The Disjunction Between Corporate Residence and Corporate Taxation: Is Improvement Possible?

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P R É C I S
Dans cet article, l'auteur analyse le concept de résidence d’une société, l’accent étant mis plus particulièrement sur les lois britannique et canadienne. Si on accepte la prémisse voulant que l'imposition des sociétés soit justifiée, il y a néanmoins une disjonction entre une imposition significative selon le pays de résidence et les définitions actuelles de résidence d’une société dans la loi nationale et les conventions fiscales. Cette disjonction existe parce que les diverses significations juridiques attribuées à la résidence d’une société exigent peu en manière d’attachement économique au supposé État de résidence. L'auteur commence par un bref examen du phénomène de la mobilité des entreprises motivée par la fiscalité, puis fait un résumé des mesures prises par le gouvernement pour répondre à cette mobilité. Dans le corps de l'article, il soutient que les concepts de résidence qui avaient pour but à l’origine de faire état des importantes activités de gestion d'entreprise ont été en grande partie éclipsés par les critères de constitution en société prévus par la loi au Royaume-Uni et au Canada, et ont été autrement affaiblis par des interprétations judiciaires de « centre de gestion et de contrôle » lorsqu’appliqués aux multinationales. L’auteur soutient alors que bien que le concept de « siège de direction effective » dans les conventions soit prometteur parce qu’il pourrait dénoter une gestion réelle et importante, cette interprétation a été jusqu’à présent écartée par les tribunaux supérieurs, du moins dans le cas des sociétés. Des causes récentes portant sur la résidence des fiducies sont indiquées parce qu’elles illustrent une approche contrastante, et peut-être préférable, à la résidence d’une entité. Étant donné que les formulations actuelles de résidence d’une société semblent comporter des lacunes, l’auteur propose des pistes concernant la façon de les améliorer pour se concentrer sur la réalité ou l’irréalité objective de l’établissement d’une entreprise.

A B S T R A C T
In this article, the author analyzes the concept of corporate residence, with particular reference to the law in the United Kingdom and Canada. Accepting that the taxation of

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corporations has some justification, there is nonetheless a disjunction between meaningful residence-based taxation and current definitions of corporate residence in domestic law and tax treaties. This disjunction occurs because the various legal meanings ascribed to corporate residence require little in the way of economic attachment to the purported home state. The author begins with a brief review of the phenomenon of tax-driven corporate mobility, followed by a summary of government responses to corporate mobility. In the main body of the article, he argues that residence concepts that were originally intended to reflect substantial activities of corporate management were largely eclipsed by legislated incorporation tests in the United Kingdom and Canada, and were otherwise devitalized by judicial interpretations of “central management and control” when applied to multinational enterprises. The author then argues that although the treaty concept of “place of effective management” has promise because it could denote real and substantive management, to date this interpretation has been eschewed by higher courts, at least in the case of corporations. Recent cases on the residence of trusts are noted because they illustrate a contrasting, and perhaps preferable, approach to entity residence. Given that current formulations of corporate residence appear to be deficient, the author makes tentative suggestions regarding how corporate residence definitions could be improved to focus on the objective reality or unreality of corporate establishment.

**KEYWORDS:** AVOIDANCE ■ CORPORATIONS ■ RESIDENCE ■ MULTINATIONALS ■ CANADA ■ UNITED KINGDOM

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INTRODUCTION

Corporate residence for income tax purposes is a beleaguered concept. It suffers from two related problems. First, those concerned with the broad contours of tax policy often advocate reducing the traditional adherence to capital export neutrality and its prescription of “worldwide” taxation based on residence, if not abandoning corporate income tax completely.1 Even if we accept that residence-based corporate taxation is justified in principle, there is the further problem that corporate residence has a legal meaning that is dislocated from what one might regard as its essential commercial attributes. The concept of residence might be understood to convey social and economic attachment, and even political obligation, to the home country: it has been observed that residence taxation “requires the attribution to companies of a characteristic that serves the same function as the residence of individuals, defining a strong nexus for taxation based on personal attachment to the jurisdiction.”2 Yet, the various legal meanings ascribed to corporate residence require little in the way of economic attachment, such as premises, personnel, or business activities within the home state. For this reason, corporate residence has been described as “ectopic.”3 An unsurprising incident of this state of affairs is that multinational enterprises (MNEs) are able to adopt foreign statehood with ease, while governments and revenue administrations complain about so-called exploitation or abuse of corporate residence for tax-avoidance purposes. Against this background, this article provides an analysis of the continuing disjunction between meaningful corporate taxation and the prevailing definitions of corporate residence in domestic law and tax treaties, with particular reference to the law in the United Kingdom and Canada, and asks whether improvement is possible.

It is important to note at the outset what the purpose of this article is not. First, the purpose is not to defend the archetypal American tax system, wherein foreign active business profits, whether remitted as branch profits or dividends, are subject to worldwide taxation with foreign tax credits if and when they are remitted.4 It is

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2 Robert Couzin, Corporate Residence and International Taxation (Amsterdam: IBFD, 2002), at 5.
4 The literature defending or criticizing US international tax rules is vast. For a useful description of the underlying principles, see J. Clifton Fleming Jr., Robert J. Peroni, and Stephen E. Shay, “Fairness in International Taxation: The Ability-To-Pay Case for Taxing
accepted that Canada’s exemption system for foreign affiliate dividends and the United Kingdom’s more recently adopted exemption system for foreign profits are defensible, provided that the underlying profits are actually “foreign,” which is itself a difficult determination to make. Nor is the purpose to advocate some radical renovation of the international tax regime generally. The goal is more modest.

In this article, it is assumed that residual corporate income taxation based on a corporation’s residence, with appropriate exclusions for foreign business profits, is relevant and should continue to be relevant. This assumption involves both a positive and a normative claim. I have argued elsewhere that although the role of corporate income taxation in countries’ tax systems may be attenuated, this form of taxation remains important to public finances. The same assumption underlies other scholarship advocating improvements to international tax rules, and is obviously fundamental to recent efforts by governments and the Organisation for Economic Co-operation and Development (OECD) to rescue tax systems from what has been called “aggressive international tax planning” or, more recently, “base erosion and profit shifting” (BEPS). Although the dominant trend is to use a territorial system,
in which active business profits are taxed only where they are earned, the current OECD consensus is to reserve the taxation of other important forms of income—notably interest, royalties, and capital gains on assets other than real property or investments deriving their value principally from real property—to the state of residence, and to accept that residence should be determined on an entity-by-entity basis. In this context, one can hardly argue that corporate residence, and taxation based on such residence, is irrelevant. As for the normative claim, I have argued elsewhere that residence-based taxation is justified if residence is regarded as a sort of residual home source—that is, if it represents a substantial economic interest in the home state—and is not justified if there is no economic interest in the home state. In other words, after allowing for foreign taxation of foreign business profits (preferably exempting both branch profits and intercorporate dividends from further taxation), it is justifiable to tax income streams that are not easily sourced to another jurisdiction, such as interest, royalties, certain capital gains, and possibly other income derived from general administrative or oversight functions, in the state of residence of the entity entitled to this income, if residence in that state means something. Such taxation is difficult or impossible to justify if residence is devoid of meaning.

The difficulty, of course, is that corporate residence as currently understood may not be particularly meaningful, and thus may not be a satisfactory gauge of a substantial economic interest in the purported home state. The term “meaningful,” like the terms “real,” “actual,” “genuine,” and “substantial,” appear throughout the case law on corporate residence and are used at various points in this article. These terms can, of course, mean different things to different people. For the purpose of this article, I treat these terms as synonymous, each conveying the existence of non-tax characteristics that connect a corporation to a particular state and that cannot be modified or undone without inviting non-tax consequences. Characteristics denoting “real” or “substantial” establishment in a jurisdiction include premises and personnel. In contrast, the criteria for “artificial” or “formal” establishment—which I regard as neutral rather than negative terms—include incorporation and registration in a jurisdiction.

Although few readers will consider it contentious that corporate residence entails little in the way of non-tax characteristics, I reiterate the point by beginning with a brief review of the phenomenon of tax-driven corporate mobility, followed by a summary of government responses to corporate mobility. In the main body of the article, I argue that residence concepts that were originally intended to reflect substantial decision-making activities of corporate management within a state were largely eclipsed by legislative adoption of an incorporation test and were otherwise...

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devitalized by judicial interpretations of the last 50 years. Looking first at the domestic law of the United Kingdom and Canada, it is argued that the incorporation test is a de jure standard that bears no relation to economic activity, while the central management and control test is little better because it constitutes a “highest functions” paradigm that is easily manipulated. Particular attention is given to Wood v. Holden13 and its ramifications. In the following section, I argue that although the treaty concept of place of effective management has promise because it could denote real and substantive management, to date this interpretation has been eschewed by higher courts, and its importation into domestic law has been resisted by governments. Recent cases on the residence of trusts are noted because they illustrate a contrasting, and perhaps preferable, approach to entity residence. In the conclusion, it is suggested that the United Kingdom and Canada should consider repealing their statutory incorporation tests and should consider introducing, both in domestic law and tax treaties, a renewed “place of effective management” test that restores the focus on the location of autonomous decision making.

THE CONTINUING RELEVANCE OF CORPORATE RESIDENCE

Globalization and Corporate Mobility

One aspect of economic globalization is the emergence of the true MNE, whose scope of activity makes it difficult to regard the enterprise as having one home country.14 The United Nations Department of Economic and Social Affairs observed over 40 years ago that “[t]he dramatic growth of multinational corporations in the postwar period has been accompanied by unprecedented growth in the number of affiliates.”15 The UN Conference on Trade and Development observed more recently that the “universe” of the largest MNEs expanded rapidly in the 1990s and the 2000s, slowing only during the global downturn of 1999-2001 and following the global financial crisis of 2008-9.16 This can be seen as a positive phenomenon to the extent that MNEs drive much foreign direct investment (FDI), which according to the United Nations serves to generate employment, raise productivity, transfer skills and technology, enhance exports, and generally contribute to the economic welfare of developing countries.

At the same time, in the absence of political globalization and a concurrent evolution of multilateral tax arrangements, MNEs equipped with sophisticated tax advice engage in various self-help activities to minimize their global tax burdens. This may involve the establishment of foreign subsidiaries with little in the way of premises or employees, often referred to as “special-purpose vehicles” or “special-purpose entities,” to facilitate the movement of dividends, interest, royalties, and other payments into low- or zero-tax states. Taken to the extreme, sophisticated tax planning may allow an MNE to create what Ed Kleinbard describes as “stateless income.” Such practices are borne out in the data regarding destinations and values of FDI. The UN reports mentioned above illustrate the extent to which MNEs operate via networks of affiliates located in low-tax states and reveal the massive inflows into these states, particularly as a percentage of gross domestic product. More specifically, Canadian and UK official statistics on inward and outward FDI illustrate the dominance of particular jurisdictions, including Bermuda, the Cayman Islands, Ireland, Luxembourg, and the Netherlands, as well as Barbados (relevant to Canada) and the Channel Islands (relevant to the United Kingdom). To see even more specific illustrations of the use of special-purpose vehicles in foreign jurisdictions, one can simply review decided cases of the last 50 years involving international tax strategies: some of these cases involved direct challenges to purported offshore residence, while numerous others involved the application of controlled foreign company (CFC) rules or transfer-pricing rules or allegations of treaty shopping and other abuses. Whether the taxpayer’s strategy was held to be effective (which it

17 Edward D. Kleinbard, “Stateless Income” (2011) 11:3 Florida Tax Review 699-773. One might reply that the income is not exactly stateless; rather, the income is directed to an entity that is legally established in a zero-tax state while having no economically substantial connections to that state.


21 Discussed at length below.

22 There are too many cases to mention. Examples from the United Kingdom include Floor v. Davis, [1978] Ch. 295 (CA); aff’d. [1980] AC 695 (HL) (Cayman Islands); Furniss v. Dawson, [1984] AC 474 (HL) (Isle of Man); Craven v. White, [1989] AC 398 (HL) (Isle of Man); Broom Holdings Limited v. IRC, [1997] STC 1179 (CA) (the Netherlands); and Indofood International Finance Ltd. v. JP Morgan Chase Bank, [2006] STC 1195 (CA) (Mauritius and the Netherlands). Examples from Canada include Spar Oil Ltd. v. The Queen, 81 DTC 5168 (FCA) (Bermuda); Indalex Ltd. v. The Queen, 88 DTC 6053 (FCA) (Bermuda); The Queen v. Irving Oil Ltd., 91 DTC 5106 (FCA) (Bermuda); Univar Canada Ltd. v. The Queen, 2005 TCC 723 (Barbados); MIL (Investments) SA v. The Queen, 2006 TCC 460; aff’d. 2007 FCA 236 (Cayman Islands and
often was) is not the point here; these cases show the frequent and varied uses of affiliates in convenient jurisdictions.

Recent waves of threatened and actual emigrations of corporate headquarters, particularly from the United States, are confirmation that tax burdens influence not only the location of FDI by MNEs but also the ultimate home of MNEs. In the United States, this practice became known as the corporate expatriation or inversion. Several US inversions occurred in the late 1990s and early 2000s, attracting both public attention and academic commentary.22 The US Congress passed legislation in 2004 making it more difficult for American corporations to undergo a direct or indirect acquisition by a new foreign parent corporation, hoping to prevent what some commentators viewed as “unpatriotic” emigrations.23 Ten years later, a new wave of US corporate inversions is again attracting public and political outcry. These inversions are not achieved through the creation of a parent shell in a zero-tax jurisdiction, but rather through a merger with an established, commercially viable entity in a jurisdiction with a lower corporate tax rate and a participation exemption for foreign profits: the popular jurisdictions are Ireland, the Netherlands, Switzerland, the United Kingdom, and Canada.24 Although the United Kingdom suffered its own wave of high-profile corporate emigrations in the years preceding the financial crisis,25 the United Kingdom and Canada now appear to be benefactors of the global competition for corporate headquarters.

**Tax Policy Responses**

Movements of companies, capital, and profits away from traditionally high-tax states, whether to a pure tax haven or simply to a jurisdiction that offers tax advantages, obviously threaten the original states’ public finances. The standard policy response in the United Kingdom, Canada, and elsewhere has not been to question whether these movements reflect commercial reality. The usual response has been

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23 For an explanation of the legal changes, see Yariv Brauner, “United States,” in *Residence of Companies*, supra note 12, 855-84, at 866, referring to section 7874 of the US Internal Revenue Code of 1986, as amended. I take no view on whether corporate inversions are “unpatriotic.”

24 For example, Kevin Drawbaugh, “Corporate Foreign Tax Moves Have Bedeviled US for Decades,” *Reuters* online, August 18, 2014 (www.reuters.com/article/2014/08/18/us-usa-tax-inversion-rules-idUSKBN0GI0B020140818). While many inversions involve pharmaceutical companies, the most notorious of the recent transactions, at least from a Canadian perspective, is the merger of Tim Hortons with Burger King: see, for example, Pete Evans, “Tim Hortons, Burger King Agree to Merger Deal” *CBC News* online, August 26, 2014 (www.cbc.ca/news/business/tim-hortons-burger-king-agree-to-merger-deal-1.2746948).

25 See, for example, Jonathan Cooklin, “Corporate Exodus: When Irish Eyes Are Smiling” [2008] no. 6 *British Tax Review* 613-23.
to assume that the legal form of corporate residence (and thus corporate emigration) is immutable, and to try to stem the outflow of corporate income through measures that, on the one hand, enhance the perceived competitiveness of the corporate tax system and, on the other hand, grasp at offshore corporate income via anti-avoidance rules and administrative censure.

The competitiveness story is well known. Both the United Kingdom and Canada have sought to increase the attractiveness of their corporate tax systems to MNEs by reducing statutory corporate tax rates and by adopting or enhancing exemption regimes for foreign profits, among other changes.\(^\text{26}\) At the same time, CFC rules have been maintained and strengthened, limitations on interest deductibility have been explored, and treaty-shopping arrangements have been challenged.\(^\text{27}\) The details of these rules and initiatives are beyond the scope of this article; a brief discussion of the recent OECD publications regarding BEPS should suffice. The OECD states that the concept of BEPS “relates chiefly to instances where the interaction of different tax rules leads to double non-taxation or less than single taxation” and also to “arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place.”\(^\text{28}\) The BEPS report addresses the role that jurisdiction to tax plays in BEPS opportunities, drawing attention to the massive levels of FDI made into or through smaller jurisdictions, including Barbados, Bermuda, the British Virgin Islands, Luxembourg, and the Netherlands,\(^\text{29}\) while the BEPS action plan criticizes “practices that artificially segregate taxable income from the activities that generate it,” making specific reference to “shell companies that have little or no substance” and “layers of legal entities” in the context of treaty shopping.\(^\text{30}\) In response, the OECD highlights the need for internationally coordinated CFC legislation, transfer-pricing rules, treaty anti-abuse rules, and other anti-avoidance provisions.

In these documents, the OECD says very little about corporate residence formulations or their potential for exploitation. Perhaps the matter of corporate residence was thought to be too granular to address at an intergovernmental level, or perhaps the concept was thought to be too well established in the international tax regime to warrant interference. In my view, corporate residence is one matter that should be addressed, not least because it underlies many of the avoidance strategies and necessary responses that the OECD has identified.\(^\text{31}\)


\(^{27}\) See thesis, supra note 8, at chapters 5-7.

\(^{28}\) BEPS action plan, supra note 11, at 10.

\(^{29}\) BEPS report, ibid., at 17-18, 33-36, and 39-41.

\(^{30}\) BEPS action plan, supra note 11, at 10, 13, and 18.

or the Cayman Islands, or a royalties conduit in Luxembourg or the Netherlands, is a letterbox corporation with no premises or employees, should revenue administrations not be prepared to ask whether the entity is actually established in its purported home state before invoking CFC rules or raising a treaty-shopping argument? It is nonetheless important to accept the possibility of a foreign corporation being a “real” resident of the intended residence state, even if its location is motivated by tax concerns. It is clear that modern MNEs operate through extensive networks of foreign affiliates, including special-purpose vehicles that may serve valuable functions. There may be good commercial and tax reasons for an enterprise to segregate particular functions into particular entities and to locate these entities in low-tax jurisdictions or, indeed, to move its corporate headquarters to a low-tax jurisdiction. A key question in either case should be whether the affiliate or parent company has been meaningfully established in the ostensible state of residence, such that its residence conveys a substantial economic interest there.

To answer that question from the point of view of UK or Canadian law, one must start with the relevant domestic law. As discussed in the next section, residence concepts in domestic laws were originally intended to reflect the fact that autonomous decision-making activities of corporate management were occurring in the state—arguably an indication of a substantial economic interest—but may fail to convey this meaning today.

CORPORATE RESIDENCE IN DOMESTIC LAW

Background

If we were to consider where a corporation’s “centre of vital interests” lies, we would seek a combination of all elements that contribute to a corporation’s existence and operation: shareholder creation and control, recognition of status by law, management and administration, and day-to-day business activity. In practice, different states rely on different features for domestic law purposes: some states determine the residence of corporations by employing formal concepts, such as the location of incorporation, registered office, or statutory seat; others may use less formal concepts, such as the place of central management and control or the place of effective management. The common theme is that the existence or occurrence of the selected feature in the taxing state results in the entity’s income being subject

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32 This is a term used in the individual dual residence tie-breaker article in many tax treaties.
to comprehensive taxation for domestic law purposes, such that we might speak of fiscal “allegiance” rather than fiscal residence,35 echoing the term used in the early international tax studies of the League of Nations.36 Further, the presence of the selected feature in the taxing state—and resulting comprehensive tax liability—generally results in the entity being entitled to the benefits of the state’s double taxation conventions or tax treaties,37 subject to dual residence rules and any anti-avoidance rules that may apply. It is thus rather important which features of an entity’s existence and operation are chosen by a state as the determinants of the entity’s residence/fiscal allegiance, because this decision triggers comprehensive tax liability—typically mitigated by foreign tax credits or foreign income exemptions—and tax treaty entitlements.

In the United Kingdom, the decision concerning the particular corporate characteristics to be used to denote residence/fiscal allegiance was originally left to the judiciary. The principles that emerged from the early cases were, like many other legal principles relevant to tax, subsequently adopted in Canada.38 It is not a coincidence that the judicial development of a formulation of corporate residence in the United Kingdom occurred at much the same time as the judicial elucidation of separate corporate personality. By the time that Salomon was decided, the English judiciary was willing to accept that a corporation was a “real thing” with a “real existence,”39 consistent with the real entity view of the corporation that was prevalent in the late 19th century.40 It followed that corporations could have, by analogy with

37 Organisation for Economic Co-operation and Development, Model Tax Convention on Income and on Capital (Paris: OECD, July 2010) (herein referred to as “the OECD model”), articles 1 and 4(1) and paragraphs 1, 3, and 8-8.8 of the commentary on article 4. The OECD released the 2014 Update to the OECD Model Tax Convention (Paris: OECD, 2014) (www.oecd.org/ctp/treaties/2014-update-model-tax-convention.htm) (herein referred to as “the OECD 2014 update”) shortly before this article was finished. The OECD 2014 update does not purport to change any of the treaty provisions or commentary referred to in this article, with one exception (see note 181). It does, however, contain important proposals regarding the meaning of “beneficial owner” (see paragraphs 34, 41, and 48).
40 For a more extensive discussion of theories of the nature of a corporation and the relevance of these theories to corporate taxation, see the thesis, supra note 8, at chapter 3; and Reuven S. Avi-Yonah, “Corporations, Society, and the State: A Defense of the Corporate Tax” (2004) 90:5 Virginia Law Review 1193-1255.
an individual, real features. In 1922, Isaacs J of the Australian High Court observed that as business corporations increasingly assumed the functions of individuals, “so more and more the law attributes to them conceptually and by analogy individual attributes in keeping with the social functions they are in fact performing.”41 One such attribute is residence.

This is not to say that corporate residence was an unprompted judicial invention. The English judiciary of the late 19th century had no choice but to ascribe residence to corporations for the purpose of applying the income tax law as Parliament had written it. Viscount Sumner later observed that “[r]esidence is not inherent in a company in the nature of things, and residence for the purpose of taxation is a matter for express legislation.”42 Because the UK Parliament had not (until 1988) enacted a test of residence for corporations, the courts “felt bound to make the Acts work as they found them.”43 The Income Tax Acts of 1842 and 1853 imposed a duty in respect of “the annual Profits or Gains arising or accruing to any Person residing in” the United Kingdom, which was extended to all “Bodies Politic, Corporate, or Collegiate, Companies, Fraternities, Fellowships, or Societies of Persons, whether Corporate or not Corporate.”44 Thus, the earliest cases on corporate residence rightly begin by positing the question: is the relevant corporation “a person residing in” the United Kingdom45 and therefore subject to the UK’s national tax jurisdiction?46

Corporations in the United Kingdom were subject to income tax in the same sense as individuals until March 1965, when a separate corporation tax regime was introduced.47 Canada enacted income tax legislation in 1917 that applied generally

41 Australasian Temperance and General Mutual Life Assurance Society Ltd. v. Howe (1922), 31 CLR 290, at 310 (HCA).
42 Egyptian Delta Land and Investment Co. Ltd. v. Todd, [1929] AC 1, at 11 (HL).
43 Ibid., at 12.
45 Whether a corporation is a person residing in a place actually involves two questions: (1) is a corporation a person, and (2) if so, where does it reside? Thus, it is accurate to use the word “resident” as an adjective, denoting a quality of the person taxed. This is consistent with the jurisprudence on the residence of individuals, in which the terms “resident” and “residence” are considered to represent a quality of the person charged: Levene v. IRC, [1928] AC 217 (HL); Lysaght v. IRC, [1928] AC 234 (HL); and Thomson v. Minister of National Revenue, [1946] SCR 209.
to individuals and corporations, which remains the pattern today, although of course there are certain rules applicable solely to corporate taxpayers. The important point is that both systems are based on the recognition of a corporation as a person; accordingly, one must start from the proposition that the worldwide income of a corporation is subject to tax in the country if it is resident there.

As indicated above, there are various factors that could be selected by legislators or judges as indicia of corporate residence, ranging from those that are essential to the commencement or recognition of the corporation’s existence, through to those that are associated with the pinnacle of the corporation’s activities, and on to those that are germane to the corporation’s day-to-day business activities. The current law in the United Kingdom and Canada relies on factors drawn from different parts of this spectrum. First is the incorporation test, which provides that a corporation is deemed to be resident in the United Kingdom or Canada if it is incorporated there, subject to certain transitional provisions. Of equal or greater significance is the test of corporate residence developed in the common law. The leading case is of course De Beers Consolidated Mines Ltd. v. Howe, which decided that a company resides where its “central management and control” is actually exercised. As explained below, central management and control has been characterized as the axis or pinnacle of a corporation’s activities. Management and control thus conceived is independent of factors that underlie the corporation’s existence—notably, incorporation, registration, and shareholder control—and is removed from a corporation’s practical management or daily business activities.

In the case of dual resident companies, the resolution of residence for tax treaty purposes is expressly given effect for domestic law purposes. Specifically, where a company is resident in the United Kingdom under either of the above formulations, but is also resident in a treaty partner state according to its domestic laws, and pursuant to the applicable treaty preference criterion (discussed below) the company is regarded as resident only in the treaty partner state, the company is deemed not to be resident for UK tax purposes. This is known as the “treaty non-resident rule.” An equivalent rule exists in Canada. These rules serve to maintain consistency between treaty outcomes and domestic law.

48 The Income War Tax Act, SC 1917, c. 28, section 2 (“person” and “taxpayer”).
49 Subsection 248(1) (definitions of “person” and “taxpayer”).
50 CTA 2009 sections 2 and 5; and subsection 2(1) of the Act.
51 CTA 2009 sections 14-15 and schedule 2. See the text accompanying note 78.
52 Subsection 250(4). See the text accompanying note 76.
54 CTA 2009 section 18.
55 Subsection 250(5).
Residence Based on Incorporation

Common-Law Rejection of Incorporation Test

Incorporation and registration are the most formal of factors that could be relied on to establish a corporation’s residence. The location of a corporation’s creation or registration is analogous to an individual’s place of birth or citizenship; this can usefully be called “nationality.” For individuals, these factors are closely associated with the private international law concept of domicile. Obviously, a corporation is unlike a human being: it is not born and cannot form an intention of living in a particular society. It is therefore difficult to think of the citizenship or domicile of a corporation. Yet, for the purposes of private international law, a corporation’s domicile is considered to be the country of its incorporation, and for the purposes of tax law some countries do base their jurisdiction on the domicile of legal entities, meaning the place of their incorporation or registration.

It is well known that the United States relies on incorporation to determine worldwide taxing jurisdiction with respect to corporations, much as it relies on citizenship (among other considerations) to determine jurisdiction over individuals. English law charted a different course, deciding in the early cases that corporate residence should be based on factors more substantive than incorporation. The distinction can be traced to two influences. First, the English courts were more willing to adopt realist theories of the nature of the corporation, in contrast to the American adherence to the legal entity/fiction theory. Second, there was a concern about tax avoidance.

Before elaborating on these two influences, an observation should be made with respect to the judgments that preceded De Beers. Reading the 19th century cases in isolation might give one the impression that the place of incorporation or registration was considered critical to corporate residence. However, it must be borne in mind that most corporate business was then organized in the form of a single corporation with foreign branches or agents. It is not surprising that the judiciary stressed the location of incorporation and registration when this generally coincided with the location of directorial control—what was sometimes styled the “seat” of the enterprise. In Cesena Sulphur/Calcutta Jute Mills, Kelly CB highlighted the place of incorporation as a relevant factor but assumed this would be coexistent with


57 Both the United Kingdom and Canada have concluded tax treaties where the residence article mentions domicile as a possibly relevant criterion, echoing the wording of the OECD model, supra note 37, at article 4(1).

58 See, for example, Daniel N. Shaviro, Decoding the US Corporate Tax (Washington, DC: Urban Institute Press, 2009), at 103-4; and Yariv Brauner, “United States,” in Residence of Companies, supra note 12, 855-84, at 865-75.

59 Farnsworth, supra note 56, at 56-63.
the place where the governing bodies met and exercised their powers (which in these cases was England).\textsuperscript{60} Thus, the court mentioned incorporation only to buttress the conclusion that had already been drawn on the basis of central management and control.\textsuperscript{61}

The judicial rejection of an incorporation test is evident from \textit{De Beers}, decided 30 years later. The De Beers company was incorporated and registered in South Africa, which is also where it carried on most of the functions of its diamond-mining business. The taxpayer’s counsel relied on a number of American authorities to support the argument that a corporation is a “legal persona whose only residence is the place of its incorporation” and that it has no legal existence abroad.\textsuperscript{62} This idea is intrinsic in the legal entity/fiction theory of the nature of the corporation. The House of Lords rejected this position. Lord Loreburn, with whom the other lords concurred, observed that “[i]n applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual.”\textsuperscript{63} Recognizing that a company cannot “eat or sleep,” he reasoned that one should look to where the company “keeps house and does business.”\textsuperscript{64} Crucially, Lord Loreburn thought it appropriate in the context of the income tax statute to determine residence on the basis of a corporation’s activities—where it keeps house and does business—rather than its existence:

Otherwise it might have its chief seat of management and its centre of trading in England under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad.\textsuperscript{65}

This statement evidences a concern about the avoidance of UK taxation (“escape the appropriate taxation by the simple expedient of being registered abroad”) and a belief that corporate taxation is justified by the benefits that a state provides to corporate businesses (“in England under the protection of English law”). The latter idea may be referred to as a corporation’s “franchise to do.” It is apparent that Lord Loreburn did not think corporate taxation was justified by the “franchise to be”—that is, by incorporation in a particular state.

Subsequent cases reaffirmed the view that incorporation was not a viable test of corporate residence. For example, in \textit{Bradbury v. English Sewing Cotton Co.} Lord

\begin{itemize}
\item \textsuperscript{60} \textit{Cesena Sulphur/Calcutta Jute Mills}, supra note 46, at 445-46; compare \textit{Alexander}, supra note 46, at 30-32.
\item \textsuperscript{61} Discussed beginning at the text accompanying note 84.
\item \textsuperscript{62} \textit{De Beers}, supra note 53, at 456. Similar submissions were made in \textit{Cesena Sulphur/Calcutta Jute Mills}, supra note 46, at 437.
\item \textsuperscript{63} \textit{De Beers}, supra note 53, at 458.
\item \textsuperscript{64} Ibid.
\item \textsuperscript{65} Ibid.
\end{itemize}
Wrenbury compared foreign corporate registration to foreign individual citizenship, observing that neither was determinative of a person’s liability to income tax in the United Kingdom’s residence-based system.66 There, as in De Beers, the court was dealing with a company incorporated abroad (the United States) but managed and controlled in the United Kingdom. Lord Wrenbury noted that the proposition that incorporation was not decisive had also been accepted in the converse case of a corporation that was registered in the United Kingdom but wholly managed abroad.67

The English courts’ willingness to discount incorporation as a factor establishing residence was tested in the Swedish Central Railway decision.68 This case involved a corporation that was registered in England but was managed and controlled in Sweden, where it was constructing a railway. The majority of the House of Lords (Lord Atkinson dissenting) held that earlier decisions had not foreclosed the possibility of a corporation being resident in two places simultaneously. The majority concluded that the corporation’s registration in the United Kingdom, in conjunction with other factors identified by the commissioners, was sufficient to establish UK residence in addition to Swedish residence.69 The decision has been subject to academic criticism70 and was tightly circumscribed in the Egyptian Delta case.71 There, Viscount Sumner noted that the term “resident” is “exceedingly unsuited to describe” a legal entity and reasoned that the only “analogy that is really possible between a natural person and a company is that of carrying on business at a place, great or small.”72 On consideration of both the decided cases and desirable tax policy principles, the court concluded that the place of incorporation could not be determinative of residence.

The same conclusion was reached by the Privy Council, on appeal from the Supreme Court of Canada, in British Columbia Electric Railway v. The King,73 which

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66 *Bradbury v. English Sewing Cotton Co.*, [1923] AC 744, at 764-65 (HL); compare *American Thread Co. v. Joyce* (1912), 6 TC 1 (CA); affd. (1913), 6 TC 163 (HL). The English Sewing Cotton Company was the UK parent of the American Thread Company, a subsidiary incorporated and registered in New Jersey.

67 *Mitchell v. Egyptian Hotels Ltd.*, [1915] AC 1022 (HL). However, in this case counsel had admitted that the company resided in England. For some reason, Buckley LJ, as he then was, commences his judgment by saying, “This company is incorporated in the United Kingdom; it is therefore resident here.” Lord Atkinson later observed that “[t]here must be some mistake in the report of this statement, since incorporation does not necessarily imply residence”: *Swedish Central Railway Co. v. Thompson*, [1925] AC 495, at 516 (HL).

68 *Swedish Central Railway*, supra note 67.

69 Ibid., at 505. Unfortunately, the report does not shed light on what these other factors were.

70 Albert Farnsworth, “Union Corporation Ltd. v. IRC,” case note (1952) 68 Law Quarterly Review 307; *Dicey and Morris*, supra note 56, at 1103-4; and Couzin, supra note 2, at 79-82.

71 Supra note 42, at 16-18. Also see the text accompanying note 104.

72 Supra note 42, at 12-15.

involved a company incorporated and registered in England but entirely managed and controlled in Canada. Viscount Simon held that the company’s residence was “unquestionably Canadian.” To the extent that Swedish Central Railway remains relevant, it stands for the proposition that central management and control may be divided, rather than the more dubious proposition that incorporation alone can establish residence. That dubious proposition gained validity only by legislative amendment.

Legislated Adoption of the Incorporation Test

Viscount Sumner’s judgment in Egyptian Delta contains a thorough consideration of alternative residence formulations based on either a company’s activities or a company’s existence. In the course of his judgment, he made this observation:

So far, my Lords, it does not seem to have occurred to any judge, that there might be two kinds of residence or two tests of its acquisition, one for the purpose of entangling foreign companies in British taxation and another for that of tying British companies down, so that they cannot wholly escape it. I submit that such a doctrine is illogical in form and in substance unjust.74

The legislatures of the United Kingdom and Canada appear to disagree that such a doctrine is illogical or unjust. Canada moved first, amending its tax legislation in 1961 to deem a corporation to be resident in Canada if it was incorporated in Canada and if it carried on business in Canada at any time in the year.75 The requirement of carrying on business was largely removed in 1965, when the current rule was enacted; it deems a corporation to be resident in Canada if it is incorporated in Canada, whether under federal or provincial law, after April 26, 1965.76 Deemed residence is also provided in the case of certain “foreign business corporations,” and other corporations that were incorporated in Canada before April 27, 1965, if they thereafter became resident (on a common-law basis) or carried on business in Canada.77 In the United Kingdom, the Finance Act 1988 introduced the rule that a company is deemed to be resident in the United Kingdom if it is incorporated there, with certain companies incorporated in the United Kingdom before March 15, 1988

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74 Egyptian Delta Land, supra note 42, at 23 (emphasis added). Similar comments had been made by Lord Atkinson in his dissenting judgment in Swedish Central Railway, supra note 67, especially at 507-8 and 511.


76 Paragraph 250(4)(a). The current provision is derived from Income Tax Act, RSC 1952, c. 148, paragraph 139(4a)(a), as amended by SC 1965, c. 18, section 28(4) (effective from 1965).

77 Paragraphs 250(4)(b) and (c). For an analysis of whether a pre-1965 incorporated entity was carrying on business in Canada and therefore resident in Canada, see Tara Exploration and Development Co. Ltd. v. MNR, 70 DTC 6370 (Ex. Ct.); aff’d. 72 DTC 6288 (SCC); and The Queen v. Gurd’s Products Co. Ltd., 85 DTC 5314 (FCA).
qualifying for an indefinite exception or a five-year transitional exception.\textsuperscript{78} Crucially, these deeming rules apply even if the corporation would be considered non-resident according to the location of its central management and control.

It is not readily apparent why the incorporation test was added to Canadian or UK law. It is unlikely that the respective legislatures became captivated by the legal entity/fiction theory and its reliance on the “franchise to be” as a justification for worldwide taxation. Part of the motivation for the Canadian 1961 amendment may have been the government’s desire for consistency with the incentives of the newly introduced branch tax: Canada was hoping for greater incorporation of subsidiaries in Canada and did not want these subsidiaries to be caught by the branch tax if they were managed abroad; thus, the subsidiaries would be deemed to be resident.\textsuperscript{79} It is also possible that the Canadian amendments were designed to bring Canadian law more in line with the US approach to corporate residence, particularly because the Canada-US tax treaty of the day defined a “Canadian enterprise” or “United States enterprise” as an enterprise carried on by an individual resident in the respective state or by a corporation, partnership, or other entity “created or organized” under the laws of the respective state.\textsuperscript{80} In my view, however, the most cogent explanation is that the government was concerned about tax avoidance through the manipulation of central management and control.\textsuperscript{81} Greater insight into this concern can be gained by looking at the motivations for the UK 1988 amendment. A key reason for adopting the incorporation test in the United Kingdom was the prevention of international tax avoidance, specifically double non-taxation. The \textit{International Manual} published by Her Majesty’s Revenue and Customs (HMRC) indicates that the incorporation rule was added to deal with so-called nowhere companies, being incorporated in the United Kingdom but managed and controlled in a state that does not use management and control as a residence test.\textsuperscript{82} The incorporation test thus can be seen as opportunistic legislation, imposing residence and residence-based taxation on a company that might otherwise not face comprehensive taxation anywhere.

\textsuperscript{78} Finance Act 1988 (UK), 1988, c. 39, section 66 and schedule 7, rewritten to CTA 2009 sections 14-15 and schedule 2. The exceptions related to the process of Treasury consent in respect of corporate migration. The Treasury consent rules were repealed effective July 2009.


\textsuperscript{80} Convention Between the United States of America and Canada Relating to the Avoidance of Double Taxation and Prevention of Fiscal Evasion in the Case of Income Taxes (1942) (as amended through 1966; terminated 1985), protocol paragraph 3. The 1942 treaty did not contemplate dual residence of corporations. The current treaty uses place of incorporation as the first preference criterion: see the text accompanying notes 158-59.

\textsuperscript{81} See also Pyrcz, supra note 79, at 386.

\textsuperscript{82} United Kingdom, HM Revenue & Customs, \textit{International Manual} (London: HMRC, 2014) (www.hmrc.gov.uk/manuals/intmanual/Index.htm), at sections 120040-50. As for Canada, in the 1960s there were various corporations incorporated in Canada and managed elsewhere (Brooks, supra note 79, at 416), rendering them “stateless.”
It is questionable why Canada or the United Kingdom should be concerned about taxing nowhere companies, because corporate income taxation is difficult or impossible to justify if there is no real economic interest in the taxing state. The policy foundations of the corporate tax were likely not given much consideration in the course of adopting the incorporation test, and perhaps the best explanation for its adoption in Canada and the United Kingdom was a desire for a clear, simple residence rule.83 Ironically, by choosing to supplement the test of central management and control with a test of incorporation, the respective governments augmented a connecting factor that is unclear, uncertain, and somewhat easy to manipulate with one that is clear, certain, and very easy to manipulate.

Residence Based on Central Management and Control

We have seen that the courts of the 19th and early 20th centuries thought it appropriate in the context of the income tax statute to determine residence on the basis of a corporation’s activities rather than its existence. This approach is, at least potentially, consistent with the thesis that residence should denote a substantial economic interest in the home state. How successful such an approach is in reflecting an economic interest depends on the precise activities that are selected as demonstrating residence. Unfortunately, a combination of 19th-century colonialism and 20th-century legal formalism has produced a “highest functions” paradigm that often fails to reflect economic interest, making this test little better than an incorporation test.

De Beers: Central Management and Control as the Real Business

De Beers is the decision that established most clearly that a company resides where its “real business is carried on,” which was said to be where its “central management and control actually abides.”84 Lord Loreburn went on to say that this is a question of fact to be determined by scrutinizing the corporation’s course of business and trading. The pertinent facts included the following: the company was incorporated and registered in South Africa, it carried on most of the functions of its diamond-mining business in South Africa, and its directors’ meetings were held in both Kimberley and London. However, a majority of its directors were resident in England, and, according to the facts as determined by the commissioners, it was at the directors’ meetings in London that “the real control” was always exercised in virtually all the important business of the company, except the mining operations themselves.85

84 De Beers, supra note 53, at 458.
85 The facts of the case are provided in the Court of Appeal judgment: [1905] 2 KB 612 (CA).
Lord Loreburn refused to disturb the commissioners’ finding of fact that “the head and seat and directing power of the affairs of the appellant company were at the office in London.”

This decision was applied without reservation throughout the 20th century, exhibiting a jurisprudential resilience that matches or exceeds that of Salomon. De Beers is considered the leading decision on corporate residence in Canada. Notable cases endorsing the decision include Crossley Carpets, Bedford Overseas Freighters, and Birmount Holdings, while many others explicitly or implicitly accept that the De Beers approach represents the law. It is regarded as the leading decision in various other Commonwealth jurisdictions as well. Judges and commentators frequently point to the statement of Lord Radcliffe in Unit Construction that Lord Loreburn’s formulation of corporate residence “was as precise and as unequivocal as a positive statutory injunction.”

There is nothing to be gained by canvassing all of the cases that influenced De Beers and those that followed from it because this has been done admirably elsewhere. It is sufficient for the purposes of this article to focus on the following key issues.

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86 Ibid., at 626.
87 American Thread, supra note 66; Mitchell, supra note 67; New Zealand Shipping Co., Ltd. v. C.H. Thew (1922), 8 TC 208 (HL); Bradbury, supra note 66; Swedish Central Railway, supra note 67; Egyptian Delta Land, supra note 42; Union Corporation Ltd. v. IRC, [1952] 1 All ER 646 (CA); aff’d on other grounds [1953] AC 482 (HL); Unit Construction Co. Ltd. v. Bullock, [1960] AC 351 (HL); Re Little Olympian Each Ways Ltd., [1995] 1 WLR 560 (Ch.); and Untelrab Ltd. v. McGregor, [1996] STC (SCD) 1.
88 MNR v. Crossley Carpets (Canada) Ltd., 69 DTC 5015, at 5016 (Ex. Ct.).
89 Bedford Overseas Freighters Ltd. v. MNR, 70 DTC 6072, at 6079 (Ex. Ct.).
90 Birmount Holdings Ltd. v. The Queen, 78 DTC 6254, at 6260 (FCA).
91 British Columbia Electric Railway, supra note 73 (although De Beers was not cited); Zebnder & Co. v. MNR, 70 DTC 6064 (Ex. Ct.); Tara Exploration, supra note 77; Victoria Insurance Co. Ltd. v. MNR, 77 DTC 320 (TRB); Capital Life Insurance Co. v. The Queen, 84 DTC 6087 (FCTD); Gurd’s Products, supra note 77; and 1143132 Ontario Ltd. v. The Queen, 2009 TCC 477. For further discussion of the Canadian case history, see Couzin, supra note 2, or the following articles: Ward, supra note 83; Pyrcz, supra note 79; James S. Hausman and George T. Tamaki, “Canada,” in The Fiscal Residence of Companies, supra note 33, at 263-72; Edwin G. Kroft, “Jurisdiction To Tax: An Update,” in Tax Planning for Canada-US and International Transactions, 1993 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1994), 1:1-138, at 1:25-32; and Brooks, supra note 79, at 413-15.
92 See the reports from Australia, India, New Zealand, and Singapore in Fiscal Residence of Companies, supra note 33.
93 Unit Construction, supra note 87, at 366.
94 See especially Couzin, supra note 2, at chapter 2.
Central Management and Control as Highest Functions

Exercising central management and control is itself one aspect of carrying on business; indeed, it is what Lord Loreburn styled the “real business.” This was made plain in San Paulo Railway,95 was confirmed in De Beers, and is undoubtedly correct as a matter of tax policy. The courts have decided that such activities are not, however, equivalent to a company’s day-to-day trading operations or even to the practical management and oversight of these operations. The activities of central management and control have been variously described as the central point,96 the paramount authority,97 the head and brain,98 the pivot and axis,99 the superior and directing authority,100 and other similar metaphors. HMRC describes them as “the highest level of control” of the company’s business.101 These are the functions of corporate governance that, in accordance with British and Canadian corporate law, are usually found where a majority or totality of the board of directors meets to exercise its powers pursuant to the corporation’s constitution. In the United Kingdom, a very similar approach applies to partnerships.102 For corporations, the relevant “control” is not that which is wielded by a majority shareholder or by the shareholders at large through their voting power; it is the control exercised by directors through their oversight, management, and direction of the company’s affairs.103 It is possible, as discussed below, that management and control may actually be exercised by a party other than the board of directors, such as a dominant shareholder or the directors of a parent corporation, but in the normal course one looks to the corporation’s immediate directorial control.

95 San Paulo Railway, supra note 46; compare Malayan Shipping Co. Ltd. v. FCT (1946), 71 CLR 156 (HCA).
96 Cesena Sulphur/Calkutta Jute Mills, supra note 46, at 454.
97 American Thread, supra note 66, at 164 (HL); and Crossley Carpets, supra note 88, at 5016.
98 San Paulo Railway, supra note 46, at 38.
99 Koitaki Para Rubber Estates Ltd. v. FCT (1941), 64 CLR 241, at 244 (HCA).
100 Union Corporation, supra note 87, at 658-62 (CA).
101 United Kingdom, Inland Revenue, Statement of Practice 1/90, at paragraph 11 (reproduced in International Manual, supra note 82, at section 120).
102 It can be significant whether the management and control of a partnership’s trade or business is located partly within the United Kingdom or wholly outside the United Kingdom. In the few cases in which this issue has arisen, the courts have accepted that the business of a partnership is managed and controlled in the place where the highest level of decision making occurs: see Padmore v. IRC, [1989] STC 493 (CA); and Mark Higgins Rallying v. HMRC, [2011] UKFTT 340 (TC).
103 American Thread, supra note 66, at 32-33 (CA); Bedford Overseas Freighters, supra note 89, at 6079-80; Birmount Holdings, supra note 90, at 6261-62; compare Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame, [1906] 2 Ch. 34 (CA).
While terms like “central point” and “paramount authority” seem to suggest a single location for management and control, and thus a single corporate residence, several judgments, including Swedish Central Railway and Unit Construction, have allowed for the possibility that a corporation may have its management and control fragmented across jurisdictions. It is open to debate whether this position is sensible or not as a matter of international tax policy. The possibility of divided residence is consistent with the thesis that residence be understood as a special form of source, yet for the purposes of applying current tax treaties it would remain necessary to determine a “paramount” residence. What is more important for our purposes is the judicial focus on highest functions to the exclusion of other business functions. This choice of residence formulation means that a company is not resident where it carries on productive operations, even on a substantial scale, unless that is also the place where the supreme and directing authority is exercised. In Calcutta Jute Mills, a case in which the major productive operations occurred in India, Kelly CB stated the following in support of his conclusion that the company was a UK resident:

Though the whole property and produce of the property is in India, and the whole capital is invested in India, and though the whole of the money which the company is ever entitled to receive, whether as profits or in any other shape, is earned in India, yet it all belongs to the company, who might at any moment virtually take possession of it. If, without their consent, anyone were to take possession of one of the jute mills, the company might immediately bring ejectment and recover it. It is the company located in England which can alone deal with, or authorize the dealing with, the property in any way.

Similarly, in San Paulo Railway Lord Halsbury asserted that although the company in question dealt entirely with land, goods, and passengers in Brazil, “the person who governs the whole commercial adventure . . . [and] makes the profits by his skill or industry, however distant may be the field of his adventure,” is the person who is trading. Lord Davey expressed that conclusion in more moderate terms: “The business is therefore in very truth carried on, in, and from the United Kingdom, although the actual operations of the company are in Brazil, and in that sense the business is also carried on in that country.”

104 In Unit Construction, supra note 87, Lord Radcliffe analyzed the earlier cases contemplating dual residence, notably Swedish Central Railway, supra note 67; Egyptian Delta Land, supra note 42; and Union Corporation, supra note 87. He concluded, at 366, that divided management and control, and thus divided residence, was possible: “Though such instances must be rare, the management and control may be divided or even, at any rate in theory, peripatetic.” This position has been accepted in Canada: Crosley Carpets, supra note 88.
105 Koitaki Para Rubber Estates, supra note 99, at 244 and 248-49.
106 Cesena Sulphur/Calcutta Jute Mills, supra note 46, at 447.
108 Ibid., at 43.
One cannot read these passages, and similar passages appearing throughout the early jurisprudence, without sensing the colonialism or imperialism that underlies them. The presence of these attitudes is not surprising when one considers that the entire progress of joint stock companies was closely associated with the progress of British colonization and the extension of foreign trade. Modern observers might contend that the “real business” of an international enterprise consists in the productive endeavours of its employees in the foreign state, rather than in the management activities of its directors in the home state. Much depends on one’s ideological perspective. It should be borne in mind that the language of the income tax statutes did not permit the courts simply to equate residence with “trade” or “business” because that would have conflated residence-based and source-based taxation as understood at the time. Having decided to ascribe residence to a corporation on the basis of its activities rather than existence, it was necessary to select specific business activities for that purpose. Selecting the activities of the “head and brain” rather than the “hands and feet” was, if not theoretically ideal, at least logically defensible.

**Subsidiary Residence in Modern Multinational Enterprises**

**Exploitation of the Highest Functions Paradigm**

Many of the early cases on corporate residence concerned a single company, incorporated and registered in the foreign jurisdiction where the productive business was located, with a delegated or managing board in that foreign jurisdiction, but with the main or supervisory board making most of the decisions in England. It is apparent that this was a common method of engaging in multinational ventures. Alas, it was a method that resulted in the relevant corporations being subject to worldwide taxation in Britain at a time when foreign tax credits were rudimentary or non-existent. Various enterprises that had been based in Britain responded so as to avoid the burden of worldwide taxation, first by moving the functions of central management and control to the delegated or managing board in the foreign jurisdiction, and later by incorporating subsidiaries with ostensibly independent boards in the foreign jurisdictions. The latter part of this evolution can be seen in the Canadian cases as well, whether in the context of foreign corporations establishing subsidiaries in Canada or of Canadian corporations establishing subsidiaries abroad.

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110 Couzin, supra note 2, at 28-29.

111 For example, *De Beers*, supra note 53; *American Thread*, supra note 66; and *New Zealand Shipping*, supra note 87.

112 For example, *Mitchell*, supra note 67; *English Sewing Cotton*, supra note 66; and *Egyptian Delta Land*, supra note 42.

113 For example, *Unit Construction*, supra note 87; and *Untelrab*, supra note 87.

114 For example, *Bedford Overseas Freighters*, supra note 89; and *Victoria Insurance*, supra note 91.
It is well known that the dominant form of international business organization is now a globally integrated network of corporations, often with a single headquarters company and numerous foreign affiliates. Obviously, this evolution in the mode of international enterprise challenges the efficacy of any tax system that is based on the twin concepts of separate corporate personality and corporate residence. This is especially true when, as explained below, courts that are asked to determine the tax residence of “offshore” subsidiaries take a formal, entity-by-entity view of the matter. Thus, Arnold has argued that the test of corporate residence from *De Beers* has become a mere “tax-planning device,”115 while McIntyre has colourfully observed that the modern MNE can “exploit its androgynous nature to make corporate residence ineffective.”116

At one time, the UK government recognized that corporate residence might be better measured by looking at functions other than the ceremonial functions of central management and control. In a 1981 consultation document, the Inland Revenue stated that the established criteria had “become artificial with the passage of time and technical innovation,” and they “enabled companies to arrange a residence for tax purposes which may bear little relation to the seat of the company’s operations.”117 It was suggested that the United Kingdom adopt a statutory test based on “practical day to day management,” “principal place of business,” or incorporation.118 The latter two options were subsequently discarded; the Inland Revenue instead proposed to define residence on the basis of where “the management of the company’s business as a whole is conducted,” which was considered to mean the place of “immediate day to day management.”119 In response to business pressure and a report by the Institute for Fiscal Studies,120 the government ultimately decided that modifying the concept of corporate residence would result in “upheaval,” so the idea was abandoned.121 The government instead elected to maintain the existing case law test and to enact specific rules aimed at international tax avoidance. Thus, the central management and control test endures.

115 Arnold, supra note 31, at 1564.
118 Ibid., at paragraphs 6-7.
Judicial Affirmation of Separate Residence

The difficulties inherent in the central management and control test have been revealed in a number of cases, often involving a sole shareholder exerting influence over the decisions and actions of foreign subsidiaries.

The Unit Construction case is a notorious illustration of the possibility that the actual exercise of central management and control may not abide where it formally should abide. The case concerned certain subvention payments that had been made by the appellant company, a wholly owned Kenyan subsidiary of an English parent, to three other Kenyan subsidiaries. The deductibility of the subvention payments depended on whether the subsidiaries were resident in the United Kingdom. The evidence showed that although the subsidiaries were registered in Kenya and had boards that were distinct from the parent board, none of the boards ever made any decisions; instead, they “stood aside” in all matters of real importance. On this evidence, the court held that the management and control of the subsidiaries was actually exercised by the parent board. It was immaterial that this usurpation of power was contrary to the subsidiaries’ corporate constitutions: “The business is not the less managed in London because it ought to be managed in Kenya.”

Couzin correctly observes that Unit Construction was not a revolutionary decision; rather, it applied the aspect of De Beers that held that central management and control must be determined by scrutinizing the actual business conduct rather than the terms of the constating documents. Nonetheless, one regularly sees warnings from revenue authorities and tax practitioners that, in determining the residence of a company, the law requires an examination of the substance of the company’s activities and not merely the legal form, with the example provided of a parent company usurping the control of an offshore subsidiary. This is merely a recapitulation of the facts of Unit Construction. The case did not establish a rule of substance over form with respect to corporate residence—its scope is narrower. This narrow scope is demonstrated by a series of more recent decisions, culminating in the 2006 judgment of the Court of Appeal in Wood v. Holden.

Wood v. Holden involved a sophisticated scheme to mitigate capital gains tax on the sale of shares of a family company. The critical element was a transfer of certain

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122 The case is unusual because the taxpayer, not the Revenue, was arguing that the companies were resident in the United Kingdom. It was essentially a loss importation arrangement.
123 Unit Construction, supra note 87, at 360 and 364.
124 Ibid., at 363.
125 Couzin, supra note 2, at 86.
126 For example, Statement of Practice 1/90, supra note 101, at paragraphs 12-17; Interpretation Bulletin IT-391R, “Status of Corporations,” September 14, 1992, at paragraph 15; and Hausman and Tamaki, supra note 91, at 265.
holding company shares from Copsewood Investments Ltd. (CIL), a company registered in the British Virgin Islands, to Eulalia Holding BV, a Dutch incorporated company wholly owned by CIL. The holding company shares were later resold to an unconnected purchaser. The taxpayers contended that both CIL and Eulalia were non-resident companies and members of the same corporate group, meaning that no gain accrued on the initial disposal.128 The primary focus in the case was the residence of the Dutch incorporated company, Eulalia. The taxpayers argued that Eulalia was non-resident at all material times, either because its central management and control was exercised in the Netherlands and not in the United Kingdom (the common-law test) or because its effective management was exercised in the Netherlands (relying on the treaty non-resident rule129 and the UK-Netherlands tax treaty130). The Revenue argued that Eulalia was resident in the United Kingdom, either on the standard of central management and control or on the standard of effective management. Its position was that the managing director of Eulalia, ABN AMRO trust (AA trust), had merely held meetings and signed documents as instructed by the taxpayers’ advisers in the United Kingdom, following a pre-ordained plan. The special commissioners agreed with this position.131 The question on appeal was what degree of independence or initiative on the part of AA trust, as managing director of Eulalia, would constitute “central” or “effective” management of Eulalia?

Both Park J in the Chancery Division and the judges in the Court of Appeal stressed that there is an important difference between actually exercising management and control and being able to “influence” those who exercise management and control. On the one hand was Unit Construction, in which the parent board had unconstitutionally usurped the management of its subsidiaries. On the other hand were several cases—all involving persons incorporating a special-purpose entity in another (low-tax) jurisdiction—in which the local management “did not take initiatives” but responded to “proposals” or “instructions” that were presented to them.132 The cases referenced were from the United Kingdom, Australia, and New

128 By reason of the Taxation of Chargeable Gains Act 1992 (UK), 1992, c. 12, sections 14(2) and 171.
129 CTA 2009 section 18.
132 Little Olympian, supra note 87 (entity held to be resident in Jersey); Untelrab, supra note 87 (entity held to be resident in Bermuda); Esquire Nominees Ltd. v. FCT (1971), 129 CLR 177 (HCA) (entity held to be resident in Norfolk Island); New Zealand Forest Products Finance NV v. CIR, [1995] 2 NZLR 357 (NZHC) (entity held to be resident in Netherlands Antilles). These cases are discussed in Wood v. Holden, supra note 13, at paragraphs 26-27 and 51-53 (Ch. D.).
Zealand; the taxpayers’ counsel could easily have added *Victoria Insurance*¹³³ to the list, a decision of the Tax Review Board, in which a Bahamas subsidiary of a Canadian corporation engaged in the business of insurance and reinsurance was held to reside in the Bahamas on the basis of its local management and control. Returning to *Wood v. Holden*, Park J stated that in the four cases under consideration the respective courts had observed that the subsidiary’s local management may have been “complaisant” but it nevertheless retained its discretion to refuse to implement an “improper or unwise” request. Park J felt it important to make the following observation:

> [I]t is possible (and is common in modern international finance and commerce) for a company to be established which may have limited functions to perform, sometimes being functions which do not require the company to remain in existence for long. Such companies are sometimes referred to as vehicle companies or SPVs (special purpose vehicles). “Vehicle” has a belittling sound to it, but such companies exist. They can and do fulfil important functions within international groups, and they are principals, not mere nominees or agents, in whatever roles they are established to undertake. They usually have board meetings in the jurisdictions in which they are believed to be resident, but the meetings may not be frequent or lengthy. The reason why not is that in many cases the things which such companies do, though important, tend not to involve much positive outward activity.¹³⁴

On the basis of the above, and the special commissioners’ finding that the directors of Eulalia “were not by-passed” and did not “stand aside” since their representatives “signed or executed the documents,” Park J held that the only conclusion open to them in law was that Eulalia was managed and controlled in the Netherlands.¹³⁵ He offered the alternative conclusion that if there was any difference between the concepts of central management and effective management, Eulalia was effectively managed in the Netherlands and therefore non-resident pursuant to the treaty non-resident rule.¹³⁶

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¹³³ *Victoria Insurance*, supra note 91. Compare *Bedford Overseas Freighters*, supra note 89, which involved a company incorporated in Canada before April 1965. Although it was said that the non-resident majority shareholder “made the major decisions for the company” and that the Canadian directors “unquestioningly carried out his instructions,” the court held that the Canadian directors nonetheless “executed agreements and attended to the business and legal affairs of the company,” such that management and control was situated in Canada (see *Bedford Overseas Freighters*, supra note 89, at 6079-80).


¹³⁵ Ibid., at paragraphs 37 and 64-72.

¹³⁶ Ibid., at paragraphs 73-81. The Court of Appeal made no decision on this issue, although Chadwick LJ suggested that the two tests were equivalent: *Wood v. Holden*, supra note 13, at paragraphs 6 and 44 (CA).
While Wood v. Holden did not involve an active global enterprise, the same reasoning has been applied to special-purpose subsidiaries of active MNEs, both before and since that decision. Many legal commentators would contend that the decision in Wood v. Holden is unassailable on the basis of longstanding principles of company law and tax law, and various practitioners have commented on the correctness of the decision while disparaging the special commissioners’ contrary opinion. I have heard both British and Canadian tax practitioners remark that the special commissioners were unduly focused on the “reality” of the arrangement. The upper court decisions are applauded because they respect the separate legal existence of subsidiaries and fix the residence of a subsidiary on the basis of the directorial functions of that corporation’s board. Such an approach is said to favour certainty and predictability in tax planning.

I do not quarrel with these observations. As a matter of tax policy, however, one must question whether this formulation of corporate residence is consistent with the principles that animate residence-based taxation. Directors who manage some special-purpose vehicle, yet who do so without “initiative” because they are “complaisant” to the will of a guiding party, are exercising little of the intellectual endeavour that is essential to economic interest. To quote counsel for the minister in Victoria Insurance, there is little or no “independence of action” on the part of these directors. The purported residence of these entities may be described as “clockwork residence” because of the meticulous design involved. When offshore statehood can be purchased by hiring offshore advisers to manage offshore shelf companies, why is such a concept of residence thought to be meaningful?

To be fair, it is conceivable that in particular circumstances a sole shareholder or other dominant party might wield sufficient power over an ostensibly foreign entity to give him or her the actual management and control, with local directors acting

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137 In the United Kingdom, see News Datacom Ltd. v. Atkinson, [2006] STC 732 (SCD), which involved a global media group with affiliates based in Hong Kong and Israel; the commissioners held that the Hong Kong affiliate was resident outside the United Kingdom on the basis of its immediate directorial control. In Canada, see 1143132 Ontario Ltd., supra note 91, where a Barbados resale affiliate was held to be resident in Barbados on the basis of its immediate directorial control. As similarly argued in Unit Construction, supra note 87, the taxpayer in this case preferred to argue that the Barbados subsidiary was resident in Canada (in order to avoid a transfer-pricing adjustment).


139 Compare Wood v. Holden, supra note 13, at paragraph 50 (CA), where Sir Christopher Staughton warned against speaking about what happened “in real life” and what were the “real decisions.”

as “mindless” nominees. This possibility was expressly contemplated in *Wood v. Holden*,141 and was held to have occurred in *Laerstate BV v. Revenue & Customs*,142 a more recent decision of the First-Tier Tribunal. Laerstate was a holding company incorporated and registered in the Netherlands that originally had two directors, one of whom was the company’s sole shareholder (Mr. Bock). He resigned as a director before the disposition of certain shares by Laerstate. The issue was whether the capital gain from that transaction was taxable in the United Kingdom, which turned on the residence of Laerstate. Referring to *De Beers, Unit Construction*, and *Wood v. Holden*, the tribunal observed that central management and control was not necessarily to be found where the board of directors met or executed documents because this was a factual question to be answered by scrutinizing the whole “course of business and trading.”143 The tribunal considered very detailed evidence regarding the company’s affairs and concluded that Mr. Bock took a dominant role while in office and after resigning as director, making most of the key decisions regarding “policy, strategic, and management matters” within the United Kingdom, while the remaining director merely implemented decisions that had already been made. The company was held to be managed and controlled—and therefore resident—in the United Kingdom.144

Other recent decisions in the United Kingdom and Canada have demonstrated some judicial willingness, in the case of foreign trusts employed in a tax-avoidance arrangement, to look beyond the formalities of trustee administration to ascertain where the “realistic, positive management” of the trust was exercised. This approach was taken in *Smallwood Trust v. HMRC*,145 although this case involved a determination of trust residence for treaty purposes (having nothing to do with central management and control). *Smallwood* and related cases on trust residence under tax treaties are discussed in more detail in the next section of this article. A more relevant decision is *Fundy Settlement v. Canada*,146 where an approach comparable to *Smallwood* was taken. To briefly describe the facts in *Fundy Settlement*, a number of Canadian individuals were direct or indirect shareholders in a Canadian corporation known as “PMPL,” and a reorganization was undertaken to avoid capital gains tax on a future disposal of the PMPL shares. The structure involved the settlement by a non-resident individual of two Barbados trusts (Fundy and Summersby), each subscribing for shares in certain Canadian holding companies, which in turn subscribed for shares of PMPL. The sole trustee of each trust was a corporation resident in Barbados

143 Ibid., at paragraphs 27-37.
144 *Laerstate*, ibid., was not appealed, apparently as a result of the death of Mr. Bock in 2010.
146 2012 SCC 14; aff’g. 2010 FCA 309 (sub nom. *St. Michael Trust Corp. v. Canada*); aff’g. 2009 TCC 450 (sub nom. *Garron Family Trust v. The Queen*).
Later, the shares of the PMPL holding companies were sold by the trusts to a third party at a substantial gain, which was, so the taxpayers argued, exempt from Canadian taxation by virtue of the Canada-Barbados tax treaty. Although various arguments were made in the case, much emphasis was placed on the residence of the trusts. Woods J reasoned that it was appropriate to apply the central management and control test of corporate residence to a trust, rather than relying on the residence of the trustee. While that aspect of the decision was itself controversial, what is more interesting for the present purposes is Woods J’s interpretation and application of the central management and control concept. On the basis of the evidence before her, she decided that all of the “substantive decisions” in respect of the trusts were made in Canada by the Canadian beneficiaries and their advisers, with St. Michael making no decisions of its own but merely executing documents and providing incidental administrative services; accordingly, the trusts were resident in Canada at all times for both domestic law purposes and treaty purposes. In my view, this may represent a more expansive reading of central management and control than was applied to corporate subsidiaries in [149] Victoria Insurance, Wood v. Holden, and similar cases. The decision was affirmed by the Federal Court of Appeal and, in a rather brief judgment, by the Supreme Court of Canada.

Given the forceful wording of the judgments in Wood v. Holden, and given the weight of authority both before and since Wood v. Holden, one can nonetheless expect that attempts to secure foreign residence for corporate entities will almost invariably succeed. The judgments in Unit Construction, Laerstate, and (indirectly) Fundy Settlement serve as warnings to taxpayers and their advisers that if they wish to achieve “clockwork residence” in a foreign jurisdiction, they must ensure that the clock is working. This does not mean that any substantial economic interest exists in the foreign state. Whereas in De Beers Lord Loreburn expressed concern about corporations avoiding UK taxation “by the simple expedient” of being registered abroad, MNEs can avoid home taxation by the simple expedient of being managed and controlled abroad, with the entrepreneurship, initiative, and influence remaining in the headquarters state. Some US authors have speculated that US international tax rules could be more resistant to profit shifting if the United States adopted a management and control test for corporate residence. In my view, they may have failed to appreciate how devitalized this concept is. If central management and control is

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147 Agreement between Canada and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (1980), article 14(4).

148 Fundy Settlement, supra note 146, at paragraphs 156-70 (TCC).

149 Ibid., at paragraphs 187-267.

as lacking in substance as I have argued, there is something to be said for using the incorporation test exclusively: while artificial, it has the benefit of simplicity and it avoids the environmental cost of board members travelling abroad to carry out equally artificial board meetings.

CORPORATE RESIDENCE FOR TREATY PURPOSES

Background

In the previous section, it was argued that neither incorporation nor central management and control (as currently understood) is a satisfying formulation of corporate residence. This leads one to ask whether residence should be determined on the basis of a different set of functions and activities. A useful source to consider is the range of definitions used for determining entity residence under the OECD model and various tax treaties. Tax treaties are worded so that they apply to persons who are residents of one or both of the contracting states. Indeed, this is one of the notable benefits associated with residence in a state. Determining who is a resident involves a consideration of the relationship between residence under domestic law, tax liability under domestic law, and residence for treaty purposes, followed by an examination of the treaty preference criteria for resolving dual residence conflicts.

Domestic Liability and Treaty Residence

The residence of a taxpayer for domestic law purposes is, of course, a matter left to each state to determine. As stated in the OECD commentary, tax treaties “do not normally concern themselves with the domestic laws of the Contracting States laying down the conditions under which a person is to be treated fiscally as ‘resident.’” The laws of the United Kingdom and Canada consider corporate residence to follow from incorporation or central management and control, as already discussed, while other states use their own (possibly similar) rules. Other residence formulations, whether derived from case law or statute, apply to individuals, partnerships, and trusts.

The tax liability of a person under domestic law is relevant because of the way that residence is defined in most tax treaties. The first sentence of article 4(1) of the OECD model defines the term “resident of a Contracting State” as “any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.” This is

151 OECD model, supra note 37, at article 1.
152 Ibid., at paragraph 4 of the commentary on article 4.
153 Ibid., at article 4(1). The OECD model is silent on the temporal scope of this rule. If a person’s factual residence for part of a year results in deemed tax liability for the entire year, the person may be considered liable to tax “by reason of” residence and thus a “resident” for treaty purposes. For further discussion, see the contrasting judgments in Smallwood, supra note 145, and Geoffrey Loomer, “Smallwood Trust v HMRC: Diverging Opinions on the Offshore Residence of a Trust,” case comment [2010] no. 5 British Tax Review 468-75.
generally considered to mean that treaty residence requires comprehensive tax liability in a state based on a personal/subjective attachment to the jurisdiction.\(^{154}\) The second sentence of article 4(1) provides that a resident of a contracting state does not include a person “who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.” While serving several purposes, one effect of this sentence is to ensure that a permanent establishment of a foreign enterprise does not qualify as a resident for treaty purposes. Whether this restriction is good tax policy is a separate question.\(^{155}\)

**Current Treaty Preference Criteria**

**Dual Residence for Treaty Purposes**

Aside from defining who is a resident of a contracting state, the other purpose of article 4 of the OECD model is to resolve issues of dual residence through the application of preference criteria, also known as “residence tie-breaker rules.” The OECD model provides that where by reason of paragraph 1 a person other than an individual is a resident of both contracting states, the person is deemed to be a resident only of the state in which its place of effective management (POEM) is situated.\(^{156}\) Thus, for the purpose of treaties that adopt this feature of the OECD model, POEM takes precedence over other residence tests that may be used in domestic law.

Most tax treaties negotiated by the United Kingdom and Canada include a residence tie-breaker rule for legal entities.\(^{157}\) POEM is the usual preference criterion in UK tax treaties, and it appears as a possibly relevant criterion in many Canadian tax treaties; this is not surprising because both countries are longstanding members of the OECD. But POEM is not the only criterion in use. In Canada, the odd affinity for incorporation as a determinant of residence under domestic law finds its way into tax treaties as well. Of the 92 comprehensive tax treaties currently in force in Canada, 55 use place of incorporation or nationality (which is the same thing in the case of a legal entity) as the sole residence tie-breaker or as the primary tie-breaker, with the secondary factor in the event that the entity is not a national of either jurisdiction

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154 OECD model, supra note 37, at paragraphs 3 and 8-8.8 of the commentary on article 4; *Crown Forest Industries Limited v. Canada*, [1995] 2 SCR 802; *TD Securities (USA) LLC v. The Queen*, 2010 TCC 186; and Vann, supra note 12, at 243-48.

155 See Vann, supra note 12, at 248-50.

156 OECD model, supra note 37, at article 4(3).

157 Some of the United Kingdom’s older tax treaties, for example, those with Belize (1947), Greece (1953), and Jersey (1952, as amended through 2009) have no tie-breaker rule. They simply provide that a company is treated as resident in one state or the other if its business is “managed and controlled” there. This was common in British tax treaties concluded before the first OECD model (1963), infra note 177: see John F. Avery Jones, “The Definition of Company Residence in Early UK Tax Treaties” [2008] no. 5 *British Tax Review* 556-86.
being either POEM or mutual agreement of the competent authorities.\textsuperscript{158} For example, under the current Canada-US tax treaty a company that is resident in both contracting states is deemed to be resident in the state under the laws of which it was created, and, if that cannot be determined, the resolution of residence is left to the competent authorities; in the absence of agreement, the company is not considered resident in either state for the purpose of claiming treaty benefits.\textsuperscript{159} Canada’s remaining 37 treaties provide that in cases of dual residence of legal entities, the competent authorities of the two states shall endeavour to resolve the matter by mutual agreement. In some of these treaties, the residence article goes on to list the factors that should be considered by the competent authorities when making that determination, including place of incorporation and POEM.\textsuperscript{160} The United Kingdom historically used the POEM rule in its tax treaties and continues to do so in some recently concluded or amended treaties,\textsuperscript{161} while in other recent treaties “mutual agreement” appears as the sole preference criterion.\textsuperscript{162} Given that the POEM criterion is frequently used, either as the sole criterion or as an alternative to place of incorporation, it is worth considering what is meant by “effective management.”

\textbf{Development of the Place of Effective Management Concept}\textsuperscript{163}

The issue of the “fiscal domicile” of companies for tax treaty purposes was analyzed by the technical experts to the League of Nations Financial Committee in their 1925 report.\textsuperscript{164} While the technical experts acknowledged that states were entitled to use their own definitions of fiscal domicile for domestic law purposes, they proposed that for tax treaty purposes the domicile of legal entities—specifically joint

\textsuperscript{158} Fourteen treaties, including the recently amended treaty with Barbados (2012), rely on the place of incorporation or nationality only. Thirty-three treaties rely on (1) the place of incorporation or nationality or (2) POEM. Eight treaties, including the treaty with the United States, rely on (1) the place of incorporation or nationality or (2) mutual agreement of the competent authorities.


\textsuperscript{160} For example, Canada’s treaties with Ireland, the Netherlands, and the United Kingdom.

\textsuperscript{161} For example, the treaties with France (2008), Germany (2010), Hong Kong (2010), and Spain (2013).

\textsuperscript{162} For example, the treaties with the United States (2001), Japan (2006), the Netherlands (2008), Barbados (2012), and Norway (2013).


stock companies—should be the place “where the concern has its effective centre, i.e., the place where the ‘brain,’ management and control of the business are situated.”\(^{165}\) This was expressed in their draft resolutions as “the real centre of management and control of the undertaking,” echoing the allocation of taxing rights over international shipping income to the state where “the real centre of management and control of the undertaking” was situated.\(^ {166}\) A key rationale given for adopting this residence definition was that it would prevent companies from “nominally transferring their headquarters to a place where the taxes are lower than in the country in which the effective centre of the business is situated.”\(^ {167}\) Presumably, such a nominal transfer was believed to be possible under a more formal test, like place of incorporation. Thus, the focus was on “real” and “effective” residence as contrasted with “nominal” residence, suggesting some elevation of substance over form. This preference continued in the drafting of later model conventions, although subtle changes in wording attenuated the fixation on “reality.”

Subsequent reports through the 1930s shortened the formulation of fiscal domicile of legal entities to the “real centre of management,” no longer referring to “control.”\(^ {168}\) This definition of fiscal domicile was adopted in the 1946 London draft model convention for companies, partnerships, and other legal entities.\(^ {169}\) It is interesting that the authors of the 1943 Mexico draft model convention decided that the fiscal domicile of legal entities should be “the State under the laws of which they were constituted.”\(^ {170}\) According to the League of Nations Fiscal Committee, the real centre of management test was used in “most” tax treaties between European countries, while the place of creation test was thought to be more consistent with American legal systems.\(^ {171}\) As in various other areas, the wording in the London draft with respect to fiscal domicile prevailed.

Neither the Mexico draft nor the London draft revealed much concern with the possibility of legal entities being resident in both contracting states under the treaty definition of residence; the analysis of dual residence focused on individuals. The subsequent work of the Organisation for European Economic Co-operation (OEEC) considered this issue in depth. In 1958, the OEEC Fiscal Committee proposed that in the unlikely event that a legal entity was resident for treaty purposes in both

\(^{165}\) Ibid., at 21.

\(^{166}\) Ibid., at 31 and 34.

\(^{167}\) Ibid., at 21.


\(^{170}\) Ibid., at protocol article 2(4).

\(^{171}\) Ibid., commentary, at 10-11.
contracting states, then the conflict should be resolved by deeming the entity to be a resident of the state where the “place of effective management” was situated.\textsuperscript{172} This proposal was adopted from the final report of Working Party 2 of the OEEC Fiscal Committee.\textsuperscript{173} Interestingly, Working Party 2 had originally considered using “management and control” as the tie-breaker, on the basis of its belief that this was how the terms were used in existing UK tax treaties.\textsuperscript{174}

The decision to use POEM as the preference criterion for entity residence was stated to be based on three considerations.\textsuperscript{175} First, the Working Party and the OEEC Fiscal Committee noted that this criterion reproduced the treaty allocation rule with respect to income from international shipping and aircraft operations, used at the time in a number of existing tax treaties. Second, the concept of “effective management” was thought to be equivalent to “management and control,” the definition of corporate residence used in tax treaties concluded by the United Kingdom near that time, although in retrospect that thinking was probably wrong. Third, and perhaps most importantly, the OEEC observed that it “would not be natural to attach importance to a purely formal criterion like registration,” again demonstrating a preference for substance over form with respect to entity residence.\textsuperscript{176}

These observations were reiterated in the commentaries to subsequent versions of the OECD model\textsuperscript{177} and the UN model tax convention.\textsuperscript{178} While the specific reference to the residence formulation used in UK tax treaties was deleted in 1992, the current OECD commentary continues to highlight the replication of the allocation rule for income from international shipping and aircraft operations.\textsuperscript{179} The com-


\textsuperscript{174} In fact, as Avery Jones explains, the working party failed to understand what “central management and control” meant in UK domestic law, and thus failed to understand that the term was inserted in UK tax treaties not as a residence tie-breaker but to forestall arguments based on \textit{Swedish Central Railway}, supra note 67, that corporate residence followed from incorporation: Avery Jones, “2008 OECD Model: Place of Effective Management,” supra note 163, at 184-85.

\textsuperscript{175} OEEC report, supra note 172, annex C, at paragraphs 18-19; and working party final report, supra note 173, at 6.

\textsuperscript{176} OEEC report, supra note 172, annex C, at paragraph 18.


\textsuperscript{178} See United Nations, Department of Economic and Social Affairs, \textit{Model Double Taxation Convention Between Developed and Developing Countries} (Geneva: UN, 2001), at 66-67 (quoting the commentary on the OECD model, supra note 37).
mentary also states the following: “It would not be an adequate solution to attach importance to a purely formal criterion like registration. Therefore paragraph 3 attaches importance to the place where the company, etc. is actually managed.” Although the word “real” has been excised from the residence preference criterion and commentary thereon, the word “actually” persists, echoing Lord Loreburn’s speech in *De Beers*. Canada and the United States have nonetheless entered reservations that they retain the right to use place of incorporation as the preference criterion and, failing that, to deny dual resident companies treaty benefits. By using incorporation as the tie-breaker, rather than POEM or some other concept, countries can neatly avoid the difficulty of determining what is “real” or “actual” in cases of dual residence.

**Meaning of Effective Management**

Even if the POEM concept suggests a more economically substantial nexus than registration or incorporation, the difficulty with using POEM as a residence preference criterion is that its meaning is far from certain. In the early OEEC reports, it seems that the authors were not clear about the meaning of POEM; it was an odd mixture of civil-law and English law concepts of fiscal domicile. This has led commentators from various countries to assume that POEM is synonymous with the definition of entity residence under their own domestic laws. One sees this in the United Kingdom and Canada, where commentators and judges have suggested that there is no difference between effective management and central management and control.

It does not help that the OECD commentary on the meaning of POEM has changed a number of times. The current OECD commentary defines POEM as follows:

> The place of effective management is 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.

179 OECD model, supra note 37, at paragraph 23 of the commentary on article 4.
180 Ibid., at paragraph 22 of the commentary on article 4.
181 Ibid., at paragraphs 27 and 31 of the commentary on article 4. Canada’s reservation in this regard has now been deleted: see the OECD 2014 update, supra note 37, at paragraph 11.
182 Avery Jones et al., supra note 163, at 719-22.
185 *Wood v. Holden*, supra note 13, at paragraphs 6 and 44 (CA); and *Fundy Settlement*, supra note 146, at paragraph 265 (TCC).
186 OECD model, supra note 37, at paragraph 24 of the commentary on article 4.
Before the 2000 revision to the OECD commentary, there was no definition offered, other than the stated considerations for using POEM as a tie-breaker, mentioned above. In 2000, a different version of the above definition was introduced. The first sentence was largely the same, but the second sentence stated that POEM “will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions,” with the proviso that “no definitive rule can be given and all relevant facts and circumstances must be examined.”

This wording suggested that effective management would “ordinarily” be the same as central management and control, as understood in UK and Canadian domestic law. However, the second sentence was changed to the above in the July 2008 revision, making it less clear that the two concepts should be considered equivalent. The words “as a whole” were also added to the first sentence. Although this amendment likely does not add much, it is notable that it echoes the Inland Revenue’s failed 1981 proposal to define corporate residence on the basis of where “the management of the company’s business as a whole is conducted.”

Where does this leave us? In one sense, we can interpret “effective” as meaning real, substantial, or primary, as opposed to nominal, formal, or subordinate. This appears to be the interpretation that HMRC pursued unsuccessfully in Wood v. Holden and successfully in Smallwood. In another sense, it can mean giving effect to, as opposed to planning or strategizing, which places the emphasis more on day-to-day management decisions. HMRC also seems to support this interpretation. It has stated that an entity’s POEM “will normally be located in the same country as central management and control but may be located at the company’s true centre of operations, where central management and control is exercised elsewhere.” The Statement of Practice on company residence suggests that POEM may be different from the place of management and control where, for example, a company is “run by executives based abroad” but the “final directing power” rests with non-executive directors in the United Kingdom. These interpretations may suggest that POEM lies closer to the productive operations of the business, while management and control involves ultimate directing power. There does not appear to be any commentary from the Canada Revenue Agency on the meaning of POEM and its possible difference from central management and control, which is not surprising, given that no Canadian tax treaties use POEM as the sole or primary preference criterion.

It remains important to determine whether POEM emphasizes substantive strategic decisions or day-to-day management decisions, particularly in the context of parent-subsidiary relationships within an MNE. Some tentative guidance is

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188 Supra note 119.

189 International Manual, supra note 82, at section 120070.

190 Statement of Practice 1/90, supra note 101, section C, at paragraph 3.

191 The same point is made by Behrens, supra note 34, at 9.
provided by a number of cases dealing with the treaty residence of trusts, where “effective management” was interpreted as “realistic, positive management,” and the court looked beyond the formal establishment of an offshore trust to the location where the real decisions were made.

The case of Wensleydale’s Settlement Trustees v. IRC192 involved the establishment of a purportedly foreign trust as part of an arrangement to avoid UK capital gains tax. The taxpayers’ goal was to have this trust considered resident in Ireland by operation of the POEM tie-breaker rule in the tax treaty between the United Kingdom and Ireland. Although the trustees had carried out certain formalities in Ireland, the special commissioner focused on where the proactive decision making really happened, which was held to be the United Kingdom.193

That analysis was applied by the special commissioners and a majority of the Court of Appeal in Smallwood, which again (as in Wood v. Holden, Wensleydale, and various other cases) involved a capital gains tax-avoidance scheme. Here, the arrangement relied on a carefully orchestrated sequence of trusteeships exercised in different states at different times within the same fiscal year, from Jersey to Mauritius to the United Kingdom. The relevant shares were disposed of by the trustees during the period of formal Mauritian residence, in the hope that the UK-Mauritius tax treaty would shield the gain from taxation.194 The argument turned on the residence of the trust for treaty purposes during the period of formal Mauritian residence, which necessitated a determination of where the trust’s POEM was located: the United Kingdom or Mauritius.195 The special commissioners relied on the OECD commentary and the reasoning in Wensleydale, seeking to determine “in which state the real top level management (or the realistic, positive management) of the trustee qua trustee is found.”196 They applied that test to the facts and concluded that although the appropriate meetings were held and the appropriate resolutions were taken by the trustees in Mauritius, the design and influence that emanated from Mr. Smallwood and his advisers in the United Kingdom were such that POEM was at all times in the United Kingdom. Although that decision was overturned by the High Court, a majority of the Court of Appeal restored the decision. Unfortunately, the analysis of the meaning of POEM by the Court of Appeal does not provide much clarity.

193 It is notable that the special commissioner relied on three corporate residence cases: Calcutta Jute Mills, supra note 46; De Beers, supra note 53; and Unit Construction, supra note 87.
195 Smallwood, supra note 145, at paragraphs 107-8 (SpC); and Smallwood, ibid., at paragraphs 46-47, 65, and 72 (CA). Mann J in the High Court held that the issue of dual residence did not arise: Smallwood, ibid., at paragraphs 44-47 (Ch.).
196 Ibid., at paragraphs 113-14 and 130 (SpC).
Hughes LJ, with whom Ward LJ agreed, chose to consider the trust’s POEM for the entire year, rather than just the period of formal residence in Mauritius, suggesting that if one focused just on the Mauritius period then the trust’s POEM would be in Mauritius. Patten LJ, dissenting, pointed to *Wood v. Holden* and the finding of fact that the trustees were not bound to act in a certain way; in his view, the only possible conclusion was that the trust was effectively managed in Mauritius.

A view of trust residence similar to that taken in *Wensleydale* and *Smallwood* was adopted at all levels of court in the *Fundy Settlement* decision. Woods J observed that *Wensleydale* and *Smallwood* were of no assistance in determining what the appropriate common-law test of trust residence should be, but nonetheless considered *Smallwood* to be relevant in terms of the interpretation and application of central management and control. As discussed previously, Woods J decided that all of the substantive decisions in respect of the trusts were made in Canada, with the Barbados trustee acting in a facilitative role only, and thus the trusts were resident in Canada for both domestic law and treaty purposes. This decision was affirmed by the Court of Appeal and the Supreme Court. It remains unclear whether the interpretation of central management and control in *Fundy Settlement* will have influence in the corporate context, whether for Canadian domestic law purposes or for interpreting POEM in the Canadian treaties where POEM is used.

**Alternative Treaty Preference Criteria**

Given the confusion regarding the meaning of POEM, there is much to be said for adopting a new residence preference criterion in the OECD model and in future tax treaty negotiations. When considering the normative basis for residence-based taxation of corporations, it seems desirable to determine residence for treaty purposes on the basis of where the “realistic, positive management” of the corporation is found, the interpretation of POEM that has been applied to trusts. But it is not even clear that judges have a uniform view of what that means. Moreover, it is unlikely, given the decision in *Wood v. Holden* and notwithstanding the decisions in *Smallwood* and *Fundy Settlement*, that such an interpretation of POEM will be applied with respect to corporations: talk of the “reality” of corporate residence is treated with derision. In my view, it is worth revisiting the “real centre of management” test proposed in the London draft, or something similar, in order to legislatively restore the focus on the place where decisions are actually made.

197 Ibid., at paragraphs 68-70 (CA).
198 Ibid., at paragraphs 61-63 (CA).
199 *Fundy Settlement*, supra note 146.
200 Ibid., at paragraphs 152-54, 181-86, and 264-66 (TCC).
201 Ibid., at paragraphs 252 and 267 (TCC).
This is not the only option. A more desperate option is exemplified in the new UK-Netherlands tax treaty,203 where the governments have broken away from using POEM as the preference criterion (it had been the criterion for 30 years). Dual residence of legal entities is now resolved by mutual agreement of the competent authorities; in the absence of agreement, the entity is not considered resident in either state for the purpose of claiming most treaty benefits.204 The 2008 explanatory memorandum to the treaty indicates that the factors to be considered by the competent authorities are (1) where senior management is carried on, (2) where board meetings are held, (3) where the headquarters are located, (4) the “extent and nature of the economic nexus” with each state, and (5) whether awarding residence to one state carries “the risk of an improper use” of the treaty or an “inappropriate application of the domestic law” of either state.205 This list of factors is consistent with the case-by-case approach to residence resolution suggested in the OECD commentary.206 Reliance on the mutual agreement of the competent authorities, with or without stating any objective preference criteria, has been the practice in various Canadian treaties as well.207

Obviously, this sort of tie-breaker is least favourable to taxpayers because it is discharged only by the exercise of mutual administrative discretion. I suspect that the amendment to the UK-Netherlands treaty was prompted in part by the decision in Wood v. Holden.208 The stated intention of considering the economic nexus to each state when determining residence is welcome. The stated concern about improper use of the treaty or domestic law is, in my view, less welcome. What this statement really means is that the respective governments (or at least the UK government) are not happy with the artificiality of current corporate residence formulations, the reliance on which is essential to various planning structures that the governments consider improper. This suggests that the governments should endeavour to change these formulations by legislation.

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204 Ibid., article 4(4). There are special rules for public companies participating in a “dual listed company arrangement.”


206 OECD model, supra note 37, at paragraph 24.1 of the commentary on article 4.

207 See the text accompanying notes 158-60.

208 Note that the United Kingdom agreed to use POEM as the tie-breaker in the treaties recently concluded with France (2008), Germany (2010), Hong Kong (2010), and Spain (2013). Presumably the UK government is not as concerned about tax-avoidance arrangements exploiting residence in these states.
CONCLUSION

In my view, the justifications for residence-based corporate taxation have force only where corporate residence is understood as a special form of source—a sort of residual home source wherein the home state is given jurisdiction over income streams that are not easily sourced to another jurisdiction. Whether one agrees with this limited form of residence taxation, or instead believes that a corporation’s residence in a particular state should grant that state the unbridled right to tax the corporation’s global income (including foreign branch profits and foreign affiliate dividends), it is desirable to have a concept of corporate residence that is meaningful rather than meaningless. Formulating a meaningful concept of corporate residence demands some articulation of what is real, whether or not it is popular to speak of reality in the context of international tax planning. The reality seems to be the intellectual efforts of people in a particular place—that is, participation in the economic life of a nation. One could consider the efforts of personnel at any level of a corporation, but, given the traditional focus on a corporation’s strategic decision makers, we may wish to keep the focus there. The unreality is a box drawn on a piece of paper, perhaps connected to other boxes, with the name “Barbco” or “Luxco” written inside it, as though the act of drawing the box creates national attachment. It is unfortunate that the current meaning of corporate residence in the United Kingdom, Canada, and other Commonwealth jurisdictions, being based on the formality of incorporation or ceremonial acts of central management and control, appears to require little beyond this drafting exercise.

The incorporation test of residence is a de jure standard that bears little or no relation to economic activity. In my view, there was no convincing normative basis for its introduction in the United Kingdom or Canada: achieving consistency with US norms and opportunistically taxing foreign-managed entities were not good reasons. Having chosen to use such a test, how can the UK or Canadian governments be heard to complain that other states, including zero-tax states, employ the same residence test, or that MNEs rely on that test in their international structuring? Although it is unlikely to occur, there is much to be said for repealing the statutory incorporation test in the United Kingdom and Canada. The central management and control standard as currently understood is little better because it constitutes a “highest functions” paradigm that is easily manipulated, notwithstanding that this standard could have been interpreted as “real” and “actual” management emanating from a state. Although the treaty concept of POEM similarly could be interpreted as “real” and “positive” management, to date this interpretation has been neglected by courts, at least with respect to corporations.

This results in an international tax system where corporate residence is a critical determinant of home state tax obligations and treaty entitlements, while at the same time being a legal artifice that may not reflect economic reality. The flexibility of the corporate residence concept is thus central to much, if not most, international tax planning. Governments and revenue administrations respond by challenging alleged international tax law abuses that are made possible by their own corporate
residence definitions. This is a regrettable incongruity that could be addressed through legislative change, both in domestic law and tax treaties. As long as corporate residence remains a key feature in international tax rules, it is desirable to adopt a test or series of tests that focuses on where the practical, daily management or principal business operations exist (as suggested by the Inland Revenue over 30 years ago) or on where the “real centre of management” is situated (as suggested by the League of Nations Fiscal Committee over 60 years ago). Given the traditional focus in the case law on a corporation’s strategic decision makers—namely, the “head and brain” versus the “hands and feet”—perhaps the most feasible and incremental change would be to introduce, both in domestic law and tax treaties, a renewed “place of effective management” test that restores the focus on the location of autonomous decision making. It is useful to recall the comment from Cesena Sulphur/Calcutta Jute Mills that the residence of a corporation should be found in “the place not where the form or shadow of business, but where the real trade and business, is carried on.”

209 Cesena Sulphur/Calcutta Jute Mills, supra note 46, at 452.