JURISDICTION TO TAX CORPORATIONS

Omri Marian*

Abstract: Corporate tax residence is fundamental to our federal income tax system. Whether a corporation is classified as "domestic" or "foreign" for U.S. federal income tax purposes determines the extent of tax jurisdiction the United States has over the corporation and its affiliates. Unfortunately, tax scholars seem to agree that the concept of corporate tax residence is "meaningless." Underlying this perception are the ideas that corporations cannot have "real" residence because they are imaginary entities and because taxpayers can easily manipulate corporate tax residence tests. Commentators try to deal with the perceived meaninglessness by either trying to identify a normative basis to guide corporate tax residence determination, or by minimizing the relevance of corporate tax residence to the calculation of tax liabilities. This Article argues that both of these approaches are misguided. Instead, this Article suggests a functional approach, under which corporate tax residence models are designed to support the policy purposes of corporate taxation. This Article concludes that the U.S. should reform the way it defines "domestic" corporations for tax purposes by adopting a two-pronged tax residence test: the place where the corporation's securities are listed for public trading, or the place of the corporation's central management and control.

Introduction

Corporate tax residence is a foundational legal construct. Determining a corporation's tax residence (namely, whether the corporation is "foreign" or "domestic" for tax purposes) is necessary to calculate the

* Assistant Professor of Law, University of Florida Levin College of Law. For helpful comments, suggestions, and razor-sharp critique, I thank Reuven Avi-Yonah, Steven Bank, Ilan Benshalom, Jennifer Bird-Pollan, Leslie Book, Yariv Brauner, Joe Dodge, David Duff, Vic Fleischer, Cliff Fleming, Paul Gugliuzza, David Herzig, Mike Kirsch, Marty McMahon, Ajay Mehrotra, Susie Morse, Gregg Polsky, Diane Ring, Ted Seto, Steve Shay and numerous participants in the following conferences and workshops where I presented earlier drafts of the Article: 16th Critical Tax Theory Conference, University of California, Hastings College of Law; Florida State University College of Law; 7th Sino-U.S. International Tax Forum; University of Kentucky College of Law; National Centre of Business Law, University of British Columbia; 2nd Annual Critical Tax Policy Workshop, University of Washington Law School; and, 2012 Southeastern Law Schools Association Conference. Amrita Boghani, Fabien Helley and Neil Rogers provided valuable research assistance. Any errors or omissions are my own.

tax liabilities of the corporation and its affiliates,[1] and sometimes, its shareholders.[2] Unfortunately, tax scholars seem to agree that corporate tax residence is a meaningless concept.[3] This Article disputes this common perception. This Article argues that the defining normative criteria commonly used to assess the "meaningfulness" of corporate tax residence are irrelevant. Instead, this Article suggests alternative criteria that are based on functional, rather than normative, considerations.

There are two reasons for the perceived "meaninglessness" of corporate tax residence. Some scholars argue that corporate tax residence lacks a convincing normative basis to justify treating a corporation as "domestic" in one jurisdiction rather than another.[4] Alternatively, some scholars propose that corporate tax residence is too vulnerable to taxpayer manipulation.[5] Effectively, these scholars argue that corporate

---

[1] This Article uses the term "affiliates" to designate corporate entities that are members of the same control group as the corporation, but whose tax residence must be determined.

[2] *See* Task Force on Int'l Task Reform, Am. Bar. Ass'n, *Report of the Task Force on International Tax Reform*, 59 TAX LAW. 649, 746 (2006) [hereinafter *Task Force on International Tax Reform*] (stating that "the manner in which, and the extent to which, U.S. tax will be imposed depends on whether the particular corporation is domestic or foreign").

[3] *See infra* notes 4–5 and accompanying text.

[4] *See* Michael J. Graetz, *The David R. Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 320 (2001) (commenting that "[i]n the case of corporations . . . the idea of residence . . . seems both outdated and unstable"); Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443, 465–67 (2007) (discussing the lack of a substantive connection between corporate tax residence and the corporate economic attributes in a global economy); Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 TAX L. REV. 99, 159 (2011) (arguing that in the United States, corporate tax residence is "completely artificial"); David R. Tillinghast, *A Matter of Definition: 'Foreign' and 'Domestic' Taxpayers*, 2 INT'L TAX & BUS. LAW. 239, 260 (1984) (describing corporate tax residence as a "crude, if not naïve, criterion"); Reuven S. Avi-Yonah, Tax Competition and the Trend Toward Territoriality (Dec. 18, 2012) (Univeristy of Michigan Law School Public Law Research Paper Series, Paper No. 297), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2191251 (arguing in favor of territorial taxation because "corporate residence is not very meaningful").

[5] REUVEN S. AVI-YONAH, NICOLA SARTORI & OMRI MARIAN, GLOBAL PERSPECTIVES ON INCOME TAXATION LAW 154 (2011) (discussing the manipulation of corporate tax residence by taxpayers); Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1575, 1593–97 (2000) (discussing how corporate tax residence rules are manipulated by taxpayers to reduce their tax liability); Michael J. McIntyre, *Determining the Residence of Members of a Corporate Group*, 51 CAN. TAX J. 1567, 1571 (2003) (arguing that "as currently constituted, [corporate tax residence tests] are elective to a substantial degree"); Daniel Shaviro, *The David R. Tillinghast Lecture: The Rising Tax-Electivity of U.S. Corporate Residence*, 64 TAX L. REV. 377, 381–85 (2011) (arguing that corporate tax residence is effectively elective in the United States). There are numerous recent discussions in the media on tax planning schemes involving corporate tax residence manipulation. *See, e.g.*, David Kocienieski, *As Oil Industry Fights a Tax, It Reaps Subsidiaries*, N.Y.

tax residence is elective.[6] Taxpayers can arrange the tax residence of corporations as they see fit, and avoid taxes.[7]

Responses to this acute problem march along two fronts.[8] One response is a continued debate on the "best" normative justification for the determination of corporate tax residence.[9] This approach will hereinafter be referred to as the "normative approach." The second response doubts that a normative foundation for corporate tax residence can be found.[10] Accordingly, this response suggests that we should minimize the importance of corporate tax residence in the calculation of tax liabilities. This second approach will hereinafter be referred to as the "pragmatic approach." Part I of this Article suggests that both the normative approach and the pragmatic approach are inadequate.[11]

Under the normative approach, corporate tax residence tests are independently justified in normative terms. For example, a normative justification for a particular residence test may be that the test is more efficient than another. A proponent of an "efficient" tax residence model takes the position that a model is desirable because it possesses an inherently positive quality—efficiency—regardless of whether the reason for taxing corporations has anything to do with efficiency.

Under an alternative normative stance, a corporate tax residence test could be justified if it captures a meaningful "nexus" of the corporation to a particular jurisdiction. Because the corporation benefits from the public goods created by the jurisdiction, it is justified to tax the corporation in that jurisdiction. The debate between the two nor-

---

TIMES, July 3, 2010, http://www.nytimes.com/2010/07/04/business/04bptax.html?pagewanted=1&_r=0; Howard Mustoe, *Wolseley Follows Shire, Ineos Group in Moving Its Tax Residence From U.K.*, BLOOMBERG (Sept. 27, 2010, 3:51 AM), http://www.bloomberg.com/news/2010-09-27/wolseley-follows-shire-ineos-group-in-moving-its-tax-residence-from-u-k-.html; Becky Yerak et al., *Aon Will Lower Tax Burden in Moving Headquarters to London*, CHI. TRIB., Jan. 14, 2012, http://articles.chicagotribune.com/2012-01-14/business/ct-biz-0114-aon-moving–20120114_1_aon-center-aon-ceo-aon-corp; Jason Zweig, *How to Owe Capital Gains Taxes Without Even Trying*, WALL ST. J., (Jan. 18, 2013, 5:39 PM), http://online.wsj.com/article/SB10001424127887323783704578249841775885514.html.

[6] McIntyre, *supra* note 5, at 1571; Shaviro, *supra* note 5, at 385.

[7] *See infra* notes 60–64 and accompanying text.

[8] *See* McIntyre, *supra* note 5, at 1570 (noting how countries can determine corporate residence either using a practical system of corporate taxation not dependent on residence, or defining corporate residence according to the intended purpose of corporate income tax); *see also infra* notes 140–148 and accompanying text (describing the two approaches to U.S. corporate tax residence).

[9] *See infra* notes 24–79 and accompanying text.

[10] *See infra* notes 60–79 and accompanying text.

[11] *See infra* notes 24–79 and accompanying text.

mative standards for corporate tax residence tests can be described as a dichotomy of formal and substantive tests.[12]

Part I, Section A argues that the normative dichotomy does not make sense in the context of theories that justify the taxation of corporate entities. Specifically, the polarized normative arguments are advanced under the assumption that either efficiency is a desirable goal, or that corporations are "real entities" capable of benefiting from public goods.

Scholars agree, however, that corporate tax itself is an inefficient model of revenue collection,[13] and that for tax purposes, corporations are *not* real beings.[14] Rather, corporations are instruments for the taxation of individuals.[15] Accordingly, the debate about corporate tax residence is advanced under assumptions that have been rejected in the context of a bigger, first-order question: Why tax corporations to begin with? It makes little sense to construct the jurisdictional threshold test of a tax regime (i.e., the question of tax residence) under assumptions that have been rejected for purposes of constructing the tax regime itself (i.e., the regime of corporate taxation).

Part I, Section B discusses the pragmatic approach and shows that the pragmatic approach does not offer a remedy to the theoretical gridlock described above. Pragmatists perceive the "meaninglessness" of corporate tax residence as a given fact, and suggest dealing with it by minimizing the importance of corporate tax residence altogether.[16] For example, under the pragmatic response, the "meaninglessness" of corporate tax residence supports recent suggestions to transform the U.S. tax system from a global system of taxation to a territorial one.[17]

Such a reform would arguably minimize the importance of corporate tax residence tests. Under a global (or "residence-based") tax system, domestic tax residents are taxed on their worldwide income from whatever source derived, but foreign tax residents are only taxed on

---

[12] *See infra* notes 24–59 and accompanying text.

[13] *See infra* notes 37–38 and accompanying text.

[14] *See infra* notes 56–58 and accompanying text.

[15] *Id.*

[16] *See* Graetz, *supra* note 4, at 323 (arguing that "[t]he fragility and manipulability of the residence of corporations suggests to me that U.S. international tax policy, to the extent possible, should reduce the tax consequences of determinations of residence for corporations"); Shaviro, *supra* note 5, at 415–17 (suggesting a reform of the U.S. tax system from a global to a territorial system as an appropriate response to corporate tax residence electivity); Avi-Yonah, *supra* note 4 (arguing in favor of a territorial tax system on the belief that corporate tax residence is not meaningful).

[17] *See* Graetz, *supra* note 4, at 323; Shaviro, *supra* note 5, at 415–17; Avi-Yonah, *supra* note 4.

income derived within the jurisdiction's territory. Alternatively, under a territorial system, a jurisdiction may only tax income derived from sources within its territory, regardless of whether such income is earned by domestic or foreign tax residents. Tax residence determination is therefore acutely important in the case of a global system, and *theoretically* less so in the context of a territorial system.[18]

Adherents to the pragmatic approach reason that the "meaninglessness" of corporate tax-residence provides one justification (among others) to abandon our global system of taxation in favor of a territorial system. Specifically, these proponents suggest that in a territorial system, residence determination will have far fewer climatic consequences because corporate tax residence is not a prerequisite for establishing taxing jurisdiction. Instead, the source of income is the deciding factor.

Part I, Section B argues, however, that reforming the U.S.'s tax system from a global to a territorial system will not cause corporate tax residence to be "less important" in calculating tax liabilities. This is because in many instances, the "source" of income is determined by reference to the *tax residence* of corporate taxpayers involved in the transactions that generate the income.[19] Accordingly, residence remains relevant even in a territorial system.

Part II identifies alternative criteria to determine "meaningful" corporate tax residence.[20] Specifically, Part II suggests structuring corporate tax residence models as instruments to support the policy purposes that underlie why jurisdictions tax corporations in the first instance. As such, Part II develops a cohesive functional model to determine corporate tax residence.

Although the suggested *functional* tax residence argument is also a normative argument, it draws its vitality from the idea that corporate tax residence tests should support the policy purposes of corporate taxation, rather than from independent normative justifications (such as "efficiency" or "nexus"). For example, if one accepts the idea that corporate taxation is imposed as a tool to exert tax burdens on specific individuals (for example, the managers or shareholders of a corporation),[21] then corporate tax residence tests can only be justified if they

---

[18] *See infra* notes 65–79 and accompanying text (describing the argument that corporate tax residence is less relevant in territorial tax systems).

[19] *See infra* notes 71–75 and accompanying text.

[20] *See infra* notes 80–132 and accompanying text.

[21] *See infra* notes 89–109 (describing the theory that corporate tax was instituted as a proxy to tax shareholders); *infra* notes 118–128 and accompanying text (describing the

indeed support such a purpose. Given this policy goal, tax residence determination would operate to assist in the collection of corporate tax in a way that burdens the intended individuals.

Part III surveys the possible critiques to the functional model that this Article develops and concludes that the traditional critiques of corporate tax residence do not pose serious challenges.[22] Because corporate tax residence tests are functionally tested, taxpayers cannot manipulate the tax residence tests unless they sacrifice some functional characteristic that justified the taxation of the corporation. For example, if the functional justification for the determination of corporate tax residence is the place of residence of the shareholders, then the shareholders will have to move in order to change the tax residence of the corporation. If the shareholders indeed move, then the functional justification for taxing the corporation is lost, and non-taxation is the correct result.

Part IV utilizes the functional approach to conclude that the U.S. should reform how it defines "domestic" corporations for tax purposes.[23] In doing so, Part IV reviews the place of incorporation ("POI") test currently in place, as well as the current reform debates in respect thereof. Part IV shows that current reform discussions are largely driven by the irrelevant formal/substantive dichotomy. It is concluded that under a functional approach, the U.S. should repeal the POI test, and adopt a test under which a corporation is a tax resident in the U.S. if: (i) the securities of such corporation are listed for public trading in the United States *or* (ii) the place of central management and control of such corporation is in the United States.

I. The "Meaninglessness" of Corporate Tax Residence

This Part discusses the normative and pragmatic approaches for structuring corporate tax residence tests and concludes that both approaches fall short. Specifically, Section A discusses the normative debate between advocates of an efficiency standard and advocates of benefits theory-based standards, showing that this debate fails to adequately consider the policy purposes of corporate taxation. Then, Section B argues that, notwithstanding the shortcomings of the normative debate, the pragmatic approach is not a viable solution because the

---

theory that corporate tax was instituted as a proxy to control the excessive accumulation of managerial power).

[22] *See infra* notes 133–136 and accompanying text.

[23] *See infra* notes 137–188 and accompanying text.

pragmatic solution to the meaninglessness of tax residence—namely, adopting a territorial system of taxation—does not significantly minimize the importance of corporate tax residence.

A. *The Formal/Substantive Dichotomy of Corporate Tax Residence Is Irrelevant*

Subsection 1 describes the two families of tests used by various jurisdictions to determine corporate tax residence. One family of tests is formal and justified by efficiency standards. This family is frequently identified with the place of incorporation ("POI") test. The other family of tests, which looks at the real seat ("RS") of corporations, is substantive and justified by benefits theory-based arguments.

Subsections 2 and 3 of this Section show that the justifications that stand to differentiate the two tests do not apply in the context of the policies underlying corporate taxation. Specifically, when the normative justifications for the tests are placed in the context of the theories that explain the taxation of corporate entities, the tests may, in fact, operate to undermine such policies.

1. The Normative Dichotomy of Corporate Tax Residence: A Description

Almost all jurisdictions that impose tax on corporate entities determine the tax residence of such entities based on one of two types of tests or a combination thereof.[24] The first type is formal and is usually based on the POI of the corporation. Under a POI test, a corporate entity is a resident for tax purposes in the jurisdiction in which it is incorporated. The United States has adopted the POI test.[25] The second type is substantive and is based on the RS of the corporation. A corporation's RS "depends on some combination of factual elements, such as the location of the administrative headquarters or the location of the firm's center of gravity as determined by the location of the employees and assets."[26] The dichotomy between "formal" and "substantive" crite-

---

[24] Hugh J. Ault & Brian J. Arnold, Comparative Income Taxation: A Structural Analysis 434 (3rd ed. 2010); Mitchell A. Kane & Edward B. Rock, *Corporate Taxation and International Charter Competition*, 106 Mich. L. Rev. 1229, 1235 (2008) (noting how jurisdictions can adopt either the place of incorporation ("POI") rule or a form of the real seat ("RS") rule to determine corporate residence for tax purposes).

[25] I.R.C. § 7701 (2006).

[26] Kane & Rock, *supra* note 24, at 1235.

ria is accepted in tax literature and guides the academic discourse on corporate tax residence.[27]

This dichotomy may be accurate as a purely descriptive matter. Some jurisdictions indeed adopt formal tests[28] and others adopt substantive tests.[29] If this dichotomy had been limited to an observation of reality, this Article would have had little to argue against. The problem is that the dichotomy also induces a normative debate about how countries *should* determine the residence of corporations for tax purposes. Commentators argue for a POI test on the grounds of efficiency, whereas an RS test is justified on the grounds of benefits theory, specifically, that taxation is a means of financing public goods. These justifications demonstrate that the debate is truly normative. Nevertheless, it is difficult to rationalize this normative debate because it ignores the basic underlying purposes of corporate taxation.

2. POI and Efficiency Arguments

Justifications for POI as the preferred corporate tax residence test are largely based on an efficiency rationale. This is best illustrated by an example.

Assume that Corporation X ("X Corp.") is incorporated in Jurisdiction A ("A"), but substantively operates in multiple jurisdictions worldwide. Further, assume that X Corp.'s headquarters is physically located in Jurisdiction B ("B"). B thus enjoys certain positive external-

---

[27] *See, e.g.*, AULT & ARNOLD, *supra* note 24, at 434 ("Two basic approaches are used in establishing a personal jurisdictional connection for corporations. One is to focus on some formal legal connection to the jurisdiction . . . . The other is to select some economic and commercial connection . . . ."); ROBERT COUZIN, CORPORATE RESIDENCE AND INTERNATIONAL TAXATION 22 (2002) (contrasting the POI test with more "fact intensive tests"); Yariv Brauner, *United States*, *in* RESIDENCE OF COMPANIES UNDER TAX TREATIES AND EC LAW 855, 865 (Guglielmo Maisto ed., 2009) [hereinafter RESIDENCE OF COMPANIES] (contrasting between the POI test in the United States and other "fact-intensive residence determination" tests used by other countries); Luc De Broe, *Corporate Tax Residence in Civil Law Jurisdiction*, *in* RESIDENCE OF COMPANIES, *supra*, at 95, 96 (differentiating between "formal and factual tests" used in civil law countries); Martin Norr, *Jurisdiction to Tax and International Income*, 17 TAX L. REV. 431, 437 (1961) (contrasting "fiscal domicile" with "legal domicile"); Tillinghast, *supra* note 4, at 260–66 (contrasting the POI test adopted in the United States with tests adopted in other jurisdictions that require "factual analysis"); Rudolf Weber-Fas, *Corporate Residence Rules for International Tax Jurisdiction: A Study of American and German Law*, 5 HARV. J. ON LEGIS. 175, 181 (1967) (noting that "[i]n sharp contrast to the simplicity of determining the seat, there are often highly complex factual issues involved in locating the place of management of a corporation . . . .").

[28] The United States and Japan are examples of countries that adopt a formal test.

[29] Most Commonwealth jurisdictions adopt substantive tests that analyze the place of central management and control.

ities stemming from X Corp.'s presence in the jurisdiction—X Corp. employs residents of B, has management facilities therein, and so on.[30] If B determines the tax residence of corporations based on POI, then X Corp. is a "foreign" corporation for tax purposes because it is *not* incorporated in B.

Furthermore, assume that B is a residence-based (or "global") tax jurisdiction. Namely, B taxes its domestic residents on their worldwide income, but taxes foreign residents only on income derived from within its territory (much like the U.S.). Because X Corp. is a foreign corporation for B's tax purposes, X Corp. is only taxed in B on income derived from sources within B's territory. All of X Corp.'s income derived from its worldwide operations outside B is not subject to B's taxing jurisdiction, notwithstanding that X Corp. is managed from within B.

If B reforms its corporate tax residence law and adopts a common version of the RS test, such as the central management and control test ("CMC"), then X Corp. would be a "domestic" corporation for tax purposes. Under a CMC test, a corporation is a resident for tax purposes in a jurisdiction where "the central management and control actually abides."[31] Because X Corp.'s management is located in B, the reform would cause X Corp. to become a "domestic" corporation for B's tax purposes. Consequently, X Corp. would be taxed in B on all of its worldwide income. Such a result creates an incentive for X Corp. to rearrange its affairs so its RS is no longer in B, which is achieved by moving its headquarters outside of B. If this happens, B will lose the benefits associated with having X Corp.'s headquarters located in B.

The efficiency argument in favor of the POI test is now apparent because unlike RS, POI does not distort taxpayers' behavior.[32] Specifically, taxpayers are relatively indifferent as to the place of legal incorporation. In contrast, taxpayers are not indifferent to real economic at-

---

[30] *See* Gary Clyde Hufbauer & Ariel Assa, U.S. Taxation of Foreign Income 116 (2007) (describing how jurisdictions benefit from corporate headquarters). Corporate headquarters are highly coveted by jurisdictions because they create well-paying jobs and are an incubator for human capital. *Id.* These benefits, naturally, have the potential to spur additional job growth within the jurisdiction. *Id.*

[31] De Beers Consol. Mines, Ltd. v. Howe, [1906] A.C. 455 (H.L.) (appeal taken from Eng.).

[32] *See, e.g.*, *Tax Reform Options: International Issues*: *Hearing Before the S. Comm. on Fin.*, 112th Cong. 7–8 (2011) [hereinafter *Tax Reform Options*] (statement of Prof. James R. Hines, Jr., University of Michigan Law School) (arguing against the adoption of a central management and control test because it persuades corporations to relocate desirable management activities); Kane & Rock, *supra* note 24, at 1240–41 (discussing the possible tax savings that may result from shifting the "tax location" of a corporation from one jurisdiction to another).

tributes such as infrastructure, customer base, and the quality of the labor force. Indeed, as this example shows, corporate taxpayers may incorporate in one jurisdiction, but physically operate in another.

The jurisdiction where a corporation physically operates has the benefit of positive externalities such as direct investment, jobs, and so on. A reform that adopts a RS test may encourage migration to another jurisdiction (or non-investment to begin with) of the relevant attributes according to which RS is determined (in the case of this example, place of management). The result of such a migration (or non-investment) is a loss of the benefits associated with having a corporation's headquarters (or other attributes according to which RS is determined) within a jurisdiction.[33] According to the efficiency-based normative approach, therefore, POI is a desirable corporate tax residence test because, unlike RS, it does not cause taxpayers to change their behavior in an economically significant manner.

Moreover, the POI test is extremely cost-effective. As compared to the fact-intensive inquiries necessitated by the RS test,[34] POI provides perfect legal certainty as to corporate tax residence status.[35] In this way, POI is very easy to administer.[36]

As currently reflected in academic debate, such efficiency-driven arguments in favor of the POI test are first-order, self-standing normative arguments. Because efficiency is viewed as an inherently positive quality, the corporate tax residence test that *should* be adopted is POI, as it is the most efficient test.

Such arguments, however, are advanced in complete disconnect from the vibrant discussions on the purposes of corporate taxation.[37] This is crucially important because one thing that legal scholars and public finance economists agree upon (a rare occasion indeed), is that

---

[33] *Tax Reform Options*, *supra* note 32 at 7–8 (statement of James R. Hines, Jr., Professor, University of Michigan Law School) (stating that the central management and control test is not preferable from a policy perspective because it causes corporations to relocate their headquarters); Shaviro, *supra* note 5, at 413–15 (rejecting the central management and control test because it risks the loss of positive externalities).

[34] *See infra* notes 44–53 and accompanying text.

[35] *See* Tillinghast, *supra* note 4, at 259–66.

[36] *See Task Force on International Tax Reform*, *supra* note 2, at 747 (noting that "[t]he place of organization rule could not be clearer or easier for taxpayers to correctly execute"); Shaviro, *supra* note 5, at 415 (rejecting the place of shareholders residence test because it is difficult to administer).

[37] *See infra* notes 89–131 and accompanying text (discussing the possible theoretical justifications for imposing income tax on corporations).

corporate taxation, as a legal model, is absolutely inefficient.[38] Corporate tax is the source of multiple behavioral distortions and is painful to administer. Yet, in spite of this, most jurisdictions *do* tax corporations. Although scholars fiercely debate why corporations are taxed, one thing is clear: it is *not* because corporate tax is an efficient model of revenue raising.[39] Corporate taxation must serve purposes other than efficiency.

Given this conclusion, it seems strange to advance a corporate tax residence definition based on efficiency arguments. If corporate tax is necessary, despite its inefficiency, why should the very basic qualification for the tax imposition be efficiency? If one's ideological aim is to advance efficiency, one could argue for the abolishment of corporate taxation altogether (and many do).[40] This is a perfectly valid and coherent argument. But adopting tax residence models simply because they are efficient, thereby disregarding the purposes of corporate taxation, could undermine such purposes. For instance, if one accepts that the purpose of corporate taxation is to impose tax burdens on corporate shareholders,[41] then it makes little sense to adopt the POI test, even though it is an efficient model of tax residence. The following example illustrates this contention.

Assume that Jurisdiction C ("C") does not impose corporate income tax, but does impose income tax on individuals. To avoid individual income taxes, residents of C regularly operate their businesses

---

[38] *See, e.g.*, *Tax Reform Options*, *supra* note 32, at 11 (statement of Reuven S. Avi-Yonah, Professor University of Michigan Law School); JANE G. GRAVELLE, THE ECONOMIC EFFECTS OF TAXING CAPITAL INCOME 75–90 (1994); Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1197–98 (2004) (describing the complications and transaction costs associated with corporate income tax, and its tendency to drive business owners away from their preferred form of organization); Yariv Brauner, *The Non-Sense Tax: A Reply to New Corporate Income Tax Advocacy*, 2008 MICH. ST. L. REV. 591, 592 (arguing that corporate income tax is "socially very costly and wasteful"); Roger H. Gordon & Jeffrey K. MacKie-Mason, *Tax Distortions to the Choice of Organizational Form*, 55 J. OF PUB. ECONS. 279, 304 (1994) (concluding that corporate tax treatment incentivizes corporations to become noncorporate and be owned by investors in extremely high personal tax brackets); Richard M. Bird, *Why Tax Corporations?* 1 (Technical Comm. on Bus. Tax., Working Paper No. 96-2, 1996) (describing the consensus among economists regarding the distortions created by corporate income tax).

[39] *See supra* note 38 and accompanying text.

[40] *See generally* U.S. DEP'T OF TREASURY, INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS (1992), http://www.treasury.gov/resource-center/tax-policy/Documents/Integration.pdf (providing a summary of the arguments for eliminating corporate taxation).

[41] *See infra* notes 168–177 and accompanying text (discussing that some corporate tax scholars adopt a position that corporate taxation serves as a proxy to tax a corporation's shareholders).

through closely held corporations. Instead of distributing the profits earned by their corporations—which would result in the imposition of individual income tax—C's residents retain their profits at the corporate level, where they remain untaxed.

C's policymakers are troubled by the loss of revenue resulting from corporate profit retention. In response, C's legislators enact a new law that taxes domestic corporations as a means of taxing the corporations' retained profits. In a sense, such a tax operates as a proxy to the taxation of C's residents, who hold equity in those domestic corporations.[42] Which corporate tax residence test should C adopt to achieve this goal?

If C adopted the POI test, the result would be efficient in the sense that no meaningful behavioral distortions would result. The new corporate tax would be unlikely to cause C's residents to change their behavior in any economically meaningful way. All that C's residents would have to do in order to keep avoiding the tax would be to accumulate their profits in corporations incorporated abroad, rather than in C. Incorporating abroad, in a low (or no) tax jurisdiction, is often an inexpensive practice that is merely a phone call away.[43]

This result makes C's corporate tax-residence test meaningless, specifically because it is based on the normative justification of efficiency, and particularly because efficiency is achieved. By adopting the most efficient model, C avoided behavioral distortions, but completely defeated the purposes for which C enacted corporate tax in the first place. C's residents can still avoid tax on retained profits.

To summarize, supporters of POI as the preferred model of corporate tax residence base their arguments on efficiency as a desirable normative value. This makes little sense in the context of corporate taxation because corporate taxes are apparently designed to achieve

[42] Some scholars argue that corporations are taxed in the United States for the very purpose of taxing the corporation's equity holders. *See* Steven A. Bank, *Entity Theory as Myth in the US Corporate Excise Tax of 1909*, *in* 2 Studies in the History of Tax Law 393, 394 (John Tiley ed., 2007) [hereinafter Bank, *US Corporate Excise Tax of 1909*]; Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 Wm. & Mary L. Rev. 447, 452 (2001) [hereinafter Bank, *Entity Theory as Myth*]; Steven A. Bank, *The Dividend Divide in Anglo-American Corporate Taxation*, 30 J. Corp. L. 1, 15–18 (2004) [hereinafter Bank, *The Dividend Divide*]. *But cf.* Avi-Yonah, *supra* note 38, at 1244–49 (arguing that in the United States corporate taxation functions primarily as a regulatory device on managers); Reuven S. Avi-Yonah, *Why Was the US Corporate Tax Enacted in 1909?*, *in* 2 Studies in the History of Tax Law 377, 387–92 (John Tiley ed., 2007).

[43] *We Set Up an Offshore Company in a Tax Haven*, NPR, (July 27, 2012, 6:04 PM) http://www.npr.org/blogs/money/2012/07/27/157499893/episode-390-we-set-up-an-offshore-company-in-a-tax-haven (illustrating the ease in which one could set up offshore companies by describing how simple it was for NPR staff to call to set up wholly owned corporations in tax havens).

purposes other than efficiency. As this Section has shown, determining corporate tax residence on efficiency considerations may operate against the policy purposes of corporate taxes.

3. RS and the Benefits Theory

The normative justifications for the RS test, like the normative justifications for the POI test, also operate against the policy purposes of corporate tax laws. Normative justifications for an RS test are difficult to distill, primarily because there are multiple subcategories of RS tests adopted by different jurisdictions.[44] All Commonwealth jurisdictions adhere, among other tests, to the CMC test discussed above.[45] Civil law countries look into multiple factors such as the place of effective management ("POEM") which is similar (and sometimes even viewed as identical) to CMC;[46] the "legal seat," which is indicated in registration documents or in the articles of association;[47] the place where the main

[44] Most jurisdictions that apply the RS test regard POI as a relevant factor in determining corporate tax residence. But unlike jurisdictions applying the POI test, foreign incorporation does not necessarily mean that a corporation is indeed "foreign." *See infra* note 47 and accompanying text.

[45] *See* Couzin, *supra* note 27, at 55–58 (discussing the adoption of the management and control tests by Commonwealth jurisdictions); *see also* Ault & Arnold, *supra* note 24, at 435 (noting that Commonwealth countries traditionally adhere to the central management and control test to determine corporate tax-residence).

[46] In most cases, POEM is the same as CMC. *See* HM Revenue & Customs, INTM 120210—Company Residence: Guidance Originally Published in the International Tax Handbook, § ITH348 (2010), *available at* http://www.hmrc.gov.uk/manuals/intmanual/intm120210.htm#IDA1ORZF (explaining the apparent differences between CMC and POEM and concluding that "it is not that easy to divorce effective management from central management and control and in the vast majority of cases they will be located in the same place"). The Organisation for Economic Co-operation and Development ("OECD") also adheres to the POEM, which it defines as "the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made." *See* OECD Comm. on Fiscal Affairs, Model Tax Convention on Income and on Capital, C-(4)8 (2010), *available at* http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-2010_9789264175181-en.

[47] *See, e.g.*, Tax Mgmt. (BNA) Portfolio 984-5th: *Business Operations in Spain*, pt. V, § A, at 2 (describing Spain, where one of the qualifying criteria for corporate tax residence is the place of "registered office"); Tax Mgmt. (BNA) Portfolio 985-4th: *Business Operations in Sweden*, pt. V, § A (describing Sweden, where a company "registered with the Swedish Companies Registration Office" is deemed a resident for tax purposes); Tax Mgmt. (BNA) Portfolio, 962-3rd, *Business Operations in Germany*, pt. V, § A, at 2 (describing Germany, where a corporation is a tax resident if, among other criteria, its statutory seat is in Germany).

economic activity of the corporation is carried on;[48] and the place of residence of shareholders.[49]

Notwithstanding the multiplicity of factors considered, justifications for different RS tests share a common theme: they all inquire into the factual connecting factors "between a company and the national territory of the State who wants to exercise its jurisdiction to tax that company . . . ."[50] This exercise is necessary, according to proponents of RS tests, because tax residence "*requires* a strong nexus with a country."[51] Under this line of substantive inquires, tax residence only arises where "there is some level of personal or locative connection that warrants, indeed, demands a high level of contribution to the public finances."[52]

These types of arguments are a succinct summary of benefits theories according to which taxation is justified as a means for financing public goods.[53] Implicit in this theory is that corporations, like individuals, benefit from government-created public goods, which in turn makes it fair for corporations to pay for those goods. Thus, determining the jurisdiction where the corporation enjoys public goods—although a fact-intensive test—is relevant.

The underlying assumptions in nexus-related arguments are that the corporation is the true beneficiary of government-created public goods, and that the corporate entity is a truly separate being from the individuals involved with it. Indeed, courts and scholars have occasionally analogized corporations to humans for purposes of making tax res-

---

[48] *See, e.g.*, Carlo Galli, Int'l Bureau of Fiscal Documentation, Corporate Taxation—Italy 26 (2013). In Italy, a corporation will be considered "domestic" for tax purposes if, among satisfaction of other criteria, it's main business purpose is in Italy for the greater part of the financial year. *Id.*

[49] Countries using some variation of the residence-of-shareholders test include, for example, Australia and Italy. *See infra* notes 108–109 and accompanying text; *see also* De Broe, *supra* note 27, at 95–99 (providing a summary of the different factual tests adopted by civil law jurisdictions).

[50] *See* Peter Behrens, *General Principles of Residence of Companies, in* Residence of Companies, *supra* note 27, at 3, 26–27; *see also* Pasquale Pistone, *EC Law and Tax Residence of Companies, in* Residence of Companies, *supra* note 27, at 183, 184–85.

[51] De Broe, *supra* note 27, at 95 (emphasis added).

[52] Couzin, *supra* note 27, at 2.

[53] *See* 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, 333–39 (2001) (providing a summary and critique of benefits analysis in the international context); 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, 225–33 (1995) (providing a summary and critique of benefits analysis).

idence arguments.[54] One commentator has even concluded that for tax purposes, a corporation, like a human, "resides in the place where it has the closest economic, political, cultural and legal links."[55]

Contemporary corporate tax theorists, however, generally agree that the "real-entity" view of corporations has little (if any) value in explaining why and how countries tax corporations.[56] Instead, it is generally understood that corporate taxes are an instrument to get into the pockets of, or affect the behavior of, certain individuals.[57] In addition, public finance empiricists seem to unanimously agree that "people, not corporations, pay taxes."[58] In short, the contemporary view is that taxes

---

[54] *See, e.g.*, Cesena Sulphur Co. v. Nicholson, [1876] 1 Exch. Div. 28 (App. Cas.) at 452 (Eng.); Matthew Collett, *Developing a New Test of Fiscal Residence for Companies*, 26 U. NEW S. WALES L.J. 622, 628 (2003). The court in *Cesena Sulphur* explained:

> The use of the word "residence" is founded upon the habits of a natural man, and is therefore inapplicable to the artificial and legal person whom we call a corporation. But for the purpose of giving effect to the words of the legislature an artificial residence must be assigned to this artificial person, and one formed on the analogy of natural persons.

Cesena Sulphur, 1 Exch. Div. 28 at 452; *see also* Collett, *supra*, at 628 (arguing that companies, like individuals, "have features which link them to particular jurisdictions," and that companies, like individuals, "consume public goods, benefit from the use of public infrastructure and have impacts on the environment . . . .").

[55] Collett, *supra* note 54, at 623; *see also* COUZIN, *supra* note 27, at 5 (arguing that corporate taxation theoretically requires the recognition of corporate personality and that nexus-based tests should therefore be formulated to tax corporations).

[56] Avi-Yonah, *supra* note 38, at 1209 (explaining why a real-entity view of corporate tax is "unpersuasive"); Bank, *Entity Theory as Myth*, *supra* note 42, at 466–67 (describing the traditional entity theory as "historically inaccurate").

[57] *See supra* note 42 and accompanying text (proposing that corporate taxation is best understood as a proxy to tax shareholders). Despite the fierce debate in corporate tax literature, it is generally agreed that individuals, not entities, carry the burden of corporate taxes. *See infra* note 58 (describing the literature that summarizes the debate about corporate tax incidence).

[58] Jack Mintz, *The Corporation Tax: A Survey*, FISCAL STUDIES, Nov. 1995, at 23, 23; *see also Does the Tax System Support Economic Efficiency, Job Creation, and Broad-Based Economic Growth?: Hearing Before the S. Comm. on Fin.*, 112th Cong. 82 (2011) (statement of Prof. Michael J. Graetz, Columbia Law School) (quoting Paul H. O'Neill while stating that "corporations don't pay taxes, they collect them"). There is an ongoing controversy regarding exactly which individuals bear the corporate tax burden. Generally, "corporate tax could be borne by some combination of the shareholders of corporations, investors in all capital through a decrease in the overall return to capital, workers through a decrease in wages, and customers through increased output prices." William M. Gentry, *A Review of the Evidence on the Incidence of the Corporate Income Tax* 3 (Dep't of the Treasury, Working Paper No. 101, 2007); *see* Alan. J. Auerbach, *Who Bears the Corporate Tax Burden: A Review of What We Know*, 20 TAX POL'Y AND ECON. 1, 1 (2006); Jennifer C. Gravelle, *Corporate Tax Incidence: A Review of Empirical Estimates and Analysis* 29 (Congr. Budget Office, Working Paper No. 2011-01, 2011).

imposed on corporations are eventually borne by real people, not by some imaginary entity.

If that is indeed the case, the attempt to analogize corporations to humans for purposes of tax residence determination is problematic. If the purpose of corporate taxation is to tax individuals, corporate tax residence tests (and any other corporate tax provision, for that matter) should be designed to ensure that the corporate tax is eventually translated into burdening the intended individuals. The "economic, political, cultural and legal links"[59] of the corporation are irrelevant. The relevant links are those of the individuals we seek to burden by way of taxing corporations in which such individuals hold interests.

To summarize, the dichotomy supporting current discussion on corporate tax residence determination seems tenuous. On one end of the spectrum, supporters of the POI test advance arguments about efficiency. Such arguments make little sense because efficiency does not support the very taxation of corporate entities in the first place. On the other side of the spectrum, RS supporters advance benefits theory-based arguments, which take a real-entity view of the corporation. The real-entity view of the corporation, however, has been unanimously rejected by corporate tax scholars. The bottom line is that the jurisdictional entry test to the corporate tax regime is supported by normative assumptions, which have been rejected in the context of justifying the corporate tax regime itself.

B. *The Importance of Corporate Tax Residence Determination Cannot Be Minimized*

This Section discusses the pragmatic approach to the perceived "meaningless" of corporate tax residence. The pragmatic approach suggests that adopting a territorial system of taxation would minimize the importance of residence determination for purposes of calculating tax liabilities, thus circumventing the meaninglessness of corporate tax residence. This Section shows, however, that despite its intention, the pragmatic approach does not avoid the meaninglessness of corporate tax residence.

1. The Pragmatic Approach: A Description

The failure to identify convincing normative bases for corporate tax residence leads some scholars to suggest that we should abandon

---

[59] *See* COUZIN, *supra* note 27, at 5; Collett, *supra* note 54, at 630.

the discussion altogether, or, at the very least, make tax residence unimportant for purposes of calculating tax outcomes.[60] This pragmatic approach takes the position that there is little sense in pursuing a normative justification for the tax residence of entities that are not themselves an intended target of tax policy.[61]

Even if some normative justification can be found, pragmatists argue that corporate tax residence cannot properly function as a legal construct because sophisticated taxpayers (and even not-so-sophisticated taxpayers) can easily manipulate corporate tax residence.[62] For example, POI residence tests can easily be avoided by incorporating in a foreign jurisdiction. Likewise, RS tests that consider the place of effective management of the corporation, such as CMC or POEM, can be avoided by ensuring that all important board meetings are conducted in a foreign country (which is commonly understood by tax practitioners to be the reason why airport hotels were invented).[63] The main thrust of the pragmatic argument is that any corporate tax residence test will be meaningless because it is elective, and thus subject to the whims of taxpayers.[64]

Pragmatists suggest that adopting territorial tax jurisdictions would solve the meaninglessness of corporate tax residence.[65] Adopting territorial tax jurisdiction arguably makes corporate tax residence irrelevant for purposes of calculating tax liabilities—thereby circumventing the

---

[60] *See* McIntyre, *supra* note 5, at 1571; Shaviro, *supra* note 5, at 385.

[61] Shaviro, *supra* note 5, at 395 (noting that "[a]fter all, corporations are not sentient beings, and cannot feel benefits or burdens. Thus, they are not directly of normative interest.").

[62] *See supra* note 5 and accompanying text (proposing that U.S. corporate tax residence is essentially elective).

[63] Until recently, board meetings were seen as the decisive factor for purposes of determining the place of management, as expressed in the previous version of the OECD tax-treaty model. *See* OECD COMM. ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 81 (2005) (proposing that "[t]he place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined"). In July 2008, however, the OECD neglected the "place of board meeting" presumption and adopted a much more nuanced (and less clear) test to determine the place of management: simply "facts and circumstances." *See* OECD COMM. ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 77 (2008) (stating that "[a]ll relevant facts and circumstances must be examined to determine the place of effective management").

[64] *See* McIntyre, *supra* note 5, at 1571; Shaviro, *supra* note 5, at 385.

[65] *See infra* notes 140–141 and accompanying text (discussing territorial tax jurisdictions within the context of U.S. tax reform).

issue of "meaninglessness" of corporate tax residence.[66] To be fair, proponents of a territorial system of taxation suggest multiple justifications to support territoriality. This Article argues, however, that the "meaninglessness" of corporate tax residence is not a convincing argument in this regard.

To understand how territorial taxation might theoretically avoid the meaninglessness of corporate residence, it is necessary to further refine the difference between global and territorial jurisdictions. Global tax jurisdictions (such as the U.S.) tax their domestic residents on their worldwide income from whatever source derived. Global tax jurisdictions, however, tax *foreign* corporations' income only to the extent that such income is derived from sources within such jurisdictions. Thus, corporate taxpayers have a great incentive to avoid being classified as "domestic residents" in global jurisdictions. Alternatively, territorial jurisdictions (such as most member states of the EU) tax only the profits derived within their territory, regardless of the foreign or domestic status of the corporate taxpayer. In such jurisdictions, the relevant issue for purposes of constituting taxing jurisdiction is not the residence of the taxpayer, but rather the geographical source of the taxable income.[67]

Hence, pragmatic commentators suggest that the solution to the meaninglessness of corporate tax residence is to adopt a territorial tax system.[68] By doing so, corporate tax residence is arguably irrelevant for purposes of calculating tax liabilities, and the issue of "meaninglessness" of corporate tax residence is avoided.[69]

2. Corporate Tax Residence Is Always Relevant

This Article argues that the course of action suggested by pragmatists fails to address the problem of tax residence's "meaninglessness" for two reasons. First, the concept of source is just as meaningless as the concept of residence. Second, residence remains important even in territorial jurisdictions.

---

[66] *See infra* notes 141–143 and accompanying text (rejecting the argument that changing from a global to a territorial system minimizes the importance of corporate tax residence).

[67] *See* Ault & Arnold, *supra* note 24, at 495–523 (providing a description of the principals of source-based taxation).

[68] See *infra* notes 140–141 and accompanying text.

[69] See *infra* notes 134–135 and accompanying text.

a. *"Source" of Income in Territorial Systems Is Just As Meaningless As "Corporate Residence" in Global Systems*

Assuming that what we care about is the "meaninglessness" of legal constructs, replacing the jurisdictional concept of "residence" with that of "source" is not a good solution. As multiple commentators have argued, the concept of source is just as meaningless as the concept of residence.[70] There is no unifying normative concept that justifies treating income as derived in one jurisdiction rather than another. For example, assume that a German distributor of a motion picture pays royalties to the U.S. studio that produced the film. What is the source of the royalty income? Is it Germany, where the film is screened and tickets are purchased? Is it the United States, where the film has been produced? What if all of the marketing activity for the screenings in Europe is handled by the studio's marketing department, located in Ireland? What if the protected content is owned by the studio's subsidiary, located in Bermuda? Just as there is no "real" physical residence for corporations, there is no "real" location where income is produced. With regards to "meaninglessness," all that a territorial system can theoretically achieve is the replacement of one meaningless legal concept with another.

b. *Residence Is Still an Important Concept in Territorial Systems*

The second argument against adopting a territorial system—that a territorial system does not avoid the meaninglessness of residence—is more important to address for purposes of this Article. Corporate tax residence is no less relevant for calculating tax liabilities in territorial jurisdictions than it is in global jurisdictions because, in many important instances, the source of income is determined by reference to the *residence* of corporate taxpayers.

---

[70] *See* Reuven S. Avi-Yonah, International Tax as International Law: An Analysis of the International Tax Regime 27 (2007) ("[T]he source of income is difficult to define. In fact, many public finance economists would claim that the concept lacks meaning in the majority of cases."); Michael P. Devereux, *Taxation of Outbound Direct Investment: Economic Principles and Tax Policy Considerations*, 24 Oxford Rev. Econ. Pol'y 698, 712–13 (2008) (discussing the difficulties in identifying the geographical source of income); Kleinbard, *supra* note 4, at 149 (noting that "[m]ore fundamentally, many scholars have concluded that the concept of 'source' ultimately is meaningless when applied to a wide range of group activities, particularly when one takes into account the theory of the firm, which emphasizes that multinational firms exist to capture unique groupwide synergies"); Lawrence Lokken, *What Is This Thing Called Source*, Int'l Tax J., May–June 2011, at 25, 25–26 (discussing the lack of general consensus of source rules, and suggesting unifying the criteria based on the type of income).

For example, assume that interest is received by Corporation M ("M Corp."), resident in Jurisdiction A, from its wholly owned subsidiary, Corporation N ("N Corp."), resident in Jurisdiction B. Assume further that Jurisdiction A is a territorial jurisdiction. In such a case, the interest received by M Corp. will be taxed to M Corp. in Jurisdiction A only to the extent the interest is sourced within Jurisdiction A.

Nevertheless, nearly all jurisdictions in the world determine the source of interest income by reference to the *residence* of the payor.[71] Because the payor in our example—N Corp.—is a corporation that is a foreign *resident* for tax purposes, the interest will be considered foreign-sourced from the point of view of Jurisdiction A, and will not be taxed in Jurisdiction A. Whether the interest is taxed in Jurisdiction A is dependent on the corporate tax residence determination of N Corp.

Similar source rules apply in almost all industrialized jurisdictions with respect to dividend payments (source is at the residence of the distributing corporation),[72] and the gains from the sale of capital assets, particularly, the stock of a corporation (source is at the residence of the seller).[73]

The determination of corporate tax residence is also critically important in territorial jurisdictions in the context of income shifting.[74] Income shifting is any tax planning strategy aimed at manipulating the jurisdiction in which income is reported, generally by manipulating the source of income. For instance, corporations that are members of the same control group and hold different residence status for tax pur-

---

[71] *See* Yariv Brauner, *An International Tax Regime in Crystallization*, 56 Tax L. Rev. 259, 281 (2002) ("The basic rule sources the interest income to the country of the payor . . . . Most countries consider the residence of the payor as the country of source.").

[72] *Id.* ("A powerful consensus also exists with respect to the source rules for dividends. They are sourced at the country of the dividends' payor, which allows the source country to get the 'first bite' of taxation."). In the United States, an exception applies where more than twenty-five percent of the gross income of a foreign corporation is effectively connected with a U.S. trade or business. *See* I.R.C. § 861 (2006).

[73] Ault & Arnold, *supra* note 24, at 539 (stating that "most countries generally accept the international treaty norm that capital gains on shares are taxable only in the residence country of the shareholder").

[74] Income shifting techniques involve the shifting of reported income from one jurisdiction to another, without shifting the economic attributes associated with the production of the income. If successful, then the income that is produced in developed markets (usually high-tax jurisdictions, which host the economic attributes of the production, such as the costumer-base), is reported in tax-havens, where the only thing present is a certificate of incorporation. *See generally* OECD, Action Plan on Base Erosion and Profit Sharing (2013), http://www.oecd.org/ctp/BEPSActionPlan.pdf (providing recent analysis of tax-base erosion resulting from income shifting techniques).

poses can easily manipulate the source of income by using certain types of intragroup payments.[75]

To illustrate, reconsider M Corp. (tax resident in Jurisdiction A) and N Corp., its subsidiary (tax resident in Jurisdiction B). If M Corp. is just a holding company, and all of the money-earning activity happens in N Corp., how can the profits reach M Corp.? N Corp. can simply distribute a dividend to M Corp., in which case the source of the income will be Jurisdiction B, because dividends are sourced to the residence of the payor. Alternatively, M Corp. can sell the stock of N Corp., in which case the income (which is attributable to the same economic activity by N Corp.) will be sourced to Jurisdiction A, because the source rule for income from the sale of capital assets (N Corp.'s stock) is the residence of the seller.

More complex income shifting strategies that involve intercompany sales debt and royalties are the bread and butter of many international tax practitioners. Importantly for our purposes, these schemes only work because some of the corporations involved in such strategies are *foreign*, while others are *domestic*. Accordingly, corporate tax residence determination remains very important even in sourced-based jurisdictions. Corporate tax residence issues are not avoided simply by adopting a territorial system of taxation.

c. *Common Responses to Income Shifting Do Not Minimize the Importance of Residence*

The solutions to the widely acknowledged problem of income shifting come in several forms, but they do not alleviate the need to determine the tax residence of the corporations involved. One type of solution to income shifting is to enact specific anti-abuse rules addressing specific types of income shifting transactions.[76] Such anti-abuse

[75] *See* Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX. REV. 699, 703 (2011) ("Stateless income is an inevitable by-product of fundamental international income tax norms, like the recognition of the separate tax personas of different juridical persons, even when they are commonly owned . . . .").

[76] *See, e.g.*, I.R.C. §§ 163(j), 482, 7701(1). The Internal Revenue Code and Department of the Treasury regulations contain multiple specific provisions to combat income shifting. For example, Section 482 of the Code and the regulations promulgated thereunder allow the IRS to target transactions between members of the same control group and reallocate income and deductions among the members if such transactions are structured to avoid taxes. *Id.* § 482. Section 163(j) of the Code and the regulations promulgated thereunder disallow interest deductions in certain cases of financing transactions between related parties. *Id.* § 163(j). Section 7701(l) and the regulations promulgated thereunder disregard certain entities in certain intragroup financing transactions. *Id.* § 7701(1).

rules target income that is shifted from "domestic" to "foreign" corporations in a manner that is perceived as abusive. Clearly, tax residence remains very relevant; the existence of "domestic" and "foreign" corporate taxpayers is sine qua non in the facilitation of such transactions.

A second solution to income shifting—widely adopted by most industrialized jurisdictions—is known as the "controlled foreign corporation" ("CFC") regime.[77] Under a CFC regime, domestic shareholders of a foreign corporation are taxed on income earned by such foreign corporation.[78] This tax applies regardless of whether the corporate earnings are distributed to the shareholders. Under a successful CFC regime, shareholders will have a hard time avoiding current taxation by accumulating profits in "foreign" corporations. But, all CFC regimes require—by definition—the determination that the "controlled foreign corporation" is "foreign." Hence, tax residence of corporate entities still plays an important role.

The third type of solution to income shifting is to simply try and define the tax residence of corporations in a "meaningful" way. When corporate tax residence is determined by using "substantive" considerations, it should prove difficult to set up a corporation that will be respected as "foreign" for tax purposes, thereby facilitating intragroup income shifting. For this reason, most territorial jurisdictions in the world have very well-developed RS tests for corporate tax residence.[79] The experience of territorial jurisdictions shows that the importance of tax residence in territorial jurisdictions is an actual issue faced by tax policymakers in territorial systems; it is not merely theoretical.

To summarize, in territorial jurisdictions the question of meaninglessness of corporate tax residence does not go away. One cannot min-

---

[77] *See* Brian J. Arnold, The Taxation of Controlled Foreign Corporations: An International Comparison 70–73 (1986) (describing the CFC regimes in various jurisdictions); Ault & Arnold, *supra* note 24, at 477 (noting that of nine countries surveyed, the Netherlands was the only nation that did not have a CFC regime in place). In the United States, the CFC regime is incorporated into what is commonly referred to as "Subpart F" of the internal Revenue Code. *See* I.R.C. §§ 951–965 (2006).

[78] *See, e.g.*, I.R.C. §§ 951–952, 954. In the U.S. tax scheme, Section 951 requires that "United States Shareholders" in "Controlled Foreign Corporation[s]" include as income all "Subpart F" income earned by the controlled foreign corporation, regardless of whether income is distributed to shareholders. *Id.* § 951. Subpart F income is generally income of passive nature (such as interests, dividends, and royalties) that can rather easily be shifted among members of the same control group. *See id.* §§ 952, 954.

[79] For example, most member countries of the European Union have a territorial, or territorial-like, system to tax corporations. Despite this, scholars still analyze corporate tax residence issues in the European Union. *See generally* Residence of Companies, *supra* note 27 (discussing the various corporate tax residence issues within the European Union member states).

imize the importance of corporate tax residence in calculating tax liabilities simply by adopting a territorial system of taxation.

II. Developing a Purpose-Driven Model of Corporate Tax Residence

Part I demonstrated that the normative debate on corporate tax residence does not provide useful guidance for the formulation of corporate tax residence models. Additionally, it showed that making tax residence "less relevant" through a pragmatic approach is not a viable solution either. Part I concluded that the "meaninglessness" of corporate tax residence exists because the current debate is largely disengaged from the purposes for which jurisdictions tax corporations.

This Part suggests that a proper remedy must force an engagement between corporate tax residence models and the policy purposes that justify the taxation of corporate entities. Accordingly, corporate tax residence discussion should be functional. The idea is to design corporate tax residence models that support the basic founding policies of corporate tax laws. Part II describes this idea in what this Article terms as the "functional approach."

Section A of this Part discusses the functional approach to corporate tax residence generally. Then, Section B describes the necessary assumptions on which such an approach relies. Lastly, Section C discusses how the functional approach operates.

A. *The Functional Approach As the Solution to the Meaninglessness of Corporate Tax Residence*

Elements of the functional approach have already been raised by other scholars. Yet no scholars have done so in an attempt to create a new coherent approach for corporate tax residence, as this Article does. For example, Michael McIntyre suggests that the remedy for taxpayers' de facto electivity of corporate tax residence is "to define corporate residence in terms of the function that residence taxation is intended to serve in a corporate income tax."[80] McIntyre assumes that "corporate tax is a tax on the income that shareholders have derived through their ownership interests in corporations,"[81] and explains his functional idea as follows: "To be successful in imposing and collecting a residence tax on corporations, a country must define 'residence' in a

[80] McIntyre, *supra* note 5, at 1570.
[81] *Id.* at 1571.

way that is not easily avoided."[82] He contends that "[a] legal standard for defining residence would focus on meaningful links that a corporation could not surrender without significant dislocations."[83]

Although McIntyre's idea is stated as functional, it is not truly functional in the sense that this Article refers to it, for three important reasons. First, McIntyre assumes that there is a single purpose for corporate taxation—the taxation of shareholders. Such an assumption is problematic because corporate tax theorists have suggested multiple purposes to be served by corporate taxation beyond the taxation of shareholders.[84]

Second, it is not clear how McIntyre's purpose of "taxing shareholders" translates into "meaningful links" of the *corporation* to the jurisdiction. If the purpose is to tax shareholders, why not have a corporate residence test that is dependent on the "meaningful links" of the *shareholders* to the jurisdiction? After all, according to McIntyre, corporate tax policy intentionally targets them.

Third, the reference to "meaningful links" seems simply to be a restatement of the normative preference towards the real seat ("RS") test. McIntyre's approach seeks to combat tax avoidance enabled by the apparent electivity of corporate tax residence. Such an approach assumes that electivity is bad. It assumes that there must be good reasons why we want to tax certain corporations in one jurisdiction, even though they "elect" to be residents in another. This is simply a different formulation of the RS test, as justified by benefits theory-based arguments.

Other commentators have occasionally made explicit functional arguments to support specific residence tests.[85] This Part addresses a few of these arguments. Such arguments, however, have been made sporadically, have assumed a single purpose for corporate taxation, and have not been made as part of an attempt to develop a cohesive model of corporate tax residence, as this Article does.

B. *Assumptions of the Functional Model of Corporate Tax Residence*

This Article's suggested functional approach to corporate tax residence rests on three important assumptions. The first is that the juris-

---

[82] *Id.*

[83] *Id.* at 1572.

[84] *See infra* notes 89–132 and accompanying text (discussing the various theoretical reasons why jurisdictions tax corporations).

[85] *See infra* notes 89–132 and accompanying text.

diction at issue is a residence-based jurisdiction. The "meaninglessness" of corporate tax residence has been constantly used to justify abandoning worldwide taxation in favor of territorial taxation. Because one explicit purpose of this Article is to argue that such "meaninglessness" does not support abandoning residence-based taxation, the model is developed in a residence-based context.

The second assumption is that various jurisdictions impose corporate income tax for various reasons.[86] Multiple commentators have suggested multiple justifications for the imposition of corporate taxes, and different justifications have seemingly gained various levels of traction in different jurisdictions.[87] Thus, the purpose of this Article's model is not to develop a single "best" corporate tax-residence test. In fact, the model rejects the "best-test" approach and instead provides a blueprint for constructing a tax residence model out of various available legal building blocks. The "correct" model to adopt can be "formal" or "substantive" depending on the purpose one seeks to achieve in taxing corporations. But being "formal" or "substantive" has no inherent value.

Third, the model assumes that it is plausible that within each jurisdiction there can be multiple reasons, beliefs, and policy purposes that support the taxation of corporations, and that such policy purposes may compete with each other. Corporate tax residence models are assumed to be a legislative outcome of political compromise and consequently heavily embedded in local contexts.[88]

C. *Constructing a Functional Model of Corporate Tax Residence*

This Section outlines a single-purpose driven functional approach to corporate tax residence. As an initial theoretical step, the assumption is that corporate taxes are imposed in each jurisdiction for one reason only (though different jurisdictions may adopt different policy choices), and questions the best functional tests under this (unrealistic) assumption.

This Section assumes and accepts the policy purposes suggested by scholars as a justification for the imposition of corporate taxes. This Section need not delve into the lively debate about which theory of corporate taxation is best. In the context of each suggested corporate

---

[86] *See* Omri Y. Marian, *Meaningless Comparisons: Corporate Tax Reform Discourse in the United States*, 32 Va. Tax Rev. 133, 189–91 (2012) (discussing the possibility that different jurisdictions tax corporations for different reasons).

[87] *See infra* notes 89–133 and accompanying text.

[88] *See infra* notes 134–135 and accompanying text (discussing the influence that context has on formulating corporate tax residence tests).

tax residence test, this Section notes possible critiques of such tests and suggests functionally oriented responses to such critiques. It shows that the critiques lose much traction when confronted with a functional, rather than a normative, perception of corporate tax residence.

1. Taxing Shareholders: Ownership Test

The question of the theoretical justification of corporate taxation is a controversial one. Multiple justifications are suggested. The first and most common justification views corporate tax as a proxy to the taxation of shareholders.[89] The reasoning underlying this justification is that, "[w]ithout a corporate tax, high income individuals could channel funds into corporations, and, with a large part of earnings retained, obtain lower tax rates than if they operated in partnership or proprietorship form or in a way that allowed them to be taxed as such."[90]

Considering such justification, the most obvious functional proxy for residence determination of a corporation is the residence of its ultimate shareholders.[91] Indeed, several commentators have supported the adoption of corporate tax residence models that are dependent on the residence of the majority of shareholders, explicitly because such tax residence tests are expected to function as an instrument for the taxation of those shareholders.[92]

The main objection to such a model is based in administrative concerns. For example, an ownership test in the U.S. context has been rejected by one scholar because a bright line rule that considers the majority of shareholders is "hard to reconcile with the fact that publicly traded companies' stock may frequently change hands . . . ."[93]

---

[89] *See* Kleinbard, *supra* note 4, at 159–60 ("[The] most coherent theory for the existence of a corporate income tax is that it serves as a substitute for the imposition of current tax on the firm's owners . . . .").

[90] Jane G. Gravelle & Thomas L. Hungerford, Congressional Research Serv., Corporate Tax Reform: Issues for Congress 4 (2007).

[91] *Task Force on International Tax Reform*, *supra* note 2, at 748 ("An alternative approach is to analyze the corporation as an economic agent acting for its shareholders. . . . This would lead one to favor a test that determined the residence of the corporation based on the residence of the corporation's shareholders.").

[92] Robert A. Green, *The Future of Source-Based Taxation of the Income of Multinational Enterprises*, 79 Cornell L. Rev. 18, 70–74 (1993); Kleinbard, *supra* note 4, at 160.

[93] Shaviro, *supra* note 5, at 415; *see also Task Force on International Tax Reform*, *supra* note 2, at 753 (stating that "it would appear administratively difficult to apply the [shareholder composition] test in the context of publicly-traded corporations").

The objection to ownership-based determination is not difficult to overcome for several reasons. First, implicit in this objection is an assumption that we only care about the tax residence of publicly traded entities. This may be the case in the United States,[94] but not necessarily in other jurisdictions. If one seriously believes that the true goal of corporate tax is to tax shareholders of *all* corporations, then there is no problem in applying the shareholder ownership test to privately owned entities.

Second, even in the context of publicly traded entities, the frequent trading of a corporation's stock is not necessarily problematic. The concern, presumably, is the headache that will be generated by the possibility that any given traded entity will continuously shift from foreign to domestic tax status.[95] This concern must be addressed in the context of public trading characteristics in any particular market. For example, U.S. residents own eighty-seven percent of the aggregate value of firms traded on U.S. stock markets.[96] Based on this piece of data, one scholar concludes that in some circumstances, it is theoretically sound to impose income tax on firms that are overwhelmingly owned by U.S. persons.[97]

Thus, although the stock of entities traded on U.S. exchanges frequently changes hands, U.S. markets' ownership data strongly implies that stock usually changes hands between *all-U.S. parties*. Assuming corporate tax residence determination follows the residence of the majority of shareholders, it is hard to imagine a frequent occurrence of tax residence change. If, on average, eighty-seven percent of the stock is owned

[94] *See infra* note 167 and accompanying text (detailing how publicly traded corporations are the only entities treated as per se corporations for tax purposes under the United States' "check the box regulations").

[95] One could also raise an issue of identifying who the shareholders are. In the current tax-reporting environment, however, this is not a terribly difficult task. Individuals who trade listed securities typically do so through accounts in financial institutions. Such institutions typically must identify and keep record of the tax-residence of the account owners. *See* 26 C.F.R § 1.441-1(b)(2) (2012) (describing the regulations for individuals). The identification requirement also applies to foreign financial institutions. *See* I.R.C. §§ 1471–1474 (2006).

[96] Kleinbard, *supra* note 4, at 159. The eighty-seven percent figure is still current; another study suggested that as of 2012, international investors owned as little as thirteen percent in U.S. equities. *See* Joe Weisenthal, *Chart of the Day: Here's Who Owns the Stock Market*, BUS. INSIDER (Nov. 30, 2012, 2:28 PM), http://www.businessinsider.com/heres-who-owns-the-stock-market-2012-11.

[97] Kleinbard, *supra* note 4, at 159–60 (explaining how this conclusion is warranted if the jurisdiction determines that corporate income tax is best justified as a substitute tax on U.S. individual owners and that taxing U.S. individuals on their worldwide income is appropriate).

by U.S. residents, more than thirty-seven percent of the stock will have to change hands *from U.S. to foreign shareholders*, in order for the corporate tax residence to be affected.[98]

Additionally, the concern of frequent changes in tax residence could be ameliorated by making ownership determinations on a time-average basis. For example, a corporation could be considered a resident in a jurisdiction in which an average majority of its shareholders resided over a period of three years. Thus, even if a significant amount of corporate stock changes hands from U.S. to foreign shareholders, the corporation will become foreign only if the foreign shareholders hold the stock for a significant period of time.

Third, overcoming the objections to ownership-based determination is possible because most countries' tax systems already use legal models that "look through" corporations to determine beneficial ownership for tax purposes. One such model, adopted by almost all industrialized jurisdictions, is the controlled foreign corporation ("CFC") regime.[99] Although CFC regimes vary in composition and complexity, they all share a common theme: preventing domestic taxpayers from avoiding current taxation by channeling income through foreign-owned corporations, thus deferring gain recognition until income is repatriated to the home jurisdiction (this practice is known as "deferral").[100] Jurisdictions adopting CFC regimes (including the U.S.) "look through" corporate structures to determine the ultimate beneficial owners of foreign corporations.[101] If a foreign corporation is ultimately found to be majority-owned by certain residents of the taxing jurisdiction, some or all of the corporation's income is deemed distributed to the domestic residents. Thus, such income is taxed to the shareholders.[102]

CFC ownership-determination models can be used not only to determine specific tax consequences, but also to determine corporate tax

---

[98] *See id.*

[99] Avi-Yonah, Sartori & Marian, *supra* note 5, at 160 (discussing the proliferation of CFC regimes).

[100] *See* Kleinbard, *supra* note 75, at 718–22 (describing how deferral regimes reduce effective tax rates).

[101] *See* I.R.C. § 958 (2006) (providing the ownership attribution rules for CFC purposes). One example of such a "look through" rule is a provision found in most U.S. tax treaties that provides for a limitation of benefits. *See*, U.S. Dep't of Treasury , United States Model Income Tax Convention of November 15, 2006, art. 22, ¶¶ 2(c), 2(e), 3(c) (outlining certain beneficial ownership rules in order to determine whether corporations are entitled to enjoy treaty benefits).

[102] *See* I.R.C. §§ 951–957.

residence. One scholar, Daniel Shaviro, objected to such an idea because it "would amount in practice to repealing deferral . . . ."[103] This argument, although theoretically correct, does not negate a functional view of corporate tax residence. An argument against deferral is an argument about how the U.S. should *substantively* tax multinational corporations, and not about how the U.S. should *functionally* determine their tax residence. Shaviro's argument takes a position that deferral is a good thing, even though it operates against worldwide residence-based taxation.[104] But if one accepts the argument that current worldwide taxation of U.S. residents is desirable, then Shaviro's response amounts to an objection to an ownership test because it actually achieves the desired result. Thus, Shaviro's objection does not respond to the functionality of the ownership test to the extent the purpose is actually to tax shareholders on a worldwide basis. At most, it argues against the purpose the ownership test intends to serve.

Lastly, some jurisdictions actually consider corporate ownership explicitly for purposes of making corporate tax residence determinations. Such models may provide comparative guidance. The most striking example is the U.S.'s anti-inversion rules in Section 7874 of the Code. Section 7874 of the Code was added as part of the Job Creation Act of 2004, with the aim of combating expatriation (or "inversion") of U.S. corporations.[105] Section 7874 is discussed further below,[106] but the pertinent fact for now is that under Section 7874, if after an "inversion transaction" at least eighty percent (in vote and value) of the stock of a foreign-incorporated entity is owned by shareholders of the inverting U.S. corporation, the foreign corporation is treated as a domestic corporation for U.S. tax purposes.[107] Thus, an explicit model for corporate tax residence determination based on ownership is already found in the Internal Revenue Code, and there is no need to stray far in search of a model.

Other jurisdictions have also adopted ownership-related tax residence models. For example, a company conducting business in Australia will be deemed a resident of Australia for tax purposes if the shareholders that control at least fifty percent of its voting power are

---

[103] Shaviro, *supra* note 5, at 415.
[104] *See id.* at 416–17, 427.
[105] *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004).
[106] *See infra* notes 141–152 and accompanying text.
[107] I.R.C. § 7874(b) (2006).

Australian residents.[108] In Italy, a foreign-incorporated corporation that holds a majority interest in Italian entities, and is also majority-owned by Italian residents, is presumed to be a resident in Italy for tax purposes.[109] Although such models may or may not provide constructive guidance to other countries, they are certainly worth considering before dismissing an ownership test as non-administrable.

2. The Benefits of Incorporation: The Place of Incorporation

Another possible justification for the imposition of corporate income tax considers that the operation in a corporation confers certain benefits to shareholders, such as limited liability, transferability of interests, and so on. This justification views corporate tax, therefore, as a fee paid in consideration for these benefits.[110]

Most U.S. scholars reject this idea as having an explanatory value for understanding the origins (or ongoing existence) of U.S. corporate taxation.[111] Indeed, the U.S. effectively collects corporate tax only from publicly traded corporations, while most other entities that confer limited liability to their owners are effectively exempt from corporate taxation.[112] That is not the case, however, in many other countries. In Japan (until recently a residence-based jurisdiction),[113] most business entities that confer limited liability to their owners are subject to corporate tax (including certain limited liability partnerships). Similarly, in France, partnership profits attributed to limited partners are taxed at the partnership level. Accordingly, it seems that the benefits-of-incorporation function of corporate taxation is still plausible in some jurisdictions.

In such cases, the functional tax residence test is the place of incorporation ("POI"). "[T]he [POI] test seems to rely on the notion that a corporation is able to earn income by virtue of being a juridical entity, in that it derives its income-earning capacity from the granting of

---

108 *See* Michael Dirkis, *Australia*, *in* RESIDENCE OF COMPANIES, *supra* note 27, at 311, 324–29 (discussing the ownership-presumption model adopted in Australia).

109 *See* Mario Tenore, *Italy*, *in* RESIDENCE OF COMPANIES, *supra* note 27, at 519, 540–44 (discussing the ownership-presumption model adopted in Italy).

110 Avi-Yonah, *supra* note 38, at 1205–06; 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, 564–67 (2005).

111 *See* Avi-Yonah, *supra* note 38, at 1209 (explaining the reasons why a real-entity view of corporate tax is "unpersuasive"); Bank, *Entity Theory as Myth*, *supra* note 42, at 465–67.

112 Partnerships, limited liability companies, and "subchapter S" corporations are generally exempt from entity-level taxes.

113 *See* Marian, *supra* note 86, at 174–77, 194 (discussing Japan's 2007 tax system reform from a global to territorial system).

its charter."[114] It follows that "[t]he jurisdiction granting the charter and investing the entity with the legal capacity to earn income then has the right to tax that income when it arises."[115]

The main objection to the POI test is that it is extremely easy to manipulate.[116] For example, one could easily avoid taxation by simply incorporating outside the home jurisdiction.[117]

From a functional point of view, however, the objection to the POI test is not necessarily problematic. Once a corporation is incorporated under the laws of some other "foreign" jurisdiction, the assumption that the corporation is able to earn income by virtue of the charter granted by the "domestic" jurisdiction no longer stands. Thus, to the extent one subscribes to the theory that corporate taxation is a fee for the benefits of corporate law, one could not seriously argue against non-taxation if taxpayers elect out of these benefits.

3. Corporate Tax As Regulation: Two Options

a. *Regulation as a Democratic Argument: POEM/CMC*

One interest justifying corporate taxation as a regulatory device is the promotion of democratic principles. Reuven Avi-Yonah argues that U.S. corporate taxation was originally justified "as a means to control the excessive accumulation of power in the hands of corporate management . . . ."[118] Specifically, Avi-Yonah argues that excessive power in the hands of corporate management hinders the proper function of a liberal democratic polity.[119]

One logical inference would be to adopt a residence test that depends on Place of Effective Management ("POEM") or Central Management and Control ("CMC"), namely, tests that depend on the place

---

114 Tillinghast, *supra* note 4, at 259.

115 *Id.*

116 *Task Force on International Tax Reform*, *supra* note 2, at 747 (noting that "[t]he place of organization test also provides taxpayers with a substantial amount of electivity in terms of deciding whether to subject the relevant corporation . . . to the U.S. tax regime applicable to domestic . . . corporations.").

117 *See, e.g.*, Kleinbard, *supra* note 75, at 706–13 (describing a tax scheme known as the "Double Irish Dutch Sandwich" where foreign incorporation plays a key role in reducing U.S. tax liabilities); Reuven S. Avi-Yonah, Beyond Territoriality and Deferral: The Promise of "Managed and Controlled" (Aug. 2011) (Univ. of Mich. Law Sch., Working Paper No. 248) (suggesting that the CMC test remains necessary to combat tax evasion).

118 Avi-Yonah, *supra* note 38, at 1249.

119 *Id.* at 1244.

of actual management (both tests will be referred to herein as CMC).[120] If such tests are adopted, then corporate tax works to counterbalance the managers' excessive accumulation of power gained through transacting business in the jurisdiction by taxing the gains from such business.

Two main objections are frequently raised against the CMC test. The first is that it is difficult to administer, and essentially elective. Sophisticated managers could carefully plan their circumstances so as to be deemed managing and controlling a corporation from a foreign jurisdiction.[121]

This argument is unpersuasive. The CMC test is the one corporate tax residence model that has been tested in multiple jurisdictions and has endured more than a century of extreme shifts in global socioeconomic structures, including the world-sweeping reforms of tax systems.[122] The CMC test was adopted by the U.K. over 150 years ago, and since then, variants of the test have been adopted by all Commonwealth jurisdictions, as well as many Organisation for Economic Co-operation and Development ("OECD") member countries.[123] Although the CMC test has certainly undergone variations, its main principle, as articulated

---

[120] Theoretically, one could also argue that managers are most powerful in the jurisdiction where most corporate assets and capital are located, which could be different from the jurisdiction in which managers reside. This option is not explored in this Article, but would presumably call for a residence test that is based on the place where the economic activity of the corporation resides. This could be determined by formulary apportionment that allocates the economic attributes of a corporation among jurisdiction. Formulary apportionment is traditionally understood to be a proxy for the source of income. In such a case, however, it would be used to determine residence. *See generally* Kimberley A. Clausing & Reuven S. Avi-Yonah, *Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment* (Brookings Inst., Hamilton Proj., Discussion Paper No. 2007-08, 2007), http://www.brookings.edu/~/media/research/files/papers/2007/6/corporatetaxes%20clausing/200706clausing_aviyonah.pdf (discussing formulary apportionment in the context of reforming the U.S tax system).

[121] *See supra* notes 62–63 and accompanying text.

[122] In the 1980s, the world underwent a so-called "world tax reform." During this period, multiple countries reformed their corporate tax systems by reducing tax rates and expanding the corporate tax-base. *See generally* WORLD TAX REFORM: CASE STUDIES OF DEVELOPED AND DEVELOPING COUNTRIES (Michael J. Boskin & Charles E. McLure, Jr., eds., 1990) (describing tax reforms, or tax reform proposals and debates, that occurred in Australia, Canada, Israel, Japan, Sweden, the U.K., China, Colombia, Indonesia, the U.S., and Mexico during the 1980s).

[123] *See* COUZIN, *supra* note 27, at 56–57. *See generally* John F. Avery Jones, *Corporate Residence in Common Law: The Origins and Current Issues*, *in* RESIDENCE OF COMPANIES, *supra* note 27, at 121 (discussing the origins, durability, and proliferation of the CMC tests); John F. Avery Jones, *Jurisdiction to Tax Companies: The Influences of the Jurisdiction of the Courts and of European Thinking*, *in* 4 STUDIES IN THE HISTORY OF TAX LAW 163 (John Tiley ed., 2010) (same).

in the 1906 decision by the House of Lords in *De Beers Consolidated Mines, Ltd. v. Howe*,[124] is cited to this day.[125] CMC models have been implemented and administered successfully by multiple jurisdictions.

Admittedly, when constructing a comparative legal model for purposes of one's own jurisdiction, one must question if a model adopted widely in other jurisdictions is indeed the same model in all such jurisdictions, or if local variants actually transformed it into various different models.[126] One also has to question if a widely adopted model can necessarily be implemented in a particular jurisdiction, given each target jurisdiction's unique circumstances.[127] At least as a heuristic device, however, the fact that CMC is widely and successfully implemented implies that it warrants serious consideration, rather than dismissal for fear of administrative difficulties.

The second argument against a CMC test has been discussed above and is associated with the positive externalities that are created by locating corporate headquarters within a particular jurisdiction.[128] That is, adoption of a CMC test creates tax costs on locating headquarters in the jurisdiction. This scheme incentivizes corporations to locate their headquarters elsewhere, resulting in the loss of the positive externalities.

This argument, however, assumes that individual managers are willing to physically move to another jurisdiction just to save money for a corporation (in which they do not necessarily own any equity). Based on practical experience, it is hard to convince managers to relocate. For a person to be willing to move to a new jurisdiction, the new jurisdiction must be appealing. Such a place would need to be a jurisdiction that is preferably geographically close to the manager's home jurisdic-

---

[124] De Beers Consol. Mines, Ltd. v. Howe, [1906] A.C. 455 (H.L.) (appeal taken from Eng.). Many regard the *De Beers* decision as the true birth of the CMC test. *See, e.g.*, McIntyre, *supra* note 5, at 1569 (referring to *De Beers* as "seminal"); Christiana HJI Panayi, *United Kingdom*, *in* RESIDENCE OF COMPANIES, *supra* note 27, at 817, 827 (referring to *De Beers* as "the landmark case").

[125] *See* HM REVENUE AND CUSTOMS, ITNM120060—COMPANY RESIDENCE: THE CASE LAW RULE—CENTRAL MANAGEMENT AND CONTROL, § INTM120060 (2010), *available at* http://www.hmrc.gov.uk/manuals/intmanual/intm120060.htm.

[126] *See* Omri Y. Marian, *The Discursive Failure in Comparative Tax Law*, 58 AM. J. COMP. L. 415, 432–35 (2010) (discussing the cultural approach to comparative law that rejects the assumption of similarities in social problems and legal solutions).

[127] Anthony C. Infanti, *The Ethics of Tax Cloning*, 6 FLA. TAX REV. 251, 319–36 (2003) (discussing the challenges of legal transplantation or "cloning" of tax models from one jurisdiction to another).

[128] *Tax Reform Options*, *supra* note 32, at 44–47 (statement of James R. Hines, Jr., Professor, University of Michigan Law School); Shaviro, *supra* note 5, at 414.

tion, relatively developed so as to be attractive to individuals, and contain very low corporate taxes.

Most low-tax jurisdictions are not appealing for long-term residence as they are largely tax havens with no real infrastructure. In the context of U.S. tax planning, for example, many intracompany tax-induced transactions involve the pocketbook incorporation of entities in tax havens such as the Cayman Islands. Such transactions only work because these pocketbook entities' foreign status is respected. If the U.S. were to adopt a CMC test, managers would actually have to move to such jurisdictions for the entities to maintain their foreign status. It is hard to believe U.S. based CEOs, CFOs, and board members would pack up in the thousands, take their families with them, and move to the Cayman Islands just to change their corporation's residence. There may be a few cases of this sort, but this "negative incentive" argument is not necessarily a cause for major concern.[129]

The problem of relocation, however, may be more acute in the EU. For example, any board-member of a U.K. company has a nearby industrialized jurisdiction which is culturally similar to the U.K. and with very low taxes—Ireland. Similarly, a German board member might find Luxemburg appealing. The bottom line is that the negative incentive argument must be contextualized.

A second response to the concern about CMC-driven corporate migration is a direct derivative of a functional view of corporate tax residence. Even if some managers were to leave the jurisdiction that adopted a CMC test, this is not a cause for concern under a functional view. In such a case, the functional justification to tax the expatriating corporation would be lost. Because the managers are no longer residents of the jurisdiction, the democratic argument no longer justifies the regulation of such managers. In this context then, non-taxation is the correct result.

If one is still concerned about management expatriation, it might be because the *real* reason for taxing corporation is not to regulate managers, but some other reason. In the alternative, it can simply be the case that corporate tax rates are set at uncompetitive rates. In such

---

[129] Other commentators have suggested that the concern that management will expatriate under a CMC regime is overstated. *See, e.g.*, Kirsch, *supra* note 110, at 574 (finding the relocation of corporate management to places outside of the United States unlikely because "key management personnel might object to being uprooted from their long established homes in the United States"); Avi-Yonah, *supra* note 117 (suggesting that the CMC test would deter tax planning because it would force managers to manage U.S. firms from abroad).

a case, the correct response is to reduce corporate tax rates, and not to create a loophole in the tax base in the form of a dysfunctional tax residence test.

b. *Regulation of Capital Markets: Place of Listing*

Another regulatory argument for corporate taxation is that it can enhance corporate governance in public corporations. Under this argument, "corporate tax is necessary because otherwise the agency-cost problem will be exacerbated when management . . . face a different tax rate for corporate actions than some shareholders."[130] If such arguments are persuasive, a tax residence test must capture corporations where such problems arise, namely public corporations that list their securities in the jurisdiction concerned with such corporate governance issues.[131]

The functional tax residence test that supports such a purpose would be in the place where the corporate securities are listed. Under such a test, all (and only) the entities that display these agency problems would be captured under the tax.

It is possible that different residence tests would be adopted for purposes of defining the tax residence of non-publicly traded entities in which agency costs are not commonly a cause for concern. If non-publicly traded corporations are still subject to corporate taxation in a place of listing jurisdiction, it is hopefully because there are other policy purposes that justify their taxation as well.

The main objection to a place of listing test is that it puts the local exchanges at a disadvantage by creating a tax cost for trading in such exchanges. The same functional counterargument applies here, as in the case of objections for using POI and CMC tests. If a company elects

---

[130] Avi-Yonah, *supra* note 38, at 1208; *see* Jennifer Arlen & Deborah M. Weiss, *A Political Theory of Corporate Taxation*, 105 YALE L.J. 325, 327 (1995) (noting that the "resilience of the corporate tax is a manifestation of the most enduring source of problems in corporate law, the separation between ownership and control of large corporations"); Hideki Kanda & Saul Levmore, *Taxes, Agency Costs, and the Price of Incorporation*, 77 VA. L. REV. 211, 229–31 (1991) (describing, by way of example, the agency cost problem that may arise in public corporations).

[131] Depending on market structures, agency problems vary across jurisdictions. In concentrated markets, agency issues arise as conflicts between majority and minority shareholders. In dispersed markets, however, conflicts may arise between managers and public shareholders. The U.S. system of corporate taxation operates in a dispersed market, whereas other OECD countries have concentrated markets. *See generally* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999) (employing data on ownership structures to demonstrate that in countries lacking strong shareholder protection, there are few firms that are widely held by shareholders).

out of the exchange, the agency costs are no longer of a concern for the jurisdiction, and need not be regulated via corporate taxation. Some may still be concerned, however, for competitive reasons. In such a case, the solution—like in the case of CMC—would be to lower corporate tax rates, rather than to "punch loopholes" in the corporate tax base in the form of adopting dysfunctional residence tests.

4. Access to Liquid Capital: Place of Listing

The last theory of corporate taxation this Article discusses views the imposition of corporate tax as a fee paid for the access to liquid capital.[132] According to this justification, the main benefits of operating in a corporate form are the abilities to raise capital from the public and to efficiently liquidate securities. Thus, corporate taxation is the fee imposed on shareholders and managers in publicly traded corporations in return for such benefits. Such a view would clearly call for the determination of corporate tax residence based on the place where the securities are listed.

The theory that corporate taxation is the fee for liquidity benefits also provides a response to the critique that a place of listing test would discourage listing. Presumably, corporate managers base their decision of where to list on multiple considerations. They are buying into a product (the public exchange) that includes, for example, access to investors and to a specific scheme of securities regulations. If the price the managers have to pay includes corporate taxes, they will factor that into their cost analysis. To the extent managers eventually decide not to list in one jurisdiction but instead to list in another, it means that they have reached a conclusion that the cost of listing in the first jurisdiction is too high. As in any market, the manufacturer of the product (i.e., the jurisdiction of the exchange) can do one of two things: improve the product to justify the price, or reduce the price to match the quality of the product. If one takes seriously the view that taxation is the price managers and shareholders pay to raise capital and quickly liquidate securities, then it makes no sense to dismiss place of listing because it creates costs—we want it to create costs! Paying the jurisdiction for creating the public market is the very reason to collect corporate tax under this view.

---

[132] *See, e.g.*, Calvin H. Johnson, Commentary, *Replace the Corporate Tax with a Market Capitalization Tax*, 117 Tax Notes 1082, 1084 (2007); Rebecca S. Rudnick, *Who Should Pay the Corporate Tax in a Flat Tax World?*, 39 Case W. Res. L. Rev. 965, 1099 (1989).

If corporate taxes discourage listing, it means that either corporate taxes are set at uncompetitive rates, or that the product (such as the securities regulation scheme) needs improvement. It does not make sense to deal with such issues by adopting a dysfunctional tax residence model.

III. Possible Critiques of the Functional Approach

There are three types of possible critiques to using the functional approach in the design of corporate tax residence models. The first two critiques are that functional models are difficult to administer and that they create negative incentives. Section A of this Part discusses these critiques and dismisses them. The third critique is that functional models fail to consider that jurisdictions tax corporations for multiple reasons. Section B responds to this third critique.

A. *Administrative Difficulties and Disincentives Do Not Negate the Functional Approach*

1. Administrative Difficulties

One might argue that adopting some of the models suggested by the functional approach may create certain administrative difficulties. This type of critique targets the specific models suggested and not at the functional approach itself. Such a critique would be a restatement of the general objection to the real seat ("RS") test because it is "fact-intensive" and thus difficult to administer.

Part II responds to different administrative-based objections in the context of each proposed functional test.[133] It concluded, however, that such concerns are generally overstated. More broadly, relatively few facts need to be determined under a functional approach. The functional approach does not seek multiple "connecting factors" of a corporation to a jurisdiction in order to substantiate the "most meaningful" connection. Rather, the functional approach seeks only the connecting factors that are relevant to the purpose the residence test is intended to serve.

---

[133] *See supra* notes 89–133 and accompanying text (discussing the functional models to corporate tax residence and the administratively-based objections to its implementation).

2. Negative Incentives

A second line of critiques concerns the negative incentives that some of the suggested tests may create, or in other words, the behavioral distortions created by certain corporate tax residence tests. Such concerns are expressions of a general normative preference of efficiency as a policy guide. As Part I showed, efficiency does not support the policy purposes of corporate taxation.

Moreover, Part II responded to such concerns within the context of each residence test suggested and demonstrated that such concerns are, for the most part, exaggerated as a factual matter.[134] In addition, Part II explained that such concerns do not negate the functional approach. If anything, the concerns *support* a functional approach. When a specific functional residence test drives corporations out of the jurisdiction, it necessarily means that the justification to tax such corporations is lost. If we are still concerned about such corporate expatriation, then it means that corporate tax rates are set at uncompetitive rates. In the alternative, if we believe that there are still valid reasons why we must tax an "expatriating corporation," it means that we adopted the wrong functional corporate tax residence test to begin with.

To summarize, incentive-related arguments, as well as administration-related arguments, do not pose a particularly difficult challenge to a functional view of corporate tax residence.

B. *Adjusting the Functional Model for Multiplicity of Purposes*

The third line of possible critiques to the functional approach to corporate tax residence has to do with the fact that, as a practical matter, jurisdictions tax corporations for many different reasons. Admittedly, the functional model suggested above takes a one-dimensional view that abstracts complex realities, and therefore may provide little or no guidance for actual tax policymaking. This is the most serious possible critique of the functional approach. There are, however, good responses to this critique, and the functional approach could be adjusted to consider the multiplicity of purposes of corporate taxation. There are three possible ways in which a functional corporate tax residence construct can be adjusted to deal with the fact that corporations are taxed for multiple reasons.

[134] *Id.*

1. The Under-Inclusive Response: Ideological Choice of a Single Test

The easiest *theoretical* response to the issue of multiplicity of purposes for taxing corporations is to make a conscious choice between competing policy purposes. From a purely theoretical point of view, this response is probably desirable because such a choice clearly reflects the ideological selections made within a jurisdiction. For example, if tax-policy makers in a jurisdiction believe that it is justified to tax corporations both as a means to tax shareholders and as a means to reduce agency costs, an election between an ownership test or a listing test would express the prevailing ideological preference. Such a response to multiplicity of purposes, however, is probably more than one could hope for in most jurisdictions. If political forces genuinely interact, most legal models are the result of a political compromise, and not a clear-cut ideological expression.

2. The Possibly Over-Inclusive Response: Alternative Residence Tests

On the other side of the spectrum, the easiest *practical* way to respond to the issue of multiplicity of purposes is simply to have alternative corporate tax residence tests, where the satisfaction of any one of them will cause a corporation to become a resident for tax purposes.

This is probably the approach that most countries take, based on anecdotal evidence. For example, in most Commonwealth countries, a corporation will be a tax resident if it is either incorporated in the jurisdiction, or managed and controlled from within such jurisdiction.[135] Similarly, most civil law countries combine alternative criteria, with no hierarchical relationships among the alternatives.[136] Although adopting various residence tests is easy to implement, it may also result in over-inclusiveness of entities that are not otherwise a policy target of corporate taxation.

3. The Context-Sensitive Response: A Single Test That Supports Multiple Purposes

The middle way to respond to the multiple policy purposes for which a jurisdiction taxes corporations is to reach a political compromise that adopts *one* corporate tax residence test (or a combination of as few tests as possible) that supports *all* (or as many as possible) competing purposes.

---

[135] AULT & ARNOLD, *supra* note 24, at 435.

[136] De Broe, *supra* note 27, at 96 n.4.

The viability of this option will depend on the interaction between the nature of the competing purposes and the local contexts of each specific jurisdiction. Specifically, although the theoretical model above identifies a single tax residence test to support each possible purpose of corporate taxation, it is possible that under specific local contexts, other models would work as well. Under a pure functional perspective, for example, the place of incorporation ("POI") test supposedly supports the benefits-of-incorporation theory of corporate taxation. If residents in a jurisdiction tend to incorporate their corporations within their home jurisdiction, however (perhaps as a result of non-tax legal requirements, or home-bias), the POI test would capture both the benefits of incorporation and the taxation of shareholders (because locally incorporated entities are also owned by domestic residents).

Such an approach may be possible, but requires a close inspection of local characteristics. Part IV explores the practicality of such an approach in the context of the current economic environment in the United States.

IV. Reviewing Current Corporate Tax Residence Determination in the United States

This Part explores the applicability of the proposed functional approach in implementing legislative reforms in the United States. Section A of this Part examines the current discourse on the determination of corporate tax residence in the United States, arguing that current talks of reform fail to consider the policy reasons behind corporate taxation in the United States. Section B discusses how the functional approach can be utilized to provide new insights into the reform discussion. In doing so, Section B shows how, under a functional analysis, the POI test—as currently adopted—fails to support U.S. corporate tax policies. Finally, Section C suggests a functional corporate tax-residence model to support the purposes that underlie corporate taxation in the United States.

A. *Current Debate Is Guided by the Dysfunctional Normative Dichotomy*

The United States adopted the POI test in the War Revenue Act of 1917.[137] Section 200 of the 1917 Act defined a "domestic" corporation as any corporation "created under the law of the United States, or of

[137] War Revenue Act, Pub. L. No. 65-50, § 200, 40 Stat. 300, 302 (1917).

any State, Territory, or District thereof."[138] This definition survived largely unchanged to this day. Currently, under section 7701(a)(4) of the Code, a corporation is considered "domestic" for federal income tax purposes if it is "created or organized in the United States or under the law of the United States or of any State . . . ."[139]

Despite the POI test's long-established history in the United States, many scholars harshly criticize this test, primarily claiming that the POI test easily facilitates tax avoidance. All one needs to do in order to claim "foreign" status for U.S. corporate income tax purposes is to incorporate elsewhere. There is no need to have any assets, employees, or other economic attributes in the jurisdiction of incorporation. Thus, these scholars view the concept of U.S. corporate tax-residence as "meaningless."[140]

As Part I details, responses to the meaninglessness of corporate tax residence tend to take one of two shapes. One approach, the pragmatic approach, is to accept reality (namely, that there is little we can do about the de facto electivity of corporate tax residence), and minimize

---

[138] *Id.* The same jurisdictional principals instituted in the War Revenue Act have been adopted implicitly even earlier than 1917. The 1917 Act was merely a semantic change to an already functioning jurisdictional concept. Specifically, the Corporate Excise Tax Act of 1909 established the same residence-based system of taxation. Act of Aug. 5, 1909, § 38, 36 Stat. 11, 112 (1909). Although the 1909 Act did not explicitly define the terms "domestic" or "foreign," the Act conferred taxing jurisdiction to "every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares" if the entity was either "organized under the laws of the United States or any State or Territory of the United States . . . or hereafter organized under the laws of any foreign country and engaged in business in any State or Territory of the United States . . . ." *Id.*; *see also* William P. McClure & Herman B. Bouma, *The Taxation of Foreign Income from 1909 to 1989: How a Tilted Playing Field Developed*, 43 TAX NOTES 1379, 1381 (1989). For corporations organized under the laws of foreign countries, the tax applied to net income "from business transacted and capital invested within the United States and its Territories . . . ." Act of Aug. 5, 1909, § 38. The same concepts have appeared in the first attempt by Congress to enact corporate tax in 1894. *See* 26 CONG. REC. S6800, S6831 (1894). The House version of the 1894 Bill applied taxation jurisdiction to corporations and associations "organized for profit *by virtue of the laws of the United States or of any State or Territory*, by means of which the liability of the individual stockholders is in any way limited." *See id.* (emphasis added) (reading the House of Representatives version of the 1894 Bill into the record). The jurisdictional application of the tax, however, was changed in the final version of the Bill, without explanation, to apply to "corporations, companies, or associations doing business for profit in the United States, *no matter how created and organized*." *See id.* (emphasis added); Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53, 87 (1990). Ultimately, however, the 1894 Act was struck down by the Supreme Court. *See* Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 583–86 (1895), *aff'd on reh'g*, 158 U.S. 601 (1895).

[139] I.R.C. § 7701 (2006).

[140] *See, e.g.*, Graetz, *supra* note 4, at 320–23; Kleinbard, *supra* note 4, at 158–62; Tillinghast, *supra* note 4, at 260; Avi-Yonah, *supra* note 4.

the importance of U.S. corporate tax residence determination to tax outcomes. Under this approach, the remedy is to adopt a territorial system of taxation.[141] Part I explains, however, that adopting a territorial system would not diminish the importance of determining corporate tax residence.[142]

Moreover, if one argues that the U.S. should change its international tax system from global to territorial, such an argument must be grounded in first-order tax policy making. For example, one could argue that a territorial system is preferable in order to meet international competitive pressures.[143] To the extent we believe such arguments, we might accept an explicit choice to reform the U.S. international tax system. Indeed, it seems to have been the exact reason why the United Kingdom recently reformed its tax system from global to territorial.[144]

It does not follow, however, that the U.S. should change its entire tax system from a global system to a territorial one just because our century-old corporate tax residence test—which the U.S. can conceivably reform—does not support global taxation.

The second approach addressing the "meaninglessness" of corporate tax residence determination is to debate corporate tax residence concepts in such a way as to make them "meaningful." The problem, as described below, is that the U.S. debate is guided by the same unhelpful normative dichotomy between formal and substantive tests, as described in Part I.

Calls for reform in the definition of domestic corporations gained considerable traction in the early 2000s, when the phenomenon of "corporate inversions" received public attention. In a typical inversion transaction, a publicly traded U.S. corporation would merge into, or

---

[141] Graetz, *supra* note 4, at 320–23; Shaviro, *supra* note 5, at 415–17.

[142] *See supra* notes 70–79 and accompanying text.

[143] *See, e.g.*, House. Comm. on Ways and Means, 112th Cong., Ways and Means Discussion Draft: Tax Reform Act of 2011 8–31 (Oct. 26, 2011), http://waysandmeans.house.gov/UploadedFiles/Discussion_Draft.pdf; *CEO Perspectives on How the Tax Code Affects Hiring, Businesses, and Economic Growth: Hearing Before the S. Comm. on Fin.*, 112th Cong. 35–43 (2011) (statement of Michael T. Duke, President and Chief Executive Officer, WalMart Stores, Inc.); *id.* at 43–51 (statement of Thomas J. Falk, Chairman and Chief Executive Officer, Kimberly-Clark Corporation); *id.* at 53–62 (statement of Gregory S. Lang, President and Chief Executive Officer, PMC-Sierra); *How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs: Hearing Before the H. Comm. on Ways and Means*, 112th Cong. 7–13 (2011) (statement of Gary M. Thomas, Partner, White and Case); *id.* at 23–37 (statement of Stephen Edge, Partner, Slaughter and May); Nat'l Comm'n on Fiscal Responsibility and Reform, The Moment of Truth 8 (2010).

[144] *See* Marian, *supra* note 86, at 179–80 (articulating why the set of circumstances that caused the U.K. to reform its international tax system are inapplicable to the Unites States).

would be "bought" by, a foreign-incorporated shell entity ("surrogate entity") that was a resident in a low-tax jurisdiction. In consideration for the purchase or merger, the shareholders of the U.S. entity would receive equity interests in the foreign surrogate entity, which would then become the publicly traded entity. From an economic point of view, the only change is that the publicly traded entity suddenly became "foreign" for U.S. tax purposes by virtue of its incorporation in a foreign jurisdiction. The shareholders, assets, and operations of the group remained the same. The only difference was that the "inverted" entity was no longer subject to U.S. tax jurisdiction.[145]

To fight such abuse, Congress enacted the "anti-inversion rule" in Section 7874 of the Code, which taxes certain gains of the surrogate entity for a period of ten years, while disallowing deductions and credits.[146] If certain thresholds of ownership by U.S. residents are met, the rule causes a surrogate entity incorporated abroad (and therefore otherwise a foreign entity), to be treated as a domestic corporation for federal income tax purposes.[147]

Notwithstanding Section 7874, some believe that a reform to the U.S. corporate tax residence test is still required. For example, in 2005, the Joint Committee on Taxation ("JCT") published a report discussing various "options to improve tax compliance and reform tax expenditures."[148] Among other options, the JCT considered adding a rule under which foreign-incorporated companies that are primarily managed and controlled from the United States would be U.S. residents for tax purposes.[149]

The JCT reasoned that such a test may be needed *in addition* to Section 7874, because even with an anti-inversion rule in place, U.S. multinational entities could use foreign-incorporated affiliates to aggressively reduce their U.S. taxes.[150] For example, by incorporating a subsidiary abroad, many times, the U.S. parent (or other affiliate) of a

---

[145] *See generally* Kirsch, *supra* note 110, at 478–81 (providing a general description of corporate inversions); Bret Wells, *Cant and the Inconvenient Truth About Corporate Inversions*, 136 TAX NOTES 429 (2012) (describing the phenomena of corporate inversions, and the successes and failures of congressional response to such phenomena).

[146] I.R.C. § 7874 (2006).

[147] *Id.*

[148] *See generally* STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES (Comm. Print 2005) (discussing a number of proposals that would reduce the size of the tax gap by curtailing tax shelters, closing unintended tax loopholes, or addressing other areas of noncompliance).

[149] *Id.* at 178–81.

[150] *Id.* at 179.

"foreign" corporation can avoid current U.S. taxation on income earned by the foreign corporation. As Part II explains, the use of "foreign" affiliates of U.S. companies enables income-shifting techniques, primarily with the use of intercompany transactions. Unsurprisingly, such transactions are structured so as to have the income accumulating with the "foreign" entity while the deductible payments—for the most part—are made by the U.S. entity.

To combat this type of tax planning, some scholars and policymakers have suggested that the U.S. adopt a "managed and controlled test" for determining corporate tax residence.[151] Avi-Yonah has suggested that a "managed and controlled" test would deter corporate inversions because they would require corporations to be actually run from abroad in order to avoid being labeled as a U.S. corporation.[152], Moreover, Senator Carl Levin introduced the "Stop Tax Haven Abuse Act," under which a public corporation (and other entities meeting specific thresholds) managed and controlled within the United States would be treated as a domestic corporation.[153]

Proponents of such central management and control ("CMC") tests evidently support the tests because they view them as effective tools to combat tax avoidance. Such a justification is implicitly a normative argument that derives its vitality from nexus theories. If one believes that a "foreign" entity must be taxed in the United States on a worldwide basis in spite of its foreign status, it is because such an entity

[151] *Tax Reform Options*, *supra* note 32, at 29–37 (statement of Reuven S. Avi-Yonah, Professor, University of Michigan Law School).

[152] *Id.* at 34–35. Other commentators embrace this view as well. *See, e.g.*, McIntyre, *supra* note 5, at 1571–72 (discussing the development of meaningful legal standards for corporate residence); *International Tax Reform*, *supra* note 2, at 748. The U.S. has incorporated the concept of place of central management and control into most of its bilateral tax treaties. This concept is therefore not foreign to federal income tax law, and can be easily transported into the U.S. tax code. *See* United States Model Income Tax Convention, art. 22, § 5(d) (2006). Article 22 defines a company's "primary place of management and control." *See id.* Article 4 explicitly recognizes a company's place of management as a determinant of tax residence. *See id* art. 4, § 1.

[153] Stop Tax Haven Abuse Act, S. 1346, 112th Cong. § 103 (2011). Under the Act, a publicly traded corporation managed "directly or indirectly, primarily within the United States . . . shall be treated as a domestic corporation." *Id.* Additional bills suggest similar reforms in corporate tax residence determinations like the Stop Tax Haven Abuse Act. *See, e.g.*, Cut Unjustified Tax Loopholes Act, S. 268, 113th Cong. § 103 (2013); Cut Unjustified Tax Loopholes Act, S. 2075, 113th Cong. § 103 (2012); International Tax Competitiveness Act of 2011, H.R. 62, 112th Cong. § 2 (2011).

must display some "meaningful connection" to the U.S. that somehow justifies the entity's taxation.[154]

Some commentators, however, fiercely object to the CMC tests and instead support the retention of the POI model. They believe that the introduction of a CMC test into the federal income tax system would "effectively [transform] a portion of the corporate tax from a tax on the return to business assets into a tax on active management and control."[155] Such a shift in tax policy may cause corporate taxpayers to shift their active managements overseas, thereby resulting in the loss (in the U.S.) of the positive externalities associated with having corporate headquarters physically located in the United States.[156] In addition, the commentators correctly argue that the POI test is also much easier to administer than the CMC test, thereby saving administrative costs.[157] Both of these arguments clearly rely on an efficiency rationale.[158]

The debate between the POI and CMC tests in the context of U.S. tax reform is completely disconnected from the parallel discourse about the policy purposes underlying the U.S.'s taxation on corporations. It is a normative debate about how the U.S. *should* determine the residence of corporations, independent of any other corporate tax constructs. Evidently, justifications for one model or the other travel along a normative spectrum between efficiency (in the case of POI) or nexus (in the case of CMC). As Part I argues, the confinement of corporate tax residence debate to this normative spectrum is the very reason for the creation of meaningless corporate tax residence concepts.

B. *The POI Test Does Not Support the Purposes of Corporate Taxation in the United States*

This Section takes a functional view of corporate tax residence in the United States to demonstrate the fresh insights such a view produces for prospective tax reform. The U.S. is one of the only countries in the world to adopt POI as its only determinative corporate tax resi-

[154] *See International Tax Reform*, *supra* note 2, at 748 (stating that "[t]he definition of a domestic corporation should efficiently encompass the factors that create a connection between the corporation and the United States that justifies residence-based corporate taxation as opposed to a mere source-based taxation").

[155] *Tax Reform Options*, *supra* note 32, at 47 (statement of James R. Hines, Jr., Professor, University of Michigan Law School).

[156] *See id.*

[157] *See id.* at 47–48.

[158] *See id.* In his testimony, Professor James Hines explicitly based his recommendations on the principle of efficiency. *Id.* at 51.

dence test.[159] As mentioned above, most other countries that utilize POI tests also adopt alternative residence tests. Taking a functional approach, this Section explains why the POI test does not support contemporary policy purposes of corporate taxation in the United States.

1. The POI Test Does Not Effectuate the Incorporation-Benefits Theory of Corporate Taxation

Although the uniqueness of the U.S.'s corporate tax residence law could be a reflection of a clear political choice to tax the benefits of incorporation, this *cannot* possibly be the case. As an initial matter, it is doubtful that the benefits granted by an act of incorporation in the United States can normatively support subjecting a corporation to worldwide taxation in the United States. Michael S. Kirsch has thoroughly researched the issue[160] and concluded that the normative justifications for a POI test are "somewhat tenuous."[161]

More importantly, however, under current U.S. law, one could achieve the full spectrum of the benefits of incorporation with little or no corporate tax consequences. This is because corporate taxation in the United States is, for the most part, an *explicitly* elective regime. Specifically, under the "check the box" regulations,[162] only certain entities organized under U.S. laws are treated as corporations for federal income tax purposes. Other forms of business entities, most notably limited liability companies, S-corporations, and partnerships, are treated as "transparent" for federal income tax purposes, even though they provide limited liability, centralized management, and other benefits of incorporation to their members. Furthermore, a 2007 report by the Congressional Research Service ("CRS") notes that "liberal rules . . . allow firms to obtain benefits of corporate status (such as limited liability) while still being taxed as unincorporated businesses . . . ."[163] The CRS report also notes a significant rise in the share of total U.S. business income received by unincorporated businesses since 1980.[164]

---

[159] Few other countries use POI as the sole test of corporate tax residence. These include, for example, Russia. *See* TAX MGMT. (BNA) Portfolio 7330-1st: *Business Operations in Russia*, pt. VI, § A (describing Russia, where a domestic corporation is a corporation organized under Russian law).

[160] Kirsch, *supra* note 110, at 551–75.

[161] *Id.* at 575.

[162] 26 C.F.R. §§ 301.7701-1 to -3 (2013).

[163] GRAVELLE & HUNGERFORD, *supra* note 90, at 4.

[164] *Id.* (noting an increase of the share of total U.S. business income received by unincorporated businesses from twenty-one percent in 1980 to sixty percent in 2007).

Among Organisation for Economic Co-operation and Development ("OECD") countries, the U.S. has one of the largest unincorporated business sectors, second only to Mexico.[165]

To summarize, even if the benefits-of-incorporation explanation for corporate taxation has theoretical appeal, which is highly disputed,[166] it probably makes little sense to argue that the current purpose of corporate taxes in the United States is to tax the benefits of incorporation. Under the "check the box" regulations, the U.S. is explicitly willing to grant such benefits without charging anything for them. The only meaningful exception is publicly traded entities, which are treated as per se corporations, and are not entitled to elect out of the corporate tax regime.[167] Thus, one can conclude that the POI test is not tasked effectively with taxing the benefits of incorporation.

One could argue, however, for POI as a tax residence test if it is context-sensitive, thereby supporting other reasons why the U.S. taxes corporations. But when considering the specific context of the U.S., this argument too cannot stand. To understand why, a brief survey of the possible reason for taxing corporations in the United States is warranted. According to U.S. scholars, there are at least four possible justifications (other than the benefits of incorporation) explaining the imposition of corporate taxes in the United States. They are discussed below.

2. The POI Test Does Not Effectively Regulate U.S. Managers

According to one theory explaining the emergence of corporate taxation in the United States, corporate tax as a real entity measure was first enacted in 1909, primarily as a regulatory device.[168] The tax reflected negative sentiment in Congress towards large-scale business entities that accumulated substantial power towards the end of the nine-

[165] *See Small Businesses and Tax Reform: Hearing Before the Subcomm. on Select Revenue Measures*, 112th Cong. 8–17 (2011) (testimony of Robert Carroll, Principal, Ernst & Young LLP).

[166] *See supra* note 56 and accompanying text. One scholar has concluded that "advances in the theory of corporate personality appear to have had only a modest influence, if any, on the taxation of the corporation . . . ." Bank, *Entity Theory as Myth*, *supra* note 42, at 466.

[167] If publically traded entities are incorporated, they are treated as per se corporations subject to corporate taxation. 26 C.F.R. § 301.7701-2. If the publically traded entity is not incorporated, however, it will be treated as partnership for federal income tax purposes. Nevertheless, a special I.R.C. provision makes such entities subject to corporate taxation. *See* I.R.C. § 7704 (2006).

[168] Avi-Yonah, *Corporations, Society, and the State*, *supra* note 38, at 1225; Avi-Yonah, *supra* note 42, at 377; Kornhauser, *supra* note 138, at 53.

teenth century.[169] Influential corporate managements were identified as a source of abuse of power.[170] It had therefore been suggested that "the imposition of the corporate tax will enable the government, the shareholders, and the public to obtain information that will serve as the basis for restricting such managerial abuses of power."[171] In this way, the 1909 Act was an attempt to restrict managerial power.[172]

Anecdotal evidence suggests that historically, U.S. managers have primarily managed U.S.-incorporated corporations.[173] Thus, the POI test may have actually functioned successfully to capture those U.S. managers that were the legislature's true target. Yet if this policy purpose of regulating managers remains relevant today,[174] there is little reason to believe it can still be supported by the POI test. Today, U.S. managers and entrepreneurs "elect out" of having their income-generating corporations incorporated in the United States,[175] and, as a

---

[169] Bank, *Entity Theory as Myth*, *supra* note 42, at 508–11; 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).

[170] Avi-Yonah, *supra* note 38, at 1220 (citing Letter from William Howard Taft to Horace Taft (June 27, 1909)).

[171] Avi-Yonah, *supra* note 42, at 383.

[172] *Id.* at 382–87.

[173] While a historical survey is beyond the scope of this Article, congressional tax writing committees often recognized the individuals targeted by the enactment of corporate taxes by name. *See* STEVEN S. WEISMAN, THE GREAT TAX WARS: LINCOLN TO WILSON—THE FIERCE BATTLES OVER MONEY AND POWER THAT TRANSFORMED THE NATION 124, 219 (2002) (describing the status of corporations within the context of the 1909 Act and quoting Representative Cordell Hull as complaining about the "'infamous system of class legislation' that burdened an average person while 'virtually exempting the Carnegies, the Vanderbilts, the Morgans, and the Rockefellers, with their aggregated billions of hoarded wealth"). Beyond the family names mentioned by Representative Hull, Congress also attempted to target famous names such as Astor, Gould, and Havemeyer, *See id.* at 137, 144. These "named" individuals were understood to be the true aim of original corporate tax laws in the United States; the individuals generally owned and managed U.S. incorporated corporations, and the POI test therefore acted to capture the intended individuals. For example, Standard Oil was incorporated by John Davison D. Rockefeller in 1870 in Ohio. *See* 7 DICTIONARY OF AMERICAN HISTORY 520–21 (Stanley I. Kutler ed., 2003). The Vanderbilt's railroad empire was composed of several state-chartered corporations, including some corporations in New York. *See* Erie Ry. Co. v. Pennsylvania, 88 U.S. 492, 493 (1874) (stating that the Erie Railway Company, of which the Vanderbilt family had controlling stake, "was chartered by an act of the legislature of the State of New York, April 24th, 1832"). Finally, the Astors' fur trading empire was operated under the American Fur Company, which was incorporated in New York in 1808. *See* An Act to Incorporate the American Fur Company, 1808 N.Y. Sess. Laws 160 (McKinney).

[174] Avi-Yonah, *supra* note 38, at 1231–50 (arguing that the policy purpose of regulating managers is still relevant today).

[175] *See infra* note 176 and accompanying text (noting that most U.S. owned corporations that accumulate profits are foreign entities).

result, such individuals are no longer captured by the POI test. To be exact, although there is no statistical evidence that U.S. individuals tend to prefer offshore incorporation,[176] there is ample evidence that U.S.-incorporated corporations accumulate their profits not directly, but in subsidiaries incorporated in offshore tax havens.[177]

3. The POI Test Does Not Effectively Tax U.S. Shareholders

Another theory explaining the inception of corporate tax in the United States provides that corporate income tax was originally intended to be a proxy for directly taxing shareholders.[178] According to this theory, the 1909 Act was simply part of a continuous attempt to tax shareholders' wealth accumulated by doing business in corporate form.[179]

For the same reasons that the POI test fails to capture U.S. managers, it also fails to capture U.S. shareholders. In the current global environment there is no reason for a U.S. shareholder to accumulate earnings in corporations incorporated in the United States. As explained in Subsection 2, earnings are regularly accumulated in corporations incorporated in foreign jurisdictions.

4. The POI Test Does Not Ameliorate Agency Problems in U.S. Public Markets

Another policy of corporate taxation, suggested by several commentators, is that corporate taxation is justified as a means to reduce agency costs arising out of nonalignment of interests between managers and shareholders of publicly traded corporations in the United States.[180] Under this theory, "corporate tax is interpreted as a substitute for contractual constraints on the agents of a firm."[181] In the absence of a corporate-level tax, corporate managers who also hold equity in the corporation is likely to prefer their own tax interests when making corporate-level decisions that affect the tax consequences of shareholders.

---

[176] Eric J. Allen & Susan C. Morse, *Tax Haven Incorporation for U.S. Headquartered Firms: No Exodus Yet*, 66 NAT'L TAX J. (forthcoming 2013).

[177] DONALD J. MARPLES & JANE G. GRAVELLE, CONGRESSIONAL RESEARCH SERV., TAX CUTS ON REPATRIATION EARNINGS AS ECONOMIC STIMULUS: AN ECONOMIC ANALYSIS 1–2 (2011); *see also* PERMANENT SUBCOMM. ON INVESTIGATIONS, REPATRIATING OFFSHORE FUNDS: 2004 WINDFALL FOR SELECT MULTINATIONALS 2–6 (2011).

[178] Bank, *Entity Theory as Myth*, *supra* note 42, at 452.

[179] Bank, *US Corporate Excise Tax of 1909*, *supra* note 42, at 395.

[180] Kanda & Levmore, *supra* note 130, at 226–34.

[181] *Id.* at 213.

Once a tax is imposed at the entity level, it creates an alignment of interests; both managers and shareholders have interest in reducing entity-level tax, regardless of their individual tax interests.[182]

The POI test does not support such a purpose. There is no requirement that an entity that is publicly traded in a U.S. exchange will also be incorporated in the United States. Foreign-incorporated corporations—which may or may not be subject to corporate-level tax in the foreign jurisdiction, and that are listed for trade in United States—are not subject to the full reach of U.S. corporate tax jurisdiction. Agency costs are not necessarily alleviated in such corporations.

5. The POI Test Does Not Function to Tax Access to U.S. Public Markets

Another theory suggests that corporate tax is imposed as a fee for access to U.S. public markets.[183] According to this theory, liquidity provides non-controlling shareholders with a significant benefit, and corporate tax can be justified as a cost on this liquidity.[184] Even still, the POI test does not function to support such a purpose given that foreign-incorporated corporations can freely list their securities on U.S. exchanges.

C. *The U.S. Should Adopt a Place of Listing or CMC Test*

Given that the POI test does not function to support any of the possible purposes of corporate taxation in the United States, the question remains whether any test can. This Section assumes that all justifications for taxing corporations in the United States are equally plausible, and tries to incorporate them all into a suggested legal construct.

Below are the four possible purposes for taxing corporations in the United States, as well as the corresponding functional test for each:

1. Taxation of shareholders—ownership test;
2. Regulation of managers—place of management and control test;
3. Reducing agency costs—place of listing test;
4. Fee to access liquid capital—place of listing test.

---

[182] *Id.* at 229–33.
[183] Rudnick, *supra* note 132, at 1092–93
[184] *Id.* at 1099–1103.

The first obvious conclusion is that any test other than POI, at the very least, achieves one or more purposes for which the U.S. imposes corporate tax. The easy conclusion is that the U.S. could adopt what Part III describes above as an over-inclusive response.[185] Namely, the U.S. could adopt a three-pronged residence test under which any corporation that is (1) majority-owned by U.S. residents, (2) managed and controlled from within the United States, *or* (3) the securities of which are listed on a U.S. exchange, will be classified as "domestic" for federal income tax purposes.

A contextual response, however,[186] might prove workable given the unique circumstances of the United States. Significantly, publicly traded U.S. corporations are overwhelmingly owned by U.S. residents.[187] Whether we adopt place of listing test, or a place of shareholders residence test, we would largely capture the same corporations under the definition. Under such circumstances, the place of listing test will capture the U.S. shareholders we presumably seek to tax. Accordingly, there is no need to adopt an ownership test in the current environment.

Of course, "domestic" publicly traded corporations may themselves hold non-publicly traded entities, and channel funds through such entities, thereby avoiding current worldwide taxation. Thus, entities controlled by corporations, the securities of which are listed on a U.S. exchange, should also be regarded as domestic for tax purposes.

The issue is more elaborate in the context of regulating managers. To the extent we are only worried about managers of publicly traded entities accumulating excessive power, the place of listing test would also work. With a lack of measurable data regarding power accumulation in private versus public entities, however, the CMC test is also needed. For example, in the absence of such a rule, a domestically listed entity could exert its "excessive power" through the use of a non-listed affiliated entity. It is therefore necessary to ensure that corporations within an affiliated group, in which a member is publicly traded in the United States, are treated as U.S. tax residents to achieve this regulatory aim.[188]

---

[185] *See supra* notes 135-136 and accompanying text.

[186] *See id.*

[187] *See supra* notes 91–97 and accompanying text.

[188] For this reason, the "Stop Tax Haven Abuse Act" may fail the functional test, as it requires a corporation to be publicly traded as a necessary condition to qualify as "domestic," or to meet the $50,000,000 threshold of assets under management. *See* Stop Tax Haven Abuse Act, S. 1346, 112th Cong. § 103 (2011). Under such circumstances, publicly traded corporations will not change their behavior and no abuse will be prevented: publicly traded corporations will simply accumulate their income in offshore private subsidiar-

The bottom line recommendation of this Article is for the U.S. to adopt a test under which a corporation that is (i) managed and controlled from the United States; or (ii) the securities of which are listed on an exchange in the United States (or a corporation controlled by a corporation, the securities of which are listed on an exchange in the United States), will be treated as a "domestic" corporation for federal income tax purposes.

Once again, it is crucial to note that in suggesting this model this Article assumes that all contemporary justifications for taxing corporations in the United States are equally plausible. The suggested model does not offer one approach that holds an inherent normative value, and to the extent one prefers certain policy purposes of corporate taxation over others, the implication would probably be to adopt a different corporate tax residence model.

Conclusion

Most countries determine the "domestic" or "foreign" tax status of corporate entities by applying one of two kinds of tests (or a combination thereof): the formal place of incorporation ("POI") test, or the substantive place of real seat ("RS") test. This Article demonstrates that for tax purposes, the rationalization for the adoption of one test or the other is driven by this apparent dichotomy, and is for the most part normative. Proponents of the POI test tend to emphasize efficiency, while RS supporters tend to highlight theories of nexus.

This dichotomy, however, provides little guidance in designing a workable corporate tax residence model. The dichotomy does not fit within the framework of theories justifying corporate taxation. Normative justifications for the POI and RS tests contain implicit assumptions that have been rejected by both tax law theorists and public finance empiricists.

As a remedy, this Article develops the first cohesive functional approach to corporate tax residence. The functional approach operates to support the policy purposes for which countries impose corporate income taxes. Because it is purpose-driven, the functional approach does not lend itself to the substantive/formal dichotomy.

The approach that this Article developed is not exhaustive, in the sense that it cannot possibly consider all possible purposes for which different countries choose to tax corporations. But its strength is in its

---

ies, ensuring that each subsidiary holds no more than $50,000,000 of assets under management. *See id.*

flexibility to consider new purposes and interactions of various purposes in the specific contexts of each jurisdiction. As such, a functional approach can provide guidance even with respect to purposes of corporate taxation not explicitly considered herein.

In addition, this Article argues that a functional view of corporate tax residence strongly suggests that the United States should reform the way it defines "domestic" and "foreign" corporations for federal income tax purposes. This Article considers the special circumstances in the United States—a world financial center, but also a place where corporations are overwhelmingly owned by domestic residents. Under such circumstances, and given the most prevalent policy purposes for which the U.S. seeks to tax corporations, the correct test to adopt is a double-pronged test of the place of listing, *or* the place of central management and control.

This Article stresses one final note. Comparative inquires suggest that different jurisdictions may tax corporations for different reasons. Therefore, corporate tax-residence tests should also be different among jurisdictions. There is no "perfect residence test"—there are only "perfect residence *tests*." Inevitably then, corporate tax residence tests are locally and politically oriented, and the "best test" discussion should be abandoned.