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Commercial Domicile: The Crumbling Pillar Of Corporate Income Taxation

by Brian Hamer

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In this installment of Revenue Matters, Hamer examines the reasons why courts and legislatures will need to rethink the role that commercial domicile plays in determining state taxing rights.

There is no question more central to state corporate income taxation than which state or states may tax the income of a multistate enterprise. In the case of certain nonbusiness income, courts and legislatures have long looked to the state of an enterprise's commercial domicile. But in our wired world, where management is often dispersed and on the move, it is becoming increasingly difficult to identify the domicile of many far-flung businesses. Soon it may be impossible. And in this world where large enterprises typically have substantial contacts with multiple states, it seems arbitrary to attribute a multistate enterprise's nonbusiness income entirely to a single state, even when it is possible to identify an enterprise's state of commercial domicile.

Given these modern realities, courts and legislatures will need to rethink how the law should assign taxing rights among the states.[1]

Commercial Domicile's Role in Determining Taxing Rights

The Supreme Court has expressed on many occasions that the due process and commerce clauses of the U.S. Constitution prevent states from taxing "value" earned outside their borders unless there is "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."[2] And as a consequence, courts have held that the income from intangible property not used in a company's business, and any gain from the sale of that intangible property, may be taxed only by the state where the property has acquired a business situs or by the company's state of commercial domicile. Courts also have held that certain other nonbusiness income, such as dividends and interest received from a nonunitary payer, may be taxed only by the state where the company receiving the income is domiciled.[3]

This case law is largely reflected in the Uniform Division of Income for Tax Purposes Act, which has been adopted in some form by most states. The current version of UDITPA provides that a state will use formulary apportionment to determine its share of multistate income that is

[1] The focus of this article is on the taxation of corporations, but the issues raised here also apply to proprietorships and passthrough entities.

[2] *See, e.g.*, *Allied-Signal Inc. v. Director, Division of Taxation*, 504 U.S. 768, 777 (1992). See also the Supreme Court's opening sentence in *MeadWestvaco Corp. v. Illinois Department of Revenue*, 553 U.S. 16, 19 (2008) ("The Due Process and Commerce Clauses forbid the States to tax 'extraterritorial values.'") (citation omitted).

[3] This jurisprudence of course does not prevent states from using formulary apportionment to determine their share of multistate income derived from a taxpayer's unitary business.

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"apportionable under the Constitution of the United States." All other income ("non-apportionable income") must be allocated to one or more states.[4] The original 1957 version of UDITPA, which is still used by most states, provides that states will apportion "business income," a defined term that is less inclusive than income apportionable under the Constitution; all other income ("nonbusiness income") must be allocated. Under both versions of the act, certain income that must be allocated is allocable only to the taxpayer's state of commercial domicile, including nonapportionable/nonbusiness interest, dividends, and capital gains realized from sales of intangible property.[5]

In recent decades, evolving Supreme Court jurisprudence has further contributed to the relevance of commercial domicile for purposes of assigning taxing rights. In the series of precedent-setting unitary business cases extending from *Mobil Oil* in 1980 to *MeadWestvaco* in 2008, the Court has considered when a state may under the Constitution require a nondomiciliary multistate corporation to pay tax on an apportioned share of certain income, and by corollary when some portion of that income must be allocated.[6] In cases in which income must be allocated, such as in the case of dividends received from a nonunitary company, that state is frequently the multistate corporation's state of commercial domicile.[7]

Implicit in both this case law and state income tax legislation is the assumption that corporate taxpayers, state tax agencies, and courts can identify the taxpayer's commercial domicile. But identifying the domicile of many multistate businesses can be no easy matter.

The Prior World

Back in the day, it was relatively easy to determine the commercial domicile of a business enterprise. A business's owners, employees, and operations were, if not located in the same place, then close to each other. And even as management and operations of some businesses became more dispersed in the decades after the Civil War and into the 20th century, top managers typically worked at a single location.

Courts therefore had little difficulty identifying the domicile of a multistate business when the law required such a determination. In the often-cited case of *Wheeling Steel*,[8] decided in 1936, the Supreme Court considered whether West Virginia could, under the due process and equal protection clauses, tax certain intangible property owned by a steel manufacturer, including various bank deposits that the company held in other states. Applying the principle that a state may treat intangibles as "localized at the owner's domicile for purposes of taxation," the Court ruled in West Virginia's favor.

In reaching its decision, the Court determined that the company was domiciled in West Virginia, even though it was incorporated in Delaware, its manufacturing facilities were located in Ohio, and it regularly operated vessels on the Allegheny, Ohio, and Mississippi rivers. What was relevant to determining domicile, the Court stated, was that West Virginia was the state where the company's officers "conducted the affairs of the Corporation," where the company maintained its general business offices and kept its books and accounting records, and where its board of directors held its meetings. In sum, West Virginia was where "the management functioned" and where the company's "center of authority" was located.

Given the singular location of senior management and corporate decision-making, the Court's determination was neither difficult to reach nor surprising.[9]

[4] See Model Compact Article IV, Division of Income, as revised by the Multistate Tax Commission (July 29, 2015). A few states, such as Maryland, have in place a statute that by its terms requires all income to be apportioned. *See* Md. Code Ann., Tax-Gen. section 10-402. These statutes of course are subject to the Constitution's limitations on state taxing power. Consequently, Maryland and other states with a similar statute may not tax an apportioned share of certain income earned by nondomiciliary corporations.

[5] Under UDITPA, not every type of nonapportionable income is allocable to commercial domicile. In particular, patent and copyright royalties are generally allocable to the state or states where the patent or copyright is used by the payer.

[6] *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *MeadWestvaco*, 553 U.S. at 19.

[7] When income is allocable to a state, that state is still free to tax only a portion of that income.

[8] *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936).

[9] Not long after *Wheeling Steel*, the Court applied similar analysis and reached a similar conclusion in *Memphis Natural Gas Co. v. Beeler*, 315 U.S. 649, 652 (1942). In the latter case, the Court found that a corporation had its commercial domicile in Tennessee because it "manage[d] its business from its office in Memphis," explaining that Memphis was where the company kept its accounts, provided for the payroll of its employees, and prepared and sent out bills to customers.

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The following year, in *First Bank Stock*,[10] the Court explained why the state where a corporation is domiciled may subject the company to tax.[11] In that case, the Court considered whether Minnesota could, consistent with the due process clause, require First Bank, a corporation domiciled there, to pay property tax on shares of stock it owned in Montana and North Dakota banks.

The Court upheld Minnesota's taxing power, explaining that the state where a corporation is domiciled may impose tax because it is where the corporation receives the benefits provided by government. "Enjoyment by the resident of a state of the protection of its laws," the Court expressed, "is inseparable from responsibility for sharing the costs of its government." To support this point, the Court cited an individual income tax case it had recently decided,[12] which in turn quoted Justice Oliver Wendell Holmes's immortal line: "Taxes are what we pay for civilized society."[13]

Over the years, many state courts have also considered where a business is domiciled for purposes of assigning taxing rights. To take just one example, in 1945 the California Court of Appeals, in *Southern Pacific*, considered whether a Kentucky corporation that operated a railroad in California and six other western states was domiciled in California.[14] The company's board of directors and executive committee held meetings in New York, and some of the company's most senior officers were located there. But the company's president, who had "immediate charge of the management, operation and traffic of the railroad," was located in San Francisco, as were five vice presidents and a general manager, who were responsible for the "actual management" of the company's transportation business. It is noteworthy that, unlike many chief executives today, the president of that company spent 90 percent of his time at headquarters. Also, most of the company's employees were located in California, including its legal, engineering, and purchasing staffs. Given these facts, the court — not surprisingly — concluded that California was the company's commercial domicile. "There can be no doubt," the court explained, that "substantially more activities are carried on, more actual control is exercised, more protection is given this corporation, and more benefits conferred on it by California than by any other state."

When deciding where a corporation is domiciled, state courts have considered many factors, including where the day-to-day affairs of the business are managed, where the CEO's office is located, where most employees work, where management meetings are held, where orders are received and fulfilled, where the business's books and bank accounts are kept, where tax returns are prepared, and where the board of directors meets. Many of these courts cited and quoted the Supreme Court's language in *Wheeling Steel*.

UDITPA defines a commercial domicile as "the principal place from which the trade or business of the taxpayer is directed or managed."[15] Numerous states have incorporated this exact language into their tax code. Some states have embellished the definition. For example, Massachusetts has adopted the UDITPA language but also has enacted the following presumption:

> It shall be presumed, subject to rebuttal, that the location from which the taxpayer's trade or business is principally managed and directed is the state of the United States or the District of Columbia to which the greatest number of employees are regularly connected or out of which they

[10] *First Bank Stock Corp. v. Minnesota*, 301 U.S. 234 (1937).

[11] While the Supreme Court has held on multiple occasions that a state may impose tax on intangibles owned by a domiciliary corporation, it has also held that certain other states may have the power to impose such a tax. For example, in *Farmers Loan & Trust Co. v. Minnesota*, 280 U.S. 204 (1930), the Court expressed that certain intangibles may acquire a situs for taxation other than in the owner's state of domicile "if they have become integral parts of some local business."

[12] *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937).

[13] *Compania General de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927). State courts have also articulated this rationale. *See, e.g.*, *Anniston Sportswear Corp. v. Alabama*, 151 So. 2d 778, 782 (Ala. 1963) (explaining that a corporation may be subject to taxation at its commercial domicile because it is there that it receives the benefits provided by the government and may therefore "be required to pay its fair and just share of the cost of such benefits.").

[14] *Southern Pacific Co. v. McColgan*, 68 Cal. App. 2d 48 (1945).

[15] UDITPA, section 1(b). When the National Conference of Commissioners on Uniform State Laws initially approved UDITPA, it included a comment making it clear that taxpayers may have only one commercial domicile. The comment reads in part: "The phrase 'directed or managed' is not intended to permit both the state where the board of directors meets and the state where the company is managed to claim the commercial domicile."

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are working, irrespective of where the services of such employees are performed, as of the last day of the taxable year.[16]

Many states have provided further guidance by promulgating regulations addressing the meaning of commercial domicile. These regulations use a wide array of terms and often provide a good deal of wiggle room. Examples include:

- *Illinois.* "In general, this is the place at which the offices of the principal executives are located. Where executive authority is scattered, the place of daily operational decision making controls. Such determinations must be made on the basis of all the facts and circumstances."[17]
- *Virginia.* "The commercial domicile will normally be the location of the headquarters office of the corporation. If the corporation has no office then the commercial domicile may be where the officers, directors and shareholders regularly meet or where the principal officer or majority shareholder/officer conducts the affairs of the corporation, depending upon the facts and circumstances."[18]
- *Louisiana.* "Commercial Domicile is in that state where management decisions are implemented which is presumed to be the state where the taxpayer conducts its principal business and thereby benefits from public facilities and protection provided by that state. The location of board of directors' meetings is not presumed to create commercial domicile at the location."[19]
- *Indiana.* The Indiana Administrative Code identifies a total of 12 factors to be considered, noting that this list is not exhaustive —

  (a) The relative amount of revenue from sales in the various states

  (b) The relative value of fixed assets in the various states

  (c) The principal place of work of a majority of the employees

  (d) The place where the corporate records are kept

  (e) The principal place of work of the corporate executives

  (f) The place where policy and investment decisions are made

  (g) The relative amount of decision-making power held by various executives and employees

  (h) The place where payments are made on intangibles held by the corporation

  (i) Whether income from intangibles held by the corporation is taxable elsewhere

  (j) The office from which the Federal income tax return is filed

  (k) Information contained in the corporation's annual and quarterly reports

  (l) The place where the board of directors meets.[20]

When a multistate corporation maintains a traditional headquarters, this statutory and regulatory authority may serve well to identify the business's "center of authority," even if the corporation operates at multiple sites and executives engage in regular business travel. But as management becomes more dispersed and mobile, this guidance becomes less useful. And given the size and footprint of many business enterprises today, the nature and complexity of modern corporate decision-making, and the mobility of decision-makers, one can easily imagine cases in which it would be difficult, if not impossible, to identify *the* principal place from which a taxpayer's trade or business is directed or managed.

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[16] Mass. Gen. Laws ch. 63, section 1.

[17] Ill. Admin. Code tit. 86, section 100.3210.

[18] 23 Va. Admin. Code section 10-120-140.

[19] La. Admin. Code tit. 61, Pt. 1, section I-306(A)(1)(g)(iii).

[20] 45 Ind. Admin. Code 3.1-1-32.

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The Emerging Reality

Boeing Corp. reflects the emerging business reality.

In 2001 the company's official headquarters moved from Seattle to Chicago, and in 2020 the headquarters moved again, this time to Arlington, Virginia. *The Wall Street Journal* reported, however, that the company's CEO, David Calhoun, never made the move to Virginia. Instead, he works out of his homes in New Hampshire and South Carolina. Meanwhile, the company's CFO and treasurer both work out of a small office in Connecticut (the treasurer oversees staff mostly based in Chicago). The company's communications chief and its human resources chief both live in Florida.[21] And the company assembles its planes in Washington and South Carolina.

According to the *Journal*, Calhoun has described remote work as part of his job and has expressed publicly: "Remember now what headquarters is — it's me [and the] CFO." A company spokesperson has stated, "Rather than this ivory tower corporate headquarters approach, there's another approach, which is: Encourage leaders to travel, get out there and engage the best they can and not worry about sitting tied to a desk at a traditional corporate HQ." The *Journal* also reported that Calhoun made more than 400 flights to and from airports near his homes over the prior three years but on average traveled to Arlington just once or twice a month. Members of the company's executive staff assemble once each calendar quarter at various locations, where they take the opportunity to spend time with Boeing employees at their worksites. About 30 percent of recent Boeing job postings advertise for hybrid or remote positions.

Boeing is hardly the only company that has moved away from the traditional headquarters model. Some multistate companies have created two headquarters. Amazon famously sought a location for "HQ2," eventually settling on Arlington, Virginia. Subway, the country's largest franchisor, operates two headquarters: one in Connecticut and one in Miami.[22] At the other end of the spectrum, some companies operate with no headquarters at all. At my request, ChatGPT produced a list of 10 companies that operate "on a fully virtual or distributed model." When Chicago's largest healthcare provider, Advocate Aurora Health, agreed to merge with a large Charlotte, North Carolina-based hospital chain in 2022, its CEO stated, "If there's anything we've learned [since the pandemic], it's that we work different today than we did before. *Headquarters is pretty much where our laptop and our phone is.*"[23]

These examples are not unique. Many CEOs put their company jets to regular use, use their laptops to engage in high-level management activities whenever and wherever they travel, and regularly interact with other members of senior staff via email, text, video call, and cellphone. Moreover, although responsibility for decision-making in large enterprises may ultimately reside with one individual (who reports to a board of directors), as a practical matter substantial decision-making is necessarily dispersed among many individuals and is often collective in nature. And many companies have outsourced activities that courts and tax agencies historically have taken into account when determining where a corporation is domiciled — for example, they have sent their books and accounting records to a remote server farm or the cloud, outsourced their payroll function, use the services of multistate banks, and rely on attorneys who work in law firms with offices sprinkled around the country. At many companies the board of directors meets at a rotating set of locations or meets virtually, with each director potentially calling in from a different state or country.

Courts have not yet addressed this emerging reality. Perhaps a recent case that comes close is *Vermont National Telephone Co.*[24] In that case, the

[21] Andrew Tangel and Mark Maremont, "Private Jets and Pop-Up Workspaces: Boeing Eases Return to Office for Top Brass," *The Wall Street Journal*, Sept. 11, 2023.

[22] Harriet Jones, "Subway's Dual HQ Strategy Still Rare for CT, Other Companies," *Hartford Business Journal*, Nov. 13, 2023. This article quotes Mohammad Elahee, a professor of international business at Quinnipiac University, who states that it is not that common for companies to establish dual headquarters, "but I think it will become more common in the future."

[23] Katherine Davis, "Advocate Aurora's HQ Will Move to N.C. in Blockbuster Merger," *Crain's Chicago Business*, May 16, 2022, p. 29 (emphasis added).

[24] *Vermont National Telephone Co. v. Department of Taxes*, 250 A.3d 567 (Vt. 2020).

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Vermont Supreme Court needed to identify the commercial domicile of the Vermont National Telephone Co. in order to determine the state to which a capital gain should be allocated. In Vermont, commercial domicile is defined as "the principal place from which the business is directed or managed."

The company asserted that its state of commercial domicile was Connecticut because that was where its president made "high-level strategic decisions" and where its board of directors met. The court rejected that argument, however, concluding that Vermont's commissioner of taxes did not err when he determined that the company's domicile was in Vermont since that was where the company "conducted business operations and received the most benefits." Specifically, Vermont was the place where the CFO, among other things, filed and paid the company's sales and withholding taxes, where most of the company's business records were kept, and where most of its employees were subject to withholding tax. And Vermont was identified as the company's principal place of business on its income tax return. In the end, perhaps it was not much of a reach to conclude that the *Vermont* National Telephone Co. was domiciled in *Vermont*.

The really hard cases are yet to come, but they are coming.

The Future

Consider a future case in which the CEO of a multinational enterprise with facilities in many states and countries works out of multiple offices and travels constantly; each of the CEO's direct reports is located in a different state; senior management meetings are mostly held via Zoom; most decision-making occurs at the operational level, typically by consensus; the board of directors, if it meets in person, conducts each meeting at a different plant site; and the business's headquarters building has been sold. In this scenario, it is hard to see how a court could find that the company's commercial domicile is in any one state. One might say that the company's "center of authority" is located in multiple states, or everywhere, or is constantly shifting, but not in one particular state.[25]

But assume for the sake of argument that it would be possible in such a case to determine the company's singular state of commercial domicile. Courts and legislatures would then need to consider whether there is any principled basis for assigning *all* taxing rights to that one state. Should state statutes provide, and does the Constitution necessarily require, that certain nonbusiness income of a corporation be assigned entirely to a single state when corporate activity and decision-making is so dispersed? Conversely, must (should?) the Constitution be read to prohibit those states that host key parts but not a plurality of a business's decision-making, and that provide substantial but not a plurality of benefits to that business, from imposing any tax at all (whatever plurality means in this context)?[26] There are compelling reasons to conclude, for reasons grounded both in fairness and common sense, that the answer to these questions is no.[27]

Supreme Court jurisprudence in fact may allow nonbusiness income that historically has been allocated to the state of commercial domicile to be allocated to one or more other states. In *MeadWestvaco*, the state of Illinois and amicus curiae Multistate Tax Commission argued that

[25] The Supreme Court envisioned this new world, and its challenges, early in the internet age. In *Hertz Corp. v. Friend*, 559 U.S. 77 (2010), a case which required the Court to craft a test to determine "principal place of business" for purposes of the federal diversity jurisdiction statute, it recognized that there would be "hard cases" because of the evolving nature of business. "For example," the Court stated, "in this era of telecommuting, some corporations may divide their command and coordinating functions among officers who work at several different locations, perhaps communicating over the Internet." It is probably fair to say, however, that the Court in 2010 did not fully understand how complex the business world was about to become.

[26] Perhaps not a perfect analogy, but one cannot help but think of the archaic predominant cost of performance rule that UDITPA at one time employed to apportion income from the sale of services. That rule was jettisoned by most states for at least two reasons. First, tax administrators and taxpayers were constantly battling over whether a particular state was the state where the taxpayer's costs were predominantly incurred. And second, policymakers in most states concluded that it made no sense to apportion 100 percent of a taxpayer's income to a single state when the taxpayer's income-producing activity occurred in multiple states.

[27] There are in fact many reasons to question the current legal framework. To take one example, under UDITPA, income from the sale of stock in a nonunitary corporation that largely owns real property is allocable to the state of the seller's commercial domicile. But if the real property were owned directly by the seller, income from the sale of that property would be allocable to the states where the real property was located. It is hard to reconcile these two results.

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Illinois could as a constitutional matter tax a share of the capital gain realized by a nondomiciliary corporation — even if the gain constituted nonbusiness income — based on the apportionment factors of the entity the corporation had sold. In its opinion, the Court acknowledged this argument and noted that some states already had in place what has become known as investee apportionment.[28] The Court declined, however, to consider the argument — not for any substantive reason, but rather because it had not been raised or considered earlier in the litigation.

A bit further afield, the Court just recently considered whether the due process clause permits a state court to exercise personal jurisdiction when the activity giving rise to an injury did not occur in the state and the state was neither the defendant's principal place of business nor its state of incorporation. In this case, *Mallory*,[29] the Court rejected the notion that, in the absence of "specific jurisdiction," a state court's authority is constitutionally limited to claims against domiciliary corporations. This decision suggests perhaps a growing openness on the part of the Court to looking beyond domicile as a source for imposing state obligations on corporations.[30]

But whether or not current jurisprudence is flexible enough to permit states to tax income that in the past has been taxed only by a taxpayer's state of commercial domicile, what is increasingly clear — for practical as well as principled reasons — is that reliance on commercial domicile will have to go. ■

[28] *MeadWestvaco*, 553 U.S. at 31.

[29] *Mallory v. Norfolk Southern Railway Co.*, 600 U.S. 122 (2023).

[30] In *Mallory*, the state of Pennsylvania had enacted legislation providing that out-of-state corporations could not do business in the state without registering and in effect consenting to Pennsylvania courts exercising general personal jurisdiction, just as these courts can over domestic corporations.

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