

Tax avoidance

Justifiable or not?

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Table of contents

1. Introduction	3
a. Tax avoidance	3
b. Relevance of the topic	3
c. Central claim.....	4
d. Scope of the thesis	4
e. Roadmap.....	4
f. Choice of the topic.....	4
2. Concepts	5
a. Taxation.....	5
b. Redistributive system of taxation.....	5
c. Functions of the Dutch tax system.....	6
d. Legal principles of the Dutch tax system	6
e. Tax avoidance or tax evasion	7
3. Main part	8
a. A redistributive system of taxation	8
b. The duty to obey tax legislation	13
c. Tax avoidance in a redistributive system of taxation.....	18
4. Conclusion	21
5. Bibliography	22

1. Introduction
 - a. Tax avoidance

'When you get rich, put some of your money in a Swiss bank account to make sure you have some left instead of losing it all to paying taxes!'

'Filling out your tax return, ignore the cash money laying around, tax authorities won't check anyway!'

These are some examples of comments heard by individuals in the Netherlands. Some comments are well meant remarks to remind the receiver that it is okay to look out for your own interest and to make sure you have some money left after paying taxes. Other comments are quite jokingly repeating what is commonly thought: when able, move your money to jurisdictions that do not levy taxes as heavily as the Netherlands does. The comments mentioned above and many more similar to those do in fact argue for tax avoidance. People generally do not enjoy paying taxes, yet enjoy and want to enjoy the benefits provided by the government, paid for by taxation.

Perhaps even more paradoxically, whatever their individual wants, collectively people seem to be against tax avoidance. Over the last decade, many cases of tax evasion and tax avoidance have come to light. Instances that have managed to make headlines are the infamous Starbucks case of 2012 for example. After investigation by Reuters, it came to light that Starbucks had paid little to no tax in the UK in the years before.¹ The company made clever use of the so called mismatches of tax legislative systems worldwide. With subsidiaries located in Switzerland and the Netherlands, the company is able to shift profits using tax treaties and the UK tax law. As a result, people in the UK started taking to the streets and protested against what they called 'tax loopholes'. They felt it was unfair that a multinational corporation like Starbucks was able to legally avoid paying taxes in the UK because of the size of the corporation and the means whilst the local shop owner had to pay taxes in full.

Although there are many more instances of corporations making headlines for tax evasion and tax avoidance, well-known individuals have not escaped public scrutiny. Recently in the Netherlands, then minister of Finance Wobke Hoekstra's personal financial affairs were put under a magnifying glass when it was reported that he had been an investor in a fund on the lowly taxed British Virgin islands for quite some years.² After the publication of the Pandora Papers, two large Dutch newspapers and an investigative platform called Investico looked into Dutch investors and came to the discovery that just before he had been sworn in as minister of Finance, Hoekstra had been one of the investors in the fund criticised for being established in a lowly taxed jurisdiction. The fund was merely passing through money to the actual investments in more highly taxed jurisdictions. The entire thing reeked of tax avoidance, so much so that Wobke Hoekstra claimed to simply have collected his initial investment and have donated all the profits to charity to try and calm the public opinion.

- b. Relevance of the topic

Academically and philosophically much has been written on taxation in general, as abroad concept. Taxation as part of the economic system of the country has been elaborately discussed by economists specialised in public finance. Taxation as part of the role of the

¹ "Starbucks 'paid just £8.6m UK tax in 14 years'," *BBC*, October 16, 2012, <https://www.bbc.com/news/business-19967397> .

² Dirk Waterval, "Wopke Hoekstra investeerde in Belastingparadijs," *Trouw*, October 3, 2021, <https://www.trouw.nl/economie/wopke-hoekstra-investeerde-in-belastingparadijs~ba9de8bd/?referrer=https%3A%2F%2Fwww.google.nl%2F> .

government has been abundantly discussed by political philosophers such as John Rawls and Robert Nozick. About the role of the individual with regards to taxation, as a subject that not only touches upon economics or the institutional system but also touches upon the role of the individual in his duty to obey in the legal system, not much has been written.

As taxation is something everyone deals with in some way, reflecting on taxation from an individual point of view is relevant in every aspect. The current tax systems of the western European world are very complicated and hard to understand when you have not studied tax law in great detail. In regards to the questions of tax avoidance tax specialists have indicated that more thought and publications by philosophers, ethicists in specific, would be welcomed.³ In practice, tax specialists are advising on tax avoidance in a redistributive tax system as the Netherlands' every day. As mentioned above, the media have scrutinised tax avoidance by multinationals abundantly and some individuals have faced the scorn of the media as well. Was this fair and has this scolding been based on solid arguments? Tax specialists and the general public have a hard time making this out. This thesis aims to shed some light on some of the aspects of this issue.

c. Central claim

As the topic of taxation in philosophy can be very broad, this thesis will focus on exploring taxation levied on individuals within a redistributive tax system such as the Netherlands has. Over the course of this thesis arguments will be given to support the following claim:

Tax avoidance by individuals in a redistributive system of taxation is justified.

d. Scope of the thesis

In order to support this claim, arguments in the area of political philosophy, economics and ethics will be discussed. These mentioned areas are extensive and are not the only areas relating to taxation. Due to the length of this thesis not all philosophers that have written on taxation within their respective fields will be discussed. This thesis will primarily focus on work by John Rawls and Michael Huemer.

e. Roadmap

To commence, main concepts used in this thesis such as tax evasion, tax avoidance and a redistributive tax system will be discussed. In order to fully understand a redistributive tax system a short introduction into the economic theory behind a redistributive tax system will be provided as well. The main part of this thesis will first explore arguments in favour of a redistributive system of taxation. Next, arguments in favour of and opposed to tax avoidance will be presented with a special focus on the 'Taxation is Theft' movement. Thirdly, the previously discussed parts of the main claim will be combined in order to defend the central claim of this thesis. To conclude, a summary will be given of all the arguments presented to support the main claim of this thesis.

f. Choice of the topic

Studying Economics of Taxation, tax avoidance is a very common subject in my main area of studies. In the field of tax law, over the last few years, there have been massive shifts in attitude towards tax evasion and tax avoidance, both from tax specialists and governments and intragovernmental organisations. This has led me to want to explore tax avoidance from a philosophical perspective.

³ Glen Loutzenhiser, "Philosophical Theorising on Taxation", *Oxford Journal of Legal Studies* 40, 4 (Winter 2020): 905-925, <https://doi.org/10.1093/ojls/gqaa030>.

2. Concepts

a. Taxation

The claim this thesis aims to defend focusses on individual taxation in a redistributive tax system. In order to understand the specific elements of a redistributive tax system, understanding of taxation in general is essential. A government can levy several taxes varying from individual income taxes to value added taxes and taxes levied on royalties and dividends. When implementing new taxes and adjusting tax rates of existing taxes governments take into account the general equilibrium on the economic market of taxes. There are several perspectives to the general equilibrium, some of which are elucidated here to give some examples. From an economic point of view, especially setting tax rates, governments have to consider the fact that according to neoclassical economic theory the burden of taxes levied on firms and corporations is divided between the supply (firms) and demand (consumers) side of the market. The least elastic side of the market carries most of the burden. In (smaller) open economies, it will always be the goods demand side, thus the consumers, that carry (most of) the burden, through for instance an increase of the price of goods. Governments have to think beyond the subject they levy taxes on. This goes for all taxes levied on corporations, not just a corporate income tax for instance, also employee taxes or taxes on dividend payments.

Secondly, from an economic perspective governments also need to take into account the conclusion that according to economic models, consumer taxes have the same effect on distribution of wealth and distortion of the economy as individual income taxes do. This means that a rise in VAT will eventually have a very similar effect as a rise in individual income taxes. This poses a challenge for governments when addressing redistribution of wealth. Later in this chapter more about redistribution of wealth using taxation will be explained.

The last aspect highlighted that governments have to consider is both an economic and a legal issue. Ideally, there is a balance in tax rates between taxes levied on individual income through employment and taxes levied on corporations and shareholders. If for instance income from employment is taxed more heavily, people will shift from working as an employee to being their own boss and earning money through dividend payments from shares in their own corporation. Tax legislation in for instance the Netherlands is based on the principle of neutrality in chosen legal form. Being engaged in an enterprise in the form of a company whose capital is divided into shares should not be more favourable than being engaged in an enterprise whose capital is simply put aside on a separate bank account.

All in all, taxation and setting tax rates is a delicate matter. Changes in means of taxation and tax rates require extensive research in advance to determine the effects on the economy and society.

b. Redistributive system of taxation

Now that a general idea of taxation and the challenges that go with it have been set, some insights in redistribution of wealth via taxation will be given. In essence, a redistributive tax system attempts use taxation in order to at the end of the day tax the wealthy more heavily and use that money to – amongst other things – provide for the poorer individuals in society. You essentially redivide money to those most in need. Governments can use benefits and grants for the poorer to redistribute some wealth. Think of healthcare benefits and benefits to help with paying rent for instance.

Most countries with a more or less European continental model of taxation that aim for redistribution of wealth using taxation, tax individual income progressively. Progressive taxation means that the more you earn, the higher the applicable tax rate will be. The issue with progressive taxation is that it causes economic distortion. A one percent increase in tax

rate will not result in a corresponding increase in tax revenue. Therefore, it will also not result in a corresponding sum of money to redistribute from the wealthy to the poor. The distortion is due to the fact that people change behaviour when tax rates change. For the scope of this thesis, a detailed understanding of this change is unnecessary.

One of the alternatives to a progressive form of taxation is a lump-sum tax. This type of taxation is not economically distortive. In the case of a lump-sum tax, every individual pays the same amount of tax. The counterpart of a lump-sum tax is a lump-sum grant, which governments may choose to give to the poor. This too, will result in a redistribution of wealth in society.

c. Functions of the Dutch tax system

In order to create common ground for all decisions regarding changes in a tax system, most countries have some general functions around which their tax system is set up. The idea is that these functions ensure a long-term basis for the tax system and provide citizens with a notion of the goals the government has taxing its citizens. The functions of the Dutch redistributive tax system will be illuminated to give an example. Among tax specialists, the Dutch system is said based on the idea that it has to have an *instrumental, budgetary and redistributive function*.⁴ The *budgetary function* is the most important function as the government uses tax revenue to pay for public facilities such as infrastructure and education. Taxes can furthermore be used to nudge people, the so-called *instrumental function*. Lastly, however most important for the scope of this thesis, taxation has a *redistributive function*.

d. Legal principles of the Dutch tax system

Taxation does not just dip into economics or broad functions, but is also very much part of the legal system of a country. Tax laws create taxing rights on the basis of which the government is allowed to tax individuals and firms whilst at the same time granting individuals and firms rights to challenge the government when they believe they are being taxed unfairly. In order to be able to argue in favour of the central claim of the thesis, a general idea the legal principles on which taxation is based is needed. Again, the Dutch tax system will be used as an example.

The principles of a tax system are closely related to the functions of a tax system.⁵ They provide the legislator with the necessary leads to create tax legislation and protects citizens from being treated unfairly, unequally et cetera. To illustrate, two of the many principles will be elucidated.

Firstly, tax legislation has to be abide by the *principle of economic capability*. This principle entails that people cannot be taxed heavier than they are economically capable. The *principle of economic capability* directly relates to the idea of redistribution and is one of the most important principles of the Dutch tax system. Secondly tax legislation is designed to conform to the *principle of equality*. This principle is also enshrined in the constitution and ensures that the law treats every individual equally.⁶

⁴ J.L.M. Gribnau, *Belastingen als moreel fenomeen. Vertrouwen en legitimiteit in de praktijk* (Den Haag: Boom fiscale uitgevers, 2013), 47-49.

⁵ "Spelregels: algemene beginselen van behoorlijk bestuur" Belastingdienst, accessed May 12, 2022, https://www.belastingdienst.nl/wps/wcm/connect/bldcontentnl/standaard_functies/prive/contact/meningsvorschil/spelregels/algemene_beginselen_van_behoortlijk_bestuur.

⁶ "Gelijkheidsbeginsel" Belastingdienst, accessed May 12, 2022, https://www.belastingdienst.nl/wps/wcm/connect/bldcontentnl/standaard_functies/prive/contact/meningsvorschil/spelregels/gelijkheidsbeginsel.

e. Tax avoidance or tax evasion

In everyday speech, tax avoidance and tax evasion are often used interchangeably. There is however one significant difference: tax avoidance is legal whilst tax evasion is illegal. Corporations and individuals accused of tax avoidance do not act illegally, yet some might say they act unethically. Tax avoidance varies from paying less taxes by for instance legally moving some of your assets to a lowly taxed jurisdiction to for instance active estate planning in the case of family owned businesses, resulting in the family optimally making use of all the legal facilities offered by a government. The issue with moving assets abroad for instance is that even though it is legal, it means that you stop paying taxes over those assets in the country you live in and in which you make use of the public facilities. The single goal of moving your assets is paying fewer taxes.

Tax evasion on the other hand is simply breaking the law by for instance deliberately not filing your tax return correctly. Say you have bank savings of around one hundred thousand Euros, but inform the tax authorities that you only have twenty thousand in your bank account. You would be lying to the tax authorities and are actively evading taxes. To illustrate, many incidences of fraud and money laundering are also closely related to tax evasion as revenues are not reported to tax authorities correctly if anywhere at all.

3. Main part
 - a. A redistributive system of taxation

Intuitively, to most people it seems only natural that we want to take care of the people less fortunate than ourselves. We seem to call this fair, whatever 'fair' may be exactly. The extent to which we personally experience the need to help others differs from person to person. One person might be inclined to donate almost all their time and money to help others, while another does not actively want to aid others but will simply make a small donation to a charity. Some people might say they do not even feel any incentive to help others and disagree with the behaviour at all. Nevertheless, the fact is that most of our societies are built on the idea that we collectively want to provide for the less fortunate and less wealthy. Some will say this comes from human beings being altruistic, others will just call it economically reasonable.

I will not go into the discussion whether or not people want to aid others too much, as for the sake of the central claim discussed in this thesis we must eventually establish the idea of a redistributive system of taxation. A redistributive system of taxation implicitly implies that we have together agreed upon the idea that we need to care about the least fortunate in our society. What I will say however, is that the reasoning behind the generally accepted notion that we take care of the least fortunate of our society matters as it might provide us with insights into the foundations on which the redistributive system of taxation is built. There are many roads to be taken to come to try and reason for the behaviour expressing that people want to take care of each other. Two of those roads shall be discussed here.

First of all, the argument of altruism comes to mind. People intrinsically want to help others. If everyone is altruistic in their expression of behaviour, Much of what we see around us every day seems to confirm this idea. Empirical evidence to support this claim is widespread. In fact, Batson once did a series of experiments in which he had an altruistic hypothesis and several egoistical hypotheses. The outcome of the series of experiments was that the altruistic hypothesis would be better at predicting the outcome of the series of experiments than the egoistical hypotheses.⁷

This is quite the opposite to the belief that Rawls had. John Rawls argues in favour of the idea that people are not altruistic at all, but rather that people are rational egoists. Later on in this thesis there will be more about Rawls and his view on rational egoism.

Applying the claim of all people being altruistic to the specific instance of taxation, it becomes clear that altruism alone does not provide all the elements of behaviour necessary to come to a redistributive system of taxation. When people are altruistic, it accounts for the idea that they want to help others and thus also the least fortunate in society. However, it does not provide us with the necessary backing to establish a system of taxation. People being altruistic would simply lead them to giving their money to the poorer people around them.

For a state to flourish, more is needed than simply giving money to those most in need of it. Funding is also needed in order to pay for roads, public services such as the police and public administration. This requires some sort of cooperation.

When thinking about cooperation, a common association is altruism. However, altruism is not necessary at all to establish cooperation. To see this, let us focus on the cooperation argument.

⁷ C. D. Batson, *The altruism question: toward a social-psychological answer* (Hillsdale NJ: Erlbaum, 1991).

The cooperation argument claims that people do not act and do not cooperate out of altruism at all. Instead, it claims that people act out of egoism because in the long-term, this will make them better off. The short-term losses that may be endured are compensated by long-term gains or at the very least the knowledge that another can do you no harm if you cooperate.⁸ This, and this alone, is the reason people agree to cooperate. Cases of cooperation where it is sure that there is no reward in the end and are thus essentially a form of self-sacrifice are irrational to act upon.⁹

Even in the case of donating money to the poor or paying taxes now, currently decreasing the tax payers wealth and satisfaction, people eventually see the long term benefit. Donating money to the poor can for instance decrease inequality in society which in turn might cause less violence, therefore increasing the general well-being of the initial donor. Paying taxes now may not only affect inequality, but will also allow the taxpayer to enjoy the safety of well-maintained dykes, public protection and education for his or her children.

The cooperation argument as the argument against the necessity of altruism as the reason behind people's behaviour to want to help others, simultaneously the second road to be explored, focusses the attention to a different kind of theory all together. The second road to be explored in this thesis has already been briefly touched upon, namely explaining behaviour from the assumption that people are rational egoists.

In *The Theory of Justice*, John Rawls mentions rational egoists on several occasions.¹⁰ According to Rawls, the only logical way is for us to be rational egoists. We benefit most from a just and equal society. The only way to achieve such a society is not by simply giving everything we owe to some stranger in need as an altruist might. Nor is it by acting on our every urge and simply looking at the short term gains.

Rawls' theory famously discusses social justice and although this has implications for the way we structure our economy, it is not a theory on economics. It can be described as a modern social contract theory. According to Rawls, the time of following utilitarianism has come to an end as that theory is flawed and does not lead to the ideal socially just circumstances. In his work, comparisons between his own theory and strict utilitarianism are made.

Strict utilitarianism states that society is well structured (and just) when the main institutions are ordered to that the greatest net balance of satisfaction summed over all the individuals belonging to the society is achieved.¹¹

One of the main problems with this classical view is that it does not take into account the separate individual balance of satisfaction, just the aggregate result. If institutions are so arranged that most of the population will be better off, resulting in an overall increase, even though the poorest among us are worse off by the for instance new regulations, utilitarianism dictates this the proper course to be taken.

According to Rawls, utilitarianism does not take into account the different weights that need to be assigned to the different individuals enough. In utilitarian theory, social welfare weights are equal among all income levels, yet Rawls argues that differentiating social welfare weights between income levels can make a big impact on the aggregated balance of satisfaction. Rawls argues that this is however, one of the main issues of a theory

⁸ "Egoism" Stanford Encyclopaedia of Philosophy, accessed May 11, 2022, <https://plato.stanford.edu/entries/egoism/>.

⁹ G. Kavka, *Hobbesian Moral and Political Theory* (Princeton: Princeton University Press, 1986), Part III.

¹⁰ John Rawls, *A Theory of Justice* (Cambridge, MA : Belknap Press of Harvard University Press, 1999).

¹¹ Rawls, *Theory of Justice*, 20.

determining how we should ideally arrange our institutions. Addressing a variation in weights to individuals will increase the justness of the system. He calls the issue assigning different weights to different individuals in a society the 'priority problem'.¹²

The priority problem is attempted to be tackled by Rawls' introduction of two principles of justice. These principles must hold in serial order, in order for something to be just.¹³ To come to a position in which we can safely and fairly judge the system, we must place ourselves outside of our own position.

Rawls introduces the – now famous – original position behind the veil of ignorance. Summarised, the veil of ignorance describes a state in which, given certain assumptions, economic and social inequalities are to be judged in terms of the long-run expectations of the least advantaged social group. According to Rawls, placing yourself behind the veil of ignorance results in the two principles.¹⁴

The first draft of the first principle reads as follows: "*each person is to have an equal right to the most extensive scheme of equal basic liberties compatible with a similar scheme of liberties for others.*"¹⁵ Rawls argues that the first principle sees to the part of society that defines and secures basic equal rights such as freedom of thought, the right to vote, the right to hold personal property and so on.

The second principle introduced is the following: "*social and economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all.*"¹⁶ As one can understand from the text, the second principle addresses the aspects regarding social and economic inequalities in society.

Rawls argues that following these two principles will ensure a just society in which the institutions are arranged solely to ensure and maintain the justness. Every decision made is made with the idea that something can only be just if all of us individually benefit from it. In the end the effect is a decrease of social inequality, mostly because the position of those that are struggling most in our society are given priority as the improvement of those positions benefits the aggregate society most.

A just society seemingly reflects a sought-after utopia. Society is just and ideally corrects itself. The question now begs: how does taxation fit into all this? After all, some form of funding is still needed to provide the institutions that Rawls, but also those advocating for a strictly utilitarian view mention, with money to run properly.

Interestingly enough, with his conception of justice, Rawls states that everyone's position should be improved when changing a situation.¹⁷ Going back to the central claim of this essay, this immediately poses the question of how this applies to a redistributive system of taxation? When a system based on lump-sum taxation is put in place, all evidently give up something of their own and are thus seemingly worse off. There is even more inequality in decrease of initial wealth when a progressive tax system is chosen.

Ideally, in Rawls' perfect world there is no taxation at all, as the two principles of social justice ensure that all is well. In practice however, this is not the case. One of the main

¹² Rawls, *Theory of Justice*, 37.

¹³ Rawls, *Theory of Justice*, 38.

¹⁴ Rawls, *Theory of Justice*, 39.

¹⁵ Rawls, *Theory of Justice*, 53.

¹⁶ Rawls, *Theory of Justice*, 53.

¹⁷ Rawls, *Theory of Justice*, 55.

issues of our world is that there is a vast inequality in wealth and as a result thereof difference social equality and opportunities. People do not automatically take care of others in a way that all individuals in society benefit.

Rawls already touches upon it briefly in *A Theory of Justice*, but we do still need institutions to try and work to this ideal of a just society. At least, according to John Rawls.

What is sure however, is that the ideal as proposed by Rawls does not come about on its own. As mentioned before, this is partly due to the already existing amount of inequality. It is also partly due to the inability of people to have all the information when making decisions. We cannot look in the future. Because we are rational egoists, we need all the information to make an informed decision about what it is we want to put our time and money in now, essentially a loss, to receive a long-term gain. Once one of the mentioned conditions is not met, it does not work out.

Society needs some kind of overarching structure to not only uphold the principles, but also try and correct previous misdoings that have led to the situation and unjust society we are in now. This is the only result of all that has been said before.

An overarching structure, call it institutions, government or something else, needs funding to function. Not only does it need to pay for its own infrastructure and employees, those willing to gather all the information to make informed decisions, the overarching structures are also tasked with taking care of the common goods. We thus do need some form of taxation in our current state of society.

Besides funding, the need for taxation also addresses the issue of voluntariness. Once an overarching structure looking out for the best interest of every individual is in place, it is very easy to 'free-ride' on the social responsibilities and investments. Individuals being rational egoists, one would look out for themselves most when they are not contributing to the maintaining of common goods and reducing social and economic inequality, therefore not enduring any of the losses, yet are reaping the benefits. Allowing such behaviour would in turn only cause more and more people to opt out of contributing to the common fund, thereby in fact destroying their own best chances of achieving the best net balance of individual and aggregate satisfaction. Society therefore is in need of an instrument of obligatory contribution to the common fund: taxation. Rawls comes to the same conclusion, albeit with slightly different argumentation.¹⁸

Rawls' argumentation hints at 'free-riding', but highlights the lack of confidence in fellow citizens and the suspicion of others not contributing equally eventually resulting in the instability of the state. Thus, the obligatory nature of taxation is needed to rid society of such suspicions. Moreover, by making taxation an obligatory instrument it must be defined in legislation, thereby taking away any vague and imprecise boundaries as to where liberties are restricted. According to Rawls, such vagueness will feed the aforementioned fear, therefore increasing the need for an obligatory contribution to a common fund.¹⁹

Again, Rawls' ideal is a world without taxation. However, as this is not possible (yet), Rawls proposes a proportional taxation on expenditure. This seems strange at first, as an expenditure tax is not the most efficient way in which to redistribute wealth. Rawls presents several arguments for his view, the most important of which shall be discussed here.

Firstly, Rawls refers back to the first principle, stating that taxing all according to what they can pay would in fact infringe basic liberties. According to Rawls it would be as if we

¹⁸ Rawls, *Theory of Justice*, 211.

¹⁹ Rawls, *Theory of Justice*, 210.

condemn the able to jobs that earn them enough money to pay higher taxes, therefore not leaving the able the option to choose whatever they please. When people are taxed periodically on the basis of the starting capital they have gotten and are regarded as economically highly capable people, their taxes would be high. The government would consider them able to contribute more through taxes. But if an individual wants to pursue a career in a lesser paid profession, such an individual would not be able to pay those higher taxes. The result would be that people conceal their endowments and capabilities so that they may choose to pursue whatever they want.

An expenditure tax would not infringe the liberties according to Rawls, as it leaves the consumer with the free choice to buy whatever it is the consumer wants to buy. Furthermore, if the expenditure tax is implemented and levied according to the principles laid down, it would not impair the poor more than the wealthy.

The second type of taxation Rawls discusses is not an expenditure tax, but addresses wealth given from one generation to the other. Initially Rawls argues that transferring wealth from those who have lots of it to those benefitting from the transfer is equal to unequal distribution of intelligence. As long as the second principle is upheld, inheritance is therefore no problem. Rawls does however support some kind of inheritance tax. The purpose of such an inheritance tax would be to prevent accumulations of wealth that would give some people unfair advantage and power compared to others.²⁰²¹

Although an inheritance tax as proposed by Rawls is a type of tax in line with a redistributive system of taxation, at first glance the expenditure tax is not. It might lead to a progressive tax system by consumer choice, but it is not the most effective way of using taxation to redistribute wealth in society. The expenditure tax is however less economically distorting than a progressive income tax, a system which the Dutch government has chosen for instance.

The expenditure tax is a form of redistributive taxation, with a duality similar to a progressive income tax. The wealthier people are, the more they tend to spend. In turn the more people spend, the more they contribute to tax revenues which may be used to support the less fortunate and strive for a socially just society.

²⁰ Jörg Alt, *"Ethics III: Tax justice vs. more just taxation"* (Joerg, 2019), 9.

²¹ Rawls, *Theory of Justice*, part III.

b. The duty to obey tax legislation

In the previous section of this thesis we have explored some arguments in favour of a society in which a redistributive system of taxation has a place. The chapter has focussed mostly on John Rawls' *Theory of Justice*, which has led us – among other things – to the conclusion that we need a government to regulate taxation and redistribute some of the wealth to ensure that everyone achieves the greatest net satisfaction.

Although Rawls provides convincing argumentation for his social theory, there are many opponents and critics of the idea that we can institute taxation as an instrument to redistribute wealth. In fact, there are many who oppose taxation at all. In this section of the thesis, the focus will be on arguments in favour of tax avoidance.

One of the movements against the contract theories that support the idea of taxation and state regulation of redistribution of wealth is the '*taxation is theft*' movement. Michael Huemer is one of the critical thinkers associated with this movement. Huemer is especially critical of the ease with which most of us simply accept the authority of the government and the government imposed laws and regulations.

Unlike more classical theories that discuss the role the government should or should not play, Huemer focusses on the reasons contributing to the public obeying government's laws and the reasons that lead to us accepting the fact that the government can force us to obey.

In his book *The Problem of Political Authority*²², Huemer argues that it is political authority that separates a government from a nongovernmental organisation. In essence Huemer argues, whenever a government imposes a law on its citizens the reason people obey the law, or at least do not break it, is because there will be a form of punishment if they do not.

To most people, this makes sense. However, should a nongovernmental organisation impose rules and obligations on you that you have not explicitly agreed to and punish you if you do not adhere to them, most of us would feel that this is not right. Huemer points out that although it seems very different, it is in fact the same principle and system. He argues that there therefore has to be an essential difference that separates governmental organisations from nongovernmental ones: political authority.

Huemer identifies two aspects of political authority that together make up the concept. Firstly, political legitimacy and secondly, political obligation.²³ The two differ in the sense that legitimacy refers to the notion that government can make laws and enforce them whereas obligation refers to citizens having to obey their government.

Huemer uses the example of taxation on several occasions to illustrate what he believes is wrong with political authority. Leading up to those examples, Huemer first elaborates on the aspects separating governmental organisations from nongovernmental organisations in order to give body to the idea that there must be some political authority.

In his attempt to further explain the difference between a governmental organisation and a nongovernmental organisation, Huemer argues that there are essentially three main differences that separate the two.²⁴ First, the notion of fair trial. A governmental organisation has a legal system in place that judges everyone equally and fairly. A non-governmental organisation does not have an entire system in place that ensures equal treatment. Second,

²² Michael Huemer, *The Problem of Political Authority, An Examination of the Right to Coerce and the Duty to Obey* (Houndmills: Palgrave Macmillan, 2013).

²³ Huemer, *Political Authority*, 5.

²⁴ Huemer, *Political Authority*, 7.

the fact that a governmental organisation has external explicate laws, whereas a non-governmental organisation only rules by an internal good or bad. The norms the non-governmental organisation is ruled by are not public knowledge. Third, and this is the most notable one, in general a governmental organisation imposing laws upon others is chosen. A non-governmental organisation is not elected by all the people it imposes rules upon.

These differences, although currently present, are easily removed. A system of trying someone that has broken a rule can be put in place. The rules a non-governmental organisation is ruled by can be made public and the board can be democratically elected.

The three differences tie into the example Huemer provides us with when talking about tasks that would be looked upon very differently when performed by a governmental organisation versus when performed by a non-governmental institution or an individual even.

Take taxation for instance. Huemer argues that this is a perfect example in which the three aspects of difference come to light. The main reason taxes are being levied is for budgetary reasons, in order to pay for the services provided including establishing order and police work, although as explained, there are instrumental and redistributive reasons as well.

Whenever a vigilante asks money for services performed or will lock you up else, people will naturally be reluctant to oblige. It feels 'bad', especially because you do not think this vigilante has the right to demand money. You did not agree to the actions he or she took, even though you may have benefitted from these actions. A vigilante threatening you to lock you up if you do not pay seems outrageous. Yet Huemer shows us this action of demanding money for services performed is hardly different from the government levying taxes, with the exception of the three elements mentioned in one of the previous paragraphs.

According to Huemer, although people generally would agree that a person is given a fair trial when disobeying the law, the underlying principle is the same. There must be (a risk of) punishment for people to feel the need to pay taxes. Perhaps initially a fine, then another fine and only eventually imprisonment. In reality we do not see anyone of the opinion that they pay too many taxes evade taxation on a whim, even though their internal judgement might be that it is unjust or 'bad'. The threat of punishment is thus sincerely felt by people. Consequently, Huemer states: "Thus the legal system is founded on intentional, harmful coercion."²⁵ The justification of this action and actions similar to these, lies in political authority.

To illustrate the difference between his dissection of (the justification of) political authority, legitimacy and obligation, and the theory of those generally defending political authority, again Huemer turns to taxation. The five elements of popular theory, namely (1) generality, (2) particularity, (3) content-independence, (4) comprehensiveness and (5) supremacy are quite discernible in the instance of taxation.²⁶ Huemer argues however, that these five elements still do not justify the difference in obeying a government enforced law in comparison to a rule upheld by a non-governmental institution or individual, referring back to the vigilante example.

To find arguments in favour of tax avoidance, we must dive deeper into the two elements of political authority: political legitimacy and political obligation. Huemer provides us with numerous arguments in favour of political authority which he opposes as well as various arguments directly opposing political authority or one of its two components. Only some of these arguments will be discussed in this thesis due to the length of the work.

²⁵Huemer, *Political Authority*, 10.

²⁶ Huemer, *Political Authority*, 12.

Political legitimacy can only be constituted when people democratically agree upon giving power to a governmental institution. In actuality, the only true political legitimacy for specific laws can be derived from referendum. A democratically elected government only constitutes indirect political legitimacy.²⁷ The question then remains whether or not unanimous agreement is the only method that constitutes legitimacy or if a unanimous vote for majority consent is enough to constitute legitimacy of a governmental institution.

Pure and direct democracy through unanimous voting is impractical and nearly impossible to achieve let alone implement in modern western societies. Many of the legislation passed, including tax laws, are too complex and too interwoven with other laws to let every single individual make an educated choice when deciding whether or not the proposed legislation should pass.

Political legitimacy and political obligation can only coexist in order for either to have sufficient foundations to hold. Political obligation, in comparison to political legitimacy, requires elaborate argumentation to establish. Two lines of argumentation are being brought forward in *The Problem of Political Authority*. The exploration of these lines of argumentation tie into the idea of having democracy as the main source of political authority, therefore already assumes the (maigre) establishment of political legitimacy.

The argument of majority is the first argument discussed and assumes rules that find their basis in direct democracy. Huemer uses an example to illustrate the argument. Imagine going to a bar with a couple of your fellow students and professors.²⁸ At the end of the evening, the bill has to be paid. Someone suggests splitting the bill evenly, you suggest that everyone pays for their own drinks and then someone suggests that you pay the bill in full. Of course, you decline, after which the group takes a vote. Everyone except you votes for the option in which you pay the bill in full. Are you obliged to pay? Does this give the group the right to coerce you into paying the bill in full by threat of force, Huemer asks?

As one can imagine, the answer to these questions is no. Simply because of the reason that in real life people would not adhere to such a way of decision-making. Others should not be in a position to decide what you should do with your property. It does not establish political obligation and consequently no political authority.

Translated to a bigger situation in which an elected governmental institution decides with a majority vote that you should pay taxes (which Huemer classifies as being your property), it shows that the obligation to pay taxes cannot be upheld either.

In order to further strengthen the argumentation leading to the conclusion that political obligation cannot be founded, Huemer discusses, what he believes, is the “best developed contemporary argument for the claim that the democratic process confers political authority.”²⁹

The Argument for Equality has been developed by Christiano.³⁰ Briefly put, it entails the following: respecting democratically made decisions is a requirement for treating everyone in society as equals.³¹ The argument is made up of two premises and a conclusion:

- a. Individuals are obligated to treat other members of their society as equals and not treat them as inferiors.

²⁷ Huemer, *Political Authority*, 65.

²⁸ Huemer, *Political Authority*, 59.

²⁹ Huemer, *Political Authority*, 65.

³⁰ Thomas Christiano, *The Constitution of Equality: Democratic Authority and Its Limits* (Oxford: Oxford University Press, 2008).

³¹ Huemer, *Political Authority*, 65-67.

- b. To treat others as equals and not as inferiors, one must obey democratic laws.
- c. Therefore, individuals are obligated to obey democratic laws.³²

One of the subarguments of (3), is according to Huemer what Christiano spends most of his work defending. This subargument states that we need democracy in order to ensure equal advancement of persons' interests. Christiano argues that a social system must satisfy a publicity requirement in order to truly ensure equality in advancing a person's interests. Only a system of democratic decision making satisfies this, as it is a procedural form of equality.³³

This form of equality is not the same as Rawls' form of procedural justice, which requires us – summarised – to satisfy both the same basic liberties and rights and equal opportunities, but does not specifically speak of publicity. Huemer points out that those kind of 'substantive interpretations of equality' do not fit the publicity requirement and require us to accept more radical ethical views. I consider it debatable whether or not it requires more radical ethical views. For now however, this question can be laid aside.

Huemer nuances the subargument of Christiano by stating it is the public equal advancement of interests, that requires the democratic decision making discussed two paragraphs prior.

The solid Argument of Equality up until this point only supports the claim that there is political authority through the political obligation created by following the path of equal advancement of people's interests, which eventually is most beneficial for all it seems.

Pursuing equal advancement of individual's interests is a requirement for treating others as equals, Christiano states.³⁴ Huemer finds this premise to be incredibly demanding and brings forward yet another monetary example which very much relates to this thesis' exploration of justification of taxation.

When your interest is of as much value as another person's interest, without any constraints to this idea, you cannot keep any money or other property to yourself. Huemer says that when you suppose you have €50,- and you decide to spend it on yourself you advance your interests more than others. You must therefore spend it on someone whose interests are clearly less advanced or divide it among individuals in society equally. But this does not only apply to the €50,-, but to everything you own, essentially leaving you with nothing.³⁵

To avoid such an outcome, one could limit the demand for justice to an obligation that requires us to promote social institutions that advance others' interests equally. In his argument, Huemer discusses various objections to the idea that we have an obligation to social institutions that advance individual's interests equally. For the sake of this thesis, the last major argument proposed opposing this idea is important.

According to Huemer, following the underlying thought process of supporting social institutions that equally advance person's interests is not too different from equally promoting other people's interests directly. One may have reasons not to spend money directly on others, as for instance your own interest are not as advanced as the average. When putting social institutions in the middle, supposing these institutions are governmental, you may assume that there are no reasons for the governmental institutions to hold back on advancing individuals' interests equally as that is their sole purpose.

³² Huemer, *Political Authority*, 66.

³³ Huemer, *Political Authority*, 67.

³⁴ Christiano, *Constitution of Equality*, 67.

³⁵ Huemer, *Political Authority*, 68.

The social institution solves the issue of determining on an aggregate basis what is needed most to advance people's interests equally and has the means to (monetarily) distribute fairly.

Such as social institution requires funding, however this alone does not constitute the political obligation for individuals to actually pay an amount to such an institution, through taxes. An individual may still have a reason not to pay taxes as the money can be used better for their own advancement of interest, should those have fallen behind the average.

In the case of charity for instance, when you decide not to donate for the same reasons, although in comparison to not paying taxes this is not a punishable act, people intuitively are okay with it. The choice is yours. The situation is not too different. Accordingly, Huemer states that the obligation to pay taxes cannot be defended on the basis of the Argument of Equality.

Huemer points out that there might be a difference between the obligation to have to pay taxes and contributing to a charity as the government can do much more for the total benefit of advancing people's interests equally than a charity.

Two arguments can be brought forward in defence. Firstly, a large and efficient charity may do just as much for the advancement of people's interests. In fact, such a charity may have a much clearer view of what is needed for the people in its surroundings. Secondly, Huemer states "The total good done by an organisation should not be confused with the good done by the individual's marginal contribution to that organisation."³⁶

In relation to the political obligation to pay taxes, and thus the political authority regarding taxation on the basis of the Argument of Equality, Huemer draws the following conclusion: "Either the obligation to promote equal advancement of interests is implausibly demanding, or it is too weak to support basic political obligations."³⁷

³⁶ Huemer, *Political Authority*, 70.

³⁷ Huemer, *Political Authority*, 70.

c. Tax avoidance in a redistributive system of taxation

The first part of this thesis has focused on Rawls' theory discussing why we need a society with a central system of taxation. The preference in a system of taxation lies with creating a redistributive system of taxation. Next, Huemer's argumentation concerning the inexistence of political authority and thus the lack of political foundation regarding a system of taxation has been explored. In order to support the central claim of this thesis, *Tax avoidance by individuals in a redistributive system of taxation is justified*, the relation between these two lines of argumentation must be explained.

Rawls' theory of social justice focusses on setting up social institutions in a way that is socially fair to all. Rawls stresses that it is most important to take into account the different weights to be assigned to individuals in order to not lose sight of the biggest absolute gain in the net aggregated balance of satisfaction for society.

Even though ideally Rawls prefers to not have any form of taxation at all, he does acknowledge that taxation helps with funding of public goods. Moreover, taxation may aid in (indirectly) redistributing some of the wealth. Consequently, the net aggregate balance of satisfaction will increase, per the different weights assigned to different individuals in society.

To defend the claim of this thesis, the idea that we need social institutions and taxation at all needs to be solid enough to withstand Huemer's claims regarding the lack of political obligation to obey tax laws. After all, the central claim of this thesis is concerned with tax avoidance, not tax evasion.

The key in achieving a society Rawls' describes, lies in the perspective from which we set up such a society and all the regulations and laws that come with it.

Individuals set up such a society with the intend to maximise the net aggregate balance of satisfaction, no matter where in society they are born. If you find yourself among the wealthier of society, you too benefit from the improvement of the satisfactions of the poorer. Moreover, you also make use of the public infrastructure, education et cetera.

By using these facilities one enters a social contract of living in such society. At the end, Rawls' theory is a modern conception of a social contract theory.

A common argument by those theorising a form of social contract is that by entering a social contract, you agree to the political authority of the government and must obey to the rules and laws imposed upon you by the government. This includes the laws relating to taxation.

An important component of the matter is the issue of property. Does the money you earn, or have inherited, belong to you or is it part of the collective that has enabled you to (temporarily) acquire this money? Although much can be said about the property issue, this thesis is not long enough to get into the debate on property and ownership, beyond what has implicitly already been discussed.

So, for the sake of the argument, let us assume that most individuals have entered some sort of social contract. As Nagel and Murphy have mentioned, there are very few individuals that are able to flourish without social and economic interactions. Hence, we are part of a collective.³⁸³⁹

³⁸ Jeffrey Schoenblum, "*Myth of Ownership / Myth of Government*" (Vanderbilt Law School Faculty Publications, 2003), 556.

³⁹ Thomas Nagel and Liam Murphy, *The Myth of Ownership: Taxes & Justice* (Oxford: Oxford University Press, 2002).

Being part of this collective means agreeing to adhere to laws that require us to give up some of our property⁴⁰. Under this course of argumentation any form of tax evasion is ruled out.

Huemer argues that there is no political authority to impose taxation on citizens. His analogies between actions taken by governmental institutions versus unaffiliated individuals show great similarities. Huemer does not agree that the differences between the actor, such as the idea of elected officials, are sufficient enough reason to justify political authority and thus create a duty to obey among other things, tax legislation.

Although Huemer highlights several problems with political authority, once an individual (chooses to live or) lives in a society that is structured in such a manner that it benefits the individual no matter what the individual's social and economic position, this individual enters the social contract. By entering the social contract, the individual gives consent to adhere to the laws imposed upon them in exchange for the rights that come with taking part in the society in question. A citizen gives status to the government.

The matter of consent in my opinion surpasses the problems laid out for us by Huemer.

One might argue that, as pointed out by Nagel and Murphy, it is near to impossible to live without any social and/or economic interaction in our current day and age. However, the fact that an individual benefits from the net aggregate balance of satisfaction of society being greatest (education, not encountering orphans, et cetera) is hard to dispute. Not only on the basis of Rawls' argumentation, but also on the basis of empirical evidence in economics and experience of everyday life. Most people will argue that their overall happiness increases when they do not wake up to seeing many homeless people on the streets. I believe most people would consider the loss of wealth in comparison to the gain of not having to deal with such poverty smaller.

Both Rawls and Huemer discuss the role of the government in taking on the task of taxation. Placing the task of getting the funding to improve overall satisfaction in society in the hands of the government decreases chances of 'free-riding'. Moreover, although Huemer does voice some reservations concerning this argument, he acknowledges that putting a governmental (social) institution in place solves the issue of determining on an aggregate basis what is needed to advance people's interests equally.

Reflecting on the argumentation above, I have to point out that benefitting from the amenities paid for with taxpayer's money is not the same as actively consenting to paying taxes. However, as Rawls has pointed out, people are rational egoists. As rational egoists, although initially one would look out for themselves most when opting out of paying taxes, yet still reaping the benefits, when taking into account all the disadvantages of 'free-riding', consenting to entering the social contract and paying taxes is the only outcome that ensures greater future benefits through aggregate, society-wide efforts than momentary individual losses.

The crux of defending the main claim of this thesis using the lines of argumentation discussed is the extent to which consent to obey on the basis of entering the social contract reaches.

In section two of the main part of this thesis, Huemer's argument of the Charity Case is discussed. In this argument, it is pointed out that a governmental institution may not be as aware of those in need as a local charity or yourself. This example is used to display a

⁴⁰ Depending on the view regarding property.

similar instance, conducted by two different institutions, with a different outcome in terms of what we consider justified.

When going back to the modern social contract with the goal of creating social (and economic)⁴¹ justice, due to previously discussed reasons, the Charity Case argument does not hold for the instance of having to pay taxes. Entering the social contract gives you rights, but also duties, including the duty to obey. Hence, tax evasion is not justified. If one disobeys, the social contract between that person and the state is broken, but the collective will not suffer much if at all. However, if more and more people start to disobey laws, it will eventually result in the instability of the state.⁴²

The Charity Case argument does however, along with other arguments by Huemer, show us the flaws of tax legislation and its constitution of political authority. It also gives an example for the belief that people are rational egoists.

The consent given to obey the laws by entering into the social contract with the state only causes a person to breach contract when acting in conflict with the laws of the state. Ergo, the consent creating the duty to obey only extends to tax evasion. It does not extend to tax avoidance.

Once the duty to obey has been fulfilled, acknowledging the limits of the governmental institution and acting accordingly is by no means not justified.

There are many reasons for tax avoidance. The Charity Case assumes the best in people, yet knowledge of the world around us provides us with enough examples of tax avoidance for one's own personal gain.

It is very hard to distinguish between cases of tax avoidance and create a common principle that helps us in determining when tax avoidance is justified and when it is not. Rawls' *Theory of Justice* provides us with principles on the basis of which we should structure our social institutions and hence our society. Huemer provides us with arguments challenging political authority at all. Following the lines of argumentation explored, it can only be said that *tax avoidance by individuals in a redistributive system of taxation is not not justified.*

⁴¹ Schoenblum, "Myth of Ownership", 560.

⁴² Huemer, *Political Authority*, 71.

4. Conclusion

This thesis has aimed to defend the claim '*Tax avoidance by individuals in a redistributive system of taxation is justified*'. It has done so by first elucidating some of the core concepts, such as tax avoidance and a redistributive system of taxation, after which work of John Rawls and Michael Huemer has been discussed.

John Rawls' *Theory of Justice* argues that we need two principles of social justice, thought of behind the veil of ignorance, to establish a society that is socially just. First of all, everyone should have the same basic liberties, such as the liberty to vote. Secondly, everyone should have the same opportunity. Once a society based on these two principles has been created, differences in terms of wealth and position in society are not discouraged, provided the second principle applies. Rawls ideally opposes taxation altogether. However, taxation is needed to provide funding for public goods and provides a feasible means to redistribute some of the wealth so that everyone will have equal opportunities and access to for instance education.

Michael Huemer is part of the '*taxation is theft*'-movement. He argues that taxation is only one of the many aspects of our society that is flawed. According to Huemer, there is no political authority that creates the duty to obey and the right to coerce. Huemer distinguishes political obligation and political legitimacy as the two aspects making up political authority. The distinctive features of governmental institutions in comparison to non-governmental institutions are not sufficient according to Huemer to create political obligation to have to obey laws imposed on citizens by the government. Hence, there is no duty to obey tax legislation.

In order to defend the central claim of this thesis, common ground between these two seemingly opposite positions had to be found. Rawls' theory focusses more on the overall design of society, essentially setting up a modern social contract. Living in a place with many social and economic interactions, which most of us do, leaves us no choice than to collectively make agreements and set up some sort of overarching institution that is purposed with taking care of public goods and keeping the peace. This can only be achieved through a modern social contract. By entering this social contract, one essentially consents to obeying the laws of the overarching, governmental, institution in order to ensure stability of the state. Tax evasion is therefore not justified. Tax avoidance however, can be justified. Rawls does not strongly oppose tax avoidance. As long as everyone has the same opportunity to avoid paying taxes, the difference in whether or not a person avoids paying taxes subordinate.

As Huemer shows us, there are many flaws in (tax) legislation and the role of the government. Tax avoidance does not jeopardize the stability of the state as there is no instance of ignoring the duty to obey the laws of the state nor has the state the right to coerce you to not avoid paying taxes. Therefore, *tax avoidance by individuals in a redistributive system of taxation is not not justified, hence justified*.

This thesis has primarily explored the works of John Rawls and Michael Huemer due to the length of this thesis. In order to fully explore the central claim of this thesis, further research into (more of) the work of a.o. Nagel, Murphy, O'Neill and Orr can be done. Furthermore, exploring the claim from a philosophy of law perspective with regards to how far one can exploit the limits of the law may provide new insights and another layer of depth to the central claim of this thesis.

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