

Domestic Regulation of Tax Avoidance by Transnational Movement of Tax Objects in the Digital Economy

Cuicui Hu

School of Law, Anhui University of Finance and Economics, Bengbu, Anhui, 233030, China

Abstract: *All along, countries have been struggling with how to regulate international tax avoidance by multinational enterprises, but international tax avoidance is still a common phenomenon. In recent years, the digital economy has developed rapidly, contributing to the economic development of countries that cannot be underestimated, but at the same time, it has also created cheaper conditions for multinational corporations to implement tax avoidance. Under the digital economy, the whole transaction process of commodities presents characteristics such as virtual, hidden and overtime, and it is difficult to determine the object of transaction, the place of transaction and even the attributes of the transaction commodities, which makes the tax jurisdiction difficult to identify and the tax collection system lags behind, which increases the difficulty of tax collection by taxation authorities. Accordingly, the existing tax collection and administration system should be improved, the technological level and supervision level of the staff of taxation authorities should be improved, and international cooperation should be strengthened by participating in multilateral or bilateral agreements to jointly combat international tax avoidance.*

Keywords: *Digital Economy; Taxation Object; International Tax Avoidance*

1. Introduction

International tax avoidance usually refers to the implementation of tax avoidance or tax burden reduction by multinational tax obligors according to the differences and deficiencies in tax rates, tax objects, tax relief and preferential policies stipulated in tax laws between countries and bilateral and multilateral agreements participated in. In short, international tax avoidance is the tax avoidance by the tax subject using the loopholes and defects of the existing tax laws and tax agreements. Therefore, international tax avoidance is a kind of behavior that is legal in form but illegal in substance, and all countries take a strict attitude to combat international tax avoidance. At present, multinational enterprises mainly avoid tax through the cross-border movement of tax subjects or the cross-border movement of tax objects, among which, the cross-border movement of tax objects is the most common means used by multinational enterprises to achieve tax avoidance.

2. Main Ways of Tax Avoidance by Using Tax Objects to Move Across Borders

At present, the ways of international tax avoidance are mainly categorized into two types of ways. One is to achieve the purpose of international tax avoidance through the transnational transfer of tax subjects. For example, China stipulates that in a tax year, people without residence in China will pay personal income tax only when they have lived in China for 183 days in total, so some people will use the provision to plan to leave China early when they are about to reach 183 days, so as to achieve the purpose of tax avoidance; for example, some people, in order to avoid paying tax, specially sail on the high seas and live on board. Secondly, the purpose of tax avoidance is achieved through the transnational movement of taxation objects. Usually, the permanent establishment is in the high tax rate country, and the other companies established or controlled by them are in the low tax rate country, so in terms of interests, the multinational joint enterprises maintain a high degree of consistency. Therefore, in order to maintain the interests of the enterprise group, multinational enterprises use the means of sharing costs and expenses, adjusting transaction prices between related enterprises, etc. to exploit the loopholes of the law, so as to achieve tax avoidance purposes. Generally speaking, the main ways of international tax avoidance through cross-border movement of tax objects are shown in Figure 1, including transfer pricing tax avoidance, tax haven tax avoidance and weakened share investment tax avoidance.

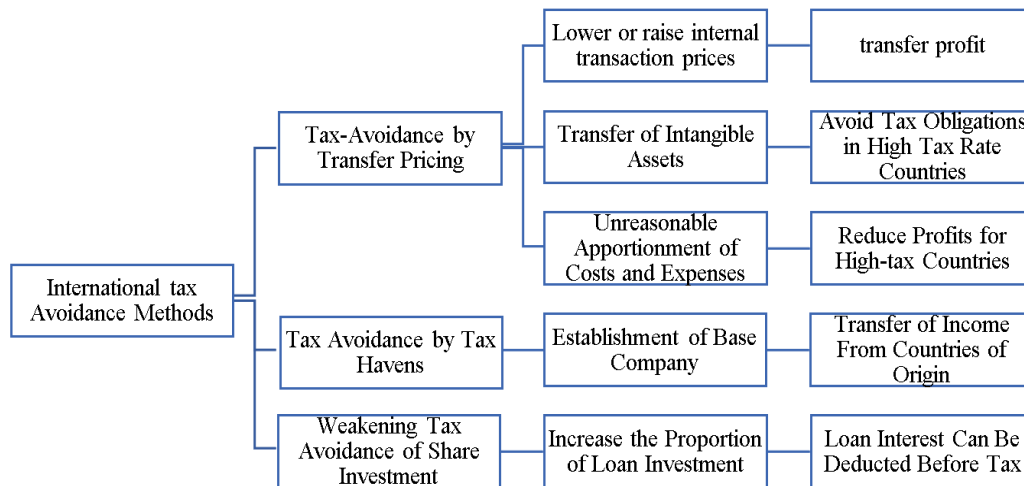


Figure 1: Main Ways of International Tax Avoidance for Multinational Enterprises

2.1 Transfer Pricing Tax Avoidance

This type of tax avoidance is often used by multinational affiliates. A multinational affiliate can be a parent company and a subsidiary, or a subsidiary and a subsidiary, or a company with a controlling and controlled relationship in terms of equity and capital, or a head office and a branch, etc., established in two or more countries. Under transfer pricing, profits are usually shifted from a high-tax country to a low- or zero-tax country, thereby achieving the goal of less taxation in the country with the higher tax rate. There are many different ways in which affiliated companies can avoid tax through transfer pricing.

2.1.1. Profit Transfer by Depressing the Internal Transaction Price or Raising the Internal Transaction Price

For example, if the parent company is established in a high tax country and the subsidiary is established in a low or zero tax country, in the course of their related transactions, the parent company artificially lowers the price of the internal transaction and sells the goods to the subsidiary at cost, and the subsidiary then sells the goods at a higher price, thus transferring the earned profit from the country where the parent company is located to the country where the subsidiary is located, and the total tax burden of the parent company is reduced by shifting. The parent company's total tax burden is reduced by the transfer of pricing.[1]

2.1.2. Use of Intangible Assets Transfer to Achieve Tax Avoidance

Multinational enterprises with related relationships avoid or reduce their obligations to pay taxes in countries with higher tax rates by transferring or using intangible assets between them, transferring or leasing them at apparently unreasonable prices, and thus transferring most of the intangible assets to countries with lower tax rates.[2]

2.1.3. Tax Avoidance through Artificial and Unreasonable Sharing of Costs and Expenses

This tax avoidance method generally occurs between the head office and branches of a multinational corporation, or between two or more branches. By artificially allocating the costs and expenses incurred by the enterprise in business activities, acquisition of fixed assets, management, etc. to the enterprise in the country with higher tax rate, the multinational corporation reduces the profits generated by the enterprise in the country with higher tax rate and thus reduces the tax amount.

2.2. Tax Havens to Set Up Base Companies to Avoid Tax

The typical feature of tax havens is the low or zero tax rate on income. At present, the low- or zero-tax countries in the world include Luxembourg, Cayman Islands, Isle of Man, Jersey, Ireland, Mauritius, Bermuda and the Netherlands, etc. These countries have very low tax rates, which attract a large number of enterprises to set up companies here to avoid the taxation of the countries where the income is earned, and thus can be considered as tax havens for multinational enterprises.

Generally speaking, companies established in tax havens are often referred to as base companies, also known as cardboard companies or book-entry companies. These base companies are often controlled by

companies in countries other than tax havens and do not engage in actual business activities. They mainly receive the income and profits earned by the controlling company in the country of origin and help the controlling company to avoid the responsibility of paying taxes in the country of residence or the country of origin of income.

2.3. Weak Share Investment Tax Avoidance

When multinational affiliated enterprises invest in each other, in order to avoid tax obligations, the proportion of loan investment is generally increased significantly and the proportion of share investment is decreased.[3] In general, shareholders can either invest in shares through share investment or through loan investment, in which, shareholders enjoy equity by holding shares, the interest generated from equity is not deductible before tax according to the tax law, and all dividends received need to be taxed according to the tax law before they can be distributed to shareholders; while the interest generated from loans is not subject to tax and can be deducted before tax, therefore, the tax basis is reduced and the tax payable is reduced. Therefore, the tax basis is reduced and the tax payable is reduced. Compared with the share investment method, the profit that shareholders can eventually distribute is increased, and multinational enterprises take advantage of this characteristic of loan investment to deliberately increase the amount of loan investment and reduce the amount of share investment, so as to achieve the purpose of tax avoidance.

3. Current Status of Domestic Regulations on Tax Avoidance By Using Cross-border Movement of Tax Objects in the Digital Economy

3.1. Adjustment of the Price of Obviously Unreasonable Connected Transactions By the Tax Authorities

Transfer pricing seriously infringes on the tax interests of the country of residence of the enterprise or the country of origin of the income and violates the tax jurisdiction of a country, so it must be severely combated. Therefore, for the related transactions of multinational affiliated enterprises, the tax authorities of the country of origin of the income and the country where the enterprise is located have the right to adjust the internal transaction price if the related transaction price is significantly lower than the general normal market price.

3.1.1 Adjustment of Internal Transaction Prices Using the Arm's Length Method

For the transfer pricing of traditional tangible goods, the normal standards of internal transaction prices can be determined by the comparable uncontrolled price method, the resale price method, and the cost-plus method.[4] Among them, the comparable uncontrolled price method, in order to make the transaction price more fair and reasonable, refers to the transaction price of similar goods or similar goods transactions between unrelated enterprises in the same period or in the recent past; the resale price method, on the other hand, refers to the transaction price generated by a multinational affiliate enterprise after completing an internal related transaction, and then one of the affiliated enterprises sells the goods to an unrelated third party enterprise. The resale price method is the transaction price resulting from the completion of an internal transaction between affiliated enterprises and the sale of goods to unrelated third-party enterprises, after deducting the gross profit of the selling party; and the price cost-plus method is the final determination of the normal transaction price standard, taking into account the cost of goods, the costs incurred and the profit made, if no similar or similar commodity transactions have occurred between unrelated enterprises during the same period, and if one of the affiliated enterprises has not resold the goods to a third-party enterprise. If the internal transaction price of the affiliated enterprise is not obviously low or high compared with the transaction price obtained by using the above three methods, it belongs to the normal transaction price and does not belong to the category of international tax avoidance and is not illegal; if it exceeds the reasonable range, the tax authority has the right to pursue the responsibility of the tax subject and order to pay back the tax according to the law.

3.1.2. Adjustment of Internal Transaction Price Using Profit Method

For the transfer pricing of intangible assets, the normal transaction price is determined by the comparable profit method, the net trading profit method and the profit split method. Among them, both the comparable profit method and the net profit method are based on the profits from commodity transactions between unaffiliated enterprises in the same period or recently, but the net profit method does not consider the gross profit; while the profit split method mainly allocates the profits obtained by the multinational affiliates among the parties according to the proportion of their contributions, and

finally presumes the income that each party should obtain in the transaction. The tax authorities have the right to make adjustments if the income earned by the multinational affiliate is significantly low or high.

3.1.3. Adjustment of Internal Transaction Prices through Reservation Pricing

Before engaging in affiliated transactions, multinational affiliated enterprises can submit the internal transaction price they want to set to the tax authorities of the country of residence for prior ruling. After the tax authorities and the enterprises reach an agreement on the transaction price, even if the price may be found to be unreasonable later, the transaction between multinational affiliated enterprises with the determined price is not an international tax avoidance act and the tax authorities have no right to adjust it.

3.2. Establishment of Safe Harbor Rules Fixed Loan to Equity Ratio

The safe harbor rule, mainly for the weak share investment tax avoidance, specifies the ratio between loan and equity when affiliated enterprises invest in each other, within the fixed ratio, the interest generated by the loan is made pre-tax deduction according to law, and the interest is not taxable; the excess interest is stipulated, and the interest generated by the loan beyond the ratio needs to pay tax and cannot be made pre-tax deduction, thus effectively preventing the loan ratio from being too high in the investment ratio. The safe harbor rule is a common practice in various countries, which plays a good role in combating the international tax avoidance behavior of multinational enterprises and, to a certain extent, maintains the tax collection power of each country.

3.3. Controlled Foreign Enterprises Are Not Entitled to Tax Deferral Benefits

This measure aims to combat multinational joint ventures that use tax havens to avoid tax. In order to combat the practice of a base company, i.e. a controlled foreign enterprise, which derives all of its income from foreign enterprises and should distribute dividends to its shareholders but does not do so, under this measure, the enterprise's failure to distribute dividends is deemed to have been distributed to its shareholders, and the tax authorities of the country where the controlled foreign enterprise is located are entitled to tax the dividends accordingly, and the controlled foreign enterprise does not benefit from the preferential policy of tax deferral.

4. Challenges to Domestic Regulation of Tax Avoidance Through the Transnational Movement of Objects of Taxation in the Digital Economy

4.1. Difficulty in Determining Tax Jurisdiction

The forms of tax jurisdiction in each country are mainly divided into two categories, one is territorial in nature, i.e., source jurisdiction or territorial jurisdiction, and the other is personal in nature, i.e., resident jurisdiction and citizen jurisdiction. Currently, most countries have both source jurisdiction and resident jurisdiction.

Place of source jurisdiction requires individuals, enterprises and other subjects to obtain income as long as it occurs in the source country's own territory, then in the source country must fulfill the limited tax obligations. Among them, the source of business income is judged by two criteria, the permanent establishment criterion and the place where the transaction activity occurs. A permanent establishment should meet at least three conditions: a place of business, a relatively fixed place of business, and a place where the main business activity of the enterprise takes place. However, in the context of the digital economy, the entire transaction process can be realized online, and there is no need to establish a permanent establishment, so multinational enterprises can completely avoid paying taxes at the place of permanent establishment.[5] In addition, the place of origin of property income is mainly determined by the place of real estate and the place of actual sale and the place of residence of the seller, while in the digital economy, the seller can change the IP address through online sales by means of technology, thus avoiding the tax obligation at the place of actual sale. [6]

Resident tax jurisdiction requires a person with resident status to have unlimited tax liability in the country of residence. The "person" here includes both natural persons and legal persons, and the determination of the resident status of natural persons is mainly based on the criteria of residence and length of stay, while the determination of the resident status of legal persons is mainly based on the criteria of the location of the actual management and control center of the legal person and the place of

incorporation. In the digital economy, the process of contracting and commodity trading between enterprises and natural persons and enterprises can be transferred to the Internet, and even the consumption of commodities can be realized online.[7]

4.2. There Is a Lag in the Tax Collection and Management System

Under the traditional real economy, the tax authorities can identify the tax objects and tax locations well by using the traditional tax collection and management system, and thus combat international tax avoidance. However, in recent years, along with the decline of traditional real economy, the new economic development mode, i.e. digital economy, is developing in full swing. The digital economy is different from the traditional real economy in that it is virtual, invisible and overtime, which provides a convenient environment for multinational enterprises to avoid tax by using the cross-border movement of tax objects. Specifically, the associated transaction process of multinational enterprises can be carried out in digital form, which becomes more and more hidden, and multinational enterprises can change the type of trading goods and transaction location to avoid tax by virtue of cloud technology and other technological means. As a result, it is difficult for the tax authorities to prove that the income of enterprises originates from the country, and thus it is impossible to tax enterprises.

In addition, the tax law is still directed at the tax collection system formulated by the traditional international tax avoidance methods, although the international tax avoidance in the digital economy can be combated based on some tax collection initiatives, but it is far from enough. At present, China has not yet made specific provisions on the new forms of international tax avoidance arising in the digital economy, the tax subject, the way to determine the tax location and how to tax, etc. Although countries have discussed the tax collection and management of multinational enterprises in the digital economy, they have not yet discussed the targeted initiatives.[8]

5. Anti-tax Avoidance Suggestions for Tax Avoidance Using Transnational Movement of Taxable Objects in the Digital Economy

5.1. Improve the Current Tax Collection and Administration System

Firstly, by continuously improving the existing tax collection and administration system, the new international tax avoidance methods in the digital economy are defined in a timely manner to prevent the tax authorities from being unable to rely on them when collecting taxes; more detailed regulations are made on the concepts of tax subjects, tax objects and tax locations in the digital economy to facilitate the tax authorities to accurately identify the tax subjects; the criteria for determining source income and resident status in the digital economy are specifically redefined. In order to prevent under-taxation and defend the tax jurisdiction of the country, the taxation system should be established to effectively combat tax avoidance.

Secondly, strengthen the supervision of online transaction links of multinational companies. First, the taxation department needs to train or absorb a large number of high-tech talents who can master the Internet, cloud computing and big data technology proficiently to improve the supervision level of the staff of the taxation authority, facilitate the taxation department to track the transaction process of the tax subject, discover international tax avoidance in time and crack down on it. Secondly, it should strengthen the supervision of online trading platforms, purify the online trading environment, close illegal trading platforms in time and prevent enterprises from using illegal trading platforms for tax avoidance.

Thirdly, to establish a unified information database about anti-avoidance in China to improve the efficiency of anti-avoidance actions against multinational enterprises; moreover, tax avoidance management is an important part of tax collection management and an important initiative of tax source monitoring in China and even in all countries, so it must be linked with tax declaration work and tax inspection to improve the level of anti-avoidance; not only that, but also to unite with customs, banks, industry associations and other departments to We should also join hands with customs, banks, industry associations and other departments to capture useful information in a timely manner from the documents and materials released by the relevant departments.

Forth, to standardize the accounting audit and income approval system in China. The payment of taxes by multinational enterprises directly involves the issue of truthful tax returns, and the smooth implementation of tax returns cannot be separated from the accounting audit and accounting system, and the soundness of the accounting audit will largely prevent tax avoidance by multinational enterprises,

therefore, during the accounting audit, especially to review the accounting books of multinational enterprises for false entries, the apportionment of costs and management expenses, etc. Whether it is reasonable, in the event that the multinational enterprise cannot provide special accounting books or the source of income cannot be identified, a certain amount will be approved within a reasonable range, taking into account the cost, profit and other factors, and the multinational enterprise will bear the tax liability according to law.

Finally, in recent years, there have been numerous cases of accounting firms and their staff violating the duty of fidelity and diligence and deliberately making false accounts to avoid tax evasion for multinational enterprises. Therefore, it is urgent to strengthen the responsibility of accounting firms and their staff by improving laws and regulations. In addition to the legal regulation, the accounting industry associations should strengthen the supervision of the quality of accounting work performed by accounting firms in the form of internal regulations and issuance of circulars, crack down on accounting firms and accounting practitioners engaging in tax avoidance activities for multinational enterprises, increase the punishment for those who engage in multinational tax avoidance, increase the civil liability, criminal liability and administrative liability for multinational tax avoidance, and crack down on In order to achieve the purpose of safeguarding the national tax sovereignty, we will increase the penalties for those who engage in cross-border tax avoidance, and increase the civil, criminal and administrative responsibilities for cross-border tax avoidance.

5.2. Enhance International Cooperation

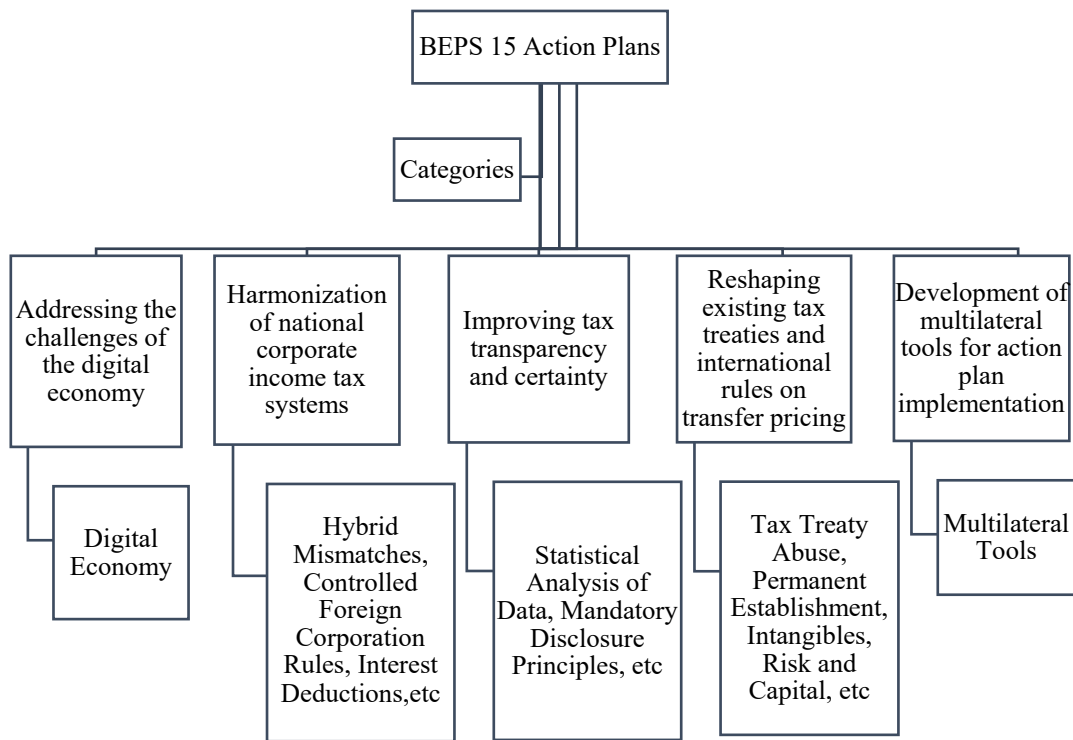


Figure 2: BEPS 15 Action Plan Classification Chart

The Base Erosion and Profit Shifting Project is an international tax reform project endorsed by the leaders of the Group of 20 (G20) and entrusted to the Organization for Economic Co-operation and Development (OECD) for continuous promotion, which is an important measure for countries under the G20 framework to join together to combat international tax evasion and work together to It is an important measure to establish a system of international tax rules and administrative cooperation mechanisms that are conducive to economic growth on a global scale. At present, the OECD issued the Action Plan on Tax Erosion and Profit Shifting, or BEPS Action Plan, which is mainly divided into five categories, as shown in Figure 2, and each of the five categories corresponds to its own action plan. The essence of the BEPS action plan is that taxation should match the substantive economic activities and value creation. Currently, more than half of global profits come from international trade, among which

multinational enterprise trade makes outstanding contributions to profit creation. Therefore, in order to keep profits in their own hands, multinational enterprises make use of loopholes in tax treaties and domestic laws to achieve tax avoidance. In order to change this situation, countries must join together to create a fairer tax collection system.

In addition, improve the norms of international tax information exchange system. Since taxation involves the sovereignty of a country, one country will certainly not share its tax information with other countries until a treaty or agreement is signed between countries, i.e., when the countries are not in an agreement relationship. However, the closed nature of tax information between countries leads to the inability of multinational enterprises to transfer income from the source country to the low-tax country without relief. If tax information is shared between countries, i.e., information is exchanged, the country of origin of the income can easily recover the tax that multinational enterprises should pay but have not paid. China should actively conclude multilateral or bilateral treaties with other countries, especially low-tax countries, to share tax information, jointly combat international tax avoidance, and maintain tax fairness.

In conclusion, in the context of digital economy, international tax avoidance is more difficult to identify and the domestic legal regulation system is not sound, so international cooperation needs to be strengthened. On the one hand, countries can jointly combat international tax avoidance under the digital economy by entering into bilateral or multilateral agreements, which is conducive to simultaneously maintaining the tax jurisdiction of each contracting country and safeguarding their own tax interests; on the other hand, they can participate in the formulation of unified international tax agreements, absorb the favorable recommendations therein and present them in the form of legislation, thus international tax avoidance. For example, OECD has put forward several recommendations for anti-international tax avoidance in the digital economy, and China can absorb the beneficial principles in the legislation.[9]

6. Conclusion

Tax avoidance by multinational corporations has always been highly valued by the state, and the emergence of the digital economy has provided more hidden and convenient conditions for international tax avoidance. In order to combat tax avoidance by using big data and other means, China should not only continuously establish a sound tax collection and management system domestically, but also actively unite with other countries to jointly combat tax avoidance and prevent multinational corporations, including other organizations and individuals, from taking advantage of laws, policies, treaties and other loopholes to implement tax avoidance to the greatest extent. In order to prevent multinational companies, including other organizations and individuals, from making use of loopholes in laws, policies, treaties, etc. to implement tax avoidance.

References

- [1] Yu Jiayi, Chen Hu. *On the benign interaction between domestic tax law and international tax law in the era of digital economy* [J]. *Taxation Research*, 2020(01):91-95.
- [2] Zheng Weihui. *Challenges and responses of the digital economy to international tax jurisdiction* [J]. *Old Brand Marketing*, 2021(11):53-54.
- [3] Chen Chao. *Experimental legal control of international tax avoidance by multinational corporations* [J]. *Modern state-owned enterprise research*, 2017(10):151.
- [4] Yu Miaomiao. *Inspiration of international tax avoidance on tax avoidance and anti-avoidance measures in China from a legal perspective on a trial basis* [J]. *Hebei Enterprise*, 2017(12):137-138.
- [5] Lin Jingwen. *The new development of permanent establishment principle in cross-border digital economy* [J]. *Journal of Wuhan Jiaotong Vocational College*, 2021, 23(03):58-62.
- [6] Zhu Xiaodan, Cao Gangshan. *On the change and impact of the legislative purpose of the Two-Pillar Framework Agreement* [J]. *International Taxation*, 2021(09):43-50.
- [7] Shi Jingxia. *Plurilateral negotiations on WTO electronic commerce in the context of digital economy: recent developments and focal issues* [J]. *Oriental Law*, 2020(02):170-184.
- [8] Li Jinyan, Chen X. *Global tax consensus on the two-pillar solution: truth-seeking and legal reality* [J]. *International Taxation*, 2022(03):12-23.
- [9] Liao Yixin. *Responding to the challenges of the digital economy to the international tax legal order* [J]. *International Taxation*, 2015(03):20-25.