

Current Situation and Countermeasure Analysis of Transfer Pricing in International Tax Avoidance

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Abstract. This article introduces the main ways of international tax avoidance and points out that transfer pricing is the most commonly used means of multinational corporations. The paper briefly introduces the definition and different types of transfer pricing, then confirms that as a means of tax avoidance, the nature of transfer pricing is still in the category of not violating the law. On this basis, the article analyzes the causes of transfer pricing, and tries to find a balance between the host country and multinational enterprises by assigning and dividing different responsibilities and obligations, to achieve the common development of international economy. The key point is not simply to recommend that countries or regions strictly crack down on and prohibit transfer pricing, but to seek a method acceptable to both host countries and multinational enterprises from the basis of its creation, taking into account the interests of multinational corporations so that the problem can be solved more effectively.

Keywords: International tax avoidance; Multinational corporate; Host country; Balance.

1. Introduction

Due to the development of economic globalization, the fund transaction between individuals and individuals or states under the international perspective are becoming more and more frequent, which makes the multinational corporate (MNC) become an important economic subject. However, due to its nature of crossing two countries or even several countries, and the differences in tariff and income tax rates in various countries, the amount of profits obtained by MNCs in the host country will often be biased, affecting their expectations. Therefore, in order to reduce costs, MNCs mostly adopt ways such as the use of international tax havens, the use of electronic media which cannot be effectively constrained by international taxation to achieve the purpose of tax evasion. For MNCs with research and development, production and marketing belonging to different links and different countries, there are internal trade exchanges, and in such internal transactions, MNCs will change the price of their products or semi-finished products to reduce the determination of their tax basis by the home country and the host country, that is, transfer pricing (TP).

2. The State of International Tax Avoidance

2.1. The Reason of Crack Down on International Tax Avoidance

The main purpose of MNCs is to gain wealth, so they consider how to obtain higher profits. In addition to increasing revenue (which is often difficult to achieve), reducing costs is a highly effective tool. For MNCs, tax accounts for a large proportion of their costs, so they often seek ways to avoid tax.

Technically, tax avoidance is not as same as tax evasion which violate the law. It is a method which legislation didn't prohibit explicitly to reduce the tax base or tax rate. In other words, the purpose of tax avoidance is to reduce the amount of payable tax by various means, rather than to pay less or no tax, which is the fundamental difference with tax evasion.

In addition to cracking down on tax evasion, countries should also minimize tax avoidance by MNCs. Although tax avoidance is still within the legal scope, it located at the border, and its nature is to use loopholes in the law or change the basic facts. It does not violate the law directly, but also be contrary to the principle of good faith. The most important thing is that MNCs tend to have a large

trade volume. If they are allowed to avoid tax, it will directly lead to a significant reduction in national tax revenue, and other enterprises will also follow suit, resulting in adverse social impacts. In addition, it will also affect the international image of the home country.

2.2. Forms of International Tax Avoidance

In practice, there are various means of tax avoidance by MNCs, and only the most important means are listed here.

2.2.1 Use “Tax Havens”

Because some countries and regions such as the Netherlands, Cayman Islands and so on implement a low tax rate or even zero tax policy, which leads the corporate income tax is very low, so many MNCs choose to register companies in these countries and regions which are called “tax havens”. One of the most famous examples is Amazon, which sets up its European shell company and operating company in Luxembourg, and the Luxembourg shell company is recognized as a non-resident enterprise in Luxembourg as a partnership. Through this arrangement, the purpose of exemption from corporate income tax is achieved. Moreover, Amazon transfers a large amount of profits from its Luxembourg operating company to shell companies in the form of royalties and pays only a small amount of tax on the small amount of profits that remain in the operating company [1].

2.2.2 Tax Deferral

The basic regulation of residence tax in countries around the world is taxing repatriated profits. As a result, many MNCs choose to keep foreign income abroad, thereby reducing the repatriation of profits and avoiding repatriation taxes [2].

2.2.3 Transfer Pricing

The basic concept of TP is “multinational companies can charge a lower price for exports sold from high-tax to low-tax countries, or a higher price for inputs coming from low-tax countries, to reduce their global tax liability [2].” Although different companies in different countries may be involved in this process, they all belong to the same MNC, it is essentially an internal transaction of a MNC, so the operation is more convenient and secret.

2.3. The Status of TP in International Tax Avoidance

As can be seen from the above three main ways of international tax avoidance, although the methods of tax avoidance are different, the core is reducing the profits on paper, in order to achieve tax reduction or avoidance.

The use of tax havens has problems such as high cost and cumbersome procedures, and many MNCs are registered in tax havens, which leads the tax rate of these countries or regions is also on the rise. And increased scrutiny of tax avoidance by MNCs is making it harder to retain profits abroad. Therefore, on this basis, since product price is a factor directly related to corporate profits, and intra-enterprise transactions have advantages such as convenient operation, low cost, and not easy to be found by tax authorities, TP has become the primary choice of most MNCs.

3. The Anatomy of TP

According to the regulations of most countries, the internal price of a MNC’s subsidiaries or branches in different countries should be similar to the price of its external sales. But in the case of internal trading, there leaves a lot of spaces for interpretation. If there are no comparable third-party transactions, i.e., external transactions, there is no “fair price” to compare [2], and the tax examination authority cannot effectively monitor. In order to achieve this effect, it is common for MNCs to change the product names so that there are no comparable products.

In general, there are many reasons for TP, e.g., the need of enterprises to allocate resources, the division of organizational revenue and cost profit centers, the need to strengthen differentiated and cooperative management within the organization, and the need of accounting mechanism [3]. Moreover, too strict regulation, on the contrary, will have a negative effect on the country's economy [4].

3.1. The Main Classification of TP

3.1.1 Tangible Assets

The tangible assets here are not the tangible assets of the company in the usual sense, such as land, office buildings, etc., but the semi-finished products or products sold by the company. In addition to taking advantage of the differences of tax rates in different countries, MNCs can also raise the price of their products in internal transactions, which reduces the sales revenue and paper profits, thereby narrowing the tax base and reducing the tax payable.

3.1.2 Intangible Assets

Intangible assets are highly liquid, and many digital enterprises take advantage of this feature to combine their cross-border transactions with tax havens to achieve the purpose of international tax avoidance. It is a common practice for MNCs to set up two companies in tax havens, one that actually operates and the other that serves only as a vehicle. When a MNC transfers its intangible assets such as copyright or trademark rights to a company which is regarded as a tool for control, then the actual operating company needs to pay a high royalty when using its copyright or trademark, which greatly increases its cost and reduces its profits [5].

3.2. The Intention of TP

3.2.1 Tax Avoidance

Circumvention of income tax and tariff is the most direct cause of TP of MNCs. Due to the different tax rates and tax policies in different countries or regions, even the subsidiaries of MNCs with the same profits will have different tax payable in different countries or regions. As a result, MNCs choose to move more profits to the low-tax countries or regions and lower the price of export products in high-tax countries, so that they can successfully avoid a large amount of tax payable by trading products to subsidiaries located in low-tax countries or regions, so that most of the profits are located in low-tax countries or regions.

And for tariffs. Because in this situation, the amount of tariffs on the products of MNCs is determined by the import price and the tariff rate, there is a lot of room for operation, so that MNCs can locate their transaction prices at internal prices rather than market prices, and also avoid a lot of tariffs [6,7].

3.2.2 Strategic Management

When MNCs set up subsidiaries or branches in other countries or regions, TP can also help to establish deeper roots for them and obtain a better corporate reputation. Because when the parent company exports a variety of raw materials, technology and manpower to its newly established subsidiaries or branches in other countries at low prices, it helps to reduce their costs, reduce their pressure to a large extent, so that they can rapidly expand, and give local consumers certain concessions, and seize the market share of the host country. This often achieves better results than exporting capital directly to a subsidiary or branch.

In addition, the parent company can also acquire the finished products of its subsidiaries or branches at high prices, so that it can obtain more profits and show better operating efficiency, which will greatly benefit its overseas financing and increase the trust of local consumers in the company.

Finally, it can improve the rational allocation of capital, as host countries may put obstacles in the way of dividends or divestments from subsidiaries or branches, so that a large amount of capital remains in their own country. MNCs can use TP to transfer the profits of subsidiaries or branches

back to their home countries in advance. In addition, multinational parent companies can also use high-interest loans to inject funds into subsidiaries through TP, to obtain large profits and quickly repatriate capital to their home countries [6,7].

3.2.3 Risk Aversion

In fact, the host country's economic and political changes will have a large direct impact on the business of MNCs, which makes the overseas business of MNCs face certain risks. TP is an effective way to avoid it.

For exchange rate changes, if the parent company can know in advance that the host country may have similar currency depreciation, it can also transfer profits out in advance through TP. In this, the parent company can also choose another country's currency for accounting, to transfer the risk to another country.

As for foreign exchange control, when the host country tightens the control of foreign exchange entering its territory in order to balance its domestic economic development. Although the parent company can provide a high-interest loan to a subsidiary or branch in order to recover the money quickly. However, in countries and regions with more strict control, the most effective and safe way is to adopt TP to withdraw profits and reduce investment risks [6,7].

4. The Countermeasure about TP

As mentioned above, TP is not an act that should be completely prohibited, because it is not an act that violates the law in nature, but an objective evaluation of it should be an act that uses the law. Although this does not mean that it should be allowed to go unchecked, it should not fall to the other extreme, which is a total ban. Therefore, this part will put forward some suggestions and countermeasures for both host countries and MNCs, trying to find a balance point to make both parties of tax legal relationship be satisfied.

4.1. For Host Country

4.1.1 Determine the Appropriate Tax Rate

The regulation of TP is essentially a game between the host country and MNCs, so the calculation of the game model can also be introduced on the basis of law. In this model, the host country, as the tax rate setter, occupies the initiative, so it needs to consider the tax rate of the MNC's home country on the turnover of the MNC [8]. Because of the widespread double taxation of MNC in reality, this is also an important reason for MNCs to choose TP for tax avoidance.

The home country is also dynamic, so the host country should timely adjust its own behavior according to the behavior of the home country, and this adjustment does not mean frequent changes to the tax rate, which is not good for the national image and legal authority. However, the host country can provide some real-time tax incentives, that is, when the home country is relaxed, the host country can be slightly tightened; When the home country tightens, the host country relaxes. This will not only help reduce the TP behavior of MNCs, but also attract more foreign capital.

4.1.2 Improve the Capacity of Tax Official

The staff of tax authorities and tax policy makers should have a deep understanding of the real intention behind the TP behavior of MNCs. Economists and accountants, for example, can better understand tax planning strategies and knowledge [9], so that they can better consider the whole picture and draw realistic conclusions in their calculation and planning work. Because when the tax authorities can reduce unnecessary losses for MNCs, MNCs will naturally not use TP and other ways to avoid tax. This seems to reduce the national tax revenue, but in fact, it raises the tax base, but increases fiscal revenue.

4.2. For MNC

4.2.1 Actively Respond to Host Country Control Measure

In order to achieve its goal of reducing its tax base, MNCs should also have a deep understanding of the foreign trade policy of the host country and take positive measures to respond to the corresponding measures of its customs and tax authorities [6]. It is also necessary to independently apply the principle of “one arm’s distance”, cooperate with the host country in supervision, and reach a consensus on international taxation [10], which is also an expression of the principle of tax legitimacy. In addition, it can also actively weaken its own capital, or adopt a variety of pricing methods, and finally achieve its purpose effectively.

4.2.2 Make an Effective TP Structure within the MNC

MNCs should have a complete and effective TP structure, must be able to control all the links, and can complete the corresponding tax work. Such an effective structure can count the internal tax situation of the enterprise, sum up the tax risks, and propose corresponding countermeasures [6].

At the same time, it is also necessary to pay attention to the behavior of the host country. When a new policy is promulgated, it should be interpreted and analyzed in time to judge whether the policy is conducive to the various behaviors of the company and ultimately achieve a win-win situation.

4.2.3 Develop Appropriate TP Strategy

MNCs should be more long-term vision, can not only focus on the immediate interests, in order to achieve the stable development of the company, even if to adopt TP behavior, but also to develop appropriate TP strategy. This is not a quest to come up with a plan that both countries and MNCs can be happy with, but to find a mutually acceptable balance in which neither side loses too much nor gains too much. Therefore, MNCs need to establish a sound tax risk control.

In addition to calculating the taxes that may need to be paid, the system also records and analyzes the tax risks, and combines the tax policies issued by the host country to conduct reasonable tax avoidance near the balance point mentioned above [6].

4.2.4 Undertake Social Responsibility

Although TP is not illegal as a means of tax avoidance, the social costs arising from it are borne by the public. Therefore, if the MNC adopts TP method, it should bear more social responsibility [11]. This is not a solution to the problem of tax avoidance but should be regarded as a requirement for MNCs, whose logic is not because MNCs are large and rich, so they are required to bear more, but after their behavior has caused a certain impact on the society to compensate or prevent in advance.

5. Conclusion

The main purpose of a company is to make more profit, but this cannot be its only purpose. Similarly, TP itself is not an illegal activity that should be completely prohibited, but it should not be beyond the bounds. It is in the interest of MNCs to use the means within the law to avoid tax, but is there a strategy that can also be in the interest of the host country? This is not about finding an ideal, unrealistic way to make both host countries and MNCs rich. It is a search for a balance, in which both parties take their share of the obligations and enjoy the rights they can enjoy. In the case of MNCS, more consideration should be given to their impact on society, and in the case of host countries, whether the tax policies of MNCS are too harsh should be considered. If both sides could think more about their immediate interests, global economic growth would not be impossible.

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