THE ELUSIVE DEFINITI ON OF CORPORATE TAX RESIDENCE

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INTRODUCTION

Because domestic corporations are subject to tax on their worldwide income while foreign corporations are subject to tax only on their U.S.-source income,[1] corporate residence is one of the more important issues in the field of international taxation.[2] Under current U.S. law, and subject to a single exception designed to inhibit the expatriation of domestic corporations via inversion,[3] a corporation's residence is a function of its place of incorporation ("POI"): a corporation created or organized under the law of any U.S. state is domestic, while a corporation created or organized under the law of any other jurisdiction is foreign.[4] Other countries tend to look to the place where the corporation is controlled or managed—common terms of usage include "central management and control" ("CMC") and "place of effective management"—to determine corporate residence.

corporate residence, there are other consequences as well. Foreign corporations, but not domestic corporations, are exempt from U.S. tax on U.S.-source portfolio interest. I.R.C. § 881(c)(1) (2012). Capital gain from the sale of personal property by a domestic corporation is subject to U.S. income tax, while capital gain from the sale of personal property by a foreign corporation is not. I.R.C. § 865(a)(1)–(2) (2012). Foreign corporations might be entitled to benefit from the terms of an income tax treaty that reduces or eliminates their U.S. tax liability for U.S.-source income. Furthermore, the U.S. tax liability of a person who receives dividends or interest from a corporation could turn on whether the corporation paying the income is domestic or foreign. I.R.C. §§ 861(a)(1)

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follow suit; others have proposed alternative tests, among them the corporation's customer base, its source of income, the stock exchange on which the corporation's shares are traded, or the country of residence of its shareholders.[6]

Although the literature has extensively discussed the issue of corporate residence, it has paid little attention to the terms of reference of the debate. A typical argument will take the following form: the law should adopt Definition D as appropriate because it closely conforms to Principle P. However, such an argument is unpersuasive unless it also provides a convincing explanation for why P is the appropriate principle. Without such an explanation, the fact that D closely conforms to P is a brute fact with no normative value. Nonetheless, the literature generally ignores this first, crucial step. In most cases, it examines tests of corporate residence without a cogent justification for the principles by which it evaluates those tests.

This Article will attempt to move the discourse to a more theoretical level by focusing attention not on the definitions themselves but rather on the criteria upon which commentators rely, either explicitly or implicitly, when considering the merits of particular definitions of corporate re

summarize the findings and offer some speculation as to why an acceptable definition of corporate residence is so elusive.

I. CRITIQUING THE CRITERIA: MANIPULABILITY, CLARITY, AND BENEFIT

"[I]f you don't know where you are going, you might not get there."[7]

A. Manipulability

The most frequently relied upon criterion for evaluating tests of corporate residence is manipulability.[8] This is particularly true with regard to POI. Critics of this test argue that it effectively makes worldwide taxation elective.[9] Perhaps the most dramatic example of POI manipulability, and the one that has caught the attention of both policy makers and the popular press, is the phenomenon of corporate inversion in which a domestic corporation essentially expatriates by the simple expedient of re-registering in a foreign jurisdiction.[10]

7. Nate Scott, *The 50 Greatest Yogi Berra Quotes*, USA TODAY SPORTS: FOR THE WIN (Sept. 23, 2015, 7:30 AM), http://ftw.usatoday.com/2015/09/the-50-greatest-yogi-berra-quotes [https://perma.cc/2T3H-3DKN] (quote is widely attributed to Yogi Berra).

8. *See, e.g.*, *infra* note 9.

9. J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Defending Worldwide Taxation with a Shareholder-Based Definition of Corporate Residence*, 2016 BYU L. REV. 1681, 1686 (2016); Aldo Forgione, *Clicks and Mortar: Taxing Multinational Business Profits in the Digital Age*, 26 SEATTLE U. L. REV. 719, 725–26 (2003); Omri Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. REV. 1613, 1643, 1653 (2013); Michael J. McIntyre, *Determining the Residence of Members of a Corporate Group*, 51 CANADIAN TAX J. 1567, 1571 (2003); Adam H. Rosenzweig,

Others have countered that POI may not be as freely electable as often assumed and that tax considerations do not necessarily predominate in choosing where to incorporate. Registration in a foreign jurisdiction involves additional costs that a cash-strapped start-up may not be able to afford or that the extraordinarily small chance that it will eventually become a successful multinational company may not justify.[11] Home bias, a widespread albeit not entirely rational phenomenon, can present a psychological barrier to registration abroad.[12] Some have argued that corporations registered in the United States may find it easier to obtain financing from domestic lenders or to attract local investors.[13] If empirically accurate, these considerations could lend credence to POI from the perspective of manipulability. Furthermore, under the manipulability standard, the fact that these impediments are of concern primarily in a corporation's early stages of development could justify restrictions placed upon attempts to expatriate via inversion during a later stage when obstacles to foreign registration no longer pose an insurmountable barrier.

Moving to other tests of corporate residence, there are those who claim that CMC, which views a corporation as a resident of the country in which corporate policy is decided, is less manipulable than and consequently preferable to POI, as CMC requires the movement of persons rather than just pieces of paper.[14] Others argue that CMC is also problematic because the board of directors ultimately decides corporate policy, and it is relatively simple to arrange for boards to convene—when they need to convene at all—in the conference room

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Fleming et al., *supra* note 9, at 1686–87 (inversion by combining with a foreign corporation); Marian, *supra* note 9, at 1654–55 (explaining how a U.S. corporation can invert by creating a foreign-incorporated shell entity and being "bought" by the foreign entity).

11. DANIEL N. SHAVIRO, FIXING U.S. INTERNATIONAL TAXATION 70–71 (2014); Susan C. Morse, *Startup Ltd.: Tax Planning and Initial Incorporation Location*, 14 FLA. TAX REV. 319, 321 (2013) (explaining how a U.S. incorporation "requires fewer monetary and other startup company resources"); Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *Designing a 21st Century Corporate Tax—An Advance U.S. Minimum Tax on Foreign Income and Other Measures to Protect the Base*, 17 FLA. TAX REV. 669, 718 (2015); Shaviro, *Rising Tax Electivity*, *supra* note 9, at 405.

12. SHAVIRO, *supra* note 11, at 66; Shay et al., *supra* note 11, at 717–18.

13. SHAVIRO, *supra* note 11, at 73; Shaviro, *Rising Tax Electivity*, *supra* note 9, at 408.

14. Reuven S. Avi-Yonah, *Beyond Territoriality and Deferral: The Promise of 'Managed and Controlled*,' 63 TAX NOTES INT'L 667, 668 (2011); Henry Ordower, *Utopian Visions Toward a Grand Unified Global Income Tax*, 14 FLA. TAX REV. 361, 404–05 (2013); Kyrie E. Thorpe, *International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?*, 11 EMORY INT'L L. REV. 633, 693 (1997); Terrence R. Chorvat, *A Different Perspective on Tax Competition*, 35 GEO. WASH. INT'L L. REV. 501, 515 (2003) (book review); *see* Reuven S. Avi-Yonah, *Corporate and International Tax Reform: Proposals for the Second Obama Administration (and Beyond)*, 40 PEPP. L. REV. 1365, 1370 (2013) (suggesting a "managed and controlled" definition of U.S. corporate residence to combat inversion).

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of an offshore island resort.[15] Consequently, some commentators prefer home office to CMC, on the theory that persuading directors to travel to an offshore

However, manipulability is purely a negative standard. In other words, while it may be reasonable to reject a test that is easily manipulable, non-manipulability does not constitute grounds for its adoption. By analogy, consider a tax based on height or eye color. The fact that it is not easy to manipulate these attributes does not mean that they are desirable tax bases.[19]

Moreover, even in its negative manifestation, manipulability is weak in that it is a technical and not a substantive criterion. A call to reject a test because it is easily manipulable is less persuasive than a demonstration that the test has no normative justification. Again, by way of analogy, consider a tax based upon the month in which a person is born. One argument against such a tax is that prospective parents can try to arrange for their children to be born in "tax friendly" months. Another is that there is no correlation between the month in which a person is born and the goals of a rational tax structure. I submit that the latter objection is more persuasive than the former.

The first issue that commentators need to address when discussing tests of corporate residence is the normative justification for imposing tax on the worldwide income of a corporation classified as domestic under the terms of each test. Why should a corporation registered in the United States be subject to U.S. tax on its worldwide income? Why should a corporation managed and controlled in the United States be subject to U.S. tax on its worldwide income? Why should a corporation whose primary customer base is in the United States be subject to U.S. tax on its foreign-source income? Analysis that focuses on manipulability as the sole or primary criterion by which to select a test for corporate residence has little persuasive force.

B. Clarity

Commentators often argue that, whatever its flaws, POI is preferable to other tests because it is clear and predicable. Its clarity saves precious resources

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being either formally or substantively elective.[21] For example, under a check-the-box regime in which corporations choose their status as domestic or foreign, the status of the corporation would be clear and formally elective.[22] Under POI, residence status is clear and substantively elective. The control and management tests are both less clear and less elective: corporations may try to keep management and control outside the country, but they cannot be certain that the attempt will succeed.

Yet clarity shares with manipulability the attribute of being technical and negative rather than substantive and positive, and the critique of manipulability applies here as well: the fact that a test is clear does not justify its adoption. Granted, when considering competing definitions, each of which is substantively justifiable, onlieed managl al.2(a)-4.2(ttr)

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tax cost of refraining from establishing such a connection or of severing such a connection once established will tend to decrease the degree of manipulability. For example, if there are nontax advantages to registration in the United States, then the risk of losing those advantages could serve as an impediment to registering abroad.

Nevertheless, the focus of the two criteria is considerably different: whereas manipulability—like clarity—is wholly technical in nature, benefit purports to be a substantive criterion. Moreover, the fact that they will often lead to the same conclusion does not mean that they always will. For instance, consider the case of expatriation, via inversion if the test is POI, via moving control and management or home offices abroad if those are the determining tests of corporate residence, and so forth. Under the criterion of manipulability, the fact that expatriation is a relatively simple procedure and involves few negative nontax consequences is probably sufficient to warrant legislative countermeasures to prevent the corporation from shedding its residence. On the other hand, under the benefit criterion, the fact that the corporation does not value the advantages, if any, of retaining the relevant link may indicate that continuing to subject it to a regime of worldwide taxation is no longer normatively justifiable.[25]

Working within the benefit criterion, some supporters of POI have argued that the advantages of U.S. registration are significant enough to justify the imposition of tax on worldwide income.[26] The literature has explored a number of supposed benefits.[27]

shareholders and management), procuring the benefits of the typical U.S. corporate regime requires incorporation in the United States.[30]

(2) Registration in the United States provides access to benefits under certain

corporation's principal customer base,[43] and its primary source of income,[44] have similarly been justified by reference to the benefit criterion. For example, when a corporation is registered in one country but maintains its home office in another, the argument can be made that the corporation procures more benefits from the latter—in the form of infrastructure, prestige, access to managerial talent, proximity to suppliers and customers, and so forth—than it does from the former. If this argument is accurate, then under the benefit criterion, the location of the corporation's home office would be a better test for determining corporate residence than would the place of registration.

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The second problem is normative. Although benefit theory once dominated the tax policy discourse,[49] tax theory has long since abandoned benefit as a viable justification for the imposition of income tax. As scholars of the nineteenth and early twentieth century demonstrated, there is no reason to believe that the benefit derived from government services bears a positive correlation to income.[50] John Stuart Mill argued that the opposite might be the case: the wealthier one is, the less one may need to rely on government services.[51] Consequently, in contemporary tax jurisprudence, the primary justification for income tax is ability-to-pay,[52] reflecting the idea that the better off one is economically the more one should contribute to the provision of public goods and to redistributive efforts. As I have argued elsewhere, benefit and ability-to-pay represent different, perhaps incompatible, conceptions of justice. By requiring individuals and firms to pay in full for the services they receive from the state, benefit taxation prevents the government from disturbing the market distribution. In contrast, ability-to-pay taxation redistributes wealth.[53]

This is not to say that a state cannot logically employ both benefit taxation and ability-to-pay taxation. Each has its proper place.[54] What it means is an attempt to justify an ability-to-pay tax (such as the income tax) in terms of benefit will necessarily fail.[55]

The distinction between benefit and ability-to-pay has an important ramification in the international arena. Ability-to-pay requires the imposition of tax on foreign-source income: if we assume that accession to wealth is an appropriate measure of ability-to-pay, then ability-to-pay is a function, not of domestic income, but of worldwide income.[56] In contrast, benefit theory would seem to lead to a territorial tax.[57] For these reasons, commentators universally rely on ability-to-pay, not benefit, as the normative justification for taxing the worldwide income of resident individuals.[58]

If benefit is incapable of justifying the imposition of tax on foreign-source income, then reliance on benefit to categorize a person as a resident, and therefore subject to tax on foreign-source income, is untenable. In other words, benefit theory cannot reasonably serve as a criterion by which to classify corporations as domestic or foreign.[59]

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status quo ante, by requiring those who benefit from government services to pay market value for them.").

54. David Elkins, *Taxation and the Terms of Justice*, 41 TOL. L. REV. 73, 77 (2009).

55. *See* Jeffrey A. Schoenblum, *Tax Fairness or Unfairness? A Consideration of the Philosophical Bases for Unequal Taxation of Individuals*, 12 AM. J. TAX POL'Y 221, 233–34 (1995).

II. PURPOSIVENESS

A more promising line of reasoning in recent literature favors what we might describe as a purposive criterion for evaluating corporate residence.[60] The idea behind purposiveness is that the corporate income tax is a means of achieving certain policy goals. Tax law should therefore adopt whichever definition of corporate residence best furthers those goals.[61]

Of course, applying the purposive criterion requires one to identify the goal of the corporate income tax and to determine which definition of corporate residence most effectively furthers that goal. Reasonable minds may differ with regard to each of these issues.[62] Nevertheless, the fact that there may be disagreement regarding how to apply this criterion does not necessarily undermine its validity. As with manipulability, clarity, and benefit, purposiveness does not dictate the appropriate test of residence but rather establishes the frame of reference for the discourse.

Professor Marian has examined several possible goals of corporate income taxation and has suggested a residence rule that would follow from each one.[63] For example, several scholars have argued that the purpose of the corporate income tax is to rein in the power of corporations and to signal that ultimately the government is more powerful than corporate management.[64] Marian

60. *See id.* at 1635 (explaining that the corporate tax residence debate is "largely disengaged from the purposes for which jurisdictions tax corporations"); *see also* McIntyre, *supra* note 9, at 1570. One route a country can use to define corporate residence is "in terms of the function that residence taxation is intended to serve in a corporate income tax." *Id.*

61. Marian, *supra* note 9, at 1617.

62. The two issues are independent of each other. Commentators can disagree regarding the goals of the corporate income tax while agreeing which definition best furthers each goal. Conversely, commentators can agree on the goal of corporate taxation but disagree with regard to the definition of corporate residence that best furthers that goal. Professor Marian argued that the corporate income tax may have multiple goals, a position that would further complicate the implementation of the purposive criterion. *Id.* at 1637.

63. With regard to past justifications for the corporate income tax, he argues that at the state level, the corporate income tax originally served as a fee for the privilege of incorporation at a time when incorporation required a specific charter and the legal personhood of a corporation ceased at the state's border, and that at the federal level, the original purpose of the corporate income tax was to tax the richest Americans, whose wealth was largely in the form of stock in corporations registered in the United States and operating in the United States. He suggests that while the POI may have been reasonable under those circumstances, it no longer makes sense in today's globalized world. Marian, *supra* note 15, at 168–75.

64. Jane G. Gravelle, *The Corporate Income Tax: A Persistent Policy Challenge*, 11 FLA. TAX REV. 75, 78–79 (2011) (recognizing that the first corporate income tax was in part intended to prevent the abuse of power of corporations); Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53, 61–62 (1990); Ajay K. Mehrotra, *The Public Control of Corporate Power: Revisiting the 1909 U.S. Corporate Tax from a Comparative Perspective*, 11 THEORETICAL INQUIRIES L. 497, 510 (2010); Avi-Yonah, *supra* note 23, at 1244; Marian, *supra* note 15, at 166 (describing this view).

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more of its shares, by vote or value, on the last day of the year.[70] They then pro

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resident of more than one country under their domestic tax laws. In such a case, tax treaties provide a list of criteria by which to determine residence, a list typically including such amorphous terms as "personal and economic relations," "permanent home," and "habitual abode."[76] Even if a corporation determines that its shareholder is a U.S. resident under U.S. domestic law, it would need to know whether that individual is the resident of another country under its domestic tax law, and, if so, with which country the shareholder's personal and economic relations are closer, where the shareholder habitually resides, and so forth. It is unreasonable to expect a corporation to have access to the information required to make such a determination. Moreover, the amorphous terms of reference mean that even if the corporation has access to all of the relevant facts it may be difficult to arrive at the appropriate legal conclusions.

Another practical issue is the expectation of avoidance measures. The significant tax consequences of the corporation crossing the threshold of U.S.-resident shareholding would in practice force taxpayers to plan their investment strategies accordingly (and tax advisors who did not caution their clients about the cost of crossing the threshold and did not suggest means of avoiding the consequences of doing so would most likely be derelict in their duty). For example, shareholders might adopt a structure that allows U.S. residents to exercise control over the corporation or to share in its earnings via contractual arrangements, such as options and other derivatives,[77] royalties, or voting compacts, rather than via shareholding. Policing such tax avoidance would require the adoption of anti-abuse provisions, which would—if experience is any guide—simply encourage more sophisticated tax planning techniques to avoid the anti-abuse provisions on the one hand and serve as a trap for innocent and less-well-advised taxpayers on the other.[78] Although, as noted, the non-manipulability of a given test is not in itself an argument in favor of its adoption, the fact that a proposed test would require extensive anti-abuse measures might well constitute a good reason to reject it.[79] Furthermore, if taxpayers are unwilling to engage in aggressive tax planning or if anti-abuse measures successfully render such techniques ineffective, then a threshold determination of corporate residence could serve as a disincentive for foreign residents to enter into joint projects with U.S. residents.

However, more important in my opinion than the practical problems inherent in app0.9(hni)5.2(r)-8.9(ei)0.8(pp0.t)5.3(hcen)-319 T i-

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