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## THE ELUSIVE DEFINITION OF CORPORATE TAX RESIDENCE

DAVID ELKINS\*

### 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,<sup>1</sup> corporate residence is one of the more important issues in the field of international taxation.<sup>2</sup> Under current U.S. law, and subject to a single exception designed to inhibit the expatriation of domestic corporations via inversion,<sup>3</sup> 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.<sup>4</sup> 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.<sup>5</sup> Some commentators have suggested that the United States

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1. I.R.C. § 882(a)(1) (2012).

2. Although liability to tax on foreign-source income is the most important consequence of 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)–(2), 862(a)(1)–(2) (2012).

3. I.R.C. § 7874(a)(1) (2012).

4. I.R.C. § 7701(4)–(5) (2012). For the purpose of this definition, "state" includes the District of Columbia. I.R.C. § 7701(10).

5. U.N. Dep't of Econ. & Soc. Affairs, U.N. Model Double Taxation Convention Between Developed and Developing Countries art. 4(3), 2011, [http://www.un.org/esa/ffd/documents/UN\\_Model\\_2011\\_Update.pdf](http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf) [<https://perma.cc/PL6M-49T5>]; Org. for Econ. Co-operation & Dev. [OECD], Model Convention with Respect to Taxes on Income and on Capital art. 4(3), Jan 28, 2003, <http://www.oecd.org/tax/treaties/1914467.pdf> [<https://perma.cc/W97Q-9VCZ>]; *De Beers Consolidated Mines Ltd. v. Howe* [1905] 2 KB 612, 631 (appeal taken from Eng.) (holding that a corporation whose CMC is in the U.K. is a U.K. resident); Luca Cerioni, *The "Place of Effective*

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.<sup>6</sup>

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 residence. In this Article, the terms "test" and "criterion" will refer, respectively, to a proposed definition of corporate residence and to a principle used to evaluate definitions.

A survey of the literature reveals four criteria for evaluating tests of corporate residence. Part I considers the three most commonly relied upon criteria: manipulability, clarity, and benefit. It argues that all three are bereft of relevant normative content. Consequently, the fact that a particular test conforms to one or more of these criteria does not constitute adequate grounds for its adoption.

The fourth criterion, and the newest member of the pantheon, is purposiveness. As opposed to the more traditional criteria, purposiveness does have normative value: a demonstration that a proposed test conforms to this criterion would constitute a reasonable argument in support of that test. Part II describes this criterion and explores whether it is possible to formulate a test that conforms to it. The answer is that it does not appear possible to do so.

The fact that no test appears capable of satisfying the demands of the only criterion with normative value suggests that the quest for an appropriate definition of corporate residence may be a futile endeavor. The Conclusion will

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*Management" as a Connecting Factor for Companies' Tax Residence Within the EU vs. the Freedom of Establishment: The Need for a Rethinking?*, 13 GERMAN L.J. 1095, 1095–96 (2012); Ashrita Prasad Kotha, *Place of Effective Management Test in the Income Tax Act, 1961: Is It the Right Way Forward?*, 8 NUJS L. REV. 13, 14 (2015) (India) (showing that India uses place of effective management test); Cerioni, *supra* note 5, at 1096 n.6 (showing that France, Germany, Hungary, Italy, the Netherlands, Poland, Slovenia, Spain, and the United Kingdom determine corporate residence by reference to effective management).

6. *See infra* Parts I and II.

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.”<sup>7</sup>

##### A. Manipulability

The most frequently relied upon criterion for evaluating tests of corporate residence is manipulability.<sup>8</sup> This is particularly true with regard to POI. Critics of this test argue that it effectively makes worldwide taxation elective.<sup>9</sup> 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.<sup>10</sup>

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 Forgiione, *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, *Source as a Solution to Residence*, 17 FLA. TAX REV. 471, 495 (2015); Daniel Shaviro, *Why Worldwide Welfare as a Normative Standard in U.S. Tax Policy?*, 60 N.Y.U. TAX L. REV. 155, 172 (2007); John A. Swain, *Same Questions, Different Answers: A Comparative Look at International and State and Local Taxation*, 50 ARIZ. L. REV. 111, 117 (2008); Joseph A. Tootle, *The Regulation of Corporate Inversions and “Substantial Business Activities,”* 33 VA. TAX REV. 353, 354 (2013); see Daniel Shaviro, *The David R. Tillinghast Lecture: The Rising Tax-Electivity of U.S. Corporate Residence*, 64 N.Y.U. TAX L. REV. 377, 381–85, 413 (2011) (distinguishing between formal and substantive electivity); see also Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1666 (2000) (acknowledging that country of incorporation is easily manipulated); Reuven S. Avi-Yonah, Kimberly A. Clausing & Michael C. Durst, *Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split*, 9 FLA. TAX REV. 497, 499 (2009); Ilan Benshalom, *The Quest to Tax Financial Income in a Global Economy: Emerging to an Allocation Phase*, 28 VA. TAX REV. 165, 216–17 (2008) (explaining how U.S. MNEs can take advantage of offshore low-tax jurisdictions simply by reincorporating there).

10. DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R43568, CORPORATE EXPATRIATION, INVERSIONS, AND MERGERS: TAX ISSUES 3 (2016), <https://fas.org/sgp/crs/misc/R43568.pdf> [<https://perma.cc/K6Z8-3GVG>]; e.g., Steven H. Goldman, *Corporate Expatriation: A Case Analysis*, 9 FLA. TAX REV. 71, 72 (2008) (inversion by forming a new foreign subsidiary); Michael J. Graetz, *The David R. Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 N.Y.U. TAX L. REV. 261, 322 (2001) (explaining how corporations can expatriate by merging with foreign entities);

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.<sup>11</sup> Home bias, a widespread albeit not entirely rational phenomenon, can present a psychological barrier to registration abroad.<sup>12</sup> 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.<sup>13</sup> 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.<sup>14</sup> 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).

of an offshore island resort.<sup>15</sup> Consequently, some commentators prefer home office to CMC, on the theory that persuading directors to travel to an offshore island resort for an occasional extended weekend may present few difficulties, but that requiring high-ranking executives to move to such a location will meet stiffer resistance.<sup>16</sup> Others counter that Bermuda and the Cayman Islands are not the only countries in the world that offer lenient corporate tax regimes. Taking up residence in Monaco, Switzerland, Belgium, Ireland, Luxembourg, or the Netherlands may not be overly distasteful for senior executives of multinational corporations.<sup>17</sup> Moreover, countries such as these are often home to individuals with the requisite managerial talent, so that multinationals could establish home offices in these countries and hire local management if the tax stakes were sufficiently significant. One commentator has suggested countering attempts at inversion by defining corporate residence in terms of the corporation's consumer base on the theory that a customer base is less manipulable than POI.<sup>18</sup>

Clearly, manipulability is a relevant consideration when formulating a tax regime. The drafters of tax rules do not have the luxury of operating in a world in which taxpayers go about their business without regard to the effect of their behavior on their tax liability. Tax provisions that, in the absence of avoidance-induced behavior, would promote the stated goals of the tax system in a fair and efficient manner may be useless or even counterproductive in a world in which taxpayers are keenly aware of the tax consequences of their actions and often adjust that behavior with a view to reducing their tax liability.

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15. Omri Marian, *The Function of Corporate Tax-Residence in Territorial Systems*, 18 CHAP. L. REV. 157, 181 (2014). Furthermore, in today's digital world convening at one physical location is no longer necessary. Oleksandr Pastukhov, *International Taxation of Income Derived from Electronic Commerce: Current Problems and Possible Solutions*, 12 B.U. J. SCI. & TECH. L. 310, 330 (2006); Julie Roin, *Can the Income Tax Be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 N.Y.U. TAX L. REV. 169, 187–88 (2008); Avi-Yonah, *Globalization*, *supra* note 9, at 1596; Thorpe, *supra* note 14, at 693–94.

16. PRESIDENT'S ADVISORY PANEL ON TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 135 (2005); David R. Tillinghast, *A Matter of Definition: "Foreign" and "Domestic" Taxpayers*, 2 INT'L TAX & BUS. LAW. 239, 262 (1984) ("[I]n recent years, the English Inland Revenue, apparently of the view that the 'central management and control' test is too maleable, has sought a legislative definition of corporate residence based on the presence in England of a company's 'principal office.'"); Avi-Yonah, *Beyond Territoriality*, *supra* note 14, at 668; Marian, *supra* note 9, at 1645.

17. Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 N.Y.U. TAX L. REV. 507, 528 (1997); Reuven S. Avi-Yonah, *And yet It Moves: Taxation and Labor Mobility in the Twenty-First Century*, 67 N.Y.U. TAX L. REV. 169, 173 (2014); Fleming et al., *supra* note 9, at 1710–11 ("[T]here is an adequate number of tax-advantaged foreign locations where U.S. managers can be stationed without their having to learn another language or sacrifice lifestyle comforts (e.g., Dublin, London, or Singapore)."); Marian, *supra* note 9, at 1646.

18. George K. Yin, Letter to the Editor, *Stopping Corporate Inversions Sensibly and Legally*, 144 TAX NOTES 1087, 1087 (2014), <http://taxprof.typepad.com/files/yin-1.pdf> [<https://perma.cc/EEX6-V9GY>].

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.<sup>19</sup>

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 that would otherwise have to be devoted to determining and perhaps litigating the question of whether the corporation is domestic or foreign. Its predictability reduces the degree of uncertainty regarding tax consequences that corporations and their shareholders face when making economic decisions.<sup>20</sup>

In many cases, clarity is the mirror image of manipulability: the clearer the definition of corporate residence, the closer corporate residence may come to

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19. For a discussion of height as a tax base, see David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43, 60–62 (2006).

20. Reuven S. Avi-Yonah, *For Haven's Sake: Reflections on Inversion Transactions*, 95 TAX NOTES 1793, 1797 (2002); Michael S. Kirsch, *The Congressional Response to Corporate Expatriations: The Tension Between Symbols and Substance in the Taxation of Multinational Corporations*, 24 VA. TAX REV. 475, 568 (2005) (discussing various benefits determined by the laws of the place of incorporation); Roin, *supra* note 15, at 189 (2008) (amending the place of incorporation definition of corporate residence will lead to ambiguity); Rosenzweig, *supra* note 9, at 489; Tillinghast, *supra* note 16, at 259–60.

being either formally or substantively elective.<sup>21</sup> 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.<sup>22</sup> 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, one might reasonably prefer the definition that is clearer just as one might in such a case reasonably prefer the definition that is less manipulable. However, without such normative content, clarity is not a reason to choose a particular definition of corporate residence.

### C. Benefit

A third criterion often relied upon for evaluating tests of corporate residence is benefit. The idea is that if a particular nexus to a country provides a corporation with sufficient benefits, then that nexus is an appropriate test of residence.<sup>23</sup> A corollary of this line of reasoning is the theory of the self-inflicted wound: knowing that availing themselves of a particular nexus will subject them to tax on their worldwide income, corporations that do so indicate by their behavior that the benefits are worth the cost and hence have no cause to complain.<sup>24</sup>

Ostensibly, benefit correlates closely to manipulability. If the benefits inuring to a certain relationship to a country are significant enough, then the non-

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21. See, e.g., Tillinghast, *supra* note 16, at 272.

22. A check-the-box regime for corporate residence may indeed be the logical conclusion of any analysis that relies upon the criterion of clarity to evaluate definitions of corporate residence. See, e.g., Tillinghast, *supra* note 16, at 266.

23. Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1201, 1205–06 (2004); Inho Andrew Mun, *Reinterpreting Corporate Inversions: Non-Tax Competitions and Frictions*, 126 YALE L.J. 2152, 2159 (2017) (suggesting that the solution to the problem of corporate inversions is to align tax paid with benefits); Kirsch, *supra* note 20, at 564–67; Marian, *supra* note 9, at 1615, 1642 (describing this view); see Rebecca S. Rudnick, *Who Should Pay the Corporate Tax in a Flat Tax World?*, 39 CASE W. RES. L. REV. 965, 1075 n.367 (1988–89). The benefits theory views “tax as a payment for the benefits of the corporate form of doing business.” *Id.*

24. Compare J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 315 (2001), with Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *The David R. Tillinghast Lecture: “What’s Source Got to Do with It?”: Source Rules and U.S. International Taxation*, 56 N.Y.U. TAX L. REV. 81, 104–05 (2002).



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.<sup>25</sup>

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.<sup>26</sup> The literature has explored a number of supposed benefits.<sup>27</sup> Some commentators have pointed to the benefit inherent in existence itself and the fact that a corporation owes its income-earning capacity to the country that granted it legal life.<sup>28</sup> However, this argument is weak primarily because the founders had free rein to incorporate their corporation anywhere they chose, so the benefit of incorporating in any particular jurisdiction is not the corporation's legal life per se, but rather the relative advantages of incorporation in that jurisdiction as opposed to in another jurisdiction.<sup>29</sup> Perhaps for this reason the literature tends to focus, not on the advantages of incorporation versus non-incorporation, but rather on the advantages of registration in the United States versus registration abroad. Discussing this issue, commentators have suggested the following advantages of U.S. incorporation:

- (1) As the laws of the jurisdiction in which a corporation is incorporated govern its internal affairs (i.e., the legal relations among shareholders and between

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25. See, e.g., Marian, *supra* note 9, at 1643.

26. SHAVIRO, *supra* note 11, at 194.

27. Marian, *supra* note 9, at 1642–43.

28. Kirsch, *supra* note 20, at 567; Tillinghast, *supra* note 16, at 259.

29. Kirsch, *supra* note 20, at 568.

shareholders and management), procuring the benefits of the typical U.S. corporate regime requires incorporation in the United States.<sup>30</sup>

- (2) Registration in the United States provides access to benefits under certain trade agreements to which the United States is a party.<sup>31</sup>
- (3) Only corporations registered in the United States are eligible to apply for certain government contracts.<sup>32</sup>
- (4) American consumers may prefer purchasing from what they view as an American corporation.<sup>33</sup>
- (5) U.S. legislators, administrators, and diplomats might be more willing to protect the interests of a corporation registered in the United States.<sup>34</sup>

The benefit criterion can also furnish objections to these arguments.<sup>35</sup> Foreign jurisdictions have corporate law regimes that are similar to what is available in the United States.<sup>36</sup> In the United States, corporate law is not federal—but state, so the advantages, if any, of domestic corporate law regimes could perhaps justify the imposition of state tax, but not federal tax.<sup>37</sup> Relatively few corporations are interested in government contracts that require registration in the United States or in benefits under trade agreements; moreover, registration abroad is not necessarily a bar to obtaining government contracts ostensibly limited to U.S.-registered corporations or to benefits under trade agreements.<sup>38</sup> Consumer identification of a corporation as American or foreign is not usually a function of the jurisdiction in which the corporation is registered.<sup>39</sup> American politicians and officials will usually protect the interests of corporations that operate in the United States even if they are registered abroad.<sup>40</sup>

Other proposed tests for corporate residence, such as CMC, home office,<sup>41</sup> the stock exchange on which the corporation's securities are listed,<sup>42</sup> the

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30. *Id.* at 551–58.

31. *Id.* at 558–61.

32. *Id.* at 561–62; *see also* Shaviro, *Rising Tax-Electivity*, *supra* note 9, at 406.

33. Kirsch, *supra* note 20, at 563; *see also* Shaviro, *Rising Tax-Electivity*, *supra* note 9, at 407–08.

34. Kirsch, *supra* note 20, at 563.

35. Marian, *supra* note 9, at 1658; Roin, *supra* note 15, at 186 (“[M]any countries have adopted legal regimes acceptable both to investors and corporate management.”).

36. Tillinghast, *supra* note 16, at 266.

37. Kirsch, *supra* note 20, at 569.

38. *Id.* at 510–11, 514.

39. *Id.* at 563, 573.

40. *Id.* at 563–64.

41. Marian, *supra* note 9, at 1619 (referring to the home office test as the “real seat” test).

42. John T. VanDenburgh, *Closing International Loopholes: Changing the Corporate Tax Base to Effectively Combat Tax Avoidance*, 47 VAL. U. L. REV. 313, 347–49 (2012) (proposing to tax corporations based “on revenue reported to a U.S. public stock exchange”); Marian, *supra* note 9, at 1648–49 (discussing this view); Rudnick, *supra* note 23, at 1099.

corporation's principal customer base,<sup>43</sup> and its primary source of income,<sup>44</sup> 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.

Benefit seems to be a more appropriate criterion than does manipulability or clarity because it relies on a substantive connection between the corporation and the country that is claiming the right to tax its income. However, there are two problems with adopting benefit as a criterion for choosing tests of corporate residence. The first problem is practical. Measures undertaken by the corporation to avoid a benefit-based definition of residence may be detrimental to the taxing jurisdiction's economic interests. For example, commentators have expressed concern that if the location of a corporation's home office determines its residence for tax purposes, corporations will refrain from establishing their home offices in the United States, with a subsequent loss of high-paying managerial jobs.<sup>45</sup> Defining residence by reference to the exchange on which a corporation's securities are traded would make American exchanges less attractive as capital-raising venues.<sup>46</sup> Professors Fleming, Peroni, and Shay have argued that tests relying on the location of the corporation's consumer base or the geographical source of its income could induce adverse behavioral effects.<sup>47</sup> Perhaps paradoxically, the fact that registration in the United States represents a much lower degree of involvement in the U.S. economy may make POI, from this perspective, a more attractive test for corporate residence. Aside for the direct tax consequences, the United States has relatively little to lose by creating an incentive for corporations to incorporate elsewhere.<sup>48</sup>

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43. Yin, *supra* note 18, at 1087.

44. Rosenzweig, *supra* note 9, at 507.

45. GARY CLYDE HUFBAUER & ARIEL ASSA, U.S. TAXATION OF FOREIGN INCOME 116 (2007); Fleming et al., *supra* note 9, at 1710–11; Marian, *supra* note 9, at 1620–22, 1657 (describing this argument); Yin, *supra* note 18, at 1087.

46. Fleming et al., *supra* note 9, at 1706–07 (suggesting this approach “might create a bias against listing companies in the United States” because a foreign corporation will be a U.S. tax resident “if any class of its shares is regularly traded in one or more U.S. public capital markets or is marketed to U.S. persons”); Marian, *supra* note 9, at 1647.

47. Fleming et al., *supra* note 9, at 1710–11.

48. Michael J. Graetz, *Can a 20th Century Business Income Tax Regime Serve a 21st Century Economy?*, 30 AUSTRALIAN TAX F. 551, 566 (2015); Paul Krugman, *Tax Avoidance du Jour: Inversion*, N.Y. TIMES (July 27, 2014), <https://www.nytimes.com/2014/07/28/opinion/paul-krugman-tax-avoidance-du-jour-inversion.html> [<https://perma.cc/57K3-P9HZ>] (“The most important thing to understand about inversion is that it does not in any meaningful sense involve

The second problem is normative. Although benefit theory once dominated the tax policy discourse,<sup>49</sup> 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.<sup>50</sup> 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.<sup>51</sup> Consequently, in contemporary tax jurisprudence, the primary justification for income tax is ability-to-pay,<sup>52</sup> 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.<sup>53</sup>

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American business “moving overseas.” . . . It [is] a purely paper transaction . . .”); Marian, *supra* note 9, at 1622. A jurisdiction with a POI test will not lose “the benefit of positive externalities such as direct investment, jobs, and so on.” *Id.*

49. See, e.g., *Report on Double Taxation Submitted to the Financial Committee by Professors Bivens, Einavai, Seligman, and Sir Josiah Stamp*, at 18, League of Nations Doc. E.F.S.73 F.19 (1923) [hereinafter 1923 Report]; JEREMY BENTHAM, *THE PRINCIPLES OF MORALS AND LEGISLATION* 160 (New York, Hafner Publishing Co. 1948) (1789); THOMAS HOBBS, *LEVIATHAN* 238 (Richard Tuck ed., Cambridge Univ. Press 1996) (1651); ADAM SMITH, *2 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 310–11 (London, A. Strahan, T. Cadell & W. Davies 9th ed. 1799) (1776).

50. JOHN STUART MILL, *PRINCIPLES OF POLITICAL ECONOMY* 156–57 (New York, D. Appleton & Co. 1884) (1848) [hereinafter MILL, *PRINCIPLES*]; JOHN STUART MILL, *UTILITARIANISM, LIBERTY, REPRESENTATIVE GOVERNMENT* 54–55 (London, J.M. Dent & Sons Ltd. 1972) (1863); HENRY C. SIMONS, *PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY* 3–4 (Univ. of Chicago Press 1938).

51. MILL, *PRINCIPLES*, *supra* note 50, at 156–57 (suggesting the “less robust members of the community” need more in the distribution of government sources).

52. See, e.g., Donna M. Byrne, *Progressive Taxation Revisited*, 37 ARIZ. L. REV. 739, 765 (1995); Erik M. Jensen, *The Taxing Power, the Sixteenth Amendment, and the Meaning of “Incomes,”* 33 ARIZ. ST. L.J. 1057, 1091 (2001); Marjorie E. Kornhauser, *Choosing a Tax Rate Structure in the Face of Disagreement*, 52 UCLA L. REV. 1697, 1708–17 (2005) (viewing taxes as payments for benefits received from the government and explaining how these benefits increase progressively as wealth and income increase); Kyle D. Logue & Gustavo G. Vettori, *Narrowing the Tax Gap Through Presumptive Taxation*, 2 COLUM. J. TAX L. 100, 112–13 (2011); 1923 Report, *supra* note 49, at 18; Shavero, *Rising Tax-Selectivity*, *supra* note 9, at 388–89; Fleming et al., *Fairness in International Taxation*, *supra* note 24, at 306.

53. David Elkins, *The Case Against Income Taxation of Multinational Enterprises*, 36 VA. TAX REV. 143, 175–76 (2017) (“[B]enefit theory is analytically the very antithesis of ability-to-pay. Ability-to-pay attempts to redistribute wealth by imposing the greatest tax burden on those who are the best off economically. Benefit taxation, on the other hand, endeavors to preserve the

This is not to say that a state cannot logically employ both benefit taxation and ability-to-pay taxation. Each has its proper place.<sup>54</sup> 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.<sup>55</sup>

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.<sup>56</sup> In contrast, benefit theory would seem to lead to a territorial tax.<sup>57</sup> For these reasons, commentators universally rely on ability-to-pay, not benefit, as the normative justification for taxing the worldwide income of resident individuals.<sup>58</sup>

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.<sup>59</sup>

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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 U. 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). The premise “those who are better able to pay must have received more benefit from the government” is “fallacious.” *Id.*

56. Elkins, *supra* note 53, at 168.

57. See, e.g., Rosenzweig, *supra* note 9, at 477–78.

58. William B. Barker, *Optimal International Taxation and Tax Competition: Overcoming the Contradictions*, 22 NW. J. INT'L L. & BUS. 161, 187–88 (2002); Jeffrey M. Colón, *Changing U.S. Tax Jurisdiction: Expatriates, Immigrants, and the Need for a Coherent Tax Policy*, 34 SAN DIEGO L. REV. 1, 9 (1997); Eva Farkas-DiNardo, *Is the Nation of Immigrants Punishing Its Emigrants: A Critical Review of the Expatriation Rules Revised by the American Jobs Creation Act of 2004*, 7 FLA. TAX REV. 5, 11–12 (2005); Chang Hee Lee, *Taxation of U.S.-Korea Technology Transfer: A Developing Country's Point of View*, 10 INT'L TAX & BUS. LAW. 1, 7 (1992); Timothy Hisao Shapiro, *Tax First, Ask Questions Later: Problems Predicting the Effect of President Obama's International Tax Reforms*, 16 STAN. J.L. BUS. & FIN. 141, 167 (2010); Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289, 1323 (2011); Fleming et al., *supra* note 24, at 306.

59. Furthermore, under benefit theory it is difficult to justify restrictions on corporate expatriation. Benefit theory does not permit the imposition of a tax burden that is greater than the benefit taxpayers derive from government services. When a corporation expatriates it indicates that the cost of maintaining the relationship that underlies the definition of corporate residence is greater than the benefit of doing so. See, e.g., Marian, *supra* note 9, at 1630.

## II. PURPOSIVENESS

A more promising line of reasoning in recent literature favors what we might describe as a purposive criterion for evaluating corporate residence.<sup>60</sup> 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.<sup>61</sup>

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.<sup>62</sup> 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.<sup>63</sup> 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.<sup>64</sup> Marian

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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).

postulates that if this view is correct, then the appropriate test for corporate residence would be control and management.<sup>65</sup> He indicates that an alternative purpose for corporate taxation is to neutralize certain agency costs and suggests that if this purpose is taken as controlling, then a corporation should be resident in the place where its securities are listed.<sup>66</sup> Combining these two goals, Marian proposes classifying a corporation as domestic if either (a) it is managed and controlled in the United States, or (b) its securities are listed on a U.S. exchange.<sup>67</sup>

Today, most scholars believe that the corporate income tax is best characterized as an administratively convenient indirect tax on shareholders.<sup>68</sup> In accordance with this perspective, some commentators have argued that corporate residence should follow shareholders' residence.<sup>69</sup> For example, in a recent article, Professors Fleming, Peroni, and Shay proposed a rule whereby a corporation would be a U.S. resident if U.S. individuals ultimately own 50% or

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65. Marian, *supra* note 9, at 1644. If a CMC test is adopted, "then corporate tax works to counterbalance the managers' excessive accumulation of power." *Id.* Even if we accept the argument that the purpose of the corporate income tax is to regulate corporate management, it is not clear that the control and management test would necessarily follow. For example, consider two corporations: one with extensive business interests in China but controlled and managed in the United States, the other with extensive business interests in the United States but controlled and managed in China. It would seem that power of the latter is of greater concern to the United States government than is the former.

66. Marian, *supra* note 9, at 1647.

67. *Id.* at 1664.

68. Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 WM. & MARY L. REV. 447, 452 (2001); William B. Barker, *A Common Sense Corporate Tax: The Case for a Destination-Based, Cash Flow Tax on Corporations*, 61 CATH. U. L. REV. 955, 996 (2012) ("[There is a] widespread belief that taxing corporations offers a convenient and practical way of indirectly taxing corporate shareholders."); Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 N.Y.U. TAX L. REV. 99, 159 (2011); Fleming et al., *supra* note 9, at 1700; Graetz, *supra* note 10, at 302–03; see Steven A. Bank, *The Dividend Divide in Anglo-American Corporate Taxation*, 30 J. CORP. L. 1, 15–18 (2004) (discussing the 1913 corporate income tax); David M. Schizer, *Between Scylla and Charybdis: Taxing Corporations or Shareholders (or Both)*, 116 COLUM. L. REV. 1849, 1859 (2016). It is important to distinguish here between the nature of a tax as direct or indirect and the incidence of the tax. The corporate income tax is an indirect tax on shareholders because its immediate effect is to reduce the after-tax profit available for distribution to shareholders. With regard to the incidence of the tax, the corporate income tax may affect the supply and demand curves for goods, services, and capital, and if so then individuals other than shareholders may bear the ultimate economic burden. However, this is true also with regard to a tax imposed directly on shareholders, as it is with regard to a tax imposed directly on wage earners and so forth. See generally DAVID ELKINS, BEHIND THE SCENES OF CORPORATE TAXATION 10–12 (2013).

69. Robert A. Green, *The Future of Source-Based Taxation of the Income of Multinational Enterprises*, 79 CORNELL L. REV. 18, 70–72 (1993); Kleinbard, *supra* note 68, at 160 (treating U.S. firms as U.S. persons if overwhelmingly owned by U.S. persons).

more of its shares, by vote or value, on the last day of the year.<sup>70</sup> They then propose an irrefutable presumption of U.S. residence for any corporation incorporated in the United States and a rebuttable presumption of U.S. residence for any corporation whose shares are traded on a U.S. security exchange.<sup>71</sup>

I agree that, as a criterion to evaluate tests of corporate residence, purposiveness is more persuasive than manipulability, clarity, or benefit. Moreover, I agree that whatever the original goal of corporate income taxation, the only purpose of the corporate income tax today is to serve as an indirect tax on shareholders.<sup>72</sup> Together, these two propositions do seem to suggest a definition of corporate residence that relies on the residence of shareholders instead of on any attribute of the corporation itself. Nevertheless, classifying a corporation as a U.S. resident when the percentage of shares held by U.S. residents passes a certain threshold would be problematic, both practically and normatively.

One practical issue is that applying such a definition requires information regarding the identity and residence of each of a corporation's shareholders, and corporations may not have access to that information.<sup>73</sup> Even when the corporation knows the identity of each of its shareholders, it may not necessarily know the shareholder's residence, as defined in relevant tax legislation. For instance, the primary test for tax residence under U.S. law is the number of days an individual spent in the United States during each year of the three-year period culminating in the year in question.<sup>74</sup> It is hardly reasonable to expect a corporation to investigate how many days each of its ultimate individual shareholders spent in the United States during the current and during the two previous years in order to determine whether the shareholder is a U.S. resident during the current year. To complicate matters further, the status of an individual as resident or nonresident can change not only from one year to the next, but also during the course of a single year.<sup>75</sup> Furthermore, an individual may be a

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70. Fleming et al., *supra* note 9, at 1693, 1703. To counter possible attempts at manipulating year-end ownership they propose as an alternative that a corporation would be a U.S. resident if on the days ending each of the four quarters of a year, U.S. individuals own an average of 50% or more of the shares. *Id.* at 1703.

71. *Id.* at 1706, 1708.

72. For example, when shareholders pay tax on their proportionate shares of the corporation's earnings (as in the case of an S Corporation), the corporation itself is not subject to tax. I.R.C. § 1363(a) (2012). Were the function of the corporate income tax other than to serve as an indirect tax on shareholders, the direct payment of tax by shareholders would not obviate the need for an additional corporate-level tax. Conversely, where a non-corporate entity's owners do not pay tax directly on their proportional shares of the entity's earnings (e.g., an LLC that elected to "check the box"), the entity itself will be subject to tax. 26 C.F.R. § 301.7701-3(a) (2016).

73. For example, shares may be held in a blind trust or by corporations or other entities that are not required to divulge the identity of their shareholders.

74. I.R.C. § 7701(b)(1)(A)(ii), (b)(3) (2012).

75. § 7701(b)(2).



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.”<sup>76</sup> 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,<sup>77</sup> 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.<sup>78</sup> 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.<sup>79</sup> 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 applying a threshold test is the normative issue. Recall that

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76. *See, e.g.*, U.S. Model Income Tax Convention art. 4(3), 2016, <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf> [<https://perma.cc/MM6K-USJQ>].

77. Fleming et al., *supra* note 9, at 1706 (acknowledging the problem of derivatives).

78. *See, e.g.*, Rosenzweig, *supra* note 9, at 497–98 (describing the over-inclusiveness of § 7874 anti-inversion rules, avoidance of the anti-inversion rules, and proposals to strengthen the anti-inversion rules in response to the avoidance techniques).

79. *See supra* Section I.A.

underlying the proposal to define corporate residence in terms of shareholder residence is the proposition that the corporate income tax is an indirect tax on shareholders. When U.S. residents own either 0% or 100% of the shares in a corporation (and ignoring the possibility of shareholder-like rights via means other than shareholding), a rule making corporate residence a function of shareholder residence would indeed accord with the purpose of the corporate income tax. In such a case, U.S. shareholders would indirectly pay tax on their worldwide income and foreign shareholders would indirectly pay tax only on their U.S.-source income. However, with regard to any corporation with both U.S. and foreign shareholders, the proposed rule would effectively lead either to the imposition of tax on the foreign-source income of foreigners simply because their fellow shareholders were U.S. residents or to the non-imposition of tax on the foreign-source income of U.S. residents simply because their fellow shareholders were foreign residents. For example, under the proposed “50% or more” rule, U.S. shareholders collectively owning less than 50% of the shares would effectively escape current tax on their foreign source income, while foreign shareholders collectively owning 50% or less of the shares would effectively be subject to U.S. tax on their foreign source income. Neither of these results is consistent with the idea that the goal of corporate taxation is to impose an indirect tax on shareholders.<sup>80</sup>

#### CONCLUSION

The literature has hitherto failed to produce a satisfactory definition of corporate residence. The most commonly applied criteria are unpersuasive. Manipulability and clarity are technical standards with no normative content, and they are negative rather than positive standards that can on occasion provide convincing reasons to reject a proposed test but cannot provide convincing reasons to adopt one. Benefit, although it purports to be substantive, cannot serve as a criterion by which to evaluate tests of corporate residence. It has long been recognized that the normative justification for income taxation in general and for the taxation of foreign-source income in particular is not benefit but rather ability-to-pay. Relying upon benefit to justify a tax on foreign-source income is incongruous.

Recently, the literature has explored the possibility of defining corporate residence by reference to the goals of corporate income taxation. This standard

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80. As a point of comparison, note that when U.S. residents and foreign residents invest in a joint project via a partnership or an LLC, the anomaly just described does not occur. The U.S. partners or members are subject to tax on their share of the entity's income on a worldwide basis. The foreign partners or members are subject to tax on their share of the entity's U.S.-source income, but not on their share of the entity's foreign-source income. From a policy perspective, it is difficult to justify a radically different result just because the vehicle through which they chose to channel their investment is a corporation.

is more convincing than manipulability, clarity, or benefit. The problem with purposiveness is not in its substance but in its application. The corporate income tax serves as an indirect tax on shareholders. To conform to the purposive criterion, a definition of corporate residence would therefore need to result in the imposition of tax on the worldwide income of resident shareholders and on the domestic-source income of nonresident shareholders. It is difficult to conceive of a test of corporate residence that could accomplish that feat, and, indeed, the literature has so far failed to produce one.

The fact that the literature has heretofore been incapable of providing a test of corporate residence that conforms to a reasonable criterion suggests that there exists no such test. Admittedly, a proof that relies on the absence of conflicting evidence is less than fully convincing. The fact that only one of the criteria discussed in the literature passes muster does not disprove the possibility that another, hitherto undiscovered criterion could reasonably serve as the basis for evaluating tests of corporate residence. Nor does the fact that of the myriad proposed tests of corporate residence, none satisfy the demands of the purposive criterion or disprove the possibility that such a test exists. However, neither of these possibilities seems likely.

The question that remains is why an acceptable definition of corporate residence remains so elusive. Perhaps the underlying problem is the very notion of corporation residence. A deeper analysis might reveal that the concept of corporate residence involves an internal contradiction and that the continuing failure to develop a successful definition of corporate residence is simply a manifestation of that theoretical impossibility. Space limitations prevent exploring that line of thought here, and I will do so in a follow-up article.<sup>81</sup>

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81. The article has since been published as David Elkins, *The Myth of Corporate Tax Residence*, 9 COLUM. J. TAX L. 5 (2017).