Politics of Intra-Firm Trade: Corporate Price Planning and the Double Role of the Arm's Length Principle

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Corporate Price Planning and the Double Role of the Arm's Length Principle

Abstract

Intra-firm trade has increased its visibility within academia, media and non-governmental organizations. One of its key elements is the shifting of profits across national boundaries through transfer pricing and other mechanisms that big companies use to cross-subsidize their subsidiaries, often to avoid taxes. Much of the information about transfer pricing is hidden behind veils of accounting rules that reproduce corporate secrecy and facilitate the use of non-market prices for intra-firm transactions. In light of increasing evidence about prevalence of non-market price setting, a significant amount of international trade cannot be meaningfully analyzed as genuine market transactions. This provokes serious questions about the validity of market assumptions in research on world trade in particular and global capitalism more generally. Our specific contribution focuses on the role of the arm's length principle and the significance of cross-subsidization and other forms of corporate planning in intra-firm trade. We suggest that under certain conditions, price planning by private corporations should be analyzed as a dimension of political rule within the economic sphere. Politics of world-economy is not merely something related to governmental intervention, but corporations should also be theorized as potentially political entities. Crossing the disciplinary boundaries between political economy and normative political theory, we will also briefly explore the possibilities that the politicization of intra-firm trade opens for applying democratic norms in the governance of global economy.

Keywords: Transfer pricing, transnational corporations, intra-firm trade, arm's-length principle, economic planning

1. Introduction

The societal power of the corporation has become a much-debated topic. Academic discussion has mushroomed from Accounting and Management Studies (e.g. Wilson 2009; Sikka 2010;

Sikka 2013; Sikka and Willmot 2010; Hasseldine and Morris 2013; Taylor and Richardson 2013) to Economics (e.g. Desai and Dharmapala 2006; Clausing 2003; Haufler and Schjelderup 2000), business ethics studies (e.g. Doyle *et al.* 2009; Weyzig 2013; Preuss, 2010; Preuss 2012; Huseynov and Klamm 2012; Muller and Kolk 2012) and Global Political Economy and Development studies (e.g. May 2015; Jenkins and Newell 2013; Otusanya 2010; Christensen and Murphy 2004; Christensen 2011; Palan *et al.* 2013; Webb 2006; Leaman and Waris 2013; Sharman 2006) and to legal studies (e.g. Picciotto 2011; Avi-Yonah 1995). While a comprehensive summary of this literature is beyond the scope of our article, we have not found sufficient attention on theoretical and ideological implications of the increasingly political role of the corporations. The phenomenon of intra-firm trade offers a suitable starting point because of its significance for the workings of global corporate capitalism and the lacunae in the research on its political implications. While our specific contribution is on the politics of intra-firm trade, we will also argue that understanding the political aspects of the corporation requires a revision of some of the key assumptions about the role of markets in global political economy.

Recent studies on intra-firm trade and transfer pricing have revealed that transactions planned in corporate headquarters constitute a significant proportion of global trade. The mere existence of conscious planning may seem a natural aspect of any strategic action, but in intra-firm trade the realm of planning involves the formation of prices, a foundational mechanism of market economy. The prices set in intra-firm trade can be adjusted in order to avoid taxes or to hide risks. As many authors have shown (e.g. Christensen 2011; Sikka and Willmot 2010; Keuschnigg and Devereux 2013; Overesch 2006, 20), tax authorities face enormous challenges in monitoring intra-firm trade and enforcing domestic tax laws. It is thus not surprising that aggressive tax avoidance has been highlighted as a key issue in much of the academic research on the intra-firm trade (e.g. Christensen 2011; Sikka and Willmot 2010). In this article, however, we want to focus on some of the more profound implications of intra-firm trade for the possibilities to analyze the global power relations. Apart from the theoretical concerns, toward the end we will also explore tax-policy-relevant issues of intra-firm trade accounting.

Intra-firm trade deviates from the basic ideals of market economy, as it takes place between units of the same corporate entity. These non-market aspects of the firm have been recognized also by

the mainstream Economics and Accounting scholarship, as even some of the accounting textbooks demonstrate (Horngren *et al.* 2012)[1]. In economic theory, the transaction costs approach pioneered by Ronald Coase (1988) has played a particularly important role in analyzing why it may make more economic sense to organize production within a firm hierarchically rather than through market transactions.[2] One dimension of the social acceptability of hierarchic organization can be measured by performance of the bottom line. Yet, as we will argue below, the overall legitimacy of hierarchic corporate control over significant aspects of society is also based on concealing its political dimensions. We suggest that the non-market dimension of the firm has far-reaching theoretical and normative implications. Even if scholars have started to pay increasing attention to the existence of intra-firm trade, most analyses of global economy tend to assume a dichotomy between politics and markets in which corporations neatly belong to the latter. We have to question such dichotomies in order to understand the politics of intra-firm trade.

We will start unpacking the debate around intra-firm trade by examining the arm's length principle and its market assumptions. We will revisit some of the historical debates on corporate power, before finally focusing in more detail on the conceptual and normative dimensions of our topic.

2. Double Role of the Arm's Length Principle

The dominant free-market ideology faces an anomaly, as statistics suggest that a significant part of the world trade is based on non-market pricing planned in corporate headquarters. In 1996, the United Nations (UN) estimated that at that time one third of the world trade was conducted within transnational corporations (UNCTAD 1996). In 2004, United Nations Conference for

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[1] Horngren *et al.* note in their widely used textbook of managerial accounting that "top management uses transfer prices (1) to focus managers' attention on the performance of their own subunits and (2) to plan and coordinate the actions of different subunits to maximize the company's income as a whole", also noting that "managers of different subunits often have very different preferences about how transfer prices should be set." (Horngren *et al*. 2012, 773)

[2] Interestingly, many of the key benefits of hierarchically organized operations supposed by the transaction cost theory, such as lower transaction costs and economic efficiency, are based on an assumption that companies do *not* operate internally according to market mechanisms (Avi-Yonah 1995, 148).

Trade and Development (UNCTAD) estimated that half of the service trade from the US could be considered intra-firm (UNCTAD 2004). Using 2009 customs data, the Organization for Economic Cooperation and Development (OECD) found that intra-firm trade accounted for 48% of US goods imports and about 30% of U.S. goods exports (Lanz and Miroudot 2011). The authors also pointed out that “intra-firm transactions are more common among OECD countries than among emerging economies. In 2009, 58% of U.S. goods imports from OECD countries were intra-firm, while only 29% of US goods imports from Brazil, the Russian Federation, India, Indonesia, China and South Africa (so called BRIICS economies) occurred between related parties.”[3]. There is plenty of direct and indirect evidence that the prices applied in the intra-firm trade often differ from market-based prices (see e.g. Webb 2006; Overesch 2006; Ylönen and Laine 2015).

How can we have a “free” market based on administered and planned prices? One way to deal with the mismatch between the assumptions of competitive markets and the reality of hierarchically organized business entities is to artificially establish competitive markets inside those parts of the world trade that deviate from the prevalent market assumptions. To accomplish this task, states have agreed on international and national norms for facilitating market-based transactions inside big corporations. As regards the intra-firm trade, the most important norm is the arm’s length principle championed by the OECD. According to this principle, whenever two parts of the same corporate entity trade with each other, they should set the prices as if they were at “arm’s length” from each other[4]. The principle helps combine the anomaly of planned prices with an analytical framework based on “free” markets. Patrik Aspers (2011, 4) has defined the market structure as “constituted by two roles, buyer and seller, each standing on one side of the market, facing the other.” In this structure, the arm’s length principle can function as a mechanism that helps corporations simulate or construct markets in their intra-firm trade. In practice it is difficult to find evidence that the arm’s length principle would have significantly contributed to creating genuine, functioning markets inside corporations. Instead, as we will

[3] In 2002 the *OECD Observer* magazine stated that approximately 60 per cent of the world trade is intra-firm trade, though no research was presented to back up this estimate (Neighbour 2002)
[4] The concept of “arm’s length” is a used also in many other contexts, meaning “avoiding intimacy or close contact” according to the Oxford dictionary. It is commonly applied e.g. when discussing borrowing (Agarwal and Hauswald 2008) or international production networks (Kimura 2006).

argue in more detail below, it plays an important ideological role in reproducing non-market aspects of world trade.

Definitional ambiguities and enforcement difficulties have always restricted the applicability of the arm's length principle. The history of the principle dates back to formulations in the U.S. War Revenue Act of 1917 (Avi-Yonah 1995, 94), International Chamber of Conference in the 1920s (OECD 2005, 81), and the League of Nations Model Tax Conventions that prevailed during the first half of the 20th century (de Ruiter 2013, Vega 2012). Conferences were organized already in the 1940s to tackle these problems (see Palan *et al.* 2013, 192-193). Since the early years, corporations have had an active role in shaping the arm's length regime. The development of the U.S. transfer pricing regulation is a telling example, as it was partly a result of active lobbying by large pharmaceutical companies. The 1963 Convention paved the way for the international triumph of the arm's length principle, which can be found today in most bilateral tax treaties that regulate taxation of transnational corporations (Durst and Culberston 2010, 495-5146).

In its initial formulations, the arm's length principle was expressed in relatively general terms. The lack of detailed rules restricted its application in many countries (Linde, 1977, 82 quoted in Vega 2012, 11). In fact, when the principle started to be applied in the United States courts, the first cases were characterized by indecisiveness between strict application of the arm's length principle based on market comparables and more ad-hoc methods that allowed prices that seemed "not unreasonable", or "fair and fairly arrived at" (Avi-Yonah 1995, 100). This ambiguity was accentuated by the early, strict definition of arm's length principle that focused on market comparables. Specifically, the Revenue Act of 1934 stated that the "standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer" (quoted in Avi-Yonah 1995, 97).

As recently as in the early 1970s, compliance with the arm's length standard was tested only sporadically with uncontrolled comparables in tax audits (Durst 2010, 24). In 1972, Rädler tellingly pointed out that "reference to the so-called arm's length rule usually does not lead much further, since to an ever-increasing extent similar or even comparable deliveries or services are

carried out only within the one multinational company”. However, this sporadic approach did not mean that tax authorities were idle. In the United States, tax authorities contested tax agreements of several multinational corporations from 1930s onward, but they often had to rely on other methods than using comparables. As a consequence, the emphasis shifted from the ideal of “uncontrolled taxpayers” to using other methods to determine acceptable transfer prices.

In the 1960s, the US Treasury Regulation 1.482-2(e) described three methods for determining an arm’s length price: the comparable uncontrolled price **(**“CUP”**)** method, the resale price method, and the cost plus method, in that order of priority. In case none of these were applicable, the courts were also left free to determine their own “fourth methods”. (Avi-Yonah 1995, 107) According to Avi-Yonah, the result was “a deliberate decision to retreat from the standard while still paying lip service to it” (*ibid*., 112). The loosening of criteria did not, however, solve the inherent problems of the principle. In 1985, the House Report on House Bill (quoted in Avi-Yonah 1995, 130) noted how

> fundamental problem is the fact that the relationship between related parties is different from that of unrelated parties. Observers have noted that multinational companies operate as an economic unit, and not "as if" they were unrelated to their foreign subsidiaries. In addition, a parent corporation that transfers potentially valuable property to its subsidiary is not faced with the same risks as if it were dealing with an unrelated party.

These problems were further addressed in the United States in 1988 with publication of the White Paper, and the consequent 1994 revision of the U.S. tax code. The White Paper argued that the lack of comparables restricted application of the traditional arm’s length principle in most cases. Methods introduced in 1968 had helped in keeping the system functioning, but the White Paper went further in introducing also option of using profit-split methods, “as long as the results reached were compatible with arm’s length results” (Avi-Yonah 1995, 135). This was a significant step away from the idealized images of comparables and market-based prices.

Major developments took place also in international forums, as the OECD Council approved in 1995 the OECD’s Transfer Pricing Guidelines, initially formulated in 1979. The 1995 Guidelines were an important step toward a more comprehensive and detailed normative framework, even if

many problems of monitoring and enforcement remained (OECD 2010, 3; OECD 2013). In line with the U.S. regulations, the OECD guidelines also allowed using various methods to determine taxable income in case comparable prices could not be found.

While the problems inherent in the transfer pricing regulation are old, they have been accentuated by the growth in world trade, characterized by its increasing concentration *within* large companies and corporate groups that operate across national borders. The recent decades have also seen a massive growth of services trade, in tandem with a trend where companies centralize the ownership of intangible rights from several group companies to one “IP company”, often located in a low-tax jurisdiction (e.g. Palazzi 2010, 24). These developments have contributed to increasing difficulties in determining the comparable market prices, even though states have begun to pay more attention to monitoring the intra-firm trade. The arm’s length system is thus highly vulnerable to manipulation by the companies. Aforementioned policy changes have been helping tax authorities and companies to go on with their day-to-day businesses, but they have distanced arm’s length principle far from its original intentions.

Most of the transfer pricing related profit shifting is conducted with small deviations from the estimated market prices. Companies can, however, also engage in more aggressive forms of planning, enabled by the difficulties many states face in enforcing and monitoring their transfer pricing rules. Boyrie *et al.* (2007, 474) have described how “in November 2005, a set of golf clubs is imported into Nigeria for $4,976, while the US/World median price for the same set of clubs is only $82. During the same month, a gasoline generator is imported into Ghana from the USA at a price of $60,000 that could be purchased at the US/World median price of $63.03”. An internal memo from Du Pont company illustrated already in 1976 the trade-offs corporations can face between compliance and transfer pricing manipulation:

> "It would seem to be desirable to bill the tax haven subsidiary at less than an 'arm's length' price because: (1) the pricing might not be challenged by the revenue agent; (2) if the pricing is challenged, we might sustain such transfer prices (3) if we cannot sustain the prices used, a transfer price will be negotiated which should not be more than an

> 'arm's length' price and might well be less; thus we would be no worse off than we would have been had we billed at the higher price." (quoted in Avi-Yonah 1995, 120-121)

Furthermore, not only states but also corporations often find it difficult to determine the market-based comparable prices. Corporate secrecy and inadequate trade statistics makes it difficult to estimate market-based prices for many commodities and services. Consequently, corporations often lack the means to even roughly estimate the prices their competitors use in their internal trade. Increasing the transparency of country-level financial information with the so-called country-by-country reporting could alleviate this problem in some extent, but the corporate interest groups have generally opposed such measures in the EU and the US. In its broad version, the country-by-country reporting initiative would make the essential country level financial information of TNCs publicly available from the company's website. At the moment, this data is scattered in national company registers whose level of publicity varies greatly (see Murphy 2009).

On the basis of this evidence, we argue that the arm's length principle has played a double role in world trade. On one hand, it can be considered an instrument to establish markets inside hierarchic corporate structures. There is enough evidence to suggest that the arm's length principle can be regarded as a failure if we consider market creation as its main purpose, as slow but steady shift of transfer pricing rules from the search of comparables to other pricing methods clearly demonstrates. Michael Durst, former director of the Advance Pricing Agreement Program of the US Internal Revenue Service, has aptly noted that "despite many efforts at reform around the world during the 40 years or so in which the current system has played an important international role, governments have never been able to administer the system effectively." What is more, he saw little prospects for getting the system to function in the future "no matter how hard one seeks to reform" it (Durst 2010, 247).

There is, however, also another role in which the arm's length principle has been more successful. We suggest that the principle also helps maintain non-market planning operations inside corporations. The principle offers a basis for assuming that markets exist in places where

their existence is difficult to verify in practice but ideologically important to simulate in theory. In this sense, it plays a more clearly ideological role.

The ideological role of the arm's length principle can be compared to another body-part metaphor, the invisible hand. As in a human body, each part has a function that sustains the whole. The invisible hand, even if mentioned only in passing by Adam Smith in *The Wealth of Nations* (1776/2003, 572; see also Rothschild 1994), has been constantly evoked to support the claim that market economy contributes to overall public good.

Scholars have debated both societal and academic roles of the invisible hand for decades from various angles (Rothschild 1994, Aydinonat 2008, 81-92). In world trade, the arm's length principle arguably plays an even more fundamental role, because it can be evoked to resolve the prior question of whether a market economy actually exists. It is therefore not surprising that private-sector tax experts have promoted arm's length principle as the preferred regulatory norm. Even if it is sometimes recognized that its flaws and ambiguities favor corporate interests (see Webb 2006, 110-111), the ideological role of the arm's length principle has not received the critical examination it deserves.

These monitoring and enforcement difficulties mean that track record of the arm's length principle is a failure only if we judge the principle by its ability to create markets where they do not exist. The same difficulties, however, can be considered important elements in the success of the principle in providing a justification for the non-market aspects of intra-firm trade, so that they seem compatible with the normative foundations of market economy. The success is not perfect, as demonstrated by the OECD-driven attempts to "fix" the arm's length principle with its Base Erosion Profit Shifting project (OECD 2013), the increasing calls for unitary taxation, and the growing public attention to these issues. By focusing on these aspects of world trade, we hope to further understanding on the politics of price planning in big corporations.

3. What does it mean to analyze corporations as systems of planning?

3.1. Political Planning of Intra-Firm Trade

According to Patrik Aspers (2011, 4), a key feature of the market is that its "actors – individuals and firms – compete with each other." Moreover, William Lazonick (1991, 59) has noted how the "definitional social characteristic of a market is the impersonal relation between buyer and seller". Both indeed characterize markets dominated by independent, rival firms. In the intra-firm trade the buyer and seller are, however, part of the same decision-making structure. Therefore, the relationship is very far from "impersonal" and not characterized by "competition" in the standard market-economy meaning of the term. In addition, the intra-firm transactions typically take place behind the veil of corporate secrecy that makes it difficult to study them in detail, in contrast to the prevailing idea of markets where relevant information is assumed to be available for all relevant participants. This reasoning initially suggests that a significant part of world trade may take place under conditions that could hardly be characterized as market economy. There is evidence that corporate planning conducted through cross-subsidization and administered prices is of such magnitude that characterizing real-world global capitalism as market economy is at least partially misleading.

Despite the problems of the simplistic market assumptions, there certainly remains a role for market considerations in the planning of intra-firm trade. Even if the intra-firm price of a particular good or service deviates from what can be considered its going market price, thus violating the arm's length principle, the overall price planning of the company needs to respond to various kinds of external pressures that include undeniable market elements. In itself, however, the fact that corporate planning needs to take market considerations into account does not invalidate approaches that regard big corporations as potentially political entities. After all, also states need to take market considerations into account in their economic planning. For example, trade treaties include elements that induce states to imitate markets by transforming government functions into state-owned companies, even if their only customers may be other state-owned agencies. The prices used in this trade are also supposed to reflect market-based prices, but these can be difficult to determine. Even in cases where the governments are strongly conditioned by these kinds of rules and market signals, few would argue that they have thus become non-political entities. Being conditioned by markets and being political are not mutually exclusive conditions.

In academic literature, transfer prices have been discussed using terms such as "misuse of transfer pricing" (e.g. Lakhal 2006: 545) "abusive transfer pricing" (e.g. Lesage *et al.* 2010: 156), "distortion of transfer prices" (Fuest and Riedel 2010: 5), "abnormal prices" (Fuest and Riedel 2010: 7), "enlarged import prices" (Fuest and Riedel 2010: 17), and "over- and under-invoiced prices" (Eden 2003: 11). Most of the terms cited above suggest an intentional agency directly impacting the price formation in intra-firm trade. Even if the political implications of this agency are often left underexplored, the choice of ethically loaded terms such as "abusive" can be considered at least potentially politicizing. On the other hand, terms such as "enlarged" or "distorted" prices implicitly suggest that it is possible to define market-based prices. As argued earlier, this is often not the case. The term "profit shifting" (Kaldor 1963: 20) avoids this assumption, though it lacks the ethical tone. In order to emphasize the planning element of intra-firm trade, we will next discuss the concepts cross-subsidization and administration of prices.

We argue that large corporations should be analyzed with concepts that leave behind the economistic assumptions about a separate economic sphere in which non-market-based planning is associated only with state intervention. Both large corporations and states participate in planning the markets and marketing their plans. There are obvious differences between states and large corporations, including the territorial boundaries that delimit the possibilities of state action, the greater role of states as creators of binding normative frameworks, and the ability of states to declare a state of exception (Schmitt 1927; Agamben 2005). It seems, however, clear that both governments and corporations can be rule-makers as well as rule-takers, although in different venues and processes. At times, corporations can make their own rules directly in private regulative bodies. In other occasions, corporations influence the rules indirectly by the instruments of economic planning.

In consequence, we will argue against the idea that the best way to analyze the differences between states and corporations is by considering only the states as political entities. Moreover, we maintain that the most significant normative difference between states and corporations is that states tend to base their legitimacy on democratic consent by its subjects, whereas corporations are in many ways shielded from the validity sphere of democratic norms. If

corporations can be argued to be political entities, arguments for applying democratic norms to them are strengthened. Here we obviously cannot claim to be reinventing the wheel, as there exists a long tradition of analyzing the political nature of economic institutions in order to open possibilities to democratize them. Our specific contribution to this important task is to explore how a realist analysis of intra-firm trade provides one avenue for this kind of politicization.

3.2. Normative implications of analyzing corporations as political entities

Among the multitude of debates in political theory about what it means to call an entity "political", Roberto Mangabeira Unger's (1987, 145-146) two basic definitions of "politics" provide a helpful starting point. For him, the narrow meaning of politics can be stated as "conflict over the mastery and uses of governmental power". To analyze other than governmental politics of practices and spaces, it is more useful to rely on the broader meaning, which Unger defines as "struggle over the resources and arrangements that set the basic terms of our practical and passionate relations".

Any meaningful analysis on political nature of transnational corporations requires that we leave behind Unger's narrow definition that connects politics with governmental power. The widely acknowledged role of non-governmental actors in the "private" governance of contemporary global economy alone would favor endorsing the ”broad” definition of politics. However, our primary focus is not on how private power impacts public decision-making bodies, as the term "private governance" is sometimes understood in studies on global economy. Rather, we maintain that intra-firm decisions on location of corporate income can have major impacts on taxation, regulation and the financial transparency of corporations. Consequently, we will argue that corporations can consciously affect these "resources and arrangements" by intra-firm planning.

Before focusing in more detail on the political nature of the intra-firm planning in corporations, we should ask why bother. Is it simply a matter of definitional taste whether one considers corporate activities such as intra-firm trade to be political in the broad sense, as we suggest, or

whether the term “political” should be reserved for activities of governments, as in the more narrow definition of Unger? The standard use of terms such as “economic planning” and “political intervention in the market” associates these activities with state governments. If we are able to establish that also corporations practice planning and intervene politically in the markets, without direct mediation by states, we participate in opening new possibilities to reflect on what kinds of normative orders are legitimate in assessing the role of corporations. In particular, understanding corporations as potentially political entities opens various kinds of questions about their democratic legitimacy.

Another justification for studying corporations as political entities can be found in the basic tenet of science as an endeavor that aims to increase our capacity to explain and understand reality. Within mainstream economics, there have been influential attempts to dismiss the importance of realist assumptions in scientific research, most famously in the often-cited article by Milton Friedman (1953). While acknowledging that non-realist simplifications may sometimes be needed in science, we suggest that the mismatch between free-market assumptions and non-market realities of intra-firm trade has become of such magnitude that the assumptions violate basic tenets of scientific research. If we accept the widely shared view that corporations have become more powerful over states than they were for example 30 or 40 years ago, there is consequently a need for analytical tools that enable us to understand this change.

Relative absence of these questions in the scholarship on corporations is at least partially a result of the division of labor between academic disciplines. Scholars in Economics, Accounting, Management and related fields may simply think that analyzing issues of democratic legitimacy belongs to political scientists. Moreover, most of the well-established approaches in the fields of Management and Economics tend to pay little attention to the historical development of their own disciplines, and even less so to what has happened in other disciplines. In political studies, questions of intra-firm trade are generally considered issues of international political economy. Research in international political economy, on the other hand, is often conducted as if it was about interactions between political and economic entities that are represented respectively by states and markets. Against this background, we need to transgress the depoliticized conceptions of the economic as a separate sphere or analytical category in order to understand the political

role of corporations and their economic planning. We believe that the concept of planning enables us to better analyze corporations as political entities and address the important ideological effects of this shift.

One of the main legitimizing assumptions that help reproduce corporate power is the idea that democratic norms are only valid within the political sphere and not within the economic sphere (Teivainen 2002). If academic research establishes some aspects of corporate action in fact forms part of the political sphere, as we believe any serious analysis of intra-firm trade at least implicitly suggests, we have a case for asking political questions that may seem uncomfortable for the continuity of the current relations of power within and around big corporations. Politicizing an entity that has traditionally been considered apolitical means revealing its potentially democratizable nature. While there exists a long tradition of political debate over economic issues, the tax-related issues of intra-firm trade were without much public attention until recently. Less than a decade ago, Michael C. Webb (2006, 109) noted the "virtual absence" of non-governmental critical activism around international corporate taxation, even though new advocacy groups such as ATTAC and Tax Justice Network had just appeared. Since then, the situation has changed markedly, as reflected also by the constant flow of tax-related scandals in the media.

Until recently, discussions on corporate social responsibility were characterized by an almost total absence of corporate finance and tax functions (Ylönen and Laine 2015), as both the public conception and corporate views of corporate responsibility have leaned heavily towards the social and environmental aspects of the corporation (e.g. Golob and Bartlett 2007, 3).[6] Even within the Accounting scholarship, Gray and Laughlin maintained only a few years ago that "taxation remains [here], as it does throughout much of accounting research, something of an un-explored desert" (2012, 237). This situation has, however, been rapidly changing in the period after the financial crisis of 2007-2009. Growing public attention on payment of taxes has resulted in calls to discuss tax policies "in the boardroom" (KPMG 2006), as company after another has found itself in the midst of tax avoidance scandals. These developments notwithstanding, tax

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[6] However, it is interesting to note that responsibility aspects of taxation are mentioned in Howard Bowen's foundational CSR book *Social Responsibilities of the Businessman*. (Bowen 1953, 207)

payment is still rarely discussed in corporate responsibility reports (see Soederberg 2010; Ylönen and Laine 2015). Corporations have usually countered the emerging pressures to bring tax into the responsibility agenda by highlighting different kinds of mandatory taxes they already pay, giving little meaningful information on the planning element (Ylönen and Laine 2015).

In other words, there exits an ongoing discursive struggle on how to frame corporate tax planning in a situation where the "tax is out and there's no going back." (KPMG 2006, 4). Moreover, the narrow framing of the voluntary tax footprint reports suggests that corporations would rather stay silent on corporate taxes and tax planning.[7] It is thus evident that corporate level and scholarly discussion on tax planning takes usually place under the doctrine of economic neutrality (Swedberg 1986, Teivainen 2002). Specifically, corporations describe their tax planning related decisions in seemingly neutral, economistic terms. The responsibility discourse has challenged this doctrine by integrating conscious choice and social consequences to the responsibility debate.

In this context, mildly moralizing terms such as over or underpricing can implicitly highlight the ideological role of the arm's length principle. They tend to suggest that the anomaly of wrongly priced products can be corrected by either hoping or assuming that corporations will conform to acting at arm's length in their internal trade. While "profit shifting" can be used as more neutral substitute that avoids such assumptions, we believe that the concepts of "administered prices" and "cross-subsidization" can also provide several benefits in analyses of corporate power. In 1970s, Barnett and Müller defined cross-subsidization as "the use of power and resources developed in one 'profit center' to start or to expand another" (1974, 255), maintaining that the "widespread use of transfer pricing so central to the cross-subsidization strategies of the global corporation is designed, as we have seen, to create what amounts to a private economy" (ibid., 277).

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[7] The tax footprints often focus on the indirect taxes paid by the corporations with little or no opportunities for planning.

While we find the concept of “a private economy” somewhat ambiguous[9], the idea of cross-subsidization is able to capture two dimensions of intra-firm transactions: subsidizing specific parts of a business unit for market-related reasons (setting up new business or outbidding competitors in highly competed sectors) and setting non-market transfer prices in order to gain tax related or other advantages. Cross-subsidization includes various forms of planning that deviate from the arm’s length principle, ranging from non-market transfer pricing to debt-related arrangements. The goals vary: cross-subsidization can by used to achieve lower tax rates, avoid regulation, or hide risks.

Cross-subsidization entails that the prices used in intra-firm trade are “administered” in ways that violate the basic assumptions of a market economy. Means and Berle argued already in the 1930s in their seminal study of the modern corporation (Berle and Means 1934, xxxiv) that contrary to the liberal market theory, corporations are able to “administer” their prices.[10] According to Means (quoted in Auerbach 1962), an “administered price” is ’a price set by someone, usually a producer or seller, and kept constant for a period of time and for a series of transactions,’ as distinguished from a “market” price, which “fluctuates on the basis of supply and demand as these forces are felt in the market.” Elsewhere, Means argued that “market” prices are to be found only in agricultural commodities and some raw materials, whereas most industrial prices, a large portion of retail prices and most wage rates are “administered” (quoted in Auerbach 1962, 144).[11]

To recap, we started by presenting a case that much of the world trade takes place under conditions that market-based lexicon can only partially capture. We argued that the intra-firm trade should be analyzed instead with the concepts of corporate planning and cross-subsidization.

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[9] In particular, there is a danger that the concept of private economy would be interpreted as a closed *but* market-based system (in contrast to the planning system that regularly violates market principles), even though this might not have been the intention of Barnett and Müller.

[10] The discussion on price administaring and planning later continued e.g. in the writings of John Kenneth Galbraith (1967) and Baran and Sweezy (1966) and Cardoso *et al*. (1969), Quijano (1971) and Marini (1977).

[11] In the US Senate antitrust hearings of 1957-1961, Means also maintained that ‘”administered” prices should be of special concern to the Subcommittee because the greater the concentration, the less the restraint upon pricing discretion imposed by market forces and the greater the possibility of the abuse of discretion’ (quoted in Auerbach 1962, 144).

We also maintained that this planning and cross-subsidization can give corporations power to affect the "resources and arrangements" in states and societies where they operate, relying on Unger's wide definition of politics. Consequently, we believe that there are grounds to analyze not only states, but also corporations as political actors.

This does not mean, however, that all corporate planning or cross-subsidization could be considered equally political. After all, many individual, isolated decisions also collectively affect the resources and arrangements, but this does not necessarily mean all these decisions should be subjected to political norms such as democratic accountability. As for example, one could think of a large corporation that operates in a small economy and forms a significant part of that economy's activities. If that corporation uses its planning power to deprive the state from the revenues it would be legally entitled to, or if it uses the intra-firm planning to conceal significant risks, there are more reasons to consider these actions political. The exact borderline between markets, planning and political planning clearly requires further research.

Another point of interest is how easily corporations can often circumvent national tax laws. While there are many countries where companies can also violate environmental or work legislation with relative ease, it is difficult to think of an area where breaking the spirit of law would be as common and widespread as in corporate tax matters. To express this in other terms, states are often incapable to effectively implement the corporate tax laws that are supposed to condition the "resources and arrangements" of corporate affairs. Meanwhile, there are occasions where corporations can use the commercialized sovereignty (Palan 2003) of tax havens to circumvent tax laws in other countries. Even more importantly, corporations can circumvent national tax laws or other regulation by cross-subsidizing their subsidiaries in low-tax and high secrecy jurisdictions.

6. From arm's length principle to unitary taxation?

Today, the efficiency of arm's length principle is debated perhaps more than ever before in both academia and policy circles. In this article, we have argued that the principle has failed in its outspoken goal of establishing artificial markets within large companies. The principle, however, has also other, much less discussed ideological role that helps legitimize international corporate tax governance. Consequently, we have called for scholarly attention to concepts of price administration, economic planning and cross-subsidization. Relying on Unger's wider definition of politics as "struggle over the resources and arrangements that set the basic terms of our practical and passionate relations", we also defend the view that the planning element constitutes a political dimension in the corporate affairs.

The first step for recognizing the double role of arm's length principle is in realizing that the idea of using market-based comparables in intra-firm transactions has never been a success and that the de facto rules of intra-firm trade have allowed using other mechanisms than comparable pricing at least since the 1960s. From the 1990s onwards, the applications of arm's length principle have moved even further from the market ideal as elements of formulary apportionment have been introduced in the international transfer pricing guidelines. While the use of comparable prices is still the first choice in transfer pricing guidelines, it has for long been overshadowed by other pricing mechanisms such as cost plus method and resale price method. For this reason, there are grounds to assess critically the role of the arm's length principle.

We acknowledge the work that many scholars have done to analyze these nuances (e.g. Avi-Yonah 1995; Durst and Culbertson 2003). However, the arm's length principle is often referred to in ways that rely on the idea that it is, at least in theory, possible to identify market based prices. Sankhanath Bandyopadhyay, for one, asks in his article (2012: 111) what should the preferably suitable price be, and answers that "as per the Transfer Pricing laws followed by various countries, it should be a fair one, that is, a price that would be charged between the parent and subsidiary companies, as if they are 'unrelated companies'." This fairness is often not achieved, he continues, since "companies often manipulate the transfer price to escape taxes". Essentially, this formulation can create an image that it is generally possible to determine comparable prices but that they are currently subject to manipulation.

Similarly, in an econometric article on distortions of transfer prices, Christian Keuschnigg and Michael P. Devereux (2010) state that "tax authorities typically apply the arm's length principle in corporate taxation and use comparable market prices to 'correctly' assess the value of intra-company trade and royalty income of multinationals". As a third example, in their recent article in the *Third World Quarterly*, Rhys Jenkins and Peter Newell (2013: 390) recommend that companies should "commit to using arm's length pricing in all transactions with related parties as recommended by the OECD Guidelines on Multinational Enterprises". They then note that it is not "always easy to establish arm's length prices for all transactions", but point out that there are regularly updated principles laid out in the OECD Guidelines that guide this process.

As a final example, Davies *et al*. (2014) have pointed to the great variance in tax payment of large companies that "may be due to several types of efforts within the firm, including transfer pricing". They then continue that "from the perspective of tax authorities, internal transactions between related parties should be valued at the market price: this is the arm's length principle". We are not claiming that Davies *et al.* or other aforementioned authors have necessarily misunderstood the breadth of methods allowed by arm's length principle or the normative implications of the term. Rather, we call for more careful attention on the double role of the arm's length principle and its implications for market assumptions.

Focusing on the ambiguities in current transfer pricing regulations, including various pricing methods offered by arm's length rules, helps demystify the principles of intra-firm trade and open up discussions on more democratic and efficient alternatives. In particular, we believe that recognizing the role of artificial formulas and estimations in currently existing intra-firm pricing is useful for discussing unitary taxation. Under unitary taxation, corporations would first be taxed on their global income regardless of the jurisdiction where it has been earned, be it Germany, Ghana or Cayman Islands. The global income would then be divided, by a method called formulary apportionment, between the jurisdictions where the company has genuine operations. This is not a new idea, as the US corporate taxation is based on formulary apportionment between states. The arm's length principle and formulary apportionment are not mutually excluding systems but more like two ends of a continuum (Avi-Yonah 1995). The key issue is, therefore, to tackle the ideological assumption that it is possible to create markets within

firms. As soon as we abandon this presumption, it will become easier to conduct meaningful analytical debates on what kind of formulas should we use for dividing the part of the added value created by corporations that belongs to the states.

Real unitary taxation would essentially transfer much of corporate planning from private hands to an issue of global governance by adopting an internationally agreed formula to divide the tax incomes from transnational corporations to states where they operate. This could be interpreted as global economic planning by states over corporations, as each state would get a share of corporate tax revenues based on a formula derived from the company's accounts. The discussions around unitary taxation have evolved fast in recent years. In September 2013, the G20 group stated in its St. Petersburg summit declaration that "profits should be taxed where economic activities deriving the profits are performed and where value is created." (G20 2013, 12) While this was not an outright endorsement for unitary taxation, it gave more weight to these demands.

The more possibilities corporations have to shape the "resources and arrangements" of the places where they operate, the more vulnerable they may also become to demands to bring their operations under more public scrutiny and accountability. Unitary taxation would shrink corporate planning and expand the sphere of public planning. The policy responses depend on how well the planning power of corporations is understood.. This underlines the normative power that the double role of the arm's length principle carries.

Depending on the formula and its application, unitary taxation could significantly diminish corporate nonmarket planning. The planning power of states would increase accordingly, but only as a result of international negotiations. The discrepancies of power between states would most likely affect the outcome of the formula, favoring some states over others. By reaching an agreement on the formula, states would delegate some of their planning power on corporate taxation to the international bodies. Effectivelly, formulary apportionment would make majority of the artificial intra-firm transfers useless.

On the other hand, partial solutions to problems at hand may lead to ideological biases not unlike the double role of arm's length principle. This has already been evident with the significant expansion of Advance Pricing Agreement (APA) programs in various countries. APAs are essentially tools that companies use to negotiate transfer prices before applying them. Essentially, companies give up some of their planning power in exchange of reducing possible tax litigation risks. Moreover, as the LuxLeaks scandal of late 2014[12] demonstrated, the APAs can also be used for aggressive tax planning and in order to avoid taxes in other countries. Multilateral negotiations for genuine unitary taxation would clearly be more preferable solution.

A crucial question is whether these themes will retain the high public interest they have enjoyed in recent years. Should the public interest wade, the political momentum will most likely also suffer. With this article, we hope to have contributed to opening new possibilities to link the often-technical debates on intra-firm trade with more fundamental political questions. Focusing on the mismatch between the market assumptions of the arm's length principle and the reality of nonmarket planning in intra-firm trade can be one way to contribute to public attention and political pressure.

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[12] The LuxLeaks scandal centered around a massive leak of Advance Pricing Agreements from Luxemburg, drafted by the Big 4 auditing firm and published by the members of the International Consortium for Investigative Journalists ICIJ.

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