UNIVERSITY OF ESSEX **DISSERTATION**

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LLM/MA IN: International commercial and business law	
STUDENT'S NAME: Kailun Zhang	
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DISSERTATION TITLE **To What Extent Transnational Corporations' Tax Administration and Tax-Laws Are Legitimate and Authoritative in the Globalized World**	

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DISSERTATION

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Introduction and background

This dissertation is associated with the transnational corporations' (TNCs) tax administration and tax-laws. It is of note that any firm which engages in international operations is not to be taken as TNC because that firm might only take orders from foreign countries and subsequently export the required services and products to that country. Simply put, it merely engages in trading with a foreign country. To the contrary, an enterprise is said to be a TNC when it establishes its presence in the foreign country and starts trading within that foreign country, and not with that foreign country.[1] When it comes to closely analysing the trading activities of TNCs, they are associated with the problem of dual international taxation. For instance, the home country of TNC might demand a tax on any accumulated gain from its trading activities, but those foreign countries wherein the TNC trades might also claim taxes on the gains derived from the trading activities likewise. This implies that the TNC would be vulnerable to be taxed twice, first from its home country, and second, from the countries where it performs its business activities.

In this context, Jessup gave many lectures centred on the subject of Transnational law in 1956.[2] Jessup came across the fact that transnational law is a great subject of debate given the post-world-war-II nations were competing and cooperating so as to stay away from the double taxation that was also the main element of agenda during those days. There was a great need to allocate and fix the taxation rights so that taxation from many countries do not overlap and give a dent to TNCs savings. But as a matter of fact, there has been a great international crises of tax legitimacy to date thanks to the inability to finding a legitimate and effective way to establish an efficient and fair taxation mechanism of income derived from the diverse flow of revenues.[3] Moreover, the international tax avoidance coupled with the facilities of offshore financial centres and tax havens for sheltering wealth contributed much to the debt crisis of those countries that do not fall in the category of developed nations.

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[1] Stanley S Surrey, J D R Adams and J Whalley, 'The International Taxation of Multinational Enterprises' (1980).
[2] Philip C Jessup, *Transnational Law* (Yale University Press 1956) 70.
[3] SOL Picciotto, 'International Business Taxation: A Study in The Internationalization of Business Regulation' (2013) 63 British Yearbook of International Law 490.

Also, the different types of taxation systems create uncertainty on and off both for those who administer the taxes, as well as those who pay it. The coexistence of different taxes cultivates the creation of costly disputes to both TNCs and the tax administrators. To cater to this, different types of tax harmonising strategies have brought in practice so as to increase and enhance the compliance of TNCs. But these tax harmonisation techniques have their own pitfalls. When it comes to examining international taxation, a study conducted by Genschel and Rixen is worth noting where they highlighted that the “transnational legal order” of international taxation which is mainly focused on “double taxation relief” has inadvertently given rise to tax competition.[4] The reason being, they provide taxpayers with the new set of options to reduce their tax burden through the process of cross-border tax arbitrage and leave governments vulnerable to compete by aggressive low-tax strategies through inbound tax arbitrage flows.

Given the facts stated above, this dissertation takes a stance that the TNCs, in this interrelated complex globalisation phenomenon, have brought in a great expansion of companies’ interaction across borders. At the same time, there is a vivid gap of finding the right answer of power and degree to which transnational corporations’ tax administration and tax-laws are legitimate and authoritative in the globalized world.[5] This dissertation is going to present the literature review which would hold general taxation history and international taxation, key philosophies behind international tax policies, overview of EU and US tax systems for TNCs, and a few other relevant topics in the following section. The literature review section is very important in this dissertation on the score that in order to take up an effective discussion of taxation, it is imperative to review its historical background, as well as the latest taxation practices for TNCs in this era of globalisation.

The literature review section in the current dissertation would highlight the historical background of taxation and international taxation at large with a focus on a few key philosophies behind international tax policies, an eye on the Ills of the international taxation coupled with the tax optimising strategies employed by TNCs on a global scale. The next section will give a detailed account on the tax administration measures adopted by international jurisdictions so as to counter/control the tax evasion and tax avoidance strategies of the transnational corporations. The third section titled as “Methodology

[4] Philipp Genschel and Thomas Rixen, *Settling and Unsettling the Transnational Legal Order of International Taxation* (Cambridge University Press 2015) 154-183.
[5] Richard J Vann, 'Improving Tax Law Improvement: An International Perspective' (1995) Aust1 193.

section” is going to give a brief account on the methodology, which is a kind of a comparative study, but this comparison is not made in statistical terms or by comparing different sets of variables as in normal comparative studies. The current methodology in this dissertation revolves around taking a close look at both sides i.e. from the TNCs side their tax evasion and evading strategies, and the tax administration authorities' side, their strengths and weaknesses, and then performing an all-inclusive critical analysis thereby seeking answer to the main title i.e. “to what extent transnational corporations' tax administration and tax-laws are legitimate and authoritative in the globalized world”. After the methodology section, the dissertation would highlight the various tax administration strategies employed by the tax administration authorities with a key focus on EU and USA jurisdictions. The last section would be a critical analysis discussion regarding the legitimacy and authority of tax administration and tax laws of TNCs. The topic of Transnational corporation taxation and the corresponding topic of tax administration authorities is extremely important because there has been very little clarity and transparency provided to the general public in this context. On one side, taxation on TNCs provide revenues to the countries, therefore, countries try to increase their revenues by expanding the domain of their tax base to the TNCs. To make it possible, countries in different jurisdictions enact pertinent taxation laws so that the TNCs pay their fair share of taxes and subsequently, the governments spend this money on the citizens' welfare. But TNCs, on the other hand, play with the taxation laws for the sole purpose of doubling their profits exponentially by either avoiding or evading the taxes. As a result, the TNCs get stronger and stronger, they intend to employ tax avoidance strategies to give an exponential rise to their profits and the countries in different jurisdictions fail to collect the desired taxation money as a consequence. This whole scenario gives credence to the view that taxation law, its authority to be enforced correctly, and the corresponding authority of the TNCs to either comply with the law or to toy with it, should be judged critically. This is where the current dissertation and its structure come handy because it critically investigates the taxation law from both sides of the continuum. Not only this structure provides the reader with a close eye on historical background of taxation, international taxation, and the corresponding tax optimising strategies employed by the transnational corporations and the tax administration laws in different jurisdictions, but it also gives a philosophical and comparative investigation regarding the legitimation and authority of TNCs in terms of complying with the tax laws and the legitimation and authority of tax administration authorities in terms of enforcing these taxation laws in different jurisdictions. The whole structure of the dissertation provides a philosophical investigation without falling prey to statistical terms and formulas that are normally employed in the discussions relevant to taxation laws. This is where the current structure and mode of investigation become peculiar and interesting in the context of the taxation law all along the line. The second reason for selecting the current structure is that the researcher wants that even an ordinary layman should be able to understand this hard topic of taxation without delving deep into the statistical or mathematical investigations. Hence, the structure is feasible and potent enough to bring a hard topic in soft language without needing tough academic qualification on the one hand, and it also provides a deep critical investigation into the matter of taxation law that would benefit the tax administration authorities to correctly enact their legislations, and is highly likely to inform and guide the TNCs to comply with the taxation laws as well.

Literature review

Historical background of taxation and international taxation

The marks of taxation existed collectively and could be found in the Colonial American period.[6] [7] However, it was 1634 when the very first law in the USA colonies was enacted in the State of Massachusetts Bay. At that point in time, the taxation law was mainly applied to the property (particularly land). It was the era when most of the colonial States used to tax their citizens based on the land property that they hold. The general law of taxation was later revised with the add-on of "ability" and "faculty" notions thereby the idea of taxation from tangible land was shifted towards intangible things.[8] Even in Rhode Island, the faculty tax notion was applied in the manner that every citizen was asked to assess the worth of their neighbour so as to assess the tax liabilities of their neighbour and subsequently suggest the tax that the neighbour should be liable for. Slowly and steadily, the taxation system in Colonial America included the taxation on profits of all professions and faculties. In the colonial USA,

[6] Delos O Kinsman, *The Income Tax in The Commonwealths of The United States* (Macmillan Co 1903).
[7] William Zebina Ripley, *The Financial History of Virginia, 1609-1776* (AMS Press 1970) 1609-1776.
[8] A B Wolfe, 'The Income Tax, A Study of The History, Theory, And Practice of Income Taxation at Home and Abroad. Edwin R. A. Seligman' (1912) 17 American Journal of Sociology 3.

there was seldom any question on whether to tax or not, but the debate was still on regarding “how to tax” the citizens. It was though hard to imagine any taxation beyond the tangible physical property in the first place, but later on, in the quest to increase their revenues by expanding the domain of tax base, many colonies adopted the taxation based on the intangible entities of abilities and faculties so as to bring that portion of population into the tax-net which did not hold the physical land-related property. The latest taxes in the United States that are also referred to as “modern tax statutes” are associated with the 16th Amendment in the US constitution.[9] Since then, several tax statutes have been modified in the form of Internal Revenue Code (IRC) to date.

The history of taxation clearly shows that one of the most omnipresent tools behind taxation was to raise revenues so that the territories could be endowed defence, as well as the provision of basic social services for the residents, or at times, taxation was also enacted to honour the royalties.[10] Taxation was applied at national levels to cater to the transactions that occur within a State. The 16th Amendment in the USA law legitimized congress constitutional power so that they could tax the citizens using broad terms. However, these national taxations raised several debates when cross border activities became involved and appeared as a great area of concern. Questions raised on and off about the legitimacy of sovereign taxing powers of many countries to apply taxation on the same income. It was obviously clear that the transnational economic activities which involve cross border transactions would create double taxation problems around the globe. The reason being, when a resident of another country (the residency country) earns an income by doing business in another country (the source country), then both countries have valid legal reasons to tax the citizen or corporation likewise. Also, the main exercise of international taxation lied in the task of resolving the competing claims of the source country and the residence country so as to avoid the double taxation which is a common occurrence when both countries try to exercise their legitimate powers with regard to taxation.

When the countries came across this situation after the world war I, the League of Nations appointed a commission with four top-rated economists so that they find a viable solution to the said taxation issue.[11]

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[9] Harry Hubbard, 'The Sixteenth Amendment' (1920) 33 Harvard Law Review 794.
[10] Diane M Ring, ‘What' S at Stake in The Sovereignty Debate? International Tax and The Nation-State’ (2008) Va 156.
[11] SOL Picciotto, 'International Business Taxation: A Study in The Internationalization of Business Regulation’ (2013) 63 British Yearbook of International Law 490.

Professor Seligman of the USA presented his argument that only the residence country should levy taxation whereas the source country should only ensure the non-occurrence of double taxation. To the contrary, it was also debated that only the country of source should levy the taxation whereas the residence country only needs to ensure the non-occurrence of double taxation. The League of Nations found a middle ground to the issue and published their report in 1923, famously know by the name "Great Compromise" wherein the source country was allowed to levy the taxation on active income (the income where there is a material participation as well as the income from salaries, tips, and wages) whereas the residence country was allowed to levy taxation charges on passive income (the income which is derived from an enterprise wherein there is no material involvement of a person in that enterprise).[12] The international tax regime was shaped with this "Great Compromise" for almost a century. It is of note that the subsequent international tax treaties and laws were formulated on the same principles of great compromise in terms of rightly allocating the power to tax. This also gave a "certain no" to the question whether double taxation should be allowed only on the score that the business had a cross border character.

Nevertheless, when the economists were shaping the great comprise, they did not imagine how much the international taxation would expand with intense international economic activity in the coming decades. The creation of multinational companies dominated the business landscape where the past solutions were certainly inappropriate. In the United States, FTC Act of 1918 was formulated until 1960 (age of benefits) with the key argument that the benefits conferred by the taxing state should be the main foundation upon which taxing jurisdiction should be grounded.[13] The subsequent era of 1961-1980 was the "age of neutrality" in which Kennedy administration promoted the concept of efficiency rather than the benefits afforded by the state. Then came the "age of competition" era 1981-1997 wherein the US tax policy was formulated on competitiveness and competition, therefore, this era was marked with a reduced focus on the US residence-based taxation. The final era 1998 till today, marks the need for a coordinated action in taxation so as to avoid double non-taxation, as well as accomplish the competitiveness at the same time. This era is famously recognised as "age of cooperation". This is

[12] Reuven S Avi-Yonah, 'Structure of International Taxation: A Proposal for Simplification' (1995) Tex 1301.
[13] Reuven S Avi-Yonah, 'All of A Piece Throughout: The Four Ages of U.S. International Taxation' (2005) Va 313.

the era in which the United States joined hands with European counterparts such as OECD so that a coordinated effort could be taken in formulating a coordinated tax policy for and with the member states. This "age of cooperation" resulted in the formulation of many tax treaties.

This brief history of taxation coupled with the historical overview of international taxation wherein the US taxation trajectory took a U-turn from source-based taxation to residence-based taxation and back, although show activism of international partners to compete and cooperate, still, does not sufficiently answer the question how the double taxation and double non-taxation could be avoided.

Key Philosophies behind international tax policies

To attract investments

The very first idea behind the imposition of tax laws in many countries was backed up by the scope of attracting investments. One of the major reasons behind this is that the world has become a global village and many countries try to attract major multinational companies so that they invest and do business. This is why many countries, both developed and non-developed have been coming with various tax incentives coupled with diverse and attractive fiscal strategies which include but not limited to tax incentives on financing, deferrals of custom taxes on imports, targeted tax exemptions, targeted reduced tax rates, investment tax allowances and tax credits, tax holidays and special zones. These measures are centred upon bringing foreign direct investment (FDI) in these countries to stimulate growth in their respective industries and in their business and economic sectors. Special zones are created in different countries so as to lenient labour requirements, increase investment, optimize taxation, and they are still being utilised as tax incentives despite the reservations posed by various commentators in terms of their capabilities to attract investments.[14] As a matter of fact, almost all types of tax incentives are being used throughout the globe, but the question remains whether they serve the purpose of attracting foreign investment and subsequent boost in growth?[15]

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[14] Aradhna Aggarwal, 'Special Economic Zones: Revisiting the Policy Debate' (2006) EAPW 4533-4536.
[15] Claudio Agostini and Soraphol Tulayasathien, *Tax Incentives and Foreign Direct Investment* (2006) RG 1.

While critically analysing the philosophy to attract investments like foreign investments, the researcher recommends that only relying on the tax incentive programs might not produce the desired results to attract foreign investment. For example, if Germany offers tax incentives and Poland follows likewise, then the foreign investments into Germany might not be large enough because the same tax incentives are available in the adjacent country Poland as well. Evidence also suggests that investors gauge different jurisdictions related strategic tax setting behaviour and then its impact on the effectivity of tax incentive programs.[16] It does not mean that investors do not take tax incentives into consideration when they formulate their strategy of foreign investment, but as a matter of fact, it becomes hard for a jurisdiction to attract investors only on the grounds of tax incentives thanks to the setting of tax benefits within the strategic interaction among various jurisdictions. For example, in addition to the provision of tax incentives, Germany can choose whether she would follow a certain strategy to facilitate investments such as differentiation leader strategy or price leader strategy, or some other strategy in place to facilitate the foreign investment alongside the tax incentives in place.

Opening markets for foreign countries and encouraging exports

The second idea for making and implementing taxation laws is based on opening markets for foreign countries and encouraging exports. It has been acknowledged that one of the most potent engines of growth is “international trade”. To encourage exports and market openness throughout the world, one of the major international organisations “International Monetary Fund” (IMF) is established so that financial assistance is provided to the developing countries.[17] The international trade has been increased after the successful implementation of IMF program especially in the developing countries which gives credence to the view that the economy gets a boosting effect with more trade.[18] In this scenario, the taxation law, especially when it comes to implementing international taxation, becomes extremely important to provide more clarity and transparency so that developing countries can promote exports in the foreign countries and then measure their market success accordingly. As a matter of fact, the market openness and the exports promotion normally translate into national and international tax rules, which again struggle to give a balance into the residency-based and source-based taxation.

[16] Ibid.
[17] International Monetary Fund, 'Financial Crisis in Developing Countries and Structural Weaknesses of The Financial System' (1989) 89 IMF Working Papers.
[18] John H Barton and others, *The Evolution of The Trade Regime* (Princeton University Press 2010).

While critically analysing aspect of foreign trade, the researcher deems that the composition and size of the trade might get influenced by the structure of taxes, and the varying considerations of trade might impact the tax designs alike. The reason being, taxes could be the trade determinant[19][20], but taxes can also boost as well as restrict trade. For example, since trade is considered as the difference between consumption and production, the trade would be reduced if taxes are imposed on particular types of consumption and there is an importable good involved. To the contrary, the trade will be promoted if there is an exportable good involved. Beyond doubt, taxes increase revenues, but they should be imposed as neutral as possible in terms of impacting the trade, and taxes should not undermine the international level competition as well. An extensive discussion in tax design objectives is available in literature.[21] Hence, in this regard, the openness of markets for foreign countries is good but the varying interactions between international trade and suitable tax design should be taken into consideration as well. It is also a great piece of question whether the countries should heavily rely on the mechanisms which rely less on trade & taxes like tariffs or countries should specifically focus on those taxes which are broadly-based like “value-added tax” (VAT).[22] So, all these things should be taken into consideration when countries try to open markets and encourage trade activities including exports.

To provide simplest taxation law

When it comes to taxation laws, there is also a great need for tax-related simplicity, both from it is economic, as well as from a legal perspective. Simply put, the taxation law should be legally simple and clear so that it could be read, comprehended, and applied to real practical scenarios.[23] That is to say, the taxation law should be clear, consistent, and certain. Here clear/clarity in taxation means the taxation should have clarity not only to the legislation’s linguistic expression, but also on the drafter’s organizational scheme alike. Consistency reflects the linkage, harmonization, and coordination among

[19] James R Melvin, 'Commodity Taxation as A Determinant of Trade' (1970) 3 The Canadian Journal of Economics 62-78.
[20] H J Krauklis and J R Melvin, The Tax Structure and Canadian Trade (1977) 3 Canadian Public Policy / Analyse de Politiques 397.
[21] Richard M Bird, Richard A Musgrave and Peggy B Musgrave, *Public Finance in Theory and Practice* (McGraw-Hill, 1989).
[22] Ben Lockwood, David De Meza and Gareth D Myles, 'When Are Origin and Destination Regimes Equivalent?' (1994) 1 ITPF 5-24.
[23] Binh Tran-Nam, 'Tax reform and tax simplicity: a new and simpler tax system' (2000) UNSWLJ 241.

all legislation parties plus the law, at any given point, should not have contradiction with any other tax legislation adopted in the said jurisdiction. The last requirement that law should be certain/certainty reflects that with reasonable efforts coupled with minimal supply of relevant data, the true tax liability of the taxpayer should be calculated. That is to say, by asking simple questions, it should be easy to calculate the taxpayer's liability. Same way, in order to provide simple international tax rules, they need to be simple because only that way they would achieve optimum administration of tax. And in case of developing countries, taxation laws should be made as simple as possible because many developing countries have rejected the OECD imposed transfer pricing regulations on the score that overly complexity of these regulations do not serve the purpose of satisfying developing countries tax administrators to perfectly apply those taxes in their countries.

While critically examining the tax simplification concept, the researcher deems that simplicity in taxation is a multi-dimensional notion because its measurement could be achieved in varying manners. For example, in terms of the simplicity in the format of the tax legislation, in terms of simplicity in the content of tax legislation, how tax administration authorities and taxpayer companies respond to the tax law, and what is the level of cost-effectiveness in order to operate tax.[24] While the key philosophies relevant to tax simplicity advocate that simplicity is desirable and a pertinent thing to achieve in taxation law, but as a matter of fact, the simple concept might be too much exaggerated in the sense that it should not be taken as a sole focus of an excellent tax system and neither it should be taken as a concept which is static. For instance, if the economy is less developed, then it is feasible to simplify the taxation, but what if the economy is mature and the commercial transactions, business organisations, and market structures grow swiftly in a complex manner? In that case, the complexity in tax law would be a normal phenomenon. Furthermore, tax simplicity is not a prosaic task to achieve at once because tax administration authorities and the taxpayers frequently demand changes in taxation law.[25] In a nutshell, the entire focus should not be on making the tax simple but making it relevant to the economic values and conditions of the market at large.

[24] Ibid.
[25] Ibid.

Simplicity remains one of the prime objectives of structuring this dissertation in a unique way and employing the methodology which is observable and understandable to even a layman. The reason being, the researcher deems that most of the taxation related dissertations and journals focus on the mathematical and statistical terms, therefore, they are only understandable to certain types of people who have a professional knack on the subject. On the flip side, if a layman tries to comprehend the subject, he cannot get along with the hard concepts, therefore, the taxation matters are mostly overlooked by the general public. In this regard, the simplest yet informative structure of this dissertation as well as the comparative analysis which focuses on the critical examination on both sides of the continuum without giving much focus on mathematical or statistical terms, provides it an upper edge over other papers written on the same subject.

Overview of the Ills of the International Taxation

When it comes to examining international taxation, it does not mean that there is an absolute single taxation system which is independent of all the countries and/or above all other countries that are used to govern the taxation in this era of globalisation. To the contrary, the international taxation is based on the cooperation between some international organisations and different countries so that the taxation against international income could be calculated. As explained above, this system of international taxation was enacted to eliminate the occurrences of double taxation. The current bedrock foundation of international taxation is strongly associated with the Arm's Length Principle.[26] This principle examines the transaction, disregards the character of the related parties, and ascertains that the arm's length price or the true economics of the deal, are accomplished. Currently, there is a great commotion with regard to the ills of the international taxation, and there is an outcry that only simple citizens pay the taxes whereas the huge and wealthy corporations take leverage of the broken international tax system and they enjoy the options of what and where to pay the taxation.[27] The outcry and lamentations by the international body are not just stories, but they are the real facts. For example, it has been reported that without paying any taxes, the UK Company Starbucks managed to accumulate around 700 million USD

[26] Chongwoo Choe and Charles e Hyde, 'Multinational Transfer Pricing, Tax Arbitrage and The Arm's Length Principle' (2008) 83 Economic Record 398-404.
[27] Houston, J and Tran, A, *A survey of tax evasion using the randomized response technique*. Advances in taxation *(*Emerald Group Publishing Limited, *2001) 69-94*.

in sales in the year 2012.[28] The same is true for other heavyweight companies such as Google, Amazon, Apple, etc since they have managed to save millions of taxes despite their billions of worldwide sales.

The issue of Transfer Pricing

The very first ill associated with international taxation is the issue of transfer pricing which is the most challenging obstacle faced by the tax policymakers and administrators in the backdrop of international taxation for Multinational companies. In this scenario, when a multinational company manufactures a product in one country and then sells it with a subsidiary in another country, then the multinational company can enjoy the price manipulation by playing the intra-group price based on the low tax jurisdiction.[29] For instance, if a US multinational company manufactures a phone at a cost of $20, then it can establish a wholly-owned subsidiary in Uganda which would be utilised to sell the phones to the Uganda market. This is where the US MNE would be able to enjoy the intra-group association with its wholly-owned Uganda Subsidiary (Uganda Sub). If both countries fall in the category of same tax jurisdiction, then there would be no taxation problem because US MNE would file $20 manufacturing cost, and Uganda Sub would file $20 distribution cost, and both would file a consolidated returns of a net gain of $60 when the phone is finally sold to the customer at a cost of $100. But when the two countries fall under separate tax jurisdictions, then the US MNE would play the intra-group transaction through a continuum of possible prices. So, the US MNE would play with the taxation, that is to say, it defeats the purpose of taxation by manipulating the location of profits. The other problem is that because this transfer pricing is only available to the wealthy and huge MNEs, it also harms the competition in response since small and medium-sized enterprises (SME's) do not enjoy this facility. It is legally allowed and justifiable that the TNCs should structure their internal flows without any outside intervention, but one could help saying that there could be massive loss in terms of collecting tax revenues if TNCs determine the transfer pricing independently. In this context, even the TNCs can enjoy the fake transfers as well. As a matter of fact, struggles to curb the abuses of transfer pricing are so

[28] Grahame R Dowling, 'The Curious Case of Corporate Tax Avoidance: Is It Socially Irresponsible?' (2014) 124 Journal of Business Ethics 173-184.
[29] Jane Gravelle, *Tax Havens: International Tax Avoidance and Evasion* (DIANE Publishing 2010).

many, still the world is struggling to stop the loopholes of various defence mechanisms that have been opted against the transfer pricing.

The use of debt allocation to achieve earning stripping

This is another type of ill commonly procured by the TNCs wherein they borrow from the low tax jurisdiction to the high tax jurisdiction, thereby generating interest deductions in the high tax jurisdiction through the subsequent interest payments thus securing more income in the low tax jurisdiction. As a matter of fact, without even exposing the company as a whole, and not a change in the overall debt profile, a multi-national company can make use of this earning stripping technique by granting a loan to its US subsidiary from a low or non-taxed jurisdiction with the effect that US taxation would be minimized or eliminated altogether.[30] This implies that tax planning has a strong influence on the MNEs profits based on their location and distribution of taxable profits.[31] Many countries and tax authorities in the developed world have implemented better systems to curb this type of debt usage and interest to shift profits phenomenon.[32] Rules and regulations are continuously being implemented by many developed nations so as to control the MNEs ability to gain profits from earning stripping technique. To the contrary, in the case of developing countries, the implementation of these systems is still far from achievable because these countries face significant difficulties when enforcing such rules. Also, if they import these taxation mechanisms in their countries, they do not have equal expertise as afforded by major TNCs.

The Hybrid mismatch arrangements

This is another type of ill in international taxation in the context of TNCs which has a disastrous effect on the intended effectivity of international taxation.[33] In this type of arrangement, the TNCs exploit the differences in the national tax treatment of a transfer, an entity, or of an instrument between two or more than two countries. This arrangement leads to either double non-taxation in both countries, or a long-

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[30] Sumantra Ghoshal and Christopher A. Bartlett, 'The Multinational Corporation as An Interorganizational Network' (1990) 15 The Academy of Management Review 603-626.
[31] Harry Huizinga and Luc Laeven, 'International Profit Shifting Within Multinationals: A Multi-Country Perspective' (2008) 92 Journal of Public Economics 1164-1182.
[32] Vijay Jog and Jianmin Tang, 'Tax Reforms, Debt Shifting and Tax Revenues: Multinational Corporations in Canada' (2001) 8 ITPF 5-25.
[33] Markus Henn, *Tax Havens and The Taxation of Transnational Corporations* (Friedrich-Ebert-Stiftung 2013).

term tax deferral, which has also an identical effect of double non-taxation. The hybrid mismatching is only allowed to TNCs which frequently put a dent into the international taxation mechanisms. The TNCs require a hybrid entity to make it work which is not treated as transparent for tax purposes in one country whereas transparent for tax purposes in another country. In this scenario, the taxpayer enjoys a deduction in one country whereas no corresponding inclusion in another, or the TNC would be able to enjoy foreign tax credit generation which would not be possible if such hybrid arrangements were not in place. This implies that even within the scope of international taxation rules and legislation, this seemingly compliance of hybrid mismatching results in distortion of the international taxation practices, put a negative impact on tax revenues (by lowering overall tax burden on the taxpayer (TNC), as well as draining the tax revenues of either all the countries involved or any one of them). As a matter of fact, these tax liberties are only provided to the TNCs who are operating in two countries at the very least whereas other SME's cannot enjoy these benefits which is certainly not recommended when it comes to pushing the tax competition in this era of globalization, a situation which only give preference to the TNC group whilst ignoring the applicability to the other groups in competition. Many efforts have been made to curb the hybrid mismatching phenomenon in international transactions so that the negative effects of these arrangements could be minimized or negated, for instance, around $3.5 billion hybrid mismatch transactions were involved in the United States.[34] Similarly, in 2009, the hybrid mismatch transactions in New Zealand involved approx. 1.5 billion. If the world witnesses more hybrid mismatch cases in the coming years, then it would equate to the TNCs manipulation of international taxation rules in their international operations.

If one reads the section of transfer pricing, he could not miss the simplest example provided to the reader where a US multinational company takes benefit of the transfer pricing phenomenon by establishing a Uganda subsidiary. This is to ensure that the reader gets familiar with the hard topic of transfer pricing with the simplest of examples. The researcher tried to get familiar with this concept by reading a few journals, but either they just scratch the surface of the topic or they were too hard to

[34] OECD, <http://www.oecd.org/ctp/exchange-of-tax-information/HYBRIDS_ENG_Final_October2012.pdf> accessed 27 August 2019.

understand.[35][36] This is one of the reasons for employing the simplest structure throughout the dissertation that is comprehensive and all-inclusive, yet easily understandable all along the line.

Tax optimizing strategies employed by TNCs

Avoiding taxation through tax havens

Due to the cross-country nature of their transactions, the TNCs employ a diverse number of techniques so as to take liberty from the contradictions and loopholes in tax legislation around the globe. In this scenario, a broad number of techniques such as the abuse of intra-firm transfer pricing, the preferential tax schemes, and the role of tax havens lead to double non-taxation. In early 2013, the protestors in the United Kingdom seized Starbucks branches in the wake of their tax-evading strategies given the fact that Starbucks admitted in 2012 that they would pay approx. 16 million dollars to the UK tax authorities so that the controversy over their virtually non-existent tax bill could be settled.[37] Also, many of the world's largest TNCs operating in many other sectors happened to be involved in paying no taxation on their cross-border transactions. As a matter of fact, it has been reported that alone UK has a tax gap which is 122 billion GBP each year which reflects the difference between what tax had to be paid in the United Kingdom and the tax which was actually paid.[38] This broad tax gap is enough even to cover the entire UK's education budget alone in addition to a surplus of 20 billion GBP. This is the reason why G20 is intensifying their efforts to tax TNCs since TNCs make use of many illegal techniques to avoid and evade taxes over their offshore transactions. For instance, the TNCs take the liberty of using tax havens which reflects the jurisdictions that permit them to evade taxes. There are certain criteria to be a tax haven country. For example, there could be certain assets in a country which would be low taxed or not taxed at all such as shares, bonds, intellectual property rights, and these assets are often granted to offshore residents only. Secondly, there could be low level of regulation for legal entities like trusts, foundations, or companies, therefore, no requirement of initial capital for setting up a legal

[35] Dirk H M Akkermans, 'Net Profit Flow Per Country From 1980 To 2009: The Long-Term Effects of Foreign Direct Investment' (2017) 12 PLOS ONE 1.
[36] Julia Anaf and others, 'Assessing the Health Impact of Transnational Corporations: A Case Study on McDonald's Australia' (2017) 13 Globalization and Health 1.
[37] Jasmine M Fisher, 'Fairer shores: tax havens, tax avoidance, and corporate social responsibility' (2014) 94 Bul Rev 337.
[38] Richard Murphy, *The Tax Gap. Tax Evasion In 2014-And What Can Be Done About It* (PCS 2014).

entity in addition to weak due diligence requirements. Thirdly, there could a guarantee of strong secrecy such as the country would guarantee no cooperation with international tax authorities, the entities would not be publicly registered etc. It is argued that to be a tax haven country, the country does not need to fulfil all of the above criteria, but as a matter of fact, most of the tax haven countries normally fulfil these criteria.

Also, only small countries and remote islands are not included in the category of tax haven countries, even the developed countries also provide tax havens to the TNCs. For example, affiliates of many TNCs take US State of Delaware as their tax haven.[39] Another example is the UK developed country where a combination of financial centre which is joined with small islands serve the purpose of tax havens. Despite that these islands have a certain degree of independence, still, they are associated with the United Kingdom and playing the role of tax havens. Given the fact that these tax havens provide financial secrecy to the cross border transactions of TNCs, the Tax Justice Network released their report in 2011 which revealed that the highest-ranking country (that was weighed upon its financial secrecy with the size of its cross border financial sector) was Switzerland, and the subsequent list holds the prominent names of Cayman Islands, Luxembourg, Hong Kong, and the United States.[40] Though these tax havens provide the best support to the TNCs in terms of tax competition and preventing excessive taxation on their cross-border transactions, but to the contrary, these tax havens also give them an upper edge to downplay the game by bringing threat to the fair economy. The reason being, the other countries, when observe the aggressive tax policies of these tax havens, they tend to lower their taxes so that they could compete with these tax havens, and this, in turn, gives rise to lower their tax revenues. If this trend would continue, then it would be highly likely that no country would be able to adequately generate the tax revenues given the fact that countries would not be able to rightly tax these TNCs. The final result would be increased taxes on incur debts and labour thereby putting negative effects on infrastructure, public services, and social justice. The TNCs get enormous benefits of avoiding taxations on their cross-border transactions because these transactions do not involve the transfer of real economic activity inside the tax havens jurisdictions, but it shows an activity of shifting on paper so as to enjoy the avoidance of taxation. It also gives a competitive disadvantage to the small and medium-

[39] Markus Henn, *Tax Havens and The Taxation of Transnational Corporations* (Friedrich-Ebert-Stiftung 2013).
[40] TJ Network, 'Tackle Tax Havens–Report 2011' (2011) 1.

sized enterprises (SME's) because these tax havens only entertain the big transnational corporations. This is surely not a fair and healthy competition at all.

TNCs tax evasion and avoidance figures through tax havens, tax holidays, and conduit

The literature points to the fact that the international banks and the TNCs together make $37 billion minimum tax evasion alone in the United States.[41] In Germany, there are no tough rules for TNCs to provide their reports but a few studies pointed out that the profits reported by the TNCs give an alarming gap of €60 to €100 billion on each passing year.[42] This shows that how much loss Germany procures every year due to TNCs related taxation problems. Another report highlights that the tax havens facilitate tax avoidance and TNCs are the number one beneficiary in this regard because they give the lowest average tax rate.[43] All these figures provide us with a worrisome overview of TNCs related taxation avoidance and evasion at large. There is no denying that the economic success of many countries is strongly based on favourable tax conditions related areas such as China, but this phenomenon also downplays the tax base thereby leaving the countries vulnerable to inadequate tax revenues.

As a matter of fact, there are also certain TNCs that are granted “Tax holidays” like the legal TNCs which are also called as the holding companies which collect certain assets or financial flows and enjoy the preferential tax regimes to conduct their cross-border transactions. Conduit is also an offer available in a country which helps the TNCs to channel money through a certain country and reap the advantages from the tax rates thereafter. The countries which offer conduit are like Luxemburg, and Netherlands, the United Kingdom and many more.[44] To make this possible, there are some Sink Offshore Financial Centres (OFCs) which work to attract and hold foreign capital whereas the Conduit-OFCs serve the

[41] Klinter Scott, Collins Chuck and Sklar Holly, 'Unfair Advantage: The Business Case Against Overseas Tax Havens' (2010) Business and Investors Against Tax Haven Abuse 102.
[42] Jost H Heckemeyer and Christoph Spengel, ' Extent of profit shifting of multinational companies-empirical evidence and implications for German tax policy' (2008) 9 Perspektiven der Wirtschaftspolitik 37.
[43] Clemens Fuest and Nadine Riedel, 'Tax Evasion and Tax Avoidance in Developing Countries: The Role of International Profit Shifting' (2010) CBTWP 1.
[44] Javier Garcia-Bernardo and others, 'Uncovering Offshore Financial Centers: Conduits and Sinks in The Global Corporate Ownership Network' (2017) 7 Scientific Reports 6246.

purpose of lucrative intermediate destinations which allows the transfer of the capital of TNCs without any taxes.

TNCs enjoy these favourable taxation jurisdictions, for instance, in Netherland, it is extremely easy to make a company's registration and get an address which would reflect a real company. It is also possible for a company to have very little staff, still, getting engaged in large scale sales. The types of tax privileges for holding companies in Switzerland have taken the country on the top spot as the world's biggest TNCs have been using it as a biggest commodity trading location in the world despite that Switzerland has almost zero commodities of its own. This shows how the world's biggest TNCs move their money into Switzerland, and when these TNCs extract their money into their own countries, they do not give taxation to their home countries.[45] Hence, apparently which seems like a real economic activity generated by the TNCs in Switzerland, is just the paperwork which does not reflect the economic activity in the TNCs home countries. What is more, it is also arguable that if the TNCs main business lies in their home countries, then what is the moral and legal validity of Switzerland to gain a large part of their profits?

Overview of the International jurisdictions and tax laws to counter TNCs tax avoidance and tax evasion practices

The establishment of Extractive Industries Transparency Initiative (EITI)

The key to tax avoidance and tax evasion related problems is transparency. In this context, tax laws and regulations in different jurisdictions require pertinent information on TNCs such as their sales, staff, assets, relevant geographic distribution on one side, and their corresponding taxation and payments to the governments on the other side. This phenomenon is also termed as country-by-country reporting.[46] This way it is possible to make a comparison of TNC based on their cross-border transactions so as to gauge the mismatches between them accordingly. One of the first steps in this regard, at the international level, is the establishment of Extractive Industries Transparency Initiative (EITI) which

[45] Ibid 33.
[46] R Murphy, *BEPS Monitoring Group Comments on OECD Country-By-Country Reporting Discussion Draft* (2014).

allows the global countries to voluntarily sign up so that their transparency could be checked.[47] This information could be used now to detect the non-taxation cases of TNCs and the corruption cases likewise. The EITI actually revealed the Glencore case, for instance, that based on the data obtained from comparable mines, Mopani Mine was giving very low taxation.[48] Although the knowledge obtained from EITI would not stop the taxation issues, still, it would serve as a stepping stone for investigating further into the issue.

US Dodd-Frank Act 2010

The Dodd-Frank Act 2010 has brought in a considerable change to the commodity companies in the United States because it compels the companies that they ought to make their governments' related payments published all over the globe. This act was enacted in the United States out of a strong reaction to the financial crisis of 2008 which makes the listed companies to be in compliance with publishing their tax payments on a project-by-project and country-by-country basis. The criteria of the US Dodd-Frank Act (2010) was reformed with the Extractive Industry Transparency Initiative (EITI) thereby including more detailed reports thereafter. The US Dodd-Frank Act was a concrete measure to tighten financial regulations which was focused on business transparency regarding overseas operations. The section 1502 in this act compels the TNCs operating in the United States to give reports whether their products contain the conflict minerals originating from other countries or from the Democratic Republic of Congo.[49] But later on, it was reported that in the year 2014, the reports submitted by the companies were insufficient which gives credence to the view that the law did not bring adequate results.[50]

Controlled Foreign Corporation (CFC) rule and the blacklist

The Controlled Foreign Corporation (CFC) rule is enacted in a bid to curb the tax avoidance strategies of TNCs so that they are deterred to accept artificial entities purely for taxation purposes. For instance, the United Kingdom, the United States, and Japan have implemented this CFC rule in their jurisdictions

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[47] James Van Alstine, 'Critical Reflections On 15 Years of The Extractive Industries Transparency Initiative' (2017) 4 EITI 766-770.
[48] Ibid 30.
[49] Jasmiina Jokinen, 'Human rights abuses of transnational corporations under international law - on the legal loopholes' (2016) Helsinki university 1.
[50] 'Digging for Transparency | Global Witness' (*Global Witness*, 2015) <https://www.globalwitness.org/en/campaigns/conflict-minerals/digging-transparency/> accessed 15 August 2019.

through which they can tax an entity in another country which is controlled by UK, Japanese, or US parent company under certain situations.[51] Of note that this rule is only applied under certain circumstances because it directly goes against the approach of "separate entity". Also, the blacklist provides the names of those countries that are harmful, so, if a TNC has a business relationship between its parent company and the affiliate companies in any of the blacklisted countries, that TNC would be subject to be penalised in return.

Double taxation agreements

The key aim of the double taxation agreements (DTAs) in the past was to prevent the occurrence of double taxation on those companies whose transactions involve cross-border transactions in two countries. Both the parent company and the subsidiary company are treated as separate entities by the DTAs which depends on the location where the actual business takes place. This separate entity approach handles the double taxation by employing two ways 1) either in one of the two signatory states, the taxation would be exempted, or the tax paid by the TNC in one state would be credited in the other. This implies that the TNC would be taxed only in one state (higher tax country or the lower), but the TNC would not be double taxed in both countries. In the context of DTAs, OECD and UN modelled important agreements. The model based on the latter one is more inclined towards the developing countries. Based on the Arm's Length Principle, both these DTAs assume that the subsidiary of a company, as well as the parent company are composed of separate entities which need to interact in the same manner as they interact with the third parties.[52] As a matter of fact, these treaties have not fully tackled the issue of double taxation on the score that the double taxation issue is now again in the limelight.[53] This implies that there are still loopholes in the DTAs enacted for the TNCs so far.

Withholding taxes

When compared with any of the anti-avoidance efforts, the withholding taxes are much more powerful which are levied at the tax base source. Withholding taxes are of many types but they all inhibit the

[51] S Picciotto, *Towards Unitary Taxation of Transnational Corporations* (Tax Justice Network 2012) 1-17.
[52] Ibid.
[53] European Commission, 'Factual Examples and Possible Ways to Tackle Double Non-Taxation Cases' (Taxation and Customs Union - European Commission, 2012).

process of money shifting so that it is free of any type of taxation thereafter. For instance, it is possible that withholding tax is imposed on a TNCs production facility, not on the bases of TNCs profits or losses, but on the bases of the staff working there. For instance, municipalities assess and impose taxation on the companies which is not based on the revenue of the company.[54] It is also a common practice of TNCs that they shift their capital gains so as to evade taxes, therefore, withholding taxes could be imposed on the TNCs in this regard as well. Withholding taxes are more important for the developing countries which host the subsidiaries of the parent companies, but do not host the parent company. So, if these subsidiaries are not properly taxed, then the developing countries would not be able to keep a fair share of the profits of the TNCs with regards to the subsidiaries hosted there. Additionally, if withholding taxes are not imposed on the subsidiary, then it is highly likely that the TNCs parent company that is based in a developed country, would secure the tax profits against the revenues. It is of note that the withholding taxes are good to make the TNCs compliant to the taxation and preventing them from tax evasion and avoidance, still, these taxes are not free of problems. For instance, when Germany tried to switch from the capital gains taxes to the withholding taxation so that the banks directly deduct the payments from the accounts, Germany experienced a huge tax cut in response coupled with the problem of anonymous payments.[55] Previously, Germany was able to secure capital gains tax of almost 50%, but when the withholding taxes were imposed, the country was only able to secure a 25% flat-rate taxation.

Methodology Section

Before this study gets into the details of the methodology part of this dissertation, it would highlight two key jurisdictions relevant to the income tax laws and regulation i.e. the United States taxation jurisdiction for the TNCs and the European Union (EU) jurisdiction. After giving an overview of these two jurisdictions, the dissertation would further investigate the legal treaties, legal frameworks, and international legal agreements of taxation laws so as to examine the norms of international legal laws with respect to TNCs. This way, the dissertation would be able to analyse and acknowledge to what

[54] Ibid 36.
[55] Ibid.

extent transnational corporations' tax administration and tax-laws are legitimate and authoritative in the globalized world.

It is of note that this study could be considered as a comparative study, but this comparison is not made in statistical terms or by comparing different sets of variables as in normal comparative studies[56][57] because power (in case of tax administration authorities) and deception (in case of TNCs) could be gauged but they cannot be measured exactly in statistical terms.[58][59] Therefore, the current methodology in this dissertation revolves around taking a close look at both sides i.e. from the TNCs side their tax evasion and evading strategies, and the tax administration authorities' side, their strengths and weaknesses, and then performing an all-inclusive critical analysis thereby seeking answer to the main title i.e. "to what extent transnational corporations' tax administration and tax-laws are legitimate and authoritative in the globalized world". This way, by identifying the strategies of tax evasion and evading strategies by the TNCs first, and then the counter strategies adopted by the tax administration authorities (in both US and EU jurisdictions), and then making a holistic opinion by comparing both things would reach to a better conclusion thereafter.

The researcher has selected this methodology because both sides of the continuum of taxation can be viewed through this methodology without needing a complex set of mathematical calculations. This methodology provides a comparative but philosophical investigation to understand the legitimation and authority of TNCs in terms of complying with the tax laws and the legitimation and authority of tax administration authorities in terms of enforcing these taxation laws in different jurisdictions. Another reason for selecting this methodology is to critically review and analyse the taxation problems in the globalised world without falling prey to the mathematical jargon which is difficult to understand at large. Hence, the structure is feasible and potent enough to bring a hard topic in soft language without needing tough academic qualification on the one hand, and it also provides a deep critical investigation into the

[56] Stephen Olejnik and James Algina, 'Measures of Effect Size for Comparative Studies: Applications, Interpretations, And Limitations' (2000) 25 Contemporary Educational Psychology 241-286.
[57] Susan C Scott, Mark S. Goldberg and Nancy E Mayo, 'Statistical Assessment of Ordinal Outcomes in Comparative Studies' (1997) 50 Journal of Clinical Epidemiology 44-55.
[58] Charles F Bond and Bella M DePaulo, 'Individual Differences in Judging Deception: Accuracy and Bias.' (2008) 134 Psychological Bulletin 477.
[59] Raymond Nelson, 'What Does the Polygraph Measure?' [2014] RG 39-47.

matter of taxation law that would benefit the tax administration authorities to correctly enact their legislations, and is highly likely to inform and guide the TNCs to comply with the taxation laws likewise.

The United States jurisdiction of tax laws and TNCs

The United States enacted considerable changes in their income tax system in the earlier decades of the 20th century. The congress was empowered after the 13th amendment so that regardless of the apportionment among different states, they could tax the income. Since then the income taxes have been an integral component in the United States taxation system. When comparing the past century with the current century, it is reported that corporate tax revenue was 4.4% in 1919, whereas in 2009, it was reported only 1.3% of GDP.[60] The key motivation in the early century was to regulate corporations and these corporations were given more incentives during those days.[61] Also, there was no corporation with the issue of double taxation on the score that the net earnings and the dividends of the corporate income were deductible from the personal tax income. When it comes to minutely analyzing the US taxation for TNCs, it is observed that the United States is losing the steam in the sense that the key US TNCs that are operating across the borders are facing challenges by the emerging companies. To minimize their expenses overseas, the US TNCs are trying to minimize their operational costs to the limits. In this situation, the tax rates play a vital role in terms of making or breaking the economy through properly regulating the big TNCs giving them leverages, incentives, and opportunities so that they base their headquarters in the US territory. As a matter of fact, the tax rate on TNCs is highest among the OECD members.[62] It is worth noting that even the individual US States are highly competing against each other in a bid to offer lower income tax to the TNCs and attract their investments likewise. This way the US States try to gain the confidence of TNCs by offering them lower tax rates. This implies that there is no single tax rate in the United States being country as a whole. At the same time, due to globalisation and competition around the globe, and the fact that TNCs are trying their best to avoid and evade taxes globally, the United States government is also imposing new tax codes on TNCs so that the tax gap could be closed. As a result, in the US jurisdictions, the TNCs are less aggressive in planning their taxes as compared to the past. The reason being, TNCs have realized that tax avoidance

[60] Li Liu, 'The Economic Effects of Corporate Income Taxation' (2011) Rutgers 6-10.
[61] Arne Friese, Simon P Link and Stefan Mayer, 'Taxation and Corporate Governance--The State of The Art' (2008) Springer 1.
[62] Joseph Henchman, 'Corporate Tax Reductions' (2012) Journal of State Taxation 41.

and evasion is associated with reputational risk, so, their Uncertain Tax Position (UTP) will be audited because the Internal Revenue Service (IRS) of the United States has been given extensive powers that they could easily challenge the aggressive tax position taken by the TNCs.[63] This is regarded as one of the biggest changes in US taxation administration system in the year 2010 wherein the TNCs are obligated to disclose a tax issue to the United States Internal Revenue Service (IRS). Similarly, the US taxation system also imposed a regulation with regards to IRS powers wherein TNCs need to disclose their specific transactions to IRS thereby giving IRS more powers to highlight tax shelters and to challenge those TNC transactions that are illegal or based on tax avoidance strategies. Furthermore, the US taxation system also allows the IRS to ask for Tax Accrual Work Papers (TAWs) of the TNC if the TNC is involved in some doubtful listed transactions, and the TAWs are referred to as one of the highly secretive documents which hold the sensitive analysis for diverse tax positions, tax opinions, and the list of tax reserves.[64] These strict taxation laws give credence to the view that the TNCs might like to reconsider or change their aggressive tax positions. Also, the Internal Revenue Code obligates the TNCs to publish penalties pertaining to tax in their annual report.

The US Whistleblower Program

Also, the tax legislation regarding the Whistleblower program which encourages people to report IRS if they find any illegal taxation activity is in the limelight. By pointing out the illegal taxation activity, the individuals would be granted a reward of 15% to 30% based on the additional collection of tax by the government.[65] The figures show that the IRS awarded $104 million in the year 2012 to the whistleblower program so that the US citizens move ahead to disclose tax-evading practices in the United States. The SEC paid the reward of $14 million to a whistleblower because he reported a fraudulent scheme. The whistleblowers have been awarded $211 million during the years 2009 to 2013 because IRS was able to collect $1.7 billion additional taxes in the wake of whistleblower reporting.[66]

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[63] Susan C Borkowski and Mary Anne Gaffney, 'FIN 48, Uncertainty and Transfer Pricing: (Im)Perfect Together?' (2012) 21 Journal of International Accounting, Auditing and Taxation 32-51.
[64] IA Lipin, 'Discovery of Tax Accrual Workpapers After Textron And Deloitte' [2011] PTS 1-9.
[65] Yehonatan Givati, 'A Theory of Whistleblower Rewards' (2016) 45 The Journal of Legal Studies 43-72.
[66] Ibid 50.

Principle of economic substance and business purpose

In the year 2010, the United States also enacted the "Principle of economic substance and business purpose" based on which the TNCs are obligated to divulge their transactions which are lacking the economic substance.[67] Thereafter, the TNCs also stay alert to pay better attention to whether their transactions have business and economic substance in compliance with the legislation.

The tax authorities in the United States which administer the tax positions of companies rarely used to challenge the aggressive tax positions of TNCs prior to 2000, therefore, the private investigations kept public unaware of the taxation frauds during those times. But after 2000, the TNCs became vulnerable to reputation risk on the score that several open investigations against many large auditing and accounting companies such as KPMG, Ernst & Young, Enron made public aware of the fraudulent activities regarding the tax shelters participation of these huge companies.[68] Prior to the period 2000, the main tax optimization strategy for TNCs in the United States was to reduce the effective tax rates (ETRs) because there were no strict rules and regulations by the tax administration authorities. The TNCs were using tax shelters on a daily routine. Suppose if any TNC gets caught up in fraudulent activity regarding the taxation, the tax authorities used to give it a lenient punishment secretly thereby such activities rarely unfold before the public. But the TNCs taxation landscape has been completely changed in favour of the tax administration authorities after 2000. The new laws and legislation described above reduced the TNCs ability to execute aggressive tax planning and tax positions likewise.

There could be many signs of tax aggressiveness examined by the tax administration authorities. For example, if the overall ETR of the TNC is low then it might point to the aggressive tax position of the TNC. The general formula of ETR calculation is the total income tax expense that is to be divided by the pre-tax income worldwide. But as a matter of fact, this figure could go against the GAAP which says that the foreign earnings must be taxed unless the TNC proves that their earnings are again invested for an indefinite time period.[69] One of the key examples in this regard is the lowest ETRs displayed by Apple Company, which definitely shows its aggressive tax positions in the countries with low tax

[67] Nguyen Van Tiep, 'The Effects of The US Corporate Tax System on The Economy' (2017) ESC 13.
[68] Ibid 52.
[69] Ibid.

jurisdiction. The reason being, Apple takes the stance that they reinvest half of their earnings for an indefinite period of time.

The US tax administration authorities should make improvements in the IRS whistleblower program so that maximum cases against the TNCs aggressive tax positions could be materialised. It is reported that there were 2300 whistleblowers claims in the year 2007, but only 9 were materialised.[70] This vividly shows that IRS might have not enough resources to investigate all of the serious claims or it might be possible that they could not find enough legal evidence so as to file a suit to the TNC. Similarly, there is a long delay reported in paying the whistleblowers which should also be improved so that the informers might not get exhausted in the process. All the above-mentioned issues should be addressed so that the United States tax authorities are able to derive full benefits of the program in the long run.

Tax legislation and tax administration in the United States on TNCs foreign earnings (The Trapped Cash Scenario)

As a matter of fact, the high corporate taxation in the United States forces TNCs to leave the highest amount of their foreign earnings abroad in the low tax jurisdictions. The same might be the reason that TNCs reinvest huge amount of their earnings to be indefinitely reinvested in the foreign countries. It is also observed that this is drastic for the US-based TNCs on the score that these foreign earnings are not invested in the instruments that can revive innovation in the TNC itself because these foreign earnings are normally invested in stocks and securities. This implies that only a fraction of their profits would be invested in the research and development thereby lacking their competitive edge which is the key requirement for a company to stay competitive in the era of globalisation. In this regard, the US TNCs "*trapped cash*" scenario is worth noting which reflects the liquid investments and money that the subsidiary possess outside the jurisdiction of the home country.[71] The TNC do not bring their foreign earnings at home for the reason that their earnings would be subject to the corporate taxation of 35% minus the credit that the company has paid for foreign income taxes. It is reported that during the past years, the magnitude of foreign earnings of US-based TNCs has hit the roof. In the year 2012, $1.2

[70] Ibid.
[71] Russell Engel and Bridget Lyons, 'When Is A Dollar Not Worth A Dollar? The 'Trapped' Cash Controversy' (2014) The Trapped Cash Controversy 1-7.

trillion untaxed profits of 70 US-based TNCs were scattered all over the world that is 18.4% when compared with the past year.[72] When the US tax Technical Director at FASB was asked the question of low deferred US income taxes on the said topic and why the TNCs are not paying taxes on their foreign earnings, she pointed towards the FASB Accounting Standards Codification (ASC) Topic 740, Income taxes in the following lines:

"*It shall be presumed that all undistributed earnings of a subsidiary will be transferred to the parent entity (740-30-25-3) unless sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely (740-30-25-17*)."

In the wake of constant growth in these foreign cash situations, the US-based TNCs become vulnerable to the risk of lacking competitive advantage, the risk of liquidity in domestic operations, and the risk of low cash required for research and development. In this regard, there should be amendments in the repatriation legislature so that the TNCs are given worthy incentives so that they are allowed to release a portion of their foreign trapped earnings to the parent company based in the United States. Nowadays, when the TNCs experience short of funds then they feel disadvantaged and they are compelled to repatriate their foreign earnings even in the presence of highly unsuited corporate income tax thereby giving a blow to the competition.

Legislation of TNCs corporate tax inversion in the United States

American Job Creation Act (AJCA) 2004 to stop inversions

It is observed that many TNCs based in the United States try to get away with the worldwide strict regulation pertaining to the taxation which includes but not limited to US corporate taxation as well. In this context, the TNCs are practising the "tax inversion" which reflects when they change their home country by purchasing a foreign company that is based outside the US in a low tax jurisdiction but at least with a size of 25% of the US company.[73] In this type of inversion, there is no major shift in the headquarter, management, or ownership of the corporation. Normally the top executives are retained at home whilst the company's legal address is shifted overseas. Clothier argues that in many senses,

[72] Ibid 56.
[73] Reuven S Avi-Yonah, 'For Haven 'S Sake: Reflections on Inversion Transactions' (2002) 1793.

tax inversion has many loopholes, still, it is not referred to as tax evasion because it still falls within the domain of tax laws.[74] As a matter fact, when a TNC avails the facility of inversion, it is not taken as a US corporation, and consequently, the TNC would not pay any taxes on the profits that it earned overseas. The democrats make legislation so that the TNCs remain in the United States and they intend to penalize those TNCs who avail the tax inversion whereas the Republicans are of the view that the tax rates should be lowered so that the TNCs do not leave their home country.[75] Burger King is one of those companies who merged with a Canadian company named Time Hortons with $11.5 billion in the year 2014. After the big merger, Burger King lost its occurrence as a US-based company. Even the US government did not like it because Burger King was avoiding the taxes but could not do anything.

Various types of tax legislation were enacted in the past with a key focus of tackling the inversion issue in the United States. For instance, the American Job Creation Act (AJCA) was enacted in the year 2004 and a new section was included in the IRC based on which the corporations could avail the inversions if they own at the very least 80% assets of the new company. Secondly, the company's new headquarters must take charge of the active operations which deterred the companies to avail inversion because this way they had to build new headquarters in the foreign country rather than the practice in which they just do the paperwork and actively operate from within the United States. Section 965 in AJCA also encouraged the TNCs to avail one-time tax holiday provided if they repatriate their foreign profits at the rate of just 5.2% instead of 35%. Nevertheless, it failed to attract most of the TNCs because out of 9700 TNCs, only 843 availed the facility.

Even the Obama administration proposed in 2014 and 2016 to permanently close the loophole of tax inversion through tough legislation. Despite the proposal, congress did not take any tough action, but merely reduced the benefits of inversion.[76] However, a legislation was put in place to inhibit serial inversions practice in which, upon availing the inversion facility, the TNC intends to own another US company. Although these legislations were put in place to deter TNCs inversions, they did not deter many TNCs at large.

[74] SL Clothier, 'Relationships Between Corporate Inversions and The Tax Cuts & Jobs Act' (2019) 2.
[75] Ibid.
[76] Ibid 62.

It was also observed that the TNCs started to accumulate foreign earnings and then opt the wait and watch policy to see when another tax holiday would be passed by the United States so that they avail the facility thereafter. This implies that TNCs were able to avoid taxes by carefully planning their taxation strategies. The following table illustrates the strengths and weaknesses of the United States Corporate Tax system in general.[77]

Strengths	Weaknesses
When compared with other developed nations, the effective tax rates are comparatively the same.	The statuary tax rate of the united states is higher when compared with other developed nations.
The tax savings are likely to prevail the non-tax considerations such as developed financial system, infrastructure, and labour force.	The corporate tax system needs to be updated.
Despite the high tax rate, the revenue is steady.	The foreign earnings of the TNCs are subjected to the corporate tax.
	Considerable administration cost incurred due to sophisticated corporate US tax code
	Still, the loopholes of corporate tax inversions are present in the system.
	Aggressive tax positions are subjected to stricter regulations in response.
	There are many exemptions in corporate tax legislation due to lobbying.

The European Union (EU) jurisdiction of tax laws and TNCs

As a matter of fact, diverse types of disputes arise that are counterproductive to both TNCs, as well as the tax administration authorities due to the coexistence of diverse types of tax systems between the

[77] Ibid 52.

EU countries. In the context of the EU, it is proposed that the tax harmonisation among the nations should be increased so as to approximate the tax systems among the nations. The core aim is to make EU states a single market where all member states are subjected to a coherent system of taxation. Harmonising the rates of corporate taxes is one of the key agendas of EU tax administration.[78]

The Ruding Report

The former finance minister of Netherlands Dr. Onno Ruding was appointed so that relevant harmonisation could be devised among the member states. However, the report completely supported the division of TNCs income on the basis of arm's length principle thereby favouring the status quo in general. In a nutshell, the Ruding Report did not achieve its harmonisation objectives. It is observed that the major obstacle to reach a consensus for tax harmonisation among the EU member states is the requirement that for any corporate related tax reform, all the member states must give a unanimous agreement.

Improving procedures pertaining to information exchange

As a matter of fact, due to the absence of relevant information, it is hard to figure out the parameters of a comparable transaction. Also, the TNCs operate in certain jurisdictions, therefore, the tax authorities cannot obtain all the relevant information of their transactions. Not only the TNCs normally hold that information overseas, but the legislation of bank secrecy laws also prohibits the tax administration authorities to gain access to specific information about TNCs. In this regard, the OECD issued a new report on this question so that all the member states give their consensus accordingly.[79] But as a matter of fact, there is a limiting factor in such information exchange between EU member states i.e. only that information which is deemed necessary under the provision of Double Taxation Agreement (DTA) would allow the authorities to conduct the information exchange.

At EU level, tax harmonisation in TNCs is slow

[78] Lindsay C Celestin, 'The Formulary Approach to The Taxation of Transnational Corporations: A Realistic Alternative?' (2000) University of Sydney 1.
[79] Ibid.

When it comes to organising and optimising the taxation within integrated European Union, the process is slow on the score that many radical tax proposals in the past were rejected during the 1980s, and approach was adopted by the tax administration authorities that was more focused on subsidiarity.[80] But as a matter of fact, the direct taxation among the member states remained slow at large. In the early 1990s, the European Commission started negotiations among all the EU states, but those negotiations took a slow pace. Although the "secretive Code of Conduct Group on Business Taxation" formulates high-level technical discussions in a bid to examine and discuss national tax legislation among member states, still, there are reports that some member states are striving to jointly block efforts against the tax evasion and tax avoidance.[81] All in all, the attempts to successfully make all the member states in compliance with a single tax harmonised tax policy have been failed. This might be due to the fact that there has never been a total consensus among all member states on a uniform taxation policy for the TNCs. It is argued that there might be valid reasons behind this failure of unanimous consensus among member states. For instance, some member states might see tax competition as a positive factor, and not a negative one, and there could be some sort of disadvantages of locations which a few member states might want some compensation. It might also because a few member states see tax harmonisation and information exchange as a hard blow to their sovereignty.[82]

Also, there is a long list of issues which policymakers face in the EU, for instance, information and time is limited that is why they are forced to pick only certain types of severe problems and the outcomes of the decision-makers are somewhat ambiguous on the score that they only use some trusted sources to pluck out the desired information. Due to all this, there is always the element of uncertainty and ambiguity in their decisions.[83] Secondly, when a proposal is handed over to the EU policy process, it is bound to take over much time and efforts for the fact that it has to be discussed by a range of institutions. Conflicts arise on a regular basis due to the undefined and multifaceted preferences of the member states. All in all, this situation equates to a messy and uncertain policy process.

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[80] D Prvu, *Corporate Income Tax Harmonization in The European Union* (Palgrave Macmillan 2014) 34.

[81] Simon Bowers, 'Jean-Claude Juncker Blocked EU Curbs on Tax Avoidance, Cables Show' (*the Guardian*, 2017) <https://www.theguardian.com/business/2017/jan/01/jean-claude-juncker-blocked-eu-curbs-on-tax-avoidance-cables-show> accessed 8 July 2019.

[82] Ibid 64.

[83] Robert Ackrill, Adrian Kay and Nikolaos Zahariadis, 'Ambiguity, Multiple Streams, And EU Policy' (2013) 20 Journal of European Public Policy 871-887.

Common Consolidated Corporate Tax Base (CCCTB)

The 2011 CCCTB was created in a bid to tackle the problems relevant with the corporate taxation and CCCTB argues that due to diverse range of tax regimes in different EU member states, there are risks and uncertainties in market conditions due to high compliance and administrative costs coupled with the risk of double taxation for those TNCs which are operating in multiple member states. The CCCTB intends to create a framework for the EU so that all the obstacles pertaining to taxes are removed and EU member states get involved in healthy competition likewise.[84] The 2011 "Proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) proposed that the TNC would be allowed to file one tax return against their complete activities in the EU member states. It was also proposed that the TNCs can either avail the CCCTB proposed tax system which requires the TNC to hold EU-based activities, or the TNC can continue to utilise the parallel corporate tax systems currently subsist within the member states. This flared up criticism against the said proposal because it gives an unfair chance to the TNCs whether they opt for a new tax system proposed by CCCTB or they continue utilising their old tax systems based on their personal requirements and preferences. Also, this duality equates to an increase in the administrative cost of most of the EU member states. It is also argued that only including the EU-based activities in the proposal provides TNCs with an opportunity to shift their profits outside the jurisdiction of the European Union.[85] However, the system aims to access the past 6 years data so as to restrict the TNCs related manipulation in taxation and this is considered as the very first consolidated attempt to harmonise all the EU member states corporate tax base.[86] A few member states such as Germany and France have been strong supporter of the 2011 "Proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB), whereas a few member states remained strong opponents of the said proposal such as UK, Netherlands, Luxemburg, and Ireland because they are of the view that this tax base harmonisation is in reality, a slippery slope towards the harmonisation of the tax rate among all member states.

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[84] Shu-Chien Chen, 'Tax Avoidance in The Sales Factor: Comparison Between the CCCTB And USA's Formulary Apportionment Taxation' (2017) Indian Journal of Tax Law 1-27.
[85] Ibid 51.
[86] Ibid 64.

The Tax Justice campaigners and the policy level variance in member states put pressure on the member states so that they tackle the TNCs tax avoidance strategies by conforming to the CCCTB proposed policies. The world also witnessed the 2008 global financial crises, and the publications of many researchers amplified the debate that the TNCs tax avoidance and tax evasion give rise to global financial inequality.[87] Despite the proposal and all the efforts, the world witnessed the biggest MNCs scandals of tax avoidance and tax evasion, for example, Starbucks scandal augmented the same debate of tax avoidance since Starbucks was paying no taxes against their UK profits. The world also came across various secret deals between the TNCs and the Luxembourg tax authority commonly known as “LuxLeaks”.[88] The latest 2016 proposal of CCCTB is also on the top-slot, still, the TNCs are trying to leverage from the loopholes in the proposal with a focus on tax avoidance and tax evasion.

Critical analysis/Discussion regarding the legitimacy and authority of tax administration and tax laws of transnational corporations

Overview and background of Transnational Legal Order for TNCs

There is an abundance of literature stuff on the topic of transnational corporations’ law with respect to the international law. In the context of tax law, during the past years, a new term “transnational legal order” is also coined in the backdrop of international tax.[89] It is a common phenomenon that tax laws are imposed by the legislative authorities for the betterment of public goods and national sovereignty. But the question remains, is there a single applicable law in the world for transnational corporations, and suppose if it exists, then what is its legitimacy and authority in the global world. How this law is comprehended and enacted in the international domains and is it a practising law or just written in law studies to fill the word count? This section is going to deeply analyse these questions so as to fill the void of unanswered questions, and to analyse the legitimacy and authority of tax administration and tax laws of transnational corporations in reality.

[87] Rémi Jardat, 'Capital in The Twenty-First Century by Thomas Piketty' (2015) 12 European Management Review 48-53.
[88] Birgit Huesecken and Michael Overesch, 'Capital Market Reaction to Tax Avoidance: Evidence from Luxleaks' (2016) 1.
[89] Philipp Genschel and Thomas Rixen, *Settling and Unsettling the Transnational Legal Order of International Taxation* (2015) 154-183.

The concept of Transnational law is not a new phenomenon in the current century because it was also coined many decades ago by Philip Jessup who presented a narrower concept of transnational law in 1956 wherein he only presented the relationship between one state and the other state because the only subject of law during those days was nation-states.[90] As a matter of fact, the nations, during those times were getting involved in a broad range of treaties in a bid to get away with double taxation. The key agenda of cooperation among different states during those days was the development of tax norms and pursuing nations to participate in international cooperation in taxation. It was also observed that the countries were reluctant to broadly cooperate in the transnational law because they deem it as a matter of sovereignty, therefore, allocation of taxation rights in the transnational tax sphere was recognised as a necessity at large, still, there was minimal cooperation from the countries. Yet today, the same agenda is in the air in full swing where the world is demanding the TNCs to pay their fair share of taxes to the states for so many reasons. For instance, when the TNCs do not pay their taxes, then the tax burden is directed towards individual taxpayers which also triggers global inequality among the rich and the poor countries at large. The world needs a flexible, yet hard formulation of law and jurisdiction in the international sphere.

This corroborates the importance of the selected topic for this dissertation i.e. finding the answer "to what extent transnational corporations' tax administration and tax-laws are legitimate and authoritative in the globalized world". The researcher chose this topic because it directly affects the general citizens in different jurisdictions. If the TNCs would continue to toy with tax legislation and keep on manipulating through tax loopholes, then the governments in different jurisdictions would be deprived of their right to collecting funds which they require to spend to facilitate the general public at large. Secondly, the chosen structure and comparative study-based methodology is also employed with the simplest of structure but in-depth thinking scope so that general public in addition to professional law authorities as well as the TNCs come to understand the basic ills of taxation in different jurisdictions and play their positive role in terms of tax compliance. Furthermore, this study would positively contribute to improving

[90] Inis L Claude, 'Transnational Law. By Philip C. Jessup. (New Haven: Yale University Press. 1956. Pp. 113. $3.00.) - Morals, Law, And Power in International Relations. By Percy E. Corbett. (Los Angeles: The John Randolph Haynes And Dora Haynes Foundation. 1956. Pp. 51. $1.50.)' (1957) 51 American Political Science Review 1117-1119.

the tax legislation scenarios so that every country gets a fair share of their taxation against the worthy services they provide to the TNCs.

When it comes to analysing TNCs, one could not help imagining the expanding scale of human's cross border interactions, and this scenario gives a call to find answers that what power or degree, the national and international law should be applied to those huge TNCs. In the past, states were only having the hard laws such as the statutes or treaties which were formulated and enacted by the authorities, and the hard law ensures a hard obligation between states and the law would be exactly worded with exact obligations undertaken.[91] To the contrary, if a law is made for attaining general goals, it is not authorised by courts or treaties, but it could be enforced by non-state actors be it non-government businesses and organisations such as global accounting standards or international institutions such as OECD, then it would be termed as "soft law".

When the transnational legal order was formulated in the past century, the main aim was to get relief from "double taxation" thereby giving tax relief to the TNCs. By allocating the jurisdiction of residence, the TNCs were endowed the double taxation relief on the one hand, but inadvertently, it acted as a catalyst to imbalance the tax competition. The reason being, it gave the TNCs to take leverage from legal options so as to reduce their tax bills and left the nations vulnerable to aggressive low-tax strategies opted by the TNCs. Afterwards, that double taxation based legal transnational order was modified in the wake of the issues pertaining to tax avoidance and evasion, but in reality, the modifications have not found full-fledged success so far. According to Genschel and Rixen, it is not possible to tackle both double taxation and tax competition without sacrificing the sovereignty internationally.[92] That is to say, the governments need to sacrifice either revenue sovereignty, administrative sovereignty, or legal sovereignty so as to deal with the double taxation and tax competition things. The reason being, the states or countries are different from one another, but they seek to regulate the TNCs which are mobile in the global market which makes legal orders as interdependent and overlapping among different states thereby leaving states' sovereignty at stake in

[91] C M Chinkin, 'The Challenge of Soft Law: Development and Change in International Law' (1989) 38 International and Comparative Law Quarterly 850-866.
[92] Ibid 73.

some way or the other. In this context, it becomes extremely hard to measure the distribution of power among different states and the legitimacy and authority of the tax administration authorities likewise.

The authority of the state as a tax collector in this globalised era of Transnational law

The authority of the state is relevant to its particular jurisdiction because the state needs the capability and power to collect tax effectively, and this role of the state is deemed essential to the notion of the statehood. The inevitability of taxation for the success of the state and constitution was well coined by Adam Smith in the year 1776.[93] He says that alone the steady revenue is capable enough to give dignity and security to the government, therefore, there should be fairness, efficiency, and certainty in taxation. It is also argued that the capacity of the state depends upon its capacity to tax.[94] But this capacity, in the current century, is diverted to the elected legislators that are constrained within the constitutional frameworks of their country. This capacity of the statehood could be seen within the state boundaries, but when it comes to analysing this power outside their borders in shape of Transnational tax law for TNCs, no state has ever been completely bound or secure by the international tax administration bodies thereby international taxation is turned out to be “performative” or “operative”.[95] The new actors and processes are continuously being involved in the process of shaping the transnational tax law.

In this globalisation era, we know that various worldly institutions and banks are connected with each other through up-to-the-minute technology because they have shifted their prospects from national to transnational institutions all across the globe. The banking card which is created by a South African bank can also take out money from the ATM machine in the US, or in many other global countries. This implies that we might have to think beyond the concepts of “source” and “residence” in the transnational law likewise because the tax jurisdictions should be based on one construct that must be explained as a “world society”. It is true that global is not separate from the national because it is deeply embedded inside the nation-state. The problem of state authority and power begins when the global transnational

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[93] ' Li Tingfang and Wu Xianghui, 'The Historical Streams of Adam Smith’s an Inquiry into The Nature and Causes of The Wealth of Nations' (2019) American Journal of History and Culture 1.
[94] R A Musgrave, 'Schumpeter's Crisis of The Tax State: An Essay in Fiscal Sociology' (1992) 2 Journal of Evolutionary Economics 89-113.
[95] Saskia Sassen, *Territory, Authority, Rights: From Medieval to Global Assemblages* (Princeton University Press 2008) 2-3.

law takes a shift of authority from global to national because, at that point in time, worrying implications arise underlying the national tax state for the legitimate fiscal bargain of the country.

Should transnational tax jurisdiction be territorially confined?

This is what Jessup observed in the first place because the tax laws in the past centuries were mostly associated with territorial concepts which include the location of property, contracts, or activities. In this regard, Jessup opines that the jurisdictions of tax should not be confined on the basis of territory.[96] Jessup says that this is just a rule of convenience, not a necessity. The territorial jurisdictions are applied to the tax law because the government's ability to collect tax applies on those who can be taxed and who lie within their jurisdictions, and the tax authority can exert its powers upon them. In most countries, the tax authorities and the governments determine this by the concept of "residency". The concept of "residence", when applied to individuals, it reflects the place where the person takes residence, a place or domicile, or the location from where the person comes from, or simply the place where the person resides for 6+ months of a year. Even in the United States, the concept of "residence" is applied so that the government can impose taxes on the citizens based on the said criteria.

This old concept of "residence" might need an extension transnationally. Would it be feasible that for the current era of technology that the same old locatable position of a taxpayer is used? This is not a totally new phenomenon in the tax law jurisdictions. This concept is also extended in the current national income tax laws wherein the concept of individual is extended to the investments of offshore entities of those persons who are still resident of a particular country, yet the individuals were able to successfully extend their presence transnationally beyond the jurisdictions of the country they were residing in. The taxation law explains it as an expression of offshore income or the worldwide income, or transnationally, one can explain it as worldwide profitability of TNCs.[97] If an individual is able to extend his income internationally, then the concept of individual residence could be extended to transnational individual as well.

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[96] Ibid 2.
[97] Kenneth Klassen, Mark Lang and Mark Wolfson, 'Geographic Income Shifting by Multinational Corporations in Response to Tax Rate Changes' (1993) 31 Journal of Accounting Research 141-173.

The legitimacy and effectivity of transnational tax administration authorities

The success of the national tax rules, as well as the transnational law which has a primary focus on capturing the evaded income, depends on what is and how much effective is the taxing power of the tax administration authorities. The past 20th century was very good for the statehood of the tax state, but it also uplifted the tax havens which was very secret topic until recently.[98] This implies that the extension of individual's jurisdiction over the subject of tax needs solid transnational enforcement imposed by the tax administration authorities. Hence, the tax administration authorities are paying almost all of their attention to the beneficial ownership of offshore trusts, opaque funds, and nominee companies in the tax havens to ascertain that the residence tax is not evaded by the actual residents. By taking a close look at the United States in the backdrop of these tax efforts, it is observed that these efforts are facing strong resistance within the United States, and it is extremely hard to chase the layers of beneficial ownership through tax information exchange thanks to the fast-paced tax information exchange but very slow efforts with regards to chasing the layers of beneficial ownership. This is where the enforcement of transnational tax administration comes handy (we will discuss it more below) because it might address those issues clearly, as well as address the double taxation and the double non-taxation issues. It is also possible that the legitimacy and effectivity of transnational tax administration authorities might give a hard blow to the tax havens sovereignty thereby substantially reconfiguring the tax jurisdictions authority into the areas where tax havens are located around the globe.

The effectivity of the transnational tax administration authorities might be strengthened if they do not track individuals merely on the basis that they are resident or non-resident, rather if they track the individuals on the grounds of their transnational movements. Why is that individuals or TNC who get benefits from the state from public goods and services, still the state is unable to tax them merely because they are non-resident, and that is why the state cannot enjoy the right or jurisdiction to tax. This implies that if the transnational tax law is implemented as a whole, then the mobile individuals who are travelling across borders and TNCs which are conducting cross-border transactions both would come under the strong surveillance of transnational tax administration authorities. One bad proxy to this

[98] G D Ikenberry, *The Nation: State in Question* (Princeton University Press 2003) 166-208.

problem is proposed by using “citizenship” as a ground for taxation, and the United States is exceptionally doing this practice. But this option is not recommended because researchers argue that citizenship taxation is producing unfair results for those US citizens who are non-resident.[99] [100]

How Australian income tax authorities administer tax from transnational students (an example worth noting in the context of transnational tax administration)

Another example of transnational tax collection could be given in the backdrop of higher education debt for former students in many countries. In Australia, the students are the beneficiaries of the government funding that is why the students owe money to the government even if they exit Australian jurisdictions.[101] Similarly, the tertiary education in the United States is also funded by private loans or the government and the students still owe them even if they go beyond US jurisdictions. It is also a heated debate that in reality, the collection from these students is still a crisis[102] due to the difficulty of cross border enforcements, still, the law is there which is enforceable on those students (or one could not help saying, transnational students). As per the Australian HECS regime, the Australian students are eligible to avail the government loan to pay their tertiary education fees. Afterwards, the tax authorities i.e. the Australian Tax Office administers the HECS levy on these students which starts at a certain income threshold each year. If the students’ income falls below that threshold, the Australian Tax Office will not charge the income tax. In the past, if the former students leave Australian jurisdiction and become resident of some other country, then due to the income tax concept based on the residence of the taxpayer, Australian Tax Office could not apply a levy to those students. However, the Australian tax administration authorities have changed this law recently, due to which, the HECS levy will be applicable to overseas Australian students based on their worldwide income of the non-resident individual.[103] This is a kind of transnational legal effect on overseas Australian students. It is of note that

[99] Ruth Mason, 'Citizenship Taxation' (2015) S Cal L Rev 5-35. The introduction says “The United States is the only country that taxes its citizens’ worldwide income, even when those citizens live indefinitely abroad. This Article critically evaluates the traditional equity, efficiency, and administrability arguments for taxing non-resident citizens. It also raises new arguments against citizenship taxation, including that it puts the United States at a disadvantage when competing with other countries for highly skilled migrants.
[100] Allison Christians, 'Uncle Sam Wants Who? A Global Perspective on Citizenship Taxation' (2016) Much J Int'l L 193.
[101] Alex McKinnon, 'To Fix America’s Student-Loan Crisis, Look for Inspiration Down Under' (Quartz, 2017).
[102] Robert Kelchen, 'Is Student Loan Debt Really A Crisis?' (*The Conversation*, 2015).
[103] 'Overseas obligations when repaying loans' (*Australian Taxation Office*, 2019).

the levy on those students is associated with their ability to pay. Also, the Australian government might not be eligible to apply levy to the overseas students in the United States because based on US law, foreign tax credit cannot be applied to their residents, but as a matter of fact, Australia could settle this by defining it as loan repayment, and not an income tax collection.

Regarding the concept of transnational taxing jurisdiction, the “brain drain” tax is also worth noting.[104] In this regard, Johnstone highlights that according to Chapman et al. if a student completes his tertiary education in a poor country, and then he migrates to a developed country like Australia, then the Australian government can collect the “Brain drain” tax which would be then remitted to the poor country from where the student migrated to Australia. Obviously, this would need cooperation among governments globally.

When it comes to transnational corporations related tax administration, the TNCs are able to manipulate their locations as well as their allocated income tax by smartly utilising the low tax jurisdictions. The corporate tax is basically enforced so as to bring the ultimate owners or shareholders of the TNCs under tax net which is linked with the net gains from their investments. But given the facts stated above in this dissertation, the loopholes in the taxation laws, the problems of taxing the TNCs across continental boundaries, and the smart tactics of TNCs, there has been a constant tension that how and to what extent the TNC, as well as their location, will be marked or unmarked by the tax authorities at large. The TNCs are able to take leverage from nationally based concepts of the “resident” and they are able to subdivide their single TNC company into specialised and multiple sub-entities thereby allowing their large corporation to enjoy diverse relationships and rights across the low and high tax jurisdictions. This situation becomes extremely complex because taxing a single TNC is one thing, but taxing hundreds of paper-based legal entities that are also associated with a diverse range of other legal taxation rules especially intellectual property across varying jurisdictions is another thing. This complexity also puts a question mark on the authority and rights of tax administration authorities as well as the states themselves. As a matter of fact, the intellectual property structures and tax-free jurisdictions have been absorbed and marked as capital by the TNCs. This has created a private zone of TNCs capital flow

[104] Jagdish Bhagwati and William Dellalfar, 'The Brain Drain and Income Taxation' (1973) 1 World Development 94-101.

wherein TNCs have become the sole bearers of rights, therefore, the whole situation is directly undermining the authority of tax administrators.

Just like the Australian government has legitimised the HECS law to impose a levy on offshore students based on their income threshold in a foreign country, the TNCs could be followed by a “look thru” or “consolidation” approach, which the world can see in terms of the US regulations in its Controlled Foreign Corporation (CFC) rules. But CFC rules also have their own limitations because the CFC rules widely diverge from each other since they give strength to only some kinds of income in some jurisdictions for some kinds of taxpayers. For example, even US CFC rules allow TNCs to accumulate overseas profits in tax havens.

The contribution of BEPS coherent tax law-making to strengthen the international tax administration for TNCs

There are a few treaties and international agreements which are offering new ways to tackle the TNC tax problems so that the tax authorities become more effective than in the past. In this context, the Multilateral Instrument (MI) is worth noting wherein those TNCs which join this tax law, would be considered a member of the new framework, and their existing treaties would be considered null and void, all with a key focus to regularise the future development of transnational taxation on the one hand and strengthening the tax administration authorities on the other hand. The MI law states the following lines in particular:

the negotiation of the multilateral instrument should include implementation of the tax treaty provisions on hybrid entities adopted during the course of the work on Action 2, the work to prevent treaty abuse under Action 6, the work to prevent the artificial avoidance of the PE standard under Action 7, the work to improve dispute resolution under Action 14, and any other treaty modifications developed during the course of the work on the remaining BEPS action items.[105]

[105] 'Action 15: A Mandate for The Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS - PDF' (*Docplayer.net*, 2019).

This is believed to be a good tax law-making that is aimed at establishing a new set of standards to prevent double non-taxation occurrences for TNCs, and a process to encourage the single tax principle so that tax administration authorities are strengthened in various TNCs situations. If one takes a close look at the various Actions explained in this law, it provides a key focus in providing coherence in TNCs tax laws by tackling most of the irregularities in terms of TNCs tax avoidance and evasion. For instance, Action 2 relates to hybrid mismatching arrangements, Action 3 is concerned with CFC rules strengthening scenarios, Action 4 is relevant to controlling base erosion through financial payments and interest deductions. Action 5 relates to effectively tackling harmful tax practices. These types of tax law-making require a certain degree of international consensus so that the results could be achieved as per expectations.

The BEPS Action 5 relates to the harmful tax practices and it has the capacity to end the double non-taxation plus it addresses the proposal to develop processes to determine disclosure requirements, intra country information exchange and transparency between OECD member states, and the corresponding rulings for taxpayers. At the same time, by reading the tax law, it is observed that OECD is extra careful to describe this Action 5 as follows:

Is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates.[106]

The BEPS law also points toward the minimum requirement of economic substance which is relevant to examining the “real” business under the garb of a single TNC or company. This is pertinent because TNCs get involved in making numerous subsidiaries which hamper to draw jurisdictional tax boundaries against their cross-border operations. In this regard, the key mantra of BEPS is to tax the profits of TNCs based on the fact where is the economic activity took place and the subsequent creation of value occurred. The BEPS law states:

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[106] Sebastiano Garufi, *International Strategies to Combat "Countries with A Privileged Tax Regime"* (2013).

Action Item 5 specifically requires substantial activity for any preferential regime. ... this requirement contributes to the second pillar of the BEPS project, which is to align taxation with substance by ensuring that taxable profits can no longer be artificially shifted away from the countries where value is created.[107]

What should be the key focus of tax administration authorities?

As explained earlier, most of the tax legislation in the past presumed that the TNC, taxpayer, or activity, can be fixed to a certain physical space or territory in order to tax them correctly. Nevertheless, there could be a possibility that the territorial concept of physical space might be fundamentally changed altogether in this era of the digital economy. This is where BEPS laws should focus these days so as to strengthen the tax administration authorities against possible tax avoidance and tax evasion strategies. For example, if the tax administration authorities keep on tracking the TNCs taxes on the basis of their physical spaces, then how would they track the economic gains that are earned by those TNCs partnered in the trading of virtual online gaming business. Who would they track, the gamer location, the location of the other gamers who are playing across continental boundaries, or the location of the servers or the IPs? Also, every TNC operates uniquely internally as well, therefore, the physical jurisdiction is becoming less viable.

It seems like the governments are trying their best to achieve networked connected transnational tax administration systems in this era of globalisation. It is also argued that globalisation is perceived as a threat to national sovereignty, but the cross-border technologies of regulation might amplify the power of state as well as the state's capability to govern.[108] The researcher does not agree with the notion that states are surrendering their tax sovereignty (as per the arguments put forth by Genschel and Rixen)[109], the researcher sees it as more empowering the tax administration authorities participating in many countries as a whole.

[107] OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 2015, Final Report* (OECD Publishing 2015).
[108] Linda Weiss, 'The State-Augmenting Effects of Globalisation' (2005) 10 New Political Economy 345-353.
[109] Ibid 4.

One of the key laws to strengthen the tax administration authorities is the Multilateral Convention under the umbrella of Global Forum, G20, and OECD, wherein many world states are participating in the purpose of Mutual Administrative Assistance in Tax Matters (MAC). The ambitious scope of MAC is written in the Explanatory Report as follows:

This instrument is framed so as to provide for all possible forms of administrative co-operation between States in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. This co-operation ranges from exchange of information to the recovery of foreign tax claims.[110] This framework could be used to strengthen the tax administration of TNCs.

The Explanatory Report also suggests that there should be speedy and direct contacts between tax administrations between states to make the tax administration assistance more effective than ever. The MAC also recommends that the tax administration of TNCs is gaining power due to automatic data sharing through fast technological systems. It is of note that MAC does not have any authority to implement automatic data exchange between the states, but it emphasises to make a mutual agreement among countries that what kind of processes and information would be included in such information exchange. Similarly, many of the Actions formulated by G20-OECD are focused on "transparency" so as to strengthen the tax administration. Now country-by-country reporting among countries has commenced wherein the TNCs data is being automatically shared, and these measures would certainly give more strength to tax administration authorities against TNCs taxation.[111] The MAC would also be feasible for the legitimacy of transnational administration, for instance, through a network of legally binding treaties. Currently, it seems like TNCs are on the upper edge than the tax administration authorities due to the loopholes in tax legislation, but the mutual cooperation among the countries would be able to balance the legitimacy and authority of the tax administration authorities against the TNCs.

Conclusion

This dissertation acknowledges that TNCs, in this interrelated complex globalisation phenomenon, have brought in a great expansion of companies' interaction across borders. At the same time, there is a vivid

[110] Miranda Stewart, 'Transnational Tax Law: Fiction or Reality, Future or Now?' (2016) ANU 1-42.
[111] Ibid 94.

gap of finding the right answer of power and degree to which transnational corporations' tax administration and tax-laws are legitimate and authoritative in the globalized world. In the context of TNCs, the system of international taxation was enacted to eliminate the occurrences of double taxation. But the efforts which were focused to get rid of double taxation on TNCs triggered other problems relevant to tax administration such as the issue of "transfer pricing manipulation by the TNCs" (using their subsidiaries in different jurisdictions), and the "earning stripping issue" (by using debt allocation wherein TNCs borrow from the low tax jurisdiction to the high tax jurisdiction and generate interest deductions in the high tax jurisdiction through the subsequent interest payments and subsequently secure more income in the low tax jurisdiction). The TNCs also take leverage from the "hybrid mismatch arrangements" wherein the TNCs exploit the differences in the national tax treatment of a transfer, an entity, or of an instrument between two or more than two countries which results in either long-term tax deferral or double non-taxation. The dissertation acknowledges the fact that due to loopholes in international tax administration, TNCs have been in a better position even in the last few years due to their smart tactics to avoid and evade taxes through tax havens and tax holidays. As a countermeasure to these TNCs related tax avoidance and tax evasion, an international level establishment of Extractive Industries Transparency Initiative (EITI) was made which allows the global countries to voluntarily sign up so that their transparency could be checked. It had shown progress, for example, the Glencore case that based on the data obtained from comparable mines, Mopani Mine was giving very low taxation. The Controlled Foreign Corporation (CFC) rule was enacted so as to give a hard blow to the tax avoidance strategies of TNCs so that they are deterred to accept artificial entities purely for taxation purposes. Now, the United States, Japan, and the United Kingdom can tax an entity in another country which is controlled by the UK, Japanese, or US parent company under certain situations. It is all because of the implementation of CFC rules in their jurisdictions. The tax administration authorities also applied the Double Taxation Agreements (DTAs) with an aim that TNC would be taxed only in one state (higher tax country or the lower), but the TNC would not be double taxed in both countries. But the results are not so far appraisable as double taxation issue is now again in the limelight.

This whole scenario shows that for any international tax legislation, the TNCs have been trying their best to avoid their taxes so that they can earn more and more. The TNCs are somewhat authoritative in the sense that they have been successfully finding their ways through the loopholes in the international taxation. To the contrary, the tax administration authorities are somewhat subdued due to the restrictions pertaining to cross border tax administration. In this regard, this study proposes that there is a great need to improve the procedures of information exchange between the countries. The tax harmonization process should be processed with a fast pace. And above all, the jurisdictions of tax should not be confined on the basis of territory. The old concept of “residence” might need an extension transnationally. The effectiveness of the transnational tax administration authorities might be strengthened if they do not track individuals merely on the basis that they are resident or non-resident because TNCs are able to manipulate their locations as well as their allocated income tax by smartly utilising the low tax jurisdictions. If the tax administration authorities keep on tracking the TNCs taxes based on their physical location, then how would they track the economic gains earned by those TNCs partnered in the trading of virtual online gaming business. Would they track the location of the gamer, the location of the other gamers who are playing across the globe, or the location of the servers or the IPs?

Hence, in order to give more power to the international tax administration authorities, the world should focus on the key legislations such as Multilateral Convention under the guidance of Global Forum, G20, and OECD, in which many world states are taking part for Mutual Administrative Assistance in Tax Matters (MAC). The study proposes that there should be speedy and direct contacts between tax administrations between states to make the tax administration assistance more effective. Automatic data sharing through fast technological systems should be incorporated. Country-by-country reporting among countries has commenced wherein the TNCs data is being automatically shared, and these measures would certainly give more strength to tax administration authorities against TNCs taxation.

It is a matter of balancing the TNCs tactics with strict but applicable international tax legislations. The reason being, all these legislations should make TNCs compliant to the tax laws, but it should not hurt them bad as it would also be bad for the world economy. Once again, this study proposed that we need to rethink the concept of territorial jurisdiction of TNCs in this era of globalisation. To make it all possible, there would be a great need of international cooperation between countries so that they empower both entities i.e. the TNCs as well as the tax administration authorities. The new treaties that are being enacted in the international tax legislation like the Multilateral Convention, Mutual Administrative

Assistance in Tax Matters (MAC), BEPS 15 Actions, automation in data sharing and information exchange between countries, and country-by-country reporting between countries, all need mutual cooperation only then the transnational corporations' tax administration and tax-laws would become legitimate, authoritative, and balanced in the globalized world.

Finding the right answer of power and degree to which transnational corporations' tax administration and tax-laws are legitimate and authoritative in the globalized world is somewhat tricky. The reason being, it is easier said than done when it comes to measuring the power (the tax administration authorities) and the deception (tax evasion and tax-avoiding strategies employed by the TNCs). It is extremely hard, even next to impossible to measure the degree of power or the extent of deception as in our case of TNCs. For example, people have invented the polygraph machines to detect lie and the emerging field of forensic linguistics is being used in courts to detect language deception, still, to measure deception mathematically is a far-fetched phenomenon. To fill this gap, there needs to be a critical analysis mechanism which analyses both sides of the continuum i.e. the side of TNCs wherein they seek refuge from tax-avoiding and evading strategies, and the tax administration authorities where new laws and legislation are constantly being formulated and enacted in a bid to track the loopholes and make the TNCs to come under compliance with the law. This is the key reason that this dissertation employs a critical analysis methodology to get an all-inclusive overview on both sides of the picture. By the help of this critical analysis, it was made possible to conclude that improving the procedures of information exchange between the countries should be the very first priority in order to strengthen tax legislation. The tax harmonisation process comes on the second slot. Third, it was examined that by merely tracking individuals and companies on the basis of their location is an old concept on the score that TNCs are able to manipulate their locations in different tax jurisdictions. The comparative but critical methodology in this dissertation allows this study to propose that we need to rethink the concept of territorial jurisdiction of TNCs in this era of globalisation. Incorporation of new information systems, country-by-country reporting, automation in data sharing, Mutual Administrative Assistance in Tax Matters (MAC), BEPS 15 Actions, all would greatly strengthen the power of tax legislation and make the TNCs to come under compliance with the law.

It is also of note that this dissertation is by no means the final answer to the proposed topic, however, it is highly likely to serve the purpose of a stepping stone to the further the research in this field. The critical analysis in this dissertation is going to make the society realise and think deeply (including the TNCs and Tax authorities) whether the tax laws have correctly conveyed the reality to them, or they need to dig deeper into the subject, conduct further researches, and perform more deeper thinking in order to overcome the prevailing inequalities of wealth and power in the society. This dissertation is the first step, but this is going to open further doors of investigation regarding critical evaluation in this field.

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