had in mind a “people” organized on a territorial basis – as this territory is essential in “supporting” their cooperative

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<sup>211</sup> *Ely* supra p.9.

<sup>212</sup> See the judgment of the House of Lords in *Whitney v. IRC*, 10 TC 88 at 112 (per Lord Wrenbury).

<sup>213</sup> *Waldron* p.16.

<sup>214</sup> *Waldron* p.19.

<sup>215</sup> *Justice for Earthlings*, p.143.

endeavors “in perpetuity”<sup>216</sup> - but he did not address the situation of resident aliens explicitly. *Michael Blake* accepts the Rawlsian view but remains unclear as well:

*“The criteria for membership within the group of people entitled to justification through principles of liberal justice, on my account, is membership as a citizen within the territorial state.”*<sup>217</sup>

We will not solve in this article the fundamental issue of delineating “membership” in a polity as its ramifications go far beyond fiscal matters<sup>218</sup>. But we can address the question of whether the current technical concept of “residence” under domestic and international tax law works as a good proxy for belonging to a stable political or social community. This is not the case. As *Ruth Mason* has shown, the notion of taxable fiscal presence in a jurisdiction on the basis of residence covers as diverse cases as students studying abroad, corporate employees being assigned to a foreign subsidiary, permanent resettlers and “accidental” foreign citizens (who have acquired citizenship in their country of birth on the basis of *ius soli* but have never lived there and may not even know about their citizenship status)<sup>219</sup>. It is clear that the strength of the link between these groups and the local communities they live in varies hugely.

This overly broad scope of fiscal residence should lead us to the conclusion that the widely agreed standard threshold for unlimited taxation – six months of presence in a territory - does not meet the benchmark for social “integration” into a domestic community. If anything, the traditional English concept of “domicile” seems to be more adequate as it makes the tax status of a resident alien dependent on the missing intention of a taxpayer to return to her home country in the future<sup>220</sup>. Residence taxation as such only seems to be a legitimate fiscal tool on the basis of the benefit principle.

Therefore, the mere residence of a (foreign) person is and remains fundamentally different from citizenship as it denotes not a “personal” or a “political” but a merely “territorial” or “economic” concept which does not easily justify worldwide taxation<sup>221</sup>. Against this background, some jurisdictions have been more generous towards alien residents to this day as regards the taxation of foreign income, most prominently the United Kingdom, which has awarded major tax benefits to non-domiciled foreign residents for more than 100 years. These only have to pay tax on their worldwide income as far as this income is “remitted” to

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<sup>216</sup> *Rawls* supra p.38.

<sup>217</sup> *Blake*, *Distributive Justice, State Coercion, and Autonomy*, 30 *Philosophy & Public Affairs* (2002), p.257 – 296 (289).

<sup>218</sup> For a fully-fledged move from birthright citizenship to a citizenship based on residence see: *Stevens*, *State without Nations: Citizenship for Mortals* (New York: Columbia University Press) 2009, p.73 et seq.

<sup>219</sup> *Mason* supra p.196 et seq.

<sup>220</sup> *Booth & Schwarz*, *Residence, Domicile and UK Taxation*, 19<sup>th</sup> Ed. (Bloomsbury) 2016.

<sup>221</sup> *Schön* supra p.25; *Schön*, supra p.557; *Vogel*, *Über „Besteuerungsrechte“ und über das Leistungsfähigkeitsprinzip im Internationalen Steuerrecht*, Festschrift Franz Klein, Cologne, 1994, p.361; *Hensel*, *Steuerrecht*, 1924, p.50 et seq. speaks of a „personal-territorial“ link between the State and the resident taxpayer.

(and probably consumed on) the territory of the United Kingdom<sup>222</sup>. A similar regime is applied in Japan where “short-term residents” (up to five years) are only taxable on their domestic income<sup>223</sup>. Over time, more and more countries have decided to follow suit and to postpone the full effect of worldwide taxation as regards foreign nationals who move their residence to a new home jurisdiction<sup>224</sup>. Most recently, Italy introduced in 2017 a new tax regime which virtually waives worldwide taxation for a period of 15 years for taxpayers who relocate to Italy and who did not reside in Italy for at least 9 years of the 10 years preceding taking residence in Italy<sup>225</sup>. This shows that countries develop a more sophisticated approach to align unlimited tax liability with a stable material presence in a country not related to the formal criterion of citizenship.

### **b) Voting rights for non-national taxpayers?**

Starting from the current international practice that resident aliens are basically obliged to pay no less tax than domestic citizens – why shouldn’t they have the right to decide on how to raise and how to spend the tax? If one takes a wide view and subscribes to the thesis that voting rights should be in the hands of those individuals who are “affected by”<sup>226</sup> the State’s actions, it becomes obvious that resident aliens cannot be excluded easily – they contribute to the State’s funds and they benefit from the State’s public expenditure. The mere fact that they entered the State’s territory voluntarily and that they are free to return to their home country whenever they want may justify their obedience to domestic tax legislation<sup>227</sup> but not the denial of voting rights as such. The participation of resident aliens in the electorate can be based on the above-mentioned requirements of political economy to reinforce the “equivalence” or “congruence” of those who pay the tax, vote on the tax and enjoy the benefits of tax-funded programs<sup>228</sup>.

What does this mean for the delineation of the electorate? If one regards residence-based taxation as a form of quasi-citizenship taxation, the argument for voting rights is strong. But again, one should hesitate before going the full distance. National elections are not only about taxation and not only about the current year. They affect many elements of public life and the diversity of issues makes it hard to extend full electoral rights to people who are not formally members of the citizenry of a State. Moreover, it is – as has been laid out above -

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<sup>222</sup> It should be noted that when modern income tax was introduced to Prussia in 1892, representatives of the enjoyable Rhine Valley towns pleaded for a similar tax privilege for rich foreigners taking their retirement homes in Prussia; this was rejected by Minister of Finance *Miquel* on several occasions (*Mathiak*, *Das preußische Einkommensteuergesetz von 1891 im Rahmen der Miquelschen Steuerreform 1891/93* (Berlin: Duncker & Humblot), 2010, p.133 et seq. and 169.

<sup>223</sup> *Ault/Arnold supra* p.434.

<sup>224</sup> Sweden, Portugal, Spain.

<sup>225</sup> *Vanessa Holder*, Italy offers non-doms la dolce vita with tax breaks, *Financial Times*, 26th January 2017.

<sup>226</sup> *Ludvig Beckman*, *Citizenship and Voting Rights: Should Resident Aliens Vote?*, 10 *Citizenship Studies* (2006) p.153 et seq.

<sup>227</sup> For a similar argument see *Waldron supra* p.8-9.

<sup>228</sup> *Supra*

not easy to measure the level of integration of a taxpayer into the domestic society on polling day. Taking this line would also lead on a slippery slope. If we grant voting rights to each individual who is subject to substantial tax claims in a country in a given year, one would also have to think about voting rights for foreign taxpayers living abroad who – due to their domestic investment and the business carried on within a jurisdiction - happen to contribute substantially to the public sector. Moreover, as internationally active taxpayers tend to pay taxes in multiple states, issues of multiple voting rights would have to be solved as well. Therefore, it makes more sense to offer alien residents generous access to acquire citizenship and thus full electoral rights than to attribute voting rights on the basis of current tax payments.

### c) Tax equality for non-national taxpayers?

This brings us back to our original thesis that any lack in “consent” should be compensated for by “content”, in particular by the application of the principle of equal treatment<sup>229</sup>. Resident aliens who cannot influence tax legislation by “voice” should be protected by the principle that they are not subjected to a harsher tax burden than domestic citizens.

This outcome is not self-evident from a historical and comparative perspective. In 1930, *Albert Hensel*, one of the founding fathers of tax law scholarship in Germany, explicitly took the view that the constitutional protection of equality (championed by him in the field of domestic taxation) should only apply among the citizenry of a country while the tax burden to be applied to resident aliens should be left to the discretion of the national legislator<sup>230</sup>. This reflects a widespread attitude dating back to the 19<sup>th</sup> century and early 20<sup>th</sup> century that the principle of equality pertains only to the citizenry of a State.

Against this background, visible safeguards against tax discrimination of foreign nationals were first introduced by means of international law, in particular under the treaties on “friendship, commerce and navigation”, which provide for equitable treatment of nationals of the Contracting States by the other country’s authorities<sup>231</sup>. Countries like the United States, Japan and Germany made wide use of them since the late 19<sup>th</sup> century, including provisions securing “national treatment” in tax matters<sup>232</sup>. Today, non-discrimination of resident aliens is firmly established around the world under Double Tax Conventions (see Art.24 par.1 of the OECD Model Tax Convention). Most forcefully, European Union Law forbids any

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<sup>229</sup> *Supra*

<sup>230</sup> *Hensel*, *Verfassungsrechtliche Bindungen des Steuergesetzgebers: Besteuerung nach der Leistungsfähigkeit – Gleichheit vor dem Gesetz*, in: 4 Vierteljahresschrift für Steuer- und Finanzrecht (1930) p.441 et seq. (42 et seq.).

<sup>231</sup> *Paulus*, *Treaties of Friendship, Commerce and Navigation*, in: Max Planck Encyclopedia of Public International Law (opil.ouplaw.com), Article last updated: March 2011; See Art.VIII of the Treaty of Friendship, Commerce and Consular Rights between the United States of America and the German Empire ratified in 1925: *The nationals and merchandise of each High Contracting Party within the territories of the other shall receive the same treatment as nationals and merchandise of the country with regard to internal taxes (...).*“

<sup>232</sup> *Rust* in: *Klaus Vogel on Double Taxation Conventions* (Aalphen an den Rijn: Kluwer) 2015, Art.24 OECD Model Convention para 6.

discrimination in fiscal matters by Member States against citizens of EU Member States wherever they reside in Europe<sup>233</sup>. Buried underneath this heap of international agreements there remains the question whether equal treatment of resident aliens in tax matters should also be a requirement under domestic constitutional law?

Taking a step back it makes sense first to address the philosophical issue of whether and under which circumstances resident non-nationals should have a right to benefit from the binding principles of distributive justice established in a society. For the sake of clarity, this issue has to be disentangled from a much larger problem: the problem of international distributive justice. There is a major international debate on whether poor states (or poor people in other states) deserve to participate in cross-border transfers of wealth in order to establish social justice at the world level<sup>234</sup>. While “internationalists” like *Rawls*<sup>235</sup> and his followers, most prominently *Nagel*<sup>236</sup>, are quite restrictive on this issue and only plead for international “assistance” and “humanitarian” help<sup>237</sup> outside the domestic community, a group of “cosmopolitans” led by *Pogge*<sup>238</sup> have established the view that national boundaries following the concept of citizenship have become arbitrary and should be abandoned when matters of equality and social justice arise. This is an issue not addressed in this article.

Compared to this unresolved major issue of world politics, the adequate treatment of resident aliens seems to be a rather trivial exercise. But we can benefit from the larger debate to sort out the arguments which are put forward when the issue of equal tax burdens comes up.

Internationalists like *Thomas Nagel* start from the assumption that the application of social justice involves

*“putting the fellow citizens of a sovereign state into a relation that they do not have with the rest of humanity, an institutional relation which must then be evaluated by the special standards of fairness and equality that fill out the content of justice”*<sup>239</sup>

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<sup>233</sup> The main feature of the European development lies in the fact that the non-discrimination principle has been extended by the CJEU from non-discrimination of foreign citizens to non-discrimination of foreign residents, a consequence not taken under Double Taxation Conventions.

<sup>234</sup> For an overview see : *Blake/Smith*, International Distributive Justice, in: Stanford Encyclopedia of Philosophy, 2013 (plato.stanford.edu).

<sup>235</sup> *Rawls* supra p.117 et seq.

<sup>236</sup> *Nagel*, The Problem of Global Justice, 33 Philosophy and Public Affairs (2005) p.113 et seq.

<sup>237</sup> See also *Blake*, Distributive Justice, State Coercion, and Autonomy, 30 Philosophy and Public Affairs (2001) p.257 et seq.; *Miller*, National Responsibility and Global Justice, OUP, 2007; among tax lawyers, this distinction has been drawn forcefully by *Graetz*,

<sup>238</sup> *Pogge*, World Poverty and Human Rights, 2002; recently: *Brock/Pogge*, Global Tax Justice and Global Justice, 1 MOPP (2014) p.1 – 15; *Ronzoni*, Global Tax Governance: The Bullets Internationalists Must Bite – And Those They Must Not, 1 MOPP (2014) p.37 – 59; *Benshalom*, The New Poor at Our Gates: Global Justice Implications for International Trade and Tax Law, 85 New York University Law Review (2010) p.1.; *Dietsch/Rixen*, Tax Competition and Global Background Justice, 22 Journal of Political Philosophy (2014) p.150.

<sup>239</sup> Supra p.120.

Taking a closer look it is fair to say that “internationalists” who reduce the ambit of distributive justice to a limited group of “members” base this claim on a tripartite concept: distributive justice requires that a group is jointly under the control of a singular “coercive power”, that the members of this group share “co-authorship” in the underlying institutional arrangements, and that they engage in some “cooperative practice” as regards political and economic affairs<sup>240</sup>. It is then widely discussed to what extent people living in different countries can be subsumed under one overarching framework, e. g. as international trade relations or supranational institutions establish that kind of “global” community which gives rise to requirements of “global” social justice<sup>241</sup>.

For resident aliens the question is simpler: Can a claim for non-discrimination of foreign residents be built on the fact that they are subject to the same “territorial” coercive power of the domestic government and engage in the same “cooperative practice”, i. e. participate in the network of the domestic economy? Or does the claim for equal treatment require a further degree of political “membership” that would include voting rights or even – to refer to the above-mentioned undercurrent of solidarity within a Nation – “common sentiments”? Nagel seems to regard both elements to be relevant for social justice: both the “coercive” power of the government and the “co-authorship” of the law:

*“I submit that it is this complex fact – that we are both putative joint authors of the coercively imposed system, and subject to its norms, i.e., expected to accept their authority even when the collective decision diverges from our personal preferences – that creates the special presumption against arbitrary inequalities in our treatment by the system.”<sup>242</sup>*

*“Justice, on the political conception, requires a collectively imposed social framework, enacted in the name of all those governed by it, and aspiring to command their acceptance of its authority even when they disagree with the substance of its decisions.”<sup>243</sup>*

The latter argument runs into problems which become clearly visible in the case of the taxation of alien residents. While they do not participate in “political membership” as they are not entitled to vote, they are still under the same coercive power and subject to exactly the same tax burden as domestic citizens. And as long as “citizens and residents, in all but the most extreme cases, provide the financial and sociological support required to sustain the state”<sup>244</sup>, it would be hard to explain or even cynical to assume that resident aliens can be forced without constraints to make those “unrequited payments” to the State but cannot demand equal treatment by that State.

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<sup>240</sup> Blake, Global Distributive Justice: Why Political Philosophy needs Political Science, 15 Annual Review of Political Science (2012) p.121 (131).

<sup>241</sup> Cohen/Sabel supra

<sup>242</sup> Nagel, p.128-129.

<sup>243</sup> Nagel, p.140.

<sup>244</sup> Sangiovanni, Global Justice, Reciprocity, and the State, 35 Philosophy and Public Affairs (2007) p.3 (20).

This leads us to agree with the opinion expressed by *Michael Blake*, that “coercion, not cooperation, seems to be the *sine qua non* of distributive justice, making relevant principles of relative deprivation”.<sup>245</sup> Co-authorship in legislation is not required for the claim for equality.<sup>246</sup> It is rather “the shared subjection to a coercive state apparatus that makes for a morally relevant property that fellow citizens share.”<sup>247</sup> Under these circumstances, equality applies “among those who share in the provision of the basic collective goods required to develop and act on a plan of life.”<sup>248</sup>

How does constitutional law address this issue<sup>249</sup>? The traditional view has it that only citizens in the formal sense benefit from the principle of equality, as can still be found in many Constitutions, e.g. in Belgium and Luxemburg<sup>250</sup>. More specifically, Art.31 of the Spanish Constitution requires tax equality according to ability to pay for all those contributing to the public sector – but this is part of the general chapter on the rights of “citizens” and not addressed in the context of the fundamental rights available to everyone. The Swedish constitution explicitly extends a large part of the fundamental rights available for citizens to non-national residents as well – but in tax matters, the constitutional text only refers to equal protection against retroactive tax legislation<sup>251</sup>. In a more generous fashion, the principle of equal treatment laid down in Art.3 par.1 of the German Basic Law does not distinguish between citizens and foreigners<sup>252</sup>. And the Constitution of the Netherlands goes even further and explicitly provides equal treatment for “all persons in the Netherlands”<sup>253</sup> on a clearly territorial basis.

From a policy perspective, this is the line to take: In order to avoid any discrimination and exploitation of resident aliens being fully taxable in a jurisdiction but deprived of the right to vote, constitutional law should prohibit any specific tax burden due to foreign nationality<sup>254</sup>. As regards our starting points – the principle of “congruence” of voters, taxpayers and beneficiaries as well as the alternative between protection by “content” or “content” this outcome represents a compromise: Only domestic citizens are in the position to vote on fiscal

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<sup>245</sup> *Blake*, 2001, p.289; *Blake/Smith*, para 3.1.

<sup>246</sup> *Sangiovanni* supra p.14 et seq.

<sup>247</sup> *Risse*, What to say about the State?, 32 *Social Theory and Practice* (2006) p.671 (678).

<sup>248</sup> *Sangiovanni* supra p.38.

<sup>249</sup> For a comparative study see from the perspective of the U.S. see: *Cole*, Are Foreign Nationals Entitled to the Same Constitutional Rights as Citizens?, 25 *T. Jefferson Law Review* (2003) p.367 – 388.

<sup>250</sup> Art.10, 11 Constitution of the Kingdom of Belgium; Art.13 Constitution of Belgium.

<sup>251</sup> Chapt.2 Art.22 Constitution of Sweden.

<sup>252</sup> This point has been elaborated very clearly in: Bundesverfassungsgericht, Judgment of 22nd March 1983 2 BvR 475/78 BVerfGE 63, S.343 ff. (368 et seq., 371); see also Bundesverfassungsgericht, judgment of 18<sup>th</sup> July 2006 2 BvL 1, 12/04 BVerfGE 116, S.243 et seq.; Bundesverfassungsgericht, judgment of 7<sup>th</sup> February 2012 1 BvL 14/07 BVerfGE 130, p.240 (252 et seq., 258 et seq.).

<sup>253</sup> Art.1 s.1 Constitution of the Netherlands of 2008.

<sup>254</sup> *Cole* supra p.376; see also *John Hart Ely*, *Democracy and Distrust: A Theory of Judicial Review* (1980) p.161 et seq.

matters and these decisions also affect resident alien residents who are liable to tax on a territorial basis. But the electorate and its representatives are not allowed to abuse their voting rights to the detriment of that non-voting part of domestic society. The “content”-oriented principle of equality will take charge of those who are not entitled to make tax policy dependent on their “consent”.

#### IV. Tax competition – the “conscious uncoupling” of taxation and democracy?

##### 1. The mechanics of tax competition

The international dimension of taxation and democracy gains a completely different dynamic once we enter the field of tax competition.

The model is easily explained: Mobile taxpayers and mobile production factors are able to move with ease between tax jurisdictions. This is particularly true for high-skill or high-net-worth individuals and for financial and intangible capital while low-skill labor, sunk investment or land are rather immobile and stay put. According to the theory – and to some extent to the reality – of tax competition this enables mobile persons and mobile factors to exert pressure on local governments to provide a beneficial tax framework. Governments will feel obliged to recast their tax system and to lower the tax burden on those mobile persons and factors. Moreover, they will also reconsider the sheer size and the composition of the public sector, the efficiency of public spending and the scale of redistribution. The very concept of the social-welfare state comes under pressure<sup>255</sup>. This leads into *Rodrik’s* aforementioned “globalization trilemma”: Countries who want to participate in open markets for persons, goods, services, and capital (and countries being members of the European Union are obliged to participate in the Internal Market) will lose control of their domestic tax policy to a certain degree. This is viewed by many authors and political actors as a severe constraint on democratic decision-making<sup>256</sup>. Mobile taxpayers gain factual influence on the political process and its outcomes going far beyond their formal voting power.

The economics of tax competition has been one of the mainstays of public finance research for several decades now and shall not be reiterated in this article<sup>257</sup>. Moreover, we shall not delve into the heated debate on the merits of concepts like “harmful” tax competition<sup>258</sup> or

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<sup>255</sup> *Sinn*, The selection principle and market failure in systems competition, 66 *Journal of Public Economics* (1997) p.247 – 274; *Avi-Yonah*, Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State, 113 *Harvard Law Review* (2000) p.1573 – 1676; *Genschel*, Globalization, Tax Competition, and the Welfare State, 30 *Politics & Society* (2002) p.245 – 275.

<sup>256</sup> *Dietsch/Rixen*, Tax Competition and Global Background Justice, 22 *Journal of Political Philosophy* (2014) p.150 (156); *Ronzoni*, Global Tax Governance; *Bullets Internationalists Must Bite – And Those They Must Not*, 1 *Moral Philosophy and Politics* (2014) p.37

<sup>257</sup> *Keen/Konrad* supra note

<sup>258</sup> *OECD*, Harmful Tax Competition: An Emerging Issue, 1998; for the grounding of mutual obligations between States to follow certain rules of „sound“ tax competition in political philosophy see: *Christians*, Sovereignty, Taxation, and Social Contract, 18 *Minnesota Journal of International Law* (2009) p.99

the assessment of “aggressive” tax planning by multinational companies<sup>259</sup>. In this respect a growing consensus among states led by international and supranational bodies like the G20, the OECD and the European Union has outlawed some extreme tax-saving options like tailor-made preferential regimes or tax arrangements devoid of any economic reality. But this development has not fundamentally changed the playing field. Taking stock of the evolving international tax framework on harmful tax practices and international tax avoidance it remains undisputed that countries are still fundamentally free to define their tax bases and the applicable tax rates. They are in no way hampered to compete for outside investment and in particular to attract bona fide business activities. This is the background for the recent new wave of reductions of corporate tax rates by the current governments of major countries as the United Kingdom and the United States. Moreover, we see a growing tendency by countries to offer attractive tax packages to “Olympic citizens”<sup>260</sup>, high net-worth individuals and high-skilled labor<sup>261</sup>. Such tax reductions will force those generous governments either to shrink the public sector or to increase other taxes or to take on additional public debt – unless an upswing in the respective economy results in higher revenue by itself. These competitive moves are not only in line with international standards after the BEPS Action Plan implemented by the G20 and OECD and EU law requirements, they are also meant to put pressure on other governments – most notably on the Member States of the European Union - to adjust their fiscal policies.

What does this mean for the balance between a majoritarian democracy and individual rights in the tax area? The outcome is mixed: We observe both improvements and distortions of the democratic process on tax legislation.

## **2. Tax competition between exit, voice, and loyalty?**

### **a) Tax competition as a complement to voting rights and constitutional constraints**

The main thesis of this article laid out in the foregoing chapters – the mutual complementarity and interaction of “consent” and “content” as guiding lights for taxation in a democratic polity – can be applied in the context of tax competition as well. Theorists of tax competition have long emphasized the fact that the option of a mobile taxpayer – corporate or individual – to move out of a tax jurisdiction can be modeled following *Albert Hirschman’s* famous trinity of exit, voice, and loyalty<sup>262</sup>. A taxpayer, whose fiscal preferences can be suppressed by majority rule but who is not constrained by strong loyalty to her country, can use the exit route in order to escape adverse conditions in her home state – either by shifting her residence to another country or by moving her investment outside the jurisdiction.

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<sup>259</sup> *OECD*, Base Erosion and Profit Shifting.

<sup>260</sup> *Shachar*, Picking Winners: Olympic Citizenship and the Global Race for Talent, 120 *Yale Law Journal* (2011) p.2088 et seq.

<sup>261</sup> *Christians*, Buying In: Residence and Citizenship by Investment, *St. Louis University Law Journal* (forthcoming).

<sup>262</sup> *Dagan supra* p.38 et seq.

Learning from anecdotal evidence, it is fair to say that tax competition may fill a useful role in complementing protective devices of “content” and “consent”. This is due to the fact that there is an inverse relationship between the market power and the voting power of the involved constituencies<sup>263</sup>. It seems that those taxpayers who are sufficiently mobile to deliver a credible threat to shift their tax base to another jurisdiction are a minority group when it comes to electoral rights. Given the fact that constitutional constraints for tax legislation are either weak or non-existent in many countries, the exit option might step in as a substitute for material controls. In the *Acemoglu/Robinson* world, tax competition works as a limitation on the expropriation of the rich minority by the poor majority.

This is particularly relevant for the progressivity of the tax rates on income, inheritance and net wealth which is hardly regulated by constitutional law. To give some examples: The special 75 % tax on high-income earners introduced by the *Hollande* Administration in France in 2012 was given green light by the *Conseil Constitutionnel* in 2013<sup>264</sup>. This surtax on the regular income tax was nonetheless abolished by the French Government in 2015 as it turned out that the amount of revenue was negligible while the threat of emigration by high net-worth individuals was serious<sup>265</sup>. The situation in Germany is not different: The question of whether constitutional law prohibits an income tax rate above 50 % has been discussed *ad nauseam* both by tax scholars and by constitutional lawyers since the invention of the “half-income limitation” by the Constitutional Court in 1995<sup>266</sup> but not a single tax assessment has been struck down on the basis of this half-income principle. Tax competition, on the other hand, drove down the corporate income tax rate since 1988 from 56 % to 15 % in less than twenty years, and the top income tax rate fell during the same period from 56 % to 47 % (including a surtax for high-income earners (“*Reichensteuer*”) and the “solidarity surcharge” on the income tax introduced in the course of German re-unification)<sup>267</sup>. Countries like the United States and the United Kingdom, where no meaningful constitutional constraints to the tax burden seem to exist, have embarked on an even more substantial lowering of the corporate tax burden, following Ireland’s example where a 12,5 % tax rate has proven to be highly attractive over many years<sup>268</sup>. It is not unreasonable to assume that without tax competition in place, the balance of powers between majority and minority in the democratic fiscal State might be tilted massively towards the majority.

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<sup>263</sup> The author is aware of the enormous effect of financial power of rich pressure groups on the democratic process when it comes to funding of election campaigns, an issue widely examined and discussed in the United States (xxx). But recent findings by political scientists show that the impact of “capture” by wealthy pressure groups should not be overestimated (*Kiser/Karceski supra p.*). In continental Europe, public funding systems for electoral campaigns provide for a certain levelling of the playing field (xxx).

<sup>264</sup> *Supra*

<sup>265</sup>

<sup>266</sup> *Supra*

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<sup>268</sup> As of 2018, the Federal corporate tax rate in the United States has been reduced from 35 % to 21 %. In the United Kingdom, the corporate tax rate is announced to be reduced to 17 % by 2020.

## b) Constitutional constraints to tax competition

At the opposing end of the spectrum we have to discuss to what extent constitutional rules and principles could and should constrain a country's engagement in tax competition. This refers to beneficial treatment for high-mobile individuals and foreign investment that is advantageous when compared to the average treatment of similar domestic individuals and domestic investment. Taking the historical emergence of tax equality in the 17<sup>th</sup> and 18<sup>th</sup> century as a starting point we are inclined to think about such modern-day fiscal preferences for global individuals and potent corporations as the return of invidious "tax privilege" for certain persons and social classes which were meant to be wiped out in the course of the 19<sup>th</sup> century. Does the principle of tax equality, being the major stronghold of protection by "content" in the tax world, resist the tendency to dole out overly generous tax breaks for foreign taxpayers and foreign capital? Those constitutions which do not include foreigners expressly into the group of taxpayers who are obliged to contribute to the public goods on the basis of equality<sup>269</sup> will be more generous to them<sup>270</sup>. But is this also true for domestic taxpayers and domestic capital who are ready to move out of the country?

In this respect, recent tax history has seen several major examples where emerging fiscal privilege driven by tax competition has been subjected to a constitutional test<sup>271</sup>. The most prominent *cause célèbre* refers to legislation in some Swiss cantons which introduced "regressive" income tax rates to attract high-income individuals. In a landmark judgment delivered in 2009, the Swiss Federal Tribunal declared these regressive income tax rates to run foul of the ability-to-pay principle as enshrined in the Swiss constitution<sup>272</sup>. But the Tribunal left open the option for the tax legislator to introduce narrower tailor-made solutions in order to be able to participate in tax competition<sup>273</sup>. In Germany, the introduction of a low flat rate on interest and dividend income in 2008 and a reform proposal to establish a "dual income tax"<sup>274</sup> along these lines gave rise to a heated debate on whether the principle of tax equality prohibits any distinction between income from (mobile) capital and income from (immobile) labor<sup>275</sup>, an issue avoided so far by the Constitutional Court in its jurisprudence<sup>276</sup>. A third example has been mentioned above: Many countries grant large-scale

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<sup>269</sup> Such as the Spanish constitution (supra) and the German constitution of the Weimar Republic (supra).

<sup>270</sup> Hensel supra.

<sup>271</sup> For a broad scholarly analysis see: Konrad, Gleichheit und Differentiation: Die Duale Einkommensteuer und der Gleichheitssatz (Berlin: Duncker & Humblot) 2006.

<sup>272</sup> Federal Tribunal of 1st June 2007 No.2P.43/2006/fco, para 8.3.

<sup>273</sup> Federal Tribunal supra paras 10/11.

<sup>274</sup> German Council of Economic Experts/Max Planck Institute for Intellectual Property, Competition and Tax Law/Centre for European Economic Research, Dual Income Tax, ZEW Economic Studies, Vol.39.

<sup>275</sup> Kirchhof, Lehner, Schön, Englisch.

<sup>276</sup> Bundesverfassungsgericht, Order of 21st June 2006 2 BvL 2/99 para 98: „Die auf die Sicherung des Standorts Deutschland gerichteten wirtschaftspolitischen Förderungs- und Lenkungsziele sind geeignet, zu dem für die Ungleichbehandlung gegenüber den Beziehern nicht gewerblicher Einkünfte entscheidenden Rechtfertigungsgrund einer Kompensation der Gewerbesteuerbelastung ergänzend hinzuzutreten. Ob diese Ziele auch für sich

exemptions from inheritance taxation to “business assets”, thus granting relief to the super-rich to a large extent and shifting the brunt of the tax on the upper middle classes who own “private assets”<sup>277</sup>. Again, one of the main arguments is competitive pressure by foreign businesses and the fear to lose out to taxpayer emigration. In its 2014 judgment, the German Constitutional Court accepted this justification but urged the German legislator to award preferential treatment to business assets on a narrow basis, examining the necessity and the proportionality of the tax benefit in the light of the principle of tax equality<sup>278</sup>.

### c) International taxation and taxpayer solidarity

One clear element of tax competition is the re-transformation of the tax into a price for benefits received – in a similar vein as contractarian political philosophers like *Locke* have conceived of the fiscal burden for the citizens of a State<sup>279</sup>. In this world, taxpayers individually decide on their willingness to pay that price for the protection of their personal and business activities by the government. From the perspective of the closed state and the closed economy, this contractarian view had been replaced during the 19<sup>th</sup> century by a state-oriented or membership-based perspective, speaking not of equal benefit for the taxpayer but of equal sacrifice by the taxpayer, hypothecating a community of citizens showing mutual solidarity to each other and contributing to the public funds according to ability-to-pay.

Tax competition gives back to taxpayers the notion of individual “consent” in the *Lockean* sense – not casting their vote in a universal ballot but deciding individually on where to take residence and to be employed or where to invest and to carry on a business. The “contractarian” view of taxation as a price for benefits delivered by the State resurges under the pressure of globalization. Against this background we are confronted with the widely-heard claim that multinational companies and other mobile taxpayers should pay their “fair share” of tax - just as everyone else does.

This brings us to the question of whether the concept of compulsory solidarity and distributive justice has a meaning in this brave new tax world? As *Miriam Ronzoni* and *Tsilly Dagan* have shown, there are two ways to think about this problem<sup>280</sup>: One can confront the issue from the vantage point of “global tax justice” - then one has to address the impact of tax competition on global inequality among the citizens of the world, in particular on the allocation of fiscal revenue between developed countries, tax havens, and developing countries<sup>281</sup>. This is a serious issue - but not at the core of this article. One can also address the impact of

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*genommen und unter anderen als den hier gegebenen Umständen hinreichende legitimierende Kraft entfalten können, kann der Senat offenlassen.“*

<sup>277</sup> *Hey et al.*, Zukunft der Erbschaftsteuer: Wege aus dem Reformdilemma aus verfassungsrechtlicher, ökonomischer und rechtspraktischer Sicht, ifst-Schrift No.506, 2015.

<sup>278</sup> Bundesverfassungsgericht

<sup>279</sup> *Dagan* regards both the „marketization“ and the „fragmentation“ of the relationship between the taxpayer and the State as dimensions of this change (supra p.24 et seq.).

<sup>280</sup> *Ronzoni* supra p.44 et seq.; *Dagan* supra p.189 et seq.

<sup>281</sup> *Dagan*, supra p.185 et seq.

tax competition on domestic democratic decision-making and distributive practice inside a given State. This is the issue this article is about. But if we want to make the claim of solidarity and social justice operational from the perspective of an individual State we face the necessity to identify and define the community to which these taxpayers belong and to which they owe solidarity in a moral sense<sup>282</sup>. This is not as easy as it looks:

- As far as foreign taxpayers and their willingness to relocate is at issue, it is simply not feasible to apply to them the principles developed for a community based on citizenship or linked to a concept of territorially defined solidarity. A State who wants to attract a foreign taxpayer to move to its territory (and to become liable to tax for the first time) cannot expect from him or her the same degree of solidarity as from a local citizen. The “contractarian” status of taxation logically and timewise precedes the accession to membership in a community where sacrifice and solidarity define the mutual relationship. The foreign taxpayer can therefore make his or her decision to relocate dependent on the willingness of the State to grant preferential fiscal status, at least for a couple of years until the entrant has become a full member of the domestic community. This is reflected in the time-limited benefits contained in most “packages” offered to high net-worth individuals and other attractive taxpayers for moving to countries like the United Kingdom, Italy, Portugal and other places.
- As far as a State does not intend to attract the foreign taxpayer in person and rather aims at foreign investment, the notion of solidarity plays an even less prominent role. A foreign taxpayer who merely invests capital in a country is neither a member of the citizenry of this country nor a member of a territorially defined society. This taxpayer is not under any moral obligation to refrain from making his investment dependent on beneficial tax treatment.
- From the perspective of social justice, the judgment can be different when a member of a given community – a citizen or a resident – exercises their right to invest abroad or to move personally to another country with the intention to reduce its overall tax burden. As long as they do not leave the country in person, the fiscal state can exercise its authority and demand full taxation of worldwide income and wealth and apply a progressive tax rate. The same holds true for domestic residents and citizens when it comes to net wealth taxation and inheritance taxation.

The problem is, that under the current framework which allocates taxing rights on the basis of residence, each taxpayer can simply cut the ties of fiscal solidarity by moving out – moving to another jurisdiction where the tax environment is more attractive while keeping their previous political membership viz. citizenship

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<sup>282</sup> *Dagan supra p.38 et seq.*

unchanged<sup>283</sup>. As shown above, under current legislation applicable in most countries, taxpayers will not even lose their voting rights once they have moved abroad, taking away the tax basis formerly attributed to their country of citizenship. The only option a country has under these circumstances is to unilaterally extend unlimited tax liability on the basis of ongoing citizenship either for good (as under U.S. law) or for a limited number of years (as under e. g. Dutch and German tax law<sup>284</sup>). Only if the taxpayer decides to give up both residency and citizenship in a country he will be able to free himself from all forward-looking fiscal obligations (apart from settling a “final tax bill” on unrealized gains and profits)<sup>285</sup>.

- The most intricate test concerns taxpayers who simply threaten to leave the country in order to press for beneficial treatment. On the one hand, they declare to remain members of the domestic community (for the time being); on the other hand, they want to make this status dependent on a significant lowering of the tax burden. While this clearly reduces the level of “solidarity” they show in terms of fiscal sacrifice, the question remains whether the domestic legislator should be prevented to meet their demands and should be obliged to stick to the principle of equality and the envisaged level of redistribution. This is a hard choice – not because of the interest of the individuals threatening to leave but because of the interest of the community to keep these individuals and their economic power inside the territory for the benefit of all members of the community. Is this (to borrow from *Rawls*<sup>286</sup>) an inequality that can be accepted in order to increase welfare for all - or is this the opening of Pandora’s box for all sorts of tax privilege?

#### **d) An obligation to join a fiscal community?**

The different examples discussed in the preceding paragraphs have been viewed from the perspective of a single country – the “losing” country which has to consider measures against loss of revenue from tax competition or the “winning” country which has to consider favorable measures to attract foreign taxpayers and foreign investment. The domestic tax issues arising from these challenges concern to a large extent the equality of treatment

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<sup>283</sup> With reference to the absolutist notion of total dominion of the „Sovereign“ over the people and the wealth located in the State’s territory, the 17th and 18th century had seen in Europe the application of a „gabella emigrationis“ (*Isaak David van Buytenhem*, *Dissertatio juridica inauguralis de Gabella Emigrationis Quae Jure Patrio Vocatur Exu-Geld*, Utrecht, 1757). This “gabella emigrationis” was only abolished after the French Revolution in many parts of Europe (*Parry*, *Review of Plender*, *International Migration Law*, 21 *American Journal of Comparative Law* (1973) p.794 et seq.; for Germany see Art.XVIII lit.b) of the “Bundesakte” concluded at the Vienna Congress in 1815, which introduced the individual right to move between countries without being subject to an emigration tax (“Nachsteuer”).

<sup>284</sup> Sec.2 Außensteuergesetz (International Tax Act). This „extended tax liability“ of citizens living abroad has been held to be compatible with the European fundamental freedoms by the European Court of Justice (Case C-513/03, *Hiltten-van der Heijden*, Judgment of 23rd February 2006 para 44 et seq.

<sup>285</sup> *Schön*

<sup>286</sup> *Rawls*, *A Theory of Justice*.

between mobile and less mobile taxpayers and the transformation of the tax from an “equal sacrifice” to a price for public goods open to negotiation.

To a certain extent, the detrimental effect this change of paradigm might have on the equity of individual taxation in a given country, can be diminished by compensating tax treatment in the other country. A case in point is limited tax liability. A foreign taxpayer who is only taxable in a country on the basis of inbound investment and local business activities, might reject the notion of “solidarity” with the local fiscal community as he is neither a member of the territorially defined social organism nor in a political sense a citizen of that State. He will simply regard source taxation as a price to pay for setting up shop. But still, the foreign taxpayer will be fully taxable in his State of residence where principles of worldwide taxation and progressivity of the tax rate will be applied. The fact that the requirements of “social justice” do not apply to him in the source State, can be accepted under the requirements of social justice if and to the extent he is fully taxable in another State. Residence taxation then works like a “backup” in order to secure “one-time taxation” and a fully progressive tax rate<sup>287</sup>. On the other hand, the state of residence is in the position to grant tax reliefs which are perceived to be adequate from the point of social justice<sup>288</sup>. In a similar vein, a State’s complaint about a taxpayer moving out of the country is less forceful if and to the extent the taxpayer becomes subject to fiscal obligations in another State, trading one tax community for another without drastically reducing the overall tax burden.

This brings up the question of whether it should be ensured that a person is taxable at least in one State in full. In recent years, this problem has been raised by the G20/BEPS process on international business taxation whenever “stateless” income seemed to go untaxed<sup>289</sup>. But the issue was recognized as early as 1888 by *Ely* who found that full taxation of resident aliens might be good policy in order to avoid that a person could free himself from unlimited tax liability for good – by emigrating from his country of citizenship without fully integrating into the country of residence. Writing like a “cosmopolitan” political philosopher *avant la lettre* he referred to this as a general matter of humanity:

*“It may be further urged that a man owes certain duties to humanity, and if he fails to discharge the offices of citizenship at home, it is ethically allowable for a foreign government, which can lay its hands on him, to force him to do his part towards the support of government.”*<sup>290</sup>

While the spirit of this position is laudable, there remain two problems to be solved. The first concerns the fact that as long as the taxpayer has not committed himself to a certain fiscal community it is hard to say which mechanism might be used to enforce his obligation “to humanity”. There is no international tax organization “allocating” taxpayers to certain countries in order to prevent them from hiding away as “citizens of nowhere”. Moreover, while

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<sup>287</sup> *Schön* supra p.557.

<sup>288</sup> Case C-279/93 (*Schumacker*) judgment of 14th February 2015.

<sup>289</sup> *Kleinbard*

<sup>290</sup> *Ely* supra p.9 Fn.2.

*Ely's* argument might justify other States to take action against resident aliens and other foreigners escaping meaningful taxation in their home country, this does not require other States to do so. Rather, as current tax competition shows, States feel inclined to offer attractive passages to foreign taxpayers built on beneficial treatment. When States have no incentive to preserve a high level of taxation and when mobile taxpayers have no incentive to fully integrate into a fiscal community, any moral obligations to pay their “fair share” of taxes “somewhere” hang up in the air. This leads us back to the *Rodrik* world where only a substantial move of public authority to a supra-national level will solve the problems of regulatory competition in open market societies. Individual States – given both their constitutional set-up and their political preferences – will not be able to ensure an equal level of taxation.

## V. Conclusion

From the point of view of the individual taxpayer, the congruence of voting, paying and enjoying doesn't always play out. For him or her, the need to be protected against exploitation by the majority or against privileges granted to powerful pressure groups, does not go away when democracy unfolds. As it is not a feasible option to make tax legislation dependent on individual “consent” or unanimous vote, material constraints providing “content” under constitutional law like the equality of the tax burden or the protection of property can provide useful guard rails against volatile tax legislation. Other institutional arrangements like super-majority requirements or an increase in the number of “veto players” in the decision-making process might help as well.

For citizens living abroad the State has some leeway as regards the allocation of voting rights as these citizens do not contribute to the public coffers on a current basis. But excluding them from political participation is not a “must” as they remain stakeholders in the future of their society. Resident aliens, on the other hand, to not deserve voting rights *per se* but should enjoy non-discrimination when it comes to the allocation of the tax burden among those who live on a State's territory.

Tax competition has both beneficial and disturbing effects on democracy. From the standpoint of the individual it might work as a useful counterbalance to majority rule. From the standpoint of the majority one might ask to what extent material principles constrain a State's ability to award beneficial treatment to mobile taxpayers. The answer does not only require a sophisticated view on the boundaries of the community in question (where principles of social justice prevail over a “contractarian” view of taxation) but also a well-advised judgment on the benefits a State can draw for all of her citizens from the inflow of people and capital.