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HYPERCOMPETITION & FISCAL ATTRACTIVENESS

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SUMMARY

Hypercompetition is at the very center of modern economies. As a consequence, both states and enterprises have been heavily engaged in an amoral power game (Colonomos, 2005) based exclusively on strength where tax systems have a prominent role. An obscure fiscal war takes place firstly between states seeking to increase their attractiveness. On the other hand, firms fight against states to optimize their revenues. Therefore, the aim of this paper is to discuss the components and the implications of the competition between states expressed through the establishment of tax havens and the launch of merciless fiscal policies. At the same time, enterprises try to shape the existing laws in a manner that favors their interests, using also aggressive fiscal strategies.

Key words: tax optimization, harmful competition, aggressive tax planning, transfer pricing, tax havens, lobbying, subventions, fiscal incentives, flat tax

INTRODUCTION

Over the last years, several summits of the G20s have highlighted the tax havens and the aggressive corporate tax planning as two major issues in the area of fiscal equity. As a result, the OECD has been charged with the responsibility of finding legal solutions to end these harmful practices. It created the Aggressive Tax Planning (ATP) Steering Group which has already received more than 400 cases submitted by member countries. Also, a new list of the tax havens has been released on July 22, 2016. The countries face the challenge to preserve their (fiscal) sovereignty and above all their ability to finance public policies, especially the social ones. In this context, fiscal systems have a huge impact on the economy; they are determining factors of the economic development (Attisnas & Klemm, 2016;Vasiliauskaite & Stankevitius, 2012; Zagler&Durnecker, 2003). Particularly, « the design of corporate tax systems affect firms ' decisions in three major ways: the government might want to reduce the average effective tax rate to attract and retain companies; the marginal effective tax rate to encourage investment; or the statutory rate to reduce profit shifting. With three objectives, but only two instruments - the rate and the base - designing a better cor-

porate tax system is hard. The challenge is boosted by the need. » (OECD, 2007). In addition to this challenge, globalization shapes the design of the tax systems (Lukovic, 2015). In a global world, it has been proved that the fiscal decisions applied in a country have a serious impact on cross-country competitiveness (Liapis & Alii, 2013; Krogstrup, 2004; Hurduzua & Alii, 2015). The power to tax is at stake (Brennan & Buchanan, 1980)! Even if it is difficult to know the extent to which globalization erodes the ability to tax corporate income, the fact is that the states have huge difficulties to conciliate the territoriality of their tax systems with the a- territoriality of global enterprises' earnings. Clearly, they don't cope with this situation and face a fiscal hypercompetition. This paper discusses the links between this hypercompetition and the concept of fiscal attractiveness that opens up unexplored ways of explaining fiscal policies' evolution. It allows to understand better the reasons and the forms of the harmful competition between states, but also the conflicts between the global firms and the tax authorities.

STATES' RACE TOWARD FISCAL ATTRACTIVENESS

There is an infinite range of tools a state can use to shape its fiscal attractiveness. Often, these tools have no direct connection to the tax law and may be perfectly justified when used properly[1]. Our work is focused on the fiscal competition between states and its forms. According to the OECD, the "harmful tax competition" is firstly evidenced by tax havens, often considered as free-rider or "renegade" states. Then, the subtle nature of subventions may act as a negative taxation and distort the market. Finally, the flat tax opens up an alternative way of stimulating the tax attractiveness of a country.

TAX HAVENS

Joseph STIGLITZ reminds us that tax havens, "the renegade states" (Eden, 2005) are "the dark side of globalization" (Stiglitz, 2016).There is no doubt that they are at the very center not only of tax evasion, but also of money laundering and also of all sorts of frauds. Many researches estimate the amount controlled through tax havens to €25 000 milliards (Perrot, 2016). But, that point has been largely documented and it will not be analyzed here[2]. More interesting for our purpose is to demonstrate that, whatever they can be, tax havens have mostly been created by big states to serve their interests. Still more disconcerting: those same states that condemn the tax havens don't seem to want them to disappear.

WHAT IS A TAX HAVEN?

There isn't a generally accepted definition of the term;[3] The most common one is given by the OECD: it has identified four key features which make a country a tax haven: "no or low taxes, lack of effective exchange of information, lack of transparency, and no requirement of substantial activity"[4] and sets up an official list.[5]

1 It is possible to find them in the civil law when, for example, they offer the choice of the law of contracts, when they allow to choose the arbitrage to fix a conflict...; in accounting: by choosing the market value over the historic value, by arranging a special regimes of mergers and acquisitions ...; in business law: status of the holdings, localization of the firms.

2 (MIHU 2012) (RADU 2012)

3 but we know that it is complex (WILSON T s.d.)

4 (EDEN L 2005) add to those criteria: the state actively promotes itself as a tax haven where tax avoidance and evasion practices are allowed; the state is known as a drug conduit state and the state has a network of tax treaties.

5 The OECD list of tax haven countries includes Andorra, the Bahamas, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, the Channel Islands, the Cook Islands, Hong Kong, The Isle of Man, Mauritius, Lichtenstein, Monaco, Panama, and St. Kitts and Nevis. Each state has its own list and this one is able to change according to its interests.

The Financial Stability Forum[6] considers tax havens as “territories that particularly attract the activity of non residents” without allowing their residents to profit from the same benefits. The Financial Action Task Force[6] at least considers them as non cooperative territories, with (very) low fiscal, corporate, anti-fraud... regulations. At its core, a tax haven is merely a jurisdiction, not always a country, whose regulation makes the territory attractive as a tax shelter for foreign money. Except that, the only requirements are the stability of politics and economics. It does not require individuals to reside in or businesses to benefit from the fiscal policy. The underlying ideas of its success may be summarized around two points: low taxation and secrecy. The problem with such a synthesis is that many states may meet this definition without being a tax haven. The United States of America are maybe not a tax haven, but they adopted the International Banking Facility (Key, 1988)... and what about the Delaware, the Wyoming or even the Nevada where Apple concentrate its US earnings to escape the 18% tax rate of California? London or Paris are not “official” tax havens, but what about the special fiscal regulation of those financial places? But why do they appear?

6 The ministers of finance and the governors of central banks from the G7 created the Forum for the International Financial Stability,in February 1999. CF: https://www. admin/user upload/banque de france/Eurosysteme et international/Questions mo netaires internationales/forum-stabilite-financiere-caracteristiques-generales.pdf

7 The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote the effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a “policy-making body” working to generate the necessary political will to implement national legislative and regulatory reforms in these areas.

WHERE DO TAX HAVENS COME FROM?

The first known tax havens appeared in Ancient Greece: the island of DELOS exempted the business of taxes, when all other cities taxed them at 2% (Tonnel, 2000). Since then, their use expanded. In their contemporary form, tax havens and tax secrecy appear in the late 1800s when the States of New Jersey and then Delaware, in exchange for a franchise tax, allowed “easy incorporation” of businesses by non-residents (Palan, 2011). Later, after the WW1, in the 1920s, Switzerland became an archetype and still keeps a nodal position in the international network of tax havens. More recently London, in the 1980s took a very discreet place in the hidden list of finance friendly territories, when the British capital liberalized its financial markets in 1986. Since then, many small territories followed the example. And, it is important not to forget the invisible havens (referred to as “offshore”) whose role in the international finance and the current financial crisis is non negligible.[8] The phenomenon appeared and has grown up for the purpose of politico-financial reasons that differ according to the place where and to the date when it began. Palan explains that “countries become tax havens from some combination of opportunism, desperation and luck”.[9] Often, as it has been the case of Switzerland in the 1920s, the choice to become a “renegade state” is just a necessity to attract vital foreign banking and commercial activities. Sometimes, that explains the diversity of tax havens; it also makes clearer their specialization. This specialization is illustrated by Mihu (2012): “It is obvious that there is no universally valid quantitative and qualitative hierarchical system of the fiscal paradises. A certain fiscal paradise becomes most desirable depending on the profile of the user and the goals of the latter. (...) If we take into account whether the would-be user of

8 50% of international trade transiting through them (RADU 2012)

9 PALAN (2011, 2002, 1998)

the fiscal paradise is a natural person or a legal person, the principality of Monaco is the perfect host" from the point of view of the income taxation of the natural persons (except for the French citizens). The principality is not as friendly in regard to the income taxation of corporations. The Island of Jersey is on the opposite side: the non-resident corporations, in exchange of a 300 British pounds annual subscription, are not under the obligation of keeping accounting books or filing tax returns, but natural persons must pay 20% of their revenue in taxes. Other fiscal paradises favorable to the legal persons are Bahrain and Guernsey (they do not tax the non-resident companies) and Bahamas, Bermudas and Cayman, all three stipulating that the non-resident corporations must carry out transactions outside the fiscal paradises in question. »
Through those short developments, it is possible to understand why there is not a unique model of tax haven a "to do everything tool". This is only by mixing many of them that multinational enterprises are able to optimize aggressively their income. The question is then: why do states still tolerate the situation?

DO STATES REALLY WANT TO ERADICATE TAX HAVENS?

As early as 1961, President Kennedy cited studies proving that tax havens « eroded the tax base by removing income from taxation (...) and caused an unfair shift of overall burden from tax evaders to loyal taxpayers and voters» (Wilson &Fullwood) and called for an end of the "abuse offoreign tax havens'", and asked for legislation to '"run such tax havens out of existence'" (Metz, 1961; Eden, 2005). Since: nothing... or so few; except some initiatives during the last G20s summits. Being financial giants, the tax havens are economical and political dwarfs and no territory is able to ignore the commune willingness of the United States and the Euro pean Union (Zucman, 2013).

So, it is quite difficult to accept the idea that the USA & the EU, both condemning the tax havens, are unable impose their financial, commercial and political will to small territories, often not bigger than one of their cities.
Still more troubling: each of the member states of the OECD has, since a long time, the legal weapons to change the situation. Every modern tax code contains disposals proper to counter tax havens and the justice has the power to enforce them. And even in the case of "hiatus" of the tax code, it is still possible to enforce the doctrine of substance over the form, to soften the injustices caused by tax havens. Nevertheless, fraudsters stay totally immune or so! (Zucman, 2013)
The evidence bursts: the big states choose to adhere to tax conventions creating tax havens. They made it consciously, through a public and deliberative process...(Wilson & Fullwood).Worst, some states, like the United Kingdom and the Netherlands are "renegade helpers". Using their political influence in the EU, they struggle to allow, "tax havens to free ride on the international tax regime (...) and weaken the overall regime effectiveness" (Eden, 2005).
The point is that the treatment of the tax havens by the OECD countries is at least incoherent:
- On one hand, they consider them as a huge danger: the American President considers that tax havens are at the very core of three political problems: (1) the loss of manufacturing jobs; (2) tax avoidance; and (3) tax evasion (Leveling the Playing Field, 2009). They also contributed to create and amplify the 2008 crisis (Picciotto, 2009). And last, but not least, they are drying the sources of funding for public finance.
- On the other hand, the states widely use tax havens to enhance their fiscal attractiveness: they want to maintain the competitive position of their businesses investing abroad. So, some countries may enter harmful practices, using tax treaties or preferential tax treatments, openly favoring tax havens (Eden, 2005). Of course, in this aim, they are helped by insider

representatives whose interests are to maintain or extend the practice.[10] By the way, in the battle against tax havens, the fiscal administrations are more and more disarmed; in Europe, they lost between 2.6% (D) to 21,9% (Gr) of their people. Maybe, the treaties enhance the fiscal cooperation and the regulations against the MNEs, but who will treat that information? (Chavagneux, 2016). Hence, some authors clearly justify their interest: "Our tax haven system has unintended consequences, but is no more or less equitable than most tax rules which both recognize and create differences between taxpayers. Tax haven rules may not be "equitable", but they are a matter of choice" (Wilson &Fullwood).

The question of tax heavens is an integral part of international business and finance and has become extremely complex even if its aim is simple: avoid taxation. At the opposite, the fiscal attractiveness of a state may be the result of negative taxation aimed by the tax authority.

NEGATIVE TAXATION: FISCAL INCENTIVES & SUBVENTIONS

Even if their real economic effects are dubious (Fox & Murray, 2004), fiscal incentives are a major tool of the public industrial policies. According to the OECD, those subventions may be as high as 35% of the earning in the farming industry and may be in excess of 25% in others sectors like shipyards or the steel industry (Biggar, 2004). That makes the subventions an important topic of the fiscal attractiveness of a nation. Due to the considerable variation in the number of tax incentives states use, for good or less good reasons[11] it is important to define what are these tax incentives or subventions. The main problem is that there exists no generally accepted definition of a subvention. In practice, it is nevertheless possible to find two views:

- the French law 2014-856 of Juilly 31, 2014 on social and solidary economics, defines a subvention as a « contribution facultative, detoute nature, valorisée dans l'acte d'attribution, justifiée par un intérêt général et destinée à la réalisation d'une action ou d'un projet d'investissement, à la contribution au développement d'activités ou au financement global de l'activité de l'organisme de droit privé bénéficiaire. Ces contributions ne peuvent constituer la rémunération de prestations individualisées répondant aux besoins des autorités ou organismes qui les accordent... ».[12]

- the OECD, provides the conditions of qualification. Thus, to be a subvention, a measure has to :
- be a public decision;
- have an influence on the competition on a market by favoring some companies over others.
- have negative consequences on public wellbeing.

Let us analyze those definitions. First, each definition insists that a subvention stems from a public decision. No matter the authority that took it. It just has to be legitimate and to act in accordance with the law. It may be a state or a local government, according to the administrative organization of the state. This decision is not required; it lies on the willingness of the authority to grant an advantage to a beneficiary.

10 The Luxleaks and panama papers revealed a high number of public deciders who hold accounts or interests directly or indirectly related to tax havens.

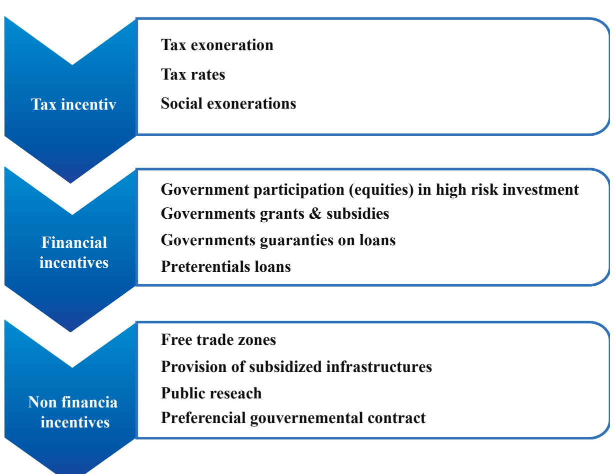
11 Revue de l'OCDE sur le droit et la politique de la concurrence, Vol. 6, n° 1 & 2, p. 140.

12 Free translation of the authors: subventions are a "discretional contribution, whatever the nature, highlighted in the act of attribution, based on the general interest and intended for the accomplishment of an action or an investment project, for the contribution to the development of activities, or for the global funding of the activity of the private law beneficiary organism. Those contributions are not allowed to constitute a remuneration for individualized services addressing the needs of the granting authorities or organisms."

Second, a subvention is made to support a public policy. The OECD does not insist on this point, where the French law makes it central. It seems that this point is fundamental: Subventions are clearly designed to incite actions[13] which otherwise might not occur.[14]

It allows differentiating a subvention from an illegal gift, which comes under the jurisdiction of laws on corruption. Above all, this makes the subvention a fantastic tool of fiscal competitive advantage.[15] Then, the definitions diverge. The French one is based on the aims of subventions. According to it, even if we ignore the social context of this specific law, the pursuit of "the" public interest justifies a subvention. More pragmatically, the OECD favors its effects: its impact on the competitiveness of the market of reference. And the OECD insists on the fact that, finally, subventions have a negative impact on public wellbeing. Now that the nature of subventions is clearer, it is possible to dress their design:

According to this synthesis, it is obvious that subventions don't have to be direct, even monetary. For example, at the time we are writing this paper, the French government is just buying 15 High Speed Train (TGV) and ordering the National Railway Company to buy another 6, in order to save the local factory of Belfort that Alstom, its owner, decided to close. (Le Monde 4/10/2016)... Like in the fashion industry, the only limit to subventions seems to be the creativity. Some are also assimilating bank secrecy to subventions (Zucman, 2013). When the purpose is to shape their fiscal competitiveness, governments are incredibly innovative. Whatever their purpose, namely attracting or keeping an activity on a territory (Hubert & Pain, 2002), it is obvious, however, that the beneficiaries of subventions are generally very few, but their costs are finally paid by the taxpayer or by the next generations. It is the price of the fiscal war. In fact the OECD is right to insist on the distortional effects of those fiscal interventions.[16] Beyond their direct effects, subventions often change the core nature of the market. On one hand, they have a substitution effect; on the other hand they also have an eviction effect.



13 Conceptually, incitation is a specific measure of non obligatory economic problems targeting particular economic agents, to make them follow a determined behavior they did not want or imagine adopting without one or more compensations given by the incitation.(QUIERS, 1978).

14 http://www.businessdictionary.com/definition/financial-incentive.html

15 (BUTTNER et RUF 2007) give us an example of its influence in the FDI of MNEs, in Germany.

16 The examples of fiscal distortions are numerous, particularly when one consider environment(PRYCE 2003) or farming (ESTIVAL 2006)

• The substitution effect of subventions. Subventions are often motivated by the influence of subgroups whose interests diverge from the general public interest. Since then, political choices may frequently close the way to competitive technologies or projects.[17] Let us take the example of the nuclear industry in France. Most of the means of research, most the results of that research and so on have been clearly oriented toward the nuclear sector, at the expense of all the alternative technologies.

• The eviction effect of the subvention. It is particularly evident in the case of industrial subventions in the less developed countries. Too often, all subventions are reserved to export or import industries. The production destined to the local market is then deprived from any resources and declines. (Porsse& Ali, 2006, Wulf).

Subventions or more generally negative taxation, are obviously a very discreet mean to increase the fiscal attractiveness of a country, at least, as long as they are not prohibited. To eliminate any risk, many countries, mainly in Eastern Europe, are using a "very simple" system of taxation: the flat tax.

THE FLAT TAX

Flat tax regimes have become increasingly popular over the last quarter century, especially in countries from Eastern Europe. A flat tax is a tax system with only one rate that applies to all taxpayers, business firms and individuals alike, regardless of the source and amount of their incomes (Rabushka, 1985). This regime is generally designed for the sole purpose of collecting revenue, not for social manipulation of firms or individuals. On the other hand, it is often seen as an instrument of competitiveness for states as the flat tax promotes growth and is easy to administer. Also, transparency and simplicity are two considerable advantages highlighted in the literature. Some authors consider that flat taxes have positive effects on individual incentives to work, save and take risks (Rabushka, 1985) and remove distortions which are preventing resources from being allocated to their highest value use (Seldon and Boyd, 1996). The elimination of existing biases against savings and toward consumption, by removing investment returns from the tax base and by taxing capital and other production inputs at a uniform rate, appears as another major plus.

BENEFITS OF THE FLAT TAX

In principle, flat tax regimes are believed to procure the following benefits:

• Reduced compliance costs as the system is simple and clear
• Reduced avoidance and evasion explained by lessened motivations for avoidance and decreased incentives for evasions.
• Instant wealth creation as the flat tax increase the after-tax revenue generated by income- producing assets.
• Reduced disincentives to investment
• Fairness due to everyone being treated the same under the flat tax.
• Increased foreign investments

At the same time, flat taxes regimes are too simple, preventing governments from being flexible to adjust taxation and fix different rates for different products (Schiau and Moga, 2009). The regime may be considered as inherently regressive because it lacks social equity.

17 FOX X, MURRAY MN (2004), Do economic effect justify the use of tax incentives ?, Souther Economic Journal, 71/1, 78-92.
http://time.com/4472500/apple-eu-irish-tax-bill/

EASTERN EUROPE COUNTRIES' EXPERIENCE

The above-mentioned benefits led several governments from Eastern Europe to adopt the flat tax. Russia, Slovakia and Romania have had mixed success so far. In the case of Russia - the country which has been studied arguably most - Gorodnichenko et al. (2008) argue that the flat tax reform was instrumental in decreasing tax evasion and that, to a certain extent, greater fiscal revenues for the country in 2001 and several years beyond can be linked to increased voluntary tax compliance and reporting. According to the results, there is a significant reduction for tax payers that experienced the largest decrease in tax rates after the flat rate income tax was introduced. This decline in tax evasion seems to be due to changes in voluntary compliance as opposed to greater enforcement effort by the tax administration authorities. The productivity effect, measured by the relative increase in consumption for households that faced smaller tax rates after the reform, seems to be small by comparison to the tax evasion effect. Several important policy implications can be drawn. The adoption of a flat rate income tax is not expected to lead to significant increases in the tax revenues because the productivity response is shown to be fairly small. However, if the economy is plagued by ubiquitous tax evasion, as in the case of Russia, then flat rate income tax reform can lead to substantial revenue gains via increases in voluntary compliance. Therefore, a positive relationship between (lower) tax rates and (lower) tax evasion can be established. In the same way, Keen et al. (2005) find that the real revenue from the personal income tax increased by approximately 26% in Russia following the introduction of the flat tax in 2001. In parallel, compliance appears to have improved substantially even though it is unclear whether it is due to the parametric tax reform or to accompanying changes in enforcement. In many cases however, the effect of switching to a flat tax cannot be estimated precisely. Adopting a flat tax system could increase the tax burdens of a majority of taxpayers, and it would significantly redistribute tax burdens, mainly from the top decile to other taxpayers (Dunbar and Pogue, 1998). Embracing the flat tax would decrease the marginal tax rate for higher income taxpayers, and it would tax capital income more lightly and labor income more heavily. The result would be a redistribution of tax burdens from recipients of capital income and higher income taxpayers to recipients of labor income and lower income taxpayers, with gains being concentrated in the top decile. Lighter taxation of capital income would combine with workers' loss of tax-free fringe benefits to increase the tax burdens of more than three-fourths of those who receive most of their income from labor. Overall, the total effect and, therefore, whether state's competitiveness is expanded is difficult to predict. A lot depends on the state of the economy as the effects of the flat tax regime are procyclical (Socol et al., 2009). For economies in a phase of expansion, the flat tax contributes to increase budgetary revenues, investment and employment. When an economy slips into recession, the flat tax has a negative effect and deepens the downturn. Moreover, even the reported positive effects are not clearly acknowledged. For stance, Estonia and Slovakia are countries that have failed to take advantage of the flat tax. Generally speaking, in the absence of appropriate social policies, the introduction of the flat tax leads to social polarization and emphasizing of poverty.

ARGUMENTS AGAINST THE FLAT TAX

Moreover, Weisbach (2000) reckons that many of the implementation issues of the flat tax would be extremely complex, which is in stark contrast to what its proponents claim. Thus, the traditional argument of the simplicity associated with this taxation regime is strongly contested. Implementation of the current income tax in a complex economy is difficult, and implementation of virtually any other tax will be as well. Even more important than complexity, the efficiency claims of the flat tax are undermined by the analysis. The flat tax is thought to reduce the distortions of current law created by incentives to structure transactions to avoid tax, but these incentives, claims Weisbach, would remain. One can ex-

pect the flat tax to create significant adverse incentives on businesses. As a result, without the claims of simplicity and efficiency, the case of the flat tax becomes extremely weak.

Also, one shouldn't forget that the flat tax regimes recently adopted differ widely and the empirical evidence of their effects is very limited. Except in Russia, several flat tax reforms have been associated with decreased revenues from the personal income taxation. The impact of the flat tax on work incentives is not clear-cut in principle, and there is no evidence that it has been strong in practice (Keen et al., 2008). The adoption of a low rate flat tax (with the emphasis increasingly, it seems, on the 'low') has commonly — almost universally — been adopted by new governments anxious to signal a fundamental regime shift, toward more market-oriented policies. In several cases, the signal appears to have been well-received.

Keane et al. (2008) offer a very interesting point of view summarizing best the challenges ahead. They claim that "what remains unclear is the sustainability of the flat tax. As the level at which countries set their flat tax becomes lower, so the fiscal constraints they impose become tighter and the pressure to deviate, should revenue become a greater priority, becomes stronger. Structurally, the flat taxes that have been adopted do not provide a coherent framework for dealing with the difficulties that almost all countries now perceive in taxing internationally mobile capital income. These tensions are most evident in the first wave of flat taxes, which in some respects, are most usefully thought of as special cases of a dual income tax. Dealing with the continuing pressures in taxing capital income may point towards pursuing that logic still further; and may also nudge the second wave reformers with the higher flat rates toward decoupling the taxation of capital income from that of labor income. Political economy considerations point toward the adoption of rate schedules that tend to benefit middle income earners: exactly the group that tends to lose most from the adoption of a second wave flat tax. Moreover, the very spread of the flat tax in itself undermines its value as a signal: it may prove too easy to mimic. While there will no doubt be new members of the flat tax community, in some respects the more interesting question is whether there will be any defections".At the end of this first section, it is obvious that the states are full of imagination in their effort to win the fiscal hypercompetion in which they are engaged. Will they race to the bottom? Fortunately, it is far from evident; since the crisis of 2008, they show a willingness to stop this lethal game. Despite this, fiscal attractiveness remains a major preoccupation for governments[18] while the fierce competition between states is not the only one to be considered as the MNEs seek to avoid taxation and exploit tax differentials.

THE WAYS GLOBAL FIRMS INSTIGATE FISCAL ATTRACTIVENESS

Hidden for a long time, the fiscal war opposing states to global enterprises is now raging. Since the crisis of 2008, many G20 meetings ended up by openly accusing the MNEs of "not playing a fair (fiscal) game" and condemning their aggressive fiscal planning. Now the war is declared: "the biggest tax battle in the history" is occurring right now. It "opposes Apple to the European Union".[19]MNEs claim that they comply with the law. It is true that their advisors make them always following strictly the terms of the law. Unfortunately, to be honest, the picture doesn't end here. Far from following the spirit of the law, the MNEs do circumvent it through many juridical and accounting technics that reduce sharply their fiscal burden. But that is still not enough. To increase the efficiency of their tax planning, most of the MNEs also shape the law by abusing the weaknesses of the tax treaties and by lobbying heavily to arrange the tax rules in

18 Since the result of the referendum on the Brexit, British government announced that it will decrease the rate of corporate income taxation; a few weeks later, the French authorities made the same proposition to businesses willing to quit London for Paris...

19 http://time.com/4472500/apple-eu-irish-tax-bill/

their favor. The facility with which they succeed in both of those tasks is disconcerting and allows to assimilate those unfair practices to technical tools aiming to reinforce the fiscal attractiveness of territories in the context of hypercompetition between states looking to retain or attract foreign direct investments.

FROM A PERVERSE COMPLIANCE….

According to MURPHY, "Big technological firms are, as a principle, opposed to taxes",[20] that's the general point of view of all global enterprises that don't want to waste earnings in territorial taxes. But to promote their image, those same enterprises have to be officially virtuous; that means they have to comply with the tax laws. To solve this dilemma, they may use all the resources the business, civil, accounting and other laws offer them. And it must be admitted that they excel at this game as it can be seen in the following example.[21] Among the vast number of legal practices aiming to circumvent the fiscal law, one particularly draws our attention, the most important and the less risky one: transfer pricing. With more than 60% of the world trade taking place within international firms, transfer pricing has become a key aspect of tax optimization practices of Multinational enterprises (MNEs). Transfer pricing is of great importance not only for large companies but also for governments as the latter seek to increase the attractiveness of their countries and avoid capital outflows. States look to attract investments

Company	Income tax expence	Pre tax profit
Level 3	-$3,150,0	-$283,0
United Continental	-$3,121,0	-$4,210,0
Americans Airlines	-$2,994,0	-$4,616,0
GM	-$1,897,0	-$7,718,0
Hewllet Packard	-$51,106,0	-$1,470,0
Amerisource Bergen	-$224,6	-$274,0
E-trade	-$177,0	-$91,0
Mallinckrodt	-$114,7	-$215,3
Qorvo	-$105,5	-$121,2
Vornado Reality	-$584,0	-$722,5
Microchip Tech.	-$569,4	-$345,9
Crown Castle	-$51,4	-$473,8
Thermo Fisher Scientific	-$43,9	-$1,936,4
Loews	-$43,0	244,0
Ventos	-$39,3	-$368,8
General Growth Properties	-$38,3	-$1,355,3
Wills Towers Watson Public	-$33,0	-$351,0
Apt. Invest & management	-$27,5	-$244,5
PG&E	-$27,0	-$847,0
Xerox	-$23,0	-$547,0
News Corp.	-$20,0	-$56,0
XL Group	-$19,2	-$1,294,2
Legg Mason	-$8,1	-$368,0
Citrix Systems	-$7,5	-$311,9
First Solar	-$6,2	-$540,3
Macerich	-$3,2	-$519,7
Weyerhauser	-$3,0	-$503,0

Adjusted for calendar year 2015, profit basen on earnings before taxes including unusal items
Source: S&P Global Market intelligence,
USA TODAY research
George Petras, USA TODAY

20 Cited in DUHIGG C., D KOCIENIEWSKI, When the big firms of the web escape taxes, New York Time, 28/04/12
21 http://www.usatoday.com/story/money/markets/2016/03/07/27-giant-profitable-companies-paid-no-taxes/81399094/

and the resulting competition is beneficial to the MNEs as they fully exploit tax differentials.

Strategies of estimating the prices for goods and services transferred among the divisions of MNEs have a direct impact on their competitiveness and their financial performance. They can be used to avoid taxes and shift profits from a high-tax jurisdiction to a low-tax jurisdiction. Profit shifting through R&D-based tangibles, the ownership structure of subsidies and the location of parent companies are all focal points in the process.

TRANSFER PRICING AND CORPORATE PROFIT-SHIFTING POLICIES

Works on transfer pricing date back to the 1950's. The market price - a major reference when valuing internal transactions - appears to be the correct transfer price solely for commodities that are produced in a competitive market (Hirshleifer, 1956). Where such a market does not exist or where the market is imperfect, the marginal cost of production should be used to value the transactions. Potential conflicts between the company's goals and the divisions' objectives influence transfer prices (O'Connor, 1997). From a principal-agent perspective, when divisions' managers do not share their private information with the company's management, creating a managerial compensation system based on transfer prices increases the firm's profits (Vaysman, 1996).

On the other hand, transfer pricing can stimulate competitive advantage and other corporate goals (Cravens, 1997) and have a strategic purpose (Alles and Datar, 1998; Gabrielsen and Schjelderup, 1999). Nielsen and Schjelderup (2001) add that the MNEs use transfer pricing as a device to win local market share. The strategic benefits are function of the relative tax rates of the countries where the MNEs are present. Transfer prices are also used to coordinate divisions and their profits (Martini, 2005) and allocating responsibilities amongst divisions' managers (Martini, Niemann and Simons, (2007).

Transfer pricing doesn't come without some controversy as it creates conflicts between the big companies and the tax authorities (Stuart, 2009) and goes far beyond tax management. It is an instrument for cash management and risk management, as well as resource allocation (Choi and Meek, 2009). In parallel, some negative effects such as delayed technical change, innovation and decreased productivity within an affiliate can be cited (Tisdell, 1989).

Nowadays, firms have at their disposal several other mechanisms through which they minimize tax payments. Shifting real activity to more labor-intensive sectors and/or to the same sector in other countries is one of them. Substituting labor for capital for a given activity level within a sector is another possibility. The relationship between corporate tax rate and personal tax rate also matters and explains some fiscal optimization decisions. Namely, an increase in the corporate tax rate relative to the personal income tax rate tends to trigger an increase in the wage bill, with the corporate profit shrinking.

Shifting income from high-tax countries to low-tax countries is possible through the choice of the financial structure of affiliates that are controlled by a multinational. For the parent company, it is more interesting to fund its affiliates in high-tax countries by debt, rather than equity, benefiting thus from the resulting tax savings at the global level.

Hines and Hubbard (1990) find that the average tax rate for foreign affiliates that make interest payments to their US parent is higher than for affiliates that do not make interest payments. The US Tax Reform Act of 1986 has nevertheless introduced limits on the extent to which interest payments can be deducted from the the income of foreign affiliates. Clausing (1998) argues that intra-firm trade balances of US parents with their foreign af-

filiates improve when the foreign effective tax rate increases, which is consistent with the overpricing (underpricing) of goods or services sold to affiliates in high-tax (low-tax) countries. Buettner et al. (2012) study the capitalization rules that limit the deductibility of interest payments for intra-firm debt, moderating by the same profit-shifting practices. Other works emphasize the role of intangible assets in profit-shifting strategies as for many firms internal transactions can't be easily compared to external deals (Grubert, 1998 & 2003; Dischinger and Riedel, 2011). Firms' abilities to engage in international tax arbitrage are functions of the benefits and costs of doing so (Lee and Swenson, 2016). Companies' effective tax rates are functions of the variance of statutory tax rates they face, the number of countries in which they have a taxable presence, and the number of subsidiaries.

STATES' RESPONSE TO FIRMS' TAX OPTIMIZATION PRACTICES

As a result, policymakers become increasingly worried about cross-country differences in tax rates. In particular, they fear losing real economic activity to other countries if tax rates are too high. The states being engaged in a fierce fiscal competition, a "race to the bottom" for taxes on mobile production factors, in particular corporate taxes, is well under way. (Bartelsman and Beetsma, 2003). In parallel, many governments across the world apply transfer price rules where "arm's length principles" have a central role. According to the OECD, these principles state: "where conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly". Thus, the prices of goods and services transferred among the divisions of the same MNEs should be the same as if those divisions were independent entities. The comparable uncontrolled price, the cost-plus method and the resale price method are used to determine whether the aforementioned arm's length principles are applied. According to a study of Ernst and Young (2007) more than 90% of the companies surveyed say that transfer pricing is an important international taxation issue they face, and 31% consider that transfer pricing would be absolutely critical for them over the next few years. Recently, the case of Apple revealed substantial tax losses, estimated at $10 billion per year. The use of transfer prices for the transactions between affiliates of the company was a major part of the tax avoidance scheme. In response, several high-tax countries adopted restrictive legislation on transfer pricing in an attempt to limit capital outflows. Rules can differ across countries but the main flaw of these legislations is the substantial administrative costs they imply for both tax authorities and firms. In the process, several countries engaged in a transfer pricing audit (Tan-Ngoyen, 2000; Hielscher and Kaneko, 1999; Lewis, 2001) with the MNEs being under increased scrutiny. Sakurai (2002) finds that different regulatory styles and practices do exist within each tax jurisdiction. Each regulatory style has advantages and disadvantages. For stance, in Japan, the tax authority and the industry are closely linked, but that doesn't seem to favor transfer pricing compliance[22]. On the other hand, 'adversarial legalism' - associated with conflicts between firms and tax authorities characterizing the US economy could encourage a creative compliance which is not illegal but escapes the intended impact of the law. Preventing creative compliance[22] requires changes in taxpayers' at-

22 As defined by McBarnet (2001).

titude towards tax and law. The latter tends to become ‘‘an instrument of legitimate policy to be respected’’ rather than ‘‘material to work on’’. Thus, stimulating confidence between taxpayers and tax authorities is an essential stage in achieving a successful and efficient regulatory framework. Despite their agressive fiscal optimisation and the inability of the states to stop their practices, the MNEs consider that they still pay too much of taxes. Then the temptation is great to shape the tax law.

TO LAW TAILORING

One could consider that it is the legislator who shapes the law according to the common interest, but the reality is subtler. At least two reasons may be cited to explain how the MNEs shape the law. First, their advisors are excellent lawyers and accountants with an impressive imagination and ability to benefit from the law, not to follow it. In the context of fiscal hypercompetition described previously, they do “shop” the best law affordable to pursue their goals. Putting fiscal laws in competition, they abuse treaties to create a new “a-territorial” fiscal world based on the weaknesses of those conventions. When this is not enough, to eliminate taxes they buy sovereignty. But to be sure to perfectly benefit from the law, there is no better way that tailoring it through lobbying.

SELECTING THE LAW: TREATY SHOPPING & RULING

In their fight to avoid taxation, the MNEs began to select carefully the laws (the country) they will deal with. For their advisors, the word is a kind of “legal supermarket” in which they shop treaties. But that is not enough: as “big clients”, the MNEs also negotiate, as often as it is possible, a tailored law or application of the law: that is the ruling.

ABUSE OF TAX TREATY

The abuse of tax treaties has been defined as the use of tax treaties by persons whom the treaties were not designed to benefit, and/or to acquire benefits that the treaties were not designed to confer (Ad hoc group, 1987).

The OECD has been concerned with the tax evasion possibilities opened by the abuse of treaties for a long time. Hence, the US Treasury defines treaty shopping as: “the use, by residents of third states, of legal entities established in a Contracting State with a principal purpose to obtain the benefits of a tax treaty between the United States and the other Contracting State.”[23]

Evidence strikes: those texts are far from being contemporary, but the practice is still usual. In October 2015, within the mandate given by the G20: “base erosion and profit shifting project”, the OECD published a final report on “preventing the granting of treaty benefits in inappropriate circumstances, action 6”. The question is then: why are the most powerful states in the world not able to enforce a salutary discipline in this regard?

Haven’t they the internal tools to fight global practices? That is doubtful: each jurisdiction has a very complete arsenal of texts and law practices. To counter treaty abuse, countries have at least at their disposal (Cruceru, 2005):

- doctrinal methods:

as a theory of abuse of rights grounded in international law, or judicial anti-avoidance principles,

- and/or domestic legislations:

as general or specific anti-avoidance rules, to deny treaty benefits, or specific anti-avoidance provisions in tax treaties to limit the scope of their application.

For stance, the US Limitation On Benefit (LOB) provision accomplishes this an-

23 1996, US Model TreatyTechnicalExplanation : Art 22 : purpose of limitation on treaty provision.

ti-treaty shopping result by generally restricting treaty benefits to entities that: (1) are owned to a sufficient degree (typically at least 50 percent) by residents of the particular treaty jurisdictions, and (2) do not erode their residence country tax base through deductible payments made to third-country residents (Rubinger, 2007).

These law technics may be cumulated to reinforce their efficiency, but even taken individually, they are very commanding. So what? At the OECD, the integrity of justice is above serious doubt. If the fiscal authorities present cases to the judges, they will follow the law and condemn. But very few cases are sued. Of course, many transactions to escape the trial are opened by the Common law. But one can doubt of the pertinence of this reason alone to explain the impunity of abusers. Because, even in the countries of Civil Law, where those transactions are generally not allowed or severely restricted, the cases are scarce. So the most acceptable explanation may be based on the positive willingness of the states to close the eyes on those practices to enforce they fiscal attractiveness in a context of tax hypercompetition.

By the way, the very fact that some countries may go as far as negotiating their fiscal rules directly with the MNEs seems to be able to reinforce this argument.

NEGOTIATION OF TAILORED RULES: THE RULING

The opportunity given to the MNEs to negotiate with the states their own fiscal rules - the "ruling" - is at the root of "the biggest tax battle in the history",[24] which is opposing Apple to the European Union, for an amount of approximately €13 milliards.

24 http://time.com/4472500/apple-eu-irish-tax-bill/

The idea comes from LUXEMBOURG, in the 1970s. This small European country, member of the European Council, created a new tax tool: the Ruling (Zucman, 2013). The technic is quite simple. To attract FDI, the territory "sold" to the MNEs the right to decide alone (or nearly, depending of their power of negotiation) of:

- The rate of their own level of taxation;
- The rules of the game they want to play
- The level of the legal constraint;
- The legal obligation they want to comply with.

Many small independent territories followed this example. Some decided to go even fur ther: they chose to « sell » their citizenship (Palan, 2002): a physical person who invests an amount of money determined by the law, in the country, or in a specific activity of the country, may ask to become a citizen. The conditions of citizenship are of course fixed by the law and may occur immediately or at a later time, mainly depending on the amount invested. One example among many others: SAINT-KITTS Island gives its nationality to any person investing at least 250 000$ in the Sugar Industry. One may think that the fiscal attractiveness is at its maximum, with this technic. But this is not the case because ruling requires negotiating his fiscal status with every state. It may be much more efficient to create the rules for an entire territory.

CREATING THE LAW: TAX LOBBYING

To shape the law, the ultimate stage is to tailor it. That is what tax lobbying is made for (Baumgartner &Alii, 2009). But determining what constitutes lobbying and who is the general public or a segment thereof is the hard part.

The Cambridge dictionary defines lobbying as "the activity of trying to persuade someone in authority, usually an elected member of a government, to support laws or rules that give your organization or industry an advantage". Even if this definition may be criticized, it is the one we will keep in mind for the following developments.

Brasher and Lowery note that "the literature does not provide very clear or consistent answers about why some organizations lobby and others do not" (Brasher, 2006). Nevertheless, many facts have been established concerning the subject. This activity is often discreet and not direct. A good knowledge of the way decisions are made up is necessary, so lobbying generally uses intensively networks. In fact, the strategies used by lobbyists are too miscellaneous to be exposed here and have been largely analyzed (Goldstein, 1999) but it is important to keep in mind that lobbying is at the very core of corporate political spending as a robust correlation between firm's expenditures and its effective tax rate may be put in light (Richter & Alii, 2009).

At this point, the reasons why (mainly) the MNEs are perpetually paying lobbyists between 15 000 and 30 000, in Brussels only, are clear: lobbying is a way to minimize their tax expenditures either in making pressure to keep an advantageous regulation in place or to promote new rules allowing to make more money. The motives of the regulators are less clear; at least the non¬corrupt ones. Transparency International insists: even in the OECD countries, regulations about lobbying are missing or not enough efficient. Sylvie Guillaume, vice-president of the European Parlement in charge of the European Lobbying registre, confirms : "Si les relations entre les politiques et la sphère publique sont absolument indispensables pour nourrir la démocratie, il reste de grands efforts à faire en matière de transparence du parcours législatifs et de conflits d'intérêts". And at least, even if the battle for political influence does not distort the tax structure, inefficiencies arise because huge resources are wasted in lobbying (Brusco, 2014).

Then, how to "save the private lobbying"? Of course, it is still possible to consider that lobbyists bring research and precious informations to civil servants who are deprived of public services to produce or find them... Let us propose a cynic alternative explanation: by tolerating (if not encouraging) lobbing, the governments consider that they increase the fiscal attractiveness of their territories, softening always more and more sophisticated tax regulations.

CONCLUSION

This paper highlights multiple incoherencies in the domain of corporate taxation. On one hand, when facing global issues, the states pursue strictly their own interests. This leads to a deleterious war which threatens their capacity to collect taxes. Without fiscal equity, the free consent to pay taxes is declining across the world. As a consequence, numerous societal models are shaken. With an increasingly dematerialized wealth, a total freedom of movement and global enterprises, the states struggle to fix a common fiscal approach to preserve the general interest. The study sheds light on the necessity to define global and coherent fiscal rules. Philosophy of laws affirms that tax "makes society" (Seligman, 1914) and it is urgent to relearn that fundamental principle.

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