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Residence-Based Formulary Apportionment: (In-)feasibility and Implications

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I. Introduction

The debate in 2017 about the adoption of destination-based cash flow taxation (DBCFT), centered in the United States but drawing commentators from across the globe, has been eye-opening in many ways. Both economists and legal scholars have had to apply their analytical tools to evaluate a largely unprecedented tax policy instrument.[1] Seemingly very specialized scholarship (of both the empirical and theoretical varieties) on the intricate connections among international trade, exchange rate and monetary policy, and tax policy quickly entered the policy spotlight.[2] The analysis of consumption taxation of financial services gained fresh impetus.[3] Older discussions about the advantages of the value added tax (VAT) were revived,[4] and led (hopefully) to improved public understanding. But perhaps most strikingly of all, the majority of U.S. commentators hardly blinked at

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[1] See, e.g., Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, House GOP Business Tax Reform: From Theory to Reality (June 18, 2017) [on file with the Tax Law Review]; Wolfgang Schön, Destination-Based Income Taxation and WTO Law: A Note, in Practical Problems in European and International Tax Law (Heike Jochum, Peter Essers, Michael Lang, Nobert Winkeljohann & Bertil Wiman eds., 2016), https://online.ibfd.org/kbase/#topic=doc&url=/Collections/ppei/html/ppei_c25.html&hash=PPei_c25&WT.z_nav=outline. Special issue, 8 Colum. J. Tax L. 113 (2017).

[2] See, e.g., Ruud de Mooij & Michael Keen, "Fiscal Devaluation" and Fiscal Consolidation: The VAT in Troubled Times, in Fiscal Policy After the Crisis 443 (Alberto Alesina & Francesco Giavazzi eds., 2013); Arnaud Costinot & Iván Werning, The Lerner Symmetry Theorem: Generalizations and Qualifications (Nat'l Bureau Econ. Research, Working Paper No. 23427, 2017), http://www.nber.org/papers/w23427; Gita Gopinath, A Macroeconomic Perspective on Border Taxes, Brookings Papers on Economic Activity 433 (2017).

[3] Alan J. Auerbach, Michael P. Devereux, Michael Keen & John Vella, Destination-Based Cash Flow Taxation (Oxford Univ. Ctr. for Bus. Tax'n, Working Paper 17/01, 2017), https://eml.berkeley.edu/~auerbach/CBTWP1701.pdf.

[4] See, e.g., Martin A. Sullivan, All Roads Lead to VAT, Commentary on The Saga of Unfilled Business Tax Reform by Harry L. Gutman, 89 Temp. L. Rev. 341 (2017).

the suggestion of completely abandoning source-based taxation of foreign investments in the United States.[5]

The abolition of the source-based corporate income tax is, of course, the very reason why the DBCFT can claim the various neutrality properties that its proponents emphasize. Multinational corporations (MNCs), on the adoption of the DBCFT, would cease to engage in tax planning of the types that have become notorious, precisely because the tax they have been busy planning around would no longer exist. Instead of seeing this as knocking down a fundamental pillar of international taxation, however, U.S. commentators have portrayed it as merely the price to pay for putting an end to past forms of corporate tax avoidance.[6] Judging from the DBCFT debate, the decade-long assault by leading U.S. tax academics on not only the normative appeal, but even the very intelligibility, of source-based taxation seems to have triumphed, at least in changing the discourse on international taxation.[7]

Two further aspects of the DBCFT debate were equally remarkable, but more bewildering. The first is how U.S. scholars and policymakers (not to mention multinational corporations, tax and legal

[5] Commentators on the GOP Blueprint, Tax Reform Task Force, A Better Way—Our Vision for a Confident America (2016), https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf, held different views about whether, after the adoption of the DBCFT, U.S. withholding taxes would continue to apply to payments of dividends, interests, and royalties. See Shay et al., note 1, at 69, 79–81. There are strong reasons to believe that the answer ought to be "no": All such source-based taxation would generate distortions in multinational corporations' investment decisions, which the DBCFT aims to avoid; moreover, outbound interest and royalty payments would no longer be deductible to U.S. payors under the DBCFT.

[6] An analogy might be drawn here. Lobbyists for some U.S. industries (and much of the U.S. media) portrayed the denial of interest expense deductions under the DBCFT as a self-standing feature of the GOP Blueprint, failing to recognize that it is instead part of the very concept of (*R*-based) cash flow taxation. See Naomi Jagoda, Tax Reform Challenges Go Beyond Border Fight, The Hill, Mar. 15, 2017, http://thehill.com/business-a-lobbying/business-a-lobbying/324005-tax-reform-challenges-go-beyond-border-fight (noting portrayal by lobbyists); What If Interest Expenses Were No Longer Deductible, Buttonwood, The Economist, Feb. 2, 2017, https://www.economist.com/finance-and-economics/2017/02/02/what-if-interest-expenses-were-no-longer-tax-deductible (media portrayal). The DBCFT's proponents would justifiably dismiss this as a crude misunderstanding. But they engage in an opposite kind of mis-ascription. Instead of fully addressing the administrative issues that the DBCFT must resolve, they advertise it mainly for solving the administrative problems for the source-based corporate income tax. See Alan J. Auerbach, Michael P. Devereux & Helen Simpson, Taxing Corporate Income, in Dimensions of Tax Design: The Mirrlees Review 837, 870-71 (Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles & James Poterba eds., 2010), https://www.ifs.org.uk/publications/7184. They fail to mention that such problems have always been "solvable" as long as one is willing to eliminate source-based taxation; the other parts of the DBCFT design have nothing to do with this "solution."

[7] For reviews of this assault, see Mitchell A. Kane, A Defense of Source Rules in International Taxation, 32 Yale J. on Reg. 311 (2015), and Wei Cui, Minimalism About Source and Residence, 38 Mich. J. Int'l L. 245 (2017).

practitioners, and financial analysts) all focused on the very short-term. How soon and how large will be the U.S. dollar exchange rate adjustment to the implicit import tariff and export subsidy effects of the DBCFT?[8] Will the DBCFT even raise revenue for the United States, either in the short term or in the long term?[9] Such questions dominated the debate, while certain basic premises of the DBCFT proposal were almost invariably accepted: The existing U.S. corporate income tax system was bankrupt and untenable. "Superficial" fixes such as lowering corporate tax rates and adopting territorial taxation were inadequate. The DBCFT would present a better, more permanent (therefore necessary), and indeed brilliant solution to the problems of international taxation, but for some unpalatable (or at least unpredictable) effects on trade, exchange rates, the global distribution of wealth, and the like, and extraneous legal concerns such as compatibility with World Trade Organization (WTO) rules. In other words, the DBCFT debate was mainly concerned with the immediate market and revenue consequences of the DBCFT, not about what it was all for. The question of "why?" was instead taken as settled. The debate proceeded as though the American public wanted an end to corporate tax avoidance—and economists wanted an end to distortions in multinationals' investment decisions—period.

Second and relatedly, the main arguments made for the DBCFT by its chief advocates were premised not on some new findings in economic theory but on intuitive assessments of the severity of certain well-known institutional problems. Transfer mispricing (not even primarily in trade in goods, but through intercompany transfers of intangibles), corporate inversions, and tax competition were presented as problems that have brought corporate income taxation to the brink of collapse.[10] The implementation of the DBCFT, however, would also face administrative problems, including tax avoidance and evasion in cross-border business-to-consumer transactions that are familiar in the VAT context, and problems in granting tax benefits for "losses" sustained by exporters. Is it inconceivable that these problems can be of the same (or even greater) order of magnitude as the problems of international tax avoidance under source-based cor-

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8 See, e.g., Caroline Freund & Joseph E. Gagnon, Effects of Consumption Taxes on Real Exchange Rates and Trade Balances (Peterson Inst. for Int'l Econ., Working Paper No. 17-5, 2017), https://piie.com/system/files/documents/wp17-5.pdf.

9 See Olivier Blanchard & Jason Furman, Who Pays for Border Adjustment? Sooner or Later, Americans Do, Peterson Inst. for Int'l Econ., Trade & Investment Pol'y Watch (Mar. 8, 2017, 5:15 PM), https://piie.com/blogs/trade-investment-policy-watch/who-pays-border-adjustment-sooner-or-later-americans-do; David Kamin & Brad Setser, House Plan's Bad Math: Revenue from a Border Adjustment, 155 Tax Notes 105 (Apr. 18, 2017).

10 See, e.g., Michael P. Devereux & John Vella, Are We Heading Towards a Corporate Tax System Fit for the 21st Century, 35 Fisc. Stud. 449, at 453-61 (2014).

porate income taxation? After all, transfer mispricing, inversion, tax evasion in cross-border business-to-consumer transactions, and rent-seeking through loss trading are all problems in tax administration. One's mere conviction that some of these problems are truly severe surely cannot substitute for an objective comparison of the magnitudes of the administrative challenges. Yet, to my knowledge, no relevant theory has been presented, and even basic arguments are often lacking.

In this Article, I hope to shed light on the DBCFT debate by examining forms of corporate income taxation that allocate taxing rights exclusively based on the residence of shareholders. In particular, I consider a type of tax design that previously has not been studied: "residence-based formulary apportionment" or RBFA. RBFA is a form of exclusively-individual-residence-based taxation of corporate income; it is thus quite consistent with the intellectual zeitgeist referred to above, that is of bracketing source-countries' claims to taxing corporate income. Superficially, RBFA also seems capable of fulfilling the neutrality objectives that motivate the DBCFT. Moreover, if RBFA were feasible, it would have an advantage over a DBCFT in that it preserves the possibility of taxing corporate income and not just corporate rent. This would allow it to serve the key traditional function of the corporate income tax, that is preventing individual shareholders from using corporations to defer their income tax liabilities. Therefore, the feasibility of RBFA clearly deserves some examination.

My tentative conclusion, unfortunately, is that the RBFA is not feasible. This infeasibility, however, is not primarily attributable to problems of jurisdiction and enforcement. I believe the international legal environment has substantially changed in favor of residence-based taxation in the last few years, thanks to the implementation of the U.S. Foreign Account Tax Compliance Act (FATCA)[11] and its associated Inter-governmental Agreements (IGAs),[12] the Common Reporting Standards (CRS)[13] promoted by the Organisation for Economic Cooperation and Development (OECD), as well as elements of the OECD's Base Erosion and Profit Shifting (BEPS) project,[14] for example country-by-country reporting. Nor does the

[11] See Foreign Account Tax Compliance Act, IRS, https://www.irs.gov/businesses/corporations/foreign-account-tax-compliance-act-fatca (last visited July 1, 2018).

[12] See Foreign Account Tax Compliance Act (FATCA), U.S. Dep't of the Treasury, https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx (last visited Apr. 9, 2018).

[13] See What Is the CRS?, OECD, http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/ (last visited July 1, 2018).

[14] See OECD, Base Erosion and Profit Shifting, http://www.oecd.org/tax/beps/ (last visited July 1, 2018).

infeasibility of RBFA lie in the traditional sources of administrative complexity, for example those associated with integrating entity and shareholder levels of taxation. Instead, the reason for RBFA's infeasibility seems fairly unique, although simple.

The infeasibility of RBFA, I believe, has two implications. First, it sends those interested in residence-based corporate taxation back to options for imposing the tax at the shareholder level. Second, it casts doubt on whether the idea of taxing corporate income (or profits) by reference to an immobile factor is at all a useful heuristic for understanding the challenges of international corporate taxation. This idea has invariably featured in explanations of the DBCFT's appeal;[15] demonstrating its nonreliability seems worthwhile.

The Article proceeds as follows. Part II describes the basic idea of RBFA, offers a taxonomy of various proposals for making the corporate income tax more residence-based, and situates RBFA within this taxonomy. It also discusses a close relative of RBFA, the proposal by Alberto Giovannini and James Hines for taxing corporate income.[16] Next, Part III argues that in light of recent changes in certain basic norms of international taxation, tax designs that, like RBFA, involve exercising taxing jurisdiction over foreign corporations should receive greater consideration. Part III also considers some implementation issues that initially may seem to detract from the plausibility of RBFA, but that arguably are resolvable. Part IV then presents the key feasibility challenge facing RBFA, namely, the seeming impossibility for it to avoid certain inter-shareholder externalities that would undermine financial markets. Finally, Part V discusses the implications of Part IV's finding for residence-based taxation and for the DBCFT. It argues that in light of RBFA's infeasibility, the idea of taxing corporate income by reference to a fixed factor has yet to lead to any useful finding. A brief conclusion follows.

II. RBFA and Its Relation to Other Tax Reform Proposals

A. *Taxing Corporate Profits by Reference to Immobile Factors*

Many recent proposals for U.S. corporate tax reform, and not only the GOP Blueprint for adopting the DBCFT, rely on critiques of source-based taxation as motivating arguments.[17] These critiques

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[15] Devereux & Vella, note 10, at 471; Auerbach et al., note 3, at 4, 15, 23, 36, 78-79. R

[16] Alberto Giovannini & James R. Hines, Jr., Capital Flight and Tax Competition: Are There Viable Solutions to Both Problems?, in European Financial Integration 172 (Alberto Giovannini & Colin Mayer eds., 1991).

[17] See, e.g., Eric Toder & Alan D. Viard, Replacing Corporate Tax Revenues with a Mark-to-Market Tax on Shareholder Income, 69 Nat'l Tax J. 701 (2016).

have long been familiar. A quarter of a century ago, Robert Green explained the rationale for switching to residence-based corporate income taxation in terms almost identical to those used today:

> Source-based income taxation is difficult to justify on theoretical grounds. In particular, source-based taxation is difficult to reconcile with the prevailing theory of the income tax as a means of allocating the cost of government among individuals on the basis of ability to pay. Moreover, it is the attempt by governments to tax income on the basis of source that gives rise to income shifting and to tax competition among governments. The ultimate solution to these problems would be to move to an international tax system that uses the residence of individuals as the exclusive basis for income tax jurisdiction.[18]

Another refrain of the international tax reform discourse is that using corporate residence as the basis for taxing corporate income is both normatively hard to justify and inherently open to abuse.[19] The U.S. decades-long battle against corporate inversions is routinely cited to support this point.[20] Before the introduction of the "destination" option, therefore, the main conceptual solution to the problems of source-based corporate taxation was taken to be anchoring corporate taxation more firmly to individual shareholders' residence. This could mean continuing with traditional corporate taxation, but tying the definition of corporate residence more closely to individual shareholder residence;[21] or it could mean taxing corporate income in some way at

[18] Robert A. Green, Future of Source-Based Taxation of the Income of Multinational Enterprises, 79 Cornell L. Rev. 18, 70 (1993). As DBCFT proponents point out, these arguments are also valid against source-based cash flow taxation, or other forms of source-based tax on corporate rent. See, e.g., Alan J. Auerbach & Michael P. Devereux, Cash-Flow Taxes in an International Setting, 10(3) Am. & Econ. J.: Econ. Pol'y 69 (2018).

[19] Green writes:

> It would be possible to devise a residence-based system at the corporate level by obtaining international agreement on the definition of corporate residence and giving the residence country exclusive jurisdiction to impose the corporate income tax. It would be difficult to justify such an allocation of jurisdiction on theoretical grounds, however, except insofar as the residence of a corporation was a good proxy for the residence of its individual shareholders. Moreover, if corporations had flexibility to choose their country of residence, as would likely be the case, the result would be tax competition among countries to induce corporations to become residents. The end result might be the effective elimination of corporate income taxation, at least for multinational enterprises.

Green, note 18, at 70 n.271. For a similar critique, see Auerbach et al., note 6, at 881-82. R

[20] See, e.g., Auerbach et al., note 6, at 882. R

[21] See generally J. Clifton Fleming Jr., Robert J. Peroni & Stephen E. Shay, Defending Worldwide Taxation with a Shareholder-Based Definition of Corporate Residence, 2016 BYU L. Rev. 1681 (2017).

the individual shareholder level.[22] This latter approach, in turn, has been taken to imply pass-through taxation for all corporations, domestic or foreign. In such a case, "corporate taxation" would become the label for an administrative mechanism for imposing tax on ultimate shareholders, much as "partnership taxation" is a label for taxing partners and not partnerships. Or it could be implemented in combination with a mark-to-market approach for publicly-traded companies.[23] If any combination of these methods was feasible and effective, both international profit-shifting and international tax competition would be eliminated.

Advocates of the DBCFT introduced a somewhat different, and seemingly more general, formulation of the problem of taxing international corporate income. The question, it is suggested, is how corporate profits can be taxed by reference to some immobile factor.[24] Corporate residence is highly mobile because it is inherently artificial. Sites of production are less artificial but also often mobile: Multinationals in possession of firm-specific technology or other mobile assets can earn rent by locating production in any number of places. If corporate profits are taxed by reference to the location of production, firm choices inevitably will be distorted. The fundamental challenge in corporate international taxation, it was thought, should be conceived as identifying immobile factors for anchoring the corporate tax.

This formulation implies the notion of allocating the taxing rights over a given base of corporate income to different countries. That notion has a surprising connection—but natural once reflected upon—to the idea of formulary apportionment. Traditionally, formulary apportionment has been thought of either as a technique of transfer pricing among related parties that supplements the arm's length principle,[25] or as a way of allocating the entire corporate tax base of a corporate group and avoiding transfer pricing among related parties all together. Either way, the use of a formula may be viewed as resorting to less manipulable factors than some alternative. For exam-

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22 Auerbach et al., note 19, at 880-81; Green, note 18, at 70-71. **R**

23 See, e.g., Eric Toder & Alan D. Viard, Urban-Brookings Tax Pol'y Ctr., Major Surgery Needed: A Call for Structural Reform of the U.S. Corporate Income Tax 29-31 (2014), http://www.taxpolicycenter.org/publications/major-surgery-needed-call-structural-reform-us-corporate-income-tax.

24 Auerbach & Devereux, note 18, at 1; Auerbach et al., note 3, at 4, 15, 23, 79; Michael P. Devereux & John Vella, Implications of Digitalization for International Corporate Tax Reform 10 (Oxford Univ. Ctr. for Bus. Tax'n, Working Paper No. 17/07, 2017), https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Working_Papers/Series_17/WP1707.pdf. **R**

25 Reuven S. Avi-Yonah & Ilan Benshalom, Formulary Apportionment—Myths and Prospects: Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative, 3 World Tax J. 371 (2011) (giving an overview of the concept of formulary apportionment as a technique of transfer pricing).

ple, taxpayers' sales, assets, payroll, or other expenses may all be less manipulable than contractual allocations of profit or the residence of related corporations. The natural affinity between the idea of allocating taxing rights over a given tax base and formulary apportionment has recently led to the latter being used to describe the allocation of the corporate tax base generally, and not just among related parties. For example, apportionment of corporate profits might be made by reference only to sales to final consumers.[26] If the location of final consumers is highly immobile, then such apportionment may be the solution to the fundamental problem of international taxation (as described by DBCFT advocates).

Against this conceptual background, residence-based formulary apportionment (RBFA) can be seen as combining formulary apportionment, the new formulation of the problem of international taxation preferred by DBCFT advocates, and the traditional case for residence-based taxation. The immobility of individual consumers is just the immobility of their residence. The residence of individual investors is similarly immobile. Under RBFA, the income (or any other corporate tax base) of a corporation would be allocated to the countries of the ultimate individual shareholders of the corporation, in proportion to the equity ownership of individual shareholders from each country. The countries of ultimate shareholder residence thus would tax both domestic and foreign corporations, at the residence countries' tax rates, based on how much corporate income of each corporation was ultimately owned by their own residents. A country would adopt RBFA if it (1) ceased to tax the income of domestic corporations insofar as such income was allocable to nonresident individual owners, and (2) commenced to tax the income of foreign corporations insofar as such income was allocable to resident individual owners.

The design of the corporate income tax using the RBFA approach has not been previously studied.[27] Instead, the meaning of taxing corporate income by reference to individual shareholder residence gener-

[26] For a proposal for a "destination-based" formulary apportionment of an income tax base, see Reuven S. Avi-Yonah, Kimberly A. Clausing & Michael C. Durst, Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split, 9 Fla. Tax. Rev. 347 (2009); for a proposal for a "destination-based" formulary apportionment of a cash flow tax base, see Michael P. Devereux & Rita de la Feria, Designing and Implementing a Destination-Based Corporate Tax (Oxford Univ. Ctr. for Bus. Tax'n, Working Paper No. 14/07, 2014), http://eureka.sbs.ox.ac.uk/5081/1/WP1407.pdf.

[27] Toder & Viard, note 23, at 25 ("A potentially even more attractive method would allocate the corporation's income in proportion to where its stockholders reside. We are not aware of any literature that discusses this approach and we are not sure whether it would be practical . . . . [The] problems may not be insurmountable and we recommend further efforts to examine whether and how such an allocation method could be made operational."). R

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ally has been interpreted in terms of pass-through and/or accrual taxation of individual shareholders. Comparing RBFA with shareholder-level taxation is a theme that runs through this and the next two Parts.

Another important comparison is between RBFA and formulary apportionment based on final sales.[28] Since both are in theory equally good solutions to the challenge of international corporate taxation (as formulated by DBCFT proponents), the remaining question is whether either option is feasible, and if both are, which is more feasible. I have previously argued that at least along one dimension, RBFA ought to be more feasible than final-sales-factor formulary apportionment.[29] This is because the identities of transacting parties are not generally transmitted in the sales of goods and services—parties transacting in goods and services often can remain anonymous with each other—but the identities of parties to financial claims generally are transmitted.[30] Therefore, it ought to be easier to determine the locations of ultimate shareholders (since they are linked to the corporation through a chain of nonanonymous financial claims) than the locations of ultimate consumers. However, it does not follow from this that RBFA is more feasible than final-sales-factor formulary apportionment overall, or that either crosses a relevant threshold level of feasibility. Parts V pursues these questions further.

B. Exclusively-Individual-Shareholder-Residence-Based Corporate Taxation: A Taxonomy

Strictly speaking, no previous proposal (that I am aware of) has contemplated making the income tax liability of a multinational company (or corporate group) depend exclusively on shareholder residence. Previous discussions have only approximated this idea, generally by making individual shareholders the taxpayers.[31] Among arrangements for taxing corporate income in the hands of shareholders, some also bear greater affinity to RBFA than others.[32] In the following, I provide a taxonomy.

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[28] See Devereux & Vella, note 24, at 11-20 (comparing shareholder-level flow-through or accrual taxation with final-sales-based formulary apportionment). R

[29] Wei Cui, Destination-Based Cash-Flow Taxation: A Critical Appraisal, 67 U. Toronto L.J. 301, 346-47 (2017).

[30] See Devereux & Vella, note 24, at 11-20 (comparing shareholder-level flow-through or accrual taxation with final-sales-based formulary apportionment). R

[31] See, e.g., Harry Grubert & Rosanne Altshuler, Shifting the Burden of Taxation from the Corporate to the Personal Level and Getting the Corporate Tax Rate Down to 15 Percent, 69 Nat'l Tax J. 643 (2016).

[32] The closest previous scholars have come to the idea of RBFA is Giovannini & Hines, note 16, at 172, and discussed further at Subsection II.B.2. R

1. Shareholder Attribution: Distinguishing Pass-Through and Integration

The idea of treating income earned by a corporation as income directly and currently earned by its (ultimate) shareholders, and subjecting such income to tax in the hands of such shareholders may not sound like a form of corporate taxation. Indeed, it easily generates confusion. It is thus important to have a clear and coherent statement of the idea.

Consider a tax (1) on the income of a corporation determined at the level of the corporation, (2) taxable to the (ultimate) individual shareholders of the corporation, but (3) which is distinct from the other income tax liabilities of the individuals. I label any tax that satisfies these criteria as adopting a shareholder-attribution approach to corporate taxation. The basic claim is that the shareholder-attribution approach is a form of corporate taxation, distinguished from the standard corporate income tax mainly in that it makes shareholders and not the corporation liable.

Most past discussions of reforming the corporate income tax by introducing shareholder-level taxation do not follow the shareholder attribution approach. For example, many authors refer to the U.S. regimes for taxing the owners of S corporations and partnerships as the relevant model for the shareholder-level tax on corporate income.[33] Such an approach may invite the question of why it is not more naturally described as the abolition of the corporate income tax and the enactment of a substitute for it in the individual income tax. In response, some authors mention the possibility that corporate income, once attributed to individual shareholders, may be subject to two nominally distinct taxes, one being the corporate and the other being the personal income tax.[34]

I believe these previous (quick) discussions of shareholder-level corporate taxation obscure two issues. First, attributing income from corporation to shareholders does not require "pass-through" treatment. Under the U.S. controlled foreign corporation (CFC) and other

[33] See, e.g., Green, note 18, at 70-71 ("This system could be implemented by having each corporation calculate its taxable income based on its separate accounts, as is done under current law. The corporation would then allocate this income among its shareholders, both individual and corporate. This process would continue through any chains of corporate ownership until all corporate income was allocated to individual shareholders"); Toder & Viard, note 17, at 702; Devereux & Vella, note 24, at 11-12. **R** **R**

[34] Green, note 18, at 71 ("any country that wished to retain a system under which corporate income was taxed twice could do so by imposing a separate 'corporate income' tax on its resident individual shareholders with respect to the corporate income allocated to them"); Giovannini & Hines, note 16, at 195 ("Corporate income would be attributed to individual shareholders without deferral, and therefore subject (potentially) to taxation at the individual level and the corporate level.") **R** **R**

anti-deferral regimes, for example, the character, geographical source, and other features of income generally do not flow through to shareholders, nor do losses.[35] None of these regimes pursues the goal of taxing corporate income as though it was received directly by the shareholder. That is the goal defining pass-through taxation.

TABLE 1
TAXONOMY OF CORPORATE- V. SHAREHOLDER-LEVEL TAXATION OF CORPORATE INCOME

	Shareholder mark-to-market	*Pass-through (e.g. partnerships)*	*Anti-deferral regimes (e.g. Subpart F)*	*Integration*	*Shareholder attribution*	*Giovannini-Hines*	*RBFA / traditional corporate taxation*
Tax is on corporate income determined at the corporate level	✘	✓	✓	✓	✓	✓	✓
Taxable to the (ultimate) individual shareholders	n/a	✓	✓	✘	✓	✓ (for refund)	✘
Tax attributes preserved when allocated to shareholders	n/a	✓	✘	✘	✘	✘	n/a
Distinct from other income tax liabilities of individuals	✘	✘	✘	✘ (reduces shareholder liability)	✓	✓	n/a

For international corporate taxation, the relevant goals instead may be taken to include the prevention of deferral, and neutrality with respect to multinationals' investment decisions. Preserving the character of income, passing through losses, and generally achieving neutrality between the use and nonuse of an entity for business activities, are arguably nonessential goals. Therefore, in describing the shareholder-level corporate tax, anti-deferral regimes offer a more appropriate analogy than the taxation of flow-through entities. If this is

[35] See Green, note 18, at 77. Indeed, Green extensively cites the "shareholder allocation prototype" in the 1992 U.S. Treasury study of integrating the individual and corporate tax systems as a model for shareholder-residence-based international taxation. See Treasury Integration Study: Treasury Dep't, Report on Integration of the Individual and Corporate Tax Systems: Taxing Business Income Once 27-38 (1992), https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Integration-1992.pdf. As the study itself emphasizes, the shareholder allocation prototype is not a pass-through regime but simply allows credit for corporate income tax paid to be given to individual shareholders. Id. at 27. R

correct, the shareholder-level corporate tax basically envisions a vast expansion of anti-deferral rules to all corporations and individuals, and the elimination of source-based taxation.

But even this analogy may not be correct. The second issue that past discussions have tended to obscure is component (3) of the shareholder-attribution approach above, that is whether the liability of the shareholder is distinct from her individual income tax liability. Under pass-through taxation, because income is already currently attributed to individual owners, it is believed that there is no longer any need for entity-level taxation (understood as an anti-deferral device).[36] Therefore, the owner's liability for the income earned through pass-through entities is the same type of individual income liability that other types of income generate. Interestingly, the taxation of subpart F income attributed to U.S. individuals also involves only a single layer, not two layers, of tax. If two layers of U.S. tax were desired on subpart F income, both deemed and actual distributions from CFCs should be taxable, but, under subpart F rules, previously taxed earnings can be distributed free of tax.[37] Thus the anti-deferral regime is similar to the pass-through regimes in adopting the aim of ensuring that the same economic income is not taxed at both the entity and the shareholder level. This goal, of course, is also shared by corporate consolidation regimes and corporate integration proposals (neither of which involves pass-through).[38]

The shareholder-attribution approach does not adopt this goal. In order to find a shareholder-level tax that substitutes for a corporate-level tax, it is enough to attribute corporate income to individual shareholders and subject it to tax. This idea is in itself consistent with a rule where an eventual dividend distribution of the corporate income to the shareholder is again taxed under the personal income tax.[39]

This second issue is especially important to point out because it may have led to an exaggerated sense of the complexity inherent in a

[36] John W. Lee, A Populist Political Perspective of the Business Tax Entities Universe: "Hey the Stars Might Lie But the Numbers Never Do," 78 Tex. L. Rev. 885, 892-96 (2000).

[37] IRC § 959. This also applies to the subpart F income includible in income by a U.S. corporation. Id. In that case, the subpart F income is subject to tax by both the domestic corporation and the U.S. individual. IRC §§ 1, 11.

[38] Martin J. McMahon, Jr., Understanding Consolidated Returns, 12 Fla. Tax Rev. 125, 128-33 (2012).

[39] In other words, to maintain two layers of tax on corporate income, one does not need to impose two taxes (one personal and one corporate) on the same item of income that is attributed (but not distributed) to the individual shareholder, as suggested by the comments of Green and of Giovannini and Hines. See note 34. Instead, it is enough to tax the R
income attributed (under the corporate tax), and tax it again (under the personal tax) when distributed.

shareholder-attribution approach to corporate taxation. Green, for example, suggested that after requiring shareholders to

> include their allocable share of corporate income on their personal income tax returns and pay tax on their total income to their country of residence . . . [t]o avoid double taxation by the residence country, the shareholders would increase their stock basis by the amount of corporate income allocated to them. Shareholders would then treat actual corporate distributions as a return of capital to the extent of their stock basis, and would treat any excess as capital gain.[40]

According to Green, the shareholder-level tax "would entail . . . all of the administrative difficulties inherent in a system of pass through integration."[41] But that need not be the case. If shareholder attribution is simply a substitute for the corporate-level tax, there is no reason to adjust share basis for income attributed to the shareholder, any more than there is reason to adjust share basis after a corporation has paid income tax. All that a shareholder-attribution approach has to do by way of avoiding multiple layers of taxation is to provide some form of intercorporate dividend exemption.[42]

To summarize, while a tax on corporate income to be imposed at the shareholder level can mean different things, under a minimalist approach, all that is required is that (1) corporate income be attributed to shareholders even in the absence of distribution, and (2) the individual shareholders bear tax liability on such income attributed that is distinct from the tax liability that they bear on other types of income actually received. There need not be any commitment to preserving the character of income when income is attributed from the corporation to the shareholder (that is, pass-through), nor to any special treatment of the future receipt of income that corresponds to income already attributed (that is, avoiding double taxation). In other words, shareholder attribution, as a way of replicating the corporate tax, rejects the aspirations of pass-through and integration, and embraces distortions in entity choice.

Defining the shareholder-attribution approach to corporate taxation in the way I have is useful for three reasons.[43] First, it presents

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[40] Green, note 18, at 70. R

[41] Id. at 72-73.

[42] Capital gains can be treated as a form of taxable income, even if they are realized from the disposition of shares from which underlying corporate income has been attributed to shareholders.

[43] The shareholder attribution approach is also distinct from mark-to-market or other forms of accrual accounting at the shareholder level (discussed by Toder & Viard, note 17, R

the simplest conception of a shareholder-level substitute for corporate taxation that is not an instance of simply eliminating corporate taxation. It also immediately dispenses with the complexities of pass-through and integration. Second, it serves as a useful point of reference for RBFA. RBFA would not attribute income to shareholders, and would impose a corporate-level rather than a shareholder-level tax. And third, DBCFT advocates' formulation of the basic problem of international taxation directly points to shareholder attribution as a solution: If corporate income is taxed only by reference to shareholders, it is clearly taxed by reference to a relatively fixed factor. However, some DBCFT advocates have explicitly rejected the feasibility of the shareholder-attribution approach, and use this as a motivating argument for the DBCFT.[44] My aim is to partly examine whether RBFA fares better than the shareholder-attribution approach on feasibility grounds.

Whether the shareholder-attribution approach describes an appealing form of entity taxation is a completely different question. Here two things may be noted.[45] First, DBCFT advocates tend to take corporate taxation as a given. Neutrality with respect to entity choice, or coordination between entity- and individual-level taxes, are simply not issues they intend to tackle. Second, many corporate tax reform proposals advocate replacing a tax on corporate income with a tax on corporate rent.[46] This means that the justification for entity-level taxation may already rest on something else other than the prevention of deferral.[47] By contrast, existing pass-through, integration, and, of course, anti-deferral regimes, are very much motivated by a conception of the purpose of an entity-level tax as dealing with deferral.

In any case, in discussing RBFA's feasibility below, I am mainly comparing RBFA with the shareholder-attribution approach to corporate taxation, and do not conceive of shareholder-level taxation as embracing pass-through or integration.

at 702, for example, as one way to reform the corporate income tax). The distinction is due to component (1) of the definition: The tax base is determined at the entity level.

44 See Auerbach et al., note 18, at 880-81 (claiming that the shareholder-level tax is infeasible, largely based on the shareholder attribution conception of such a tax). R

45 See Cui, note 29, at 316-19. R

46 In addition to DBCFT proposals, see Edward D. Kleinbard, The Right Tax at the Right Time, 21 Fla. Tax Rev. 208 (2017); Robin Boadway & Jean-François Tremblay, Corporate Tax Reform: Issues and Prospects for Canada (Mowat Centre School of Public Policy and Governance, U. of Toronto Research Paper #88, 2014), https://mowatcentre.ca/corporate-tax-reform;

47 Id.

2. *The Giovannini-Hines Proposal: Income Attribution Plus Revenue Transfer*

In the early 1990's, Giovannini and Hines proposed a model for corporate taxation, to be implemented in the European Community, that would be based exclusively on individual shareholder residence.[48] This model displays an interesting combination of both the shareholder-attribution approach—as defined above—and the approach of RBFA.

In the Giovannini-Hines model, corporations operating in Europe would be taxed on their income in the countries where they conduct business—the countries of "source"—at a uniform 50% rate.[49] The income tax base would be computed through a harmonized method based on Haig-Simons principles. While subject to source taxation, the corporations also would report their income to their ultimate shareholders, such that corporate income would be attributed to individual shareholders (even if absolute precision was not possible when share ownerships change). The residence countries of the shareholders then would require the individual residents to file tax returns to report such attributed corporate income. Residence countries could not set tax rates higher than 50% on such income, but could set lower rates. When a residence country's rate was lower than 50%, the country would refund the excess of the source country tax collected over the shareholder tax liability to the individual shareholders. Consequently, the corporate income attributed to individual shareholders would be taxed only at the resident country rate. The source country would transfer the revenue collected from the corporation to the shareholder residence country through a clearing house system.[50]

The Giovannini-Hines model is closely related to the shareholder-attribution approach to corporate taxation described above. Corporate income would be attributed to ultimate individual shareholders through chains of ownership, and taxable to the shareholders. Moreover, Giovannini and Hines do not introduce any element of pass-through or integration. They suggest that intermediate companies that only hold shares in European companies subject to tax in the way described above would be exempt from tax in the system.[51] This is enough to mitigate multiple layers of corporate taxation, but does not aim to integrate entity and individual-level taxation. What the Giovannini-Hines model adds to the shareholder-attribution approach is the withholding of the residence country tax by the source country

48 Giovannini & Hines, note 16, at 172. R
49 Id. at 194.
50 Id. at 195.
51 Id.

government. This form of withholding brings many of the advantages that are associated with RBFA. For example, it would solve the liquidity problem for shareholders. It also would leverage the compliance tendencies of corporations. It might also mobilize the enforcement capacity of the source country.[52]

While the Giovannini-Hines proposal thus interestingly anticipates both the shareholder-attribution and RBFA approach of taxing corporate income, I mainly consider it as a form of shareholder attribution. The reason is that by combining shareholder attribution and RBFA, the Giovannini-Hines proposal inevitably would require revenue transfers among national governments. I believe that no such system of transfers—even if they have been implemented to some extent in Europe—should be assumed in discussing the design of international taxation in general. I follow Michael Keen and David Wildasin in taking binding national budget constraints as defining the problem of international taxation.[53] Relaxing these constraints risks assuming the problem away.[54] By themselves, neither shareholder attribution nor RBFA requires intergovernmental transfers. Therefore my focus is to compare these nonhybrid approaches.

III. Rationales for RBFA and Favorable Factors for Implementation

RBFA would not involve income attribution to shareholders, and would impose a tax on corporations rather than shareholders. The comparison of RBFA with the shareholder-attribution approach should start with some very general considerations about the choice between entity- and individual-level taxation.

A. Taxing Corporations v. Taxing Shareholders

A basic justification for the corporate income tax is that it prevents individuals from deferring tax liability by earning income through distinct legal entities. To achieve this objective, any country should tax corporations owned by its individual taxpayers, regardless of whether the corporation is domestic or foreign. If, as a legal matter, a country cannot claim the right to tax the foreign income of a foreign corporation owned by a resident, simply because the corporation is foreign

[52] Although the incentives to enforce might be diluted because any (net) revenue collected from income attributed to foreign owners would not remain in the source country.

[53] Michael Keen & David Wildasin, Pareto-Efficient International Taxation, 94 Am. Econ. Rev. 259, 259 (2004).

[54] To put it differently, if intergovernmental revenue transfers are possible, there may be many optimal solutions to the problems of international taxation.

(for example, formed under foreign law and operated abroad), then a fundamental objective of the corporate income tax would be immediately frustrated. For this reason, countries have often implemented legal systems where foreign income earned through foreign corporations is effectively subject to current taxation. Under CFC regimes, for example, foreign corporate income is taxed to domestic shareholders by deeming distributions to have been made.[55] Such legal devices are applied when the risk of taxpayer abuse is particularly high, for example, in cases of mobile passive income and other "foreign base company income," and/or where the shareholders have control of foreign corporations' distribution policy.[56] In other words, the legal principle about the nontaxability of the foreign income of a foreign corporation can be defeated by other legal devices, as long as there is a sufficient policy justification and enforcement is possible.

Given the objective of preventing deferral, the choice between taxing corporations and taxing shareholders involves balancing various administrative considerations. For example, taxing corporations avoids the problem of shareholder liquidity: Instead of asking shareholders to pay cash tax regardless of whether the corporations actually distributed income, taxing corporations makes the entities that have the cash the taxpayers.[57] On the other hand, enforcement against a domestic individual is in many respects easier and more powerful (for example, through the seizure of other personal assets) than enforcement against a foreign corporation. This may seem to favor imposing the tax at the shareholder level. Nonetheless, if the foreign corporation in question is a large firm that engages extensively in market transactions and that by necessity relies on legal systems to enforce contracts with third parties and the intra-firm division of rent, the corporation's tendency towards voluntary compliance (even though it is foreign) may be higher than the compliance tendency of individuals.[58] Imposing a tax at the corporate level thus would allow tax authorities to tap into fundamental institutional drivers of compliance, as well as to make collection easier.[59]

In fact, from a tax administration perspective, the optimal tax design may involve both forms of taxation. Corporate-level taxation

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55 See, e.g., IRC § 951(a).

56 See, e.g., IRC § 952(a).

57 See Green, note 18, at 72; see also Auerbach & Devereux note 18, at 880. **R**

58 Wei Cui, Taxation Without Information: The Institutional Foundations of Modern Tax Collection, 20 U. Pa. J. Bus. L. 93, 138 (2018).

59 This is recognized, for example, in the 1993 Treasury Integration Study, note 35, at 29 **R** ("[B]ecause tax is more likely to be collected if paid at the corporate level, the shareholder allocation prototype retains the current system requiring payment at the corporate level and then allocates to share-holders the corporation's taxable income and taxes paid.")

may be particularly suitable for large firms that can deliver economy of scale in compliance and collection, whereas shareholder-level taxation, or at least shareholder secondary liability, may be appropriate for smaller firms. What should be recognized from the start, however, is that in designing individual-residence-based taxation of corporation income, there is no predetermined, arbitrary, and absolute legal norm that says that countries cannot tax foreign corporations on foreign income. There are many actual and possible examples of legal rules that counter this understanding of international tax law (or of international law).

Consider, for instance, the following hypothetical. Recall that, under U.S. CFC rules, subpart F income is taxed to U.S. shareholders as deemed distributions.[60] What if the CFC is further required to withhold U.S. tax on such deemed distributions? Such a requirement would effectively impose a tax directly on the CFC on its subpart F income, yet it is not clear to me that any legal norm precludes the possibility of the U.S. enacting such a requirement. The requirement to withhold on nominal income is illustrated by the obligation, under the U.S. original issue discount rules, of U.S. debtors to withhold tax on interest accruing to foreign creditors.[61] The requirement on nonresidents to withhold U.S. tax on payments to nonresidents is illustrated both by secondary withholding on dividends[62] and the FATCA "pass-through withholding" rules.[63]

Extensive taxing jurisdiction over foreign corporations is of course not just a phenomenon of U.S. tax law.[64] Especially in the last few years, national governments have been able to extend such jurisdiction under a number of distinct initiatives that have received wide international support. The country-by-country reporting regime promoted by the OECD BEPS project, for example, allows any participating country to effectively impose disclosure obligations on the entire corporate groups of MNCs, as long as one member of the corporate group operates in that country.[65] Similarly, the U.K. diverted

[60] IRC § 951(a)(1)(A).

[61] IRC § 871(a)(1)(C).

[62] IRC § 861 (a)(2)(B).

[63] IRC § 1471 (b)(1)(D).

[64] Besides the examples discussed in the text, consider the tax many countries impose on the capital gain nonresidents realize on the sale of foreign corporations' shares, where the value of such shares derives (often only indirectly) from some domestic asset such as real estate. See Wei Cui, Taxing Indirect Transfers: Improving an Instrument for Stemming Tax and Legal Base Erosion, 33 Va. Tax Rev. 653, 654-55 (2014).

[65] OECD, Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report 16, 21 (2015), https://read.oecd-ilibrary.org/taxation/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report_9789264241480-en#page4.

profit tax[66] and the Australian multinational anti-avoidance law[67] enable these countries to impose a tax, under certain conditions, on any corporate group that has a subsidiary in them. Controversial just a few years ago, these tax policy measures now are not only widely regarded as conceptually defensible[68] but have also been accepted by other national governments. Like the "extraterritorial jurisdiction" exhibited by the country-by-country regime, imposing taxes or tax-related obligations on entire corporate groups by virtue of just "one point of contact" seems now a firm part of positive international law. Going beyond this, the 113 jurisdictions that entered into IGAs with the U.S. to implement FATCA[69] can be interpreted as accepting the jurisdictional claim that the U.S. has laid on foreign financial institutions, even if the only connection that such an institution has with the United States is acting as a nominee or agent receiving payments from the United States.

It is possible that, in the past, exclusively individual-shareholder-residence-based corporate income taxation was thought as legally feasible only if the tax was imposed at the shareholder level. But this belief no longer tracks the state of international law in the tax sphere. The legal possibility of taxing multinationals themselves is wide open. The real question is what policy substantively is justifiable (and enforceable).

RBFA would achieve the goal of preventing deferral just like CFC regimes. But it also aims to accomplish more, that is to allocate the corporate tax base of MNCs away from source countries, and to end profit-shifting, tax competition, and distortions in MNC investment decisions.[70] Assuming that these are compelling policy goals, countries have even greater reason not to feel constrained by traditional legal norms regarding the possibility of taxing foreign corporations on foreign income than in the design of CFC rules. Moreover, taxing multinationals directly instead of their shareholders may bring very important administrative advantages, and therefore should be expected to play a major role in corporate tax reform.

These are general reasons for considering both RBFA and a shareholder approach in designing a residence-based corporate tax. I now turn to some specific feasibility comparisons between the two. In

[66] Finance Act 2015, c. 11, §§ 77–116 (Eng.).

[67] Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015 (Cth) (Austl.).

[68] As the Paul Oosterhuis and Amanda Parsons argue, the United States may well want to adopt this approach in the future. Paul Oosterhuis & Amanda Parson, Destination-Based Income Taxation: Neither Principled Nor Practical?, 71 Tax L. Rev. 515 (2018).

[69] See U.S. Treasury, note 12. R

[70] See Section II.A.

principle, RBFA requires a taxpayer corporation to apportion its income (or loss), computed in some way, to ultimate individual shareholders grouped by their countries of residence. If *Country A* imposes a RBFA-style tax, the corporation would pay to *Country A* an amount of income tax equal to *Country A*'s RBFA tax rate multiplied by the income apportioned to investors from *County A*. For this to be possible, the corporation needs to (1) know its ultimate ownership pattern during the tax period, (2) know how to compute its tax base, and, of course, (3) be willing to subject itself to *Country A*'s jurisdiction and comply with its laws. Each of these elements may seem far-fetched to many readers. There are, however, also many good reasons for suspending disbelief.

B. Determining Patterns of Ultimate Ownership

Corporate equity ownership is a type of financial claim where the identities of the corporation and the immediate shareholders are almost always known to each other.[71] Therefore, the identity of an ultimate shareholder is known to the corporate entity she immediately owns, which in turn can transmit this information down the chain of ownership. For the purpose of apportionment to investor countries, RBFA would not require the taxpayer corporation to know the identities of ultimate individual shareholders or even how many there are. The corporation only would need to know the aggregate percentage of ownership associated with each relevant country of shareholder residence. The information needed to be obtained from any shareholder that is not an ultimate individual shareholder is thus comparable with what U.S. withholding agents need to obtain from Qualified Intermediaries regarding the ultimate beneficial owners of payments of FDAP income subject to § 1441 withholding: not their identities, but only their residence status and proportions of entitlement to payment, are included.[72]

Indeed, if it were not for the problem of intra-shareholder externalities discussed in Part IV, the relative simplicity of aggregating shareholder residence information is a key advantage of RBFA over the shareholder attribution approach to taxing corporate income. Under the latter approach, income must be apportioned to each ultimate in-

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[71] If the shareholders act through nominees or agents and the corporation has privity only with the latter, then the corporation is connected to the shareholder through two links of nonanonymous relationship, as the nominee/agent must know the identities of the principals.

[72] That is, (1) if it is a U.S. person but no W-9 is provided, backup withholding applies; (2) if it is a non-U.S. person and treaty benefits are claimed, which treaties are invoked; and (3) if it is a non-U.S. person and no treaty benefits are claimed, regular withholding applies.

dividual shareholder and such information must also be transmitted to each individual shareholder in the absence of actual distribution. This is, of course, not unprecedented: It is how anti-deferral regimes work.[73] Nonetheless, the absence of payment to particular individuals would seem to make such a (global) apportionment exercise very difficult to verify, even in a sophisticated financial system. This concern, for example, is particularly acute for the Giovannini-Hines proposal, where residence countries offer refunds for income apportioned but not received:[74] the risk of fraud in such a system seems intolerable. But even under a pure shareholder attribution approach that requires tax payment instead of refunds, a system that relies on the accuracy of accounting exercises that are not accompanied by payments and other transactional information (for example, market prices) seems hard to accept. The incentives for individual fraud may be just too great.

In other words, the key feasibility objection to the shareholder-attribution approach may not have to do with complications in tax accounting. Tax accounting methods to achieve pass-through and integration would indeed impose such complexities, but as already argued, the shareholder-attribution approach need not take on such complexities. Instead, the chief problem may be the need to apportion taxable income through chains of ownership without payment.

By contrast, RBFA would require all intermediate entities between a corporation and its ultimate shareholders to act as information-providing intermediaries. The scope of information transmission would be wider not only than the qualified intermediary regime but even than the FATCA regime (where all financial institutions and a wide range of entities not engaged in active business must participate in compliance). RBFA, however, is a proposal for a fundamental change in corporate taxation: It would completely replace source-based corporate taxation. Many of the intermediary entities may themselves be subject to RBFA (for example, insofar as they receive income other than from other corporations).[75] Moreover, the information transmitted is truly simple: It concerns only percentages of ultimate shareholder ownership aggregated at the country level. Finally, not only does the administrative task seem straightforward, any fraud by the corporate taxpayer may require collusion among multiple sharehold-

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[73] Attribution without distribution may be less common under flow-through regimes, insofar as flow-through entities such as partnerships tend to distribute profits.

[74] See Giovannini & Hines, note 16. **R**

[75] Moreover, the implementation of RBFA, if otherwise feasible, would require fundamental changes to tax treaties and not just add-on arrangements such as FATCA-type IGAs. Thus the widespread transmission of shareholder information is not unimaginable. See Section III.C.

ers: The risk of such collective fraud is arguably lower than the risk of individual fraud under the shareholder attribution approach.

Ownership changes have long been regarded as posing tremendous administrative problems for any form of pass-through or integration system.[76] They also would pose problems for RBFA, but in two potentially very different ways. First, if RBFA eventually needed to be combined with some attribution mechanism to be viable, then the problems of ownership change generally relevant for such a mechanism would also infect RBFA implementation. Second, and by contrast, when individual shareholder information was aggregated at the country level, changes in ownership would matter for a corporation's computation of its tax liability only because the corporation might be owned by residents from different countries in changing proportions during the course of a tax period (for example, a year). In this latter case, some way of computing an annual average of (ultimate) ownership would be sufficient.[77]

C. *Whose Tax Law to Apply?*

If, under RBFA, a corporation has to pay income tax to different countries of ultimate shareholder residence, whose tax law should the corporation apply to determine its tax base? This question also arises for the shareholder-attribution approach to corporate taxation, since, under such proposals, firms owned by shareholders from different countries also need to provide information to the shareholders about what income accrues to them, based on their respective tax laws.[78]

To answer this question, it is important to reflect on what corporate tax policy would look like when it was purely individual-residence-based. Arguably, much tax policy directed at business firms is source-based: Policymakers aim to stimulate investment, incentivize R&D, boost employment, encourage sustainable energy use and environmental preservation, and so on, in particular places. These are often the places where both the owners reside and the firms operate. Countries would have much less incentive to adopt such policies when the

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[76] See Treasury Integration Study, note 35, at 33-35. R

[77] When the goal is to determine the tax liabilities of individuals, imputation/accrual would have to be done very accurately to track the ownership period of particular individuals. When the goal is to determine the tax liabilities of a corporation (owned by various individuals), however, the requirement of precision regarding ownership periods of particular individuals could be relaxed.

[78] Green, note 18, at 72. As a matter of compliance realities, many multinational companies already have to file tax returns in multiple jurisdictions—both national and subnational—and thus apply different tax laws to the same business facts. Anti-deferral regimes also generally require foreign income to be computed according to the residence countries' tax laws, which are invariably different from source countries' tax laws. R

firms to which they apply operate elsewhere in the world. U.S. lawmakers are much less interested in tinkering with the corporate tax base for firms that operate in Mexico and Vietnam than firms that operate in Ohio and Wisconsin, even if these firms are all owned by U.S. individuals. However, it is these tax policy choices (along with the choice of tax rate) that are important for government sovereignty. If it were not for varying tax policy preferences—if the demarcation of the corporate income tax base is merely a matter of the implementation of general income tax norms (which may still differ substantially from management and financial accounting norms)—then it is not clear why most countries would not adopt some generally accepted income tax principles analogous to the GAAP or IAS.[79] In other words, if we can imagine governments giving up source-based business taxation,[80] then we can imagine variations in business taxation among different countries substantially disappearing.

Nevertheless, it is difficult to imagine governments giving up the goal of using business tax policy to affect business operations in their own countries. Suppose, for example, that among all companies that are owned by U.S. individuals, the vast majority (in terms of number as well as of revenue, assets, and employment) operate in the United States. Then U.S. lawmakers, in designing U.S. tax law under an RBFA framework, might have strong reasons to define the corporate income tax base in ways that promote domestic economic policy objectives. In this case, tax policy, and therefore tax law, might continue to differ substantially across countries. RBFA design has various choices in dealing with this problem. One is to require firms to determine their tax base according to the different laws of the main shareholder-residence countries (for example, any country with shareholder ownership of 10% or more). Another is to require firms to determine their tax base only according to the laws of the largest shareholder-residence countries: For example, either the law of the majority shareholder-residence country applies, or, if there was no majority shareholder country, some international standard for applying income tax principles would be used.

These different options trade compliance costs against other policy objectives. More importantly, they would lead to inter-investor externalities: Investors' tax burdens would depend on where other investors come from. Inter-shareholder externalities created by rate differentials pose the most serious feasibility challenge for RBFA de-

79 Both Green, note 18, and Giovannini & Hines, note 16, are inclined to assume a single set of rules when corporate income is taxed in different resident countries. The discussion here provides a justification for such assumption. R

80 It seems implausible to assume that they would give up the very aim of attracting mobile business factors, through whatever means.

sign.[81] Inter-shareholder externalities created by tax base differences can be seen a different form of the same challenge.

D. Why Would Firms Comply at All?

A third, obvious, and basic question for RBFA, which may strike many readers as being the most fundamental, is why firms would even try to fulfill compliance obligations imposed by ultimate investor countries. Why would a U.S. company operating entirely in the United States have an incentive to pay corporate tax to governments in Canada, Europe, or Asia? These governments cannot directly audit or enforce tax liabilities of a U.S. company without operating in the United States. They may not even know of the existence of the company. If audits and enforcement in foreign countries are conditions of the feasibility of RBFA, then perhaps we should conclude that RBFA is infeasible.

There are at least two reasons for suspending disbelief here, one having to do with intergovernmental cooperation and the other with market forces for compliance.

1. Treaty-Based Mutual Administrative Assistance

To begin, many firms have both foreign and domestic ultimate individual ownership. Therefore, tax authorities in the countries where these firms operate should have largely the same reasons to audit the firms under RBFA as they do today—the audits would generate domestic tax revenue.[82]

Moreover, it is natural to imagine the adoption of RBFA (if it were otherwise feasible), or indeed of any exclusively individual-residence-based corporate taxation (such as shareholder attribution), to proceed through treaty negotiations. Since only corporate income tax reform is at issue, the international tax framework for individual taxation presumably would remain, where both source and residence taxation were still contemplated. One would thus expect the system of bilateral tax treaties to remain. The contracting states would surrender source country taxing rights over corporate income in exchange for individual residence-based taxing rights. In other words, the replacement of source-based by individual residence-based corporate taxation would happen only on a reciprocal basis: One contracting state would give up its source-based taxing rights over corporate income

[81] See Part IV.

[82] Conversely, it is likely that even today, the audit rate for wholly-foreign-owned U.S. corporations is lower than the average audit rate for U.S. corporations.

only conditional on the other contracting state giving up similar rights.[83]

This exchange may itself be conditioned on a greater extent of mutual assistance in (corporate tax) enforcement than is practiced under tax treaty frameworks today. It seems that such enhanced mutual assistance can only be expected if the fundamental norms of international taxation are to change.[84] To assess the possibility of such mutual assistance, I believe it is important to recognize two points. First, mutual administrative assistance is a much weaker form of government reciprocity than the clearing house system of inter-national revenue transfer described in Giovannini and Hines (and actually practiced for some purposes among E.U. member countries).[85] It requires governments not to collect taxes for one another but only to devote some audit resources on one another's behalf.

Second, I believe it is difficult to over-emphasize how much international legal norms have changed regarding the degree of acceptable mutual assistance in tax collection during the last few years. The OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters now has 113 participating jurisdictions,[86] and supports two separate and comprehensive regimes for the automatic exchange of information: the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports,[87] and the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (pursuant to the Common Reporting Standard).[88] This has been possible, of course, not because states have suddenly become very altruistic or better resourced in their enforcement apparatuses. Instead, it is because much of the administrative burden of these regimes are shouldered by and large by

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83 In addition, the incomplete adoption of RBFA might leave some portion of the corporate tax base still subject to source taxation. Suppose pension funds from Canada and China jointly invest in a U.S. firm. Suppose Canada and the United States enter into a new treaty reciprocally adopting RBFA (or shareholder attribution) for taxing corporate income, but China and the United States do not enter into such a treaty. The U.S. firm jointly owned by Chinese and Canadian investors would continue to pay source-based tax to the United States on the portion of its income attributable to Chinese investors.

84 Under an exclusively residence-based corporate tax system, the enforcement assistance of source countries might nonetheless be required. See Green, note 18, at 72-73. R

85 See text accompanying notes 49-52. R

86 OECD, Jurisdictions Participating in The Convention On Mutual Administrative Assistance in Tax Matters (Jan. 24, 2018), http://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf.

87 OECD, Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (Dec. 17, 2017), https://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/CbC-MCAA-Signatories.pdf.

88 OECD, Signatories of the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (Jan. 15, 2018), https://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/MCAA-Signatories.pdf.

private parties: Mutual assistance only requires two states to enable their own subjects to comply with the requests of the other state. In this context of monumental changes in international legal norms, it seems difficult to draw a line between government enforcement efforts focused on ensuring that information is properly collected pursuant to exchange of information agreements and those that feature audits.[89]

2. *Market Forces*

The real world experiment that is the implementation of FATCA has shown how much a powerful source country can do to marshal market forces to elicit compliance from foreign firms. Although the blunt compliance device of FATCA is to subject noncompliant financial institutions to FATCA withholding, FATCA has achieved as much success as it has mainly because the threat of withholding triggered extensive market forces: If financial institutions want to have customers—which they can do only by preserving exposure to U.S. investments—they had better comply with FATCA. Better FATCA-readiness meant better access to economic rent from providing global financial services; conversely, worse FATCA-readiness meant the risk of being excluded from earning such economic rent. Indeed, the large number of tax haven countries that rushed to enter into IGAs with the United States suggests that both countries and firms compete to offer compliance, if economic rent can be earned in return.

Thus in some ways still not well understood, FATCA withholding has become an example of the type of optimal sanctions discussed in textbooks: It serves a deterrence function without ever having to be applied. It is natural to conjecture that the United States and other OECD countries, as dominant locations of investor residence, can leverage the same kind of power in steering major market players towards compliance with individual-residence-based corporate taxation, including RBFA.

IV. The Infeasibility of RBFA

Legal jurisdiction, the possibility of enforcement, compliance costs, as well as the accounting complexities of integrating corporate- and shareholder-level taxation, have in the past been presented as the main feasibility obstacles in the way of exclusively individual resi-

[89] It may even be difficult to draw a line between audits and collection. If this is the case, then the only legal norm that constitutes an obstacle to one government collecting revenue on behalf of another is revenue transfer between countries—and we know that even this norm may not be absolute, based on experience in the European Union.

dence-based corporate taxation.[90] The question is whether RBFA can be designed so as to mitigate some of these concerns without triggering worse problems. While the last Part surveyed considerations that are generally favorable to RBFA, I now highlight one potentially detrimental problem.

Suppose that *Company X* is owned ultimately in equal proportion by investors from *Countries A*, *B*, *C,* and *D*, which have RBFA corporate tax rates of 10%, 20%, 30% and 40%, respectively. After apportioning $100 of income (based on generally accepted income tax principles) equally to the four countries, *Company X* makes payments to the countries in the amount of $2.50, $5, $7.50, and $10, respectively. *Company X* will have $75 left for distribution. The average effective tax rate of 25% is determined by the composition of ultimate shareholders and their respective countries' tax rates, and not by decisions about where to locate production or profits made by corporate managers. The corporation's investment decisions, therefore, may be undistorted by corporate taxes.

Shareholders' behavior, however, might be distorted. If *Company X* made pro rata distributions to its shareholders, then the 25% average rate would affect the after-tax returns of all investors. This clearly would be to the detriment of investors from *Countries A* and *B*, and to the benefit of investors from *Countries C* and *D*. Unless shareholders knew who the other ultimate shareholders were (and could predict how ownership patterns might change), they would not be able to project their investment returns.[91] But the choice to impose corporate-level taxation as opposed to shareholder-level taxation tends to be justified precisely when ownership may change and shareholders are not in privity with one other. Therefore, unpredictable shareholder changes represent the most relevant scenario for RBFA to consider. The imposition of the RBFA, however, seems to make equity financing impossible to price in such a scenario.

Could *Company X* make non-pro rata distributions to shareholder pools from different countries? This would neutralize the inter-shareholder tax externality. But this solution seems unavailable for two reasons. First, most firms do not make regular distributions of all retained earnings; therefore, in between distributions, shareholder patterns might easily change. It does not seem generally possible to use non-pro rata distributions to match, on the one hand, the apportionment of corporate income to different shareholder-residence countries

[90] See Green, note 18, at 70-74; Auerbach et al., note 19, at 880-81. R

[91] If shareholder composition can be relatively accurately predicted, then high-tax country investors may be required to pay premia for their equity investments and low-tax country investors would require discounts.

(in one period) with, on the other, the distributions to shareholders from these countries (in possibly another period). For instance, suppose that *Company X* made formulary apportionment in Year 1 according to that year's ownership pattern; made formulary apportionment in Year 2 according to a different ownership pattern in Year 2, and made a distribution in Year 3 when owned by yet a third pattern of owners. The question is in what ways the distribution could be made, non-pro rata, to register the fact that it comes (perhaps only in part) out of Year 1 and Year 2 retained earnings, each subject to a different RBFA formula. I do not see an answer to this question.

Second, non-pro rata distributions based on ultimate shareholder residence would effectively create different classes of shares, even within what by corporate law would be a single class of shares (or even a single share). It would thus seem to require accommodation from the corporate laws of different countries, and would no longer be just a matter of tax compliance. In all, therefore, unless RBFA can be designed to allow pro rata distributions without generating destabilizing externalities among shareholders, it does not seem to be an acceptable form of residence-based taxation.

This (rather nasty looking) problem does not arise for other types of exclusively individual residence-based tax systems. Consider first a system where corporate income is allocated to ultimate shareholders, and countries of individual residence simply tax this phantom income. Because no tax would be imposed at the entity level, pro rata distributions pose no problems, and there would be no more intra-shareholder externalities than exist under the current corporate income tax. Alternatively, under the Giovannini-Hines model, a uniform tax of 50% would be imposed at the corporate level, and differences in residence country tax rates would be reflected by residence country refunds.[92] This again is consistent with pro rata distributions.

If RBFA is infeasible, the project of taxing corporate income by reference to individual shareholder residence will need to revert to shareholder-level tax instruments.[93] As discussed in Part II, some scholars have suggested that this can be done through the flow-through taxation of corporations, through accrual accounting (for example through mark-to-market) of individual income, or through a combination of both. An obvious question for such suggestions is why we have not simply changed the topic: Have we not simply abandoned corporate taxation and decided to deal with the problem of deferral through other methods of individual income taxation? Alter-

[92] See Giovannini & Hines, note 16, at 194. R

[93] Or revisit proposals to define corporate residence by shareholder residence. See Fleming et al., note 21, at 1693. R

natively, the shareholder attribution approach to corporate taxation can be seen as an administrative variant of the corporate tax distinct from individual taxation. Yet, as long as tax liabilities are pinned to individuals, it may always seem artificial to maintain that the tax is imposed on entities instead. Many may find the task of making such an artificial looking tax feasible unappealing.

V. Implications

The challenge RBFA faces in dealing with inter-shareholder externalities may be viewed as a rude reminder of how problematic it is, in tax design, to pursue neutrality with respect to just one set of decisions by one set of actors (for example corporate managers' decisions in maximizing after-tax returns). Arguably, depicting the problem of international corporate taxation as one of finding relatively immobile factors by reference to which to tax corporate income (or rent) simply invites one to commit this kind of error. As discussed in Section II.A, this formulation of the problem of international corporate taxation is one of the fundamental themes in discussions of the DBCFT. While it is unclear how many scholars have accepted the formulation, not many have disputed its appeal, either.[94]

I believe that in the extant literature, only two types of tax design can strictly be seen as responding to this conception of the problem of international taxation. The first is exclusively individual-shareholder-residence-based corporate taxation, including both RBFA and shareholder attribution. Neither of these two options has so far received much attention, especially compared to other reform proposals for shareholder-level taxation that has an international dimension, for example, shareholder accrual or mark-to-market (of the Toder-Viard variety[95]) or pass-through taxation. However, whether these latter types of shareholder-level taxation are best understood as ways of reforming corporate taxation, in the sense DBCFT proponents intend, is debatable.

A second type of tax design that responds to the problem of taxing corporate income by reference to immobile factors is formulary apportionment by reference to the location of final consumers.[96] I have previously argued that final consumer-based formulary apportionment is most likely infeasible, because the identities of buyers are not generally transmitted through market transactions in goods and ser-

[94] See Section II.A for further discussion of this problem.

[95] See Toder & Viard, note 17, at 702. R

[96] See Avi-Yonah et al., note 26, at 517-18; Devereux & de la Feria, note 26, at 3-4. R

vices.[97] Others, however, may continue to pursue this type of tax design. Indeed, as Oosterhuis and Parsons' contribution to this symposium shows, some might simply see it as a way of extending/revising source-based taxation.[98] Whatever the short-term pragmatic merits of this approach are for the United States, I find it interesting in two respects. The first is that while proponents of "destination-based" taxation often denounce the very concept of source, it is clear that others see the source concept as sufficiently malleable as to be able to incorporate intuitions about "destination".[99] The second is that, other than a narrow and contextual conception of neutrality, not much has been offered by way of a normative justification for consumption-based allocation of taxing rights over corporate profits. Countries are awakening to the attraction of such allocation mostly because, as a matter of administration and of legal norms, they can. Therefore, taxation by virtue of consumer location is likely to come about not because of its superior efficiency or other normative properties, but simply by force majeure. This, of course, has long been suspected to be the logic of source-based taxation.[100]

What about the destination-based cash flow tax itself? It may be useful to repeat here a distinction I make elsewhere. There are two clearly distinct senses of taxing corporate profit by reference to final consumer location.[101] The first is to tax corporate profit in the location where the sales to final consumers generating such profit are made. This is a type of formulary apportionment. The second is to tax corporate profit in the location where the owners of the profit use the profit for consumption. This is what the DBCFT (aka the border adjustment tax) does. In other words, the DBCFT taxes corporate profit not where the customers of profit-making corporations are, but where the owners of such profit reside—not surprisingly, that is also where they consume.[102] The DBCFT, therefore, has the effect of individual residence-based taxation of consumption (and as a consumption tax, it is no longer concerned with the problem of deferral). Therefore, it is misleading to say that the DBCFT implements a new way (that is not based on source or residence) of allocating the taxing right over corporate profit.

[97] Cui, note 29, at 342-44. It is also not clear that such apportionment is normatively attractive. Id. at 319-21. R

[98] Oosterhuis & Parsons, note 68. R

[99] See, e.g., Avi-Yonah et al., note 26, at 509-10; Schön, note 1, at 429-30; Auerbach et al., note 3, at 6-8; Devereux & de la Feria, note 26, at 3-4. R R

[100] Cui, note 7, at 262-63. R

[101] These correspond, respectively, to what I called Version 1 and Version 2 of the destination-based cash flow tax. See Cui, note 29, at 304-05. R

[102] The DBCFT is to personal taxation of consumption financed out of corporate rent what the VAT is to personal consumption taxation.

Overall, then, the conceptual heuristic of taxing corporate income by reference to immobile factors seems to have yielded no findings.

VI. Conclusion

This Article makes the following four contributions to the current debate about the structure of international corporate income taxation.

First, I offer a new taxonomy of different ways of taxing corporate income by reference to individual shareholders, and distinguish what I call the "shareholder-attribution" approach from integration, pass-through, and other approaches. Second, I argue that although traditional international legal norms had led international tax design to avoid taxing foreign corporations "unconnected" with the taxing jurisdiction (for example, foreign corporations earning only foreign income), these legal norms have gone through substantial transformations in recent years. The exercise of jurisdiction over foreign corporations has vastly expanded in the sphere of international taxation, as has the extent of mutual assistance in tax collection. Consequently, the choice between taxing foreign corporations and taxing shareholders should be made mainly on administrative (including enforceability) grounds other than international legal norms.

Third, against this new landscape of international tax law, I compare the relative administrative advantages of two forms of tax design that implement exclusively individual-shareholder-residence-based taxation of corporate income: the shareholder-attribution approach, and RBFA. I conclude that while otherwise promising, RBFA is infeasible because it is incompatible with most corporations' need to make pro rata distributions.

Fourth and finally, some economists have recently formulated the challenge of international corporate taxation as one of taxing corporate income or profit by reference to immobile factors. I argue that exclusively individual-shareholder-residence-based taxation of corporate income is among the few types of tax design that directly address this challenge, but the difficulties all of them face suggest that this formulation has not proven particularly helpful.