Chapter 1

Corporate Tax Residence at the Crossroads between International Competition and Convergence: Outlining the Debate

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The concept of residence is one of the cornerstones of corporate income taxation, both in domestic and international law.[1] At the same time, authoritative voices, not only in the United States but also in Europe, have expressed scepticism regarding the adequacy of this concept in continuing to play such a prominent role in a globalized world.[2] This introduction aims to delineate the scope of the current debates around this delicate issue and at outlining its possible future evolution.[3]

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1. On corporate residence in tax matters, *see* G. Maisto (ed.), *Residence of Companies under Tax Treaties and EC Law* sec. 23.1. (IBFD 2009); D. Gutmann (ed.), *Corporate Income Tax Subjects*, EATLP Annual Congress Lisbon 2013 (2016); International Fiscal Association, *Source and residence: new configuration of their principles*, Cahiers de Droit Fiscal International, vol. 90a (2005); IFA, *The fiscal residence of companies*, Cahiers de droit fiscal international, vol. 72a (1987); IFA, *The delimitation between the country of residence and other countries of the power to tax corporations and/or their shareholders*, Cahiers de droit fiscal international, vol. 49b (1964); R. Couzin, *Corporate residence and international taxation* (Amsterdam, IBFD 2002); Ismer & Riemer, *Article 4, Resident-Residence*, in Reimer/Rust (ed.), *Klaus Vogel on Double Taxation conventions*, 4th ed. (2015), pp. 217-291. *See also* the doctoral dissertations of E.-J. Navez, *Le transfert transfrontalier du siège social des sociétés à l'épreuve du principe de territorialité au sein de l'Union européenne* (Catholic University of Louvain 2015), 888 p.; L. Brosens, *Het fiscaal inwonerschap van vennootschappen in een gemondialiseerde economie*, Ph. Thesis (University of Antwerp 2018), 811 p.
2. In the United States, *see* Michael J. Graetz, *The David R. Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 Tax L. Rev. 261 (2001), p. 320; Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 Tax L. Rev. 99 (2011), p. 159; Daniel Shaviro, *The David R. Tillinghast lecture. The rising tax-electivity of U.S. corporate residence*, Tax Law Review (2011), p. 395; D.R. Tillinghast, *A matter of definition: foreign and domestic taxpayers*, 2 Berkeley Journal of International Law (1984), p. 260. In Europe, *see*, for example, W. Schoen, *International tax coordination for a second best world (part I)*, World Tax Journal (2009), p. 67; S. van Weeghel, *Article 4(3) of the OECD Model Convention: an inconvenient truth*, in G. Maisto (ed.), *Residence of Companies under Tax Treaties and EC Law* (Amsterdam, IBFD 2009), p. 305; L. Hinnekens, *How OECD proposes to apply existing criteria of jurisdiction to tax profits arising from cross-border electronic commerce*, 29 Intertax (2001), pp. 323-324.
3. For a discussion of more specific issues, or of the domestic situation of specific countries, *see* the special and national reports contained in this book.

1.1. Functions of the residence concept for the application of corporate taxation[4]

Despite its importance for tax purposes, the concept of residence finds its roots in other areas of law, such as civil and commercial law and international private law. In these latter areas, the issue of the corporate seat touches upon one of the most controversial juridical issues, namely the legal recognition of incorporated persons.[5] Historically, even if the exact origin of the concept is still unclear,[6] the attribution of legal personality to fictitious entities, whether human communities or a combination of items of property aimed at a specific (economic) goal, had raised a number of controversies among European scholars in the 19th and 20th centuries as to its justification and extent.[7] At the time, those debates did not entail a territorial aspect: it was indeed obvious that corporations as "creatures of the law" were located in the country whose legal system had granted them legal personality.

4. For a more thorough analysis of the definition and functions of the concept of residence, *see* ch. 2 as well as the national reports in this book.

5. Moreover, labour law, consumer law and insolvency law also rely on residence to impose obligations on companies towards their stakeholders.

6. On the origin of corporate legal personality, R. Saleilles, *De la personnalité juridique, historique et théorie*, (2e éd.), (Paris, Éd. Rousseau 1922); B. Eliachevitch, *La personnalité juridique en droit privé romain* (Paris, Sirey 1942); H. Levy-Bruhl, *Histoire juridique des sociétés de commerce en France aux XVIIe et XVIIIe siècles* (Paris, Montchrestien, 1938); E. Richard, Mon nom est personne: La construction de la personnalité morale ou les vertus de la patience, 4 Entreprises et histoire 57 (2009), pp. 15-20; J. Dewey, *The Historic Background of Corporate Legal Personality*, 35 Yale Law Journal 6 (Apr. 1926), pp. 655-673; R. Grantham & C. Rickett (eds.), *Corporate Personality in the 20th Century* (Hart Publishing 1998); R. Harris, *The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business*, 63 Wash. & Lee L. Rev. 1421 (2006), pp. 1424-25.

7. *See*, for example, F.K. von Savigny, *System des heutigen Römischen Rechts*. Bd. 2. (Berlin 1840), p. 235 et seq., available at http://www.deutschestextarchiv.de/book/view/savigny_system02_1840; M. Vauthier, *Études sur les personnes morales dans le droit romain et dans le droit français*, (Bruxelles, Manceaux, Paris, Pedone-Lauriel 1887); O. von Gierke, *Die Genossenschaftstheorie und die deutsche Rechtsprechung* (Weidmann 1887); G. Bonelli, *Di una nuova teorica della personalità giuridica*, in Riv. italiana per le scienze giuridiche, t. IX, fasc. III, (Roma 1890), p. 325; M. Hauriou, *De la personnalité comme élément de la réalité sociale*, Rev. Gén. Dr. Légis. Juris., t. xxii (1898), pp. 1-119; M. Planiol, *Traité élémentaire de droit civil*, Pichon, t. I, (3rd ed.) (1900), pp. 977 et seq.; E. Hoelder, *Natürliche und juristische Personen* (Leipzig, Dunker & Humblot 1905); J. Binder, *Das Problem des juristischen Persönlichkeit* (Leipzig, Deichert 1907); F.W. Maitland, *Moral Personality and Legal Personality*, in *The Collected Papers*, vol. III, (Cambridge University Press 1911), pp. 304-320; A. Nekam, *The personality conception of the legal entity*, Harvard studies in the conflict of laws, vol. III (Harvard University Press 1938); H. Velge, *Associations et fondations en Belgique, Histoire et théorie* (Bruxelles, Bruylant 1942).

The increased mobility of economic factors due to the growth of international trade raised the issue of corporate citizenship and of the recognition of foreign entities, which was first solved by the adoption of unilateral domestic provisions, the conclusion of bilateral commercial agreements[8] and later within multilateral organizations, such as the European Union.[9]

The development of (corporate) income taxation throughout the 20th century then forced states to determine whether, on what grounds and to what extent domestic and foreign legal entities would be subject to tax[10] and whether the exercise of sovereign taxing powers should be coordinated at the international level through specific agreements.[11]

1.1.1. In domestic law

In the domestic context, residence first defines the scope and the extent of corporate taxpayers' liability. The main function of the residence concept

8. B. Nolde, *Droit et technique des traités de commerce*, Rec. cours dr. int. La Haye, vol. 3, II (1924), pp. 291-462; A. Gildemeister, *L'arbitrage des différents fiscaux en droit international des investissements* (LGDJ 2013), pp. 7-12; J. Englisch, *Germany*, in Maisto (ed.), *Residence of Companies under Tax Treaties and EC Law* (Amsterdam, IBFD 2009), p. 473.

9. On the EU aspects of company law, *see* M. Menjucq, *Droit international et européen des sociétés* (3e éd.) (Paris, Montchrestien 2011); S. Grundmann, *European Company Law* (2e éd.) (Cambridge, Antwerp, Intersentia 2012); P. Paschalidis, *Freedom of Establishment and Private International Law for Corporations* (Oxford University Press 2012). For an historical perspective, Y. Loussouarn, *La condition des personnes morales en droit international privé*, Rec. cours dr. int. La Haye, vol. 96, I (1959), p. 489; R. Houin, *Le régime juridique des sociétés dans la Communauté économique européenne*, R.T.D.E. (1965), p. 22; J. Dieu, *La reconnaissance mutuelle des sociétés et personnes morales dans les Communautés européennes*, C.D.E. (1968), p. 539.

10. On the early attempt to justify the (non-)taxation of corporations in an international context, *see*, for example, E.R.A. Seligman, *Double taxation and international fiscal cooperation* (New York, The Macmillan Company 1928), pp. 105-106; League of Nations Economic and Financial Commission, Report on double taxation submitted to the Financial Committee by professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, E.F.S.73.F.19, (Genève 5 Apr. 1923); P.A. Harris, *Corporate/shareholder income taxation and allocating taxing rights between countries. A comparison of imputation systems* (Amsterdam, IBFD 1996); H.J. Ault, *Corporate integration and the division on the international tax base*, 47 Tax Law Review 3 (1992), p. 567; A.S. Bank, *From sword to shield: the transformation of the corporate income tax, 1861 to present*, (Oxford University Press, 2010); A.S. Bank, *Anglo-American corporate taxation: tracing the common roots of divergent approaches* (Cambridge University Press, 2011).

11. On the history of double taxation conventions, *see* for Belgium, I. Richelle/E. Traversa (with J. Gombeer), *The history of double taxation conventions in Belgium*, in Alabaster 1938-2013, 75th Anniversary book of the International Fiscal Association – Belgian Branch (C. Docclo ed., Anthemis 2013), pp. 53-71.

is to subject resident corporate taxpayers to full tax liability, usually on a worldwide basis (France being the notable exception within the European Union). The worldwide taxation of resident taxpayers has been justified – more or less convincingly – under several arguments, such as the ability to pay, equality, the efficiency of capital allocation, neutrality, economic allegiance, equity or redistribution.[12] The discussions around the concept of residence are almost inextricably intertwined with the justifications of worldwide tax systems. However, it appears important to keep both issues separated, since they do not necessarily overlap.

For example, residence also plays a meaningful role in territorial tax systems.[13] Residence of the payer is indeed often used as a proxy to determine the source of income. This is, in particular, the case for capital income, such as dividends, interest and some capital gains, or for the consideration of services or the use of material goods, such as equipment, or intangibles (royalties). Consequently, states tend to impose withholding tax obligations on resident payers of those items of income, especially when their beneficiaries are foreign.[14]

From a comparative perspective, countries use a wide range of connecting factors in order to determine the company residence for domestic tax purposes. Those criteria are often taken from company law or international private law. However, symmetry between areas of law is not a necessity, and disjunction is possible. In company law, the determination of the residence or seat of a company is not merely a geographical exercise, it is essential to identify the applicable law and therefore to assess the existence of a corporate person as such. Indeed, unlike natural persons, there is no such thing as a stateless company, disconnected from the legal system that brought it into being (or subsequently recognized its legal existence). In tax law, however, residence does not work in such a binary way. It certainly influences the extent of the tax liability of the company, but it is the exclusive factor: a non-resident company may also be subject to the domestic rule of

12. *See* K. Vogel, *Worldwide vs. Source Taxation of Income – A Review and Re-Evaluation of Arguments*, 16 Intertax 8/9 (1988), pp. 216-229, 310-320 and 393-402, as well as in McLure, Sinn & Musgrave (eds.), *Influence of tax differentials on international competitiveness: proceedings of the Munich Symposium on International Taxation*, Papers, (Kluwer 1990).
13. O. Marian, *The Function of Corporate Tax-Residence in Territorial Systems*, 18 Chap. L. Rev. 157, (2014) at p. 158.
14. *See* Schindel & Atchabahian, *General report*, in *Source and residence: new configuration of their principles,* IFA Cahiers de Droit Fiscal International, vol. 90a (2005), pp. 52-55 and the references quoted.

a state. This fundamental difference with other areas of law has to be taken into consideration.

The two most common categories of criteria used in domestic corporate taxation are the place of incorporation/registered office[15] or legal seat and the place of effective management (POEM) or real seat. Most countries tend to apply a combination of both, with a relative predominance of the POEM. There are exceptions like Finland,[16] Ukraine,[17] Sweden[18] (with minor exceptions) and the United States,[19] which only apply the place of incorporation. Denmark applies the incorporation criterion only for limited companies incorporated in Denmark and has a dual approach for other companies, including those incorporated abroad, which in practice means that Danish residence may derive from the POEM in Denmark.[20]

However, the notion of the POEM is interpreted differently among jurisdictions. In some, for example the United Kingdom, Czech Republic and Belgium, it refers to the place of central management and control. In others, like Austria and Germany, it focuses on the place of the operational, day-to-day management. Moreover, the POEM can be interpreted rather formally, like in Belgium (the place where the board of administrators meet), or more substantially, like in Italy, where the place of the main and substantial activity is taken into consideration. Regarding the implementation, some countries have detailed legislation on the elements of the POEM, such as Russia,[21] while others, like the United Kingdom or Austria, leave it to the courts to decide on a case-by-case basis. It should be noted that it is not always an easy task for the domestic tax administrations to determine the POEM, particularly in cross-border situations.

Other elements contained in the domestic tax legislation of countries to determine the POEM include the place of the head or main office, the place of principal activity, the nationality or residence of the company's

15. On the differences between place of incorporation and place of registered office, *see* P. Behrens, *General principles on residence of companies. A comparative analysis for connecting factors used for the determination of the proper law of companies*, in G. Maisto (ed.), *Residence of Companies under Tax Treaties and EC Law* (Amsterdam, IBFD 2009), pp. 3-28; W. Schön, *The mobility of companies in Europe and the organizational freedom of Company Founders* (ECFR 2006), pp. 139-140.
16. *See* ch. 10 (Finland).
17. *See* ch. 26 (Ukraine).
18. *See* ch. 23 (Sweden).
19. *See* ch. 28 (United States).
20. *See* ch. 9 (Denmark).
21. *See* ch. 20 (Russia).

shareholders and the location of the company's most valuable assets. Since each criterion has its own advantages and shortcomings, it is common for states to determine corporate tax residence based on a mixed approach, combining several elements.[22]

1.1.2. In tax treaties

In the international context, residence conditions the entitlement to double taxation treaties and plays a fundamental role in the allocation of the power to tax between contracting states in order to avoid double taxation.[23]

On the one hand, it usually determines the applicability of the provisions of a convention to taxpayers (with the exception of the non-discrimination clause),[24] provided they are liable to tax in their country of residence.[25] However, residence remains defined by reference to domestic law. Due to the divergences in the criteria used by states, double taxation deriving from multiple residence appears unavoidable. Tax treaties therefore provide for criteria aimed at solving the positive conflicts of residence. In many double taxation conventions that are based on the OECD Model Convention until its 2017 update, the POEM is used as a tie-breaker rule.[26] This traditional

22. *See*, for example, ch. 24 (Switzerland). For a discussion, *see* ch. 2.
23. Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, *Report on Double Taxation submitted to the Financial Committee – Economic and Financial Commission Report by the Experts on Double Taxation*, Document E.F.S.73. F.19 (5 Apr. 1923), Volume 4 Section 1: League of Nations, available at http://www.taxtreatieshistory.org/, p. 18 et seq.
24. N. Bammens, *The Principle of Non-Discrimination in International and European Tax Law*, (IBFD 2013), p. 63 et seq.
25. On the expression "liable to tax", *see* Ismer & Riemer in E. Reimer & A. Rust (eds.), *Vogel on double taxation conventions*, 4th ed. (Kluwer Law International 2015), p. 243 et seq.; R. Vann, *"Liable to Tax" and Company Residence under Tax Treaties*, in Maisto (2009), *supra* n. 15, at pp. 197-271. *See*, however, the numerous reservations made by states on art. 4(3).
26. *See* art. 4(3) before its 2017 update and Comm. Art. 4 OECD Model, paras. 21-24. The OECD Commentary defines the POEM as: "the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time. The place of effective management is where the management's significant policies are made. It does not necessarily include the place where these policies are executed (day-to-day management)". *See* J. Avery Jones, *2008 OECD Model: Place of Effective Management – What One Can Learn from History*, Bulletin for International Taxation (2009), pp. 183-186; J. Sasseville, The Meaning of "Place of Effective Management", in G. Maisto (ed.), *Residence of Companies under Tax Treaties and EC Law* (Amsterdam,

solution appears in the majority of the treaties concluded by some countries, such as Italy, Austria and Canada.[27] However, it does not constitute a guarantee for uniformity, since states tend to interpret that expression according to their domestic law (*see* section 1.1.1.). Proposals have been made to improve the functioning of the current tie-breaker rule,[28] but those attempts are unlikely to succeed, considering the modification of the OECD Model in 2017.

There are some exceptions: some treaties use as a tie-breaker the head office treaties concluded (the new Germany-China treaty that entered into force in 2016 or the Ireland-Japan treaty) or the place of incorporation (Germany-Australia and Austria-United States). However, there is a clear tendency at the OECD level in the BEPS process – but also in the United States and a few other countries like Serbia (for practical reasons) – to abandon the POEM as a criterion and to replace it with a mutual agreement procedure. In 2017, article 4(3) of the OECD Model was modified to read as follows:

> Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be

IBFD 2009), pp. 287-300; M. Widrig, *The expression "by reason of his domicile, residence, place of management…" as applied to companies*, in G. Maisto (ed.), *Residence of Companies under Tax Treaties and EC Law* (Amsterdam, IBFD 2009), p. 278; B. Aniceto da Silva, *The tie-breaker rule (Art. 4 of the OECD MC): relevance of domestic law or autonomous interpretation?* in M. Schilcher & P. Weninger (eds.), *Fundamental issues and practical problems in tax treaty interpretation* (Wien, Linde 2008), p. 347; C. Romano, *The evolving concept of "place of effective management" as a tie-breaker rule under the OECD Model Convention and Italian law*, European Taxation (2001), p. 340.

27. On the Canadian experience, *see* G. Loomer, *The disjunction between corporate residence and corporate taxation: is improvement possible?* Canadian Tax Journal (2015), p. 99; K. Brooks, *Residence of Companies Under Tax Treaties and EU Law (Canada)*, in Maisto (2009), *supra* n. 15, pp. 407-440.

28. *See* OECD, *The impact of the Communications revolution on the application of "place of effective management" as a tie breaker rule*. A discussion paper from the technical advisory group on monitoring the application of existing treaty norms for the taxation of business profits (Paris 2001), available at www.oecd.org/dataoecd/46/27/1923328.pdf. *See also* S. van Weeghel, *The tie-breaker revisited: towards a formal criterion?*, in L. Hinnekens & Ph. Hinnekens (eds.), *A vision of taxes within and outside European borders: Festschrift in honor of Prof. Dr. Frans Vanistendael* (Alphen aan den Rijn, Kluwer Law International 2008), pp. 964-965; E. Burgstaller & K. Haslinger, *Place of effective management as a tie-breaker rule – concept, developments and prospects*, 32 Intertax 8/9 (2004), pp. 383-386.

> entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

The Multilateral Instrument deriving from BEPS Action 15 also contains a similar provision.[29] This development has drawn criticism, namely in Germany, Austria, Italy and Sweden, mainly considering how cumbersome and unpredictable those mutual agreement procedures are.

On the other hand, residence also plays a fundamental role in the division of taxing powers between contracting states. In most non-tax matters, the applicable domestic law has a unique and exclusive character: companies cannot be simultaneously subject to different legal systems. Therefore, international agreements (or EU legislation), when they exist, determine a single state whose legal system will apply to the company, with the other states left to acknowledge this situation, with minor exceptions, for example overriding mandatory rules in private international law.[30] In taxation, the international allocation of taxing powers of corporate income is not made according to one single criterion, but to different connecting factors depending on the category of income.

According to the OECD Model, the country of residence is entitled to exclusive taxing rights on the company's business income, unless there is a permanent establishment in the other country (article 7) and on passive income, except for dividends and sometimes interest and royalties (articles 10 to 13), where the taxing competence may be shared. Moreover, the residual clause attributes to the country of residence the exclusive right to tax the items of income not defined by the convention (article 21).

The OECD model also attributes income to states other than the state of residence, for example the state of the permanent establishment, the state where immovable property is located or – at least partly – the state where dividends (or – more rarely – interest and royalties) are distributed. Even in this case, however, residence plays an important role, because source is often identified with the state of residence of the payer of the income.

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29. *See* OECD, Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, 2 Nov. 2016, article 4 (available at http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf).
30. *See* Michael Wilderspin, *Overriding mandatory rules*, in Jürgen Basedow, Giesela Rühl, Franco Ferrari & Pedro de Miguel Asensio (eds.), *Encyclopedia of Private International Law* (Edward Elgar 2017), pp. 1331-1336.

The central character of the residence criteria in a double taxation convention constitutes an incentive for companies to (re)locate in states offering the most favourable tax treatment,[31] therefore triggering tax competition. However, some authors point out that residence also works as a safety net that enables states to collect tax even in situations where the state of source would abandon its taxing rights, which is likely in some cases to reduce the incentive to delocalize.[32] Moreover, the predominance of the residence state is often seen as a type of tax imperialism from industrialized, capital exporting countries towards developing, capital importing countries.[33]

1.1.3. The EU law dimension

In European law, residence gives access to the legal protection granted to companies by the treaties and secondary law, which also tends to refer to the domestic law of the Member States. Indeed, article 54 of the Treaty on the Functioning of the European Union (TFEU) grants the right of establishment to "companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union", which leaves Member States free to determine which connecting criteria they want to use, as it has been recognized by the European Court of Justice (ECJ).[34] Corporate Tax Directives also determine their scope of application by reference to

31. On inversions and corporate relocations, *see* M.A. Desai & J.R. Hines Jr., *Expectations and expatriations: tracing the causes and consequences of corporate inversions*, 55 National Tax Journal (2002), p. 415; R.S. Avi-Yonah, *For haven's sake: reflections on inversion transactions*, Tax Notes (2002), p. 1793; T. Laamanen, T. Simula & S. Torstila, *Cross-border relocations of headquarters in Europe*, Journal of International Business Studies (2012), p. 200; O. Marian, *Home-country effects of corporate inversions*, Washington Law Review (2014), p. 171.

32. *See* L. Brosens (2018), *supra* n. 1, p. 593.

33. L. Sheppard, *Revenge of the Source Countries, Part IV: Who Gets the Bill?,* 40 Tax Notes Int'l 411 (2005), p. 416. *See also* Reuven Avi-Yonah, *Bridging the North/South Divide: International Redistribution and Tax Competition*, 26 Mich. J. Int'L L. 371 (2004); Victor Thuronyi, *Tax Treaties and Developing Countries*, in *Tax Treaties: Building Bridges Between Law and Economics* 441 (Michael Lang et al. eds., 2010), p. 445. Many other authors have expressed strong critiques against the residence principle, *see* K. Vogel, *Worldwide vs. Source Taxation of Income – A Review and Re-Evaluation of Arguments*, 16 Intertax 8/9 (1988), pp. 216-229, 310-320 and 393-402; E.C.C.M. Kemmeren, *Principle of origin in tax conventions. A rethinking of models* (Dongen, Pijnenburg, 2001), p. 28; R.J. Jeffrey, *The impact of state sovereignty on global trade and international taxation* (Den Haag, Kluwer Law International 1999), pp. 49-50. *See also* M. Devereux & P.B. Sørensen, *The Corporate Income Tax: International Trends and Options for Fundamental Reform*, European Commission, Economic Papers No. 264 (2006), p.17.

34. ECJ, 29 Nov. 2011, *National Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*, C-371/10, para. 27; 16 Dec. 2008, *Cartesio Oktató és*

domestic law of the Member States. For example, the Parent-Subsidiary Directive applies to companies that "according to the tax laws of a Member State [are] considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, [are] not considered to be resident for tax purposes outside the Union".[35]

Despite numerous attempts, harmonization at the EU level of the definition of seat in corporate law seems unlikely.[36] This also holds true for corporate tax residence, although harmonization has been advocated by some authors[37] and even – arguably – by the European Commission.[38]

However, progress has been made towards the resolution of residence conflicts within the European Union. The recent adoption by the Council of a directive on dispute resolution in cases of double taxation is likely to reduce the negative impact for taxpayers of disparities between Member

Szolgáltató bt, C-210/06, para. 110. *See also* ECJ, 27 Sept. 1988, 81/87, *The Queen v. H.M. Treasury and Commissioners of Inland Revenue*, ex parte Daily Mail and General Trust PCJUE, para. 23.

35. Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345, 29 Dec. 2011, pp. 8-16, art. 2, A. *See also* Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310, 25 Nov. 2009, pp. 34-46; Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ 2003 L 157, p. 49, art. 3; Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19 July 2016, p. 1, arts. 1, 2 and 7, as well as Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 146, 3 June 2016, p. 8, art. 1.

36. *See* the European Commission DG/LSE, *Study on the law applicable to companies: Final Report* (2016). On the history of corporate law harmonization in the European Union, *see* Martin Gelter, *Centros, the Freedom of Establishment for Companies, and the Court's Accidental Vision for Corporate Law* (13 Feb. 2015), in: Fernanda Nicola & Bill Davies, *EU Law Stories* (Cambridge University Press, 2017); Fordham Law Legal Studies Research Paper No. 2564765, ECGI - Law Working Paper No. 287/2015, available at https://ssrn.com/abstract=2564765 or http://dx.doi.org/10.2139/ssrn.2564765.

37. *See*, for example, P. Pistone, *Company Residence and EC Tax Law*, in Maisto (2009), *supra* n. 15, p. 187; A. Ribes, *Tax residence and the mobility of companies in the European Union: the desirable harmonization of the tax connecting factors*, Intertax (2012), p. 607; L. Brosens, *supra* n. 1, p. 719.

38. Commission Communication, *Double Taxation in the Single Market*, 11 Nov. 2011, COM(2011) 712 final, 10.

States' tax systems, including as to the definition of residence.[39] On the other hand, issues of double residence resulting in double non-taxation have been specifically addressed at EU level through different instruments. The Anti-Tax Avoidance Directive contains a provision specifically addressing tax residency mismatches, which refers to the applicable bilateral tax treaty. According to this provision (article 9b),

> [t]o the extent that a deduction for payment, expenses or losses of a taxpayer who is resident for tax purposes in two or more jurisdictions is deductible from the tax base in both jurisdictions, the Member State of the taxpayer shall deny the deduction to the extent that the other jurisdiction allows the duplicate deduction to be set off against income that is not dual-inclusion income. If both jurisdictions are Member States, the Member State where the taxpayer is not deemed to be a resident according to the double taxation treaty between the two Member States concerned shall deny the deduction.[40]

Abusive reliance on domestic, EU or international tax rules by dual (non-) residents can also be tackled by the general anti-abuse clause contained in the Anti-Tax Avoidance Directive (ATAD).[41] Moreover, the recent Commission's decisions in the area of State aid, in particular in the Apple case,[42] could also – if confirmed by the ECJ – deter intentional situations of double non-residence when intentionally exploited to obtain a tax advantage.

1.2. Residence and cross-border mobility under international and EU tax law

EU law has strongly influenced the legal framework applicable to the transfer of residence of a company between Member States.

39. Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, OJ L 265, 14 Oct. 2017, pp. 1-14. The directive is applicable to "any person, including an individual, that is a resident of a Member State for tax purposes, and whose taxation is directly affected by a question in dispute".
40. Council Directive (EU) 2016/1164 of 12 July 2016, as amended by Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, OJ L 144, 7 June 2017, pp. 1-11, art. 9b.
41. Council Directive (EU) 2016/1164 of 12 July 2016, art. 6.
42. Ireland – Implemented State Aid to Apple, Commission Decision Finding State Aid, 30 Aug. 2016, C(2016) 5605 final, paras. 48-52.

The Merger Directive[43] directly tackles the issue of cross-border transfers of registered office or "cross-border conversion",[44] and the tax implications thereof, yet exclusively concerning the *Societas Europaea* (SE) and European Cooperative Society (SCE).

Regarding the transfer of the residence of other types of companies, their tax treatment is determined at the domestic level, to be assessed through the lens of its compatibility with the freedom of establishment.[45] The said freedom is enshrined in articles 49 to 55 of the TFEU and notably precludes Member States from imposing any restrictions on foreign economic actors willing to implant a permanent activity on their soil (article 49), while further, ensuring these are subsequently treated equal to natural persons who are nationals of the said Member States (article 54).

According to the Court, the freedom of establishment "applies to an operation whereby a company incorporated under the law of one Member State transfers its statutory seat to another Member State with the aim of converting itself into a company governed by the law of the latter Member State, in so far as that company actually establishes itself in the other Member State, or intends to do so, for the purpose of pursuing genuine economic activity there".[46] This right does not, however, guarantee the tax neutrality of conversions/transfers and in no way does it require Member States to draw up their tax rules on the basis of those in another Member State to avoid disparities.[47] Member States are thus allowed to compensate the loss of taxing power upon not yet realized gains at the occasion of a transfer of

43. Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310, 25 Nov. 2009, pp. 34-46.
44. ECJ, 25 Oct. 2017, Case C-106/16, *Polbud - Wykonawstwo sp. z o.o.*, para. 22 "process whereby a company is converted into a company subject to the law of another Member State, the latter company coming into existence in the course of that process".
45. As reminded in ECJ, 11 Mar. 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie,* para. 44 "the prohibition on Member States establishing restrictions on the freedom of establishment also applies to tax provisions. According to consistent case-law, even if, in the current state of Community law, direct taxation does not as such fall within the scope of the Community's jurisdiction, Member States must nevertheless exercise their retained powers in compliance with Community law".
46. Opinion of Advocate General Kokott delivered on 4 May 2017 in relation to Case C-106/16, *Polbud - Wykonawstwo sp. z o.o.* (*supra* n. 44), para. 26.
47. ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indu*s, para. 62.

seat[48] by means of applying an exit tax on the transferred assets. However, such taxation must constitute a proportionate tax measure, thus taking into account temporality and not exceeding the aforementioned aim as to not "prohibit, impede or render less attractive the exercise of the freedom of establishment".[49] In this respect, important elements are to be found in the remarkable case law developed by the ECJ.[50]

Moreover, "to improve the resilience of the internal market as a whole against cross-border tax avoidance practices", the European legislator expressly confirmed and regulated the possibility of effective taxation of capital gains in case of a transfer of seat in the ATAD.[51] At first glance, this provision appears to codify the case law developed by the Court. It is, however, fundamentally different, as under its provisions, exit taxation is no longer merely allowed but becomes mandatory.[52] Moreover, the exit tax in case of transfers of seat provided by the Directive only applies to assets that entail a loss of taxing powers, thus excluding those assets that remain effectively connected with a permanent establishment in the first Member State. As the Directive operates minimal harmonization, the exact design of such a tax as being a tax avoidance tool is left up to the Member States, which may in theory opt for stricter regimes than the ones outlined in the Directive. In such a case, the compliance of such a regime with the freedom of establishment should still be assessed, based on the condition contained in the Directive itself and, if necessary, based on the pre-existing case law.[53]

In any event, it ought to be noted that such cross-border conversions require upstream verification of requirements applicable thereto under civil and commercial law. Member States still remain free to define the connecting

48. Since the dominant residence criterion and dominant tie-breaker rule under DTCs are the POEM, transfers of seat being accompanied by an effective transfer of activity do automatically entail a loss of taxing power.

49. ECJ, 5 Oct. 2004, C-442/02, *Caixa Bank v. Ministère de l'Économie, des Finances et de l'Industrie*, para. 11; *National Grid Indus*, *supra* n. 47, para. 36.

50. In this respect, *see* the already mentioned *National Grid Indus*, *supra* n. 47, and the subsequent cases: ECJ, 6 Sept. 2012, Case C-38/10, *Commission v. Portugal*; ECJ, 25 Apr. 2013, Case C-64/11, *Commission v. Spain*; ECJ, 18 July 2013, Case C-261/11, *Commission v. Denmark*; ECJ, 23 Jan. 2014, Case C-164/12, *DMC*; ECJ, 21 May 2015, Case C-657/13, *Verder Lab Tec*; ECJ, 14 Sept. 2017, Case C-646/5, *Trustees of the P Panayi Accumulation & Maintenance Settlements v. Commissioners for Her Majesty's Revenue and Customs*.

51. Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19 July 2016, pp. 1-14.

52. Art. 5 ATAD; for a detailed analysis, *see* S. Peeters, *Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool*, EC Tax Review 3 (2017), pp. 122-132.

53. As pointed out in S. Peeters, id., p. 123.

factors to be considered for a company to be a subject of their national law. Thus, depending on the choice between incorporation and real seat theory operated by the concerned states, as well as the inbound or outbound nature of the transfer, the said transfer may be either allowed or forbidden.[54] Only if a conversion should be possible under civil and commercial law will the question of loss of taxing power arise.

Consequently, the case law developed by the Court in relation to transfers of seat from a corporate law perspective provides important elements to be taken into account.[55] Notably, it specified that should the conversion be possible under civil and commercial law, it ought to entail actual establishment in the host Member State and therefore the transfer of the economic activity of the company, in order to benefit from the protection provided against excessive tax treatment, because "although that freedom gives economic operators in the European Union the right to choose the location of their economic activity, it does not give them the right to choose the law applicable to them. Consequently, a cross-border conversion is not caught by the freedom of establishment where it is an end in itself".[56] Considering the broad interpretation of an establishment,[57] transfers solely conceived as concerning the corporate seat, not the real seat, do not fall under the scope of protection of this freedom.[58] In other words, artificial transfers aimed at

54. As reminded in Opinion of Advocate General Kokott delivered on 4 May 2017 in relation to Case C-106/16, *Polbud - Wykonawstwo sp. z o.o.*, para. 23: "the success of such a conversion depends in principle on the legal systems of both the Member State of origin and the host Member State".

55. *See* the case law developed by the ECJ in relation to seat transfers from a corporate law perspective, notably: ECJ, 27 Sept. 1988, Case C-81/87, *Daily Mail and General Trust*; ECJ, 3 Dec. 2005, Case C-11/03, *Sevic Systems*; ECJ, 16 Dec. 2008, C-210/06, *Cartesio*; ECJ, 12 July 2012, Case C-378-10, *VALE Építési kft*.; aforementioned Case C-106/16, - *Wykonawstwo sp. z o.o.*; on the relation between this case law and tax matter, *see* S. Peeters, *Exit Taxation on Capital Gains in the European Union: A Necessary Consequence of Corporate Relocations*, ECFR (2013), pp. 507-522.

56. Opinion of Advocate General Kokott, *supra* n. 54, para. 38.

57. Understood as the "actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period" (*Polbud Wykonawstwo sp. z o.o*, para. 67), preferably demonstrated by the existence of infrastructures enabling such economic activity in the concerned Member State (ECJ, 11 Dec. 2003, Case C-215-/01, *Bruno Schnitzer*), even the existence of an intention to implant such infrastructures even if not yet backed by any concrete premises satisfies this requirement (*Vale*, *supra* n. 55, para. 35, as well as ECJ, 12 Sept. 2006, Case C-196:04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, para. 54).

58. The mere registration in another Member State is indeed not sufficient to constitute an "establishment" in the said Member State (ECJ, 19 June 1990, Case C-213/89, *The Queen v. Secretary of State for Transport*, ex parte: *Factortame Ltd and others*, preliminary ruling, para. 21).

avoiding or evading tax should be excluded from the protection of EU law, leaving Member States free to adopt anti-avoidance measures.

1.3. The simultaneous reinforcement and erosion of the concept of residence in the time of BEPS

Today, the traditional concept of corporate residence appears – paradoxically – to be both reinforced and eroded by the evolution of the global economy, in particular the development of multinational firms and the digitalization of the management and operating activities of companies.[59]

Residence has become more important because digitalization has allowed the carrying out of significant economic activities without material – and soon without any human – support. The modification of business structures and value creation models diminishes the importance of traditionally core economic activities, such as manufacturing and brick-and-mortar production processes in general, in the generation of profits and the growing importance of dematerialized features, such as data collection, use of information, e-marketing and software development.[60] This shift – which was not tax, but technology-driven – has made the permanent establishment concept totally outdated, leaving residence as the only connecting factor of those digital businesses with the "real" world.[61]

At the same time, as Wolfgang Schoen said,

> the factual basis for the identification of corporate residence is gradually eroding. […] Firstly, it is far easier for companies than for individuals to move their residence around. Depending on the benchmark for residence under national and international law, this requires reincorporation in another jurisdiction or transfer of central management and control, but it does not require a different allocation for the large bulk of profit-generating operative and auxiliary structures around the world. […] Moreover, the allocation of central management functions and other indicators for corporate residence can be more easily

59. R. Couzin, *Corporate Residence and International Taxation* (Amsterdam, IBFD 2002), p. 259 et seq.
60. M. Olbert & C. Spengel, *International Taxation in the Digital Economy: Challenge Accepted?*, 9 World Tax Journal (2017), p. 4. *See also* Eli Hadzhieva, *Tax Challenges of the Digital Economy*, European Parliament, Study for the TAXE 2 Committee (2016), p. 17 et seq.
61. Such a change appears even more clear looking how activities considered in the OECD Model as ancillary and preparatory – and therefore excluded from the PE concept – have become essential activities to the conduct of certain businesses (like storage for e-commerce platforms, or customer service). *See* M. Olbert & C. Spengel, id., p. 9.

> divided today among different jurisdictions, thus increasing the probability of dual-resident companies. This undermines the assumption that the location of central management can work as a meaningful starting point for worldwide allocation of profits arising from the activities of a multinational enterprise.[62]

The geographical dislocation of the functions performed within multinational firms makes it harder to identify a single place – if any – from which the firm operates. Multinational enterprises are indeed composed of many distinct legal entities, whose residence is to be determined according to the law applicable in the relevant jurisdictions where they are established. The difficulty is that their legal structure does not always mirror the economic relationship between them. In particular, the notion of POEM tends to become blurred, since those companies tend be managed globally and centrally. Traditional tools used by courts and administrations to determine residence, such as the "central management and control" test in common law jurisdictions, become inadequate and are easy to manipulate.

This is not only the consequence of technological changes but has also been actively encouraged through institutional and legal developments, such as the conclusion of international agreements and the removal of domestic impediments to cross-border transactions and transfers, whether under the World Trade Organization or the European Union. Moreover, regulatory and tax competition between states – including EU Member States – to attract foreign businesses makes it now easier to set up entities with very little or no substance.[63] As a result, the place of incorporation or registration cannot be relied upon as a trustworthy proxy to locate the different elements of the company that contribute to the generation of (taxable) profits.

Recent international scandals involving letterbox/shell companies have led states to reassess the notion of residence in light of the fight against tax evasion and avoidance. In particular, tax planning strategies involving location or transfer of seat to low-tax jurisdictions have come under the spotlight. Several measures have been proposed or adopted at the domestic, EU and international level, in order to disregard the effects of corporate residence on the taxpayers' tax liability and/or to give more weight to substance requirements. In particular, the OECD has recommended in the Final Reports of the BEPS Action Plan to adopt controlled foreign corporation (CFC) rules

62. W. Schön, *International tax coordination for a second best world (part I)*, World Tax Journal (2009), pp. 69-70.
63. Incorporating a business has become so easy that that service is offered online by numerous websites across the world. *See* S. Deakin, *Legal Diversity and Regulatory Competition: Which Model for Europe?*, 12 European Law Journal (2006), pp. 440-454.

and limitation on benefits (LOB) clauses.[64] CFC legislation allows the taxation of undistributed profits of associated companies in the hands of the controlling company. LOB clauses deny the benefit of the application of tax treaties to certain resident companies with insufficient ties to the country. Those measures will undoubtedly impact the international balance of taxing powers between states and modify the tax planning strategies of taxpayers. Those developments, however, cannot be seen as a thorough reconsideration of the role and function of the residence concept, as the whole BEPS initiative cannot be regarded as an overhaul of the existing global tax order.[65] Despite its shortcomings, residence indeed remains a cornerstone in domestic and international taxation.

1.4. Possible evolution of the residence concept

The comparative analysis developed in this book allows for some provisional conclusions to be drawn and offers an idea of how the concept of corporate tax residence may evolve.

First, making residence for tax purposes dependent on factors that have been developed in other areas of law does not seem adequate. Tax residence aims at determining taxpayers' liability and locating taxing powers between states. Those aims are at odds with the objective of private (commercial) law to enable individuals to cooperate and pursue their own mutual interests, or corporate law, which is "to advance the aggregate welfare of all who are affected by a firm's activities",[66] or, more narrowly defined, of the shareholders.[67] Considering that the purpose of taxation goes beyond the

64. *See* OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report*, (OECD 2015), available at http://dx.doi.org/10.1787/9789264241152-en and OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report*, (OECD 2015), available at http://dx.doi.org/10.1787/9789264241695-en.

65. Y. Brauner, *BEPS: An Interim Evaluation*, 6 World Tax Journal (2014); M. Herzfeld, *The Case against BEPS – Lessons for Coordination* (2 Aug. 2017), available at https://ssrn.com/abstract=2985752 or http://dx.doi.org/10.2139/ssrn.2985752.

66. On the objectives pursued by corporate law, *see* J. Armour, H. Hansmann & R. Kraakman, *The Essential Elements of Corporate Law*, Oxford Legal Studies Research Paper No. 20 (2009); Yale Law, Economics & Public Policy Research Paper No. 387; Harvard Law and Economics Research Paper No. 643; Harvard Public Law Working Paper No. 09-39; ECGI – Law Working Paper No. 134/2009, available at https://ssrn.com/abstract=1436551.

67. This shareholder approach has been eloquently summarized by Milton Friedman in *The Social Responsibility of Business is to Increase its Profits*, The New York Times Magazine, 13 Sept. 1970 ("there is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits so long as it

maximization of the interests of those paying them – except when adopting a very narrow view of the benefit principle[68] –, then defining tax residence along the same criteria used in corporate law does not appear appropriate. Moreover, there is a tendency in corporate law in some EU Member States to evolve towards more formal connecting factors, such as place of registration, in the name of legal certainty, mobility and autonomy.[69] This tendency seems at odds with the current trends in international taxation, which aim at anchoring companies to a territory and limiting the planning opportunities for taxpayers, therefore suppressing the "elective" character of tax residence.[70]

Second, assuming that residence remains a suitable criterion to be used in international and domestic tax law, it should entail a connection with the territory that could be defined as "substantial", in order to avoid purely tax-driven manipulation. However, economic substance is probably the most difficult legal concept to determine, because of the inherent tension between (static) legal certainty and (dynamic) economic reality. Fleming, Peroni and Shay have proposed to determine residence on the basis of the place where the company's shareholders are located.[71] The argument is certainly

stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud"). *See also* M. Friedman, *Capitalism and Freedom*, (University of Chicago Press 1962), p. 112.

68. On the justifications for taxation and the discussion of the benefit principle, *see* W. Schön, *International tax coordination for a second best world (part I)*, World Tax Journal (2009), p. 5 et seq.; J.M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability to pay Principles*, 58 Tax L. Rev. (2005), p. 399; L. Murphy & T. Nagel, *The myth of ownership* (Oxford, OUP 2002), p. 16 et seq. K. Vogel, *The justification for taxation: a forgotten question*, 33 American Journal of Jurisprudence 1 (1988), p. 19; R.A. Musgrave, *A brief history of fiscal doctrine*, in Auerbach & Feldstein (eds.), *Handbook of Public Economics*, vol. I (Elsevier 1985), pp. 16-21. For a contemporary critique of the benefit principle, *see* L. Murphy & T. Nagel, *The myth of ownership* (Oxford, OUP 2002), p. 16 et seq.

69. *See*, for example, C. Gerner-Beuerle, F.M. Mucciarelli, E.-Ph. Schuster & M.M. Siems, *Study on the law applicable to companies*, European Commission (2017), available at https://dx.doi.org/10.2838/527231; J.E. Antunes, Th. Baums, B.J. Clarke, P.-H. Conac, L. Enriques, A.I. Hanak, J. Lau Hansen, H.J. de Kluiver, V. Knapp, N. Lenoir, L. Linnainmaa, S. Soltysinski & E. Wymeersch, *Report of the Reflection Group on the future of EU company law*, 5 Apr. 2011, European Commission, available at http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf.

70. Empirical studies seem, however, to indicate in some EU Member States a decline in corporate mobility since the mid-2000s, namely due to a more restrictive legislative framework, judicial attitude and social acceptability towards what is increasingly perceived as an abuse. *See* W.-G. Ringe, *Corporate Mobility in the European Union – a Flash in the Pan? An empirical study on the success of lawmaking and regulatory competition* 10 European Company and Financial Law Review 230 (2013).

71. J.C. Fleming, R.J. Peroni & S.E. Shay, *Defending Worldwide Taxation with a Shareholder-Based Definition of Corporate Residence*, 2016 Brigham Young University

valid for closely held businesses or for jurisdictions where shareholdings are mainly held by residents, such as the United States. It is, however, inadequate for (large) companies with a geographically diffuse shareholding, which are more common in Europe.

Other authors favour a test based on substance, such as (reinforced) effective control, sometimes together with more formal criteria such as the place of incorporation/registered office or the place where the companies' securities are listed.[72] Finally, others propose to move away from criteria based on shareholding and/or management and to focus on the origin of the income generated by the company.[73] Such a perspective is only one step away from even more radical reforms of the corporate income tax, like (sales-based) formulary apportionment.[74] In any case, as O. Marian rightly points out, "comparative inquires suggest that different jurisdictions may tax corporations for different reasons. Therefore, corporate tax-residence tests should also be different among jurisdictions. There is no 'perfect residence test' – there are only 'perfect residence tests.' Inevitably then, corporate tax residence tests are locally and politically oriented, and the 'best test' discussion should be abandoned".[75]

However, the rising of multinational enterprises has fundamentally altered the way tax systems work, including residence rules. Classical corporate income tax systems seemed to rely on certain assumptions. First, the principles applicable to personal income tax should be applied per analogy to companies in particular worldwide tax liability based on residence and separate and independent taxation of each legal person.[76] In this perspective, the corporate income tax is deemed to be as a backstop/prepayment for the personal income tax. Second, corporations always have stronger economic/business links to one jurisdiction, where the controlling shareholders usu-

Law Review 6 (2017), U of Texas Law, Public Law Research Paper No. 663, BYU Law Research Paper No. 17-20, available at https://ssrn.com/abstract=2912395.

72. L. Brosens, *supra* n. 1, p. 721. *See also* O. Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. Rev. 1613 (2013), at p. 1664.

73. A.H. Rosenzweig, *Source as a solution to residence*, Florida Tax Review (2015), pp. 504-505.

74. On formulary apportionment, *see* R. Avi Yonah & I. Benshalom, *Formulary Apportionment – Myths and Prospects. Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Apportionment*, World Tax Journal (2011), p. 378 et seq. Another study on the benefits of the international tax system based on formulary apportionment is provided by Brauner, *Formula Based Transfer Pricing*, 42 Intertax 10 (2014), pp. 615-631.

75. O. Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. Rev. 1613 (2013), p. 1655.

76. The hypothesis of joint taxation of married couples is left aside, which could however be an interesting analogy to justify comprehensive taxation of MNEs.

ally reside. As such, residence of the company is a proxy for the residence of the (controlling/majority) shareholders. But these assumptions do not hold true anymore when it comes to the situations of multinational enterprises, whether parent or subsidiary companies of a group. As Daniel Shaviro said, unlike individual taxation, corporate income taxation is largely based on fictions. Corporations are fictions. Corporate residence is also a fiction, and it is therefore hard to give substance or reality to a fiction.[77] Moreover, the division of tasks and the fragmentation of markets make it very difficult to identify the single state with which a corporation has economic ties. Multinational companies tend to become more and more independent from their shareholders and do not always redistribute all their profits.[78] In addition, within multinational groups, the centralization of the decision-making process leaves little room for each of the group's legal entities to manoeuvre, in particular subsidiaries, which weakens the relevance of traditional criteria such as "central management and control" or "effective management" used in most jurisdictions. Such an evolution, which concerns not only digital but also manufacturing companies,[79] has lead Wolfgang Schoen to consider the residence criterion "precarious" for parent companies and "next to useless" for subsidiaries.[80] As Adema, De Wilde and Burgers rightly point out,[81] a solution consisting of reinforcing substance requirements for companies belonging to MNEs would only add to the legal uncertainty and would not solve the problem.

Tax systems therefore have to adapt. The most immediate answer to the risk of profit shifting deriving from the manipulability of the residence criterion would be – at least certainly in the European Union – to harmonize the concept. This has been proposed by some authors,[82] but due to the great diversity of criteria used at the domestic level, it appears extremely difficult to achieve politically. Another path would be to focus on the undesirable effects of mismatches deriving from the absence of uniformity among states

77. D. Shaviro, *The Rising Tax-Electivity of U.S. Corporate Residence*, Tax Law Review 64 (2010-2011), pp. 377-430.
78. Much has been written about big digital companies holding tens – if not hundreds – of billions of dollars somewhere in the world, with no intention to distribute it (and, more worrying, nor to invest it).
79. *See*, for example, FCA – Fiat Chrysler Automobiles is certainly one of the best examples, with its activity or existence split between Italy, the United States, the Netherlands, the United Kingdom, and many production sites throughout the world.
80. W. Schön, *Residence of Corporate Subsidiaries – Two Wrong Baselines and Four Lines of Defense*; Presentation held at the EATLP Congress 2017, Lodz (1 June 2017).
81. *See* ch. 4.
82. L. Brosens, *supra* n. 1, p. 718; E.-J. Navez, *supra* n. 1, p. 385. *See also* F. Pitrone, *Tax residence of individuals within the European Union*, World Tax Journal (2016), pp. 365-366.

and develop instruments to mitigate risks of double (non-)taxation in case of double (non-)residence or transfer of residence. This approach has been undertaken by the OECD and at the EU level: specific measures have been adopted as regards hybrid structures, the coordination of exit taxes or the resolution of disputes involving double taxation through mutual agreement and arbitration.

It seems that residence will continue to be an important concept in domestic taxation but will be less and less credible as a proxy to the place of income-generating economic activity and will remain largely uncoordinated at the international level. As a consequence, a desirable evolution would be to reduce its importance in the international allocation of profits. As Michael Graetz states, "the fragility and manipulability of the residence of corporations suggests to me that US international tax policy, to the extent possible, should reduce the tax consequences of determinations of residence for corporations". From this perspective, solving the problems arising from the inadequate character of the criteria of corporate residence could be less an issue of reinventing them – which could turn out to be impossible – than one of redefining the function of tax residence for the purposes of determining corporate tax liability.

The allocation of income between countries based on exclusive criteria and, in particular, based on residence does not offer a satisfactory solution from the point of view of international equity,[83] even when compared to source-based taxation systems. According to Auerbach, Devereux and Simpson:

> When one shifts to a consideration of corporate taxes, the picture becomes cloudy, because a corporation's residence may differ from that of its shareholders and may also be much more easily adjusted in response to taxation. To the extent that corporations are internationally mobile, taxes based on corporate residence may have undesired effects similar to taxes based on source. Thus, the distinction between source-based and residence-based taxes is less clear for corporate income taxes than for taxes on individuals, and residence-based taxes are less obviously superior.[84]

To keep pace with the evolution of globalization, creative and comprehensive solutions should therefore be envisaged at the international level. They

83. *See* the literature quoted *supra* n. 33. A system that would only be based on source would run counter similar objections. *See* D. Pinto, *Exclusive Source or Residence-Based Taxation – Is a New and Simpler World Tax Order Possible?*, Bulletin for International Taxation (2007), p. 277

84. A. J. Auerbach, M. P. Devereux, and H. Simpson, *Taxing Corporate income*, in S. Adam et al. Dimensions of Tax Design – The Mirrless review (vol. 1), (2010), p. 869.

should take the form of joint or shared cooperation mechanisms, such as clearing systems, concerning both the allocation of taxable income and tax collection.[85] Together with existing transparency initiatives,[86] such mechanisms would not necessarily require the harmonization of domestic tax systems or the transfer of taxing powers to supranational structures. If those mechanisms were to be adopted, the role of tax residence would change without becoming meaningless.[87] Its first function would be as a "letterbox", which would allow tax administrations and taxpayers to communicate and transfer information, while tax liability would be determined totally or partially according to other factors, in particular within multinational groups of companies. Those factors could be based on the location of inputs or of outputs (sales), or a combination of both, and residence would be one of the proxies used to determine the place, i.e. the country, where the elements that have concurred to the generation of the income are located. In such a context, the experience with value added tax could also be useful, because VAT liability is based on actual consumption and therefore depends less on residence, which is, however, sometimes used as a proxy for consumption.[88]

To conclude on a more philosophical note, it appears important to stress that, like for natural persons, residence does not only bear a territorial significance but has an ontological nature.[89] As Heidegger would put it, "to be" (*Sein*) and "to be there" (*Dasein*) may be seen as synonymous.[90] Therefore, residence defines the essence of the relationship between subjects in a specific place. Applied to international taxation, the evolution of the residence concept reveals a more structural mutation – if not a dissolution – of corporate tax citizenship. Corporations are not instruments to accomplish economic goals within a market and a society anymore, therefore socially and geographically connected and contributing to its wealth and development. We have entered an era where corporate beings are able to create global markets while at the same time generating stateless and untaxed income.

85. *See* M. Valta, *Das Internationale Steuerrecht zwischen Effizienz, Gerechtigkeit und Entwicklungshilfe,* (2014), p. 616 et seq.; P. Pistone, *Tax Treaties with Developing Countries a Plea for New Allocation Rules and a Combined Legal and Economic Approach*, M. Lang et al (eds.), *Tax Treaties: Building Bridges between Law and Economics* (2010), p. 436.
86. M. Stewart, *Transnational Tax Information Exchange Networks: Steps towards a Globalized, Legitimate Tax Administration?* 4 World Tax Journal 2 (2012).
87. O. Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. Rev. 1613 (2013), p. 1614 et seq., available at http://scholarship.law.ufl.edu/facultypub/359.
88. R. Millar, *Echoes of Source and Residence in VAT Jurisdictional Rules*, Sydney Law School Research Paper No. 09/44 (9 June 2009), available at https://ssrn.com/abstract=1416495.
89. *See*, for example, G.-H. de Radkowski, *Anthropologie de l'habiter*.(2002), p. 50.
90. M. Heidegger, *Sein und Zeit*, 1953 (English translation by Joan Staumbaugh, New York University Press, 1996, *see*, in particular, p. 51 et. seq.).

Stakeholders, whose well-being still depends on these corporate leviathans, do not feel capable of orienting their behaviour anymore, even through other collective structures such as states.[91] In this context, solving the challenges of corporate tax residence would not only ensure the effectiveness of taxation but also provide legal certainty for taxpayers. More importantly, maintaining the effectiveness of corporate tax systems represents for societies a test bed for regaining their capacity for collective self-determination in a context of global mobility of economic actors.[92]

91. *See* C.N. Pitelis & D.J. Teece, *The (new) nature and essence of the firm*, 6 European Management Review 1, pp. 5-15.

92. On the validity of the traditional justifications of corporate taxation today, *see* R. Avi-Yonah, Corporations, Society, and the State: A Defense of the Corporate Tax, 90 Virginia Law Review, 1193 (2004). The alternative would be for the states to have a total incapacity to regulate, as Friedrich von Hayek pointed out in *The economic conditions of interstate federalism* (originally from 1939, republished in *Individualism and economic order*, University of Chicago Press, Chicago, 1948, p. 255).