

Comments on Gamage-Shanske, *Tax Cannibalization & Fiscal Federalism*,  
and Grinberg, *The New International Tax Diplomacy*

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## Two very different papers ...

It's always nice for a commenter on 2 papers to find common themes.  
But not here! (Despite international / state-local commonalities.)

Gamage & Shanske look at vertical hierarchy in a federal system;  
Grinberg at the absence of vertical hierarchy.

Gamage & Shanske look at incentives in theory (albeit with institutional detail);  
Grinberg at a particular historical episode (albeit with theoretical backup).

But both papers were interesting & informative; I learned from each.

# Gamage-Shanske paper

I read this paper in the light of Gamage 2015 (“The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth”), favoring more small taxes instead of fewer big ones.

The idea: even taxes with similar / overlapping content in theory may have administratively distinct avoidance & evasion margins in practice.

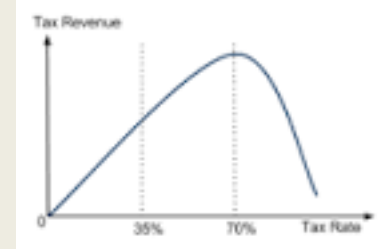
So the more the merrier (up to a point), if have rising ratios of DWL / revenue at each margin.

Gamage-Shanske applies this to overlapping federal / state & local taxes, with 2 twists.

The first pertains to lower-tier governments’ structural incentives; the second to top-tier (federal) steering of the lower tiers in practice.

# Lower-tier incentives in a federal system

Say the Laffer Curve for income tax revenue (individual or corporate) looks something like this.



A benign unitary government might consider how far to the right it wants to go, given rising DWL/revenue ratio as it nears the peak.

But a lower-tier government, when it shifts the overall curve to the right, can ignore both losses in higher-tier revenue (“tax cannibalization”) & outsiders’ DWL.

Possible effect: too far to the right overall; perhaps even to the right of the overall revenue peak.

Another analogy for tax cannibalization: Medigap insurance coverage for Medicare coinsurance.

# The lower-tier government choice

If just one tax base (& insofar as all act at the same margin, e.g., work vs. leisure), all this shows is a lower-tier government incentive to set overall tax rates too high.

Offset by other incentive problems? E.g., consider tax competition, when taxes fund public goods with positive spillovers.

But under Gamage 2015, we might get too much willingness to focus on the same avoidance/evasion margins as the feds. E.g., corporate income tax instead of sales & property taxes.

Lower-tier governments have reason to focus on where along a given Laffer curve they start out – further to the left seems better.

But it's true that they'll have skewed incentives, if moving to the right reduces federal revenues.

# Federal steering of state tax systems

Feds should push state & local governments towards using taxes with distinctive avoidance/evasion margins – e.g., sales & property taxes.

But instead they push the other way – piggybacking for income but not property/sales, SALT deductibility, use tax & *Quill*.

The current draft's discussion of how to address incentives is interesting / promising, but still preliminary.

Keep in mind overlaps as well as distinctions between tax bases.

Again, insofar as distinct taxes operate at the same margins, tax cannibalization is independent of the tax base choice.

## A separate paper?

G & S also critique lower-tier particularized tax competition – e.g., via incentives for new investment, extra-weighting sales in formulary apportionment (rather than just lower rates).

They note that the federal government could, & the EU does, impose greater restrictions here.

I'm sympathetic (see Shaviro 1990), but note broader issues – e.g., could extra-weighting sales be a race to the top?

But in any event, this appears to me to be a separate topic / paper.

# Grinberg paper

Earlier title: “*Breaking BEPS: The New International Tax Diplomacy.*”

Deleted because misleading? Paper is mainly about bifurcating BEPS, not destroying it.

But I always like a good triple entendre (bifurcating, destroying, “breaking news”).

Or better still, a quadruple entendre, if “Br[e]aking BEPS.”

Title aside, while I like the paper’s content, I have suggestions re. its framing.



# What do we learn from IFL?

Paper says its main contribution is bringing the international financial law (IFL) literature to bear on OECD-BEPS. IFL shows:

(1) effects of high political salience, (2) soft law can work absent distributive problems, (3) but it's bad at resolving distributive issues, (4) importance of path dependency, (5) feasibility of mock compliance.

The paper nicely demonstrates each in re. OECD-BEPS. But ...

... the 5 points aren't very startling at a general level – what's good about the paper is how it fleshes them out in the OECD-BEPS context.

So it's less: “Here's what IFL teaches us” than “Here's what I can tell you about OECD-BEPS.” IFL parallels are instructive, but perhaps incidental.

# Some points of interest

1) Surprising success (so far) of country-by-country reporting (CBCR).

Note the analogy to globalized FATCA, also arguably (as elsewhere discussed by Grinberg) faring better than one might have expected.

2) Unsurprising lack of progress in developing even preliminary consensus regarding tougher CFC regimes.

Paper notes that CFC rules may involve residence countries taking a hit to the benefit of source countries, not themselves.

A further problem is lack of agreement re. how to define residence countries' self-interest! (Suppose we asked a range of U.S. tax academics what we ought unilaterally to do re. "stateless income" that CFC rules may combat.)

# The U.S. story in Grinberg

One of the paper's notable features is its story re. how the U.S. may have gotten quasi-rolled in the OECD-BEPS process.

E.g., 2009 Obama Administration rhetoric re. check-the-box prompted attacks on hybridity that we perhaps shouldn't welcome.

U.S. power / influence unusually low re. foreign-to-foreign tax planning, the treaty process, & the design of permanent establishment rules.

This is an interesting & significant topic, meriting stand-alone attention that Grinberg may be well-positioned to offer (outside this paper).

How distinctive are U.S. companies? Are their antics just better-known?

How distinctive is U.S. exposure? From the size of our economy? The size of the oceans on each coast? Our not being subject to the ECJ?

# Bilateral treaties as a multilateral instrument

I learned a lot re. the OECD treaty process (partly reflecting my own prior ignorance).

The paper suggests that, even though treaties are bilateral & nominally fixed upon signing unless renegotiated, they can be self-updating & effectively multilateral.

Causes for this include: (1) influence on treaty negotiators of the OECD model, (2) influence on judges of official OECD commentaries, (3) “ambulatory” theory of treaty interpretation.

Under the last of these, changes in OECD interpretation reach back in time to affect previously negotiated treaties (!).

Scalia-ish legal formalism notwithstanding, the paper shows that there’s something to be said for this.