Comparative Advantage of Taxation Systems

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I. Introduction

In International trade the term 'comparative advantage' has long been meant to represent a nation's natural advantage in producing a product. The term explains one advantage of trading between national boundaries. Whether the advantage is access to certain natural resources, materials, growing areas or specialized labor force, the advantage represented a naturally occurring advantage in producing a certain product for trade. The term was most likely not meant to represent an artificially occurring advantage such as a nation's taxation system.

A nation's taxation system or the manner in which a nation taxes its companies is a sovereign right. It is long established that companies located within the borders of given nation are subject to the laws and taxes of that nation. In addition to taxing its people most nations also tax its companies. There are several distinct methods of taxing companies. The most widely used method is the value added tax (VAT). The method the United States uses is the income tax. Both methods have their advantages and disadvantages.

One of the advantages of the VAT is that it does not tax a company's exports. This gives some advantage to exporters from nations using VAT. Several attempts to equalize this advantage have been judged to be inconsistent with international trade agreements. In order to equalize this advantage it might be necessary ultimately to change the United States tax system. However, changing the United States tax system might not be in the interest of the goals and priorities the nation's tax system.

II. VAT taxation system

VAT is a taxation system on goods and services when the goods and services are consumed.[1] The tax is based on a proportion of the price that's the good or service is sold.[2] Even though the ultimate tax is only when the goods a finally consumed the tax is paid on each transaction.[3] Then the tax paid up to that point is deducted from the tax owed.[4]

Each transaction is taxed. For example Miner sells $10 worth of iron ore to Forge. If the tax rate is 10% then he collects $11 from Forge and pays $1 to the Tax Collector. Forge then turns the iron ore into $20 of steel and sells it to Auto Company. He collects $22 but then deducts the $1 the miner paid and pays $1 to tax collector. Finally the Auto Company sells $30 worth of car to Driver. He collects $33 and pays one dollar to tax collector as well.

Each step on the transaction or production of goods is taxed. This is the feature that gives VAT it's name "value added." Because each time value is added, the system taxes that proportion of value. In the end one rate is applied to the final consumed good. Although only the final person is theoretically taxed each person along the way is taxed.

Any person or entity engaged in economic activity is considered a taxable person.[5] This would include companies as well as individuals. However, it only includes people and companies within the territory.[6] Goods are taxed where a person receives

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[1] Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax. EU 2006/112/EC. Article 1 (2).

[2] Id.

[3] Id.

[4] Id.

[5] Id at article 9.

[6] Id. at article 2(1)(a).

them but services are taxed where a person performs the service.[7] These are the basic aspects of the VAT System. Many countries use the VAT system as a method of revenue. But most notably the European Union has set the standard for its use between member states.[8] The EU believes the VAT system creates the best opportunity for neutrality and simplicity in revenue connection.[9]

A. VAT System of The European Union

The EU is the most prominent user of the VAT. An examination of VAT in the EU will present the best view some of the aspects of VAT system. The EU has also sought to set uniform principles of applying VAT to its various member states that help to shed more light on various aspects of the system.[10] The practical challenges in creating a more uniform VAT application illustrate the comparative differences in VAT application. By examining these rules, the underlying problems they address will be more evident and a fuller explanation of the aspects can be made.

The unifying aspects that the EU sought to address in creating the common system of VAT are establishing a minimum tax rate between members, setting the groups and goods and services that should be taxed, harmonizing the exemptions and exceptions to the tax, and defining who should be taxed.[11] The purpose of the common system is the application of taxes so they do not distort competition or hinder the free movement of goods and services throughout the Union.[12]

7 Id.
8 Id. at preamble.
9 Id. at preamble section 5.
10 Id.
11 Id. at preamble.
12 Id at preamble section 4.

These are consistent with the goals of free trade and the creation of the Union in the first place. A goal of a commonality of laws which allows for individual differences but do not allow for trade distortions or artificial economic incentives.

The first alignment is the tax rate. The EU has set, for most items, a minimum VAT Tax rate of 15% which must be applied by all countries.[13] A country wishing to set her taxes higher could do so. Since higher taxes usually have a debilitating effect on economic performance that debilitating effect will serve as the upper cap on taxes. The lower limit would keep maverick states from undercutting other member states and there by attracting more business and people into their region. This distortion effect is the purpose of the minimum tax.[14]

Another important alignment is uniformly deciding what should be taxed and where it should be taxed.[15] Certain goods that maybe provided by the state are required to be taxed. For example gas and electric services, "thermal energy," are a required tax even if the state provides it.[16] They other key feature is it is considered a territorial based tax.[17] It only taxes transactions that occur within its borders.[18]

The territorial feature is one that creates some conflict in trade. Transactions are taxed on goods at the place the goods are when they are supplied.[19] But that is provided the goods are going to a member state. Goods being exported out side the union are not

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13 Id. at preamble section (29)
14 Id.
15 Id. at Title 1.
16 Id. at Article 15.
17 Minella, Nicolas, *Motives and Consequences of the FSC Dispute: Recent Salvo in a Long Standing Trade War or fashioning a Bargaining Chip?,* 27 Brooklyn J. Int'l L. 1065, 1072.
18 Id.
19 EU 2006/112/EC. at Article 31.

taxed.[20] Goods that are imported are tax at the location of the designated importer at the same rate as domestically produced goods.[21]

Furthermore the transfer of property, or immovable assets, is required to be taxed as goods.[22] But there is an allowance for the reduction in tax by the amount of tax that was last paid on that transaction.[23] Furthermore leasing property is exempted from tax under the EU scheme.[24] It seems this would be a clear preference to limit alienation of property in favor of landowners.

The major benefit of the value added tax is its neutrality of taxation. It taxes every transaction equally. However, this benefit also makes it considered a regressive tax.[25] Every transaction regardless of whether the person transacting is wealthy or poor is taxed at the same rate. People with higher incomes tend to spend less as a percentage of their income.[26] Less of their income is taxed. To combat the regressive effects there are several allowances for reduced tax rates for certain goods.[27]

The EU exempts certain transactions from the minimum tax rate.[28] Some of the items are clearly to offset the regressive effects of a VAT system such as foodstuffs, pharmaceuticals, medical services, social services and water.[29] A larger proportion of expenses of lower income people will be spent on food and medical services. However,

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20 Id. at Article 138.
21 Id. at Article 32.
22 Id. at Article 14 and 15.
23 Id. at Article 167.
24 Id. at Article 135.
25 Nolan, John, *Before The Annual Meeting of the American College of Tax Counsel*, 12 Am. J. Tax Pol'y 207,215.
26 Id.
27 EU 2006/112/EC. at Article 98.
28 Id.
29 Id at Annex III.

some exemptions are likely for political reasons, for example admission to sporting events.[30]

While certain goods are exempt from the minimum tax rate for social and political reason there are certain goods even if the state provides them they need to be taxed.[31] Even if the state provides gas, electricity, thermal energy and water, for example they need to tax the sale of those goods and services.[32] Expenditures for these items will also effect lower income as a larger proportion of there income will be spent necessities like gas and electricity. Although this is not entirely regressive because higher income individuals will likely have larger places to heat will so they will spend more on these items than lower income individuals.

B. VAT in Europe as Compared to Consumption Based Tax in General

Many people argue that the VAT or consumption based tax encourages savings as expenditures.[33] Economists have not reached a conclusion about this though.[34] In a 1995 study conducted Dr. Janet Meade using 90 undergraduate subjects found that a consumption based tax had a neutral effect on the savings rate.[35] This finding corroborated previous studies.[36]

The VAT system in Europe requires companies pay the tax. Some members still retain an income tax for individuals earning money in the territory. However, companies will then recover that tax at the point of sale; the VAT is passed on directly to the consumers. Despite VAT being a tax on businesses it actual taxes consumers. So it is not

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30 Id.
31 Id. at Article 13.
32 Id. at Annex I.
33 Nolan, *supra* n. 25, at 213.
34 Id.
35 Meade, Janet A., *The effects of income and consumption tax regimes and future tax rate uncertainty on proportional savings and risk-taking*., 70 Acct. rev. 635 (Oct 1995).
36 Id.

a complete consumption tax system. Some people advocate to have a complete consumption based system instead of taxing the point of sale they should use the cash flow alternative.[37]

The cash flow alternative of a consumption based tax, taxes all income which is not saved. Income is either consumed or saved is the saved income is deducted from the taxes then only the consumed income is taxed.[38] This alternative way to create a consumption based tax might also be preferable to the VAT system because it allows the consumption tax to be graduated and more progressive.[39]

The European VAT attempts to make the tax more progressive by lowering the rates of certain goods like agriculture products and water.[40] Presumably lower income people will spend more of their income on basic necessities such as food and water. However, its does not address other needs for basic necessities.

III. Income Based Taxation System

The income based tax system has been in use in the United States since 1913 and the corporate income tax since 1909.[41] Although an income based tax system was used briefly during the civil war in early years the country relied on import duties and excise taxes on tobacco and alcohol.[42] The income tax was originally unconstitutional until the

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37 McNulty, John, *Symposium on law in the twentieth Century: Flat tax, Consumption Tax, Consumption-Type Tax proposals in the United States: a Tax policy Discussion of Fundamental tax Reform*, 88 Calif. L.Rev. 2095, 2109.

38 Id.

39 Warren, Alvin, *Would a Consumption Tax be Fairer Than an Income Tax?*, 89 Yale L. J. 1081, 1083.

40 EU/2006/112/EC. at Annex III.

41 Mc Nulty, *supra* n. 37, at 2098.

42 Id. at 2098 to 2099.

passage of the sixteenth amendment in 1913 making it legal.[43] Now the income tax is part of our constitution.

One general notion of the United based tax system is the graduated effect. It is a multi rated system where lower incomes pay a lesser proportion of their income through different tiered rates. This makes the tax classified as progressive. Even without the multi rate system a flat tax system is also considered a progressive tax system. People with high income pay more tax.

This graduated effect could cause people to avoid output. If they know that every addition hour of output will be taxed at a higher and higher rate at some point they will choose to cease producing. An income based tax system is also considered a production tax. However, both capital and labor are taxed.

Businesses under the US income tax system pay a flat tax pretty close to a flat tax of 22% for all income.[44] Every business deriving income in the United States either foreign or domestic is required to pay tax on the income. [45] Businesses paying income tax are taxed on income not revenue. A VAT system would tax every transaction or all revenue which would be passed on directly to consumers in higher prices. Income is taxed on revenue less costs or profits. This tax would not be passed on to consumers directly but would be only part of the price calculation.

The income tax in the US allows both corporations and individuals to deduct donations to charitable organizations from their income.[46] Thereby eliminating tax on income directed to causes deemed beneficial for the common good. This is to encourage

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43 Id.
44 26 CFR 1.11-1.
45 Id.
46 26 CFR 1.170.

charitable giving or a behavior encouraging aspect. The income tax has many other behavior inducing deductions. One aspect of the income tax system in the United Sates is that certain extraordinary rules have been added in induce people to behave in manners that have been decided by lawmakers to be desirable. It would be more difficult to put behavior inducing taxes into a VAT system. Although charitable services are exempt from taxation.[47] Of course taxing a charitable service would be quite novel since it would require for example the destitute person to pay out VAT when he received food from a soup line, or the charity to pay the tax collector for the free services it rendered.

IV. Societal Comparison

A. Regressive or Progressive

One major distinction between a VAT and an income based systems is whether the system is considered regressive or progressive. Progressive means moving toward a better condition. In the context a tax system it concerns the way it apportions its burden between the wealthier and poorer elements. A progressive tax will tend to have a Robinhood effect.

In contrast a regressive tax will have the opposite or neutral effect. Generally it is consider more regressive because lower income individuals spend a higher proportion of their income that higher income individuals.[48] Graduating an income tax to reach more progressive results would be fairly easy. However graduating a consumption based tax so more frivolous or luxury goods would be taxed at a higher rate would be much more difficult.

B. Savings or consumption.

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47 EU/2006/112/EC. at Article 132.

48 Mc Nulty, *supra* n. 37, at 2148.

The major advantage on the consumption based tax over the income based tax is the consumption based tax encourages people to save money. Because money saved is not taxed, people will have a tendency to save money to avoid paying taxes. If consumption is taxed then people will limit consumption for fear of being taxed. This simple argument, however, is not entirely accurate of the behavioral studies.[49]

In comparison to a no tax system a consumption based tax was concluded to have a neutral or no effect on rates of savings and consumption.[50] While the income based tax system was found instead to lower the savings rate and increase rates of consumption when compared to a no tax environment.[51] So although consumption taxes are actual neutral on rates of savings when compared to income tax they do encourage savings.

Many people consider consumption to be an undesirable activity. Consumption is considered the ultimate "destruction of economic resources."[52] They also argue that it is the take of resources from the common wealth for personal use.[53] It is only consider fair that people taking from the "commons" should be taxed.[54] On the other hand income is production or creation economic value.[55] Income is the sum of accumulation and consumptions.[56] It seems only fair that destruction of common wealth should be taxed and creation of common wealth should not be taxed. What this sentiment concludes though is accumulation is desirable.

One adverse side affect of the encouragement to save is the increase of legacy potential. Money saved or accumulated indefinitely will never be taxed. Labor as well

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49 Meade, *supra* n. 35.
50 Id.
51 Id.
52 Warren, *supra* n. 39, at 1084.
53 Mc Nulty, *supra* n. 37, at 2152.
54 Id.
55 Warren, *supra* n. 39, at 1084.
56 Id. (citing H.Simons. Personal Income Taxation. 59-102. (1938)).

capital is productive.[57] If consumption is taxed and the individual is only tax when they consume the income from capital may continue indefinitely and the accumulation is not taxed. This would facility income not through labor only but also through productive accumulation.

Finally the encouraging of savings and discouraging of consumption might be considered a limitation of liberty. By taxing production, the taxpayer is done with his obligation to the collective good after collecting income and paying taxes.[58] While under the consumption based tax a person does not become free from tax until he consumes.[59] Quantitative consumption decisions are left for the collective not individual judgment.[60]

C. Risk Taking

One interesting advantage of the income based system is the effects on investing. Income based tax systems tend to favor more risky investmenting.[61] Because taxes are only paid when the investor makes a return and losses can offset income from elsewhere.[62] To maximize the end amount of fund the investor has taxes on income tend to push investments to riskier investments with higher return.[63] Because the income based tax is after the outcome of risk tax or an *ex post* tax instead of an *ex ante* tax it will burden the winner of risk and ameliorate the looser of risk instead of treating both equally.[64]

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57 Id. at 1086.
58 Id. at 1120.
59 Id. at 1121.
60 Id.
61 Musgrave, Richard and Domar, Evsey, *Proportional Income Taxation and Risk Taking*, 70 Q. J. of Econ. 388, 388. (1947).
62 Id. at 389.
63 Id. at 411.
64 Warren, *supra* n. 39, at 1105.

A corporation or large investor may take riskier investments knowing that losses will offset income from elsewhere.[65] The income based tax as applied to business entities is considered a success based tax. Since tax is based only on profits or income only a successful and profitable entities will be taxed. Under VAT system every product is taxed equally.

New Innovative products tend to be more costly to produce. Frequently companies sell at a loss initially until the product becomes fully adopted and profits can be made later. Furthermore the recouping of research and development costs, are usually done during the initial sales period with the hope that future sales will become profitable. If a VAT were applied to products equally the development of new products would be stunted because the price to produce the new product when combined with the tax might raise the price beyond feasibility. It would more difficult to introduce newer products due to the tax burden.

In addition income tax systems push investments toward riskier investments. When considering the economic calculus that increase risk will equal increased yield potential the addition of an income tax into the equation will lead to an asset combination with a higher risk yield ratio.[66] This can be proven mathematically. When the risk-yield curve, of potential asset allocations, is constrained by an income tax the curve shifts inward.[67] When the risk-yield curve shifts inward the tangent of the curve with the counter to that, the indifference curve, also shifts inward.[68] Where tangent where the

65 Musgrave, *supra* n. 61, at 391.
66 Id. at 411.
67 Id.
68 Id. at 412.

indifference curve and the risk yield curve meet is the optimal asset allocation.[69] When the curves shift in due to the constraint from an income tax the optimal asset allocation point is move in but at steeper slope.[70] A steeper slope indicates a change in the risk to yield ratio in favor if higher risk.[71]

An income tax increases the amount of risk an investor will want to take when figuring the optimal asset allocation. This has also been demonstrated behavioral studies.[72] It was found that students given an income based tax scenario tended to allocate their savings in riskier investments than their counterparts in consumption base scenarios.[73]

D. Trading Advantages

One difference between the VAT system and United States application of the income based taxation system is the taxation of exports. The VAT system is considered a territorial system taxing only on economic activity within the territory.[74] While the U.S. income based system is considered a world wide system taxing income regardless of where is it generated.[75] Under the U.S. system income on exports will be taxed while under the VAT the income will not be taxed. [76]

Some European countries do not collect tax at all on exports.[77] The common VAT code exempts the collection of VAT on goods destine outside of the territory.[78] Under the

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69 Id.
70 Id. at 413.
71 Id.
72 Meade, *supra* n. 35.
73 Id.
74 Minnella, *supra* n.4, at 1072.
75 Id.
76 Von Hoff, Carrie Anne, Student Author, *Avoiding a Nuclear Trade War: Strategies for Retaining Tax Incentives for U.S. Corporations in a Post-FSC World*, 35 Vand. J. Transnat'l L. 1349, 1354.
77 Id. at 1356.
78 EU 2006/112/EC at article 146.

VAT system the tax is refunded to the exporter.[79] The lack of taxation on exports is considered an advantage in trade for companies operating in VAT territories.[80] This places US companies at a disadvantage in trade of goods.

In addition to the trade disadvantage a double taxation occurs for goods from a income country to a VAT country. Products in a VAT system are taxed in the system at the VAT tax rate. Likewise so are products that are imported. Products that were imported from a system where an income based tax was used have already been taxed in the exporting country by taxing the profits on the company that made the sale. The profit on the sale of the product was taxed in the income based country and when it arrives in the VAT country it is then taxed again under the VAT system. This amounts to a double taxation. Likewise products from a VAT country have there taxes refunded while the profit from the sale is never taxed.

There are two different characterizations between the two tax systems that allow this artificial advantage occur while also allowing this advantage to pierce the in the world trading agreements. The first is the territorial based and non territorial based tax. The choice between territorial and non territorial taxation systems is considered by the world trading agreements a largely internal nation choice.[81] Nations are free to choose between worldwide based tax system and a territorial system.[82] The fact that one system provides a benefit in trade is not addressed by the trading regime.

The second characteristic is the direct and indirect method of taxation. The income based taxation is considered a direct tax on the individual while the VAT system

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79 Minnella, *supra* n.4, at 1076.
80 Von Hoff, *supra* n. 76, at 1349,
81 Id. at 1355.
82 Minnella, *supra* n.4, at 1072.

is an indirect tax on the good.[83] Under the General Agreement on Tariffs and Trade (GATT) rules a direct tax on individuals can not be rebated on exports while an indirect tax on goods can be rebated to the exporter.[84] This relieves European exports from almost all taxes. [85] Companies in nations using the VAT system then can export at lower prices than companies in the United States.[86] This legal loop hole creates a comparative advantage in trade based on the artificial taxation system of the trading nations.[87]

E. Attempt to Reconcile the Trading Advantage.

Congress attempted to remedy this advantage by creating the Foreign Sales Corporations (FSC) Act.[88] The act allowed exporters to sell their goods to offshore companies and book the profits to an offshore entity.[89] This allowed them to save taxes on exports.[90] The offshore companies were no more than shells designed to book profits on over seas sales.

Congress created four laws to address the imbalance. The first was in 1971 the Domestic International Sales Corporation or DISC provision.[91] This was nothing more than a tax deferment program on export profits.[92] Then the FSC followed by the Extraterritorial Income Exclusion Act (ETIA) and ally the Jobs Act.[93] However, the

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83 Id. at 1075.
84 Id. at 1076. citing. GATT Art. XVI:4.
85 Id. 1077.
86 Id.
87 Id.
88 Von Hoff, *supra* n. 76, at 1354.
89 Id.
90 Id.
91 O'Leary, Brenda, *The Continued Viability of Foreign Sales Corporations (FSCs): An Analysis of the WTO Decision Declaring FSCs Incompatible with GATT Trading Rules*, 2 San Diego Int'l L.J. 149,152. (2001)
92 Id.
93 Minnella, *supra* n.4, at 1065.

European Union has challenged each one before the World Trade Organization (WTO) as an illegal subsidy on exports.[94]

Under the GATT rules countries cannot subsidies their exports.[95] Under the current agreement, the Agreement on Subsidies and Countervailing Measures (SMC) says that no country shall give a subsidy based on the condition of exporting.[96] The United States claims the tax break given to exports was not a subsidy but only a mean to level the playing field with VAT countries.[97]

The European Union challenged the FSC, ETIA and the Jobs Act as an illegal subsidy at the WTO's quasi judicial wing of the Dispute Settlement Body (DSB).[98] The DSB found that the FSC, (and later its successors) confirmed a benefit on companies and that benefit was contingent on exporting.[99] The panel also ruled that the United States was free to choose between a territorial tax or an extra territorial tax, and between a direct tax on its companies and people or an indirect tax on goods.[100] But it was not free to confirm a benefit on its exporters based the disadvantage of its chosen tax system.[101] The European Union called this a United States "internal problem."[102]

Most recently the dispute settlement panel found that the Jobs Act failed to implement DSB previous ruling against the ETIA because if maintain the same subsidies on exports.[103] As a result of these losses under the WTO a country can either bring its

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94 Von Hoff, *supra* n. 76, at 1358.
95 GATT 1994 Article XVI:4
96 Agreement on Subsidies and Countervailing Measures. Article 3.1 (a)
97 Von Hoff, *supra* n. 76, at 1353.
98 Id. at 1354.
99 McDaniel, Paul, *Panel IV: The Pursuit of National Tax Policies in a Globalized Environment: Principal Paper: Trade and Taxation,* 26 Brooklyn J. Int'l L. 1621, 1629.
100 Id. at 1632.
101 Id.
102 Von Hoff, *supra* n. 76, at 1355.
103 WT/DS108/AB/RW2, section 29.

law in compliance with the DSB or the complaining country is authorized to levy sanctions against the violating country.[104] The European Union is now authorized to levy sanctions in the amount of 4 billion dollars against the United States.[105] So far they have not exercised their right. Some believe they might be using the victory just as a bargaining chip.[106]

What can be done to rectify this situation and even the playing field for the trade of goods? Several commentators have come up with proposals. The first option is to rewrite the FSC and the Jobs Act;[107] or pay the sanctions;[108] or revoke the tax breaks and leave the field uneven;[109] or leave the WTO;[110] or finally to negotiate a settlement.[111] Only the last one has a realistic chance of occurring.

Rewriting the law will be more difficult than just saying rewrite it. It has been rewritten four times already and each successive time still found in violation of the WTO SCM agreement. The key to rewriting it would be to avoid rewriting it so that there is a differential treatment between exports and domestic sales.[112] One problem will be if the new law seems have the same purpose as the old law it will called the old law under a new name and challenged as just a sham.[113] In fact the Jobs Act was found just to be a

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[104] Von Hoff, *supra* n. 76, at 1350.
[105] Id. at 1351.
[106] Minella, *supra* n.4, at 1095. (Asserts the EU attacking the FSC was possibly due to its losses in the Banana dispute and Beef Hormone dispute.)
[107] Von Hoff, *supra* n. 76, at 1376., O'Leary, *supra* n. 91, at 164.
[108] Von Hoff, *supra* n. 76, at 1378., O'Leary, *supra* n. 91, at 168.
[109] Von Hoff, *supra* n. 76, at 1378. ,O'Leary, *supra* n. 91, at 168.
[110] Von Hoff, *supra* n. 76, at 1377.
[111] Von Hoff, *supra* n. 76, at 1376., O'Leary, *supra* n. 91, at 164. Minella, *supra* n.4, at 1101.
[112] Von Hoff, *supra* n. 76, at 1377.
[113] Id.

continuation of the ETIA.[114] Rewriting the law is not going to viable without substantial changes to the way the U.S. taxes it's companies.[115]

Just paying the sanctions would have a huge detrimental impact on trade.[116] The four billion dollar of sanctions would hurt both the United States and the European Union. The issuer of sanctions is also damaged by the sanctions by blocking the benefits of trade. Giving up the tax breaks would be a better solution but then it would allow US exporters to be at a continual disadvantage to companies from VAT nations.[117]

But the DSB decision seems like just a matter of semantics. Whether a nation has a direct tax or indirect tax does not really matter. It is still a manner of taxation. Furthermore a territorial based tax system as apposed to a non territorial based system is just words use to describe a tax system. The plain fact is goods leave a VAT nation without the burden of responsibility to state revenue and goods leave an income based system with a burden of state revenue on its profits. The goal of free and fair trade is for goods to leave one nation with the same inherent ability to compete without artificial advantages. Obviously the way our trade agreements are written this is not a possible outcome. That is why some people advocate leaving the WTO.[118] But leaving the WTO is also not a viable option.[119] The United States has too much invested in the WTO to simply withdraw.[120]

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[114] WT/DS108/AB/RW2, section 29.
[115] Von Hoff, *supra* n. 76, at 1377.
[116] Id. at 1378.
[117] Id. at 1379.
[118] Id. at 1377.
[119] Id. at 1378.
[120] Id.

Finally the only viable option, outside changing our taxation system, will be to negotiate a settlement.[121] Negotiations between the EU and the US have seldom been done on substantial trade issues.[122] The *modus operandi* of trade negotiators is tit for tat procedural battles get one side better than the other for their nation's companies.[123] There is a tendency to win sanctions first and then use that to bargain a deal.[124] This is a case where there needs to be a comprehensive solution between the EU and the US.[125] There are many structural differences between members of the WTO all of which cannot be straighten out easily.[126] This is one that the US and EU need to work out.[127]

F. Globalization of Tax.

This dispute between the US and EU has lead many to argue that there is a need for not only the US to change its tax system but for a globalization of tax policies.[128] Reasons to create a globalize tax policy are greater mobility of wealth and people and difficulties in administering regional taxes between systems.[129]

There is greater mobility of people and resources this makes it more difficult for nations to establish economic rent.[130] Companies tend to relocate people and resources to countries where the can limit taxes.[131] For example they might relocate profit earning manufacturing operations to a country where it is not taxed, like a VAT country. Then they might relocate research and development to a country where it is tax deductible like

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121 Id. at 1380.
122 Minella, *supra* n.4, at1101.
123 Id.
124 Id.
125 Id. at 1102.
126 Id. at 1103.
127 Id. at 1105.
128 Mintz, Jack, *Panel I: Principal Paper: National Tax Policy and Global Competition*, 26 Brooklyn L. Int'l L.J. 1285, 1287.
129 Id.
130 Id. at 1289.
131 Id.

an income based country. Furthermore they may shift income.[132] They may shift income on royalties and fees to countries where it is not taxed.[133]

Under a VAT system they may shift the place of transactions. Services are charged where the service is performed.[134] Therefore companies might move services to a place where taxes on that service are not charged.[135] Financial services such as capital gains are also highly mobile and almost impossible to tax on a international level given arm's length accounting systems.[136]

One solution is to create a more harmonic global tax system.[137] The EU has already sought to harmonize its application of VAT.[138] Mr. Jack Mintz, believes there will be greater need to harmonize corporation income taxes within the EU as well.[139] But governments might have to rely more on payroll taxes and fees on government services than taxes on companies and capital gains in the future. [140]

But changing the tax system brings into question the philosophical bases of a tax system. Theories of justice affect all of society and they affect out tax system.[141] The conflicting values of American society that are reflected in the tax system are equality and liberty.[142] The obtainment of wealth is a legitimate exercise of liberty.[143] There is a recognized morality in rewarding merit.[144] However, American beliefs in political

132 Id.
133 Id. at 1290.
134 Id.
135 Id.
136 Id. at 1291.
137 Id. at 1296.
138 Id.
139 Id.
140 Id. at 1299.
141 Kornhauser, Marjorie, *Equality, Liberty, and a Fair Income Tax,* 23 Fordham Urb. L.J. 607, 620.
142 Id. at 623.
143 Id. at 651.
144 Id.

equality, tempers the belief in 'merit' equality.[145] Also there is a belief in order to be free a person must have enough physical goods to exercise that freedom.[146] The progressive income tax system stems from the American sense of distributed justice based on conflicting ideals that are in line with American collective ideals of distributive justice.[147]

V. Conclusion

While the trade debate creates an artificial tax advantage toward the VAT system, it does not necessarily follow that United States should adopt is own VAT just to eliminate that trading advantage. The tax system could be a reflection of the culture of the United States. A culture that rejects legacy, promotes consumption, encourages risk taking and tries to be more progressive, are elements of the income based tax system that are also prevalent in the culture. It may be argued that some elements might be a "wag the dog" scenario. For example, our consumer culture might stem from the income based tax system rather than the system being a reflection on our choice for higher consumption. Even though some cultural elements, like consumerism, might not desirable for the good of society, it appears to be a national choice as a culture.

For good or bad the income based tax system seem to reflect the nations values like the VAT seems to reflect the values of the nations that use that. It is of higher importance that the method of taxation reflects the people who pay more than an outside standard. The fairest way to attribute the burden of collective society on its citizens will also be a topic of much debate. It is important to include in that debate the consideration of the culture of her citizens.

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145 Id. at 657.
146 Id. at 658.
147 Id at 661.