

# International Tax Law and the Equilibrium Between States and Corporations

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*Note to readers: This paper is a working draft. It will be obvious to the reader that some parts are less well developed than others; in particular, much more work needs to be done on the application of the theoretical analysis to international taxation in part 5, and the contemporary developments in international taxation of the digitalised economy. I am very interested in your comments and feedback, on any aspect.*

The expansion of big business has led to a corresponding expansion of State power, “big democracy.” ... a “new system of separation of powers” has emerged in the form of an equilibrium between the State and business.<sup>1</sup>

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1 Klaus Vogel, “The Justification for Taxation: A Forgotten Question” (1988) 33 *American Journal of Jurisprudence* 19-59 (hereafter, Vogel, “Justification for Taxation”).

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## 1 INTRODUCTION

A core narrative about the justification of taxation in capitalist democracies, which are “tax states”, concerns the fiscal bargain between society and the state.<sup>2</sup> The concept of the “tax state” was first used early in the 20<sup>th</sup> century and is usually attributed to Joseph Schumpeter.<sup>3</sup> The narrative states that taxation harnesses a portion of private return to individuals in a market economy for government to fund public goods and redistribution: hence, “taxes are what we pay for a civilized society”.<sup>4</sup> The fiscal bargain is also, generally, a *democratic* bargain which requires that taxation must be levied in accordance with the rule of law, enacted by a representative government, and applied in a way perceived to be fair by society.

This narrative is based on an individual relationship between taxpayers and the state, which assumes a (somewhat imperfect) match between being a taxpayer and participation in the democratic compact, usually associated with citizenship and some level of participation in decision-making by the “taxpayer-voter”.<sup>5</sup> While simplistic, this narrative remains true in many respects. By far the most numerous taxpayers in successful tax states are individuals, mostly wage earners during

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<sup>2</sup> Miranda Stewart, *Tax and Government in the 21<sup>st</sup> Century* (2022, Cambridge University Press), chapter 1.

<sup>3</sup> Joseph A Schumpeter, ‘The Crisis of the Tax State’ [1918] (1954) 4 *International Economic Papers* 5–38, trans. Wolfgang Stolper and Richard A Musgrave; Richard A Musgrave, ‘Schumpeter's Crisis of the Tax State: An Essay in Fiscal Sociology’ (1992) 2(2) *Journal of Evolutionary Economics* 89–113. Schumpeter also developed a sophisticated theory of the entrepreneur and was the originator of the concept of “creative destruction” in the market.

<sup>4</sup> Justice Oliver Wendell Holmes, ; Brookings Institute, *Good reasons for taxes* (April 16, 2006) <https://www.brookings.edu/articles/good-reasons-for-taxes/>

<sup>5</sup> Research into the tax bargain between society and the state often refers to a concept of “fiscal citizenship”, which in most countries depends mainly on tax “residence” rather than “citizenship” as such. *See, e.g.* Ajay K Mehrotra, ‘Reviving Fiscal Citizenship’ (2015) 113(6) *Michigan Law Review* 943-972; the Fiscal Citizenship Project (Canada, United Kingdom, Germany), <https://taxresearch.network/blog-welcome/reflections-on-managing-funded-research-the-fiscal-citizenship-project/>.

the course of their lifetime, who pay most taxes and (more or less) tend to be voters or participate as fiscal citizens in society and the state. Individual workers pay most of the income tax, consumption tax (in most countries a Value-Added Tax, VAT; in the US, state sales taxes of various kinds), and other kinds of taxes such as tariffs and excises on fuel, alcohol and tobacco.<sup>6</sup> The corporate income tax, and the taxation of business income in other entity forms, is a relatively small share of revenue in most tax states, and of course it is also ultimately borne by individuals.

However, this narrative of the fiscal bargain between the state and society is missing two key elements that grew in importance through the 20<sup>th</sup> century, and are even important so today. *First*, it is missing the dominant and most powerful participants in the economy, who are not individuals, but *businesses organized in firms*. Given their importance in the economy, it is plausible that firms (whether corporations, or other types of entity) may have an effect on the fiscal bargain. *Second*, it is missing the *international* dimension. The tax state does not exist in splendid isolation but is embedded in a world of states and in a global digital economy. This, too, seems likely to have an effect on the fiscal bargain. This paper seeks to explore the questions of the fiscal bargain and equilibrium between states and business in the global digital economy, and the effect in particular of international taxation rules, taking as its starting point a 1988 essay by a leading German tax law professor, Klaus Vogel, “*The Justification for Taxation: A Forgotten Question*”.<sup>7</sup>

Part 2 of the paper presents relevant aspects of *Justification of Taxation* regarding states and business. Vogel observed that the market economy changed in the period from the late 19<sup>th</sup> century

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<sup>7</sup> Vogel, “Justification for Taxation”, 49, citing Schattschneider, *The Semisovereign People* (fn 179).

into the 20<sup>th</sup> century because business came to be organized mostly in corporate enterprises. Despite their purpose being to engage in competitive market activity for profit, corporations are bounded, *non-market* organizations.<sup>8</sup> Vogel argued that businesses organized in corporations became a powerful separate “system” from the state, and this generated a “triangular relationship between the State, the economy and the society”.<sup>9</sup> This new triangular relationship required a tripartite equilibrium in taxation between the systems of the state, the economy (organized mostly in firms) and individuals in society which replaced the old dual equilibrium between society and the state. It thereby fundamentally altered the fiscal bargain that justifies taxation.

This paper considers what we can learn from Vogel’s analysis of the equilibrium between the tax state and business today, nearly 40 years later, that is, the first element identified above. To do so, we must also consider the second element: what happens when we extend the analysis of the equilibrium between the tax state and business to the international context. The two elements – the role of business organized in firms, and the international context of the tax state and the economy - are inextricably connected to each other. This is because international investment is dominated by firms, mainly corporate groups operating as multinational enterprises (MNEs), so that international tax rules are crucial in understanding whether, or how, the fiscal bargain has changed.

It is difficult to define the system of business activity organised in firms or corporations. However, it seems necessary to have some sort of definition for an analysis of business and international taxation. Part 3 presents some definitions of business, in particular MNEs, and

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8 As recognized famously by Robert Coase, “The Nature of the Firm” (1937) *Economica* 386; Paul Walker, *The Economic Theory of the Firm* (Routledge, 2017) for a survey of a wide and deep literature. See further part 4.1.

9 Vogel, “Justification for Taxation”, 49.

statistics about business size, profit and ownership. While recognising the importance of small and medium enterprises, the paper focuses mainly on what could be called “big business” conducted through corporations, or corporate groups, domestically and as MNEs in the international context.<sup>10</sup> Part 3 also presents some statistics about business. Of interest is the role of MNEs headquartered in the United States, which became dominant around the globe in the second half of the 20<sup>th</sup> century and have also been crucial to the development of US corporate and international tax policy.

Part 4 considers the historically contingent and evolving nature of the state and business and the boundaries of these two systems, as well as the supposed equilibrium between them. The paper argues that the boundaries of both the state and business are dynamic and may change over time, including through the effect of tax rules. The paper draws on two further theories to help us consider these boundaries and the effect of tax rules on them. Theories of the firm can help us understand the boundaries of business organization.<sup>11</sup> Theories of the state, especially in a global economy, can help to explore how the boundary of the tax state is established in relation to business and society.

Part 5 seeks to apply the analysis in considering how domestic and international tax law contribute to shaping the boundaries of firms and the tax state. It draws on the recent paper by Jordan Barry and Victor Fleischer who analyse the impact of taxation on the boundaries of the firm

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<sup>10</sup> The reader will notice slippage in language in this paper between the terms “business”, “firms”, “corporations”, “big business”, “corporate groups”, “multinational enterprises” and so on. Some definitions are in part 3. The slippage matters, as the paper is exploring the boundaries of the firm, and the role of corporate income tax as a critical element in the definition of the two systems of the state and business. The slippage between these terms also appears in Vogel, and in other writers who discuss the relationship of business and the state. I am still working out these distinctions and how best to approach them. At this stage, it is important to acknowledge the substantial role of business conducted through pass-through entities, which is itself likely to be a function of tax rules of the last several decades.

<sup>11</sup> Famously, Ronald Coase, “The Nature of the Firm” (1937) *Economica* 386; see Paul Walker, *The Theory of the Firm: An Overview of the Economic Mainstream* (UK: Routledge, 2016) for a survey of a wide and deep literature.

in the United States.<sup>12</sup> It then seeks to consider how the elements of tax law that shape the boundaries of firms also affect the boundaries of the tax state. It further examines how international tax rules (domestic, in treaties, or globally coordinated) affect the boundaries and of business and the state. It argues that in the contemporary global digital economy, we observe an unstable *disequilibrium* in international corporate taxation. This has an impact on the boundaries of both firms and states in the international arena, and has the potential to undermine the fiscal bargain and justification of taxation within states. Part 6 presents tentative conclusions.

## 2 “TWO SYSTEMS”: STATES AND CORPORATIONS

Vogel’s focus in *Justification for Taxation* was largely historical, but he thought the “time is right” to reconsider this issue at the time of writing in the late 1980s.<sup>13</sup> The decade of the 1980s saw a wave of globalization in investment and trade which occurred after the collapse of capital controls, and a period of stagnating economic growth, inflation and unemployment during the 1970s. The “tax state”<sup>14</sup> had matured in the United States, Germany and other developed countries, but it was facing a period of difficulty, even crisis, at this time. In Germany in 1988, income taxes and social security at more than 50% rates applied to average workers, while the tax level was half

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12 Jordan M Barry and Victor Fleischer, *Tax and the Boundaries of the Firm* (2024) USC Gould School of Law Center for Law and Social Science Research Paper Series No. 24-15 (Jan. 2024, forthcoming, Southern California Law Review). There is of course a long tradition of analysis in the US of entity form, tax and governance. See a recent discussion in Jason S Oh, ‘Does the Corporate Tax Still Distort Organizational Governance?’ (2025) *NYU Journal of Law and Business* 71; see also Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 *Harvard L. R.* 2. 1333, 1350–54, 1388–99 (2006); Henry Hansmann, *The Ownership of Enterprise* I. However, this discussion is focused on the US domestic context and does not explore the corporate form and cross-border tax implications, or the MNE corporate group structure.

13 Vogel, “Justification for Taxation”, 19.

14 As it was termed by Joseph Schumpeter, *Die Krise des Steuerstaates* (1918). I survey this chronology in Miranda Stewart, *Tax and Government in the 21st Century* (2022, CUP), ch. 2.

or more of GDP.<sup>15</sup> Despite high tax rates, Germany, like many other developed states, faced large fiscal deficits. There was significant tax avoidance and evasion, and even tax revolts.<sup>16</sup>

Vogel focused on the declining legitimacy of taxation in Germany and seemed to be concerned about excessive tax burdens on businesses. It is worth noting that Vogel wrote the essay while visiting an American university. No doubt he observed the rate-lowering and base-broadening tax reforms in the United States, followed in many other countries, which led to the 1980s being considered a decade of tax reform.<sup>17</sup>

Vogel's starting point in "The Justification of Taxation" was the theory of Lorenzo Von Stein about taxation and civil society that Von Stein developed in the late 19<sup>th</sup> century in Germany.<sup>18</sup> This theory was developed within the venerable German tradition of public finance law, policy and political economy.<sup>19</sup> Von Stein defined the "mutual" relationship in taxation between people, who comprise civil society, and the state, which represents the community as a whole. Vogel observed that Von Stein was a lawyer and a philosopher, not an economist, who examined taxation through a

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<sup>15</sup> Vogel, *Justification for Taxation*, p. 20-21.

<sup>16</sup> See, for example, Francesco Forte and Emilio Giardina, "The Crisis of the Fiscal State" in Karl W. Roskamp and Francesco Forte (eds.), *Reforms of Tax Systems* (Detroit, MI: Wayne State University Press, 1981), 1-9.

<sup>17</sup> See, e.g. Jeffrey Owens and Edward Whitehouse, "Tax Reform for the 21st Century" *Bulletin for International Fiscal Documentation* 50(11/12) (1996); Cedric Sandford, *Successful Tax Reform: Lessons from an Analysis of Tax Reform in Six Countries* (Bath: Fiscal Publications, 1993).

<sup>18</sup> Lorenz von Stein, *Lehrbuch der Finanzwissenschaft* [Public Finance textbook], 5th ed. Erster Theil and Zweiter Theil, Erste Abtheilung (1885).

<sup>19</sup> Indeed, the theory of the income tax that is often applied today had its origins in Germany, where Schanz originated a theory of income tax that led to the work of Haig and subsequently Simons in the United States. Georg Schanz, "Der Einkommensbegriff Und Die Einkommensteuergesetze," *FinanzArchiv / Public Finance Analysis* 13, no. 1 (1896): 1-87; see Carl S. Shoup, "The Schanz Concept of Income and the United States Federal Income Tax," *FinanzArchiv / Public Finance Analysis* 42, no. 3 (1984): 433-44; Robert M. Haig, "The Concept of Income - Economic and Legal Aspects," in *The Federal Income Tax* (Columbia University Press, 1921); Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (University of Chicago Press, 1938). See also Daniel Shaviro, "The Rise, Fall, And Survival of the Haig-Simon Income Definition as a Policy Guide"

political lens as part of “the institutions of cooperative human existence, State and civil society”.<sup>20</sup> Stein justified taxation on the basis that “it is only through taxation that the community is placed in the position to provide individuals with ‘the economic conditions required for their development’. In other words, through taxes individuals return to the community ‘a portion of the economic progress they derive therefrom’”.<sup>21</sup>

Building on Von Stein, Vogel argued for “the necessity of justifying the concept of ‘tax,’ which then organizes the State itself. The State must formalize through its legislation the idea of a tax, ‘the development of its concept and essence out of the essence and personality of the State itself’”.<sup>22</sup> However, this requires an equilibrium with the economy. While taxes must raise sufficient revenues for the state to provide for the welfare of the community (the “financial principle” of taxation), taxes must also be designed for their own sustainability – this is the “economic success” of taxation.<sup>23</sup> Vogel refers to Von Stein’s “national economic principle”, according to which taxes must not impinge excessively on capital, or the production of income: he said that excessive taxation “would slowly destroy the process of the new formation of the same through income and accumulation of income and capital”.<sup>24</sup>

Writing in 1988, Vogel considered that Von Stein’s analysis is “convincing even today” but must be modified because of a change in the “reality” of the state’s relations to the market.<sup>25</sup> The

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20 Von Stein, *Lehrbuch der Finanzwissenschaft* and other sources, cited in Vogel, “Justification for Taxation”, fn 106.

21 Vogel, *Justification for Taxation*, p. 43, citing Von Stein.

22 Vogel, “Justification for Taxation”, 40.

23 Vogel, “Justification for Taxation”, 40.

24 Vogel, “Justification for Taxation”, 40.

25 Vogel, “Justification for Taxation”, 44.

crucial development that he identified as a change in “reality” was the organization of economic activity, or business, in firms. Business in firms, in particular what Vogel calls “big business”, historically and today is organized mainly in the legal form of the corporation. He mentioned the role of managers in reinvesting capital in large corporations without it being returned to owner-shareholders, but he did not discuss in any detail the interior operations or activities of the firm. However, the corporation is a form of organization that is bureaucratic, hierarchical and *non-market* while still operating in the market economy. Vogel observed that by the 1980s, corporations had grown “to increasingly larger and more diverse organizations, and began to draw away a major portion of production and distribution”.<sup>26</sup> This has the consequence that “‘the economy’ today to a very large extent no longer is exchange, not market, but organization. Not only conceptually, but even in the empirical world it has become an independent ‘subsystem’ of its own.”<sup>27</sup>

Vogel drew on several other authors in his argument that business had become a separate system from the state. He observed that Schumpeter (referred to above as the inventor of the concept of the “tax state”) had suggested that the tax State stands “opposite” the sphere of private business as “something peripheral, foreign to the specific purpose of private business, even as something inimical.”<sup>28</sup> Most interestingly for present purposes, he discussed US political and economic thinkers, in particular E. E. Schattschneider, *The Semisovereign People: A Realist’s View*

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<sup>26</sup> Vogel, “Justification for Taxation”, 45, citing various sources in relation to these developments in the United States: Chandler, *The Visible Hand* (1977); Chandler, *Strategy and Structure* (1962) (fn 164); Berle & Means, *The Modern Corporation and Private Property* (1932); Cassier, *Wer bestimmt die Geschäftspolitik der Großunternehmen?* (1962); Herman, *Corporate Control, Corporate Power* (1981).

<sup>27</sup> Vogel, “Justification for Taxation”, 46.

<sup>28</sup> Schumpeter, \* in Vogel, “Justification for Taxation”, 49.

of *Democracy in America*<sup>29</sup> and JK Galbraith, *The New Industrial State*.<sup>30</sup>

Vogel preferred the view of the political scientist Schattschneider, whose main focus in *The Semisovereign People* was an analysis of democratic politics as a way of managing, or socialising, conflict in the United States. In 1960, Schattschneider suggested the existence of two “empires” in the United States, being “two major power systems, government and business”, which he described as antagonists, “independent and inseparable”.<sup>31</sup> In a striking analysis of how people fit into the state and business, Schattschneider suggested that “everybody belongs to both empires.”<sup>32</sup> He further argued that the conflict between government and business is “well-developed” and “unresolvable”, “built into a system that is both democratic and capitalistic”.<sup>33</sup> This “unresolved tension” dominates politics, and indeed politics is organised around it, in Schattschneider’s view. It is interesting to present the full picture of US business in *The Semisovereign People*, at it appeared to Schattschneider:

“Business so dominates the nongovernmental world that it looks very much like a power system able to compete with the government itself. Once upon a time the church was the principal nongovernment institution; today it is business. ... the relations of government and business largely determine the character of the regime. Seen this way the struggle for power is largely a confrontation of two major power systems, government and business.

The very magnitude of the two systems makes it impossible for them to be indifferent to each other. ...

The rivalry of government and business is not abated by the fact that the antagonists are interdependent and inseparable (everybody belongs to both

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29 E. E. Schattschneider, *The Semisovereign People: A Realist’s View of Democracy in America* (Holt, Reinhardt and Winston, 1960), cited in Vogel, “Justification for Taxation”, 48.

<sup>30</sup> John Kenneth Galbraith, *The New Industrial State* (Boston: Houghton Mifflin, 1967, 1971 edition).

<sup>31</sup> Schattschneider, 119.

<sup>32</sup> Schattschneider, *The Semisovereign People*, 119.

<sup>33</sup> Schattschneider, *The Semisovereign People*, 116.

empires). ... The quarrel dominates the political system precisely because it is not a war of extermination; this is what makes the conflict unresolvable. The political system has had a long time to organize itself around this quarrel.”<sup>34</sup>

In contrast, Vogel rejected the view of Galbraith in *The New Industrial State* that the state and corporations are *one system*. Galbraith called this a “technostructure” or “the industrial system” and asserted that large business was “inextricably associated with the state. And the state, in important matters, is an instrument of the industrial system”.<sup>35</sup>

Building on this analysis, Vogel saw a crucial role for the separate “system” of business to both generate economic return that supports the tax state and wellbeing of the community, *and* to provide limits on taxation by the “system” of the state, and thereby to support the fiscal bargain. This view depended on big business operating in a competitive market. Vogel observed that:

“Large enterprises, of course, are bureaucracies. [...] Economy, however, has a standard by which it measures behavior, and determines whether behavior accomplishes its purpose adequately ... . This standard, which politics lacks ... is profit and loss.”<sup>36</sup>

Nonetheless, Vogel affirmed that the state is the only organization that has as its focus the welfare of the community and observed that the state achieved this in the 20th century “welfare-state”.<sup>37</sup> The state “leaves production to the economy and, therefore, depends on taxes. Its claim for taxes is legitimized ... because taxation returns to the State a portion of the economic value that the

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<sup>34</sup> Schattschneider, *The Semisovereign People*, 116-119 (extracts). Taking a longer view, Schattschneider characterised the history of American democracy as being about the attempt to “split the political power from the economic power”, which he suggests may be the greatest American political achievement: 120-121.

<sup>35</sup> Galbraith, *The New Industrial State*, 298, cited in Vogel, “Justification for Taxation”, 49 (fn 189). Vogel also contrasts his analysis with a Marxist view of the capitalist economy, which I do not discuss here.

<sup>36</sup> Vogel, “Justification of Taxation”, 53.

<sup>37</sup> Vogel, *Justification of Taxation*, 54.

State for its own part has assisted in producing”.<sup>38</sup> Taxation “touches on the distribution of functions and weights between the State and the economy”; “If this distribution is balanced, taxation can jeopardize the equilibrium, and if it is not, this may provide a justification for taxing, but it certainly does not dispense of the need for a justification.”<sup>39</sup>

How should we define the “system” of business today and consider the mechanism, if it could be said still to exist, by which business limits state taxing power and thereby supports legitimacy of the fiscal bargain? Vogel argued that the equilibrium between corporations and the state must be maintained because it enables the expansion of both so that “big business” is balanced by “big democracy”:

The expansion of big business has led to a corresponding expansion of State power, “big democracy.” Thus, in place of the former system of separation of powers, which lost its effectiveness as a result of social changes, a “new system of separation of powers” has emerged in the form of an equilibrium between the State and business.<sup>40</sup>

### **3 DEFINING “BIG BUSINESS” AND MULTINATIONAL ENTERPRISES**

#### **3.1 Corporations separate from not subject to the state**

Vogel’s argument seems to operate on two levels: first, the singular firm conducting business in a company or a corporate group for the purpose of private profit and, second, the collective of businesses, a “system” of economic organization which could be called “big business” as a whole. He argued that “Even very big business acts within the context of the market and is dependent on

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<sup>38</sup> Vogel, “Justification for Taxation”, 57.

<sup>39</sup> Vogel, “Justification for Taxation”, 56.

<sup>40</sup> Vogel, “Justification for Taxation”, 49, citing Schattschneider, *The Semisovereign People* (fn 179).

the circumstances existing within the market, unless it occupies a monopoly position.”<sup>41</sup> Thus, the competition in the market for profit is important. The possible exception for monopolies may be relevant to contemporary conditions, including in relation to “big tech”, suggesting that the existence of monopoly or oligopoly power may lead to a different analysis of the taxation equilibrium between states and corporations.<sup>42</sup>

The analysis of business as a separate system on the same level or as powerful as the state seems odd when considered as a matter of law. Corporations (or any other legal entities through which business is conducted) are, legally speaking, *created by*, and *subordinate to* states, under the state laws that create them.<sup>43</sup> The corporation organized under national law is a legal construct. While it has separate legal personality and limited liability, it is constrained by a wide range of rules. Nonetheless, once properly constituted under the law of a particular state, corporations have legal, economic and fiscal effects.

There is evidence that business enterprises established by law in a corporate form date back to the Roman Empire, or before.<sup>44</sup> There is also a long history of evidence of corporations functioning as extensions or projections of state power, including in relation to taxation.<sup>45</sup> For example, tax

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41 Vogel, “Justification for Taxation”, 53.

42 Noting that the existence and effect of monopolies or oligopolies in the tech or other sectors is a complex question. See, e.g. Herbert Hovenkamp, *Tech Monopoly* (Cambridge, MA: MIT Press, 2024).

43 An exception is the European Union, where the European company form is becoming increasingly popular, the *Societas Europaea*, which is a public limited-liability company that can operate across the European Union under a single set of rules: [https://europa.eu/youreurope/business/running-business/developing-business/setting-up-european-company/index\\_en.htm](https://europa.eu/youreurope/business/running-business/developing-business/setting-up-european-company/index_en.htm).

44 Walker, *Economic Theory of the Firm*, 121; the features endowed by the state included separate entity status, the ability to establish joint funding with combinations of investors and limited liability; for example, in ancient Assyria, Greece, and India.

45 Steven Bank traces the early history of state charters for corporations in the United States: *From Sword to Shield*

farming in ancient Rome – an early form of tax collection and lending to the state<sup>46</sup> – came to be organized in *societates* in which individual partners had a share to guarantee levies to the empire that were beyond the means of any single person.<sup>47</sup> Vogel highlights the growth in the power and role of the corporation in capitalist economies since the 19th century. It is interesting that the legal historian Ron Harris, in his discussion of the history of corporations and the British empire, identifies the end of the 19<sup>th</sup> century as a pivotal time in which not only corporations, but transnational corporations (or MNEs), came to be a power of their own, *outside* the state. Previously, chartered business corporations were required to serve the interests of rulers and states; they were “semi-public in their functions”; by the end of the 19<sup>th</sup> century, this was no longer the case, and corporations pursued profit independently of the state. Harris writes:

“in the last few decades of the 19<sup>th</sup> century, the business corporation escaped state control. By this I mean the control of any state, be it the British State and any colonial or foreign state”.<sup>48</sup>

How should we think about the “system” of corporations in the international context? During the 20<sup>th</sup> century, a core element of the success and empowerment (and enrichment) of corporations, including MNEs, was the standardization of the corporate form, in corporate (and tax) law around the world. Katharina Pistor argued that this enabled the organized extraction of private profit and wealth accumulation, contributing to growing inequality.<sup>49</sup> This suggests that corporations may

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(Oxford: Oxford University Press, 2010).

46 Margaret Levi, *Of Rule and Revenue* (University of California Press, 1988).

47 Walker, *Economic Theory of the Firm*, 12.

48 Ron Harris, *Empire Ltd*, draft book chapter 4, NYU Legal History Colloquium, September 23, 2026, p. 6.

49 Katharina Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton: Princeton University Press, 2019). John Kay suggests the key is organization itself, rather than capital, but nonetheless accepts the importance of the corporation: *The Corporation in the 21st Century* (Yale University Press, 2024).

even be *more* powerful than states, an idea that is also consistent with the concept that an “equilibrium” is needed between “big business” and the state to support the democratic fiscal bargain.

In international law, as at the national level, it is a standard assumption that corporations cannot “make” law; only states can make law, and only states can be subjects of public international law. However, both propositions have been contested. Stephen Tully argues that corporations do “make” international law and it would be better if we recognized them as so doing, while others have demonstrated the state-like characteristics and actions of large corporations.<sup>50</sup> Vogel in fact seems to suggest that “big business” is in a sense prior to the social-welfare “big democracy” state of the 20th century – business has generated the (presumably fiscal) returns that enabled the social tax-and-welfare state to thrive.

In a globalized economy, it seems likely that a key reason for the power and size of corporations is precisely their ability to act and expand across borders – to generate new production, exploit new resources and reach new markets – and their ability to exit the jurisdiction contributes to the equilibrium referred to by Vogel.

### **3.2 The Multinational Enterprise (MNE)**

While Vogel does not mention MNEs in his analysis, this is essential in considering the

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<sup>50</sup> Stephen Tully, *Corporations and International Lawmaking* (Boston: Martinus Nijhof Press, 2007). *See also* Haris Jamil and Sundhya Pahuja, “Making sense of the corporation in international law: notes on comparative reading” (2025) *Journal of International Economic Law* 28(2) 339-358; Doreen Lustig, *Veiled Power: International Law and the Private Corporation 1886-1981* (Oxford: Oxford University Press, 2020).

equilibrium between states and corporations today.<sup>51</sup> It therefore seems important to define an MNE so that we can better understand the “system” of corporations in relation to states in an international tax context. However, this is not as straightforward as it appears. It also would be useful to understand more about the size of “big business”, in terms of the scale of MNEs, profits, and share of the economy. [STATISTICS YET TO COME]

A statistical definition of an MNE is:

“an enterprise producing goods or delivering services in more than one country. A multinational enterprise has its management headquarters in one (or rarely more than one) country, the home country, while also operating in other countries, the host countries”.<sup>52</sup>

A legal definition of an MNE is “a group of companies operating under common ownership or control, whose members are incorporated under the laws of more than one State”.<sup>53</sup> The legal structure of the parent corporation and its owned and controlled subsidiaries in the corporate group is critical to its operation and to the application of tax rules of multiple states. The existence of a parent entity in a “home” state and its investments or activities in subsidiaries in “host” states also means that MNEs are not truly global. Rather, it is an essential part of their operation that they are embedded in different states through separate controlled corporate entities.<sup>54</sup>

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<sup>51</sup> There is a large literature on MNEs including the expansion of US MNEs. See, e.g. Vernon, Raymond. 1971. *Sovereignty at Bay: the Multinational Spread of US Enterprises*. Basic Books, New York; Vernon, Raymond. 1998. *In the Hurricane's Eye: The Troubled Prospects of Multinational Enterprises*. Cambridge, MA: Harvard University Press.

<sup>52</sup> European Commission, *Statistics Glossary*, [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Multinational\\_enterprise\\_\(MNE\)](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Multinational_enterprise_(MNE)). Sometimes also called a “transnational corporation” or “multinational corporation”.

<sup>53</sup> *Justitia Et Pace Institut De Droit International Session of Lisbonne* – 1995, *Obligations of Multinational Enterprises and their Member Companies* (Rapporteur, Andreas Lowenfeld), art. 1.

<sup>54</sup> Paul Doremus, William W Keller, Louis W Pauly and Simon Reich, *The Myth of the Global Corporation* (Princeton University Press, 1998).

There are a great many different tax definitions of an MNE. The key to the operation of an MNE, including for tax purposes, is control.<sup>55</sup> However, control of an MNE does not require 100% common ownership or voting power, but could be much less. One definition of “foreign direct investment” which requires operational or managerial control requires as little as 10% to 20% ownership of the corporation.<sup>56</sup> Different countries apply different threshold ownership or control rules for various tax purposes, such as corporate consolidated tax reporting, CFC rules, country-by-country reporting and so on.

Financial reporting for consolidated groups under the International Financial Reporting Standards has a nuanced test about effective control which may be much less than 100%.<sup>57</sup> The Pillar Two Global Base Erosion (GloBE) minimum tax Model Rules have outsourced the boundary-setting task to the private system of accounting standards. The Model Rules define an “MNE Group” as a collection of entities that are related through ownership or control such that the assets, liabilities, income, expenses and cash flows of those entities are included in the consolidated financial statements of the parent entity.<sup>58</sup>

Identifying the boundaries of corporations that comprise “big business” today depends on the

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55 Richard Winchester, “A Tax Theory of the Firm” (2019) 88(1) *University of Cincinnati Law Review*, available at: <https://scholarship.law.uc.edu/uclr/vol88/iss1/1>. The boundaries of corporations also change constantly through merger and acquisition processes, which are not addressed here.

56 McKinsey, *Report: How foreign direct investment today may shape industry and trade tomorrow* (22 Sept. 2025), available <https://www.mckinsey.com/mgi/our-research/the-fdi-shake-up-how-foreign-direct-investment-today-may-shape-industry-and-trade-tomorrow>.

57 Institute of Financial Reporting standards, <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-10-consolidated-financial-statements/>.

58 OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)* (Paris: OECD, 2021), art. 1.2; this is a “controlling interest”, art. 10.1, available <https://doi.org/10.1787/782bac33-en>.

laws of multiple different states, which are themselves differentiated as to purpose and effect. This makes it more difficult to identify the boundaries of “big business” and complicates any attempt to identify an equilibrium between big business and the tax state.

The argument in this paper that corporations and states may be in an equilibrium, or disequilibrium, does not depend on public ownership of corporations; rather, it relies on the opposite, that corporations are separate from states. It is quite interesting to consider the relevance of public ownership of large corporations to the analysis. Many large MNE investments, especially in developing countries, are state-owned or controlled. However, public ownership may be a relatively small proportion of the total shares; the UNCTAD statistics identify public participation greater than 10% of voting rights.<sup>59</sup>

## **4 THEORISING THE BOUNDARIES OF THE FIRM AND THE TAX STATE**

### **4.1 The boundary of the firm**

The economic theory of the firm seeks to get away from the complexities of legal entity rules despite the importance of these rules for tax and other regulatory functions of the state.<sup>60</sup> Barry and Fleischer summarize the traditional Coasean framework for defining the firm as being whether “to make or to buy”.<sup>61</sup> Should entrepreneurs make inputs themselves in an integrated manner “inside”

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<sup>59</sup> UNCTAD, World Investment Report, 60.

<sup>60</sup> Coase, *Nature of the Firm*; Walker, *The Theory of the Firm*; Jensen, Michael C. and Meckling, William H. (1976) “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure”, *Journal of Financial Economics*, 3(4): 305-60, rejecting the legal form as relevant for the analysis. However, some argue for a legal theory of the firm to be connected with economic theory: David Gindis and Geoffrey M Hodgson, “The legal nature of the firm” in Josef Windsberger and Aved Raha (eds.) *Research Handbook on the Theory of the Firm* (Edward Elgar, 2024).

<sup>61</sup> Barry and Fleischer, Tax and the Boundaries of the Firm, 9.

the firm or buy those inputs in a market transaction with unrelated firms “outside” the firm? Coase explained this as follows:

“Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the *entrepreneur-co-ordinator*, who directs production.”<sup>62</sup>

Key innovations of Coase included the identification of the entrepreneur-co-ordinator and the internal hierarchy of the firm, and the proposition that “the boundaries of the firm are set at the point at which overall transaction costs are minimized”.<sup>63</sup> This requires balancing the transaction costs of relying on the price mechanism (such as lack of information in ascertaining the price, differing time horizons for receipt and payment, and managing risk and uncertainty) with the costs of operating in a bureaucratic, hierarchical structure. While Vogel does not refer to the theory of the firm, his recognition that the business corporation is internally a bureaucracy is consistent with this approach. In this, the firm is similar to the state, which is also conceived as being organized along hierarchical, bureaucratic and non-market lines.

Importantly, Coase recognized that the boundary of the firm may not be clearly defined. He considered that it is dynamic, not static, and there is great diversity as the amount of “vertical” integration varies greatly from industry to industry and even from firm to firm. There may be relational bargaining *between* firms and price mechanisms or sub-markets *within* firms.

The theory of the firm was not substantially developed by economists until the late 20th

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<sup>62</sup> Coase, *The Nature of the Firm*, 388 (emphasis in the original).

<sup>63</sup> Barry and Fleischer, *Tax and the Boundaries of the Firm*, 9.

century.<sup>64</sup> However, theory developed in a broader field of research into business organization from the 1950s onwards.<sup>65</sup> One important approach is the “resource” theory of the firm first propounded by Edith Penrose in 1959.<sup>66</sup> Penrose argued that the firm exists as a collection of resources and capabilities that can be directed to the production of goods and services (including assets and people, skills, knowledge and innovation) combined with an administrative function that coordinates it in an ongoing social process.<sup>67</sup> Penrose applied this analysis to MNEs in the mid-20th century and suggested that the harnessing of resources helped to explain the growth of MNEs.<sup>68</sup> She commented that “there is a strong tendency for a business enterprise possessing extensive and versatile internal managerial resources continually to expand, not only in its existing fields but also into new products and new markets as opportunity offers.”<sup>69</sup> In the international level, the ability of firms to exploit tax laws of different countries would be an additional capability of the firm, while today, the resources of the firm are no doubt mainly intangible, as perhaps in the theory they mainly were: skills, knowledge, and intellectual property. The limits of the firm considered as a collection of resources and capabilities are presumably reached when it is no longer profitable to hold and control such resources and knowledge and exploit it; but it seems that this

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64 Walker, *Theory of the Firm*, 14.

65 Gerald F Davis and Theodore DeWitt, “Organization Theory and the Resource-Based View of the Firm: The Great Divide” (2021) 47(7) *Journal of Management* 1684, 1687; James March and Herbert Simon, *Organizations* (1958); Edith Tilton Penrose, *The theory of the growth of the firm* (1995, third edition; 1959).

66 Coase, *Nature of the Firm*, 393, 404.

67 Penrose, *The theory of the growth of the firm*. This approach is cited and seems essentially to be adopted by John Kay, *The Corporation in the 21st Century*, 260.

68 Edith Tilton Penrose, “Foreign Investment and the Growth of the Firm” (1956) 66 No. 262 *The Economic Journal* 20-235; *The Large International Firm in Developing Countries* (1968) focusing on the oil industry.

69 Penrose, *Foreign Investment and the Growth of the Firm*, 225.

could, for some kinds of firm, be essentially limit-less.

#### 4.2 The boundary of the tax state

Like the boundary of the firm, the boundary of the tax state is not fixed; it is historically contingent and changes over time. *Justification of Taxation* suggested, perhaps unfairly, that most public finance theory from the 18<sup>th</sup> century onward did not understand this; that “none” of the various authors considered by Vogel “seems to have been aware that his views are historically contingent, that the concept of the State on which they base their arguments ... is not fixed but is itself in a process of development”.<sup>70</sup> Vogel made an exception for Von Stein who recognised that the state is “not fixed but is itself in a process of development”.<sup>71</sup> Recognition of the dynamism of the state is necessary for Vogel’s view that an “equilibrium” must be maintained in the fiscal bargain between business and the tax state (and in his implication that, at the time of writing, the balance may not be so harmonious). To regain equilibrium, the extent, level or process of taxation, which establish the boundaries of the tax state, may need to change.

Schattschneider, who was relied on by Vogel, did not directly consider the boundary of the (United States) government in the *Semisovereign People*. However, his theory of the public versus private management of conflict is fundamentally about the size of the state, so that the more public the management of political conflict, the larger the state (or the more invested it is in the people’s affairs). Schattschneider also did not directly address the international context of the state (being the

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<sup>70</sup> Vogel, *Justification for Taxation*, p. 37.

<sup>71</sup> Vogel, “Justification for Taxation”, 37. I leave aside here obvious breaches or changes of border through invasion and empire, among other things.

United States). However, he did address this obliquely. Schattschneider formed the view that by 1960, American politics was undergoing, or had already undergone, a change because of what he called *foreign affairs*, which included “a titanic struggle for survival”.<sup>72</sup> He observed:

“While we were looking the other way, the government of the United States became a global operation a decade or two ago. The budget is about two hundred fifty times as large as it was seventy years ago. ... the government is now involved in a wholly new dimension of conflict. ... Today, the government itself competes for power.”<sup>73</sup>

This new *global operation* of the US state was a massively bigger government, which required a much larger level of taxation from its people. This implicitly changed the fiscal bargain – the political bargain, between public and private, between the state and the people.

One well-known way to think about opening the borders of the tax state is the approach developed by Geoffrey Brennan and James Buchanan who modelled the state as a revenue-maximizing leviathan rather than a social-welfare-maximizing body (in contrast to the assumption of Vogel that the state can maximize general welfare). Brennan and Buchanan argued that, in a closed state, “the polity and the economy are perfect mappings of each other with respect to geography, membership, and the extent of trade and resource allocation”.<sup>74</sup> However, this is not the case when borders are opened – this enables the right of “exit” and “voice” and limits the coercive taxing power of the state in the fiscal constitution. Brennan and Buchanan did not, however, engage with the role of business enterprise or organization of the firm in this fiscal bargain; their theory

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<sup>72</sup> Schattschneider, *Semisovereign People*, 112. Perhaps, he was referring to the post-WWII role of the US globally, and to the cold war; he does not discuss it directly.

<sup>73</sup> Schattschneider, *Semisovereign People*, 117-8.

<sup>74</sup> Geoffrey Brennan and James M Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge, UK: Cambridge University Press, 1980), 168.

seems focused mainly on citizens, or individuals.<sup>75</sup>

Another way to consider the relationship is in the concept of “regulatory capitalism” developed a decade after Vogel’s analysis by John Braithwaite and Peter Drahos.<sup>76</sup> Braithwaite and Drahos suggest that “regulatory capitalism” reflected a successful bargain between business and government that was established in the middle of the 20<sup>th</sup> century. This bargain seems consistent with Vogel’s view about a fiscal equilibrium between “big democracy” and “big business”.<sup>77</sup> The fiscal bargain depended in part on the successful collection, and generally compliant behaviour, of big business in relation to the corporate income tax. However, much more importantly, it depended on the collection of most *other* taxes from corporations – and those other taxes were borne by workers. The harnessing of corporations in the tax system was critical to the extension of governmental capacity and the success of the tax state. The main tax base became withholding on wages and consumption that grew with the economy, which required a “withholder” that would generally comply; the application of administrative techniques that co-opted corporate systems such as data sharing and information access from banks and large business; as well as the growth of the corporate income tax, as corporate profit grew. These regulatory techniques also “increased delegation to business and professional self-regulation and to civil society, to intra- and

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75 Brennan and Buchanan suggest in later work that the corporate income tax raises significant revenue for the state and seem to assume it applies to capital; *see*, e.g. Geoffrey Brennan and James M Buchanan, “Consumption Taxation and Democratic Process” in Manfred Rose (ed) *Heidelberg Congress on Taxing Consumption* (Berlin: Springer-Verlag, 1989), 191.

76 John Braithwaite and Peter Drahos, *Global Business Regulation* (Cambridge: Cambridge University Press, 2000); and *see* John Braithwaite, *Regulatory Capitalism: How It Works, Ideas for Making It Work Better* (Cheltenham: Edward Elgar, 2008).

77 I discuss this in Stewart, *Tax and Government*, ch. 2.

international networks of regulatory experts”.<sup>78</sup>

This is a somewhat optimistic story, while identifying some elements of the privatization of law-making and the exercise of regulation beyond the borders of the state. However, Braithwaite and Drahos concluded that the optimism did not apply to the taxation of corporations across borders. The competitive approach of states in seeking to tax mobile capital was no match for the “monocentric complexity” of MNEs that have the ability to plan tax outcomes across hundreds of subsidiaries and different jurisdictions and this has led to “a genuine erosion of state sovereignty” in taxation.<sup>79</sup>

Social scientist Saskia Sassen analysed key characteristics of the state and sovereignty – which she identified as a monopoly over territory, authority and rights – and how this was transformed in the global financial economy of the 1990s.<sup>80</sup> She argued that the boundary of the state is actively contested in a global economy, in a process that reconfigures the distribution of territory, authority and rights, not only between one state and another, but also between states and business. In particular, Sassen argued that the financialisation of the global economy in the 1990s transformed the three elements of territory, authority and rights of the state. These three elements began to be privatized and to operate through market mechanisms rather than through the legitimate exercise of state political power. The change occurred incrementally through contestation in the “borderlands”

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<sup>78</sup> Braithwaite, *Regulatory Capitalism*, 11.

<sup>79</sup> Braithwaite and Drahos, *Global Business Regulation*, 107.

<sup>80</sup> Saskia Sassen, *Territory, Authority and Rights* (Princeton: Princeton University Press, 2006); Miranda Stewart, “Tax states, jurisdiction and the multilateral reality” in C. Elliffe (ed.) *International Tax at the Crossroads: Institutionalisation and Policy Reform in the Era of Digitalisation* (Cheltenham: Edward Elgar, 2023) 115-140; Miranda Stewart, “The Future of Tax Jurisdiction” (2024) *Singapore Journal of Legal Studies* 1-23.

of states, with a consequence that states no longer had a monopoly on territory, authority or rights. For example, the floating of the currency, global credit markets, and the growth of derivatives undermined state authority over monetary policy. One consequences of this change identified by Sassen was the redistribution of financial risk towards individuals, and to the state, and away from business or financial corporations. Another consequence was the concentration of power *within* the state, to the executive rather than the legislature, and to private actors, such as corporations or banks, rather than public actors, rendering the state less democratic.

I have previously argued that the contestation of the boundaries of the state identified by Sassen in relation to financial capitalism is also taking place in respect of the taxing power of the state.<sup>81</sup> The boundary of the tax state is defined by tax law, including rules for international tax jurisdiction over corporations; the scope and extent of the tax state is altered in a contest in which MNEs become like states, taking over elements of territory, authority and rights; accruing characteristics of state sovereignty in a geographically embedded global digital economy.

## **5 INTERNATIONAL TAX AND THE EQUILIBRIUM OF FIRMS AND STATES**

### **5.1 Tax and the boundaries of the firm**

Coase identified taxation as one of the factors in determining the existence or size of a firm because transactions organized *within* or *outside* a firm “are often treated differently by Governments or other bodies with regulatory powers”.<sup>82</sup> For example, he suggested that a sales tax

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<sup>81</sup> Stewart, Tax States, Jurisdiction and the Multilateral Reality.

<sup>82</sup> Coase, Nature of the Firm, 393.

on value-added or market transactions would not apply to internal value-add within a single firm and this would tend to make the firm larger.<sup>83</sup> As Coase made clear in a later exposition:

the main transaction costs that are saved are those which would otherwise have been incurred in market transactions between the factors now cooperating within the firm. It is the *comparison* of these costs with those that would have to be incurred to operate a firm which determines whether it would be profitable to establish a firm.<sup>84</sup> [Emphasis added.]

So, in terms of a sales tax on market transactions in a value chain, if a firm could vertically integrate some of the value-add, there would not be tax on those intermediate elements.<sup>85</sup> This analysis could also apply to labour costs and taxes on workers (payroll), whether social security or income tax. Here, the savings would arise if the firm could externalize the labour that would bear the labour tax, for example through making them independent contractors.

However, Coase did not address the potential impact of an income tax on the boundaries of the firm.

Barry and Fleischer show that there are many differences in tax characteristics that may lead the income tax to affect the boundaries of the firm and the conduct of business in the form of corporations, including different tax rates, the “double” taxation of corporate profit, the tax treatment of losses, the application of tax incentives, and taxation rules applying in more than one jurisdiction.<sup>86</sup>

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83 R. H. Coase, “The Nature of the Firm: Meaning” (1988) 4(1) *Journal of Law, Economics, and Organisation* 19, 26.

84 Coase, “Nature of the Firm: Meaning”, 32.

85 Barry and Fleischer suggest that a VAT would not affect the boundary of the firm, contrary to an income tax based on realization; however, vertical integration remains an issue in the context of a VAT in some sectors, in particular financial services, which is the reason these are more lightly taxed at a significant cost to revenue.

86 Barry and Fleischer, Tax and the Boundary of the Firm.

[MORE TO COME]

## 5.2 International Tax and the Equilibrium Between States and Business

Vogel was a renowned expert on international tax law and tax treaties, and he wrote substantial articles expressing his view in support of source taxation in the same year as the “Justification of Taxation”.<sup>87</sup> Despite this, *Justification for Taxation* does not address international taxation issues. It is a surprising omission, but it is worth noting that the essay was published before the 1990s financialization and digitalisation of the global economy. Vogel was an observer of the OECD’s Harmful Tax Competition project,<sup>88</sup> but he passed away before the G20-OECD Base Erosion and Profit Shifting (BEPS) Project that commenced around 2010 after the global financial crisis.<sup>89</sup>

If we consider the tax state in a global economy, we can see that states and MNEs are engaged in a dynamic negotiation that affects the boundaries of both the state and MNEs. This extends the view of Tsilly Dagan, who suggests that the opening of the economy leads to states operating more like market actors. As she explains:

The implicit traditional conception of states sees them as powerful sovereigns that operate in a closed economy with the capacity to make and enforce mandatory rules, impose taxes, and set redistribution. However, in many ways, states have come to resemble actors in a competitive global market, where their ability to govern is increasingly shaped by the international supply and demand of resources and the elasticity of taxpayers’ choices.<sup>90</sup>

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87 Klaus Vogel, “Worldwide vs. source taxation of income – A review and re-evaluation of the arguments” (Parts I, II, III) (1988) *Intertax* Nos 8/9, 216-229; 10, 310-320; and 11, 393-402.

88 OECD, *Harmful Tax Competition* (Paris: OECD, 1998).

89 OECD, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD, 2013).

90 Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation* (Cambridge: Cambridge University Press, 2018), 44.

When we open the borders of the tax state, the corporate income tax of various jurisdictions becomes a potential “cost” to the MNE that can be minimized through shifting real investment or through international tax planning or arbitrage. At the international level, taxation may become an even more important element of the transaction costs, or the allocation and control of resources and capabilities, in determining the boundaries of the firm than at the domestic level. MNEs will compare the transaction costs (including taxation) of operating through external contracts with the transaction costs (including lower taxation) that they can achieve when operating within corporate boundaries. The boundary of an MNE, its “home” and its “host” state are (at least to some extent) in the power and control of the entrepreneur-coordinator, whether that is analysed as the board of directors, executive management or controlling shareholders. This occurs through making choices to create or dissolve subsidiaries or invest across corporate boundaries, and this tends to turn corporations into lawmakers.

While international dealings bring with them the risk of double taxation, international tax planning, as is well known, frequently brings significant benefits in lowering the effective tax rate, but tax planning and shifting investment also have their own transaction costs: effects on real return, legal and planning costs, risk of audit and penalties and reputational risk.<sup>91</sup> Recent studies of MNEs

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91 There is a wide body of literature in the fields of taxation and international business on the benefits and costs of MNE tax planning; *see*, e.g. Maggie Cooper and Quyen T K Nguyen, “Multinational enterprises and corporate tax planning: A review of the literature and suggestions for a future research agenda” (2020) 29 *International Business Review* 101692; Michael P Devereux, Rachel Griffith and Alexander Klemm, “Corporate Income Tax Reforms and International Tax Competition”, Warwick: Centre for Economic Policy Research University of Warwick, 2002); Rosanne Altshuler, Lysle Boller, Kevin A Roberts and Juan Carlos Suarez Serrato, “Tax Planning and Multinational Behavior” Working Paper (Feb. 2025); OECD, *Tax Planning by multinational firms: Firm-level evidence from a cross-country database* (Economics Department Working Paper, 16 Feb. 2017), [https://www.oecd.org/en/publications/tax-planning-by-multinational-firms\\_9ea89b4d-en.html](https://www.oecd.org/en/publications/tax-planning-by-multinational-firms_9ea89b4d-en.html) and other OECD research on the G20-OECD BEPS project and Two Pillar solution.

and the law show a strong awareness of these potential effects of international taxation.<sup>92</sup>

Looking back to the 1980s, it seems clear that economic globalization has changed the previous equilibrium between business and the state in taxation. While Vogel did not refer to this explicitly, he appeared to imply that, during the 1980s, taxation on business was too heavy, and this undermined the fiscal bargain. Today, the equilibrium is again disrupted and tax sovereignty is contested in respect of territory (the geographical boundaries of the tax state), authority (the state's limited but justified authority to make tax laws) and rights (the legitimate tax state as the sole arbiter of rights and duties relating to taxation).<sup>93</sup> This is a consequence of contestation in the “borderlands” of the tax state between MNEs and the state.

This part briefly discusses taxation rules relating to (i) corporate residence, (ii) corporate finance (debt and equity); (iii) the extension of residence through controlled foreign corporation (CFC) rules and (iv) the source tax base (with reference to Vogel's views on the topic) which include both nexus and transfer pricing as it applies to MNEs in the global value chain.

### 5.2.1 *Corporate tax residence: the territorial embeddedness of firms*

During the past century, capital mobility has usually meant *corporate* mobility. Michael Devereux and co-authors argued, consistently with the resource theory of the firm, that governments:

compete for the activities of mobile multinational firms, which have access to

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92 See, e.g. Peter Muchlinski, *Multinational Enterprises and the Law* (3rd edition, 2021), which has a lengthy chapter on taxation.

93 Miranda Stewart, “Tax states, jurisdiction and the multilateral reality” in Elliffe, C (ed) *International Tax at the Crossroads: Institutionalisation and Policy Reform in the Era of Digitalisation* (Cheltenham: Edward Elgar, 2023) 115-140.

valuable proprietary assets, rather than simply for mobile capital. [...] such firms make discrete investment choices: for example, whether to export to a new market or to produce locally, or where within a new location to site a new production facility.<sup>94</sup>

While sometimes a branch or PE is utilized, MNEs usually establish or acquire a subsidiary company with a tax residence. Rules defining residence and associated tax obligations are a key element to be taken into account by businesses in establishing across various jurisdictions. The details may differ for defining corporate residence rules across countries, but the international tax law concept of “residence” has essentially been standardized as “one of the cornerstones of corporate income taxation, both in domestic and international law”.<sup>95</sup> This is the case whether “residence” relies only on registration or incorporation of a company in a jurisdiction (such as the legal requirement for being a “US corporation” in the United States), or on the “place of effective management” or “central management and control” adopted elsewhere.

The growth of MNEs arises because a cross-border investment decision into a new “host” jurisdiction does not usually involve an “exit” from one jurisdiction and “entry” into another jurisdiction by a single firm. While it is possible that an existing MNE would move some of its production activities from one jurisdiction to another chasing tax incentives for the activity, it is more likely that the foreign investment would be in a local subsidiary that produces an *enlargement* of the MNE or would entail an acquisition of an existing local corporation (or corporate group). This is because the subsidiary corporation as a member of an MNE and provided by a state with a

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94 Michael P Devereux, Rachel Griffith and Alexander Klemm, “Corporate Income Tax Reforms and International Tax Competition” (Warwick: Centre for Economic Policy Research, University of Warwick, 2002).

95 As discussed in Stewart, *Tax and Government*, ch. 10; Edoardo Traversa (ed.), *Corporate Residence and Mobility*, EATLP International Tax Series No 16 (Amsterdam: IBFD, 2017), 1.

tax “residence” is ideally suited for the distribution of the ownership of assets and the construction of transactions located in high-tax and low-tax territories around the world, i.e. the adjustment of source taxation. In some circumstances, it would be ideal for a subsidiary to be non-resident – perhaps, not resident anywhere – and this, too, may be able to be constructed through the utilization of differing definitions of corporate “residence”, generating “non-residence” or statelessness of a corporation.<sup>96</sup>

Corporate tax rules, including the definition of corporate residence, may have had some influence on the flight of capital away from the corporate sector into pass-through entities and funds, although this effect is likely to have been most pronounced in the United States domestic context, as discussed by Barry and Fleischer.<sup>97</sup> Internationally, we have seen the rise of cross-border investment through flow-through entities, including hedge funds, widely held investment trusts or limited partnerships, pension funds and sovereign wealth funds. Some forms of physical, infrastructure or active business investment now appear to be held in non-corporate entities, with more diffuse control. However, such funds almost always perform an intermediary role in channelling investment into corporations around the world.

The importance of the separate entity status of the corporation for international tax planning by US-headquartered MNEs is reinforced by the US “check-the-box” regulations in operation since 1997.<sup>98</sup> These generated new approaches to MNE tax planning because they enable US parent

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<sup>96</sup> Stewart, *Tax and Government*, 309.

<sup>97</sup> Barry and Fleischer, *Tax and the Boundary of the Firm; Bank, From Sword to Shield*, 258-9.

<sup>98</sup> Title 26 Treas. Reg. § 301.7701-3 (US), under which a US corporation can elect, by checking a box on the return, to have a foreign wholly owned subsidiary treated as if it does not exist for purposes of US corporate income tax liability.

companies to “look through” subsidiaries when this suited tax planning while in other circumstances recognizing separate legal status.<sup>99</sup> Most such international tax planning approaches rely on low-tax jurisdictions, or tax havens. Therefore, when we examine the cross-border context, we need to consider not only a “residence” state and a “source” state but also a third type of jurisdiction: tax havens. In this tripartite world, it is impossible to optimize global welfare absent a global minimum tax.<sup>100</sup> States operating unilaterally or bilaterally cannot achieve an equilibrium with MNEs if those MNEs can arbitrage taxation across multiple state borders, including through a tax haven.

In relation to the “home” jurisdiction, a question arises as to the strength of the connection of the “resident” MNE to its “home”. Vogel argued that the state and big business are separate “systems” which are nonetheless inseparable. He did not directly claim that business itself is also fundamentally linked to that home jurisdiction, but we may speculate that this is an assumption of Vogel that would be consistent with a history of German business.<sup>101</sup> In the past century, the place of residence or incorporation of the parent company of an MNE was a clear signal of the “home” of the MNE. A large business conducted through a multinational corporate group, headquartered in one country and with substantial investments in subsidiary corporations in other jurisdictions, was in

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99 Edward Kleinbard, “Stateless Income” (2011) 11(9) *Florida Tax Review* 700-66; and see Altshuler et al., *Tax Planning and Multinational Behavior*.

100 Rosanne Altshuler, “Lessons from the Study of Taxes and the Behavior of US Multinational Corporations” in Iris Claus, Norman Gemmell, Michelle Harding and David White (eds.), *Tax Reform in Open Economies* (London: Edward Elgar, 2010), 61-77.

101 This raises many issues, discussion of which is beyond the scope of this article; see, e.g. Caroline Fohlin, “The History of Corporate Ownership and Control in Germany” in Randall K Morek (ed.) *A History of Corporate Governance Around the World: Family Business Groups to Professional Managers* (Chicago: University of Chicago Press, 2005), 223.

some way nationally representative.

For example, Caterpillar is perceived as a US company, Toyota as a Japanese company, Mercedes-Benz as a German company. The investments of the MNE beyond the boundaries of its “home” state were identified more or less with the state and were even perceived as an extension of state power that would benefit or enhance economic interests of the “home” state. This was often assumed to be within the control of the “home” state, which might seek to develop tax rules that aimed to manipulate the size and type of capital outflow (or inflow) to its own advantage.<sup>102</sup>

However, as the national corporation developed into the flexible, mobile and globally proliferating form of the MNE during this century, Mihir Desai suggested that the link between the MNE and the “home” state is broken and “the center cannot hold”: “The archetypal multinational firm with a particular national identity and a corporate headquarters fixed in one country is becoming obsolete as firms continue to maximize the opportunities created by global markets. National identities can mutate with remarkable ease and firms are unbundling critical headquarters functions and reallocating them worldwide.”<sup>103</sup>

An MNE may detach itself from the “home” jurisdiction in numerous ways, such as shifting its tax residence, a reverse takeover or “corporate inversion”. From the 1980s until the United States enacted anti-inversion rules and, subsequently, the US corporate tax rate was lowered from 35% to 21%, there were numerous “inversions” of US corporations to locate headquarters in low-taxed

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102 Peggy B. Musgrave, “Sovereignty, Entitlement, and Cooperation in International Taxation” *Brooklyn J International Law* 26, 1335 (2001): 1340.

103 Mihir A Desai, “The Decentering of the Global Firm” (2009) 32 *The World Economy* 1271-90, <https://doi.org/10.1111/j.1467-9701.2009.01212.x>.

jurisdictions. Bank describes the “decentering” as partly due to a dramatic rise in cross-border mergers and acquisitions of US corporations during the 1990s.<sup>104</sup> In 2015, the pharmaceutical group Pfizer entered into a USD 160 billion inversion agreement with Ireland-based pharmaceutical corporation Allergan. The headquarters of the merged group were to be in Ireland, facing a favourable 12.5% tax rate. The deal was terminated following the introduction of anti-inversion rules in the US tax code, and today Pfizer remains headquartered in the United States.<sup>105</sup>

If it seems important to national sovereignty to “keep” such MNEs, one way to achieve it is to lower the tax rate – which is precisely what the United States did in 2017. Barry and Fleischer suggest that lowering the corporate tax rate may have been a necessary response to address the many distortions of the boundaries of the firm.<sup>106</sup> It has also likely attracted “back” various MNEs to a more favourable tax and regulatory environment.

### 5.2.2 *Tax and corporate finance in a global financial economy*

As discussed by Barry and Fleischer, most tax academic scholarship that discusses the impact of tax on the boundary of the firm concerns corporate finance and, in particular, the tax rules about debt and equity. There is a wide literature on the debt-equity distinction and “how tax considerations can distort capital structure”.<sup>107</sup> The different tax treatment of dividends (non-deductible) or capital

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104 Steven Bank, *From Sword to Shield*, 262.

105 Michelle C Neely and Larry D Sherrer, “A Look at Corporate Inversions, Inside and Out” (2017) *The Regional Economist* 1-3, [www.stlouisfed.org/~media/publications/regional-economist/2017/first\\_quarter\\_2017/corporate\\_inversions.pdf](http://www.stlouisfed.org/~media/publications/regional-economist/2017/first_quarter_2017/corporate_inversions.pdf).

106 Barry and Fleischer, *Tax and the Boundaries of the Firm*.

107 Barry and Fleischer, *Tax and the Boundaries of the Firm*, 12 (fn 52), citing Franco Modigliani & Merton H. Miller, “The Cost of Capital, Corporation Finance and the Theory of Investment,” 48 *American Economic Review* 261 (1958).

gains (potentially lower rates) relative to interest (deductible; taxed as ordinary income) is central to tax treatment and may affect corporate finance and investment decisions.

In relation to corporate equity, the issue is not the scale of equity issued but the level of control. For example, the mere fact of public listing and being widely held by thousands of shareholders does not change the boundaries of the firm, even if some of those shareholders are themselves corporations. In contrast, a dominant share investment enables engagement in management of the firm. This could imply expansion of the boundaries of the firm to include the new controlling shareholder *inside* the firm.

In contrast, lending money to a firm on commercial terms is a market transaction that is *outside* the firm, even if the loan is large, and even if repayment and return have priority. So, we would distinguish between even very large commercial debt contracts and large and controlling equity “contracts” (so to speak) in relation to the boundaries of the firm. However, private equity, managed funds, limited partnership structures and high debt financing all may blur the boundary of the firm, achieving an injection of capital and managerial control without necessarily establishing direct equity ownership in the corporation.

When considered in the international tax context, the choice of debt or equity investment has significant and divergent tax consequences in relation to different countries that have higher or lower tax rates. The ability to arbitrage debt deductions across borders is a reason to expand the size of an MNE. It is attractive for owners to control both equity and debt by bringing a subsidiary under control that is nonetheless recognized as a separate legal entity in another jurisdiction. Higher debt from the controlled subsidiary with a deductible return (thin capitalization) is attractive where the subsidiary is in a high-taxed country, as it achieves base erosion in that jurisdiction. Higher equity is

attractive where the subsidiary is in a low-taxed country, especially if dividends may be zero or low-taxed, for example under a tax treaty.

Therefore, MNEs may seek to expand the size of the corporate group so that they can control related-party debt as well as equity while still maintaining low interest rates for external borrowing by the MNE through achieving global scale. This is also a reason why thin capitalization and anti-hybrid rules are so important in international tax, for example, those established in many countries to implement BEPS Actions 2 and 4.<sup>108</sup> The United States did not explicitly implement those Actions in reforming its tax treatment of hybrids and corporate finance. However, the thin capitalization limit is more or less consistent with the BEPS Action 4 approach.

The BEPS Action 4 change in the structure of thin capitalization rules from a debt-to-asset ratio or other metric to a limit based on earnings before interest and depreciation of assets (“EBITDA”)<sup>109</sup> may also have an effect on the boundary of the firm, and alter the relationship between the state and MNEs. This is because the EBITDA limit delivers greater interest deductions to MNEs that invest in expensive depreciable plant and equipment – such as gas extraction or data centres – effectively subsidizing debt finance for these businesses relative to others, while being either a result of, or contributor to a closer alignment between such enterprises and the state.

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108 Action 2 report; OECD (2015), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/9789264241176-en>.

109 As recommended by the Action 4 report and adopted by many countries including the United States in the One Big Beautiful Bill Act of 2025: Internal Revenue Code section 163(j).

### 5.2.3 *Controlled foreign corporations and “deferral”*

The place of residence of a company is a foundation for various other corporate tax rules, including CFC rules, corporate group consolidated taxation in many countries, the identification of the head entity for operation of the GloBE, and a range of other tax obligations relating to data sharing and country-by-country reporting obligations.

In relation to CFC rules, the US Treasury historically called the benefit of holding income in a subsidiary offshore “deferral”, a description that assumed a right to tax foreign profit on the basis that worldwide income encompasses income controlled in other entities and even arising in other states.<sup>110</sup> Originally, President Kennedy proposed that *all* controlled foreign income of US parent corporations would be taxable on an accrual basis, equalizing the treatment of foreign controlled subsidiaries and branches.<sup>111</sup> However, the enacted CFC rules excluded most foreign active business income, the “political compromise” of Subpart F applying accrual taxation only to so-called “passive” income.<sup>112</sup> The equal treatment of branches through the concept of a PE and subsidiaries was intended to produce neutrality to the corporate structure of investment. Either way, the foreign production was within the boundaries of the firm.

The heart of CFC rules is a legal definition of the corporate group and of the “control” of foreign subsidiaries of a resident parent entity and its shareholders in the home jurisdiction. CFC

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110 Vogel suggested this was an overreach or bias of the United States in the assertion of jurisdiction beyond the borders of the state: Klaus Vogel, “Worldwide vs. source taxation of income – A review and re-evaluation of the arguments” (Parts I, II, III) (1988) *Intertax* Nos 8/9, 216-229; 10, 310-320; and 11, 393-402.

111 President Kennedy, H.R. Rep. No. 1447, 87th Cong., 2nd session 1962.

112 Yariv Brauner and C.A. Davis, ch. 42: “Controlled Foreign Company Legislation in the United States”, in *Controlled Foreign Company Legislation* (G.W. Koflere et al. eds., IBFD, 2020).

rules extend residence tax jurisdiction both across national borders and across the border of the firm, as well as overcoming another “border” of many income tax systems – the realization requirement – to tax foreign profits on an accrual basis to the parent entity.

Many countries have not had CFC rules in the past, but they are increasingly adopted and have recently been required in Europe in the Anti-Tax-Avoidance Directive (ATAD).<sup>113</sup> While rules vary significantly, usually, they apply a 50% ownership or voting control requirement for a CFC, which may usually be traced through a chain of subsidiary entities. CFC rules clearly seek to expand, or shore up, the boundaries of the tax state. However, they may affect the boundaries of the firm in different ways. An effective CFC rule may render it no longer attractive for a business to derive various types of income offshore in lower-taxed jurisdictions – potentially, this could have the effect of repatriation of such income to the resident entities or reducing the offshore presence of the firm. More likely, CFC rules may have the effect of adding complexity to the legal structure of the MNE and even expanding its boundaries to achieve tax planning that minimizes their impact.

While CFC rules could be considered as anti-abuse or integrity rules aimed at protecting the residence worldwide jurisdiction for passive income (and not just extensions of tax jurisdiction beyond borders), they may themselves be avoided depending on the definition of the corporate group and the control requirements. This ensures that the legal form and structure of the MNE will continue to be important in tax planning. For example, the EU ATAD requirements for a minimum CFC rule in member states mainly refer to de jure structural ownership and control at the 50% minimum. Consequently, they can be avoided by substituting de facto control for de jure control,

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113 EU Council Directive 2016/1164 (12 July 2016), art. 7.

adjusting the proportion of ownership or inserting a “blocker” intermediary company in a foreign jurisdiction.<sup>114</sup> The assertion of taxing jurisdiction or expansion of the boundaries of the tax state may be repelled by a change in the boundaries of the legal entity structure of the firm.

#### 5.2.4 Source taxation and transfer pricing

The introduction referred to Vogel’s three-part review and re-evaluation of the arguments for worldwide versus source taxation of income published in 1988.<sup>115</sup> Surprisingly, Vogel did not directly connect this work to the equilibrium that he sought between business and the state in *The Justification of Taxation*.

To briefly summarize his detailed exegesis, Vogel argued that both efficiency and equity support the primacy of the source state, and hence he favoured a territorial system, in direct contradiction to the assertion of residence jurisdiction (for example, in CFC rules, as discussed in 5.2.3.) The importance of source taxation and many of Vogel’s proposals are under further consideration today.<sup>116</sup> The source basis would be accommodated by the residence state exempting income arising from a source elsewhere.

Vogel argued that source taxation should prevail for direct investment defined by production and carried on, mainly, by business enterprises through a PE. He also argued in support of source

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114 Thomas Kollruss, “The Relationship between Taxation, Accounting and Legal Forms” (2025) 15(2) *Accounting, Economics and Law* 275-305 doi.org/10.1515/acl-2019-0076.

115 Klaus Vogel, “Worldwide vs. source taxation of income – A review and re-evaluation of the arguments” (Parts I, II, III) (1988) *Intertax* Nos 8/9, 216-229; 10, 310-320; and 11, 393-402.

116 Yariv Brauner, “Income and Territory: A Purpose-based Reform of Income Sourcing Rules” (2026) 74 *Canadian Tax Journal* (forthcoming); Yariv Brauner, “Comfortably Numb: Should the Reign of Residence Over the International Tax Regime Continue in the 21st Century” in Tsilly Dagan and Ruth Mason (eds.), *Taxing People: The Next 100 Years* (Cambridge: Cambridge University Press, 2025).

taxation of portfolio investment and of royalties, sales and services income. For income from rentals and royalties, Vogel suggested that the asset's "services" component should be allocated between countries, as distinct from the asset's "amortization" component. Income from sales would be taxable up to a "trader's" margin in the market state but otherwise in the state of production if sold directly by the manufacturer, while income from services would be taxable in the state where the services were performed. Even where sales or services do not arise from trading within a state or are not performed in the state, Vogel considered that the tax jurisdiction should be apportioned half to the source and half to the residence state, while in other circumstances he supported a one quarter (residence): three quarters (source) allocation.

It seems likely that Vogel's strong support for source taxation is a further expression of Vogel's suggested equilibrium between state and business, which recognizes the importance of production and the benefit provided by the source state. This respect for the source state provides the justification for source taxation, which is to support that state's commitment to the welfare of its people. However, Vogel's analysis of source taxation does not address the situation of tax havens or where there are three or more jurisdictions, some of which are low-taxed. It is also somewhat ambivalent as regards the situation where the source state abrogates their taxing rights by enacting tax incentives. Vogel does expect that tax rates may well be lower in host countries but would still prefer the primacy of source taxation and the exemption system. He does not directly address the dynamic of power and resources between state and MNEs which are selecting locations for investment (such as manufacturing) and which base this not only on wages or distance from markets but also on a lower tax rate.

Source taxation requires the determination of profits of the MNE to be allocated to the source

jurisdiction, leading to a need for a principle for such allocation. Of course, this has grounded the requirement for transfer pricing rules since the middle of the last century, to address the situation of common control (between related parties) of the price for transactions within the boundaries of the MNE. The standard arm's length principle, and its detailed application in the adoption of transfer pricing guidelines that emphasize functions, assets and risks,<sup>117</sup> is an attempt to unwind or overcome the internal hierarchical control over pricing inside the MNE, effectively changing this to a market transaction. Considered in light of the discussion of the boundaries of the firm and the tax state (part 4), this suggests an attempt by the state to alter the very organizational institutionalized structure of the MNE, as it operates in a global digital economy.

Transfer pricing rules seek to limit or remove a key taxation benefit of the transaction cost savings of forming an MNE without undoing the other benefits of this organizational form adopted by big business operating across borders. However, can this ever be successful in an environment where international taxation appears to have been fundamentally important in the structuring of MNEs? The availability of tax havens and the opportunity to do international tax arbitrage provide a significant advantage to those businesses that can restructure globally compared to those that cannot. It seems likely that this has contributed to the agglomeration of resources and capabilities, including capital and technology, in MNEs. The arm's length principle appears to be long-standing and stable, but it has ultimately generated instability, as it has enabled MNEs to transform the boundaries of tax states. Transfer pricing rules can no longer (if they ever could) achieve a stable equilibrium between big business, in the form of MNEs, and states.

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117 OECD (2022), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, OECD Publishing, Paris, <https://doi.org/10.1787/0e655865-en>.

As has been argued by many, this therefore suggests a need for an alternative approach to “arm’s length” so as to tax profits of corporate groups, for example through formulary apportionment. Yet these alternative approaches also rely on a definition of the boundary of the firm. This may be based, as is the case for the GloBE, on an accounting definition of firm profits and the boundary of firm control. A response to such a rule could be for MNEs to unravel, for example by shifting to different forms of third-party arrangements with control established through contractual terms.

In response to this phenomenon, David Quentin suggests that we need to consider the MNE as it operates in a broader global value chain that extends *outside* the boundaries of the firm but in which it nonetheless can exert significant control and limit prices through contractual terms that compress the returns of other contracting parties, extracting what could be termed value chain economic rents.<sup>118</sup> Even in the current system, there is some empirical evidence of such internalizing or externalizing of contracts in production and value chains within or outside MNE corporate groups, depending on the effective tax rate.<sup>119</sup>

### **5.3 Disequilibrium in the Global Digital Economy**

How much has digitalization changed the tax landscape since the 1980s? It seems that today, at least in relation to the returns to services and “big tech”, states and big business are not in equilibrium; rather, they are in a highly unstable and uncertain state. The latest disruptive

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118 David Quentin, “Corporate Tax Reform and “Value Creation”: Towards Unfettered Diagonal Re-allocation across the Global Inequality Chain” (2017) *Accounting Economics and Law* DOI 10.1515/acl-2016-0020, 13.

119 Xiangjun Ma, “Do taxes influence the organizational boundaries of international firms? An incomplete-contracting model with empirical evidence” (2017) *Journal of International Trade & Economic Development* 26(7), 801-828.

developments in the United States, including tariffs, proposed “revenge” taxes and President Trump’s direct engagement with tech executives and companies through public investment or executive appointments, are symptoms of a change in the state-business bargain.<sup>120</sup>

Regarding the resources, growth and scale of MNEs, Penrose observed during the 1990s that we can consider the resources of the firm in a global era as highly mobile “packages containing different proportions and types of capital, managerial services, technology, etc. bound together within the integrated framework of a firm” that could grow or be moved across national borders.<sup>121</sup> She also suggested that very large global firms may require a different analysis, which is relevant given data suggesting the continued growth and dominance of a small number of very large firms.<sup>122</sup>

In the global digital economy, a result of the contestation over international taxing power suggested by Dagan is that the bureaucratic, hierarchical state becomes more like a market actor, competing with other states for capital, people and resources.

At the same time, MNEs are becoming more like states. The theory of the firm tells us that MNEs already operate in a bureaucratic and hierarchical organizational form. In respect of international taxation in a global digital economy, MNEs take on even more state characteristics. They become tax lawmakers and expand or even enclose low-tax territory by piecing together

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120 There is general agreement that the current situation is unstable, but disagreement about “who started” the trade and tax war or generated the instability - some take the view that it was the UK, and other countries, implementing unilateral DSTs on US tech MNEs that caused the instability. See, e.g. Scott Levine, Alexandra Minkovich and Gary D Sprague, “An Updated Look at the Policy Justifications for the U.K. Digital Services Tax” *Tax Notes International* 122, 483.

121 Edith Tilton Penrose, *The theory of the growth of the firm* (1995, 3rd edition; 1959), Preface, xv.

122 UNCTAD, World Investment Report.

different tax regimes in jurisdictions, entity forms, and types of business function, or participating in privatized legal regimes of soft law, self-regulation and financial accounting.<sup>123</sup> The core features of territory, authority and rights of the tax state appear to shift through these changes into other organizational structures such as the MNE.

### *5.3.1 Disappearance of the firm?*

A different kind of risk is that the state-business bargain may break down, or at least become unbalanced, because firms themselves are changing. That is, today's firms are not the institutions that they once were, embedded in a state-market system or in regulatory capitalism. We may see the full marketization of all inputs and digital and platform economies, with the consequence that the boundaries of firms (or "organizations") may be disappearing.<sup>124</sup> In Coase's analysis, the transaction cost savings of keeping transactions *inside* a large firm may be eliminated by marketization. This may occur if the resources which a firm controlled and which lowered its transaction costs are becoming "algorithmized" into digital capital inputs or are being delivered outside the firm, including capital markets, supply markets, labour markets and even management skills. The main element remaining is innovation, or knowledge of the entrepreneur. Perhaps what is holding MNEs together is taxation and capital advantages combined with innovation.

### *5.3.2 State responses*

States may respond to this challenge in different ways. They may "vacate" the field, applying

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123 This is consistent with the history of corporations asserting state or governmental coercive power, such as the Dutch East India Company; *see, e.g. Pahuja, Making Sense of the Corporation in International Law.*

124 Davis and DeWitt, Organization Theory and the Resource-Based View of the Firm.

lower tax rates, tax incentives, or tax rulings that support low taxation of MNEs. Alternatively, they may step up enforcement, attempt to develop unilateral tax rules that extend jurisdictional scope or shift away from the corporate income tax (such as diverted profits taxes or digital services taxes). Finally, they may seek to cooperate with each other across borders. We can see each of these elements, and indeed combinations of them, in both residence and source state behaviour since about 2010.

One possibility is that states take on more of the attributes of corporations to survive in this globally and digitally interconnected world. These attributes include competition, as already noted. States may seek to increase their capability or capacity to tax by relying on technology, data and AI; it is not clear whether this could make a difference with respect to the tech enterprises themselves. Alternatively, state interests may become fragmented, and state lawmaking authority may be diluted. Power within states may shift towards the executive; states may become more hierarchical and led by executive power, as suggested by Sassen.

For example, the fiscal bargain with big business may be brokered more by the executive and less by dispersed decision-making in the legislature, and this is likely to lead to greater potential for corruption. Nationalism may be stronger than ever – but it may be a particular kind of nationalism in which the tax state is shaped either in alignment *with* business interests or *against* them. Perhaps, the legitimacy of the fiscal bargain (the triangular relationship of state, civil society, and business identified by Vogel) would be rendered in two dimensions, with civil society either aligned with, or opposed to, a state-business combination.

A different response to the current disequilibrium between states and corporations is to increase multilateral cooperation between states, including the Two Pillars and other BEPS measures, and at

the United Nations. The Pillar Two global minimum tax appears to have established some legislative and jurisdictional weight, potentially protecting the baseline capacity of the corporate income tax in a world without borders. It is not clear yet whether the legitimacy and stability of this bargain will be undermined by the “side by side” agreement with the United States.<sup>125</sup> Even if it operates, however, attention has now turned to the effects of the minimum tax on the structure of tax incentives in a context where it is likely that “systems competition” will continue even if “tax competition” is constrained.<sup>126</sup> The global minimum tax may lead over time to a restructuring of other elements of state governance of the economy, and it may also reduce some of the advantages for big business of operating in an MNE.

In contrast, attempts at multilateral agreement on taxing the economic rents of very large MNEs have so far failed, with the multilateral convention for Pillar One designed with an embedded US veto building on a US state-corporate alliance.<sup>127</sup> The proposed United Nations Framework Convention on International Tax Cooperation offers potential benefits to all states in seeking to recognize the market, value-creation, users, or data as a foundation for source tax jurisdiction; to date, developed countries are resistant to this opportunity.<sup>128</sup>

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125 OECD, Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), Side-by-Side Package, Jan. 2026, <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/side-by-side-package.pdf>.

126 Hans-Werner Sinn, *The New Systems Competition* (Malden, MA: Blackwell Publishing, 2003).

127 OECD, Multilateral Convention to Implement Amount A of Pillar One, <https://www.oecd.org/en/topics/sub-issues/reallocation-of-taxing-rights-to-market-jurisdictions/multilateral-convention-to-implement-amount-a-of-pillar-one.html> (OECD, 2023).

128 Co-Leads Zero Draft, United Nations Framework Convention on International Tax Cooperation, Article 5, available from <https://financing.desa.un.org/unfeitc> (July 2026).

### 5.3.3 Can the “two system” analysis hold?

Perhaps what we are seeing is a renewal of a strong linkage or interdependence of business with geopolitical and state concerns, which looks more like a new form of Galbraith’s techno-industrial state than Vogel’s two-system equilibrium. That is, a bargain between two *separate* systems of state and business as advocated by Vogel may no longer be possible in a global digital economy. Rather, some MNEs will align with some states, while others may detach altogether from state linkage; the interests of state and business will merge in some respects or in some sectors and will be less interdependent in others.

This is reflected today in a renewed focus on the “nationality”, or lack thereof, of “big tech” MNEs, in particular, in the area of social media, chips and AI. This has long been observed in relation to China, but we also see it now in the United States and perhaps elsewhere. The debate about TikTok leading to the proposal to spin off its US operations (and data) into US-owned and controlled companies, the US government’s acquisition of 9.9% of Intel and the NVIDIA deal and punishing tariffs on importation of chips are all evidence of this.<sup>129</sup> Tax is far from the most important issue here. The issues concern geopolitical and resource security and control. The combination of state and enterprise in the world of tech dominance has been called, at an extreme, “technofeudalism”.<sup>130</sup>

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129 See, e.g. NBC News, <https://www.nbcnews.com/tech/tech-news/trump-signs-executive-order-tiktok-deal-know-rcna233518> ; <https://www.cnn.com/2025/09/18/intel-nvidia-investment.html>; <https://www.wsj.com/economy/trade/trump-chip-tariffs-exemptions-90fa2ab3>.

130 Hochuli, A, “Technofeudalism versus Total Capitalism” *American Affairs* IX(3) (Fall 2025): 129-57, available <https://americanaffairsjournal.org/2025/08/technofeudalism-versus-total-capitalism/>; Cédric Durand, *Techno-féodalisme: Critique de l’économie numérique* (Paris: Éditions Zones, 2020); Cédric Durand, *How Silicon Valley Unleashed Techno-Feudalism: The Making of the Digital Economy*, trans. David Broder (New York and London: Verso

The breaking down of the separate “systems” of state and business may ultimately go hand in hand with monopoly and the extraction of economic rents from consumers and workers in the global market by large MNEs, as well as “tax rents” from ongoing tax planning across jurisdictions where a multilateral solution is not achieved.

The main challenge of the global digital era has been to *levy tax at all* – to tax the economic rents or global super-profits of these corporate giants. This may be a result of monopoly, or oligopoly of sorts. In Arnold Harberger’s words, we can think of the return to the monopolist as itself like a “privately imposed, privately collected excise tax on the monopolized product or products”.<sup>131</sup> The extraction of value by the monopolist wrongly co-opts the economic return that should go to consumers in the market, or to governments as sovereign actors. Harberger concluded that there is no easy way to tax monopoly profits except by a corporate income tax.<sup>132</sup>

These changes may in a sense force MNEs back into a bargain with their own states (and increasing domestic investment in response to state carrots and sticks) while at the same time reducing the power of states to tax them (lower corporate tax rates and the aforesaid carrots). States may ultimately fail to levy much taxation on the profits of business enterprises that are most strongly aligned with state interests if they comply with the demands of the relevant state. States may reduce taxes on those corporations that extend state power while raising taxes on those that disagree. States may seek multilateral cooperation that sufficiently protects the capacity of the

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Books, 2024).

131 Arnold Harberger, “The Incidence of the Corporation Income Tax Revisited” (2008) 61(2) *National Tax Journal*: 303-12.

132 Stewart, *Tax and Government*, ch. 7, 191; Arnold C. Harberger, “The Incidence of the Corporation Income Tax Revisited” (2008) 61(2) *National Tax Journal*: 303-12.

residence state to tax its own residents, including “its” corporations, while limiting the capacity of other states to do so. States may also take action against other states that seek to tax “their” (the former states’) MNEs. Powerful states may adapt elements of international tax law to accommodate capital, specific MNEs or particular sectors, so that international tax law becomes a weapon used against other states, including by small states in either coerced or symbiotic relationships with global capital. States and corporations more generally may combine to assert power with respect to tax lawmaking over other states – a form of aggression, or a renewed form of imperialism. In this scenario, international tax rules are far from a means to share tax jurisdiction (with a weight towards the source country) as proposed by Vogel.

## **6 CONCLUDING THOUGHTS**

This paper has examined the relationship between states and corporations in today’s global digital era, taking as its starting point Klaus Vogel’s essay *The Justification of Taxation* of 1988. Vogel argued that the justification of taxation (and by implication the stability of the tax state) rested on an equilibrium in a triangular relationship between the state, big business and civil society. The state achieved substantial and effective taxing power enabling delivery of the means of wellbeing and welfare for the community, while the strong economy that generated the fiscal return was mainly represented by big business organized in corporations. The equilibrium had become unsettled during the 1980s, perhaps because the tax burden on business (and society) was too high. Vogel did not refer to economic globalization, but with hindsight this seems to have been of great importance in the destabilisation of the fiscal equilibrium, and continues to be so today in a global digital era.

The concept of an equilibrium between big business and the state remains useful in

contemporary conditions. However, today, states and corporations no longer seem to be in equilibrium but instead seem to operate in an era of instability, uncertainty, rapid change or even crisis. The boundaries of both states and corporations, specifically MNEs in the global digital economy, are less clearly identified than Vogel's concept of separate "systems" suggests. Business organized in MNEs seem to be becoming "bigger" than ever before or, alternatively, to be dissolving as the market or price mechanism reaches into the firm. Capital combined with technology enables new diversified forms of business operation that provide a less accessible tax "handle" than the corporation. These boundaries are dynamic and continually negotiated through modes of cooperation or conflict in the tax borderlands. This produces a shifting distribution of power, territory and resources between states and corporations while also impacting their organizational boundaries.

We seem to be struggling to generate a stable fiscal bargain between "big democracies" and "big business" in the United States, and elsewhere. Applying the systems and equilibrium analysis of Vogel helps us to explain the variety of responses to this situation, including contradictory turns towards "deglobalization" or "America first"; towards multilateralism by some states; or towards unilateral measures or substantial tax reforms that shift tax systems to bases different from the traditional corporate income tax, such as cashflow-style taxes, digital services taxes or tariffs. It may also help to explain the process through which big business and states align in an enhancement of executive power, which has the potential to undermine the legitimacy of the fiscal bargain of states. The ideal equilibrium in our new "reality" requires international tax rules that support an equilibrium between state and business that promotes the welfare of society as a whole.