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Tax Avoidance and Regulation of Transfer Pricing: From the Perspective of International Law

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Abstract: With the social economy developing continuously and the deepening of economic globalization, the scale of multinational corporations is expanding increasingly. However, due to the gap in tax rates between different countries, multinational corporations have room for tax planning. As a common means of tax avoidance in multinational enterprises, transfer pricing is officially realized by relying on the difference of tax rates in different countries. But transfer pricing in bring huge profits to multinational companies at the same time, the multinational home and host country revenue caused great damage, so the transfer pricing has become the focus of the tax authority regulation, this paper mainly through the case analysis of Coca-Cola company, this paper expounds the multinational companies through the transfer pricing tax avoidance and transfer pricing multidimensional adjustment of thinking. Therefore, for multinational corporations, under the constraints of relevant laws and norms, reasonable planning and control of the risk of transfer pricing is the key to enterprise tax avoidance compliance.

Keywords: Transnational enterprises, Transfer pricing, Tax avoidance, Independent trade principle.

1. Introduction

These days, the continuous development of economic globalization causes that many multinational enterprises are growing in scale. In order to obtain greater profits, multinational enterprises reduce the cost through various methods, among which the reduction of tax cost plays an important role in it."Tax avoidance" reasonable tax avoidance is a kind of legal behavior, is based on the relevant tax law is not systematic, the system is not perfect. Taxpayers have the desire to reduce the tax burden and maximize their own interests, or take advantage of the defects of different tax jurisdiction standards and relevant international laws and regulations for tax planning, or take advantage of the difference in tax rates of various countries to reasonably avoid tax. As a common method of international tax avoidance, transfer pricing has attracted widespread attention.

At present, the amount of cross-border related party transactions of enterprise groups is huge, occupying the main proportion of international trade profits. However, these transactions are basically carried out under the current legal norms and system, realizing reasonable tax avoidance, which can not only avoid the tax of the home country of the enterprise, but also avoid the tax of the host country. The main ways of transfer pricing are: enterprises in high-tax countries set low prices for economic

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activities to low-tax enterprises such as goods transaction, service provision and the transfer of intangible assets, but instead, enterprises set high prices for the same economic activities for affiliated enterprises in high-tax countries. In this way, most of the profits are transferred to low-tax countries, enjoying lower tax costs and making greater profits. Take Nike Multinational as an example. According to statistics, from 2007 to 2014, Nike withheld $6.6 billion through this approach. From 2015 to 2017, Nike intercepted another $5 billion through the same tax avoidance method, even controlling the comprehensive negative tax rate of offshore profits outside the United States at 2% [1]. In just a decade, Nike has avoided $11.6 billion in tax avoidance. At the same time, the effect of pricing transfer is not only related to external factors such as corporate income tax rate, currency exchange rate change, corporate asset scale, average industry profit rate of the multinational corporation host country, but also related to the internal motivation of enterprises.

Thus it can be seen that transfer pricing destroys the investment environment of high-tax countries and brings huge financial losses to the governments of high-tax countries by manipulating profits. It is urgent to standardize the relevant laws of transfer pricing and improve the relevant mechanisms. Therefore, this paper mainly discusses the adverse effects and existing problems of transfer pricing, the shortcomings of the existing system and relevant suggestions.

2. The Underlying Principle of Transfer Pricing

2.1. Definition of Transfer Pricing

As a common tax avoidance method for multinational enterprises, transfer pricing refers to the pricing production of internal transactions that provide the right to use products, services and intangible assets within the company group or among related enterprises. According to the characteristics of transfer pricing, the relevant laws and regulations mainly aim at the transaction pricing between multinational affiliated enterprises. In international law, related parties are generally considered to include the following three types: first, individuals, enterprises or other organizations with direct or indirect control relations in terms of capital, purchase and sale, operation, etc.; second, individuals, enterprises or other organizations with directly or indirectly control controlled by third parties; and third, they have other related relationships in terms of interests. At the same time, the problem of transfer pricing can occur within a country, or between countries, and the transfer pricing between countries is called international transfer pricing, which is the focus of this paper.

2.2. The Main Method of Transfer Pricing

2.2.1. Transfer Pricing of Goods Transactions

With the accelerated advancement of economic globalization process , the trade of goods still occupies a large proportion in international transactions."Goods" referred to here only refers to raw materials, processed raw materials, semi-finished products and finished products, and tangible assets such as fixed assets and financial securities are not included, nor are intangible assets such as proprietary technology. According to the 2022 OECD Guide on Transfer Pricing for Transnational Enterprises and Tax Authorities, there are mainly four categories: First, the comparable uncontrolled pricing method, in which compares the price of property or services transferred by affiliated enterprises with that of comparable non-controlled enterprises in comparable situations. Second, the resale price method, based on the resale of products purchased from affiliated enterprises at the price of an independent enterprise. Third, the cost price increase method, based on the supplier's cost, plus the appropriate profit value. Fourth, the transfer pricing method based on net profit, which is compared on the basis of net profit, and eliminates the factor of cost, so as to enhance the comparability [2].

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2.2.2. Transfer Pricing of Labor Services Provided

The method of labor service provision transfer pricing, also known as "related transaction of labor service transfer", is the specific manifestation of labor service provision in transfer pricing. It takes labor service as the carrier, and multinational enterprises provide research, consulting and other services among affiliated enterprises. In practice, it is shown that companies in low-tax countries provide services to companies in high-tax countries and set higher service prices when companies in low-tax countries provide services to companies in high-tax countries. Thus increase the cost of the company's labor service, to artificially increase the company's pre-tax cost, reduce the tax payable [3]. Because of its serious impact on national tax revenue, many countries have adopted legislation to regulate transfer pricing. In term of the international community, the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration released by the OECD in 2022 was revised and updated on the basis of the document which was published in 2017, regarding the context of labor transfer, emphatically points out that tax authorities and taxpayers bear the burden of proof, should be well prepared, as far as possible in accordance with the fair trade principle of labor transfer related transactions.

2.2.3. Intangible Assets Transfer Pricing

The swift advancement of technical science is changing with each passing day whereas the proportion of intangible assets to the high profits of multinational companies is gradually increasing. At the same time, intangible assets have also become a powerful weapon for multinational enterprises in the market competition of various countries. Therefore, the investment of multinational enterprises in intangible assets is also increasing. According to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Authorities(2022), intangible assets are defined as "intangible assets are intangible assets owned or controlled by enterprises in commercial activities that do not have physical state, and the intangible assets should be paid when used or transferred by independent enterprises under comparable circumstances [2]".

The OECD Transfer Pricing Guide divides intangible assets into trading intangible assets and marketing intangible assets. In addition, it also mentions the classification of conventional intangible assets and unconventional intangible assets, which are not discussed in this article. Trade-oriented intangible assets include patents, proprietary technology, designs and models, and the intangible rights contained in the product itself. Marketing intangible assets refer to the intangible assets related to marketing, which are specifically manifested as trademarks, trade names, customer lists, and unique names and marks with commercial value [4]. The value of distinguishing the two is to promote the reallocation of ownership of intangible assets. In the case of GlaxoSmithKline, 77% of the Internal Revenue Administration's profits from Ranitidine were transferred to Glaxo America because its profit ownership is mainly attributed to marketing intangible assets [5].

3. The Adverse Effects of Transfer Pricing

3.1. Infringes on the Due Interests of Developing Countries

This adverse effect is mainly reflected in the emerging countries and mature countries, due to the cooperation has a huge economic advantage, developed countries are more likely to master the pricing power of multinational companies, even the control of the multinational enterprises, and developing countries may face the transfer pricing transfer multinational huge profits to the risk of the parent company, developing countries cannot equally enjoy the profits of multinational companies, and damage the interests of investors in developing countries.

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3.2. Cause the International Tax Distribution Imbalance

By means of transfer pricing, multinational enterprises can increase or reduce the expenses and income of affiliated enterprises, which affects the tax changes of relevant national governments. For example, in the transfer pricing of labor provision, enterprises reduce the amount of tax payable by enterprises by increasing labor costs, thus reducing the tax revenue of the national government. One of the common ways for multinational enterprises is to transfer their profits from high tax countries to low tax countries such as Ireland in order to pay the least tax and maximize the profits of multinational enterprises. If some multinational enterprises in the high tax rate countries transfer most of the profits to the low tax rate countries and reduce the tax amount payable in the high tax rate countries, it will inevitably lead to the loss of government tax revenue in the high tax rate countries.

3.3. Leading to the International Balance of Payments Imbalance

This adverse effect is mainly reflected in the way of goods trade transfer pricing, if the multinational enterprises using the method of resale, to cost products to low tax countries, then at high prices to high tax rate countries, resulting in the country of high tax multinational enterprise income, spending, thus makes the balance of payments imbalance. The imbalance of income and expenditure of multinational enterprises in high tax rate countries will also be reflected in the books of multinational enterprises. Internally, the illusion of low profits of multinational enterprises in high tax rate countries appears, which conveys the information that the investment return of multinational enterprises is not ideal, thus affecting the reputation of the investment environment of countries with high tax rate and causing bad effects.

3.4. Cause Unfair Competition in the Domestic Market

This adverse impact is reflected in the transfer pricing of intangible assets, especially in the overseas parent company of traded intangible assets, multinational enterprises enjoy the proprietary technology, patents and other intangible assets of product production, so as to produce products on a large scale with very low cost. The products are sold to the subsidiaries of low-rate countries at low prices, enabling the subsidiaries to quickly open the market of low-rate countries with huge price advantage, and even reach the degree of monopoly [6]. After that, multinational enterprises are likely to take advantage of a relatively large market share to set higher industry prices and obtain huge profits. This practice will cause unfair competition in the domestic market of low-tax rate countries, which is not conducive to the benign operation of the market economy.

4. International Regulation and Response to Transfer Pricing

4.1. The OECD's Regulatory Guidelines on Transfer Pricing

From the perspective of international law, most of the tax planning related to transfer pricing takes the Transfer Pricing Guide for Transnational Enterprises and Tax Authorities issued by the OECD as a norm with legal significance. The text reflects the consensus formed by the member states on setting pricing for cross-border transfers.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Authorities (2022) released on January 20, 2022 has made some important revisions on the basis of the 2017 edition. First, the new Guidelines on Tax Management Application of Intangible Assets approved on June 4, 2018, which follows the definition of intangible assets in Item 8-10 of the BEPS Action Plan, and indicates the non-comparable rights of intangible assets or intangible assets and the assumption that future cash flow, revenue forecast and value assessment are highly uncertain. Second, the new Guide

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for the Application of the Transaction Profit Division Method, approved on June 4,2018, points out three situations in which the profit division method applies: (1) All parties to the transaction have made unique and valuable contributions, covering both the assets used and the functions of execution. (2) Business operations are highly integrated, that is, the functions, risks and assets used by the parties to the transaction are connected to each other. (3) The parties to the transaction bear major economic risks or the parties bear closely related risks. Third, the newly added Transfer Pricing Guide for Financial Transactions, which was approved on January 20,2020, mainly complements the transfer pricing methods of financial transactions, such as the income difference method, cost method and capital support method for guarantee transactions [2]. The Transfer Pricing Guide for Multinational Enterprises and Tax Authorities issued by the OECD has been recognized by countries around the world, minimizing the possibility of controversy.

The multinational enterprises and tax authorities transfer pricing guide is the core of independent trading principle, namely the business relationship between two enterprises or financial relationship is different from the relationship between independent enterprises, so should be obtained by one of the enterprises, but because some factors actually no profit, can be included in the enterprise profits, and the tax [7]. This principle is not only present in the Transfer Pricing Guide, but also takes the principle of independent transaction as the basic principle of international taxation in the International Tax Model formulated by the OECD. The principle of independent transaction has always been the principle that must be followed in the international community, and often appears in the bilateral tax treaties of most countries [8]. However, it is difficult to find comparable transactions as reference in judicial practice, so it is impossible to accurately measure whether related party transactions conform to the principle of independent transaction. This institutional defect also leads to different countries following the OECD Transfer Pricing Guide despite the differences in the specific conditions of the country and the specific circumstances of the cases.

4.2. National Tax Policies on Transfer Pricing

When formulating tax policies, all countries supplement and adjust transfer pricing on the basis of the OECD "Transfer Pricing Guide", and follow the principle of independent transaction, but due to their different national conditions, they also have some emphasis on tax policies. For example, in Japan, building on emphasizing the independent transaction principle, asks companies to prepare documents of transfer pricing and use the comparable uncontrolled pricing method and other methods to adjust the transfer pricing. The Japanese tax authorities also strictly examine the transfer pricing of multinational companies [6]. Germany, based on the principles of independent trading, values on the preparation of transfer pricing documents and the provision of concurrent information, There are no too many restrictions on the adjustment method; Britain is following basic principles, On the basis of emphasizing the preparation of transfer pricing documents, Emphasize that the tax authorities have the obligation to modify the unreasonable transfer pricing; The United States has incorporated the independent transaction principle into the national tax system.

In the domestic law of the United States, the United States Congress wrote the principle of independent transaction into law in 1928. Since 1934, the principle of independent trading has been existed in the Domestic Revenue Code of the United States. Meanwhile, in practice, the United States signed bilateral tax treaties with other countries [9]. Since 1935, according to the Regulations on Financial Management, the IRS has followed the independent transaction principle in every case of transfer pricing. In terms of international law, the United States, as the first country to use the independent transaction principle, incorporated in 1932 into bilateral tax treaties with other countries. It can be seen that the independent transaction principle is the pillar of international tax revenue that American taxpayers rely on for a long time, and it has gradually become the measure of tax levied by IRS on enterprises. For example, in Coca-Cola v. IRS, IRS vested in the income of Coca-Cola affiliates in low-tax countries like Coca-Cola in Ireland, and taxed Coca-Cola as taxable income. This also became the focus of controversy in this case [10]. Because multinational enterprises themselves have the special nature of "their own countries", they often take advantage of the international tax loopholes of the different tax rates of different countries to intercept the amount of tax payable. Coca-Cola's income tax rate in Ireland is only 12.5%. With this tax benefit, Coca-Cola transforms the bottlers from the supply point management to an independent third party. The supply point is also concentrated in seven countries, and the cost-plus rate of the supply point is as high as 57%, much higher than the normal level of 6% -8.5%, thus retaining huge profits in Ireland. IRS questioned the rationality of the huge profits, believing that its profits mainly come from intangible assets such as formula, trademark, bottle appearance or its rights, and these intangible assets and their rights are held by TCC (the Coca-Cola company) in the United States, so the vast majority of profits are within the scope of taxable income. The court ultimately determined that IRS's adoption of different methods of transfer pricing was not an abuse of discretion, but on the contrary, IRS's approach was more conducive to ensuring tax fairness [11].

5. Problems and Limitations of the Current Transfer Pricing Regulation

As social economy keeps evolving and technological science makes continuous progress, the business models of multinational enterprises are also constantly innovating, which subtly affects the global investment structure and economic layout of multinational enterprises. Even though the relevant legal norms and tax policies today have been greatly improved compared with the previous ones, compared with the expansion rate and the growth rate of trade, the relevant laws and policies still have a lag.

On the legal level, on the one hand, most countries in the world have the problems of low effectiveness level of relevant legal norms and imperfect relevant legal system. In China, for example, China's regulation transfer pricing law only three: the foreign investment enterprises and foreign enterprise income tax law (abolished), the tax administration law, the enterprise income tax law, and in order to better adapt to the development of society, respond to the needs of the market, the state administration of taxation and other authorities made part of the regulations, regulations and other administrative regulations, rules and local regulations. Therefore, two problems arise: first, the large number of relevant normative documents is large, but it has not formed a complete system; second, because the number of relevant laws and regulations are not equal, in practice, the lower law often violates the upper law [6]. On the other hand, the identification standards of associated enterprises in legal provision have limitations. Taking China as an example, China's laws and regulations adopt the method of listing the identification standards for related transactions and affiliated enterprises. For example, in the Tax Law of China, it only lists 8 kinds of relationships between enterprises, and to meet one thing, affiliated enterprises are constituted. But in practice the market main body itself is complex, the intervention of the digital economy make the change of the market more flexible, so through the way of listing does not timely guide the tax authorities in the new field, new situation on the recognition of associated enterprises, nor tax avoidance behavior of the enterprise play the role of timely regulation and specification [1].

On the level of international tax, the limitations of the current transfer pricing mechanism are also reflected in the system of international tax itself. The excessive difference of international tax is an important problem in the international tax system, and it is also an unavoidable phenomenon. Tax is the embodiment of national sovereignty in the field of tax, exclusivity and independence, not interference by other countries or international organizations, so some countries to attract foreign investment to multinational companies great preferential policies, developed into low tax countries such as Singapore, in addition due to national political, cultural and other factors can also lead to international tax differences. Therefore, the difference in international tax revenue is inevitable.

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6. Suggestions on Perfecting the Current System

6.1. Establish a Systematic Transfer Pricing Legal System

Internationally, there are basic laws on pricing transfer in some developed countries, such as the United States. However, in most developing countries, the legal norms concerning transfer pricing are scattered in various legal norms, and the legal system regulating transfer pricing is not complete or even has not been formed. On the other hand, in view of the problem of low effectiveness of relevant legal norms, all countries should improve the relevant legislative system and integrate the relevant legal norms on the basis of clarifying the legislative core of the transfer pricing law, so as to form a law specifically for transfer pricing. Thus, it can not only improve the hierarchical effect of transfer pricing legal norms, but also improve the legal system of transfer pricing law. Make the transfer pricing law in the legal practice more authoritative, more specific play its guiding role.

6.2. Improve the Reservation Pricing Agreement System

As a tool of tax planning, the reservation pricing mechanism means that the taxpayer can voluntarily negotiate with the tax authorities on a series of standards, such as the pricing and calculation method of related party transactions for a period of time in the future, and reach a written agreement. This mechanism reduces tax disputes caused by transfer pricing and improves the transparency of tax revenue. At the same time, on the basis of advance negotiation between taxpayers and tax authorities, enterprises can carry out tax planning to a certain extent and reduce tax risks. To improve this system, it is necessary to focus on improving the practical operation of the reservation pricing agreement on the basis of adhering to the principle of independent transaction, so that the reservation pricing agreement can really play its legal effect in the practical work, and can truly provide a stable tax environment for enterprises.

6.3. Use Global Value Chain Analysis to Jointly Deal with Tax Risks

Based on the transfer pricing of a single national information acquisition one-sided, difficult, global value chain analysis by focusing on design, production, assembly, value creation of each link and contact these link distribution in different countries and regions, help countries and governments correctly identify the advantages and disadvantages in international competition, so as to formulate the corresponding strategy and planning. In the context of economic globalization, the global value chain analysis method reveals the complexity and dynamics of the global production network, as well as the increasing dependence between enterprises and countries. In this regard, the application of the global value chain analysis method requires the international community to strengthen cooperation, and timely update the tax information through the establishment of tax information sharing and tax information exchange mechanisms, so as to realize the balance of international payments and ensure fair competition in the international market.

7. Conclusion

To strengthen the development trend of economic globalization, production globalization, trade globalization, financial globalization makes the dependence between associated enterprises and countries, and the tax differences between different countries makes multinational companies caught the defects of the international tax revenue, using the transfer pricing to intercept tax, on the basis of multinational enterprises obtained huge profits. But it has caused huge losses to the national finance. Therefore, the process of regulating the transfer pricing is urgent. A series of questions such as how

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to play the guiding role of the transfer pricing method in specific practice and how to adjust the transfer pricing in other dimensions are worth our thinking and exploring.

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