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Cross-Border Startups and Regulatory Arbitrage: Navigating Legal Complexity in the Global Entrepreneurial Ecosystem

[1]Mr. J P Singh, [2]Dr. Sonia Dhir, [3]Dr. Tanu, [4]Dr. Pooja Kudesia

[1]Professor, Jagan Institute of Management Studies

[2]Associate Professor, Jagan Institute of Management Studies

[3]Assistant Professor, Jagannath University, Bahadurgarh

[4]Associate Professor, Jagannath University, Jaipur

Abstract:

The expression "regulatory arbitrage" is commonly used to refer to cross-border startups, but it can refer to three different approaches that have three distinct mechanisms, legal risks, and normative status. In this paper, arbitrage (which involves the transfer of the activity away from the rule's jurisdiction), structural layering (which involves the separation of legal situs from economic situs, but does not involve the relocation of the activity), and regulatory entrepreneurship (which involves operating in legal ambivalence and engaging in activism that attempts to alter the rule rather than to avoid it) are distinguished. Two variables of the structure of the regulated activity, its mobility, and the reach of the rule, are shown to determine which strategy is available, and the arbitrage feasibility space is developed accordingly. The main thesis of the paper is that this area is shrinking. It is being closed by four forces: the large market influence of regulation, international tax coordination, automatic information exchange, and moving from entity-based to activity-based and data-based regulatory design. Meanwhile, the law becomes more intricate. As a result, the complexity paradox is that the compliance costs of operating across jurisdictions rise as the arbitrage benefits decrease; that is, complexity becomes more of a fixed cost, and fixed costs are regressive in firm size. We introduce the concept of 'jurisdictional debt' to describe the arrangements that are established at an early stage for reasons of capital access, with the cost of unwinding those arrangements piling up and materializing at a later stage, and we theorize about a legitimacy triage between arbitrage that takes advantage of the real competition among policies and arbitrage that takes advantage of an enforcement gap or externalizes harm. There are seven propositions and an analytical protocol provided, but no invented statistics are reported.

Keywords: regulatory arbitrage; cross-border entrepreneurship; regulatory entrepreneurship; international new ventures; corporate structuring; extraterritoriality; compliance cost; institutional entrepreneurship

1. Introduction

A start-up can have customers on four continents within the first year, be protected by IP rights in a second, have a parent company in a third, use engineers in a third country via contract, and accept payments via an authorized company in a fourth country. This is no different from what they're used to; it's the standard design for software-driven startups with global aspirations. The phenomenon had been noticed long before it became commonplace, as some firms are not international when they start, but rather through a process of internationalisation (Knight & Cavusgil, 2004; Oviatt & McDougall, 1994). The legal environment that these companies find themselves in is what has not been predicted by that literature. The connectivity that makes a small company viable for global demand also makes it vulnerable to the regulatory demands of all the markets where demand occurs – and these demands have grown more numerous and more demanding. There are data protection regimes that impose responsibilities on the processing of residents' data, irrespective of the location of the processor. Foreign firms' conduct that impacts domestic users is covered by digital-market regulation. Technology does not come with a set of sanctions or with export-control regimes. The outcome is a company of twenty people with a compliance face that would be of a multinational a generation back.

The default answer for such companies is regulatory arbitrage. It's too big a job for the term. It's used in a start-up that incorporates in Delaware in order to take advantage of existing investment documents, for a group with IP rights in a lower-tax jurisdiction, for a ride-hailing service that's launching in a city where it's likely illegal, and for a crypto exchange moving to a more hospitable jurisdiction. Not variants of one strategy. They differ in that they involve some type of movement vs no movement, a rule that can follow vs a rule that cannot follow, legal risk taken vs no legal risk taken, and costs borne by third parties vs not borne by third parties. Their consideration as one phenomenon has caused the descriptive literature to become vague and leads to the normative literature being of little assistance, since a blanket condemnation and blanket defence of arbitrage is both obviously incorrect if the cases are separated.

This paper has four contributions. It breaks down the strategies and identifies the structural environment that makes each feasible, and creates the arbitrage feasibility space from two dimensions: the mobility of the regulated activity, and the scope of the rule. It creates a concept of 'jurisdictional debt' to account for the increasing costs for the buildings that were constructed early because of the circumstances and then no longer needed, which can be seen in the redomiciliation of companies that were previously 'flipped offshore'. It also states that four recognisable forces are shrinking the feasibility space; complexity is growing and creating an increasing 'complexity paradox' that sees legal fragmentation becoming an increasingly 'fixed cost' for startups and being a positive 'exploitable opportunity' for incumbents. It provides a form of legitimacy triage which is useful to distinguish arbitraging in the real policy competition from arbitraging in enforcement gaps or forcing harms onto third parties.

The analysis is not based on jurisdiction but on structure. It does not deal with specific regimes the details of which is changing more quickly than any might track nor does it depend on the actual contents of any particular instrument. It poses instead the question of what factors influence the options for a cross-border enterprise and how they are evolving.

2. Three Strategies, Often Conflated

Table 1 separates the strategies. The distinction that does most analytical work is between moving the activity and moving only its legal characterisation.

Table 1. Three strategies conflated under the label of regulatory arbitrage

Strategy	Definition	What moves	Legal risk profile	Dependence on rule reach	Illustrative domain
Arbitrage proper	Locating an activity where a burdensome rule does not apply	The activity itself, or its operative locus	Low if genuine; high if the relocation is nominal	Fails entirely where the rule is effects-based	Licensing-sensitive online services
Structural layering	Separating legal situs from economic situs while the activity stays put	Only the legal characterisation	Moderate; exposed to substance and anti-avoidance doctrine	Contested at the margin rather than defeated	Holding-company and intellectual property structures
Regulatory entrepreneurship	Operating in legal ambiguity while	Nothing; the firm confronts the rule	High and deliberate; treated as a	Adopted precisely	Platform services requiring local

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Strategy	Definition	What moves	Legal risk profile	Dependence on rule reach	Illustrative domain
	mobilising to change the rule		business cost	where exit is unavailable	physical presence
Compliance-by-design	Building to the strictest applicable regime and treating it as a global standard	Nothing; the constraint is internalised	Lowest; but highest fixed cost	Rational when the strictest rule has wide reach	Data-intensive services in large markets
Passive non-compliance	Ignoring foreign claims on the assumption of non-enforcement	Nothing	Latent; crystallises at financing, listing, or acquisition	Depends on enforcement capacity rather than rule reach	Early-stage firms below enforcement thresholds

Two of these need to be expanded, as they are often incorrectly described. Pollman and Barry (2017) have developed a definition of regulatory entrepreneurship that is not a form of arbitrage. The firm does not try to move into a place where the rule doesn't apply, it goes to a place where the rule does apply, and it hopes that political pressure by users, growth to a point where prohibition is too expensive, and the confusion of applying old categories to new services will result in change in the law. This is a method of confrontation, and its resources, primarily capital sufficient to withstand the constant threat of litigation, and a user base that could be rallied as a political group, vary from arbitrage. It is only offered by well-funded ventures, thus making it more common among those that have raised a lot of capital, compared with those that are bootstrapped.

The most common strategy in practice and least discussed in the literature is passive non-compliance, which is rarely articulated as a strategy. That it is a small company that serves clients in thirty countries is, as far as formal law goes, pretty much a guarantee it's not registered, not paying taxes, or indeed not complying with consumer protection laws in several of those countries; and it's even more of a certainty for practical purposes. This is a legitimate and rational position, but it is not a resolution - it's a deferral, and it will come up in diligence when the funding round, the acquisition or the listing comes around, when the price to remediate is highest and the leverage situation of the firm is weakest.

3. The Architecture of Cross-Border Structures

3.1 Common configurations

Table 2 presents some configurations that can be found in various ecosystems, the rationale for their use, and their difficulty, especially in reversing. Capital access is the strong force behind the most prevalent structures. Investors from stable funds like to have a familiar regime, with a familiar corporate structure and documentation, and dispute resolution, and the added cost of educating the investment committee of an unfamiliar regime is absorbed by the founder, either in the form of a lower valuation of the fund, or a failed round altogether. The resulting structure is selected when there is the most information asymmetry and the least bargaining power of the founders, the heart of the argument of the next subsection.

Table 2. Recurring cross-border configurations

Configuration	Principal rationale	Secondary rationale	Typical adoption point	Reversal difficulty	Principal later cost
Foreign holding company over a domestic operating subsidiary	Investor familiarity with corporate law and documentation	Access to a deeper capital pool	First institutional financing round	High; reversal is a taxable event in many regimes	Charge on unwinding; constraints on domestic listing
Intellectual property held in a separate jurisdiction from development	Tax efficiency on licensing income	Ring-fencing of the core asset	Once revenue becomes material	High; transfer pricing on migration	Substance requirements; anti-avoidance exposure
Regional operating entity for a licensed activity	Access to a passportable licence	Proximity to a regulator	When licensing becomes unavoidable	Moderate	Ongoing substance and capital requirements
Contractor-based distributed employment	Speed and avoidance of entity formation	Cost	From inception	Low legally, high in practice	Reclassification exposure; permanent-establishment risk
Payments entity separate from the trading entity	Regulatory necessity in most regimes	Settlement efficiency	At first material transaction volume	Moderate	Capital adequacy and reporting obligations
Domestic-only structure with cross-border sales	Simplicity and low fixed cost	Preservation of optionality	Default at inception	Not applicable	Accumulated latent non-compliance in customer jurisdictions

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3.2 Jurisdictional debt

We suggest the concept of a jurisdictional debt the cost of an overhanging legal regime set up when circumstances change, but then disappear. The comparison to the concept of debt is apt in its significant ways: the structure provides a real value at time of adoption, the cost of the structure is not avoided, the debt itself accumulates over time as a maintenance expense, governance is duplicated, and the structure's debt values are not always aligned with the actual investment focus of the firm, and servicing the debt becomes costly at the time of unwinding. This is graphically represented in Figure 1.

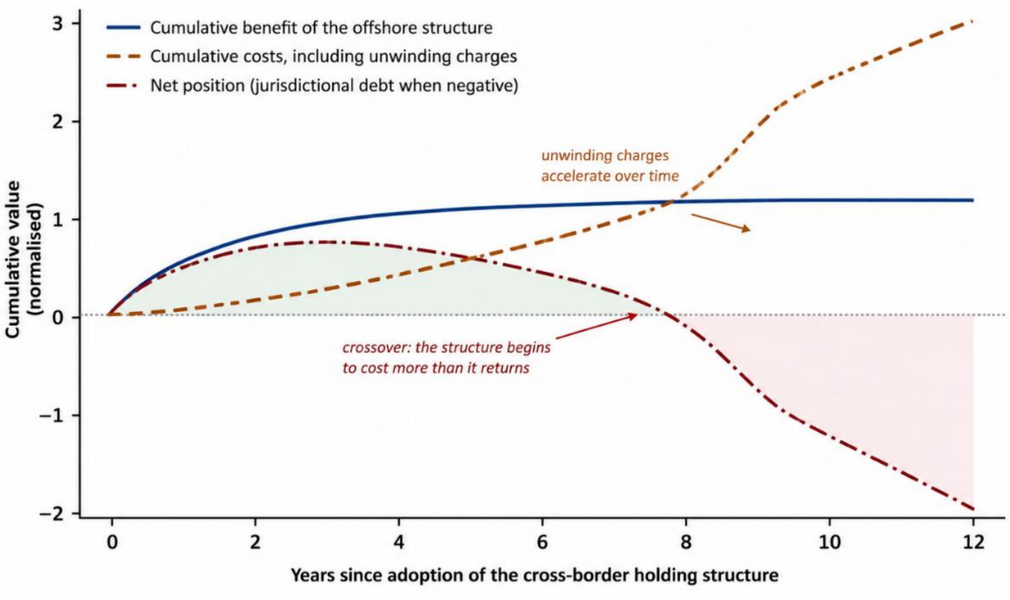

Figure 1. Jurisdictional debt. Cumulative benefit of a cross-border holding structure against cumulative cost including the unwinding charge, with the crossover point at which the structure begins to cost more than it returns. Values are generated from declared parameters and illustrate the argument's structure only; they are not empirical estimates.

There is no fault in the mechanism. The structure is usually sound at the time of adoption, providing capital that may not otherwise be available, and the other option is that it may not be financially available at all. What modifications does the environment undergo. Domestic capital markets deepen, home-listing becomes appealing, or is mandated by sectoral regulation; the requirements for substance become more stringent, to the point where one parent company with no employees is no longer viable, and the firm's customers, revenue and employees become located where the operating subsidiary is located, not where the parent is registered. The same structure which was the year-two problem is the year-eight problem and generally unwinding the structure elicits a charge based on a valuation that has increased exactly because the venture was successful.

This has implications on the way the phenomenon should be assessed. Redomiciliation of previously offshore ventures back to their home jurisdictions has become apparent in several ecosystems as capital markets at home have matured; no such thing as a wrongly set up structuring, or a defeat of arbitrage. It is the act of paying back a debt that has been incurred for some value received. It is the question of how to make the round trip cheaper, a question about depth of the domestic capital markets, and one about tax treatment of redomicilitations, not one about anti-avoidance.

3.3 The talent and equity dimension

Talk about cross-border structuring focuses on capital and tax, and barely considers the people who will be impacted the most by it: the workforce with equity. Employee option schemes are one of the most jurisdictionally complex types of securities that a startup can offer, as they can be taxed in a widely divergent manner across jurisdictions, often at values that fail to align with that of the startup's securities, and can be a highly ambiguous type of security under the securities laws of certain jurisdictions. The employee in the operating jurisdiction who holds an option to call or redeem the foreign parent may be subject to tax on exercise of an option on an illiquid instrument; a currency exposure between the grant and realisation of the option may apply; and a regime for holding foreign securities has been structured for the benefit of portfolio investors rather than employees in the operating jurisdiction.

Three consequences follow. First, structuring decisions are regressive within the firm: the founder/ investor would have advisers and liquidity, and be able to plan around the frictions, whereas the junior employees would have only that instrument, and not any of the three. Second, the conflicts are greatest when the scheme is meant to be benefiting, at the time of a secondary sale or exit, and undermine the function for which the equity was given. Third, employee holdings are often the most administratively complex component of unwinding and the cost of unwinding such holdings rarely is part of an estimate that is used to decide on the redomic.

Another constraint is in relation to the mobility of people and not of entities. A great deal of the existing research on international new ventures views the firm as the unit of relocation, whereas the facts and dynamics of immigration depend mainly on the immigration regime, which is the least harmonised and most unpredictable factor in the environment. A legal structure based on a founder moving to the jurisdiction of the parent will be dependent on a visa determination, which can't be provided by legal structuring. This is one of the starkest examples of the context of entrepreneurship that is not formalistically limited to the rules regulating the enterprise (North, 1990; Autio et al., 2014).

4. The Arbitrage Feasibility Space

The strategy that a particular venture can adopt in a particular domain is not a choice of the venturer, but a fact. It is dependent on two structural variables. The first is the mobility of the regulated activity, that is, whether or not the substance of what is regulated is mobile. The car and driver is in the city regardless of the company's structure - ride-hailing in this city is indeed highly mobile software. The second is the extent of the rule and can be either conduct in a territory or effects on residents wherever the actor is. These axes are set up to represent representative domains and the corresponding strategy is indicated in each quadrant in Figure 2, with the strategy indicated in Table 3.

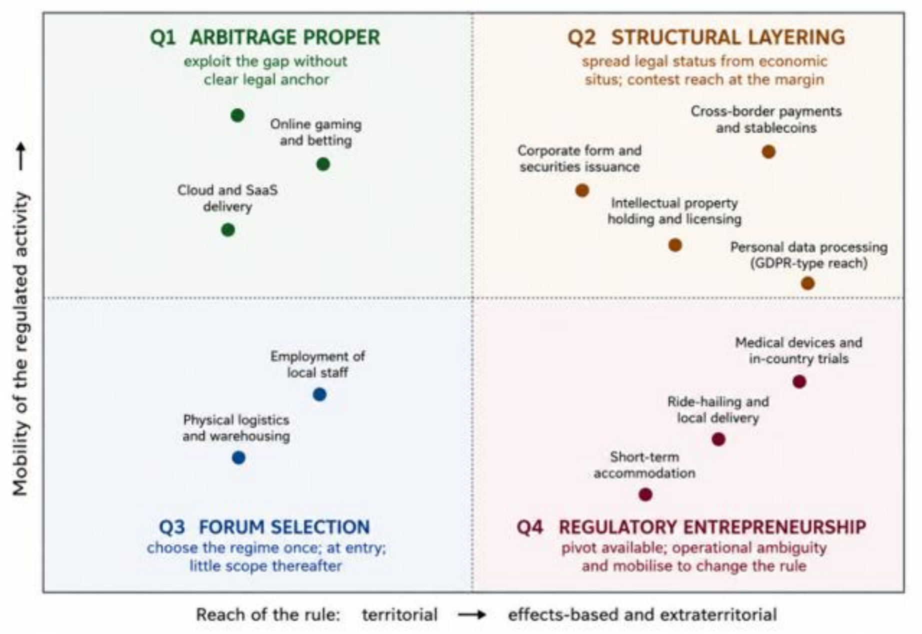

Figure 2. The arbitrage feasibility space. Regulatory domains positioned by the mobility of the regulated activity and the reach of the rule, with the dominant viable strategy in each quadrant. Positions are analytic judgements offered for discussion, not measurements.

Table 3. Quadrants of the arbitrage feasibility space

Quadrant	Activity mobility	Rule reach	Dominant viable strategy	Why alternatives fail	Direction of change
Q1	High	Territorial	Arbitrage proper	Confrontation is unnecessary when exit is cheap	Shrinking as rules become effects-based
Q2	High	Extraterritorial	Structural layering and compliance-by-design	Relocation does not defeat a rule that follows the user	Growing; now the modal condition for digital ventures
Q3	Low	Territorial	Forum selection at entry only	Neither exit nor structure changes the applicable law	Stable; the classical position of physical businesses
Q4	Low	Extraterritorial	Regulatory entrepreneurship or compliance	No exit exists; the firm must contest or comply	Growing; capital-intensive and available to few

The framework gives rise to a number of observations which are hidden in the undifferentiated language of arbitrage. First, the existence of arbitrage is a property of the domain and not of the sophistication of the firm so that the common belief that more sophisticated startups are more capable of arbitrage is only true within a quadrant. Second, movement between quadrants occurs via regulatory design and not by the action of the firms themselves: If a legislature changes a territorial rule to an effects-based one, then all the firms in that domain will shift from Q1 to Q2 simultaneously, and strategies that were once viable become nominal. Third, it's only in Q4 that the conflicts are most visible, as that's when they are the ones that impact public perception; the most talked about would be the least representative of the kind of work most cross-border startups perform, given that they are the ones where arbitrage was not a possibility.

It is also important to have a dynamic qualification. The position of a venture in a space is not constant throughout its life, and the average course is from Q1 to Q2, as a venture grows. At small scale a firm with foreign customers is effectively beyond the reach of most regimes and its behaviour as though it was in Q1, regardless of its formal position. But as the revenue, the number of users or visibility reaches the point where regimes can attach, and enforcement is worthwhile, the same firm finds itself in Q2 with no change in their operations. This strategic mistake is prevalent and predictable: a structure and a compliance posture that are safe and sensible at one scale is extended to a scale at which it is neither and the transition is not marked by anything extralegal, as nothing in the law has changed.

5. Four Forces Closing the Space

5.1 The four forces

The feasibility space is not static, and its direction of movement is consistent across domains. Table 4 sets out four forces, each independently sufficient to narrow it and jointly producing a substantial contraction over the past decade.

Table 4. Forces contracting the arbitrage feasibility space

Force	Mechanism	Effect on the space	Limits of the force	Implication for startups
Extraterritorial reach of large-market regulation	Obligations attach to effects on residents rather than to the location of the actor	Converts Q1 domains into Q2	Enforcement against small foreign firms remains costly and selective	Compliance-by-design becomes rational earlier than firm size would suggest
International tax coordination	Minimum effective taxation and coordinated anti-base-erosion rules reduce differentials	Removes the return to purely tax-motivated layering	Thresholds exclude most startups directly, but affect their acquirers	Structuring rationale shifts from tax toward capital access
Automatic information exchange	Cross-border reporting of accounts and beneficial ownership	Eliminates opacity-dependent strategies	Coverage and quality vary by jurisdiction	Passive non-compliance becomes discoverable rather than invisible
Activity- and data-based regulatory design	Rules attach to what is done and to what data is touched, not to entity form	Defeats entity-level restructuring specifically	Definitional boundaries remain contestable	Corporate structure ceases to be the operative lever
De facto standard convergence	Firms build to the strictest applicable regime and export it globally	Reduces the practical differential even where legal differences persist	Convergence is partial and contested across blocs	The strictest regime effectively sets the product specification

The first is the most significant for digital ventures, and is best represented in the literature on the global influence of large-market regulation (Bradford, 2012, 2020), the idea being that, given a large market, its size and the value of indivisible products and processes means that the standards set by the jurisdiction that regulates that market will proliferate and spread globally, regardless of any formal harmonisation. Indivisibility is more binding at small scale, so the mechanism is important for startups in particular because it compels a smaller firm to produce to the most stringent rule that it has, a larger firm can produce a differentiated set of regional products. The Brussels effect is therefore more complete in terms of start-ups than with the incumbents with which it is typically associated.

It is important to note that the fifth force is different to the first one because it isn't based upon the law, but on the choice of the company. If a firm has been built to a hard standard, adding a global component is less costly than keeping variants, and thus becomes a de facto global policy. This is how regulatory influence becomes more important than regulatory jurisdiction, and it is an underestimate of the impact of a rule by looking at its formal extent only.

There are two qualifications to prevent overstatement. Passive non-compliance is still prevalent as the capacity to enforce does not equate with legal reach and for a company of 20, there is little exposure in most domains in a distant jurisdiction anyway. But there is no global convergence – divergence in the major regulatory blocs around data flows, artificial intelligence, and platform obligations is significant and, on current trends, increasing, not decreasing, and it is the consolidation to a few incompatible regimes, not unification, that would be the likely outcome (Aaronson & Leblond, 2018; Bradford, 2023; Chander & Lê, 2015).

5.2 Enforcement asymmetry and the small-firm shadow

There is a difference between legal reach and enforcement capacity and in the case of the start-ups, it is the difference between these two that is the factor. A rule that formally applies to a firm that no authority will ever attempt to enforce has only that effect on the behaviour of the firm because the firm expects in the future to be subject to a scrutiny. This creates what could be called the small-firm shadow the area where obligations are present, known to be present, and not being met, and where enforcement at current scale is unlikely because of an accurate assessment.

The shadow has three characteristics which make it different from regular non-compliance. It is scale dependent and thus the exposure increases as the firm succeeds, not when it changes its behavior. It is not time limited as limitation periods are usually based on discovery or based on the filing which is never filed; therefore growth makes dormant exposure live. It is also asymmetrically valuable to counterparties: An acquirer that does diligence finds the exposure at the time when the target has limited options, and the price adjustment allows the acquirer to take value away from the founders and employees and place it in the arms of the acquirer who had the goal of protecting the regulator. The goal of regulation is therefore not met and the expense falls on the party that the regime was least interested in.

This implies that it is proportionality in obligation design and not heightened enforcement that is the correct answer. Enforcement of identical obligations, irrespective of the size of the business, leads to technical non-compliance across the board with small businesses, and the cost of enforcement for achieving compliance is disproportionate to the damage caused. Scale thresholds, simplified regimes and safe harbours based on good faith registration, bring the shadow into the light of compliance at little enforcement expense and at the same time do not impose lower obligations on those firms large enough to cause the harm the regime is designed to prevent.

6. The Complexity Paradox

The two trends described above are conflicting, and the juxtaposition of the two is the empirical thrust of the paper. The opportunities for arbitrage are becoming harder to come by. The legal landscape is becoming more complex, with an increasing number of data-protection laws, sectoral digital regulations, sanctions and export controls, distributed-workforces employment classification laws and payments licensing. The position obtained is shown in Figure 3.

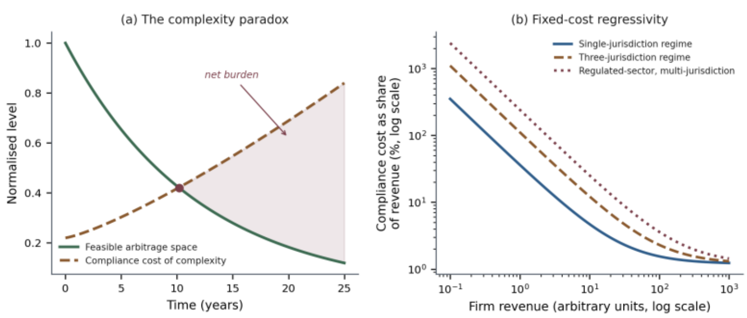

Figure 3. Panel (a) the complexity paradox: the feasible arbitrage space contracts while the compliance cost of complexity rises, leaving a growing net burden. Panel (b) compliance cost as a share of revenue under three regulatory configurations, illustrating the regressivity of fixed compliance costs. All values are generated from declared parameters and illustrate model behaviour only; they are not empirical estimates.

What that means is that the legal fragmentation that has been the topic of discussion for years for mobile companies is becoming an obstacle to entry. That's because of the cost structure. Compliance costs are highly concentrated on firm size: deciding whether or not a regime is applicable, seeking advice, obtaining consent and data-handling infrastructure and keeping filings are all costs that do not differ much between a firm with two million and two hundred million in revenue. The arithmetic is shown in panel (b) of Figure 3. Such a cost structure is regressive in size of firm, and thus shifts the incidence of costs to entrants in the industry.

This contradicts a common view held in both policy and entrepreneurship literature. In fact, regulation is often cited as a hindrance for small firms and a benefit for large firms, and the empirical literature on entry regulation has confirmed that entry restrictions are correlated with lower rates of entrepreneurship and with impacts on the sectors that rely the most on external financing (Djankov et al., 2002; Klapper et al., 2006). The case of the cross-border comes with a mechanism: not the strictness of any one regime, but the cumulative effect of multiple regimes (each individually sensible) whose costs are fixed. There is no single regulator to oversee the aggregate, and no impact assessment which measures it, since each assessment takes one instrument and compares it to firms already under the purview of the other.

Table 5. Domains of cross-border legal complexity and their cost character

Domain	Nature of the obligation	Cost character	Triggering event	Scope for structural mitigation
Corporate and securities	Entity formation, filings, investor documentation	Largely fixed per jurisdiction	Entity formation; financing	High; this is where structuring operates
Taxation	Registration, transfer pricing, permanent establishment	Fixed plus scale-varying	Revenue or presence thresholds	Moderate and narrowing
Data protection	Lawful basis, transfer mechanisms, subject rights, breach reporting	Predominantly fixed; infrastructure-heavy	Processing residents' data	Low; reach is effects-based
Employment and classification	Contractor status, benefits, termination protection	Fixed per jurisdiction plus per-head	Engaging a worker	Low; substance-tested
Payments and financial services	Licensing, capital, anti-money-laundering obligations	Very high fixed; ongoing supervisory cost	Handling funds	Moderate via licensed partners
Sanctions and export control	Screening, technology transfer restrictions	Fixed screening infrastructure	Nationality of counterparty or technology	Very low; travels with the technology
Intellectual property	Registration, enforcement, licensing structure	Fixed per jurisdiction	Commercialisation	High

Domain	Nature of the obligation	Cost character	Triggering event	Scope for structural mitigation
Sectoral regulation	Health, education, mobility, financial advice	Very high fixed	Sector entry	Low; typically territorial and licensed

6.1 Measuring what currently goes unmeasured

The claim that no one measures the aggregate burden is not rhetorical, and the measurement gap is tractable. Three instruments would be required, none of which presents novel methodological difficulty.

The first is a regime-count index constructed at the level of the venture rather than the jurisdiction. Existing regulatory indices measure the stringency of instruments within a country, which is the wrong unit for a firm subject to many countries simultaneously. The relevant quantity is the number of distinct regimes to which a venture of a given profile is subject, weighted by whether each imposes fixed or scale-varying obligations. Constructing this requires a profile-based approach: specify a representative venture by sector, customer geography, data handling, and workforce distribution, and enumerate the applicable regimes. The result is a comparable index across ventures rather than across countries, and P6 depends on it.

The second is separate accounting for compliance expenditure. Compliance cost is currently bundled into professional fees and general administrative expense, which makes it invisible in exactly the datasets where it would be most useful. Voluntary or threshold-based disaggregation in statutory accounts would allow the elasticities in P5 to be estimated directly rather than inferred from surveys with known reporting problems, and it would give regulators the aggregate figure that no impact assessment currently produces.

The third is linkage between corporate registry data and economic location. Registry data record where an entity is incorporated and are silent on where value is created, which means that studies of structuring routinely measure legal situs while purporting to analyse economic behaviour. Linkage to employment, payroll, or revenue location, which several statistical agencies already hold in separate systems, would convert a large body of descriptive work on incorporation choice into evidence about substance. Work developing scalable measures of entrepreneurial quality from administrative records demonstrates that linkage of this kind is feasible at national scale (Guzman & Stern, 2020).

7. Normative Triage

7.1 Five categories

Blanket evaluation of arbitrage is unhelpful because the cases differ in whether anyone is harmed and in whether the differential exploited reflects a deliberate policy choice. Baumol's distinction between productive, unproductive, and destructive entrepreneurship supplies the organising principle: entrepreneurial effort flows to wherever the prevailing reward structure directs it, and institutions determine whether that direction is socially useful (Baumol, 1990). Table 6 applies this to arbitrage.

Table 6. A legitimacy triage for regulatory arbitrage

Category	Description	Who bears the cost	Normative status	Appropriate response
Policy-competition arbitrage	Exploiting a differential a jurisdiction	No one; the differential is intended	Legitimate; the mechanism is	None; this is regulatory competition operating

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Category	Description	Who bears the cost	Normative status	Appropriate response
	deliberately created to attract activity		functioning as designed	
Coordination-failure arbitrage	Exploiting an unintended gap between regimes neither intended to create	Diffuse; the regulatory objective is partially defeated	Ambiguous; the firm is not at fault but the outcome is unintended	Inter-jurisdictional coordination, not firm-level sanction
Enforcement-gap arbitrage	Relying on the improbability of enforcement rather than on any legal difference	The compliant competitor, who bears a cost the arbitrageur avoids	Illegitimate; it is non-compliance rather than arbitrage	Enforcement, proportionate to firm scale
Externalising arbitrage	Relocating to escape a rule protecting identifiable third parties	Consumers, workers, or the public in the exiting jurisdiction	Illegitimate irrespective of formal lawfulness	Effects-based rule design; this is the strongest case for extraterritoriality
Nominal arbitrage	Legal relocation unsupported by any movement of substance	The revenue base and compliant competitors	Illegitimate; targeted by substance doctrine in most regimes	Substance requirements; anti-avoidance rules

Two implications follow. The first is that the strongest normative case for extraterritorial regulation is precisely the externalising category, and the weakest is the policy-competition category, where extraterritorial reach overrides another jurisdiction's deliberate choice. Debates about the legitimacy of extraterritoriality would be more tractable if they specified which category is at issue. The second is that the enforcement-gap category, which is the most common in practice among small ventures, is not a policy problem about arbitrage at all; it is a proportionality problem in enforcement design. A regime whose obligations are not calibrated to firm scale produces widespread technical non-compliance among small firms, which then functions as a latent liability discoverable at diligence, benefiting acquirers rather than the regulatory objective.

A longer-standing debate about corporate-law competition provides the relevant precedent and a caution against assuming the answer. The dispute over whether jurisdictional competition drives standards downward or upward has never been settled, with sustained arguments on both sides and a substantial body of empirical work on where firms actually incorporate and why (Bebchuk, 1992; Bebchuk & Cohen, 2003; Cary, 1974; Romano, 1985; Winter, 1977). The theoretical case that mobility disciplines jurisdictions rests on assumptions about information and about who bears the cost of a jurisdiction's choices (Tiebout, 1956), and those assumptions hold considerably better for corporate law, where the affected parties are the contracting ones, than for data protection or employment standards, where they are not.

7.2 The view from the source jurisdiction

As of now, the analysis has been done from the firm's point of view. The jurisdictions to which ventures move to structure away have another jurisdiction, and that jurisdiction's policy choices are not as unfettered as the rhetoric of retention often suggests. That is, if a domestic venture puts its foreign parent ahead of it, the source jurisdiction is deprived of having the eventual capital gain, the listing, and part of the governance relationship, but not the employment or the operations and the vast majority of the value creation. Whether this is a loss that should be acted upon depends on the jurisdiction's priorities, and often is not as clear as it is made out to be by the politics.

There are three answers and each of them is of varying effectiveness. Restriction, in the sense of restrictions on offshore structuring, or restrictions on movement of IP, tends to preclude financing, rather than structuring, because the structure is meant to attract a source of funds not being provided from the domestic market. Offshore environments are emulated through special regimes such as international financial centres, ring-fenced areas with separate regulatory and tax regimes and through regulatory sandboxes, which are useful to the extent that they achieve what investors sought in the first place – that is, dispute resolution which is predictable and familiar, and the documentation which is also familiar. Market deepening (domestic institutional capital), listing of loss-making growth firms, and enforceable investor protection, are the most important and slow to come in and address the root cause. There is comparative literature that indicates that the level of investor protection and legal origin, and not fiscal incentives, are the limiting factors on where capital can elect to reside (La Porta et al., 1998).

The tax dimension warrants special attention since it is often overlooked and the most talked about of all the dimensions for startups in particular. The empirical literature on profit shifting focuses on firms with already high profits to shift and most start-ups have no profits at all (Dharmapala, 2014; Desai et al., 2006; Hines & Rice, 1994; Zucman, 2014). Coordination measures targeting large multinationals, such as minimum effective taxation, are designed to take effect once a company reaches a certain threshold of revenue, and do not directly impact most startups (OECD, 2021), although they do indirectly impact them by altering the structuring choices of the most likely acquirer of startups. If a jurisdiction takes action against startup redomiciliation with anti-avoidance provisions tailored to mature, multinational corporations, it is dealing with an anti-avoidance if it has to address an anti-avoidance.

8. Propositions and Analytical Protocol

Table 7 states seven propositions with the strategy that would test each. Several are testable with data already assembled in corporate registries, vacancy and funding databases, and regulatory filings.

Table 7. Propositions and testing strategy

Proposition	Statement	Testing strategy	Parameter of interest
P1	Strategy choice is predicted by domain position in the feasibility space, not by firm characteristics such as funding or founder experience.	Classify ventures by domain and strategy; compare explanatory power	Variance shares [v1d], [v1f]
P2	Conversion of a rule from territorial to effects-based reduces relocation and raises compliance investment in the affected domain.	Event study around regulatory scope changes	Effect [b2]
P3	Regulatory entrepreneurship is concentrated among heavily capitalised	Funding level regressed on observed confrontation strategy	Coefficient [b3]

Proposition	Statement	Testing strategy	Parameter of interest
	ventures, because sustained legal risk requires balance-sheet capacity.		
P4	Jurisdictional debt crystallises at predictable events, principally domestic listing, acquisition, and sectoral licensing	Hazard model of redomiciliation on event indicators	Hazard ratios [h4]
P5	Compliance cost as a share of revenue declines with firm size and rises with jurisdiction count, so complexity is regressive in size.	Survey or filings-based cost estimation across a size distribution	Elasticities [e5s], [e5j]
P6	Entry rates in cross-border digital sectors fall following increases in the number of applicable regimes, independent of the stringency of any one.	Panel of entry rates on a regime-count index	Coefficient [b6]
P7	Redomiciliation is predicted by domestic capital-market depth rather than by changes in tax differentials.	Competing-risks model with market-depth and differential covariates	Contrast [b7]

Four measurement cautions apply. Corporate registry data record legal situs and are silent on economic situs, so any structure-based measure requires linkage to employment or revenue location to be interpretable. Strategy classification from public sources is subject to severe survivorship, since ventures whose confrontation strategies failed are absent from the samples in which such strategies are usually studied. Compliance cost is rarely recorded separately in accounts and is typically bundled into professional fees, so estimation requires either survey instruments with known reporting problems or careful extraction from filings. And regulatory stringency indices aggregate heterogeneous instruments in ways that obscure the distinction between the count of regimes and the stringency of each, which is exactly the distinction P6 requires.

9. Discussion

9.1 Implications for founders and investors

Three practical implications are then given. The first is sequencing, relating to the fact that jurisdictional debt is accrued at regular occasions, so a question of structuring is not the best way to structure now but, rather, the cheapest way to exit the scenario under which the venture is proceeding. An unexpressed exit cost estimate is a financing without one of its key terms. The second is about Q2 – the new estate of digital ventures – the proper posture is 'compliance by design' and not 'structural cleverness' – because it will be more expensive to maintain variants than to build to the strictest applicable regime and it will exclude a whole class of latent liability that will arise at the worst possible moment. The third is a matter of enforcement gap: relying on it is a defensible intermediate step, but needs to be recognised and provisioned as a deferred liability, not an absence of it.

Another factor is not legal but legitimate. Costs of being foreign may be present in firms that operate in a different country but do not result from any regulatory requirement; these costs involve country unfamiliarity, differential treatment and lack of standing with local regulators and counterparties (Zaheer, 1995). They are aggravated by complex multi-jurisdictional structures as long as they seem to be set up in their manner of avoidance; but that legitimacy in one jurisdiction that can be bought for another (Kostova & Zaheer, 1999). For platform businesses, which have a politically salient business model, and whose business model is still contested by regulation, this can overpower the technical structuring analysis altogether (Rahman & Thelen, 2019; Thelen, 2018).

9.2 Implications for policy

This is the policy message most clearly emerging from Section 6: No regulator is responsible for the overall effect on the compliance burden for cross-border ventures since each instrument is tested independently on companies that face the burden of all other instruments. This is dealt with through proportionality mechanisms which do not impair any of the regulatory aims and can include scale thresholds, simplified regimes for small businesses and mutual recognition of compliance under comparable regimes. The second implication relates to redomiciliation, where a jurisdiction is trying to lure back ventures that structured offshore for reasons of capital access, and the instruments are capital-market depth and the structuring of the round trip itself, not the original structuring, which would not have led to the venture structuring offshore, but to the flip. The third is that the interest in the externalisation category (Table 6) is the only one that lends itself to being extended to the rest, and that the extending jurisdiction's decisions are imposed on ventures outside that category in a way that is not easily defensible on the rationale typically proffered for extending jurisdiction.

9.3 Limitations

There are three limitations which should be clearly stated. It is not an empirical paper: the propositions are proposed rather than demonstrated, the figures in Figure 2 are not actual figures but are as a consequence of stipulating parameters, and the juxtapication of the positions of the domains in Figure 2 are analytic statements, which are offered for debate. Second, the legal context portrayed is extremely dynamic and the depictions of tax coordination, data regimes and regulation of the digital markets should be checked against existing instruments before reliance; some of the legal frameworks referred to were subject to ongoing revision during the production of this analysis. Third, the analysis can only be relevant to digital and software-intensive ventures in ecosystems where corporate registration and contract enforcements exist and are robust; the transferability to ecosystems where contract enforcements are weak and the informal sector is large needs to be explored instead of assumed; in the latter case, the enforcement-gap category will likely dominate the entire analysis.

10. Conclusion

The traditional answer to the question of how cross-border startups and legal complexity relate has always been ‘regulatory arbitrage' but it is growing less accurate each year. The strategies it includes are different, the contexts in which they can operate are structural, and, where the most widely recognized one exists, the area in which it is discussed is shrinking as its conditions continue to deteriorate. It's not so much that complexity is increasing, it's that complexity itself is growing, and the costs of complexity are very much fixed; so they're borne by the entrants that the entrepreneurial ecosystem depends on, and not the incumbents that can absorb them. The change this implies is that the fragmented nature of the law should be analyzed not so much as a hurdle for the nimble as an impediment to entry. That reframing alters the nature of the areas worth studying because the interesting variation is in how the compliance costs are structured and in the order in which decisions are made about structures, not in ingenious avoidance. It alters which things should be optimized for, because costs of the exit of the structure are more important than the efficiency of the structure. And it shifts the measurement of what policy makers should measure, but no one does measure the quantity that binds. These are seven propositions and an analytical protocol designed to make these claims testable and thus potentially refutable.

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