Regulatory Issues and Recommendations on Transfer Pricing Tax Avoidance by Multinational Corporations

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Abstract. In recent years, with the continuous development of the global economy, multinational corporations allocate resources in various ways to reduce the overall tax burden of the group to achieve the business goal of profit maximization. The transfer pricing method is one of the most common international tax avoidances means used by multinational corporations. Although transfer pricing tax avoidance does not constitute an illegal act in form, in substance, it causes serious capital loss in the host country and infringes on the tax sovereignty of the host country. However, there are still many research gaps in international anti-avoidance regulation, so it is necessary to analyze and recommend the regulation of transfer pricing tax avoidance by multinational companies. This paper introduces a typical case of transfer pricing tax avoidance by Apple, introduces the principles and hazards of transfer pricing tax avoidance, and analyzes the current situation and shortcomings of transfer pricing tax avoidance regulation from three levels: multinational corporations, home countries, and host countries, and then propose suggestions to improve the regulation at the national, multinational corporation and social management levels.

Keywords: Multinational corporations; Transfer pricing; Tax avoidance; Regulation.

1. Introduction

With the deepening of world economic integration in recent years, multinational companies have gradually increased their use of transfer pricing to avoid taxation in various countries to save global transaction costs and maximize profits, which not only causes serious capital loss in the host country but also infringes on the tax sovereignty of the host country. Apple, for example, successfully avoided $44 billion in taxes from 2009 to 2012, relying on the tax structure it set up in Ireland. Ireland's corporate income tax rate of 12.5 percent is much lower than that of the United States and is known as a "tax haven. Apple's parent company has three offshore subsidiaries in Ireland, Apple Sales Inc. (ASI), Apple Operations International (AOI), and Apple Operations Europe (AOE) [1]. To legitimize the flow of funds from these three affiliates, Apple entered into a cost-sharing agreement with AOE and ASI, whereby Apple's parent company shared the research of Apple's technology development activities with AOE and ASI and shared the research and development costs in proportion to the revenue generated from the intellectual property. Ultimately, AOE and ASI were only required to pay a portion of the R&D costs, reducing corporate income tax payments, while being able to own the rights to use and transfer ownership of the intellectual property, allowing them to produce and sell products at a significant profit. Specifically, Apple transfers the IP assets it owns to AOI, and the cash paid by the user goes to ASI's account. The Apple IP assets used by ASI in this sales process require the payment of IP royalties to ASI, and ASI transfers the sales costs to AOI and ultimately to Ireland through the AOE in the name of royalties. Under U.S. tax law, tax residency is determined by the company's place of incorporation, while Ireland determines the company's tax residency based solely on the location of the company's core control and management, which makes AOI a "ghost company" with no tax liability to any country. AOE and ASI pay tax on only 1% of their income from operations in Ireland [2]. So, Apple only pays a low transaction tax and income tax to Ireland in this flow-through process [3]. It is easy to see that the international legal system for avoiding transfer pricing tax avoidance is not sound, and many of the tax-related regulations are relatively general and vague. In the global perspective of the rapid development of Internet big data, the relevant legal system of the international community is still conservative and old-fashioned, innovative and practical enough to effectively regulate the tax avoidance behavior of multinational companies. This paper will focus on the regulation of multinational companies' tax avoidance by transfer pricing, analyze the regulatory shortcomings of the international community from various aspects, and propose improvement solutions.

2. An Overview of Transfer Pricing Tax Avoidance Methods

Transfer pricing is the practice of internal enterprises of MNCs in pricing their products, services, or technologies to their affiliates, such as parent companies to subsidiaries, and among individual subsidiaries. For overall strategic purposes, MNCs will coordinate effectively among their internal enterprises to take advantage of tax rate differences between different countries or regions to shift prices between host countries, adopting a high-in-low-out strategy to shift profits in host countries with higher tax rates and a low-in-high strategy to strand profits in host countries with lower tax rates or tax exemptions [4]. Transfer pricing method can enable MNCs to effectively avoid tax liabilities.

2.1. Corporate Income Tax

Transfer pricing, as a common international capital dispatching tool used by MNCs, is used to avoid corporate income tax in the first place. The corporate income tax is directly based on the profits of products or services, which can be manipulated by multinational companies to avoid tax. The tax types, tax rates, taxation objects, and related preferential policies are different among countries or regions, and multinational companies take advantage of this difference to set overseas affiliates in different countries or regions flexibly and transfer profits to countries and regions with lower tax rates to pay corporate income tax. By doing so, the overall amount of tax paid by the multinational group is reduced accordingly and the overall benefit is maximized, thus achieving the purpose of avoiding corporate income tax [5].

2.2. Tariffs

Since the amount of tariff per unit of goods is determined by the import price and tariff rate, MNCs can reduce the base of tariff payment if they conduct internal transactions by coordinating the business strategies of internal enterprises and lowering the prices of products or services of each enterprise. Since the internal transfer price of each enterprise will not be affected by the supply and demand in the international market and is completely set by the internal decision-making level of the MNC, the MNC has more flexible space to avoid tariffs when applying transfer pricing methods [6].

3. Regulatory Issues

3.1. Multinational Companies

3.1.1 Transfer pricing methods among multinational companies

MNCs operate in different environments and have different profit models. For the sake of profit maximization, MNCs tend to adopt different pricing methods. There are three main international pricing methods, namely market-based pricing, cost-based pricing, and negotiated pricing. First of all, there are restrictions on the use of each pricing method, which makes multinational companies often bound by a particular aspect of the factors, facing greater transaction risk. For example, the cost-based pricing method is based on the company's manufacturing costs and sales value to determine product pricing, this pricing method is relatively simple and objective, but because it does not indicate the perceived price of the market, the lack of flexibility and sensitivity to the market, so if the product does not sell well, the company must adjust the cost-plus ratio to adapt to changes in market conditions pricing strategy and price changes and corporate countermeasures. Moreover, the scale, management level, and objectives of each multinational company using cost-based pricing methods are different, and there are large gaps in overhead and selling expenses. Therefore, the prices of products and services offered by each company can vary greatly, which is not conducive to the development of the market and affects the process of its international development.

3.1.2 High strategic costs and lax management of multinational companies

With the progress of global economic integration, various countries are developing rapidly in terms of culture, economy, and trade. It is worthwhile to examine how MNCs can coordinate their managerial inputs and various costs for transfer pricing so as not to affect the overall profit of the company. MNCs face excessive strategic costs, which makes the management of MNCs reluctant to invest too many human, material, and financial resources in management. This phenomenon leads to their overly lax management and non-compliance with the relevant laws of the host country, which may subject them to huge taxes and lead to a decline in global profits. First, MNCs face huge political costs. Due to the instability of host countries, as well as home country governments and societies, host and home country policies in politics, economics, security, etc., often change, resulting in the value of multinational companies' cross-border business activities being affected. Host and home country governments often step in to intervene, and certain policies they set can interfere with the competitive position of MNCs. Therefore, MNCs need to consider many factors involving political risks, such as whether the home country and the host country in diplomatic and military relations are friendly, and whether the host country's political stability, which requires MNCs to bear a large political cost. Secondly, MNCs face greater macroeconomic risks in foreign investment. The macroeconomic instability of the host country, often economic disorders, such as high inflation rate, and debt crisis, may lead to economic recession, depression, and other phenomena, so multinational companies face the risk of economic losses. In the face of these macroeconomic risks, multinational companies must take measures in advance to judge the current international economic situation, in the economic downturn to stop the continued investment of capital. It makes multinational companies must bear the macroeconomic costs not small. Finally, multinational companies because of their global operation, their business scope inevitably involves the culture of different countries, which is bound to involve cultural differences. And the cultural differences will be reflected in the order and management methods of different countries. In this regard, MNCs have to pay high costs to adapt to the environment, culture, and market of MNCs with large differences in each country.

3.2. Home Country

The regulatory will of MNCs' home countries is weak, and the regulatory system is formal, making it difficult to form a strong and effective regulatory model. Since MNCs and home countries are mutually beneficial relationships, home countries are more inclined to cooperate with MNCs to gain benefits rather than suppress them. On the economic level, the degree of development of MNCs and their share in the international market represents the economic strength of the home country, which in turn enables them to stand firmly in the international community. Most home countries choose to strongly cultivate MNCs and support their development in the host country. If the home country reduces its regulatory efforts and the constraints on MNCs in the development process, MNCs will also return their overseas profits to the home country on a sustainable basis, allowing the economic strength of the home country to grow significantly. From the political level, as the home country of the majority of developed countries, multinational corporations are one of the main interest groups supporting their elections and making investments, if the candidates supported by multinational corporations are successfully elected in the home country, they will act as their interests advocates and defend the interests of multinational corporations. This cooperation from both economic and political perspectives forms an indestructible bond between the MNC and the home country, which does not over-regulate the behavior of the MNC, which would also endanger the interests of the home country itself. Home countries lack the will to do so from the ideological level, and they are simply not interested in international legislative activities that constrain MNCs, rather than being constrained and limited by the right to regulate The Dilemma of MNC Regulation and Countermeasures - An Exploration from the Perspective of Developing Countries. Therefore, this relationship of cooperation and even interdependence is difficult to break, which brings a lot of difficulties to the establishment of a regulatory system.

3.3. Host Country

Multinational corporations often use transfer pricing to evade host country tax and foreign exchange controls, disrupt the normal economic order of the host country, and reduce the host country's tax revenue, forcing the host country to develop a more specific tax system and improve the regulatory policy of anti-avoidance. But the establishment of a tight regulatory system is not easy for the host country, when the host country increases the supervision of multinational companies, multinational companies will measure the new environment of the host country, in the international context of investment liberalization, if the multinational companies at this time that the host country's economic environment is not good, operating risks, internal transaction risks are too large, may gradually withdraw from the investment in the host country. Because the host country relies heavily on the entry of TNC foreign investment to optimize the industrial structure, the disinvestment of foreign subsidiaries of TNCs has a significant negative impact on the evolution of the industrial structure of the host country, so the host country does not dare to implement strict regulatory policies to trigger the consideration of TNC disinvestment. Even TNCs can threaten host countries by stopping new investment or disinvestment, so host countries cannot establish effective regulatory strategies to deal with the actual disinvestment or threatening behavior of TNCs, and the regulation is ineffective or unregulated.

4. Regulatory Recommendations

4.1. National Level

Sovereign states should regulate the behavior of MNCs from both domestic and international levels to improve the paradigm shift of MNC social responsibility regulation under global governance [7].

4.1.1 Domestic

Countries should actively formulate relevant domestic laws, establish a comprehensive anti-avoidance risk control system, conduct tax investigations to screen suspected tax avoidance companies, and provide for the social responsibility of multinational companies.

Determining whether the pricing between the parent company of a multinational corporation and its subsidiaries or various departments of the company is reasonable is the key to perfecting the system of controlling anti-tax avoidance risks, and mastering the price information of various products and services in the international market is a prerequisite for judging whether the pricing is reasonable. At present, there does not exist a comprehensive and open information database in international trade to support international anti-avoidance work, which makes it difficult to discover the tax avoidance risks in the internal business transactions of multinational companies [8]. Therefore, tax agencies in each country should actively communicate with each other, comprehensively integrate information, establish an information resource sharing mechanism, broaden the information exchange channels between various departments in each country, and establish information communication systems with banks, securities, real estate, etc. to break the industry and regional information barriers between governments.

4.1.2 International

Due to the complexity and hidden nature of the transfer pricing issue, the laws of a single country can no longer effectively restrain the behavior of multinational companies, and it is difficult to stop the transfer pricing behavior of multinational companies with the power of only a few countries. At this time, the international community needs to set up intergovernmental international organizations to play its advantages in officiality, authority, and enforceability, establish management mechanisms at the international level, prevent and combat the transfer pricing tax avoidance behavior of multinational companies, and require multinational companies to take responsibility for their multinational business behavior [9]. For example, the Code of Conduct for Multinational Corporations promulgated by the Organization for Economic Cooperation and Development in 1976 is a typical example, which has important reference value for both the regulation of sovereign countries and the self-regulation of multinational corporations. In the future, relevant intergovernmental international organizations should actively contribute to the formulation of agreements regulating the economic activities and tax order of multinational corporations, and promote countries to become signatories of these agreements, and countries should also consciously comply with the relevant treaties reached by intergovernmental international organizations and cooperate to promote the process of regulating the responsibilities of multinational corporations under the rule of law.

4.2. Multinational Company Level

4.2.1 Flexible use of pricing

For the host country, no matter what transfer pricing strategy MNCs take, they will to a certain extent damage the national interests of the host country and be controlled. Therefore, MNCs should have an in-depth understanding of the foreign trade policy of the host country and take active measures to cope with the control measures of the host country, such as taking into account objective and subjective factors in the process of formulating transfer pricing policies, flexibly using a variety of pricing methods, selecting international transfer pricing strategies according to the political policies and economic environment of the host country, making its different types of transfer pricing methods play their respective advantages to achieve international business strategies and profit maximization strategic objectives [10]. Moreover, multinational companies should form a complete transfer pricing structure within the company, and make effective tax planning for all aspects of the transaction, and when the host country promulgates new policies, the corresponding pricing policies of multinational companies should make timely responses to avoid the possible tax risks.

4.2.2 Encourage multinational companies to self-regulate

The international community requires multinational corporations to take the initiative to assume social responsibility for the growing momentum, of the influence of the pressure of social opinion, for multinational corporations, taking the initiative to develop relevant rules can effectively avoid the intervention of government power, reduce the burden of enterprises due to assume the social responsibility imposed by the government and increase, reduce the institutional transaction costs of multinational corporations, and obtain higher profitability. Compared with government constraints, the self-restraint model of multinational corporations under the rational taxation of higher motivation, self-restraint model of multinational corporations to regulate half the effort, so the international community should actively encourage multinational corporations to develop self-restraint development regulations, can be through company to develop self-restraint of relevant documents, such as business activities guidelines, monitoring reports, such as Wal-Mart Corporation once issued internal production code For example, Wal-Mart has issued an internal production code and monitored its implementation through CSR and sustainable development reports. Or through the establishment of alliances between multinational companies to urge each other to take social responsibility in paying taxes. Although these documents are not binding at the legal level, the effectiveness of these self-regulatory documents is gradually strengthened as MNCs continue to enhance their economic strength and expand their social influence, gradually forming a good economic order in the international community.

4.3. Social Management Level

Social supervision is one of the powerful tools to curb the tax avoidance behavior of MNCs. The government can actively use social public opinion supervision to expose the tax evasion cases of

MNCs promptly. With the power of the masses, stimulate the awareness of the masses and social opinion to supervise the tax-related activities of multinational companies, seriously treat the reports of the public on the tax avoidance behavior of multinational companies, and give appropriate rewards to the whistleblowers who provide important clues. For multinational corporations with significant tax avoidance behavior, the government can make them enter the blacklist of international trade and restrict their trade activities, and can also affect the economic interests of multinational corporations' stocks through public opinion, and take advantage of the potential consequences of the reduction of their customers and market shares to reduce the tax avoidance behavior of multinational corporations, and then achieve strong curbs on the tax avoidance behavior of multinational corporations.

5. Conclusion

Multinational corporations can avoid paying corporate income tax and customs duties globally mainly because of the urgent problems in the international regulatory system. This paper analyzes the current problems of international regulation and puts forward relevant regulatory recommendations for transfer pricing tax avoidance by multinational companies. At the level of sovereign countries, this paper suggests that countries should actively establish a perfect anti-avoidance risk control system and set up an intergovernmental international organization to combat tax avoidance; at the level of multinational companies, this paper suggests that multinational companies should use pricing methods flexibly and encourage them to exercise self-restraint; at the level of social management, this paper suggests that social opinion should be actively used for supervision. The above suggestions are conducive to the international community to further improve the regulatory system and regulate the order of multinational corporations' transactions. However, this paper focuses on the idea of regulating the international regulatory model, how to effectively implement and enforce it is a question that should be considered in future research. The above suggestions can be further refined in the future to help better circumvent the regulatory behavior of multinational companies' transfer pricing.

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