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TRANSFER PRICING AGGRESSIVENESS AND TAX MINIMISATION BY MULTINATIONAL CORPORATIONS

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ABSTRACT: ***This paper examines transfer pricing aggressiveness and tax minimization by multinational corporations. The library-based research design was used for this study which is based fundamentally on review of extant literature. There is sufficient evidence that suggest that these organizations establish diverse transfer pricing strategies to minimize the tax liabilities. It is accomplished with the aid of transfer pricing method to transfer profit from high-tax regions to low-tax regions. However, there is huge dearth of investigations on how transfer pricing and tax minimization by multinational corporations affect developing countries. To this end, thus there is need for future enquiry to focus on providing research evidence for developing economies. As most governments focus revenue generated from taxation to drive economic development, it is imperative that there is universal cooperation if profit movement is to be efficiently achieved and controlled. For Nigeria in particular and with its increasing concentration of multinationals, there is the need for effective enforcing of transfer pricing regulations.***

Key words: transfer pricing aggressiveness, multinational corporations, tax minimisation

INTRODUCTION

Transfer pricing has been a major issue in academic research environment from the time when the innovative works of Hirshleifer (1956) came into inception, its influence has been addressed in different perspectives and hence transfer pricing seems to be a major issue generally as a result of the high rate by which companies engage in it to minimize tax. Ernst and Young's (2011) suggest that multinationals facing internationally tax risk is connected with transfer pricing.

There are cases where transfer pricing is of significance to organization, first is where companies that operates solely within one boundaries and transfer of goods and services are done within various units or regions (including subsidiaries). For these companies the importance of transfer pricing is paramount because the units are valued based on its earnings, return on investment, or residual income, and a commitment must be recognized for such transfer (Noreen, Brewer, & Garrison, 2011). Second, Multinational corporations (MNCs) that transfer products between countries also consider transfer pricing important because they indulge in it as a strategy to move profit from higher tax regions to lower tax regions.

Therefore, an effective global transfer pricing policy consequently influences on the activities of the firm, not just in terms of prices of products but on other financial transactions. (SKV,2007). Hence, a MNC's transfer pricing policy is actually vital to tax authority and also in the minimization of tax and sustainable growth. Over nine various corporate goals have been identified in establishing transfer pricing policy for the MNCs' operations this include: decrease of income taxes, decrease of tariffs, management of cash-flows, prevention of encounters with host nations' governments, motivation and global harmonization, competitiveness, performance evaluations (Abdallah, 2004) etc. Various researches have advocated that a foremost portion of income transfer is done with the support of transfer pricing, particularly in MNCs with intangible assets (Clausing, 2003; Grubert 2003).

Google paid $ 1.8 billion taxes to the French administration due to their transfer pricing method. While the remaining profitable companies, Apple and Microsoft satisfactorily locate profits in low tax regions and increase tax deductible expenses in high tax locations to lessen taxable profits consequently (Duhigg & Kocieniewski, 2012; Mutti & Grubert, 2009; Womack & Drucker, 2011). Hence, one of the identified motivations for transfer pricing practices by MNC is the obsession for the minimisation of tax. There are lot of literature (Klassen, 2007; Korn and Lengsfeld, 2004) about transfer pricing being used as tool for tax minimisation essentially through tax management.

Rego (2003) reported that organization that are more bouyant will have the tendency and resources to establish transfer pricing procedures to move funds from high-tax nations to low-tax nations in order to reduce taxable profits. From tax perspective, transfer pricing is a major view of profit shifting. It is in this light that multinational corporations employ transfer pricing strategy to reduce their tax liabilities to achieve shareholder's ultimate goals and objective of their corporations. In any forms and manners transfer pricing behavior has become unbearable to government, tax authority and the society at large because as tax burden are shifted, many developing countries are deprived of economic resources for development. The corporate strategies to minimise tax and maximize global profit has increased the attention of government to transfer pricing issues (U.S government Accountability Office, 2004).

This study is a review of the literature and theoretical discourse on transfer pricing practice and its use by MNCs to minimise tax.

Tax Minimisation

In recent times, MNC are increasingly managed on global networks and build up unusual transfer pricing practices to upsurge their earnings by minimizing taxes. Tax minimisation is when you legitimately arrange your tax affairs to reduce the amount of tax you pay. MNCs see tax as cost of doing business in effect reducing or minimising taxes boost their shareholders value and post-tax earnings and returns, corporations build transfer pricing strategies not only for evaluation of performance of the division but minimizing taxes on corporate profit (Haslam, 2014).

Tax minimisation has become a key site for corporation using transfer pricing strategies to relocate profit and reduce their taxes to gain competitive advantage (Baker, 2005). Tax minimization is inevitably connected to transfer prices practices established by corporations. So long as government levy taxes on corporate profit, MNCs will have more reasons to develop transfer pricing strategies to minimize taxes (Picciotto,1992). Klassen, Lisowsky, and Mescall (2013) stated it is a method adopted by corporations in reducing global taxes. The motive behind this is that high tax burden will prompt multinational companies to impose lower selling prices amongst associated organizations and relocate the profit to countries with lower tax rate. This transmission is a means to reduce tax expenditures and thereby increase parent company's profit (Kiswanto & Purwaningsih, 2015). Furthermore, the tax minimization goal will replicate the internal purpose of the transfer pricing operation.

Transfer Pricing

Harrowven (2014) states that transfer pricing is that price which organization demands from each other and could be in any form of transactions between related parties. Transfer pricing comes to being when large entities come up with a distinct divisions within the firm in order to accomplish benefits from decentralization in decision making. These separations or unit are in most cases practically independent profit centres and they most times transfer and sell goods and services between one another. These transfers are made through transfer pricing mechanism (Hirshleifer, 1956).

Urquidi (2008) asserts that as at 1979, transfer pricing was one of the methods used by many firms for regarding earnings manipulation. The Organisation for Economic Cooperation and Development's (OECD, 2010), guidelines represent the foremost to institute a framework for regulating transfer pricing activities (Siwele, 2011). By the late 1980s, the term transfer pricing has totally become an immensely debated issues in American political circles (Boulogne, 2008; Cools, 2008). Also in Canada in 1979, transfer pricing legislation was established and its embodies the Arm's Length Principle (Pinto, 2012). According to Walpole (2001), transfer pricing is seen as a technique of moving profits away from the country of business to low tax rate jurisdiction.

Multinational corporations have successfully taken advantage of global tax systems resulting from financial and economic differences between jurisdictions by shifting profits or losses among various associates firms that been incorporated in various tax domain through cautious operation of intercompany transfer prices. Hence, profit is shifted reported in less tax areas and as such cost is recorded in high tax areas and these undertakings is totally not in consonance with arm's length standard

Lin and Chang (2010) outline a number of benefits that makes companies to engage in transfer prices, there include the need to take benefit of global tax and penetrate new markets by appearing more competitive, which may be a consequence of a parent company or a sister subsidiary moving goods at below market prices. This, therefore, implies that transfer pricing can be used for discarding goods into new markets, in order to have perceived competitive advantage. The practices as a whole may not be illegal but as tax burden are shifted, many developing nations are deprived of economic resources and social development.

Transfer Pricing Aggressiveness

The concept entails the shifting of funds between group associates established in different tax authorities via careful modification of intercompany transfer prices (Ricardo, 2016). According to Bartelsman and Beetsma (2003), the concept of transfer pricing may be categorized with the increase of tax aid for multinationals, as an entire, resultant from mispricing of services, products, interest, loan, and royalties among interrelated parties and consequently reflects transfer pricing activities dwindling into the gray areas of tax compliance, as well as, actions that are obviously illegal (Hanlon & Heitzman, 2010). Eden and Smith (2011) considers the terms to be a tax or financial benefit effectively occupied by MNCs resultant from financial, economic or legislative arbitrage changes between jurisdictions.

Transfer pricing aggressive action is revealed by wide non-arm's length dealings between related events. Similarly, global tax authorities have raised concern about the loss of tax revenues which may be the result of aggressive transfer pricing practices. (Hamilton, 2001).

Prior Studies

The major reason why MNC pursue transfer pricing avenues is largely borne out of the need for tax minimisation and this is achieved through divisionalisation, subsidiaries etc, persuading reduction in costs and taxable profits. The vital aim of transfer pricing regulations is to enhance profits this is achieved via tax-minimization (Atrill & McLaney, 2007). In an attempt to minimize tax via transfer pricing, corporations develop procedures for assigning expenditures and develop policies in assessing transfer prices of products. Basically, MNC tend to engage in profit shifting across affiliates in order to lower corporate tax payment.

According to Baldenius, (2004) as the number of multinational corporations increases, this profit shifting is increasingly cited as one of the great challenges for tax agencies According to Klassen, Lisowsky, and Mescall (2013) transfer pricing is a tools utilized by multinational initiatives to enable them decrease global taxes. The motive behind this is that higher tax liability will prompt multinational companies to enact lower selling prices amongst associated firms and move the returns to countries with lower tax rate. This transfer is actually carried out to reduce tax expenses and therefore increase the profit of parent company's (Kiswanto & Purwaningsih, 2015). Furthermore, the tedious nature of applying the arm's length belief offers avenues for multinational companies to influence transfer pricing in a bid to avoid corporation taxes (Chen Ye Ekström, Dall, & Nikolajeva, 2014).

Jacob (1996) stated that profitable MNCs have better motives to participate in aggressive transfer pricing activities to actually evade substantial corporate taxes. Ricardo (2016), found out that significant associations exist between transfer pricing aggressiveness and tax avoidance, implying that MNCs explore tax prospects in higher tax regions so as to reduce their tax burden in the home country. Similarly, Richardson and Taylor (2015) stated that tax minimization is significantly related with aggressive transfer pricing behaviors at a level which shows a strong linkage. Richardson (2013) assert that firms are able to reduce taxable profits accordingly when they discover income in lower tax domains and increase tax deductible expenses in higher tax domain.

Kusuma and Wijaya (2017) examine the intensity of transfer pricing practices. With the aid of purposive sampling, a total of two hundred and fifty nine (259) firms stood as the sample for a period of five years ranging from 2011-2015. It was measured using Dummy Related party transaction (RPT) ratio. Sales to related parties are rated 1 otherwise 0. The result indicated that intangible assets, firm size, tax avoidance, and effectiveness significantly improved the intensity of the transfer pricing practise.

Richardson et al. (2013) examine transfer pricing aggressiveness using a sample of a hundred and eighty three (183) listed Australian firms. Transfer pricing aggressiveness was measured using transfer pricing index. The regression results show that tax avoidance is significantly positively related with transfer pricing aggressiveness. Their findings also indicate that firms augment their transfer pricing aggressiveness through the joint effects of intangible assets and multinationality.

Clausing, (2009) asserts that MNCs have a tendency to be more capable and have high tax chances to move profits to advantageous tax region, but as well to allocate vital permissible tax to high tax jurisdictions and have greater probabilities to decrease their corporate tax burden when associated with those companies functioning purely on the interior market. They further stresses that MNCs rely seriously on foreign dealings have higher reasons and scope to participate in income movement behaviors.

Transfer Pricing Regulations

The dominant and most widely cited regulations are the arm's length principle and advance pricing agreement.

Arm's length Principle

In order to assist both multinational Corporations (MNCs) and tax authorities to determine a suitable reward. The arm's length principle outlines that transfer prices are meant to be comparable to prices charged when one organization sells goods or services to another organization. The arm's length value is based on uncontrolled transactions. It is believed that the most accurate way to get a fair price is to find out what unrelated companies pay for similar services (Yacker, 2000). This leads to values being manipulated to help companies reduce their taxable income. While this practice benefits the MNC's bottom line, it likely hurts one or both of the countries involved in the transaction. It seems feasible that if countries are successful in establishing an acceptable arm's length value, it will go a long way towards establishing the closest thing to a win-win scenario. The OECD guidelines (2012) suggests forms of ascertaining arm's length value in diverse ways extending from the simple cost plus method (C+CP) to the profit split method (PSM). By determining a fair arm's length price that is acceptable both to the MNE and the countries involved is very important in addressing the issues involved with transfer pricing.

Advance Pricing Agreement (APA)

Advance Pricing Agreement (APA)is one of the model adopted by countries in curbing the activities of transfer pricing. The motive is to come to terms in progress on adequate transfer prices between tax authorities and multinational companies. It provides ways for reducing the undesirable discernments and concerns involved in transfer pricing, as well as in minimizing disputes between MNC and tax authorities. Where an agreement has been reached, it becomes a binding agreement between the parties concerned.

In as much as the APA is a good development with a main focus on minimizing the influence of transfer pricing and creating a pleasant atmosphere for multinational corporations, there are still challenges.

Transfer Pricing in the Nigerian Context

Before 2012, Nigeria had no established transfer pricing regulations. FIRS made available a fresh legislation on September 21st, 2012, which ushered in a dispensation of modification for the Nigerian government in terms of addressing global industries and taxation and replicates the move toward formal transfer pricing rules in Nigeria (Ahmed, 2014).

The (Transfer Pricing) by-law was passed in Nigeria as a watchdog on transfer pricing misuse and the principal objective was to certify that the country will be able to tax on a suitable taxable basis conforming to the economic actions arrayed by taxable individuals in Nigeria, including in their transactions and dealings with related organization. The Income Tax (Transfer Pricing) Regulations 2012 are verse in the arm's length principle, which is the foundation of approximately all established transfer pricing administrations worldwide (Taiwo & Anthony, 2013).

Onyeukwu (2010), in the Nigerian tax laws, the grounds for charging tax transactions amongst related firms is stated in section 13 (2) (d) of Companies Income Tax Act (CITA) where the Act empowers the Federal Inland Revenue Service (FIRS) to make changes in order to capture arm's length transactions in circumstances where in its view its considers the business or activities between interrelated parties to be artificial or fictitious. The power of this provision is that the FIRS shall ignore any disposition, which in this effect means any trust, grant, covenant, agreement or arrangement that would reduce the tax payable and direct any such adjustments in order to counteract the reduction of liability to tax. By insinuation, the tax authority is given the duty to make alterations where the inner pricing devices of the related parties tend not to reflect the open market prices. The inference of the sections of CITA seem to place concerns of ascertaining transfer pricing within the Nigerian context as an implementation of subjective judgment by the tax authority.

As a result of the issues that bedeviled the regulation of the 2012, the Income Tax (Transfer Pricing) Regulations 2018 was issued by the Federal Inland Revenue Service (FIRS). It came into effect for financial years commencing after 12th March 2018 and revoke the Income Tax (Transfer Pricing) Regulations, 2012.

THEORETICAL REVIEW

Stewardship theory

To get a clearer and broader understanding of transfer pricing aggressiveness there is the need to link the study to an existing theory. There are several theories that explain transfer pricing aggressiveness; however the theory underpinning this study is the stewardship theory. Stewardship theory, the idea is that the firms serves a broad spectrum of social purposes rather than just trying to maximize the wealth of shareholders. The theory is established on the fact that organization are social entities that influences stakeholders' welfare. Stewardship theory explains the relationship between tax minimization and transfer pricing. From the perspective of this theory, management of the multinational organisation protects the wellbeing of the owners or stockholders and take judgments on their behalf. This overall objective is to generate and preserve a performance of the enterprise for stakeholder's wealth.

A multinational enterprise group openly held hint of the pressure from shareholders to display high productivity at the parent company level. Concurrently, company's productivity may influence its determination to sign future prospects of the concerned foreigners such as creditors, and potential investors and. In the framework of the transfer pricing, more lucrative companies may adjust transfer prices to decrease stated profits in higher tax regions by bearing in mind their pre-tax income. In addition, companies with higher profit before tax have the tendency to avoid taxable income and taxes paid to advance its profitability. These firms then use tax avoidance prospect in the transfer pricing mechanism to improve stakeholder wealth. Multinational corporations may try to reduce their tax with the aid of transfer pricing influence so has to maximize the wealth of the shareholders.

CONCLUSION

The focus of this study is to examine transfer pricing aggressiveness and tax minimisation by multinational corporations. The basic objectives of business entities are to achieve organisational goals, realizing this requires minimizing tax.

The study concluded that numerous multinational firms take advantage of tax strategy to minimize the tax burden. These are achieved through utilizing transfer pricing strategy to move profit from higher tax domains to lower tax domains. Multinational companies as integrated entities exploit international differences and produce additional economies by setting transfer prices that are not the same as prices arm's length parties would bid for. There should be high level of awareness on the part of tax authorities on the prerequisite to issue documents concerning transfer pricing, so as to enhance the level of observation of MNCs transfer pricing compliance. Transfer pricing must be made available to tax establishments for computation of both border, and corporate income taxes. As most governments rest on tax revenues for driving economic development, it is imperative that there be international cooperation if profit move is to be efficiently managed and organized. For Nigeria in particular with its increasing concentration of multinationals especially in the oil and gas sectors, there is the need for effective enforcing of transfer pricing regulations.

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