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PROFIT SHIFTING: THE PERSPECTIVE BASED ON MULTINATIONAL CORPORATION MANAGERS

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ABSTRACT

The profit shifting has been carried out by the multinational corporations around the world. During the COVID-19 pandemic, technology-based companies such as Google, Microsoft and Facebook, which is supposed to produce huge profits, they precisely shifted their profits through low-tax jurisdiction and did not pay sufficient taxes in developed countries. Due to these circumstances, the developing countries do not have sufficient income derived from taxes. For that reason, profit shifting is consistently associated in negative way. The purpose of this research is to understand the meaning of the profit shifting which is seen from multinational corporation managers' perspective. For that purpose, this study uses qualitative approach with interpretive paradigm. This study used unstructured interview from five selective informants. Intentionalism hermeneutic approach is used to explore and dig deeper the meaning of the profit shifting from the multinational corporation managers. As the result, this study concludes that there are two meanings of profit shifting, they are: (1) profit shifting as to maximize profit, (2) profit shifting as tax planning strategy. This research is expected to provide new perspective to the academic community in understanding the profit shifting. Additionally, the result of this research proves the profit shifting can provide the positive way, especially for the multinational corporations to expand their businesses.

KEY WORDS

Profit shifting, transfer pricing, multinational corporation, intentionalism hermeneutics, managers, tax.

The development of digital technology around the world brings several influences, especially in the economy aspect which may allow the companies performing the cross-border transactions. These companies that generally operate in more than one country under one group's control, are identified as multinational corporation. In most cases, the multinational corporations carry out profit shifting from countries with high tax rates to countries with low tax rates by using transfer pricing schemes (Darussalam et al., 2013). The profit shifting that is performed by the multinational corporation has led to a decline in the state revenues. In 2021, Indonesia has experienced tax losses of approximately 2 billion dollars, which is almost 97% of the tax losses are incurred by the multinational corporation (TaxJusticeNetwork, 2021).

The profit shifting has been carried out by the multinational corporation around the world. During the COVID-19 pandemic, technology-based companies such as Google, Microsoft and Facebook, which is supposed to produce huge profits, they precisely shifted their profits through low-tax jurisdiction and did not pay sufficient taxes in developed countries. As stated by ActionAid, tax payments performed by the companies between developed and developing countries, such as India, Indonesia, Brazil, Nigeria and Bangladesh show a significant gap (BBC, 2020). Due to these circumstances, these countries do not have sufficient income derived from taxes. A few years ago, Google had shifted their profit shifting from Indonesia to Singapore. According to the tax treaty between



Indonesia and Singapore, Google pays 0% tax rate on income in Indonesia and records their revenue under their affiliates in Singapore (Susanti et al., 2017).

Previous researches have examined the phenomenon of profit shifting as part of a transfer pricing scheme. However, most of them used quantitative approach for testing the variables, thus they do not study the profit shifting from other perspectives. Research on profit shifting has been carried out by Omar & Zolkafli (2015), Agana et al. (2018) and Sari et al. (2020) which examines the existences of profit shifting on the multinational corporation. In contrast, these studies only revealed the existences of the profit shifting itself and do not examine deeper about how multinational corporation managers as perpetrators view the profit shifting. For that purpose, we want to know how the multinational corporation managers interpret the meaning of the profit shifting.

The approach used in this study is the hermeneutic approach. As stated by Sari (2014), hermeneutics is a branch of philosophy as an attempt to interpret "texts" in order to obtain the understanding. Hermeneutics also allow people to make different interpretations of the meaning of a particular idea (Sumaryono, 2006). In this study, intentionalism hermeneutic was chosen because the we want to try to explore the meaning of profit shifting in the form of text and words.

Those previous studies motivate us to explore the meaning of the profit shifting from the perspective of the multinational corporation managers. This study uses an intentionalism hermeneutic approach as the novelty of research and is considered a unique approach in exploring the meaning of the profit shifting.

METHODS OF RESEARCH

This research uses a qualitative approach. Qualitative research aims to obtain a general understanding of social reality based on the participants' perspective, with the intention of providing conclusion based on general understanding of the reality that occurs (Purnamasari & Triyuwono, 2010). Qualitative research includes many paradigms in it. According to Creswell (2007:19), researchers need to convey the research paradigm that will be used. By determining the paradigm, researchers can determine the framework as a basic reference for research to be used. The purpose of this study is to understand the meaning of profit shifting based on the perspective of multinational company managers. For this purpose, the most suitable paradigm to be used is the interpretive paradigm, which focused on exploring the initial nature of social world based on the extent of individual experience (Burrell & Morgan, 1979:28).

This research engages intentionalism hermeneutic to provide an understanding of the profit shifting based upon the multinational company managers. Intentionalism hermeneutics view that the meaning of the "text" already exists because it is brought by the author so that the meaning of the "text" will be interpreted by the interpreter (Attamimi, 2012). According to Sari (2014) the research that uses an intentionalism hermeneutic approach, can interpret and dig deeper into the meaning of the "text" and informants' perspective, both said and thought by the informants.

The data of this study will be collected from unstructured interviews and observation of the informants. The interviews take 5 (five) selective informants to obtain information of the profit shifting based upon the multinational company managers perspective. In this case, the informants will provide information and deeper understanding of what is being researched.

RESULTS AND DISCUSSION

Overview of the Informants. The first informant was Mr. Sen who was the finance manager of manufacturing company. Mr. Sen has graduated from private university in Jakarta majoring in accounting. He has been working at the same company for more than 10 years. For that reason, he understands very well about the profit shifting.



The second informant was Mr. Hen who was also the finance manager of manufacturing company. He graduated from accounting major in the private university in Central Java and has experienced for more than three years in finance field.

The third informant was Ms. Lala who was the assistant tax manager of the expedition company. Ms. Lala has graduated from university in East Java majoring in taxation and continued her Master's Program in the same university majoring in accounting. She used to be tax consultant in Surabaya, so this made her understands very well about tax activities in her company, including profit shifting.

The fourth informant was Mr. Pur who was the manager of consulting company. He graduated from private university in Central Java as Bachelor's Degree of Accounting and has been working in the company for about to five years.

The last informant was Ms. Ani who was the finance manager from manufacturing company. She graduated from public university in Central Java and has been working for about to three years. She used to work at consulting company as auditor. This made her an expert in accounting field.

The historical context of the five selected informants shows that they have excellent education background and have experience as manager or assistant manager of multinational company. It can be said that the multinational company considers the good criteria for the manager, especially for the higher educational background and their job experience.

Different Term in Profit Shifting and Income Shifting. There are several terms in foreign languages then they are translated into Bahasa. However, these terms are having the same meaning in Bahasa so these terms become ambiguous. The terms "profit shifting" and "income shifting" are often considered as the same term. OECD (2022) defined profit shifting as income and expenses that is allocated to branches or affiliated companies within a whole group company by using transfer pricing schemes to reduce tax burden. Furthermore Agana et al. (2018) stated that academic community recognized the practice of decreasing and increasing profit from one subsidiary or division to another one as income shifting. Based on those two terms, profit shifting is the common term for tax practitioners because the term income shifting is specifically popular among the academic community.

Profit Shifting as To Maximize Profit. As stated by Munir & Tjiptoherijanto (1978), one of the objectives the company wants to expand their businesses is to maximize their profit. This can be reached by reduce the payment of expenses, including tax payments. Furthermore, the companies could reach their higher profit by using specific strategy such as profit shifting. Such strategy can be proved by Mr. Sen. When he is asked about the purpose of use of profit shifting, he answered:

When talking about profit shifting, the informants tend to associate this term with transfer pricing. In the interview, Mr. Hen stated as follows:

"The company's main goal is to maximize profits by reducing expenses. Tax is one of them, and the mechanism to reduce it is by using transfer pricing and profit shifting."

As stated by Mr. Hen, the meaning of profit shifting as the way the company fulfilled their goals, such as maximize their profit. He said that the multinational company will try to reduce their expenses by using profit shifting mechanism. This result of the meaning of profit shifting as to maximize profit is inseparable with his other statement. He stated as follows:

"The company uses profit shifting in order to achieve their goals. So, they usually make the annual target like... this year we have to achieve this amount of profit, and next year we will make a little higher amount of profit."

Mr. Sen said this statement with the confused look on his face. He also said that the profit shifting was carried out by the company in order to achieve the profit desired by the company. This meaning shows the meaning of profit shifting as the companies' goal is to maximize their profit. As an accounting graduate, of course, Mr. Sen is familiar with the term profit shifting in general.

When it comes to profit shifting mechanism, Mr. Hen who was also the finance manager of manufacturing company like Mr. Sen answered as follows:



“We have to minimize the production cost and then we have to reduce other expenses, including tax. So how we do that? We have to allocate these expenses to another company (affiliate)”

Those statements are relevant with the statement of OECD (2022) who defined profit shifting as income and expenses that is allocated to branches or affiliated companies within a whole group company to reduce tax burden. Therefore, the first meaning of profit shifting has opened. However, there is also another hidden meaning of profit shifting based on multinational companies' managers perspectives.

Profit Shifting as Tax Planning Strategy. Tax planning is the strategy that is used by multinational companies' managers to reduce their tax payment. Tax planning is considered as legal act since they are set by the tax law.

Profit Shifting as the Way to Perform Transfer Pricing. Based on the definition of profit shifting of OECD, the way to do profit shifting is using transfer pricing mechanism. Transfer pricing strategy is performed by company manager as the way manipulate the amount of profit in order to affect on tax payment and the dividend that will be received by the shareholders (Herianti & Chairina, 2019). When talking about profit shifting, Ms. Ani associate this term with transfer pricing. She answered as follows:

“When you are talking about profit shifting, it could not be separated from transfer pricing. One of the reasons transfer pricing still exist is because it can be used as a loophole for the company to do profit shifting then tax avoidance.”

Then, she also stated how she defined transfer pricing, such as:

“In my opinion, what is meant by transfer pricing is to shift or transfer the price of the products, both goods and services. The both parties have already known the prices. I am not saying that we manipulate the prices, but there is special agreement which is made by both parties. So, it is not that I am manipulating the prices but this is indeed an agreement. So, what is the ending? The ending is we can manipulate the profit target at certain profit which is already agreed by the both parties.”

Ms. Ani interpreted profit shifting as a result of the transfer pricing mechanism that company used to reduce tax. In addition to this, he said that both transfer pricing and profit shifting did not harm any parties because it is already agreement between two parties.

Profit Shifting as the Way to Minimize Double Taxation. Double taxation may occur when the income is subjected with tax by the two jurisdictions. This continually occurs to multinational corporations with their cross-border transaction. According to Mr. Pur, he said that this could be avoided by the profit shifting.

“We use this –profit shifting– in order to avoid tax burden. Our parent company comes from overseas and we are from the subsidiary in Indonesia, right? We are afraid that we have to paid the tax in Indonesia and the parent company overseas also being subjected for tax. That is so called double taxation. In order to avoid the double taxation, we perform profit shifting in our company.”

This statement by Mr. Pur show that the profit shifting can be interpreted as the way to avoid double taxation for the multinational corporations. Furthermore, Ms. Lala said the similar thing with Mr. Pur as follows:

“In avoiding double taxation, we can use profit shifting and optimize the use of our treaty with other countries, like Singapore, Hongkong and Panama. For example, if we have affiliates firm in Singapore, we have to fulfill the need of COR etc. That could be a way to reduce double taxation, on my point of view.”

In order to avoid double taxation between two countries, she suggests to use profit shifting and tax treaty as the mechanism. According to what Mr. Pur and Ms. Lala said, we can describe that profit shifting could be the way to avoid double taxation between two countries.

Profit Shifting as the Way to Facilitate Tax Administration. Tax administration is associated with the taxpayers, including the multinational corporation. They ensure the multinational corporations to pay the right amount of tax. Ms. Lala stated that the profit shifting could simplify the tax administration in the certain country. Here is the statement of Ms. Lala:



“I think profit shifting will makes tax administration easier if the company has affiliates in the countries that do not have the tax treaty between them. For instance, East Timor. We do not have tax treaty with East Timor. So, we make affiliates firm on there then it will come easier if we shift the profit there. In order to make tax administration become easier, we have to shift the profit there.”

Based on what she stated, the profit shifting could facilitate tax administration in the certain country. Especially, if that certain country did not have tax treaty with Indonesia. In addition, she said as follows:

“It is natural for the companies to optimize their profit, but we have to do them based on the law provisions, whether they still meet the provisions or not. If they are not relevant with the provisions, we won’t do it. We have to consider all aspects.”

With that, profit shifting could be considered as legal way for a company to optimize their profit.

From the explains above, we could interpret that the second meaning of profit shifting is its role as tax planning strategy. This second meaning proves that the meaning of profit shifting that based on practitioners and academic community and our result are not that different. Based on Tax Justice Network (2022), profit shifting is considered as strategy to reduce their tax payment by moving their profit to low-tax jurisdiction. From this definition, we know that multinational company used profit shifting to reduce their tax payment by any mechanism, such as transfer pricing, avoiding double taxation, facilitating tax administration in the country where they operated.

The exploration of the meaning of the profit shifting will stop at the second meaning. We hope the future research will be able to find another meaning of profit shifting by using different method.

CONCLUSION

This study seeks to explore the meaning of profit shifting based on multinational managers’ perspective by using intentionalism approach. As discussed on previous chapter, we interpreted 2 (two) different meaning of profit shifting, they are: (1) profit shifting as the way to maximize profit, and (2) profit shifting as tax planning strategy. This result of this research is indeed subjective study and cannot be generalized to another research. For further research, we suggest that this research can be developed from various aspect, such as using different approach to view profit shifting. Different profession can also be applied to the next research, in order to get different perspective. With this, we hope that this topic can be developed further.

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