Chapter 16
The Control of Transfer Pricing of Corporations by Blockchain Technology:
Challenges and Solutions

Habip Demirhan
Hakkari University, Turkey

ABSTRACT

The globalization movements that had emerged in the last century have not only influenced the world's social, political, and cultural structure, but also have influenced its economic structure as well. The globalization of the world economy makes locations and economic units between countries or regions interdependent on one another. The primary driving forces of this process include technological change and multinational enterprises. Thus, intercompany transactions are important for multinational enterprises. In recent years, discussions regarding the applicability of blockchain technology, or more commonly referred to as crypto coins, for the public sector have emerged. This study therefore attempts to explain the applicability of blockchain technology in relation to transfer pricing, and it clarifies (1) how blockchain technology represents a new approach to transfer pricing, (2) how blockchain technology reduces transfer pricing evasion, and (3) how blockchain technology increases both transparency and accountability.

INTRODUCTION

Globalization has led to the concentration of economic activity of multinational corporations. These development has let multinational corporations to shift their profits across borders to reduce their tax bills. In other words, this development has made it more challenging for governments to raise revenue from corporate income tax. In recent years, policy-makers have become increasingly concerned about this issue as the extent of profit shifting has intensified. Multinational corporations use different instruments to shift their profits. One of the most important key instruments for these corporations is transfer

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pricing. Multinational corporations manipulate transfer prices they charge on transactions between related parties within their groups. Multinational corporations, to reduce pre-tax profits, can charge a lower price while selling to a related party in a low-tax country. Tax-motivated transfer mispricing can take place in trade in goods as well as in services, and in particular in the form of royalty and licensing payments on intellectual property rights held abroad. For this reason, tax authorities worldwide started to search for new way to control transfer mispricing of Multinational Enterprises (MNEs). Each country in its global network subject accounting, finance, transfer pricing. The cross-border intercompany transactions of MNEs are complex. For this reason, these transactions are subject to various regulation, compliance and audit of Regulatory Authorities in each jurisdiction (IBM, 2018). The United Nations data shows that intra firm trade makes up %30 of global trade (Frankovski et al., 2017). MNEs has a certain amount of discretion in determining how to apportion expenses and returns to its subsidiaries in different countries. Transfer pricing, a price that applied when an entity transferring its assets and intangible assets to associated companies, has a positive meaning. However, if there is a significant difference between the price used in the commercial and financial transactions among the subsidies and the price to be decided among the independent entities which are parties to the same or similar transactions, such pricing will be named as "artificial transfer pricing". In this context, the concept of transfer pricing becomes negative (Yaltı, 1996). Although transactions between intra-group companies in the same country only concern tax revenues of that country, the pricing of goods and services transfers on international level is closely concerns the national income and tax income of more than one country (Aktaş, 2003). Artificial transfer pricing, which refers to tax free profit shifting to a particular subject and/or to a certain geographical location through pricing, is a phenomenon that law is trying to prevent. For example, Turkish Corporate Tax law assumes that private law contracts where artificial transfer pricing applied in transactions between associated parties, are misused. The law also recognizes that such contracts are "disguising contracts" (Yaltı, 2007).

The rapid development of information and communication technologies (ICTs) that has taken place in recent decades has brought about new approaches in the field of public administration. Indeed, since the early 1980s, public administration has been increasingly influenced by ICTs. Certain concepts, such as accountability, transparency, effectiveness, and productivity, which the private sector was already familiar with, have also become important tools for the public sector. It is certainly true that the accession of reliable information has become increasingly important in recent times. Further, the development of ICTs has increased the number of digital public services (e-governments). In these days, a word called "blockchain" become a buzzword for researchers to bring solutions for many fields. Some researchers claim that blockchain is an emerging technology for business revolution. Although the technology is still in its early stages, many are excited about its potential to fundamentally transform business (Slemmer, 2018). Blockchain owes its reputation thanks to Bitcoin. But it is important to be aware that blockchain and Bitcoin are not same things. Blockchain is a system that Bitcoin transactions run on it. Blockchain technology has distributed ledgers as it is also known "Distributed Ledger Technology". Unlike traditional ledgers, blockchain technology records cannot be altered secretly (Slemmer, 2018). The companies record their transactions by ledgers. These ledgers are secure, controllable and peer to peer oriented. Thus, once you record a transaction it is impossible to delete it. These features make easier to control and trace frauds.

The technology also has potential to enhance the reliability of transactional records. For this reason, some researchers claim that blockchain technology has a potential to reduce tax burden and to control transfer pricing transactions.