The Social Contract, Tacit Consent, and International Taxation

By:

Douglas Bamford

July 15, 2020

What do we owe our States, and what do our states owe us? This is a difficult question, sometimes answered by invoking a social contract between the rulers and the ruled which implicitly sets out the rights and responsibilities of each. Matters get even more complicated where international citizens and multinational corporations are concerned. Are they party to multiple social contracts? Or none? I will argue that if there is a social contract, then those involved in the international tax system—including tax evasion and facilitating novel forms of tax avoidance—are party to it.

The Social contract

Socrates famously chose to face death rather than exile when condemned by his fellow citizens. He felt this was his duty to his fellow Athenians, perhaps an early invocation of the idea that there is a social contract between city and citizen. The social contract tradition is most associated with thinkers such as Thomas Hobbes and John Locke, who considered what life would be like without

a state to set rules and enforce them. This stateless scenario is sometimes called the "state of nature." Hobbes pessimistically assumed that life without a *leviathan* state would be 'solitary, poor, nasty, brutish, and short.' Locke, on the other hand, felt that people would respect and enforce natural rights even without a state.

For Hobbes, a social contract to create a state was necessary to provide peace rather than a war of all against all. For Locke, the state was necessary because people would not reliably enforce natural rights in the state of nature. Whatever the state of nature is really like—and many such as Rousseau will disagree with both these thinkers—the point is that people would come together to create a state.

Express vs tacit consent

Perhaps there were pre-historic acts of state creation among individuals. More likely, there was a gradual process of domination by some over others that over time has got us to where we are. Either way, the idea that *we now* are bound to the state because some ancestor of ours bound themselves is unconvincing. Their consent is not our consent.

Are there are other ways that we consent to the social contract? Voting and pledges of allegiance have been suggested, but these do not seem like reliable and universal instances of consent. If everyone is forced to do these things, then it cannot be taken as a sign of voluntary consent.

Locke believed that "nobody doubts but an express consent, of any man entering into any society, makes him a perfect member of that society, a subject of that government." For him, then, immigrants can be said to have given express consent. If they are asked to sign an agreement, such as an immigration visa, then perhaps we can agree they have signed the social contract.

For native-born citizens, Locke felt it was enough to rely on implicit, or tacit, consent. Benefitting from the society, whether that be having "possessions, or enjoyment, of any part of the dominions of any government" is taken as a sign

of tacit consent. As a result, they are "obliged to obedience to the laws of that government."

Hume's criticism of social contract theory

David Hume presented a devastating criticism of the idea that all members of society have tacitly consented by enjoying the benefits of society in his essay "Of the Original Contract." He pointed out that most people don't even think about the issue, but even if they did, taking enjoyment from society cannot be a sign of consent.

Hume famously wrote:

> Can we seriously say, that a poor peasant or artizan has a free choice to leave his country when he knows no foreign language or manners, and lives, from day to day, by the small wages which he acquires? We may as well assert, that man by remaining in a vessel, freely consents to the dominion of the master; though he was carried on board while asleep, and must leap into the ocean, and perish, the moment he leaves her.

Hume also rejects contract theory in general for other, controversial reasons, and there are plenty of other criticisms of it. Nevertheless, even Hume accepts that the immigrant who settles in full knowledge of the government and laws represents the "truest tacit consent." To recap, we cannot rely on tacit consent providing proof that *all* members of a given society have agreed to the social contract. However, those who immigrate and those who have no major impediments to leaving do not have the excuse that Hume's "poor peasant" has.

International Taxation

International taxation has received increasing attention recently, as those involved have been using the system to engage in tax abuse. These activities cost billions of dollars in tax lost tax revenue to states in Africa and elsewhere. There are various forms of tax abuse, some clearly immoral and illegal to others that are in a moral grey area. The tax abuser aims to achieve 'double non-taxation' where they pay no (or virtually no) tax in any of the countries in

which they do business. We can compare what the business would pay if its entire operation were in a single country.

My claim here is that all those involved in international taxation cannot use Hume's 'poor peasant' excuse to engage in tax abuse. Elites and investors are not forced to benefit from a country. I will consider the relevant parties, using Kenya as an example state. *Multinational companies* do not have to have operations in Kenya; they elect to locate there based on the benefits they expect to obtain. If they take advantage of their international set-up to evade taxation, or even reduce their tax rate by taking advantage of spurious loopholes and transfer mispricing, then they are breaking the social contract they signed when setting up in Kenya. *Wealthy international individuals* similarly do not have to have investments in Kenya. They choose to engage with Kenya and are therefore bound to the Kenyan people via their contract with the Kenyan state. *Taxation professionals*, such as lawyers and accountants, are also bound to the social contract. This is going to be the case if they are outsiders who are benefitting from working in Kenya or even working with clients with interests in Kenya. However, local professionals are also going to have skills that should provide them with opportunities to leave Kenya; they cannot use the 'poor peasant' excuse.

Perhaps we can even add members of the *local elite* as well. They will often have the resources to be able to leave Kenya and would be welcomed elsewhere.

Other excuses or justifications for tax abuse?

Another Humane 'excuse' would be that the parties would not have considered leaving, and therefore cannot be said to be tacitly consenting. I think it is enough that the individuals have been in a position where they have made decisions about where to base themselves. This is bound to be the case for multinational companies, of course, but I think it will apply to most individuals involved in the international tax business.

The second line of excuse might be that some states are illegitimate, and it would be better not to provide revenues to governments that violate human

rights. This is a compelling argument. However, I would question whether the correct response to human rights violations is to extract wealth from the state. This is not going to make the situation any better. The benefits from tax abuse could be placed in a trust fund to be used to support a future legitimate government. It certainly cannot justify *making profits* from the state.

What does the state owe?

The social contract is between the state and the people. The state is a supra-human entitle of course, but certain individuals have responsibilities to ensure that the state honours the contract: the head of state, members of government, and high-ranking officials. They owe the citizens protections from external threats, but also internal ones as well. If the state is illegitimate, as mentioned above, then the social contract is broken. In this case, the international investors should boycott the state, or at the very least engage only in ways that benefit the people of the state and not their oppressors.

My focus here is on international taxation, and in this regard, officials should be looking to ensure that their citizens do not lose out from international taxation. Officials should view tax abuse as a threat to the citizens of the country, and certainly not an opportunity to exploit for personal gain. My focus here is on the other parties, however.

What do citizens and international investors owe?

I expect one main response to my argument will be that the social contract only requires people to follow the law. If those involved in international taxation do follow the law, what is the problem? If they break the law, then they are subject to legal sanction, and rightly so. But does this cover all cases?

In some cases of tax abuse, the law is broken, but the state does not *realise* because those involved hide the situation. However, this is to say that some people who claim this defense are acting in bad faith. Of course, it would be wrong for states to punish those who *have not* broken the law. However, this does not mean that all those who have not been found guilty have done nothing wrong. They should not fool themselves or the rest of us.

The deeper complaint is that those involved in international taxation should not be actively seeking to enable tax abuse which robs states of revenue in the first place. Hopefully, professionals will already inform the authorities of any wrongdoing, and also inform the government and civil society of any new loopholes. Multinational corporations might take the position that they have competitors who will be seeking out international tax advantages, meaning that they need to as well. There is no room for expensive do-gooding in the corporate world; do-gooding companies will just get taken over by more ruthless rivals. The international corporate world is akin to Hobbes' 'state of nature.'

However, companies and their agents can respond to this situation in two ways. Option one is to advertise that these loopholes exist, to express that they are a source of great regret and that they should be closed as soon as possible. Option two is to take advantage of the loopholes quietly and to seek out new ones. To seek to empower low-tax and secrecy jurisdictions and to undermine attempts to clean up the system. Option two does not seem compatible with the social contract to me.

Conclusion

Political obligation, in general, has come under fire from philosophical anarchists, and I have not responded to those objections here (though I remain unconvinced). There are also other theories of political obligation as well as consent theories. But even if tax abusers claim to be philosophical anarchists, I would argue they should avoid engaging with states (perhaps basing themselves in stateless areas of the world) rather than seek to gain from investing in them.

I have not considered *all* the arguments against consent theories—I have focused on Hume's early criticism of the social contract. My argument, therefore, is a conditional one. *If there is a social contract*, then certain participants in society are clearly a party to it. This will include those in a position to engage in tax avoidance and evasion using international loopholes.

References (all accessed 24 June 2020)

Dagger, R. & Lefkowitz, D. "Political Obligation" *The Stanford Encyclopedia of Philosophy* (2014).

Locke, J. *Two Treatises on Government* [1688]

Hobbes, T. *Leviathan* [1651]

Hume, D. "Of the Original Contract" from his *Essays: Moral, Political, and Literary* [1751] International Bar Association,

Lipsett, L. and Cohen, S. B. *Tax Abuses, Poverty and Human Rights* (2013)

Plato *Crito* [399BCE]

Rousseau, J. J. *Discourse on inequality* [1755]

View online: The Social Contract, Tacit Consent, and International Taxation

Provided by Afronomicslaw