Section on Taxation's Writing Competition Winning Paper's Abstract

The Challenges of Redefining Corporate Tax Residence in a Competitive Global Market

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The basic premise of worldwide taxation is fairly straightforward: U.S. residents are taxed on all their income, regardless of where they earned it, whereas nonresidents are taxed in the United States only on income that is connected to the United States. Although the details are notoriously complicated, at least the rule on corporate residence is simple: the United States determines a corporation's residence based on its place of incorporation. A corporation is "domestic" if it is "created or organized in the United States or under the law of the United States or of any state." A foreign corporation is one that is not "domestic." Recently, however, a spate of bills has been introduced in Congress that would change this long-standing rule. The International Tax Competitiveness Act and the Stop Tax Haven Abuse Act, both of which were introduced last year, would instead include a provision in the Internal Revenue Code that would treat what would otherwise be foreign corporations as domestic corporations for tax purposes if the corporations were "managed and controlled" in the United States.

This proposal offers Congress another tool with which to combat the abusive use of international tax planning as a way to limit U.S. tax liability. Under the "managed and controlled" standard, a taxpayer may no longer be able to minimize his or her U.S. taxes successfully by using foreign shell corporations. At the same time, however, other countries are revisiting their tax policies, and the United States must strive to remain competitive in order to attract or retain investment in these trying economic times. This proposal would also affect foreign operations of multinationals that have key senior managers based in the United States, foreign entities acquired by U.S. investors with management based in the United States, and U.S.-managed start-up businesses organized outside the United States. With a bright spotlight currently trained on how Congress might modify (or overhaul) the Internal Revenue Code, the pressure is on members of Congress to address such competing policy objectives.

This paper argues that, even though the bills that have been introduced certainly mean well, the proposed statutory language is problematic and is not the appropriate means by which to make inroads toward international tax competitiveness or stop the abusive use of tax havens. The first part of the essay provides background on the current law on corporate residence and discusses the underlying policy rationales, and the second part presents the outstanding issues implicated in redefining corporate residence—the most important of which is the best interpretation of what "managed and controlled" means. This paper looks to English, Canadian, and Australian tax law, as well as language from the Organisation for Economic Co-operation and Development's Model Tax Convention and the tax treaty between the United States and the Netherlands to arrive at the conclusion that the English understanding of "management and control" is more appropriate than the language proposed in both bills. In closing, however, the author cautions that it would be unwise to modify a single rule in isolation when a number of other tax reform proposals are also before Congress. **TFL**

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