

ARTICLES

THE MYTH OF CORPORATE TAX RESIDENCE

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Abstract

The issue of corporate residence has recently attracted a great deal of attention in both the popular press and in academic discourse, primarily because of the phenomenon of corporate inversions. The consensus among commentators is that the root of the problem is a flawed definition of corporate residence, and they have therefore proposed replacing the current definition, which relies upon place of incorporation, with another that relies upon control and management, home office, customer base, source of income, or the residence of shareholders.

The thesis of this article is that the concept of tax residence is inapplicable to corporations. Residence in tax law delineates the boundaries of distributive justice, and whereas corporations cannot be parties to a scheme of distributive justice, corporate residence is a misnomer. The incongruity of corporate residence along with the fact that residence is a fundamental concept in international taxation is one reason that the current international tax regime has proven unviable.

The article then goes on to describe in broad outline an international corporate tax regime that avoids the problem of corporate residence by focusing on shareholders instead of on corporations.

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I. INTRODUCTION

Although straddling the cusp between two of the more esoteric subfields of tax law—corporate taxation and international taxation—the phenomenon of corporate inversions has caught the attention of the public and the popular press.¹ Journalists, politicians, government officials, and scholars point out that a little paperwork can convert a domestic corporation (which pays tax on its worldwide income) into a foreign corporation (which pays tax only on its U.S.-source income).² They go on to argue that the exploitation of this loophole by multinational corporations is unfair to ordinary citizens.³ Charges of immorality, or worse, are frequent.⁴ Responding to such concerns,

¹ An inversion is a sophisticated maneuver enabling a U.S. corporation to expatriate. Technically, a domestic corporation cannot become a foreign corporation. Because U.S. tax law classifies corporations as domestic or foreign according to the jurisdiction that imbued them with legal personhood (a corporation created under the laws of the United States or any State is domestic, while a corporation created under the laws of a foreign jurisdiction is foreign), a domestic corporation will forever remain domestic. I.R.C. § 7701(a)(4) (defining “domestic”) and § 7701(a)(5) (defining “foreign”). For a brief history of these definitions, see David R. Tillinghast, *A Matter of Definitions: “Foreign” and “Domestic” Taxpayers*, 2 INT’L TAX & BUS. LAW. 239, 252–53 (1984). Granted, a domestic corporation or its shareholders can establish a new corporation under the laws of a foreign jurisdiction, but the foreign corporation will have its own legal personality and will be a subsidiary or a sibling (or some other relative) of the old domestic corporation. The domestic corporation will not have become the foreign corporation. See, e.g., Tillinghast, *id.* at 259 (“[A] mid-life shift in a corporation’s status may be achieved only at the price of ‘killing’ the old corporation and ‘creating’ a new one . . .”). To circumvent this obstacle to expatriation, tax planners developed a series of techniques collectively known as inversions. See, e.g., Donald J. Marples & Jane G. Gravelle, *Corporate Expatriation, Inversions, and Mergers: Tax Issues*, CONG. RES. SERV. 4–5 (2017), <https://fas.org/sgp/crs/misc/R43568.pdf> [<https://perma.cc/6SPK-CVTN>]. In a typical inversion, the subsidiary of a foreign corporation merges into a U.S. corporation that had served as the parent of a multinational group. See, e.g., Steven Goldman, *Corporate Expatriation: A Case Analysis*, 9 FLA. TAX REV. 71, 73–75, 84–91 (2008). Simultaneously, assets that produce foreign-source income are transferred from the U.S. corporation to the foreign corporation. See, e.g., Goldman, *id.* at 77–80, 92–98. When the smoke clears, the corporate structure may be very similar to what it was previously, except that at the peak of the corporate pyramid now stands a foreign corporation instead of a domestic corporation. See, e.g., Omri Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. REV. 1613, 1654–55 (2013).

² Joseph A. Tootle, *The Regulation of Corporate Inversions and “Substantial Business Activities,”* 33 VA. TAX REV. 353, 354 (2013) (“Corporate inversions are transactions in which a U.S.-based company changes its place of incorporation from the United States to a foreign jurisdiction, often without an accompanying change in its business operations.”); Adam H. Rosenzweig, *Source as a Solution to Residence*, 17 FLA. TAX REV. 471, 497 (2015) (“[Inversions involve] a significant change in tax consequences for what was, in effect, a relatively small formal legal change with virtually no change in business model, ownership, management, or internal structure. This is precisely what concerned policymakers about inversions.”); Michael J. Graetz, *The David R. Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdates Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 321 (2001) (reporting that the Chief of Staff of the Joint Committee on Taxation and the Assistant Treasury Secretary for Tax Policy had expressed concern “about the legal loophole that allowed property and casualty insurers to stop paying income tax simply by moving the parent corporation to Bermuda.”); Jeffrey Zients & Seth Hanlon, *The Corporate Inversions Tax Loophole: What You Need to Know*, THE WHITE HOUSE (Apr. 8, 2016, 6:39 PM), <https://obamawhitehouse.archives.gov/blog/2016/04/08/corporate-inversions-tax-loophole-what-you-need-know> [<https://perma.cc/RK7G-WQGP>] (“Corporate inversions are a tax loophole that allow U.S. companies to avoid paying U.S. taxes by relocating—on paper—to a foreign country”); Paul Krugman, *Corporate Artful Dodgers*, N.Y. TIMES, July 24, 2014, at A17 (“The most important thing to understand about inversion is that it does not in any meaningful sense involve American business moving overseas . . . It [is] a purely paper transaction.”).

³ THE WHITE HOUSE, *You Don’t Get to Pick Your Tax Rate. Neither Should Corporations* (Sept. 26, 2014), <https://obamawhitehouse.archives.gov/share/the-facts-on-inversions> [<https://perma.cc/G5F8-3SVP>] (“When large corporations invert overseas to reduce the taxes they paid in the United States, working

Congress in 2004 amended the Internal Revenue Code and made it more difficult for domestic corporations to expatriate. I.R.C. § 7874 now provides that, in certain cases, the post-inversion successor to a domestic corporation will be classified as a domestic corporation, even if it was organized under the laws of a foreign jurisdiction. In 2016, the Treasury issued temporary regulations that further limit the opportunity of obtaining tax advantages by inverting.⁵

The often emotionally charged rhetoric tends to ignore the foundational question of why the post-inversion, foreign-registered corporation should be subject to U.S. worldwide taxation. The argument seems to be that a U.S. corporation should not be able to shed its U.S. residence by the mere shuffling of papers.⁶ However, this argument succeeds merely in raising the question of why the pre-inversion company was subject to tax on its worldwide income in the first place. If place of incorporation (POI) is the proper determinant of residence,⁷ then reincorporation abroad severs the relevant tie and the post-inversion company is appropriately classified as a foreign resident. On the other hand, if POI is not a proper determinant of residence, then the fact that the pre-inversion company was incorporated in the United States is irrelevant in establishing the residence either of it or of the post-inversion company.⁸

Rarely mentioned in the discourse is that founders have free rein to organize their corporation in any jurisdiction they choose and that a corporation registered in a foreign jurisdiction is, from its inception, exempt from U.S. tax on its foreign-source income.⁹ An inversion merely equalizes the future tax treatment of corporations originally organized

Americans ultimately have to pay more to help fund the services we all rely on.”); Andrew Soergel, *Ask an Economist: What the Heck is a Corporate Inversion?*, U.S. NEWS & WORLD REP. (Feb. 16, 2016, 6:00 AM), <http://www.usnews.com/news/the-report/articles/2016-02-16/ask-an-economist-what-the-heck-is-a-corporate-inversion> [https://perma.cc/TMY4-KP2J] (“All of that revenue drain, who’s going to pay for that? Either you’re going to have to increase the budget deficit or tax all the taxpayers.”).

⁴ Allan Sloan, *Positively Un-American*, FORTUNE (July 7, 2014), <http://fortune.com/2014/07/07/taxes-offshore-dodge> [https://perma.cc/L98C-HVT5] (describing inversions as “disgusting”); Jennifer Karr, *Immoral Legislation and Tax Benefits for Expat Corporations*, 48 CONN. L. REV. 1703, 1706 (2016) (“Frequent criticisms of corporate inversions tend to involve assessing the morality (or lack thereof) of corporations engaging in the practice.”); Hale E. Sheppard, *Fight or Flight of U.S.-Based Multinational Businesses: Analyzing the Causes for, Effects of, and Solutions to the Corporate Inversion Trend*, 23 NW. J. INT’L L. & BUS. 551, 558 (2003) (“[C]ritics of inversions have questioned the morality, patriotism and scruples of corporate directors.”).

⁵ Temp. Treas. Reg. § 1.7874–8T. *But see* Chamber of Commerce of the U.S. v. Internal Revenue Serv., No. 16–944 (W.D. Tex. Sept. 29, 2017) (invalidating regulations on procedural grounds).

⁶ See the sources cited *supra* note 2.

⁷ See *supra*, note 1.

⁸ See 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, 502, 549 (2005) (describing inversions as a “red herring” and asking, “If ... a change in the corporate parent’s place of incorporation is mere “paperwork” involving a new “sheet of paper,” the logical question is why does the U.S. tax code generally rely on a corporation’s place of incorporation as the touchstone for defining residence?”). A similar line of reasoning applies to expatriation under other tests of corporate residence. See, e.g., Marian, *supra* note 1, at 1647 (“If one is ... concerned about management expatriation, it might be because the *real* reason for taxing corporation [*sic*] is not to regulate managers, but some other reason.” (emphasis in the original)).

⁹ I.R.C. § 882(b) (providing that “[i]n the case of a foreign corporation ... gross income includes only—(1) gross income which is derived from sources within the United States ... and (2) gross income which is effectively connected with the conduct of a trade or business within the United States.”). In this Article, the term “U.S.-source income” will include both income derived from U.S. sources and income that is effectively connected to a U.S. trade or business.

in the United States with that of corporations originally registered abroad. Notably, neither the amended Code nor the regulations place any restrictions on where a corporation is originally registered.¹⁰ In other words, despite the fact that POI was and remains completely discretionary, a U.S.-registered corporation that attempts to expatriate faces both moral outrage and strict anti-avoidance provisions, while a corporation whose founders had the foresight to organize under the laws of a foreign jurisdiction can quietly continue to enjoy the privileged status of a foreign corporation.¹¹ In many instances, registration in the United States is no more than a foot fault, but with far-reaching consequences.¹²

Another major issue in international taxation, one that has attracted considerably less attention but is much more significant in practice, is the phenomenon of U.S. corporations operating abroad via subsidiaries registered in a foreign jurisdiction. In theory, U.S. corporations are subject to tax on their worldwide income.¹³ In practice, foreign-source income is not subject to U.S. tax until the U.S. parent receives a dividend from, or sells its shares in, the foreign subsidiary. Because the U.S. parent can defer payment of tax indefinitely, the effective rate of tax on its foreign-source income is close to zero.¹⁴ Lamenting the fact that corporations are effectively subject to tax only on their U.S.-source income, some commentators have called upon Congress to tighten up the rules of international corporate taxation and to require U.S. multinationals to pay tax on their worldwide income, including income earned via foreign subsidiaries.¹⁵ From the opposite end of the political spectrum, others have argued that the U.S. corporate tax is uncompetitive and have urged the adoption of a formal territorial tax structure.¹⁶

¹⁰ See, e.g., Graetz, *supra* note 2, at 322.

¹¹ See, e.g., William B. Barker, *International Tax Reform Should Begin at Home: Replace the Corporate Income Tax with a Territorial Expenditure Tax*, 30 NW. J. INT'L L. & BUS. 647, 665 (2010) ("For new corporations, there is considerable choice in choosing residence. For existing corporations, though tax is a strong incentive to change residence, changing residence is difficult without adverse tax and political consequences."); PRESIDENT'S ADVISORY PANEL ON TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 135 (2005) [hereinafter PRESIDENT'S ADVISORY PANEL]; Eric Toder, *International Competitiveness: Who Competes Against Whom and for What?*, 65 TAX L. REV. 505, 513–14 (2012) ("There are substantial barriers preventing existing corporations from changing their corporate residence. But the start-ups that will become the corporate giants of the future have a choice of where to establish residence.").

¹² Professor Shaviro notes that "[t]ax lawyers who permit U.S. incorporation may be guilty of malpractice." Daniel Shaviro, *The David R. Tillinghast Lecture: The Rising Tax-Electivity of U.S. Corporate Residence*, 64 TAX L. REV. 377, 378 (2011).

¹³ I.R.C. § 61(a) (defining gross income as "all income from whatever source derived"), § 63(a) (defining taxable income as gross income minus certain deductions), § 11(a) (imposing tax "on the taxable income of every corporation").

¹⁴ The formula for computing the present value of a future liability is $y=x/(1+r)^n$, where y is the present value, x is the nominal amount of the liability, r is the relevant rate of interest, and n is the number of years until the actual payment. As the value of n increases, the value of y decreases. In other words, the longer the taxpayer succeeds in deferring the payment of tax, the less the present value of the payment.

¹⁵ Edward D. Kleinbard et al., *24 International Tax Experts Address Current Tax Reform Efforts in Congress* (2015), available at <https://americansfortaxfairness.org/files/24-International-Tax-Experts-Letter-to-Congress-9-25-15-FINAL-for-printing.pdf> [<https://perma.cc/KLQ6-H6HW>].

¹⁶ See, e.g., Michael S. Knoll, *Taxation, Competitiveness, and Inversions: A Response to Kleinbard*, 155 TAX NOTES 619 (May 1, 2017); PAUL RYAN & KEVIN BRADY, A BETTER WAY: OUR VISION FOR A CONFIDENT AMERICA 10 (2016), available at https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf [<https://perma.cc/U7X2-6U4C>] (Report of the GOP Tax Reform Tax Force, appointed by Speaker Paul Ryan and chaired by Rep. Kevin Brady) ("Our high corporate rate, our outdated worldwide tax system, and our origin-basis system that taxes exports have created a perfect storm that has encouraged so

Proposals for a tax holiday that would permit U.S. multinationals to repatriate, at a reduced rate of tax, earnings currently held by foreign subsidiaries have been vigorously debated.¹⁷

Here, too, behind the rhetoric lies the paradox of corporate tax residence. On the one hand, if place of incorporation properly determines residence, then the subsidiary is not a U.S. resident and its income is properly not reportable until received by the U.S. parent. On the other hand, if place of incorporation is not determinative, then the fact that the corporation sitting at the apex of the corporate hierarchy was incorporated in the United States should not expose to U.S. tax either its or its subsidiaries' foreign-source income.

Responding to these challenges, numerous commentators have argued that the problem lies with the current flawed definition of corporate residence. Consequently, they have proposed alternative tests that look to factors other than POI, such as central management and control,¹⁸ home office,¹⁹ customer base,²⁰ primary source of income,²¹ the stock exchange listing the corporation's shares,²² or the residence of a majority of its shareholders.²³ The criteria by which commentators evaluate the appropriateness of the different test are also many and varied.²⁴ Against the background of corporate inversions,

many businesses to move their headquarters overseas. That is why the pace of so-called inversions ... has accelerated dramatically in recent years.”)

¹⁷ Ciara Linnane, *Trump's Tax Holiday Won't Make Much of a Difference Without Corporate-Tax Reform*, MARKET WATCH (Dec. 10, 2016), <http://www.marketwatch.com/story/trumps-tax-holiday-wont-make-much-of-a-difference-without-corporate-tax-reform-2016-12-08> [<https://perma.cc/5BJD-WSYR>]; Kevin Drawbaugh, *U.S. Senators Propose Tax Holiday for Foreign Profits*, REUTERS (Jan. 30, 2015), <http://www.reuters.com/article/us-usa-tax-repatriation-idUSKBN0L32CP20150130> [<https://perma.cc/P8NZ-B46F>]. In 2004, Congress granted a tax holiday that permitted U.S. multinationals to repatriate profits at a 5.25% tax rate. American Jobs Creation Act of 2004, Pub. L. No. 108–357, § 965, 118 Stat. 1514, 1518 (2004).

¹⁸ Marian, *supra* note 1, at 1664; Kyrie E. Thorpe, *International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?*, 11 EMORY INT'L L. REV. 633, 693 (1997); Reuven S. Avi-Yonah, *Beyond Territoriality and Deferral: The Promise of "Managed and Controlled"* (Univ. of Mich. Law Sch., Working Paper No. 248, 2011), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1908707 [<https://perma.cc/5XJ9-6N23>] [hereinafter Avi-Yonah, *Beyond Territoriality*]; Henry Ordower, *Utopian Visions Toward a Grand Unified Global Income Tax*, 14 FLA. TAX REV. 361, 404–05 (2013); Terrence R. Chorvat, *Book Review: "A Different Perspective on Tax Competition"*, 35 GEO. WASH. INT'L L. REV. 501, 515 (2003); Reuven S. Avi-Yonah, *Tax Advice for the Second Obama Administration: Corporate and International Tax Reform: Proposals for the Second Obama Administration (and Beyond)*, 40 PEPP. L. REV. 1365, 1370 (2013).

¹⁹ Marian, *supra* note 1, at 1645; Avi-Yonah, *Beyond Territoriality*, *supra* note 18; PRESIDENT'S ADVISORY PANEL, *supra* note 11, at 135; Tillinghast, *supra* note 1, at 262; Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507, 528 (1997).

²⁰ George K. Yin, *Letter to the Editor, Stopping Corporate Inversions Sensibly and Legally*, 144 TAX NOTES 1087 (2004).

²¹ Rosenzweig, *supra* note 2, at 507.

²² Marian, *supra* note 1, at 1664; Rebecca Rudnick, *Who Should Pay the Corporate Tax in a Flat Tax World?*, 39 CASE W. RES. L. REV. 965, 1099 (1988–89); John T. VanDenburgh, *Closing International Loopholes, Changing the Corporation Tax Base to Effectively Combat Tax Avoidance*, 47 VAL. U. L. REV. 313, 347–54 (2012).

²³ J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Defending Worldwide Taxation With a Shareholder-Based Definition of Corporate Residence*, 2016 B.Y.U. L. REV. 1681 (2017); Robert A. Green, *The Future of Source-Based Taxation of the Income of Multinational Enterprises*, 79 CORNELL L. REV. 18, 70–74 (1993); Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 TAX L. REV. 99, 160 (2011).

²⁴ See generally David Elkins, *The Elusive Definition of Corporate Tax Residence*, 62 ST. LOUIS U. L.J. (forthcoming 2018).

many ask which test of corporate residence is the least manipulable.²⁵ Others prefer tests that are clear and predictable.²⁶ Some attempt to correlate residence with benefit.²⁷ Several scholars have recently suggested looking to the purpose of corporate taxation in order to ascertain the most appropriate definition of corporate residence.²⁸

However, the literature has hitherto failed to address what I believe to be the fundamental questions that must underlie any discussion of corporate tax residence. First, why is residence a relevant attribute when determining tax liability? Second, is the concept of tax residence applicable to the corporate entity? Instead, the tacit assumption underlying the discourse is that the concept of residence is in principle applicable to corporations and that it is the task of commentators and policy makers to formulate an appropriate test by which to determine the residence of corporations.²⁹

The thesis of this article is that such an assumption is unwarranted and that tax residence is an attribute of individuals only, inapplicable to the corporate entity. Already at the outset, it is important to stress that the argument is not semantic. I will not rest my claim on the fact that, as nonphysical entities, corporations cannot “reside” in a place in the same sense that natural persons can. Rather, I will argue that the distinction between residents and nonresidents derives from the need to delineate the universe within which

²⁵ Fleming et al., *supra* note 23, at 1687–89, 1691, 1710; Marian, *supra* note 1, at 1643, 1653; Shaviro, *supra* note 12, at 381–85 (distinguishing between formal and substantive electivity); Rosenzweig, *supra* note 2, at 495; Michael J. McIntyre, *Determining the Residence of Members of a Corporate Group*, 51 CAN. TAX J. 1567, 1571 (2003); Aldo Forgione, *Clicks and Mortar: Taxing Multinational Business Profits in the Digital Age*, 26 SEATTLE U. L. REV. 719, 725–26 (2003); Daniel Shaviro, *Why Worldwide Welfare as a Normative Standard in U.S. Tax Policy?*, 60 TAX L. REV. 155, 172 (2007); Ilan Benshalom, *The Quest to Tax Financial Income in a Global Economy: Emerging to an Allocation Phase*, 28 VA. TAX REV. 165, 216–17 (2008); Tootle, *supra* note 2, at 354; Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1595–96 (2000) [hereinafter Avi-Yonah, *Globalization*]; John A. Swain, *Same Questions, Different Answers: A Comparative Look at International and State and Local Taxation*, 50 ARIZ. L. REV. 111, 117 (2008); Reuven S. Avi-Yonah, Kimberly A. Clausen & Michael C. Durst, *Allocating Business Profits For Tax Purposes: A Proposal to Adopt A Formulary Profit Split*, 9 FLA. TAX REV. 497, 499 (2009) [hereinafter Avi-Yonah et al., *Allocating*]; Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *Designing a 21st Century Corporate Tax – An Advance U.S. Minimum Tax on Foreign Income and Other Measures to Protect the Base*, 17 FLA. TAX REV. 669, 718 (2015); Susan C. Morse, *Startup Ltd.: Tax Planning and Initial Incorporation Location*, 14 FLA. TAX REV. 319 (2013); DANIEL N. SHAVIRO, *FIXING U.S. INTERNATIONAL TAXATION 70–71* (2014) [hereinafter SHAVIRO, *FIXING*]; Avi-Yonah, *supra* note 19, at 528.

²⁶ Tillinghast, *supra* note 1, at 258–66; Rosenzweig, *supra* note 2, at 489; Julie Roin, *Can the Income Tax Be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 TAX L. REV. 169, 189 (2008); Kirsch, *supra* note 8, at 568; Reuven S. Avi-Yonah, *For Haven's Sake: Reflections on Inversion Transactions*, 95 TAX NOTES 1793, 1797 (June 17, 2002).

²⁷ Rudnick, *supra* note 22, at 994; Marian, *supra* note 1, at 1615, 1642 (describing this view); Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1205–06 (2004); Kirsch, *supra* note 8, at 551–67; Andrew Mun, *Reinterpreting Corporate Inversions: Non-Tax Competitions and Frictions*, 126 YALE L.J. 2152 (2017) (solution to problem of corporate inversions is to align tax paid with benefits). *Cf.* J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 315 (2001); Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *The David R. Tillinghast Lecture: ‘What’s Source Got to Do With It?’ Source Rules and U.S. International Taxation*, 56 TAX L. REV. 81, 104–05 (2002).

²⁸ Fleming et al., *supra* note 23; Marian, *supra* note 1; McIntyre, *supra* note 25, at 1570.

²⁹ On rare occasion, the assumption is explicit. *See, e.g.,* Tillinghast, *supra* note 1, at 239–40; Rosenzweig, *supra* note 2, at 475 (“[T]his Article assumes that the United States has an income tax that turns, in part, on the residency of corporations ...”).

certain norms of distributive justice operate and that, as the nature of the corporate entity precludes its membership in any scheme of distributive justice, the categories of “resident” and “nonresident” are inapplicable to it.

Part II will explore why residence is a relevant attribute when determining the tax liability of individuals. It will explain that income tax is an application of the principle that tax liability should accord with ability-to-pay and that, in turn, ability-to-pay derives from a certain set of conceptions regarding distributive justice. Under these conceptions, distributive justice is not universal in scope, but applies only to those with a significant personal connection to a given society. Residents are those who are subject to taxation in accordance with their ability to pay. For nonresidents, the guiding principle in determining tax liability is not distributive justice but rather commutative justice.

Part III will examine whether the concept of residence is applicable to corporations. It will argue that as corporations have no personal identity, experience neither pleasure nor pain, have no personal attachments, and are not Kantian rational beings, they cannot be members of a collective to which the terms of distributive justice apply.

Part IV distinguishes between corporations and their shareholders. Although corporations cannot be residents of a country, individual shareholders can, and as computing their ability-to-pay requires taking into account their accession to wealth derived from shareholding, a means must be found whereby to tax them on that income. In the domestic arena, the corporate income tax serves this function. However, with regard to any corporation with both U.S. and foreign shareholders, the imposition of tax on the corporate entity as a proxy for taxing individual shareholders is not feasible. Consequently, the current corporate tax regime is unviable in the international arena.

Part V describes in broad outline an alternative international corporate tax regime that would attempt to reach the worldwide income of resident shareholders and the U.S.-source income of nonresident shareholders.

Part VI summarizes the findings and offers some concluding thoughts.

II. INDIVIDUAL RESIDENCE

A. Introduction

In order to examine whether the concept of residence is applicable to corporations, we first need to understand why a person’s residence is relevant when determining tax liability. This Part will explore residence in the context of individual taxpayers. Part III will then turn to corporate residence.

B. Ability-to-Pay

The role played by residence in international taxation is a function of the normative underpinnings of home-country income taxation.³⁰ Contemporary literature

³⁰ Home country taxation is the tax imposed by a country on its own residents. Host country taxation is the tax imposed by a country on foreign residents who engage in economic activity, including passive investment, within its territory. In other words, if we focus on income tax, an individual may be

justifies the income tax by reference to the principle of ability-to-pay.³¹ This term expresses the idea that those who are better off should contribute more to the provision of services for the general welfare than do those who are less well off. Why they should do so is a question to which supporters of ability-to-pay taxation offer various answers.³² Some refer to Utilitarian doctrine.³³ Because of the decreasing marginal utility of money, taking a dollar from a wealthy individual causes less disutility than does taking a dollar from a poor individual; and taking a dollar from a wealthy individual and using it to

subject to a country's income tax regime either by virtue of the fact that the individual resides in the country or by virtue of the fact that the individual derives income from sources located within that country.

³¹ See, e.g., PROFESSORS BRUINS, EINAUDI, SELIGMAN & SIR JOSIAH STAMP, REPORT ON DOUBLE TAXATION SUBMITTED TO THE FINANCIAL COMMITTEE OF THE LEAGUE OF NATIONS (1923), *reprinted in* 4 STAFF OF JOINT COMM. ON TAX'N, LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS 4022 (1962) [hereinafter LEAGUE OF NATIONS REPORT ON DOUBLE TAXATION] (“[T]he entire exchange theory has been supplanted in modern times by the faculty theory or theory of ability to pay.”); Shay et al., *supra* note 27, at 94 (“[T]he principal normative justification for income taxation is that it allocates the cost of government among taxpayers on the basis of comparative economic well-being, or ability to pay.”); Kyle C. Logue & Gustavo G. Vetton, *Narrowing the Tax Gap Through Presumptive Taxation*, 2 COLUM. J. TAX L. 100, 112–13, 121 (2010); Donna M. Byre, *Progressive Taxation Revisited*, 27 ARIZ. L. REV. 739, 765 (1995); Eric Jensen, *The Taxing Power, the Sixteenth Amendment, and the Meaning of “Incomes,”* 33 ARIZ. ST. L.J. 1057, 1091 (2001) (“From the beginning, supporters of the modern income tax stressed that it was necessary to tie taxation to ability to pay . . .”); Marjorie E. Kornhauser, *Choosing a Tax Rate Structure in the Face of Disagreement*, 52 UCLA L. REV. 1697, 1708–17 (2005); Shaviro, *supra* note 12, at 388–89.

Before the mid-nineteenth century, benefit theory dominated the tax policy discourse. See, e.g., THOMAS HOBBS, LEVIATHAN 238 (Richard Tuck ed., 1996) (Taxes should be imposed in accordance with “the benefit that every one receiveth thereby . . .”); ADAM SMITH, AN INQUIRY INTO THE NATURE OF AND CAUSES OF THE WEALTH OF NATIONS 310 (1776); JEREMY BENTHAM, THE PRINCIPLES OF MORALS AND LEGISLATION 160 (1789) (“To defend the community against its external as well as its internal adversaries, are tasks, not to mention others of a less indispensable nature, which cannot be fulfilled but at a considerable expense. But whence is the money for defraying to costs to come? It can be obtained in no other manner than by contributions to be collected from individuals; in a word, by taxes. The produce then of these taxes is to be looked upon as a kind of *benefit* which it is necessary the governing part of the community should receive for the use of the whole.” (emphasis in the original)); LEAGUE OF NATIONS REPORT ON DOUBLE TAXATION, *supra* note 31, at 4022 (“The older theory of taxation was the exchange theory, which was related directly to the philosophical basis of society in the ‘social contract,’ according to which the reason and measure of taxation are in accordance with the principles of an exchange as between the government and the individual . . . The benefit theory was that taxes ought to be paid in accordance with the particular benefits conferred upon the individual.”). One of the first to challenge the then-conventional view was JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY 398 (1848) [hereinafter MILL, PRINCIPLES] (“If there were any justice, therefore, in the theory of justice now under consideration, those who are least able of helping or defending themselves, being those to whom the protection of the government is the most indispensable, ought to pay the greatest share of its price . . .”); JOHN STUART MILL, UTILITARIANISM, LIBERTY, REPRESENTATIVE GOVERNMENT 54–55 (1863) (“[I]f there were no law or government the rich would be far better able to protect themselves than the poor would be, and indeed would probably succeed in making the poor their slaves . . . From these confusions there is no other mode of extrication other than the utilitarian.”). By the mid-twentieth century, benefit theory as a basis for broad-based taxes, such as the income tax, had been relegated to merely historical interest. HENRY C. SIMONS, PERSONAL INCOME TAXATION 3 (1938) (“[I]t is fair to say . . . that this principle, with reference to the allocation of the whole tax burden, is now of interest only for the history of the doctrine . . . [and] has been repudiated as completely by students as by legislatures.”).

³² The classic text examining this issue is WALTER J. BLUM & HARRY J. KALVEN, UNEASY CASE FOR PROGRESSIVE TAXATION (1953).

³³ See, in particular, the works of Jeremy Bentham and John Stuart Mill, *supra*, note 31. For a review of Jeremy Bentham’s writings and their applicability to tax theory, see Sagit Leviner, *The Normative Underpinnings of Taxation*, 13 NEV. L.J. 95, 113–21 (2012).

provide public services or to assist the needy increases the total quantum of happiness.³⁴ Some rely on Rawlsian principles. According to Rawls, everyone has an equal moral claim to material resources and other primary goods.³⁵ Justice permits deviation from an equal distribution of wealth only to the extent that such inequality works to the benefit of the least well-off stratum of society.³⁶ If the market distribution is more unequal than that—as is likely the case—then justice requires a redistribution of resources.³⁷ Some refer to sacrifice theory, according to which each person should experience the same degree of pain from paying taxes: because of the declining marginal utility of money, a wealthy individual would need to pay more than a poor person in order to experience the same degree of disutility.³⁸ Others seem to rely on an innate sense of fairness not necessarily grounded in a rigorous theory of social philosophy.³⁹ That individuals who can afford to

³⁴ See, e.g., HENRY SIDGWICK, *THE PRINCIPLES OF POLITICAL ECONOMY* 519 (1887) (“The common sense of mankind, in considering these inequalities, implicitly adopts, as I conceive, two propositions laid down by Bentham as to the relation of wealth to happiness: viz. (1) that an increase of wealth is—speaking broadly and generally—productive of an increase of happiness to its possessor; and (2) that the resulting increase in happiness is not simply proportional to the increase in wealth, but stands in a decreasing ratio to it . . . And from these two propositions taken together the obvious conclusion is that the more any society approximates to equality in the distribution of wealth among its members, the greater on the whole is the aggregate of satisfactions which the society in question derives from the wealth it possesses.”).

See also Jennifer Bird-Pollan, *Utilitarianism and Wealth Transfer Taxation*, 69 *ARK. L. REV.* 695 (2016); Calvin H. Johnson, *Was It Lost? Personal Deductions Under Tax Reform*, 59 *SMU L. REV.* 689, 693 (2006); Martin J. McMahon, Jr. & Alice G. Abreu, *Winner-Take-All Markets: Easing the Case for Progressive Taxation*, 4 *FLA. TAX REV.* 1 (1998). See also the sources cited in 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, 236–42 (1995).

³⁵ JOHN RAWLS, *A THEORY OF JUSTICE* 103–04 (1971).

³⁶ *Id.* at 62, 75–78.

³⁷ *Id.* at 246–47 (justifying “steeply progressive income taxes” “given the injustice of existing institutions”). See also Jennifer Bird-Pollan, *Unseating Privilege: Rawls, Equality of Opportunity, and Wealth Transfer Taxation*, 59 *WAYNE L. REV.* 713, 713 (2013); Schoenblum, *supra* note 34, at 251–57 (1995) (discussing and criticizing the principles of taxation derivable from Rawls).

³⁸ Jay A. Soled, *A Proposal to Lengthen the Tax Accounting Period*, 14 *AM. J. TAX POL’Y* 35, 57 (1997) (describing proportional sacrifice as “one of the fundamental tenets of a progressive tax structure”); Bruce Anderson, *Strategic Choice Taxation: A Solution to the Federal Revenue Crisis*, 1995 *COLUM. BUS. L. REV.* 281, 297, n.48; McMahon & Abreu, *supra* note 34, at 32 (“The most persuasive arguments for the equity of progressive taxation rest on the concept . . . that taxation ought to exact equiproportional sacrifice”); Richard Winchester, *Parity Lost: The Price of a Corporate Tax in a Progressive Tax World*, 9 *NEV. L.J.* 130, 131 (2008) (“[T]he income tax in the United States has always been intended to allocate the burden based on an individual’s ability to pay. This essentially embraces a theory of fairness referred to as the equal sacrifice theory.”) David Kamin, *What is a Progressive Tax Change?: Unmasking Hidden Values in Distributional Debates*, 83 *N.Y.U. L. REV.* 241, 272–79 (2008); Jeffrey H. Kahn, *Personal Deductions – A Tax “Ideal” or Just Another “Deal”?*, 2002 *MICH. ST. U. – DETROIT COLL. L. REV.* 1, 23 (“[E]qual sacrifice theory provides the most compelling argument for progressivity.”); Eric Rakowski, *Symposium on Wealth Taxes Part I: Can Wealth Taxes Be Justified?*, 53 *TAX L. REV.* 263, 310–16 (2000); Robert F. Parsley, *Building a House of Cards: A Policy Evaluation of Tennessee’s Tax Reform Act of 2002 With Emphasis on Fairness to the Poor*, 70 *TENN. L. REV.* 1177, 1181–82 (2003); Kornhauser, *supra* note 31, at 1717–21; Sagit Leviner, *From Deontology to Practical Application: The Vision of a Good Society and the Tax System*, 26 *VA. TAX REV.* 405, 427 (2006).

³⁹ Schoenblum, *supra* note 34, at 235 (“The ability to pay principle has now gained such widespread currency that its underlying premise rarely is questioned by tax law scholars. They tend to assume uncritically that there is a direct relation between ability to pay and fairness.”); Fleming et al., *supra* note 27, at 309 (describing the ability-to-pay doctrine as “dogma”).

do so should pay more than those who are struggling seems to strike an intuitive chord that is often sufficient to support a policy of taxation according to ability-to-pay.⁴⁰

For the purpose of our discussion, it is not important to identify the precise theoretical justification for taxation according to ability-to-pay or even to determine whether it has a precise theoretical justification. All that we need to note is that the subject matter of ability-to-pay taxation is the welfare of the various members of the collective, the conflicting claims to material resources held by various members of the collective, and the rights and obligations of those who are better off vis-à-vis those who are not as well off. Furthermore, in the context of tax policy, ability-to-pay is not an absolute or descriptive, but rather a relative and normative, term of art. It does not describe an individual's absolute capacity to pay tax (a term which, when taken literally, refers to a person's entire wealth or entire income); rather, it compares the relative effect of paying tax on the welfare of different individuals.⁴¹

Granted, not all commentators accept the idea of taxation according to ability-to-pay. Some argue that justice permits charging individuals no more than the market price of the services that they receive.⁴² More extreme versions hold that justice prohibits charging for services, even those that confer positive value, unless the recipient of those services explicitly contracted to pay for them.⁴³ However, as income tax derives from the doctrine of ability-to-pay and as the question we are considering is whether residence is a concept applicable to corporations within the framework of income taxation, we do not need to consider these views here.

C. Taxation of Worldwide Income

The fact that income tax derives from the concept of ability-to-pay has an important ramification in the international arena. If the appropriate measure of ability-to-pay is accession to wealth,⁴⁴ then tax liability must be a function of worldwide income.⁴⁵

⁴⁰ See, e.g., Sergio Pareja, *Taxation Without Liquidation: Rethinking "Ability to Pay,"* 8 WIS. L. REV. 841, 843 (2008) ("Our tax system aims to tax people based on their ability to pay. As a society, we believe that it is fairer to make a billionaire pay more taxes than a homeless person."); JOEL S. NEWMAN, A SHORT & HAPPY GUIDE TO FEDERAL INCOME TAXATION 7 (2017) ("Quite a few of us can't afford \$6,250 per year ... On the other hand, there are quite a few other folks in the US who can afford to pay a lot more than \$6,250 per year. So what should we do? We should levy taxes based upon ability to pay.").

⁴¹ The text intentionally leaves the term "welfare" vague, as there are different opinions regarding the ultimate subject matter of distributive justice: pleasure, happiness, satisfaction of rational desire, access to resources necessary to realize one's ends, and so forth. See generally RAWLS, *supra* note 35, at 25, 92–93; Ronald Dworkin, *What is Equality? Part 1: Equality of Welfare*, 10 PHIL. & PUB. AFF. 185 (1981); Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 PHIL. & PUB. AFF. 283 (1981).

⁴² See, e.g., John R. McCulloch, *For Proportional Taxation*, in VIEWPOINTS ON PUBLIC FINANCE 22, 25 (Harold M. Grooves ed., 1947) ("Providence has not been charged with injustice because the corn and other articles used indifferently by the poor and the rich cost one class as much as they cost the other. And such being the case, how can it be pretended that governments, in laying equal duties on these articles, commit injustice? A rich man will, of course, pay taxes and everything else, with less inconvenience than one who is poor. But is that any reason why he should be unfairly treated?").

⁴³ See, e.g., ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 95 (1974) ("One cannot, whatever one's purposes, just act so as to give people benefits and then demand (or seize) payment. Nor can a group of persons do this.").

⁴⁴ This view is not universally held. There are those who argue that consumption and wealth are better measures of ability-to-pay than is income. See, e.g., William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113 (1974); David F. Bradford, *The Case for a Personal Consumption Tax*, in WHAT SHOULD BE TAXED: INCOME OR EXPENDITURE? 75 (Joseph A. Pechman

For example, an individual with \$100,000 in domestic income and \$900,000 in foreign-source income has—subject to proper accounting for any foreign income tax liability—the same ability to pay tax as does an individual with \$1,000,000 in domestic-source income.⁴⁶ Imposing tax only on their domestic-source income would constitute a clear violation of the doctrine of ability-to-pay, manifested in this context of this example as a violation of horizontal equity.⁴⁷ Furthermore, as the wealthy tend to have relatively more foreign-source earnings than those who are less well off, ignoring foreign-source income in calculating ability-to-pay would violate vertical equity, another principle derived from the principle of taxation in accordance with ability-to-pay.

D. Delineating the Parameters of the Collective

The concept of ability-to-pay is meaningless without delineating the parameters of the collective to which it refers. In other words, whose welfare, whose needs, whose claims, and whose resources are relevant? The collective to which the principles of distributive justice apply is a contentious issue in social philosophy. Social philosophers of the cosmopolitan school argue that the proper collective is humanity as a whole and that the rights and obligations of distributive justice transcend national boundaries.⁴⁸ Adopting such an approach would require taking into account the ability-to-pay and the needs of every person on the planet, imposing a worldwide tax, and providing worldwide benefits.⁴⁹ Others disagree and limit the scope of distributive justice to the confines of a political society.⁵⁰ Under this approach, it is the ability-to-pay and the needs of members

ed., 1980); David Shakow & Reed Shuldiner, *A Comprehensive Wealth Tax*, 53 TAX L. REV. 499 (2000). However, we do not need to consider these views here. The purpose of this article is not to challenge income taxation but to challenge the concept of corporate taxation within the framework of income taxation. Consequently, I will accept arguendo the underlying assumptions of income taxation: that people should pay tax in accordance with their ability-to-pay, and that the appropriate measure of ability-to-pay is income.

⁴⁵ In contrast, benefit theory has a difficult time justifying the taxation of foreign-source income: when income is earned abroad, it is the host country that provides the relevant services.

⁴⁶ See, e.g., Fleming et al., *supra* note 27, at 310–13; Michael S. Kirsch, *The Role of Physical Presence in the Taxation of Cross-Border Personal Services*, 51 B.C. L. REV. 993, 1043–44 (2010); Rosenzweig, *supra* note 2, at 478; Paul R. McDaniel, *Territorial vs Worldwide International Tax Systems: Which is Better for the U.S.?*, 8 FLA. TAX REV. 283, 299–300 (2007); John P. Steines, Jr., *The Foreign Tax Credit at Ninety-Five Bionic Centenarian*, 66 TAX L. REV. 545 (2013).

⁴⁷ Horizontal equity dictates that similarly situated persons should bear identical tax burdens. See, e.g., David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43 (2006); Ira K. Lindsay, *Tax Fairness by Convention: A Defense of Horizontal Equity*, 19 FLA. TAX REV. 79 (2016); James Repetti & Diane Ring, *Horizontal Equity Revisited*, 13 FLA. TAX REV. 135 (2012); Brian Galle, *Tax Fairness*, 65 WASH. & LEE L. REV. 1323 (2008).

⁴⁸ See, e.g., BRIAN BARRY, *THE LIBERAL THEORY OF JUSTICE: A CRITICAL EXAMINATION OF THE PRINCIPLE DOCTRINES IN A THEORY OF JUSTICE BY JOHN RAWLS* 128–30 (1973); CHARLES R. BEITZ, *POLITICAL THEORY AND INTERNATIONAL RELATIONS* 139–41, 143–53 (1979); Loren Lomasky, *Toward a Liberal Theory of Natural Boundaries*, in *BOUNDARIES AND JUSTICE* 55, 56–60 (David Miller & Sohail H. Hashmi eds., 2001); THOMAS W. POGGE, *REALIZING RAWLS* 240, 250–51 (1989); KOK-CHOR TAN, *JUSTICE WITHOUT BORDERS: COSMOPOLITANISM, NATIONALISM AND PATRIOTISM* 60 (Russell Hardin et al. eds., 2004).

⁴⁹ Such a structure might not be possible without a world government with global enforcement powers. See, e.g., Thomas Nagel, *The Problem of Global Justice*, 33 PHIL. & PUB. AFF. 113, 115 (2005) (“If Hobbes is right, the idea of global justice without a world government is a chimera.”).

⁵⁰ DANIEL BELL, *COMMUNITARIANISM AND ITS CRITICS* 150–51 (1993); MARGARET CANOVAN, *NATIONHOOD AND POLITICAL THEORY* 28–29 (1996); RONALD DWORKIN, *LAW'S EMPIRE* 208 (1986); WILL KYMLICKA, *POLITICS IN THE VERNACULAR: NATIONALISM, MULTICULTURALISM AND CITIZENSHIP* 225 (2001); AVISHAI MARGALIT, *THE ETHICS OF MEMORY* 74–76 (2002); JOHN RAWLS, *THE LAW OF PEOPLES* (1999);

of the society, not those of outsiders, that dictate who pays how much tax and how the revenue is spent. National legislatures—whether because of a principled rejection of cosmopolitanism or because of the practical limits of national sovereignty—adopt the latter approach.⁵¹

Consequently, domestic law needs to distinguish between members of the collective and outsiders, between those among whom the norms of distributive justice apply and those who are beyond the parameters of those norms. While there is no universally accepted criterion by which countries delineate which individuals are members of the collective and which are not, the common denominator of all such criteria is that they reflect an individual's personal attachments to the society in question. Typical criteria include physical presence, habitual abode, personal and social attachments, and domicile.⁵² Under U.S. tax law, the criteria for including an individual within the ambit of those whose ability-to-pay is a factor in determining tax liability are physical presence,⁵³ citizenship,⁵⁴ and formal status as a permanent resident (“green card” holder).⁵⁵ Those whom the law views as members of the collective are ordinarily termed “residents.” Those whom the law views as outside the collective are ordinarily termed “nonresidents” or “foreigners.”⁵⁶ The goal of the tax system and of the services that it funds is to promote the welfare of residents.

Of course, the welfare interests of residents can conflict. Policies that promote the welfare of some may be detrimental to the welfare of others, and this is particularly true with regard to taxation. However, this conflict is precisely what the norms of distributive justice seek to regulate: given the fact that resources are limited, how should

RICHARD RORTY, *CONTINGENCY, IRONY, AND SOLIDARITY* 190–91 (1989); Yael Tamir, *LIBERAL NATIONALISM* 121 (1993).

⁵¹ See, e.g., Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443, 480 (2007) (“The threshold question is whether ability-to-pay analysis should adopt a worldwide perspective, which would consider the relative incomes of all individuals worldwide, or whether it should adopt a national perspective, looking only at the incomes of members of U.S. society (however defined). Commentators who have addressed this issue have generally concluded that, for both practical and theoretical reasons, U.S. tax policy should take a national perspective.”); Shaviro, *FIXING*, *supra* note 25, at 98–103.

⁵² Ruth Mason, *Citizenship Taxation*, 89 S. CAL. L. REV. 169, 178 (2016) (“States ... determine residence by evaluating connecting factors such as whether the taxpayer has a dwelling in the jurisdiction, whether her family resides there, and whether she has social and economic connections to the jurisdiction.”); Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289, 1323 (2011) (“Many nations, implicitly or expressly, define residence for tax purposes as domicile ...”); Daniel Shaviro, *Taxing Potential Community Members’ Foreign Source Income 2* (New York Univ. Ctr. for Law, Econ. & Org., Working Paper No. 15-09, 2015), available at https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2625732 [<https://perma.cc/88VA-9A4S>] (mentioning “location of property that one owns in-country, such as a home; the place where one’s primary business or other economic ties appear to be located; and the place of residence for close family members.”).

⁵³ I.R.C. § 7701(b)(1)(A)(ii), (3).

⁵⁴ I.R.C. § 872(a) (excluding foreign source income from the gross income of “nonresident alien individuals” and leaving nonresident citizens subject to the general provisions of I.R.C. § 61(a), under which “gross income means all income from whatever source derived ...”).

⁵⁵ I.R.C. § 7701(b)(1)(A)(i).

⁵⁶ Because the United States includes citizens, whatever their other attachments to the country, within the collective, the terms employed by U.S. tax law for individuals who outside the collective is “nonresident alien.” I.R.C. § 872. Nevertheless, for the sake of simplicity the text will refer to those subject to tax on their worldwide income as “residents” and to those who are not as “nonresidents” or “foreigners.” In the U.S. context, the term “residents” includes nonresident citizens, and the terms “nonresidents” and “foreigners” refer to nonresident aliens.

they be distributed among the members of the collective?⁵⁷ Each theory of distributive justice effectively provides a matrix by which to evaluate the justice of alternative distributions of resources. For example, under a Utilitarian approach, the ideal distribution is one that maximizes total welfare.⁵⁸ Under Rawls' difference principle, the ideal distribution is one that maximizes the well-being of the least well-off segment of society.⁵⁹ Alternative approaches to distributive justice might assign different values to efficiency, equality, contribution, need, and so forth and choose other distributions as ideal.⁶⁰ For our purposes, the details and justifications of the various conceptions of distributive justice are not important. What is important from our perspective is that each considers the effect of public policy on the welfare of the members of the collective and attempts, each in its own way, to describe an appropriate balance.

The welfare of nonresidents is not an essential element of the matrix by which national governments determine their tax policy. Granted, relatively wealthy countries often provide foreign aid to countries that are less well off. However, there is both a qualitative and a quantitative difference between public funds spent on foreign aid and public funds spent on services to residents. Qualitatively, the motivation for foreign aid is often the promotion of the donor country's own power or prestige.⁶¹ In other words, it is the welfare of the donor country's residents—those who stand to benefit from their country's improved international standing—that serves as the basis of the distributive justice matrix. Quantitatively, the amount that countries typically dedicate to foreign aid is minuscule relative the amount that they spend promoting the welfare of their own residents.⁶²

E. Taxation of Nonresidents

Under current international usage, countries may and often do impose tax on nonresidents who engage in economic activity—including passive investment—within

⁵⁷ See, e.g., RAWLS, *supra* note 35, at 4 (“[A]lthough a society is a cooperative venture for mutual advantage, it is typically marked by a conflict as well as by an identity of interests. There is an identity of interests since social cooperation makes possible a better life for all than any would have if each were to live solely by his own efforts. There is a conflict of interests since persons are not indifferent as to how the greater benefits produced by their collaboration are distributed, for in order to pursue their ends they each prefer a larger to a lesser share. A set of principles is required for choosing among the various social arrangements which determine this division of advantages and for underwriting an agreement on the proper distributive shares. These principles are the principles of social justice ...”).

⁵⁸ See note 34, *supra*.

⁵⁹ See notes 35–37, *supra*.

⁶⁰ See, e.g., Menahem E. Yaari, *A Controversial Proposal Concerning Inequality Measurement*, 44 J. OF ECON. THEORY 381 (1988).

⁶¹ See, e.g., A. Cooper Drury, Richard Stuart Olson & Douglas A. Van Belle, *The Politics of Humanitarian Aid: U.S. Foreign Disaster Assistance, 1964–1995*, 67 J. OF POL. 454 (2005); Andrea Civelli, Andrew W. W. Horowitz & Arilton Teixeira, *Is Foreign Aid Motivated by Altruism or Self Interest? A Theoretical Model and Empirical Test* (Feb. 2014), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2390448 [<https://perma.cc/2FC5-7KZB>].

⁶² In 2015, the nineteen member countries of the OECD's Development Assistance Council spent 0.47% of their combined gross national income on foreign aid. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), *Development Aid in 2015 Continues to Grow Despite Costs for In-Donor Refugees*, 3 (Apr. 13, 2016), <http://www.oecd.org/dac/stats/ODA-2015-detailed-summary.pdf> [<https://perma.cc/9T5J-UFTM>]. In contrast, total government spending by OECD countries in 2015 ranged from 29.4% (Ireland) to 57.0% (Finland) of GNP. OECD, *General Government Spending* (2017), <https://data.oecd.org/gga/general-government-spending.htm> [<https://perma.cc/LWE5-PWJV>].

their territory. Furthermore, countries often provide tax-funded services to such nonresidents. However, the payment of tax and receipt of services does not mean that the rights and obligations of distributive justice apply to nonresidents economically active in a country. When formulating its policies vis-à-vis nonresidents, it is not the welfare of those nonresidents that is of primary concern to the host country, but rather the welfare of its own residents.⁶³ The host country provides services to nonresidents in order to encourage investment from which it hopes its residents will benefit. It collects tax from nonresidents because doing so allows it to alleviate the tax burden it imposes on its own residents or to provide them with more services without increasing their tax payments.⁶⁴ The primary practical limitation on taxing nonresidents is that doing so may discourage beneficial foreign investment and, as a consequence, negatively affect the welfare of residents.⁶⁵

The taxation of nonresidents derives not from principles of distributive justice—as in the case of residents—but rather from principles of commutative justice,⁶⁶ a concept referred to in the tax literature as exchange theory or benefit theory.⁶⁷ Host countries provide services—including granting the right to operate within their sovereign territory, to access their markets, and so forth—and are entitled to charge for those services whatever the market will bear.⁶⁸ With regard to nonresidents, the principle of ability to pay is irrelevant. The fact that a nonresident pays more tax than a resident who is wealthier than she, or less than a resident who is poorer than she, does not ground a claim of unjust treatment either of the nonresident (in the former case) or of the resident (in the latter). The principle of ability-to-pay applies only among residents.

Furthermore, although countries that impose income tax ordinarily include foreign-source income in the tax base of their individual residents, to the best of my knowledge no country attempts to tax the foreign-source income of nonresidents.⁶⁹ This phenomenon too is a consequence of the inapplicability of norms of distributive justice to nonresidents. Because the inclusion of foreign-source earnings in the tax base is a

⁶³ Graetz, *supra* note 2, at 280; Shavero, *supra* note 12, at 397.

⁶⁴ LEAGUE OF NATIONS REPORT ON DOUBLE TAXATION, *supra* note 31, at 4044 (“A survey of the whole field of recent taxation shows how completely the Governments are dominated by the desire to tax the foreigner.”); Shay et al., *supra* note 27, at 89.

⁶⁵ David Elkins, *The Merits of Tax Competition in a Globalized Economy*, 91 IND. L.J. 905, 932, 948 (2016).

⁶⁶ For a discussion of commutative justice in taxation, see David Elkins, *Taxation and the Terms of Justice*, 41 U. TOLEDO L. REV. 73, 78–82 (2009).

⁶⁷ Barker, *supra* note 11, at 665 (“The exchange or benefit principle of taxation is the primary theory that underlies source-based international taxation.”); Fleming et al., *supra* note 27, at 307 n.13 (“Because ... [the tax regime applicable to nonresidents] usually reaches less than the taxpayer’s entire net income, it cannot be grounded on ability-to-pay. Instead, it is often rationalized as a benefit-based charge imposed by the source country.”); J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Designing a U.S. Exemption System for Foreign Income When the Treasury Is Empty*, 13 FLA. TAX REV. 397, 401 (2012) (“[E]very country has a normative claim, based on a benefits-received rationale, to tax income earned by foreigners within its borders.”); Lawrence Lokken, *The Source of Income from International Uses and Disposition of Intellectual Property*, 36 TAX L. REV. 235, 239–40 (1981); Herwig J. Schlunk, *How I Learned to Stop Worrying and Love Double Taxation*, 79 NOTRE DAME L. REV. 127, 129–30 (2003); Shay et al., *supra* note 27, at 90–91.

⁶⁸ Shay et al., *supra* note 27, at 95 (“[T]he justification for source taxation cannot be ability to pay but instead must be a charge for access to the source country market.”).

⁶⁹ Recall that in the case of the United States, the term “resident” in the text refers also to nonresident citizens. See note 56, *supra*.

function of the ability-to-pay concept, and because ability-to-pay is inapplicable to nonresidents, nonresidents are not subject to tax on their foreign-source income. In summation, the distinction between residents and nonresidents is ultimately a distinction between those who are subject to taxation according to the standard of ability-to-pay and those who are not.⁷⁰

III. CORPORATE RESIDENCE

Part II demonstrated that for individuals, residence means a personal connection significant enough that one's welfare is properly taken into account as part of the matrix of distributive justice and that one is therefore properly subject to taxation in accordance with the principle of ability-to-pay. This Part will examine whether the income tax concept of residence is applicable to corporations.

A. Welfare

Residence is a matter of whose welfare is important. In designing the contours of its tax structure, a country's only or primary concern is promoting the welfare of its own residents. The potential impact on the welfare of nonresidents plays little or no role (except to the extent that the resultant behavior of nonresidents might affect the welfare of residents). Therefore, when we ask which corporations are residents and which are nonresidents, we are effectively asking which corporations' welfare should constitute part of the matrix by which we determine economic and social policy.

Phrasing the question in this manner underscores the absurdity inherent therein. However much the law or popular discourse might anthropomorphize the corporate entity,⁷¹ a corporation is not a sentient being.⁷² Well-being, in the sense that is relevant to distributive justice, is not an attribute of juristic entities.⁷³ Of course, the success or failure of a corporation can affect the welfare of individuals and the fate of the corporate enterprise is consequently of interest for public policy, but it is the welfare of the affected

⁷⁰ For a discussion of “[t]he paradox [that i]f you’re among ‘us’ and we care about you, you lose ... since it means that [you] may have to pay tax on [your foreign source income],” see Shaviro, *supra* note 52, at 24–29. (emphasis removed).

⁷¹ See, e.g., Brent Fisse & John Braithwaite, *The Allocation of Responsibility for Corporate Crime: Individualism, Collectivism and Accountability*, 11 SYDNEY L. REV. 468, 482 (1988) (“We often react to corporate offenders not merely as impersonal harm-producing forces but as responsible, blameworthy entities.”) (footnote omitted).

⁷² See, e.g., ROBERT B. REICH, *SUPERCAPITALISM: THE TRANSFORMATION OF BUSINESS, DEMOCRACY, AND EVERYDAY LIFE* 216 (2007) (“A final truth that needs to be emphasized—the most basic of all—is that corporations are not people.”).

⁷³ See William B. Barker, *A Common Sense Corporate Tax: The Case for a Destination-Based, Cash Flow Tax on Corporations*, 61 CATH. U. L. REV. 955, 1000 (2012) (“Corporations have control over resources, but, as artificial persons, their relation to the state and society cannot be described in the same way as individuals.”) (footnote omitted); Fleming et al., *supra* note 27, at 319 (“This taxation scheme cannot be explained on ability-to-pay grounds because liability under the corporate-level tax is calibrated to the taxable income of the corporation and bears no necessary relationship to the respective abilities to pay of any individuals.”) (footnote omitted); Shaviro, *supra* note 12, at 395 (“[C]orporations are not sentient beings, and cannot feel benefits or burdens. Thus, they are not directly of normative interest. Relevant distributional goals can only relate to people.”).

individuals rather than the success or failure of the corporation that has normative and economic import.⁷⁴

In the literal, descriptive sense of the term, a corporation has an ability-to-pay tax. Its ability-to-pay is equal to its net equity, the totality of its assets, or the whole of its income: the government simply cannot take more than that amount.⁷⁵ However, we have already noted that in the context of tax policy, the concept of ability-to-pay is not descriptive or absolute, but rather prescriptive and relative.⁷⁶ It compares the effect of paying tax on the welfare of various taxpayers and evaluates which tax schemes most closely conform to the relevant conception of distributive justice. In this sense of the term, corporations have no ability-to-pay tax because there is no such thing as the welfare of a corporation.⁷⁷

The primary purpose for distinguishing between residents and non-residents is that residents and only residents are properly subject to ability-to-pay taxation. The fact that the principle of ability-to-pay is inapplicable to the corporate entity means that residence too is inapplicable to the corporate entity.

B. Personal Connections

The principle of ability-to-pay applies to those with a substantial personal connection to the country concerned.⁷⁸ Purely economic connections, however extensive, are in themselves insufficient to invoke the rights and obligations of distributive justice that underlie ability-to-pay taxation. Granted, in borderline cases, when an individual has strong personal connections to more than one country, economic connections might be relevant in determining residence. For example, most income tax treaties include among their “tie-breaking” rules, used to assign residence when an individual is a resident of both contracting states under their domestic laws, a reference to the country “with which his personal and economic relations are closer (center of vital interests).”⁷⁹ Nevertheless,

⁷⁴ Despite its reputation as the dismal science, “[t]he ultimate goal of economic science is to improve the living conditions of people in their everyday lives.” PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 7 (2010).

⁷⁵ Whether the measure of descriptive (as opposed to normative) ability-to-pay is equity, assets, or income is a matter of definition. If ability-to-pay means the most that a corporation could pay while retaining enough assets to repay its creditors, then its ability-to-pay is equal to its equity. If ability-to-pay means the most the government could take without regard to the claims of creditors, then the corporation’s ability-to-pay is equal to the totality of its assets (although one might reasonably argue that the ability-to-pay of the corporation is limited to its equity and that any amount taken beyond that is part of the ability-to-pay of the creditors). If ability-to-pay means the most the government could take while allowing the corporation to continue functioning indefinitely, then the corporation’s ability-to-pay is equal to the whole of its periodic income.

⁷⁶ See *supra* text accompanying note 41.

⁷⁷ Joseph M. Dodge, *A Combined Mark-to-Market and Pass-Through Corporate-Shareholder Integration Proposal*, 50 *TAX L. REV.* 265, 274 (1995) (“The ability to pay norm ... is ... a maxim ... of tax fairness, which has to do with how the aggregate burden of taxation should be apportioned among individuals. Thus, saying that a public corporation has a separate ability to pay does not justify its being treated as a separate taxable unit from a fairness perspective, other than as ... perhaps a withholding vehicle pending dividend distributions.”) (footnotes omitted); Marian, *supra* note 1, at 1616 (“Scholars agree ... that for tax purposes, corporations are *not* real beings. Rather, corporations are instruments for the taxation of individuals.”) (footnotes omitted).

⁷⁸ See *supra* Part II.D.

⁷⁹ See, e.g., UNITED STATES MODEL INCOME TAX CONVENTION, art. 4, ¶ (3)(a) (2016); U.N. DEP’T OF ECON. & SOC. AFFAIRS, U.N. MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND

a number of caveats are in order. First, the United States, the OECD, and the UN model income tax conventions all rely on an initial tie-breaking rule that involves a purely personal connection: the place of the individual's permanent home. Only if the permanent home test does not resolve the issue—either because the individual has a permanent home in both countries or because she does not have a permanent home in either country—do the treaties invoke “center of vital interests” as a secondary tie-breaker.⁸⁰ Second, the primary focus of the “center of vital interests” test itself is the individual's personal, not economic, connections.⁸¹ Third, and perhaps most important, economic connections can never establish residency. The basis for residence is the country's determination, under its domestic laws, that the individual has a sufficient personal nexus to the country.⁸² The economic connection serves merely to limit a country's right to tax an individual, despite the personal connection, because of the individual's stronger connection to another country.

The emphasis on an individual's personal connection to a country is not capricious. Those personal connections that bind members of a community together function as a trigger for the rights and obligations of distributive justice that underlie ability-to-pay taxation. Assume, for instance, that one of the obligations of distributive justice is a duty to provide some level of support to those who are incapable of providing for their own needs. Now consider the case of an individual whose sole connection to a country is economic. Perhaps she owns income-producing property in the country. Perhaps she even has active business interests in the country. Should she become destitute for whatever reason, she would have no claim under the terms of distributive justice for support from the host country. The country that she would need to turn to for support would be her own country of residence, the one with which she maintains her strongest personal connections.

Of course, the fact that economic connections cannot serve as the basis for individual residence does not mean that economic connections cannot serve as the basis for the imposition of tax. As a sovereign entity, a country has a right under international

DEVELOPING COUNTRIES, art. 4, ¶ (2)(a), (2011); OECD, *Articles of the Model Tax Convention with Respect to Taxes on Income and on Capital*, art. 4, ¶ (2)(a) (Jan. 28, 2003).

⁸⁰ UNITED STATES MODEL INCOME TAX CONVENTION, *supra* note 79, at art. 4, ¶ (3)(a); U.N. DEP'T OF ECON. & SOC. AFFAIRS, *supra* note 79, at art. 4, ¶ (2)(a); OECD, *supra* note 79, at art. 4, ¶ (2)(a). The Commentary to the OECD Model Income Tax Convention C(4)–5 states that “[t]he Article gives preference to the Contracting State in which individual has a permanent home available to him. This criterion will frequently be sufficient to solve the conflict ...” OECD, *Commentaries on the Articles of the Convention*, 86 (2010). The United States Model Technical Explanation Accompanying the United States Model Income Tax Convention of November 15, 2006 ([the government has not yet published a technical explanation of the 2016 model treaty] clarifies that “[t]hese tests are to be applied in the order in which they are stated.”), available at <https://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf> [<https://perma.cc/CQ8C-PBY2>].

⁸¹ The Commentary to the OECD Model Income Tax Convention C(4)–6 explains the “centre of vital interest” test as follows: “regard will be had to his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property, etc. The circumstances must be examined as a whole, but it is nevertheless obvious that consideration based on the personal acts of the individual must receive special attention.” OECD, *supra* note 80, at 87.

⁸² See, e.g., UNITED STATES MODEL INCOME TAX CONVENTION, *supra* note 79, at art. 4, ¶ (3)(a); OECD, *supra* note 79, at art. 4, ¶ (1) (“the term ‘resident of a Contracting State’ means any person who, under the laws of that [Contracting] State, is liable to tax therein by reason of his domicile, residence, [citizenship] ... or any other criterion of a similar nature ...”). The corresponding Articles of the OECD and UN Model Tax Treaties are identical, except that they do not include citizenship as a criterion of residence.

law to charge nonresidents for access to its territory and its markets.⁸³ In the field of income taxation, this means that countries have the right to impose tax on nonresidents for income derived from domestic sources.⁸⁴ They do not have the right to impose tax on the foreign-source income of nonresidents.

Corporations have no personal connections. Due to their nature as juristic persons, the only type of connection that they can have with a country is economic. The country with which it has such a connection may impose tax on the income that the corporation derives from its economic involvement with the country. However, because an economic connection by itself is insufficient to establish a right to impose tax on foreign-source income and because a corporation cannot have any connection other than economic, there can be no justification for imposing tax on a corporation's foreign-source income.

Consider the leading case of *De Beers*, decided by the House of Lords in 1906.⁸⁵ *De Beers* concerned the question of when a corporation is a United Kingdom resident for the purpose of the corporate income tax. Under UK law at the time, a person residing in the United Kingdom was liable for tax on annual profits "from any kind of property, whether situated in the United Kingdom or elsewhere" and "from any profession, trade, employment, or vacation, whether the same shall be respectively carried on in the United Kingdom or elsewhere."⁸⁶ The problem facing the House of Lords was that residence is a term that conceptually applies to individuals, not to corporations: "it is easy to ascertain where an individual resides, but when the inquiry relates to a company, which in a natural sense does not reside anywhere, some artificial test must be applied."⁸⁷

The House of Lords decided that in determining the residence of a corporation, one should "proceed as nearly as we can upon the analogy of an individual."⁸⁸ The question was then how to analogize, with regard to residence, from a natural person to an artificial person when the terms of reference relate specifically to those characteristics of the former that are absent in the case of the latter. The taxpayer argued that a corporation resides in the country in which it is registered and that, registered in South Africa, it was a resident of that territory and not of the United Kingdom. In rejecting this argument, the House of Lords viewed registration as corresponding not to an individual's residence but rather to an individual's citizenship. *De Beers* was in an analogous position to a citizen of South Africa. However, just as an individual who is a foreign national may reside in the United Kingdom, so too a corporation registered abroad may be a UK resident.⁸⁹

⁸³ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 402(1)(a) (AM. LAW INST. 1987); Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 L. & POL'Y INT'L BUS. 145, 198 (1998) ("A finding that ... part of one or more [of] the considerations relevant to economic allegiance ... occurs within the territory ... of a state is [enough] to endow that state with a competence to tax the income thus produced ..."); Reuven S. Avi-Yonah, *International Tax as International Law*, 57 TAX L. REV. 483, 490 (2004) ("The right of countries to tax income arising in their territory is well established in international law.").

⁸⁴ While host countries have the right to tax the domestic source income of nonresidents who operate within their territory, I have argued elsewhere that income is not an appropriate base for taxing nonresidents. See generally David Elkins, *The Case Against Income Taxation of Multinational Enterprises*, 36 VA. TAX REV. 143 (2017).

⁸⁵ *De Beers Consolidated Mines, Ltd. v. Howe* [1906] AC 455 (HL) (appeal taken from Eng.).

⁸⁶ *Id.* at 457–58 (quoting Section 2 of the Income Tax Act 1853, Schedule D).

⁸⁷ *Id.* at 458.

⁸⁸ *Id.*

⁸⁹ *Id.*

What then are the characteristics of a corporation that are analogous to the residence of an individual? “A company cannot eat or sleep,” the House of Lords noted, “but it can keep house and do business. We ought, therefore to see where it really keeps house and does business.”⁹⁰ In other words, for individuals, residence is a function of various aspects of their personal lives (where they eat and sleep). A corporation has no personal life. All it has is a business life. The House of Lords therefore analogized between the personal life of an individual and the business life of a corporation and determined that a corporation is a resident of the country in which it conducts its business. Of course, this leaves open the question of where a multinational corporation conducts its business. In the case of *De Beers*, its head office was in South Africa, it held its general meetings in South Africa, its mines were in South Africa, it delivered its diamonds to purchasers in South Africa, some of the directors and life governors lived in South Africa, and some of the directors’ meetings were held in South Africa.⁹¹ Nevertheless, the House of Lords was of the opinion that “the real business is carried on where the central management and control actually abides” and not where its business operations are located.⁹² In the case of *De Beers*, “the majority of directors and life governors live in England [and] the directors’ meetings in London are the meetings where the real control is always exercised ...”⁹³ Consequently, the House of Lords concluded that the corporation was a resident of the United Kingdom and was liable for UK tax on its worldwide income.⁹⁴

For our purposes, the significance of *De Beers* is not the central management and control test, but rather the fact that the House of Lords relied upon the analogy between the personal life of an individual and the business life of a corporation. Upon closer examination, this analogy turns out to be false. Individuals have both business lives and personal lives. Their personal lives, as appropriate to the terms of distributive justice that underlie the income tax, determine where they are subject to worldwide taxation.⁹⁵ Their business lives—that is, the location of their investments and their business interests, where they work, and so forth—determine where they are subject to territorial taxation. An individual’s business interests, however extensive, are by themselves insufficient to trigger residence and to subject the individual to tax on foreign-source income.⁹⁶ In

⁹⁰ *Id.*

⁹¹ *Id.* at 458–59.

⁹² *Id.* at 458.

⁹³ *Id.* at 459.

⁹⁴ For a review of the development of the central management and control test in UK case law following *De Beers*, see William M. Funk, *On and Over the Horizon: Emerging Issues in U.S. Taxation of Investment*, 10 *HOUS. BUS. & TAX L. J.* 1, 24–28 (2010); Tillinghast, *supra* note 1, at 261–62. In 1988, Parliament expanded the common law definition of residents by providing that a corporation incorporated in the United Kingdom is a UK corporation regardless of where it is controlled and managed. Finance Act 1988, c. 39 (UK), <https://www.legislation.gov.uk/ukpga/1988/39/contents>; STEPHAN RAMMELOO, *CORPORATIONS IN PRIVATE INTERNATIONAL LAW: A EUROPEAN PERSPECTIVE* 135 (2001). Since 1965 Canadian income tax law has no statutory definition of corporate residence, except for a provision that companies incorporated in Canada after April 26, 1965 are deemed to be residents of Canada. In determining residence beyond the statutory provision, Canadian courts generally follow UK case law. Michael S. Schadewald & Tracy A. Kaye, *Source of Income Rules and Treaty Relief from Double Taxation within the NAFTA Trading Bloc*, 61 *LA. L. REV.* 353, 363 (2001).

⁹⁵ See *supra* Subpart B.

⁹⁶ Cf. John K. Sweet, *Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-Based Taxation in an Era of Eroding Traditional Income Tax Principles*, 146 *U. PA. L. REV.* 1949, 1993 (1998) (“Unlike individuals, corporations, especially multinational

contrast to individuals, corporations have no personal lives; they only have business lives.⁹⁷ Therefore, a proper analogy between individuals and corporations would lead to an opposite conclusion than that arrived at by the House of Lords. Corporations should be subject to territorial taxation wherever they have economic interests and should nowhere be subject to worldwide taxation.⁹⁸ In other words, the ontological nature of a corporation precludes it from being a resident of any country.

C. The Categorical Imperative

On a deeper philosophical level, taxation in accordance with ability-to-pay, much more so than competing theories, reflects the Kantian imperative always to treat rational beings not merely as means but always also as ends.⁹⁹ Under benefit theory, for example, the primary goal of taxation is to prevent a free ride by those who would benefit from public services without paying for them. By requiring that all persons contribute in accordance with the value that they receive, the tax prevents unjust enrichment. Effectively, it views government as a means of overcoming market failure: the government provides services that the market cannot and covers the cost by charging each person a fair price for value received.¹⁰⁰ Factors such as need and relative well-being are irrelevant under benefit theory: what one pays is a function of what one gets. Of course, it is difficult in practice to correlate benefits and payments precisely, and scholars have for centuries debated the question of how much each strata of society benefits from

enterprises, may operate in multiple places at any given time, rendering it difficult to determine the official ‘residence’ of any particular corporation.”). It is not clear why individuals, like corporations, cannot operate in multiple places at any given time. Like a corporation, an individual may have business interests and other investments in various places around the globe.

⁹⁷ Barker, *supra* note 73, at 1001 (“The essence of the individual’s relationship is totality; individuals are social, political, and economic actors. The essence of a corporation’s relationship is primarily economic.”).

⁹⁸ *Cf.* an earlier nontax case, *Cesena Sulphur Co. v. Nicholson* [1876] 1 Exch. Div. 28, 452 (Eng.). (“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.”).

⁹⁹ IMMANUEL KANT, *GROUNDWORK OF THE METAPHYSIC OF MORALS* 95–98 (H. J. Paton trans., 1964) (1785) [hereinafter KANT, *GROUNDWORK*]. Kant claimed that his three formulations of the categorical imperative—maxims must be chosen as if they were to hold as universal laws of nature, a rational being is by its nature an end in itself, and all maxims ought to harmonize with a possible kingdom of ends—are substantively identical. *Id.* at 103–04. The question of whether they actually are has been the subject of philosophical debate. In any case, the text focuses on the second formulation of the imperative. For Kant’s own view of what we today refer to as distributive justice, see, e.g., IMMANUEL KANT, *LECTURES ON ETHICS* 179 (Peter Heath & J.B. Schneewind eds., Peter Heath trans., 1997) (“[I]f we . . . do a kindness to an unfortunate, we have not made a free gift to him, but repaid him what we were helping to take away through a general injustice. For if none might appropriate more of this world’s goods than his neighbor, there would be no rich folk, but also no poor. Thus even acts of kindness are acts of duty and indebtedness, arising from the rights of others.”).

Rawls expressed his version of the Kantian imperative as it applies to distributive justice when he charged that “Utilitarianism does not take seriously the distinction between persons.” RAWLS, *supra* note 35, at 24. Interestingly, Nozick hurled the same charge against Rawls’ own difference principle. NOZICK, *supra* note 43, at 228.

¹⁰⁰ See, e.g., C.V. BROWN & P.M. JACKSON, *PUBLIC SECTOR ECONOMICS* 27–60 (1990); DAVID N. HYMAN, *PUBLIC FINANCE: A CONTEMPORARY APPLICATION OF THEORY TO POLICY* 67–68 (2014).

government services.¹⁰¹ Nevertheless, the overriding principle is that tax burdens should correlate as nearly as possible with value actually received.¹⁰²

Ability-to-pay, on the other hand, looks more to the person than to the service that the person receives. Instead of viewing taxpayers merely as a means of financing public expenditures and inquiring how the distribute the burden most fairly, it views them as people with needs and desires and it places at the forefront of the discourse not what the person received from the government but how the payment of tax will affect that person's welfare. Although both benefit theory and ability-to-pay ultimately view persons as ends—under benefit theory, tax is a means by which the government provides taxpayers with welfare-enhancing services¹⁰³—ability-to-pay takes the imperative one step further by applying it not only to the government's expenditure function but also to its tax collecting function. It effectively posits that when structuring the tax system, we should treat people also as ends in themselves and not merely as sources of revenue.

Does the Kantian imperative dictate our relationship to the legal person known as a corporation? In introducing this formulation of the categorical imperative, Kant writes as follows:

Suppose, however, that there were something *whose existence has in itself* an absolute value, something which as *an end in itself* could be a ground of determinate law; then in it, and in it alone, would there be a ground of a possible categorical imperative—that is, of a practical law.

Now I say that man, and in general every rational being, exists as an end in himself, *not merely as a means* for arbitrary use by this or that will; he must in all his actions, whether they are directed to himself or to other rational beings, always be viewed *at the same time as an end*.¹⁰⁴

¹⁰¹ See, e.g., HOBBS, *supra* note 31, at 238; SMITH, *supra* note 31, at 310; MILL, PRINCIPLES, *supra* note 31, at 156–57.

¹⁰² Schoenblum, *supra* note 34, at 233 n.52; David G. Duff, *Benefit Taxes and User Fees in Theory and Practice*, 54 UNIV. OF TORONTO L. J. 391, 405–06 (2004); Elkins, *supra* note 65, at 80; Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 MICH. L. REV. 465, 483–84 (1987).

¹⁰³ Benefit theory emerged during the Age of Reason as a corollary to the theory of the social contract. In medieval times, monarchs ruled by right, and taxation, although often subject to the dictates of custom with regard to manner and method, was one of the quintessential prerogatives of monarchs, who depended upon tax revenue to support themselves and their court. Klaus Vogel, *The Justification for Taxation: A Forgotten Question*, 33 AM. J. JURIS. 19, 25 (1988) (“Scholastic literature provides a list of examples of permissible purposes for taxation, including funding military armament, the living expenses of the sovereign, ransom of the sovereign from imprisonment, and the dowry for his daughters.”); MAURICE KEEN, *ENGLAND IN THE LATER MIDDLE AGES* 33–34 (2003); SIMONS, *supra* note 31, at 3–4 (noting that prior to the French revolution, taxes imposed on the commoners supported the tax-exempt aristocracy and clergy); Joseph M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles*, 58 TAX L. REV. 399, 399 (2005). In contrast, the Enlightenment's theory of social contract posits that governments exist to protect and serve the governed and that taxes are payments by the public for services they receive from the state. HOBBS, *supra* note 31, at 238; JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* § 138 (1689); Jean-Jacques Rousseau, *The Social Contract*, in *SOCIAL CONTRACT* 167 (Ernest Barker ed., 1962); cf. David Hume, *Of the Original Contract*, in *SOCIAL CONTRACT* 145–66 (Ernest Barker ed., 1962) (rejecting the concept of an original contract based on freely given consent).

¹⁰⁴ KANT, *GROUNDWORK*, *supra* note 99, at 95 (italics in the original).

Corporations are not rational beings in the Kantian sense of the term.¹⁰⁵ They do not exist as ends in themselves, but are rather means for the furthering of human welfare. Consider, for example, Jonathan Swift's satirical proposal to raise children for food.¹⁰⁶ One reason that the proposal is morally repugnant is that it treats people as commodities.¹⁰⁷ Such prohibitions do not apply to our treatment of corporations. Forming a corporation in order to exploit it for economic gain and dissolving it when the cost of maintaining its legal personhood exceeds the benefits it provides is morally permissible.

Granted, the extent to which a corporation is a person has generated vociferous debate in recent years. In *Citizens United*, the Supreme Court held that corporations have the constitutional right to engage in political speech.¹⁰⁸ The academic literature almost unanimously disagrees.¹⁰⁹ Some philosophers have argued that the corporation is a moral agent with moral duties in its own right (i.e., beyond those it has by virtue of acting as agent for its various stakeholders).¹¹⁰ Others deny the corporate entity capable of bearing moral duties.¹¹¹ Nevertheless, to the best of my knowledge, no commentator in any field has gone so far as to advance the view that corporations are entitled to treatment as Kantian "rational beings." In fact, one argument raised against the idea of corporate

¹⁰⁵ Malla Pollack, *The Romantic Corporation: Trademark, Trust, and Tyranny*, 42 U. BAL. L. REV. 81, 108 (2012) ("Any likeness between a Kantian-self and a business firm is purely metaphorical.").

¹⁰⁶ Jonathan Swift, *A Modest Proposal for Preventing the Children of Poor People From Being a Burden to Their Parents or Country and For Making Them Beneficial to the Publick*, in A MODEST PROPOSAL AND OTHER SATIRES 226 (2004).

¹⁰⁷ George Wittkowsky, *Swift's Modest Proposal: The Biography of an Early Georgian Pamphlet*, 4 J. OF THE HIST. OF IDEAS 75, 101 (1943).

¹⁰⁸ *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

¹⁰⁹ See, e.g., Molly J. Walker Wilson, *Too Much of a Good Thing: Campaign Speech After Citizens United*, 31 CARDOZO L. REV. 2365 (2010); William Alan Nelson II, *Buying the Electorate: An Empirical Study of the Current Campaign Finance Landscape and How the Supreme Court Erred in Not Revisiting Citizens United*, 61 CLEV. ST. L. REV. 443 (2013); Ganash Sitaraman, *Contracting Around Citizens United*, 114 COLUM. L. REV. 755 (2014); Amy J. Sepinwall, *Citizens United and the Ineluctable Question of Corporate Citizenship*, 44 CONN. L. REV. 575 (2012); James A. Gardner, *Anti-Regulatory Absolutism in the Campaign Arena: Citizens United and the Implied Slippery Slope*, 20 CORNELL L. & PUB. POL'Y 673, 674 (2011) ("[T]he Court's decision in *Citizens United* was subjected immediately to severe criticism from regulators, academics, journalists, and citizens."); Jocelyn Benson, *Saving Democracy: A Blueprint for Reform in the Post-Citizens United Era*, 40 FORDHAM URB. L. J. 723 (2012).

¹¹⁰ PETER A. FRENCH, *COLLECTIVE AND CORPORATE RESPONSIBILITY* (1984); PETER A. FRENCH, *CORPORATE ETHICS* (1995); PATRICIA J. WERHANE, *PERSONS, RIGHTS, AND CORPORATIONS* (1985); Wim Dubbink & Jeffery Smith, *A Political Account of Corporate Moral Responsibility*, 14 ETHICAL THEORY & MORAL PRAC. 223 (2010); Peter A. French, *The Corporation as a Moral Person*, 16 AM. PHIL. Q. 207 (1979); Rita C. Manning, *Corporate Responsibility and Corporate Personhood*, 3 J. BUS. ETHICS 77 (1984); Michael J. Phillips, *Corporate Moral Personhood and Three Conceptions of the Corporation*, 2 BUS. ETHICS Q. 435 (1992).

¹¹¹ THOMAS DONALDSON, *CORPORATIONS AND MORALITY* 20–23 (1982); Peter Arenella, *Convicting the Morally Blameless: Reassessing the Relationship between Legal and Moral Accountability*, 39 UCLA L. REV. 1511 (1992); John Hasnas, *The Centenary of a Mistake: One Hundred Years of Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1329 (2009); Manuel G. Velasquez, *Why Corporations Are Not Morally Responsible for Anything They Do*, BUS. & PROF. ETHICS J. (1983); Thomas Weigend, *Societas Delinquere Non Potest?*, 6 J. INT. CRIM. JUST. 927 (2008); Susan Wolf, *The Legal and Moral Responsibility of Organizations*, 27 CRIM. JUST. 267 (1985); G. Sullivan, *Expressing Corporate Guilt*, 15 OXFORD J. LEGAL STUD. 281 (1995) (reviewing CELIA WELLS, *CORPORATIONS AND CRIMINAL RESPONSIBILITY* (1993)).

moral agency is that corporations clearly have no rights under the terms of distributive justice.¹¹²

If the concept of residence in the field of income taxation delineates the universe of persons for whom the overriding principle in determining their tax liability is ability-to-pay, if ability-to-pay reflects the idea that we are obliged to treat people not only as means but also as ends, and if corporations are not ends but merely means, then residence cannot be an attribute of corporations.

D. Incorporeality

Commentators have posited that the problem with assigning residence to corporations stems from their incorporeality. For example, Professors Fleming, Peroni, and Shay have observed that “precisely because corporations are fictional, they do not live anywhere. Thus, determining where a corporation resides is a much more difficult endeavor than determining the residence of a human being.”¹¹³ According to Professor Rosenzweig, the “difficulty with defining residency for entities is that the most straightforward way to define residency—physical presence—is not available, simply because legal entities cannot be physically present in the same manner as individuals.”¹¹⁴

While it is certainly true that the incorporeality of a corporation renders inapplicable the classic determinants of individual residence (physical presence, habitual abode, and so forth), I believe that the fundamental issue goes much deeper. The fact that an individual lives, or is physically present in, a certain place does not have independent normative significance. The reason that the law relies upon these factors is that the law views them as indicative of membership in a collective to which the norms of distributive justice apply.¹¹⁵ If, counterfactually, a corporation could be the subject of distributive justice, the law would properly seek indicia of corporate membership in the relevant community. However, corporations cannot be members of a community to which norms of distributive justice apply, not because they cannot be present in a physical place, but rather because they have no personal identity, do not experience well-being in the relevant sense of the term, have no personal connections, and are not Kantian rational beings.¹¹⁶

As a perhaps bizarre, but hopefully insightful thought experiment, imagine that there exist communities of disembodied spirits, that each community possesses resources that can produce (their equivalent of) happiness or reduce (their equivalent of) suffering and that each community has a set of rules to determine who is required to contribute to (and is entitled to benefit from) the communal resources. Due to their nature, the rules that these spirits would adopt to delineate community membership would likely be quite different from ours (whether they would use the terms “residence” or some other term

¹¹² Donaldson, *supra* note 111, at 23 (“[I]t seems implausible that [corporations] should have to the right ... to draw Social Security benefits.”).

¹¹³ Fleming et al., *supra* note 23, at 1683 (emphasis in the original).

¹¹⁴ Rosenzweig, *supra* note 2, at 479–80.

¹¹⁵ Shaviro, *supra* note 52, at 21 (describing physical location as one factor “that would appear to have strong intuitive appeal, when one thinks about the ‘us’ category ...”).

¹¹⁶ A similar issue arises with regard to the application of criminal law to corporations. See Albert W. Alschuler, *Ancient Law and the Punishment of Corporations: of Frankpledge and Deodand*, 71 B.U. L. REV. 307 (1991); Weigend, *supra* note 111. See also Lawrence Friedman, *In Defense of Corporate Criminal Liability*, 23 HARV. J.L. & PUB. POL’Y 833, 841–43 (2000).

more appropriate to their circumstances is irrelevant). Their rules would reflect whatever type of connection that they considered pertinent in determining who was a member of the relevant community and who was not.

These disembodied spirits share with corporations the attribute that they are incorporeal, and consequently, cannot live or be physically present anywhere as can human beings. Nevertheless, because they share with humans the attributes of having personal identity and personal connections, of experiencing (their equivalent of) happiness and suffering and of being Kantian rational beings, it would be reasonable for them to develop a system of distributive justice and to adopt rules by which to determine who is subject to the rights and obligations of that system.¹¹⁷ It is because corporations lack these attributes—and not because, as incorporeal persons, they do not “reside” anywhere—that they cannot be members of a collective to which the norms of distributive justice apply.

IV. TAXING CORPORATIONS AND TAXING SHAREHOLDERS

The conclusion so far, that the concept of residence is inapplicable to corporations, means that the distinction between domestic corporations and foreign corporations is incongruous for tax purposes. Granted, there are corporations with economic ties to various countries, just as there are individuals with economic ties to various countries. Under the norms of international tax law, those countries are justified in imposing taxes as they see fit on the income allocable to those economic ties.¹¹⁸

¹¹⁷ Kant explicitly entertained the possibility of nonhuman rational beings and averred that the moral law would apply to them. “[U]nless we wish to deny to the concept of morality all truth and all relation to a possible object, we cannot dispute that its law is of such widespread significance as to hold, not merely for men, but for all *rational being as such* ...”. KANT, *GROUNDWORK*, *supra* note 99, at 76 (italics in the original).

¹¹⁸ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE U.S. § 402(1)(a) (AM. LAW. INST. 1987); Avi-Yonah, *supra* note 83, at 490 (“The right of countries to tax income arising in their territory is well established in international law.”).

The question of how to allocate a corporation’s income among the various countries in which it operates has attracted significant attention in recent years. One current proposal is a formulary approach, in which you allocate the corporation’s income to the various countries with which it has economic ties. Avi-Yonah et al., *Allocating*, *supra* note 25 at 501; Reuven S. Avi-Yonah & Ilan Benshalom, *Formulary Apportionment: Myths and Prospects—Promoting Better International Policy and Utilizing the Misunderstood and Under-Theorized Formulary Alternative*, 3 *WORLD TAX J.* 371 (2011); Benshalom, *supra* note 25; Ilan Benshalom, *Taxing the Financial Income of Multinational Enterprises by Employing a Hybrid Formulary and Arm’s Length Allocation Method*, 28 *VA. TAX REV.* 619 (2009); Eric T. Laity, *The Competence of Nations and International Tax Law*, 19 *DUKE J. COMP. & INT’L L.* 187, 239–42 (2009); Kimberly A. Clausing & Reuven S. Avi-Yonah, *Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment*, The Hamilton Project (Policy Brief No. 2007–08, 2007), http://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/Reforming_Corporate_Taxation_in_a_Global_Economy- A_Proposal_to_Adopt_Formulary_Apportionment_Brief.pdf [<https://perma.cc/MSQ3-JJCJ>]; Benshalom, *supra* note 25. For critique of the formulary apportionment model, see J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Formulary Apportionment in the U.S. International Income Tax System: Putting Lipstick on a Pig?*, 36 *MICH. J. INT’L L.* 1, 2–3, 7 (2014); Roin, *supra* note 26. *But see* OECD, *ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING 14* (2013), *available at* www.oecd.org/ctp/BEPSActionPlan.pdf [<https://perma.cc/ZE6N-XPV4>] (“[T]here is consensus among governments that moving to a system of formulary apportionment of profits is not a viable way forward; it is also unclear that the behavioural changes companies might adopt in response to the use of a formula would lead to investment decisions that are more efficient and tax-neutral than under a separate entity approach.”). Nevertheless, the OECD may have taken the first step toward implementing such a scheme by requiring

However, the mere fact that a taxpayer—whether individual or corporate—has economic ties to a country does not warrant the imposition of a tax on foreign-source income.

Nevertheless, it is crucial to distinguish between corporations and their shareholders. In contrast to the corporation in which they own shares, individual shareholders can be residents of a country. As such, and in accordance with the principle of ability-to-pay, resident shareholders would need to account for their accession to wealth derived from shareholding. The only question is how best to do so.

In the domestic arena, the primary means by which shareholders are subject to tax on their accession to wealth is the corporate income tax,¹¹⁹ which effectively operates as an indirect tax on shareholders.¹²⁰ However, in the international arena, imposing tax on the corporate entity as a proxy for taxing individual shareholders is not a feasible solution

country-by-country reporting. OECD, OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT: TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING, ACTION 13 – 2015 FINAL REPORT 12, 16, 29–57 (2015), <http://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm> [<https://perma.cc/F5CG-GHCL>]. See also EUROPEAN COMMISSION, COMMON CONSOLIDATED CORPORATE TAX BASE (2016), available at https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en [<https://perma.cc/U7KP-PHG3>] (The European Union’s proposal to reinstitute the Common Consolidated Corporate Tax Base (CCCTB)).

¹¹⁹ The text reflects the prevailing view among scholars—a view to which I subscribe—that, whatever the historical context in which it arose, the corporation income tax today functions as an administratively convenient indirect tax on shareholders. See, e.g., Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 WM. & MARY L. REV. 447, 452 (2001); Steven A. Bank, *The Dividend Divide in Anglo-American Corporate Taxation*, 30 J. CORP. L. 1, 15–18 (2004); William B. Barker, *A Common Sense Corporate Tax: The Case for a Destination-Based, Cash-Flow Tax on Corporations*, 61 CATH. U.L. REV. 955, 996 (2012) (describing “the widespread belief that taxing corporations offers a convenient and practical way of indirectly taxing corporate shareholders.”); Fleming et al., *supra* note 23 at 1693; Graetz, *supra* note 2 at 302–03; Kleinbard, *supra* note 23 at 159; David M. Schizer, *Between Scylla and Charybdis: Taxing Corporations or Shareholders (or Both)*, 116 COLUM. L. REV. 1849 (2016).

Support for this view can be found in the fact that in certain circumstances, the law permits corporations and their shareholders to choose whether the corporation will pay tax on its income or whether the corporation will be exempt from tax and instead shareholders will pay tax directly on their proportionate share of the corporation’s income. I.R.C. §§ 1361–79 (S corporations). See also the “check-the-box” rules that apply to limited liability companies (LLCs) and certain other entities. Treas. Reg. § 301.7701–3. For other views, see Avi-Yonah, *supra* note 27 at 1025–26; Jane G. Granville, *The Corporate Income Tax: A Persistent Challenge*, 11 FLA. TAX REV. 73 (2011); Marjorie Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53 (1990); Marian, *supra* note 1 at 1647; Ajay K. Mehrotra, *The Public Control of Corporate Power: Revisiting the 1909 U.S. Corporate Tax from a Comparative Perspective*, 11 THEORETICAL INQUIRIES IN L. 497, 510 (2010).

Under current law, shareholders, in addition to bearing the indirect corporate-level tax, bear an additional shareholder-level tax when they receive dividends or sell their shares, although the shareholder-level tax rate is considerably less than the rate to which individuals are ordinarily subject. I.R.C. §§ 1(h)(11), 61(a)(7). The result is a “partially integrated” corporate tax structure. However, a comprehensive analysis of the corporate tax structure and a comparison among integrated, partially integrated, and double (or “classic”) tax systems is beyond the scope of this article. See generally KAREN C. BURKE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 388–403 (2003).

¹²⁰ It is important to distinguish between the nature of a tax as direct or indirect and the incidence of the tax. The corporate income tax is an indirect tax on shareholders because its immediate effect is to reduce the after-tax profit available for distribution to shareholders. With regard to the incidence of the tax, the corporate income tax may affect the supply and demand curves for goods, services, and capital, and if so then individuals other than shareholders may bear the ultimate economic burden. However, this is true also with regard to a tax imposed directly on shareholders, as it is with regard to a tax imposed directly on wage earners and so forth. See generally DAVID ELKINS, BEHIND THE SCENES OF CORPORATE TAXATION 10–12 (2013).

to the problem of taxing shareholders' accession to wealth. In order to reach the income of all resident individuals, a country would need to tax the worldwide income of every corporation on the planet, or at least of every corporation with at least one domestic shareholder. Even if it were within the power of a country to impose and enforce a worldwide corporate income tax, such a tax would constitute unjustifiable overreaching.

Current law does not attempt to tax the foreign-source income of all corporations.¹²¹ Instead, it distinguishes between corporations that it categorizes as "domestic" and those that it categorizes as "foreign," and then imposes tax on the worldwide income of the former and on the domestic-source income of the latter.¹²² However, this approach is both over-inclusive and under-inclusive. It is over-inclusive because nonresidents who hold shares in "domestic corporations" are effectively subject to tax on their worldwide income. It is under-inclusive because residents who hold shares in "foreign corporations" are effectively subject to tax only on their U.S.-source income.¹²³ The problem here is not the particular test used to distinguish between foreign and domestic corporations. The problem is that, however, the law makes the distinction, residents who own shares in "foreign corporations" (however defined) will effectively escape taxation on their accession to wealth attributable to the corporation's foreign-source earnings and nonresidents who own shares in "domestic corporations" (however defined) will effectively be subject to U.S. income tax on income that is not U.S.-source.

The corporate tax regime confronts an irresolvable predicament in the international arena. On the one hand, residence is a fundamental concept in the field of international taxation. On the other hand, the idea of residence is both conceptually and practically inapplicable to corporations. It is no wonder that the current international corporate tax regime has proven unworkable and that reform proposals—which continue to rely upon the concept of corporate residence—fair little better. Of course, this is not to say that the corporate tax regime, as currently construed, functions properly even in the domestic arena. In the domestic arena, the corporate tax regime contains innumerable loopholes (which tax advisors are constantly trying to exploit and Congress is constantly trying to close) and traps (which tax advisors are constantly trying to avoid and about which Congress appears not too concerned).¹²⁴ However, the problems faced by the domestic corporate tax regime are not systemic but rather the result of certain flaws that have crept into the system. Within the domestic arena, it is, in theory, possible to reform the corporate tax regime and transform it into a coherent and consistent structure.¹²⁵ In the international arena, it is simply not possible to design a corporate tax structure that achieves coherence and consistency. The problem is not in the details but in the very attempt to treat corporations as taxpayers in an arena in which the concept of residence is indispensable.

¹²¹ I.R.C. § 882(b).

¹²² I.R.C. § 11(a) (imposing tax "on the taxable income of every corporation") and § 882(b) (qualifying § 11(a) and providing that in the case of a foreign corporation, gross income includes only income derived from U.S. sources and income effectively connected to a U.S. trade or business).

¹²³ In certain instances, the Code provides for the taxation of U.S. residents who are shareholders in "foreign corporations." See I.R.C. §§ 951–59 ("Subpart F").

¹²⁴ ELKINS, *supra* note 120, at v.

¹²⁵ See, e.g., *id.* at 21–25, 309–12 (arguing that a great deal of the complexity and inequity of the corporate tax structure could be avoided by bifurcating the price of stock into the amount paid for the right to receive pre-acquisition earnings on the one hand and the remaining rights attached to the stock on the other).

V. A PROPOSAL FOR A NEW INTERNATIONAL CORPORATE TAX REGIME

Because residence is such a crucial element in international taxation and because the concept of residence is inapplicable to corporations, the current corporate tax regime is unviable in the international arena. Thus, there is no feasible alternative other than to abandon the current international corporate tax regime.

This Part will describe how one might go about designing an international corporate tax regime that focuses on shareholders instead of corporations.¹²⁶ Due to the complexity of the subject matter, a detailed proposal for such an international corporate tax regime would go far beyond the scope of the current article. What I can do here is describe in broad outline the most fundamental issues that such a regime would face and suggest how it might go about dealing with those issues.¹²⁷

¹²⁶ To a great extent, the analysis in this Part relies upon a 1995 article by Professor Joseph Dodge, in which he proposed abandoning the corporate income tax altogether. Dodge, *supra* note 77. The essence of Dodge's proposal was that when shares are publicly traded, shareholders would be taxed on a mark-to-market basis, while closely held corporations would be treated for tax purposes as partnerships. However, Dodge freely admitted that applying his proposal in the international arena presents complex design problems. *Id.* at 334. He begins by stating, as a matter of fact, that U.S. corporations are subject to tax on their worldwide income and that foreign corporations are subject to tax only on their U.S.-source income. *Id.* at 335. He goes on to analyze the tax liability of U.S. individuals who own shares in foreign corporations. *Id.* at 336–37. He considers U.S. corporations with substantial foreign equity ownership, foreign corporations in which U.S. equity interest is “quite low,” foreign corporations in which U.S. equity interest is “fairly high” and foreign corporations “largely (say, 80%) controlled by U.S. shareholders.” *Id.* at 338–39, 342–43. For instance, he calls for a “flat rate withholding tax directly on the foreign corporation’s net income ... where the percentage of control by U.S. shareholders is fairly high,” but “a withholding tax on the foreign [corporation’s] U.S. income only” when “U.S. equity does not exceed the requisite threshold.” *Id.* at 339. He goes on to distinguish between the described withholding tax on U.S. income and “a ‘straight’ U.S. tax on the foreign ... corporation’s U.S. income.” *Id.* at 339. I cannot here undertake a thorough review of Professor Dodge’s ambitious proposal and its application in the international arena. However, I would suggest that these distinctions, which greatly complicate the analysis, are both unnecessary and normatively unjustifiable. If residence is not a proper attribute of corporations, then we do not need to distinguish between U.S. corporations and foreign corporations and can focus our attention on resident shareholders and nonresident shareholders. Furthermore, the tax treatment of a corporation or its shareholders should not depend upon whether U.S. equity ownership crosses a certain threshold. As I explain in the text, *infra*, the only distinctions that we need to make are between corporations with U.S. source income and those without U.S. source income and between corporation that provide U.S. authorities with both the relevant information and adequate audit opportunities and those that do not. I submit that reducing the number of categories into which we need to classify corporations permits a proposal that is more coherent and simpler to implement in practice.

¹²⁷ Because the tax regime described in the text is a response to challenges faced by the current corporate tax regime in the international arena—the fact that residence is a fundamental concept in the field of international taxation but conceptually inapplicable to the corporate entity—it is possible to adopt the proposed tax regime in the international arena while retaining something akin to the current corporate tax regime in the domestic arena. Should policy makers deem it desirable to do so, I would suggest that the domestic tax regime be formally elective (“check the box”), without regard to the corporation’s POI, its economic ties to the U.S., or the residence of its shareholders. Corporations electing the domestic tax regime would be liable to tax on their worldwide income. Following current law, shareholders in such a corporation would be subject to further tax at reduced rates on dividends and on capital gain from the sale of shares. Of course, they would be exempt from the shareholder-level tax in the proposed international corporate tax regime described in the text.

Already a third of a century ago, Tillinghast suggested the possibility of a check-the-box regime for corporate international taxation. See Tillinghast, *supra* note 1, at 266 (“The logic of this conclusion leads to another view so radical that it has not even been whispered for twenty years, that U.S. persons might be given the election to treat a U.S. incorporated entity as a foreign one.”).

A. Computing the Income of U.S. Shareholders

The first issue that a shareholder-focused international corporate tax regime would need to confront is how to calculate a resident shareholder's accession to wealth. Publicly traded shares present the fewest problems in this regard. The fact that the market value of the shares at any given moment can easily be ascertained means that quantifying the shareholder's economic gain (or loss) during the year is a simple mathematical exercise.¹²⁸ Within the framework of a tax regime that refrains from taxing corporations and instead imposes tax directly on shareholders,¹²⁹ mark-to-market reflects the idea that a corporation's accession to wealth is irrelevant from the perspective of the normative goals of the tax system. The fact that a corporation may have reported a profit has no normative significance if shareholders experience no economic gain. Conversely, the fact that there is no reported profit on the corporate level has no normative import if shareholders do experience an accession to wealth. Granted, numerous factors ranging from well-founded expectations regarding the corporation's future prospects to unsubstantiated swings in market mood may explain why share prices do not track corporate income, so that the market price may not reflect true underlying economic value. Nevertheless, by definition a shareholder's accession to wealth is a function of the changing market values of the securities that the shareholder owns (along with any distributions that the shareholder receives), and it is the individual shareholder's accession to wealth that has normative import from the perspective of income taxation.¹³⁰

¹²⁸ Gain (or loss) equals (a) the market value of any shares held at the end of the year plus (b) the amount received for any shares sold during the year plus (c) any distributions received during the year minus (d) the market value of any shares held at the beginning of the year minus (e) the amount paid for any shares purchased during the year. As an example, assume that as of the end of 2016, Terry, a U.S. resident individual, owned 500 shares of stock in XYZ Corporation and that the market value of each share of stock as of the end of 2016 was \$100. On March 13, 2017, Terry purchased an addition 300 shares of XYZ at \$120 a share. On June 15, 2017, XYZ paid a dividend of \$12 a share. On October 8, 2017, Terry sold 200 shares of XYZ for \$110 a share. At the end of trading on December 31, 2017, XYZ shares were worth \$95 each. Using the above formula, Terry's accession to wealth resulting from the investment in XYZ stock would be: $(600 \times \$95) + (200 \times \$110) + (800 \times \$12) - (500 \times \$100) - (300 \times \$120) = \$2,600$.

¹²⁹ Even within the framework of the current corporate tax regime, commentators have suggested that marking securities to market is superior to deferring recognition of shareholder-level gain or loss until realization. See, e.g., John P. Bransfield, *Proposal to Change the Federal Income Taxation of Marketable Securities*, 2 HOUS. BUS. & TAX L.J. 328 (2001–2002); Samuel D. Brunson, *Taxing Investors on a Mark-to-Market Basis*, 43 LOY. L.A. L. REV. 507 (2010); Eric D. Chason, *Naked and Coved in Monte Carlo: A Reappraisal of Option Taxation*, 27 VA. TAX REV. 135 (2007); David Elkins, *The Myth of Realization: Mark-to-Market Taxation of Publically-Traded Securities*, 10 FLA. TAX REV. 375 (2010); Timothy Hurley, "Robbing" the Rich to Give to the Poor: *Abolishing Realization and Adopting Mark-to-Market Taxation*, 25 THOMAS M. COOLEY L. REV. 529 (2008); Mark L. Louie, *Realizing Appreciation Without Sale: Accrual Taxation of Capital Gains on Marketable Securities*, 34 STAN. L. REV. 857 (1982); Clarissa Potter, *Mark-to-Market Taxation as the Way to Save the Income Tax – A Former Administrator's View*, 33 VAL. U.L. REV. 879 (1999); David J. Shakow, *Taxation Without Realization: A Proposal for Accrual Taxation*, 134 U. PA. L. REV. 1111 (1986); David Slawson, *Taxing as Ordinary Income the Appreciation of Publicly Held Stock*, 76 YALE L. J. 623 (1967); David A. Weisbach, *A Partial Mark-to-Market System*, 53 N.Y.U. TAX REV. 95 (1999); But see Edward A. Zelinsky, *For Realization: Income Taxation, Sectoral Accretionism and the Virtue of Attainable Values*, 19 CARDOZO L. REV. 861, 889–91 (1997).

¹³⁰ Ordinarily the law refrains from taxing unrealized gains because of the problems of valuation and liquidity. In other words, despite the fact that appreciation in the value of one's assets constitutes clear economic gain, requiring payment of tax would impose significant compliance and enforcement costs. With regard to publicly traded securities, these costs are minimal. As noted, the market price of a publicly traded

Computing an individual's gain from shareholding in a closely held corporation is more difficult. The absence of a fluid market complicates the task of tracking the changing market value of the shares.¹³¹ In such a case, the best practical alternative may be tentatively to assume that shareholders' (positive or negative) accession to wealth is equal to their proportionate share of the corporation's profit (or loss) and adopt a flow-through tax regime. Under current law, a number of legal entities are subject to flow-through regimes, prominent among them being partnerships,¹³² S corporations,¹³³ and multi-member limited liability companies (LLCs).¹³⁴ Describing in detail the contours of these regimes and the differences between them and analyzing which would be most appropriate for corporations in the international arena is beyond the scope of this article. However, I can mention in brief the common features of the various flow-through regimes. First, the entity itself pays no tax. Second, its stakeholders (partners, shareholders, or members, depending on the type of entity involved) report on an annual basis their proportionate share of the entity's gain or loss. Third, when the stakeholders sell their rights in the entity, they report gain or loss reflecting the difference between their total economic gain or loss and the sum of the gains or losses periodically reported.

One practical problem that could arise in this regard is that the corporation might not prepare financial statements at all, might not calculate its income in accordance with U.S. tax principles, or might not permit U.S. tax authorities to audit its books. This problem is most likely to arise when the United States does not have jurisdiction over the corporation and the U.S. shareholder is not in a position to impel the corporation to comply with the demands of U.S. tax law. In such a case, it would be reasonable to adopt the tax regime applicable under current law to U.S. persons who own shares in "passive foreign investment companies" (PFICs). Under the provisions of I.R.C. § 1291 (which apply to U.S. shareholders who did not make an election to be taxed on their proportionate share of the PFIC's income or to be taxed on a mark-to-market basis), tax is deferred until the sale or exchange of the stock, but the shareholder must pay interest to compensate the government for the deferral.¹³⁵ Under the proposed regime, deferral with the accompanying interest charge would not depend upon the percentage interest of U.S. shareholders (and certainly would not depend on the "residence" of the corporation). It

share is easily ascertainable. The fact that the shareholder can sell any amount of shares with very low transaction costs solves the problem of liquidity. In other words, the taxpayer can at any given moment compute gain, determine how much of that gain belongs to the government, and can extract an amount necessary to satisfy the government's claim. See the sources cited *supra* note 129.

¹³¹ Furthermore, the absence of a fluid market creates problems of liquidity—the shareholder may have experienced an accession to wealth but not have cash available to pay the tax. Because of the lack of a ready market and because of the possible effect on the shareholder's control of the corporation, selling shares in a closely held corporation is fundamentally different from selling shares in a widely-held, publicly traded corporation.

¹³² I.R.C. §§ 701–77 ("Subpart K").

¹³³ I.R.C. §§ 1361–78.

¹³⁴ Treas. Reg. §§ 301.7701–3(a), (b)(1)(i) (1997).

¹³⁵ The gain is considered as having accrued pro rata over the period the stock was held, the gain allocated to each year is taxed at the highest statutory rate for that year, and the tax due then accrues interest from the end of the that year. For example, assume that the stock was purchased at the beginning of Year 1 for \$100,000 and was sold at the end of Year 10 for \$300,000, that the highest statutory tax rate each year was 40% and the applicable interest is 5% a year. Under I.R.C. § 1291, Year 1 gain would be \$20,000, Year 1 tax would be \$8,000, and the amount due including interest would be $\$8,000 \times 1.05^9 = \$12,411$. Year 2 gain would be \$20,000, Year 2 tax would be \$8,000 the amount due including interest would be $\$8,000 \times 1.05^8 = \$11,820$, and so forth. The tax due, including interest, for the entire gain would be \$100,624.

would apply to all U.S. shareholders of any corporation that, in fact, did not keep or did not produce the appropriate books.¹³⁶

B. Taxing Nonresident Shareholders

The second issue that the proposed international corporate tax regime would need to confront is the treatment of nonresident shareholders. Under current international norms, countries have the right to impose tax on nonresidents who earn domestic-source income.¹³⁷ However, attempting to enforce a direct tax on nonresident shareholders for their proportional share of a corporation's domestic-source income would likely prove difficult in practice. Consequently, taxing nonresidents on their domestic source income probably requires the imposition of a territorial tax at the corporate level. In this context, it is important to reiterate that the proposal does not categorize corporations as "domestic" or "foreign."¹³⁸ The only relevant distinction among corporations is that some have U.S.-source income and some do not. No corporation would be subject to U.S. tax on its foreign-source income.¹³⁹ All corporations would, in principle, be subject to U.S. tax on their U.S.-source income.¹⁴⁰ The sole intended "targets" of the corporate-level tax would be nonresident shareholders. Shareholders who are U.S. residents would be subject to direct tax via one of the methods already described: mark-to-market, flow-through, or realization plus interest.¹⁴¹

Following this line of reasoning, the corporate tax rate would be the rate applicable to nonresident individuals who derive U.S. source income.¹⁴² As an example, under current law nonresidents are exempt from tax on U.S. source portfolio interest.¹⁴³ If, due to the pressures of international tax competition, this policy continues,

¹³⁶ As the deferral with interest regime is often onerous, it is reasonable to expect that U.S. shareholders would tend to prefer corporations that commit to maintain and produce such books. *See, e.g.*, RICHARD L. DOERNBERG, INTERNATIONAL TAXATION 380 (2009) ("This method can be quite punitive."). Corporations that wish to attract U.S. investors might therefore voluntarily comply with the requirements of U.S. tax even though they may be under no legal requirement to do so.

¹³⁷ *See sources cited supra* note 118.

¹³⁸ *Cf. Graetz, supra* note 2, at 321: "[T]he thrust of these efforts is to impose residence-based taxation whenever the foreign corporation is substantially owned or controlled by U.S. persons (including other corporations)." In other words, when a "U.S. corporation" owns a "foreign corporation," the goal of residence-based taxation requires the current taxation of the income earned by the latter. However, it is far from clear why the residence of the "U.S. corporation" is any less artificial than the residence of the "foreign corporation." If the concept of residence is applicable to corporations, then the income of the "foreign corporation" is the income of a foreign resident and should not be subject to U.S. taxation. If the concept of residence is not applicable to corporations, then the fact that at the apex of the corporate structure is a "U.S. corporation" is of no normative import.

¹³⁹ But see the description of a possible domestic corporate tax regime that could operate parallel the proposed international tax regime, *supra* note 125.

¹⁴⁰ Some corporations might be exempt from the tax. *See the text, infra*, surrounding note 154–56.

¹⁴¹ *See supra* Subpart A. Subpart C, *infra*, considers how to prevent double taxation of U.S. residents who own shares in corporations with domestic-source income.

¹⁴² I have elsewhere argued that income is an inappropriate tax base for nonresidents in general and for multinational enterprises in particular. Elkins, *supra* note 84. The text assumes that the United States continues its current policy of taxing nonresidents on their domestic source income. Should the United States abandon that policy and adopt a base other than income for taxing nonresidents, the same tax regime would also apply to corporations.

¹⁴³ I.R.C. §§ 871(h), 881(c).

corporations should similarly be exempt from tax on their portfolio interest.¹⁴⁴ Such an exemption would substantively affect only nonresident shareholders, as resident shareholders would be subject to tax directly, via the previously described mark-to-market, flow-through, or deferral-plus-interest regime. As another example, under current law nonresidents who earn “fixed or determinable annual or periodical gains, profits, and income” (“FDAP income”) are subject to a 30% tax on gross income.¹⁴⁵ As long as this policy continues to apply to nonresident individuals, then under the proposal anyone paying FDAP income to a corporation would need to withhold tax at the rate of 30%.¹⁴⁶

If a corporation receiving U.S. source income is a resident of another country in accordance with that country’s tax law (I am considering here the possibility that other countries may retain the concept of corporate residence), the corporation might be in a position to claim benefits under a tax treaty between the United States and its country of residence. Ostensibly, treaty protection presents a problem for the proposed international tax regime: shareholders might be residents either of countries that do not have tax treaties with the United States or of countries the terms of whose treaties with the United States are less generous than those of the treaty between the United States and the corporation’s country of residence. For example, assume that the domestic laws of Country A classify Corporation X as a Country A resident and that the tax treaty between the United States and Country A prohibits either country from imposing tax on royalties received by residents of the other country.¹⁴⁷ Assume also that Individual Y owns shares in Corporation X and that Individual Y is a resident of a country that does not have a tax treaty with the United States. Were Individual Y to receive U.S.-source royalties directly, the royalty would be subject to U.S. tax at the rate of 30%.¹⁴⁸ However, because Individual Y indirectly receives the royalty via Corporation X, the royalty will escape U.S. taxation.

Tax treaties to which the United States is a signatory deal with this issue, known as “treaty shopping,” by means of a Limitation of Benefits provision (LOB).¹⁴⁹ While the details of LOB are intricate and vary from treaty to treaty, the underlying idea is that a corporation resident in one of the countries may not claim benefits under the treaty unless at least 50% of its shares are beneficially owned by individuals resident in that country or its shares are publicly traded on an exchange located in that country.¹⁵⁰ LOB is an anti-abuse measure designed to prevent individuals from establishing a corporation in a country, other than that of which they themselves are residents, in order to benefit from

¹⁴⁴ See, e.g., Elkins, *supra* note 65, at 912; Ming-Sung Kuo, *(Dis)embodiments of Constitutional Authorship: Global Tax Competition and the Crisis of Constitutional Democracy*, 41 GEO. WASH. INT’L L. REV. 181, 187 (2009); Avi-Yonah, *Globalization*, *supra* note 25, at 1581–83; Yoram Keinan, *The Case for Residency-Based Taxation of Financial Transactions in Developing Countries*, 9 FLA. TAX REV. 1, 29 (2008).

¹⁴⁵ I.R.C. §§ 871(a), 881(a).

¹⁴⁶ For the current withholding requirement, see I.R.C. §§ 1441, 1442. Under the proposal, the withholding requirement under I.R.C. § 1442 would apply not to “foreign corporations,” but to all corporations (except for those subject to a possible parallel domestic tax regime as described in note 126, *supra*, and those exempt from corporate-level as described in the text surrounding notes 154–56, *infra*).

¹⁴⁷ See, e.g., Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Art. 13(1), Neth.-U.S., Dec. 18, 1992, 2291 U.N.T.S. 40832.

¹⁴⁸ I.R.C. § 871(h).

¹⁴⁹ See UNITED STATES MODEL INCOME TAX CONVENTION, *supra* note 79, at art. 22.

¹⁵⁰ *Id.*, at art. 22(2)(d).

the provisions of the tax treaty between the United States and the corporation's country of residence.¹⁵¹

It might seem that for a tax regime that purports to reject the concept of corporate residence, LOB as currently constituted is insufficient. When a corporation qualifies under LOB, those shareholders who are not resident in the corporation's country of residence benefit from the provisions of the treaty even though they would not so benefit were they to have received the income directly. However, I would submit that this problem is less acute than it might appear at first glance. The distinction between residents of two foreign countries is substantively different from the distinction between foreign residents and domestic residents. With regard to the distinction between domestic and foreign residents, there is a normative policy goal to tax the former on their worldwide income and to tax the latter only on their domestic-source income. Taxing nonresidents on their foreign-source income or permitting residents to escape tax on their foreign-source income is inconsistent with that policy. With regard to residents of foreign countries, treaty provisions derive not from normative, but from practical considerations: each side agrees to limit its right to tax certain types of income in return for a similar commitment from the other signatory. When another country demands that corporations that it classifies as domestic residents receive benefits under the treaty, the United States has to consider whether the overall advantages of the treaty are worth the cost of agreeing to such a provision. Current U.S. policy is to reject such a demand unless the corporation meets the LOB criteria.¹⁵² Of course, by way of reciprocity, the United States is willing to agree to impose a similar condition on U.S. corporations seeking treaty benefits.

Under the proposed tax regime, the United States would no longer classify corporations as either domestic or foreign. This would mean that no treaty to which the United States is currently a signatory would protect any corporation, even one wholly owned by U.S. resident individuals, from the taxing authority of the other country. Therefore, the abandonment of the notion of corporate residence would require a renegotiation of the United States' treaty network. As a condition of agreeing to allow corporations resident in the other country to benefit from the provisions of the treaty, the United States should demand protection for U.S. resident individuals who are shareholders of corporations that derive income from sources in the other country.

A comprehensive discussion of how to accommodate the U.S. treaty network to the proposed tax regime is beyond the scope of this Article. However, I will briefly mention two possible modifications that might be appropriate. One would be an expansion of the term "resident" to include not only a corporation that "is liable to tax therein by reason of ... place of management, place of incorporation, or any other criterion of a similar nature,"¹⁵³ but also a corporation a certain percentage of whose shareholders are liable to tax therein by virtue of residence. In other words, a corporation,

¹⁵¹ See, e.g., *id.* at art. 22(6) ("If a resident of a Contracting State is [not] a qualified person ... the competent authority of the other Contracting State may, nevertheless, grant the benefits of this Convention ... if such resident demonstrates to the satisfaction of such competent authority a substantial nontax nexus to its Contracting State of residence and that neither its establishment, acquisition or maintenance, nor the conduct of its operations had as one of its principal purposes the obtaining of benefits under this Convention.").

¹⁵² Prior to 1977, the United States did not include LOB in the treaties that it signed. During the 1980s and 1990s, the U.S. renegotiated its treaty network, and today all treaties to which the United States is a signatory contain LOB. See generally JOSEPH ISENBERGH, *INTERNATIONAL TAXATION* 280–81 (2005).

¹⁵³ See UNITED STATES MODEL INCOME TAX CONVENTION, *supra* note 79, at art. 4(1).

although not a “resident” under U.S. domestic law, might nevertheless be a “U.S. resident” for purposes of the treaty. Such a provision would effectively constitute a mirror image of LOB. The idea would be that a corporation with a sufficiently large percentage of shareholders who are U.S. residents would be treated for purposes of the treaty as if it itself were a U.S. resident. This problem with such a provision is that, like any provision that assigns residence to corporations, it is both under-inclusive and over-inclusive.¹⁵⁴ It is under-inclusive because it does not protect U.S. residents who are shareholders in corporations whose U.S. ownership does not reach the threshold. It is over-inclusive because it effectively protects non-U.S. residents who are shareholders in corporations whose U.S. ownership does reach the threshold.¹⁵⁵ Another possibility would be to permit the other country to tax corporations as it sees fit, but to require it to refund a proportionate share of the tax to any shareholder of the corporation who is a U.S. resident. Such a provision is more thematic in the sense that it targets all U.S. shareholders and only U.S. shareholders. The disadvantage of such a provision is that it might be more complicated to implement.

As noted, the purpose of the corporate income tax as described in this Subpart would be to serve as an indirect tax on nonresident shareholders. Therefore, I would propose an exemption from the corporate-level tax in two cases. First, a corporation should be exempt from tax if proves that all of its shareholders are U.S. residents. Second, a corporation some or all of whose shareholder are nonresidents would be exempt from tax if it proves that all of its nonresident shareholders filed U.S. tax returns in which they reported and paid tax on their share of the corporation’s U.S. source income.¹⁵⁶ In other words, in those instances in which the corporation’s shareholders pay tax directly on the corporation’s domestic source income, the corporate-level tax would be superfluous.¹⁵⁷ These exemptions, in addition to being conceptually thematic, would simplify the structure by preventing at the outset the double taxation of residents who own shares in corporations with domestic-source income and obviating the need for a subsequent mitigation of the double tax.¹⁵⁸

C. Avoiding Double Taxation

The third issue that the proposed international tax regime would need to consider is how to account for taxes paid at the corporate level when computing the tax liability of resident shareholders. For the purpose of our discussion, I will assume that the United States wishes to continue its current policy of taxing nonresidents on their U.S.-source income, that other countries routinely impose tax on income derived from sources within

¹⁵⁴ See *supra* Part IV.

¹⁵⁵ Ostensibly, such overprotection is not of real concern to the United States. However, insisting upon such overprotection (implicit in the demand that a corporation with a certain level of U.S. ownership is entitled to treaty benefits) would increase the cost of the treaty to the other signatory, which might demand additional U.S. concessions as a *quid pro quo*.

¹⁵⁶ This Article does not consider the procedure by which a corporate would demonstrate either that all of its shareholders were U.S. residents or that all of its nonresident shareholders filed the necessary returns and paid the applicable tax. Nor does it consider under what circumstances it might be appropriate to impose reporting or withholding obligations on the corporation to guarantee payment of tax by the shareholders.

¹⁵⁷ These exemptions, in addition to being conceptually thematic, would simplify the structure by preventing at the outset the double taxation of residents who own shares in corporations with domestic-source income and obviating the need for a subsequent mitigation of the double tax, as described in Subpart C, *infra*.

¹⁵⁸ See Subpart C, *infra*.

their territory, and that the United States wishes to continue its policy of mitigating double taxation by permitting a credit for foreign income taxes paid by U.S. residents.¹⁵⁹ Each of these policies is controversial, and it is far from certain that an ideal international tax regime would retain all or even any of them.¹⁶⁰ However, to keep the discussion manageable and to demonstrate how the proposed international corporate tax regime might operate under the most plausible set of assumptions regarding international tax policy that one can make at this time, I will assume that the aforementioned policies will continue.

The imposition of a corporate-level territorial tax as a means of indirectly taxing nonresident shareholders complicates the taxation of U.S. shareholders. As we have seen, U.S. residents will pay tax on the income derived from their shareholding (computed mark-to-market, on a flow-through basis, or at realization with an interest charge). When the corporation has U.S.-source income, the corporate-level tax would mean that the same income would be subject to double U.S. taxation. Furthermore, if the corporation has foreign-source income subject to foreign income taxes, that income would also be subject both to foreign tax (at the corporate level) and to U.S. tax (at the shareholder level).¹⁶¹

Consequently, U.S. shareholders should be entitled to a credit equal to their proportionate share of the income tax, whether U.S. or foreign, incurred by the corporation.¹⁶² From the perspective of shareholders who are U.S. residents, this would effectively eliminate the corporate-level tax and leave only the shareholder-level tax. As the credit is indirect (a shareholder-level credit for a corporate-level tax) and is available for both U.S. and foreign corporate-level income taxes, I will refer to it as an Indirect Tax Credit or ITC.

On a technical note, whenever the shareholder's income is a function of a shareholder-level event (e.g., change in value of the shareholder's shares, receipt of a dividend, or sale of shares), the amount of the ITC would need to be considered additional income in the hands of the shareholder. The reason is that because the corporate-level tax presumably reduces the value of the shares, the taxpayer receives an implicit deduction for tax paid by the corporation. A credit in addition to the deduction

¹⁵⁹ I.R.C. § 901.

¹⁶⁰ With regard to the taxing the domestic source income of nonresidents, see note 140, *supra*. With regard to the foreign tax credit, it is arguable that foreign income taxes are properly viewed as an expense of operating in foreign countries and thus do not create a problem of double taxation. See, e.g., SHAVIRO, FIXING, *supra* note 25, at 68; Daniel Shaviro, *The Case Against Foreign Tax Credits*, 3 J. OF LEGAL ANALYSIS 65 (2011). See also ISENBERGH, *supra* note 152, at 134 ("The only allowance for foreign income taxes in the 1913 Income Tax Law was a deduction for taxes paid to foreign governments as a cost of doing business."). Nevertheless, as noted by Shaviro, "[p]erhaps no feature of modern income tax systems has gained such consistent ... approval from commentators as the foreign tax credit." Daniel N. Shaviro, *Rethinking Foreign Tax Creditability*, 63 NAT'L TAX J. 709, 709 (2010).

¹⁶¹ As noted, this Subpart will proceed from the assumption that U.S. tax policy continues to view the imposition of tax both by the source country and by the country of residence as an inappropriate double tax.

¹⁶² As tax liability is ordinarily computed on an annual basis, I would suggest that shareholders who acquired or disposed of shares during the course of a year be entitled to a proportionate share of the credit to which they would otherwise be entitled. For example, assume that a U.S. resident purchases 20% of the shares on April 1 and an additional 15% of the shares on September 1 and that the corporation incurred income tax liability (both U.S. and foreign) of \$500,000. The shareholder's foreign tax credit would equal $\$500,000 \times [(20\% \times 9/12) + (15\% \times 4/12)] = \$100,000$.

would overcompensate the shareholder for the corporate-level tax.¹⁶³ To avoid overcompensation, we need to eliminate the deduction before granting the credit. The same issue arises under current law when a domestic corporation claims a credit for foreign taxes paid by another corporation in which it owns stock and from which it receives a taxable dividend.¹⁶⁴ I.R.C. § 78 provides that in such a case, an amount equal to the claimed credit will constitute income in the hands of the domestic corporation. Although the framework within which § 78 operates is different from that of this Article's proposal, the method adopted by § 78 is the simplest way to "gross up" the income.¹⁶⁵ Therefore, I would propose that, whenever a shareholder's taxable income is the function of a shareholder-level event, the ITC constitute income in hands of the individual claiming the credit.¹⁶⁶

To demonstrate, assume that Pat, a U.S. resident subject to a tax rate of 40%, owns 100,000 out of ABC Corp's 10,000,000 outstanding shares. During the year in question, the market price of ABC shares rose from \$50 a share to \$58 a share, and ABC paid income tax, both U.S. and foreign, of \$15,000,000. The computation of Pat's U.S. tax liability would be as follows:

- (1) Pat's shares increased in value by \$800,000.¹⁶⁷
- (2) As the owner of 1% of the shares in ABC, Pat would be entitled to an ITC of \$150,000.¹⁶⁸
- (3) Pat's taxable income attributable to holding shares in ABC would be \$950,000.¹⁶⁹
- (4) Pat's initial U.S. tax liability, before the ITC, would be \$380,000.¹⁷⁰

¹⁶³ For example, assume that Sally is a resident individual who owns shares in a publicly traded corporation, that her shares appreciated by \$1,000, that her proportionate share of income taxes paid by the corporation is \$250, and that she is subject to tax at the rate of 40%. Were we to compute her tax liability by multiplying \$1,000 by 40% and then subtracting \$250, we would end up with a figure of \$150. This would constitute overcompensation for the corporate-level taxes. Presumably, the value of the shares reflects those corporate-level taxes. In other words, without the corporate-level tax, Sally's shares would have appreciated not by \$1,000 but by \$1,250. At a 40% tax rate, Sally would have paid tax of \$500. With the corporate level-tax and the overly generous credit, she will bear a total tax burden, both direct and indirect, of only \$400 (her share of the corporate-level tax is \$250 and her direct tax liability is \$150). In other words, instead of after-tax income of \$750 (\$1,250 – \$500), Sally will end up with after-tax income of \$850 (\$1,000 – \$150).

¹⁶⁴ I.R.C. §§ 902(a), 960(a)(1).

¹⁶⁵ I.R.C. § 78 refers to a **domestic corporation** claiming an indirect credit for **foreign taxes** paid by a corporation from which it receives a dividend. The proposal presented here refers to a **resident individual** claiming an indirect credit for **either foreign taxes or domestic taxes** paid by **any corporation in which the individual owns shares**.

¹⁶⁶ The adjustment described in this paragraph is not necessary in the case of a privately held corporation when the shareholder reports her proportionate share of the corporation's tax income. The reason for this is that because income tax is not a deductible expense, taxable income represents the corporation's income before payment of tax. For example, assume that Sally's share of the corporation's taxable income is \$1,250 that her proportionate share of the corporate-level tax is \$250. As the figure of \$1,250 is her proportionate share of the corporation's income before payment of the corporate-level tax, it would not be appropriate to add the latter to the former in determining her income. In other words, to compute her tax liability we would multiply \$1,250 by 40% and subtract \$250 and end up with a figure of \$250. She will thus bear a total tax burden, both direct and indirect, of \$500 (her share of the corporate-level tax is \$250 and her direct tax liability is also \$250), which is equivalent to the tax burden that she would have born in the absence of the corporate-level tax.

¹⁶⁷ $100,000 \times (\$58 - \$50) = \$800,000$.

¹⁶⁸ $\$15,000,000 \times (100,000/10,000,000) = \$150,000$.

¹⁶⁹ $\$800,000 + \$150,000 = \$950,000$.

(5) Following the ITC, Pat would pay U.S. tax of \$230,000.¹⁷¹

However, the algorithm may have to be a little more complicated, because the simple computation just described did not consider the geographical source of earnings, nor did it take into consideration the jurisdiction to which the corporation paid tax. Under current U.S. tax policy there is an important distinction between U.S.-source income and foreign-source income and between U.S. income tax and foreign income tax. Foreign income taxes are creditable only to the extent of the taxpayer's U.S. tax liability on foreign-source income.¹⁷² The idea behind this provision is that foreign income tax should not be able to reduce U.S. income tax liability on U.S.-source income. This limitation of the Foreign Tax Credit (FTC) is not free from controversy.¹⁷³ Nonetheless, as with other aspects of current U.S. international tax policy, I will assume that this policy continues to hold and will attempt to show how the proposed international corporate tax regime might accommodate it.

I would suggest that to accommodate the limitations on the crediting of foreign income taxes, corporations would, as they do under current law, track and report on an annual basis their U.S.-source income, their foreign-source income, their U.S. income tax liability, and their foreign income tax liability. Shareholders' income would be allocated to U.S. sources and to foreign sources in accordance with the corporation's ratio of U.S.-source income to foreign-source income. ITC from payment of foreign income tax would be treated as an FTC and subject all of the limitation applicable thereto, while ITC from payment of U.S. income would be creditable without restriction.

Returning to our example, assume that ABC Corp. reported \$30,000,000 of foreign-source income, \$120,000,000 of U.S.-source income, \$10,000,000 of foreign income tax, and \$5,000,000 of U.S. income tax.¹⁷⁴ The computation would be as follows:

(1) Of Pat's \$950,000 in income,¹⁷⁵ \$190,000 would be foreign-source income,¹⁷⁶ and \$760,000 would be U.S.-source income.¹⁷⁷

(2) Pat's initial U.S. tax liability, before the ITC, on the foreign-source income would be \$76,000.¹⁷⁸ Her initial U.S. tax liability, before the ITC, on the U.S.-source income would be \$304,000.¹⁷⁹

¹⁷⁰ $\$950,000 \times 40\% = \$380,000$.

¹⁷¹ $\$380,000 - \$150,000 = \$230,000$.

¹⁷² I.R.C. § 904.

¹⁷³ David Hasen, *Tax Neutrality and Tax Amenities*, 12 FLA. TAX REV. 57, 64–65, 72 (2012); Paul R. McDaniel, *The U.S. Tax Treatment of Foreign Source Income Earned in Developing Countries: A Policy Analysis*, 35 GEO. WASH. INT'L L. REV. 265, 268–69 (2003); Charles E. McLure Jr., *Legislative, Judicial, Soft Law, Cooperative Approaches to Harmonizing Corporate Income*, 14 COLUM. J. EUR. L. 377, 387 n.32 (2008).

¹⁷⁴ In the example, the U.S. corporate tax rate on U.S. source income is extremely low (\$5 million/\$120 million = 4.17%). The reason that I chose these figures is to demonstrate what happens when the ITC for U.S. income tax is insufficient to eliminate U.S. tax liability on U.S. source income. However, the low rate of tax is not unrealistic. For example, under current U.S. law, nonresidents are exempt from tax on portfolio interest. Assuming that this policy continues, the exclusion would apply not only to foreign individuals but also to corporations. See the text accompanying notes 140–44, *supra*.

¹⁷⁵ See note 169, *supra*.

¹⁷⁶ $\$950,000 \times (\$30,000,000/\$150,000,000) = \$190,000$.

¹⁷⁷ $\$950,000 \times (\$120,000,000/\$150,000,000) = \$760,000$.

¹⁷⁸ $\$190,000 \times 40\% = \$76,000$.

¹⁷⁹ $\$760,000 \times 40\% = \$304,000$.

(3) Of Pat's \$150,000 of ITC, \$100,000 would be subject to the limitations of the FTC,¹⁸⁰ and \$50,000 will be creditable without restriction.¹⁸¹

(4) Pat would not need to pay any tax on the foreign source income because the ITC subject to the limits of the FTC (\$100,000) is greater than the initial U.S. tax liability on foreign-source income (\$76,000). Pat may use the remaining \$24,000 to reduce U.S. tax liability on other foreign-source income in accordance to the relevant provisions of the Code.

(5) Regarding income attributable to U.S. sources, Pat would pay tax of \$254,000, derived from an initial tax liability of \$304,000 and an ITC of \$50,000.¹⁸²

From a practical perspective, the United States does not have the jurisdiction to compel all corporations to track and report U.S.-source income, foreign-source income, U.S. income tax incurred, and foreign income tax incurred; nor does it have the jurisdiction to compel all corporations to submit to an audit by U.S. administrators to verify the numbers that it does report. Consequently, I would propose that when the corporation does not produce such a report or does not provide U.S. tax authorities an opportunity to conduct a satisfactory audit, all income would be deemed U.S.-source. Stated in other terms, shareholders would bear the burden of refuting a presumption that the corporation's income is all U.S. source. With regard to the ITC, granting the credit would in any case depend upon the corporation providing sufficient proof of such payment to U.S. tax authorities, who could then determine how much of the ITC is traceable to the payment of foreign income tax and how much is traceable to the payment of U.S. income tax. In the absence of such proof, shareholders would not be entitled to an ITC.

The purpose of these procedural provisions would be twofold. First, by creating a rebuttable presumption that all income is U.S.-source and that that the corporation paid no income tax, they would protect U.S. international tax policy goals by preventing the crediting of corporate-level income tax that was not in fact paid and by preventing the crediting of foreign income taxes against U.S.-source income. Second, by assuming what is from the perspective of shareholders a worst-case scenario, they would create an incentive for corporations that wish to attract U.S. investment to provide the documentation shareholders would need to rebut the statutory presumptions.

VI. CONCLUSION

Corporate personhood is a legal fiction, useful in some contexts, less so in others. Corporate residence is not a legal fiction. It is an oxymoron. It is an attempt to assign to corporations an attribute that contradicts their fundamental nature. The inapplicability of residence to corporation is not because corporations cannot "reside" in a place in the manner of human beings. This is a semantic, not a substantive issue. Rather, the reason that corporate cannot be residents for purposes of income tax is that residence delineates the boundaries of taxation in accordance with ability-to-pay, and ability-to-pay is a concept that is inapplicable to the corporate entity.

¹⁸⁰ $\$10,000,000 \times 1\% = \$100,000$.

¹⁸¹ $\$5,000,000 \times 1\% = \$50,000$.

¹⁸² Pat cannot use the unused ITC of \$24,000 here, as this is U.S.-source income and the \$24,000 is creditable only against U.S. tax liability from foreign-source income.

First, taxation in accordance with ability-to-pay is an attempt to implement certain norms of distributive justice. Distributive justice, in turn, concerns the distribution of resources among those who have personal identity, who are Kantian rational beings, and for whom welfare is a pertinent term. As none of these attributes applies to the corporate entity, a corporation cannot conceptually be party to a scheme of distributive justice. In other words, the moral value of a redistribution of resources from one corporation to another, from a corporation to an individual, or from an individual to a corporation cannot be determined except by reference to the effect of such redistribution on the welfare of individuals.

Second, the principles of distributive justice as embodied in the concept of ability-to-pay are not universal in scope but apply exclusively to members of the relevant society. For this reason, only residents pay tax on their worldwide income. Membership in a society is a function of one's personal connections. A country with which one has purely economic connections may have a claim under benefit theory to tax the income deriving from those ties. It does not have a claim to tax the income derived from foreign sources. As a corporation cannot have personal ties, the idea of corporate residence is a misnomer.

Why, then, are corporations subject to income taxation at all? The most persuasive justification for the corporate income tax is that it is an administratively convenient indirect tax on individual shareholders. This would seem to imply that we could assign residence to corporations by looking to the residence of their shareholders. However, such a model cannot succeed. With regard to any corporation with both domestic and foreign shareholders, we would face an irresolvable dilemma: classifying it as a resident, and consequently liable to tax on its foreign-source income, would unjustifiably overtax its foreign shareholders; classifying it as a nonresident, and consequently not subject to tax on its foreign-source income, would unjustifiably undertax its domestic shareholders.

Because residence is such a fundamental concept in international taxation, the incongruity of corporate residence irrevocably undermines the current international corporate tax regime. Therefore, there is no realistic alternative other than imposing tax directly on resident shareholders, retaining a territorial corporate income tax as a means of taxing foreign individuals who indirectly derive income from domestic sources, and adopting appropriate measures on the shareholder level to avoid double taxation of resident shareholders.

The current international corporate tax regime has proven unworkable in practice. To a great extent, the seemingly insurmountable challenges encountered by the current regime—such as expatriation and the exploitation of foreign subsidiaries—are simply practical manifestations of a flaw in the underlying theoretical framework. Abandoning the concept of corporate residence is the most thematic and most effective way to reform the international corporate tax regime.