Journal of Forensic and Investigative Accounting
Volume 14: Issue 3, Special Issue 2022

The Ethics of Transfer Pricing: Insights From the Fraud Triangle

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1. Introduction

The price of a transaction between commonly controlled entities (related parties) is called a *transfer price* and the process by which controlled entities set prices or returns for their intrafirm transactions is called *transfer pricing*. Transfer pricing, once a relatively obscure area in the academic literature (e.g., Hirshleifer, 1956, 1957; Horst, 1971; Rugman and Eden, 1985), has now become front-page news due to the multi-million dollar tax disputes involving related-party transactions within multinational enterprises (MNEs).[1] Transfer pricing court cases have been especially prevalent in the United States, involving such well-known firms as Altera, Coca-Cola, Eaton Corporation, Caterpillar, and Medtronic.[2] See Crumbley et al. (2019) for a discussion of the Caterpillar dispute.

While both multi-unit domestic businesses and MNEs set prices for intrafirm transactions, transfer pricing has become so controversial primarily because it can be used to arbitrage differences in government regulations and shift profits, which we refer to as transfer price manipulation (TPM), across national borders. Due to its cross-border effects on business profits and taxes, TPM has become an important accounting and financial reporting issue (McKinley and Owsley, 2013), with a key issue being whether TPM is (i) legal or illegal and (ii) ethical or unethical (cf., Ahrens, Bothner, Hakelberg, and Rixen, 2021).

Governments are specifically concerned about situations where TPM moves "over the line" from legal regulatory arbitrage into aggressive transfer pricing that is unethical and/or illegal, which we define as abusive transfer pricing. Abusive TPM has been identified as a major source of tax base erosion and profit shifting (BEPS) by the OECD (2013) and UNCTAD (2015). Abusive transfer pricing is now being studied using forensic accounting and data analysis (Curtis, 2016; Curtis and Chamberlain, 2021; Curtis and Lahav, 2020) and governments now conduct transfer pricing risk assessments (IRS, 2016, 2022; OECD, 2017). Curtis and Lahav (2020, p. 311), for example, estimate that the U.S. Treasury may have lost nearly two trillion dollars in tax revenues over 1993-2015 due to abusive TPM.

In this article, we explore the ethics of transfer pricing, addressing the following research question: Given that TPM generates both benefits and risks for MNEs, under what circumstances are MNEs more or less likely to engage in abusive transfer pricing? We begin by outlining the benefits and risks to the MNE of engaging in TPM. We then explore the ethics and legality of TPM. While TPM seldom rises to the level of tax fraud, we argue that the fraud triangle (Cressy, 1953) provides a useful framework for understanding how and why TPM can move from legal regulatory arbitrage to abusive (unethical and/or illegal) transfer pricing. We conclude that MNEs are more likely to engage in abusive transfer pricing when opportunities and motivation are high, and TPM can be rationalized as legitimate and beneficial for shareholders. Lastly, we provide some policy recommendations for detecting and deterring abusive transfer pricing.

2. The Benefits and Risks of Transfer Pricing

Transfer pricing policies inside MNEs are typically developed by a small group of highly trained international tax professionals in the Tax or Finance departments at MNE headquarters. The MNE's internal transfer pricing staff work with

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[1] Beeton (2021) provides summaries of two dozen opinions on transfer pricing disputes filed by tax courts during 2020 in a dozen different countries and the European Union.
[2] U.S. court opinions include Altera (2018, 2019), Coca-Cola (2017, 2020), Eaton Corp (2017, 2019), and Medtronic (2018). According to the website http://www.tpcases.com, there were 64 court opinions in U.S. transfer pricing cases between 1943 and 2021, with 44% of the decisions in the most recent decade (16 in 1990–1999; 11 in 2000–2009 and 28 in 2010–2019).

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outside consultants drawn from accounting and consulting firms (e.g., EY, KPMG, Grant Thornton) to develop transfer pricing policies, file transfer pricing documentation, and handle disputes with national tax authorities. The field is highly technical and specialized.

Transfer pricing and tax professionals see TPM as a 'normal and appropriate' aspect of business operations that is both legal and ethical (Hand, 1934, 1947; Friedman, 1970). Because TPM can raise MNE after-tax profits on a worldwide basis, transfer pricing is a valued activity that creates shareholder wealth for the MNE. Transfer pricing is also a widely used tool by which firms can manage internal operations and evaluate managerial performance. Moreover, MNEs and tax professionals see transfer pricing as a highly regulated compliance exercise, one fraught with regulatory risks due to the many governments that now regulate transfer pricing and the wide variations and rapidity of changes in their transfer pricing regulations (EY, 2021a). For example, in some countries including the United States, MNEs face additional tax penalties if the tax authority finds that transfer prices were not arm's length (Eden, Juárez Valdez, and Li, 2005).

To discourage TPM, most governments have adopted the arm's length standard (ALS) as part of their international tax rules. The ALS requires that the results of transactions between controlled enterprises should be based on the results that would have occurred between uncontrolled enterprises for the same or similar transactions under the same or similar facts and circumstances (Picciotto, 1992; Eden, 1998, 2019b; Eden, Dacin, and Wan, 2001). As of 2021, 131 countries now include the ALS in their tax laws and regulations (EY, 2021). Both the OECD and United Nations publish guidelines that, although they do not have the force of law, may be used by governments and MNEs to interpret and implement the ALS (see OECD (2022) and UN (2021)). Many U.S. states now also regulate transfer pricing and the number of state tax court cases related to TPM is increasing (Schwerdt, Sanschagrin, and Lunka, 2022a,b).

Non-governmental organizations (NGOs) also are interested in transfer pricing (e.g., Tax Justice Network, 2007; Christian Aid, 2009). More than 20 years ago, the World Council of Churches (2000) was concerned that "developing countries annually lose millions, perhaps billions, of dollars because of transfer pricing". Christian Aid (2009) published reports arguing that transfer pricing is "tax dodging", "cooking the books", "secret deals", "scams", that "rob the poor to keep the rich tax-free" and strip income from developing countries.

Academics also have studied transfer pricing for many years, primarily by analysing how MNEs set transfer prices in response to exogenous factors. Differences in tax rates have received the most scholarly attention, but tariffs, export controls and foreign exchange controls are also external motivations for TPM.[3] The academic literature argues that the goal of TPM is not to minimize taxes but rather to maximize global after-tax profits because the gain from arbitraging tax differentials must be traded off against the efficiency costs created by misallocating resources within the MNE (Eden, 1985) and the risks of tax penalties (Eden, 1998, 308–313; 460–469).

Given that TPM generates both benefits and risks, why and when are MNEs likely to engage in abusive (i.e., unethical and/or illegal) transfer pricing? To answer this question, we must clarify the ethicality and legality of transfer pricing, to which we now turn.

3. The Ethics of Transfer Pricing

The literature on the ethics of transfer pricing is sparse, with most pieces focused on the basics of transfer pricing (Dembinski, 2006; Bateman, 2007; Jeffers, Burgess, and Hughes, 2008). An early and useful article is Hanson, Crosser and Laufer (1992), which examines transfer pricing using two ethical lenses: tax ethics and moral ethics. We explore and expand on Hanson et al.'s two ethical views below, arguing that, while the tax laws define right and wrong, they do not necessarily equate with ethics.

The tax ethics view builds on Friedman's (1970) argument that the social responsibility of business is to use its resources and engage in activities designed to increase profits if the firm stays within "the rules of the game" as set by governments. MNEs must comply with tax laws but are not obliged to go beyond that. If the transfer prices are legal (i.e., they comply with the ALS) and disclosed to the tax authorities, MNEs are not obligated to do more. MNEs are behaving

[3] The wide variation across countries, ranging from no transfer pricing rules in many tax havens to extensive rules in many OECD member countries, provide significant regulatory arbitrage opportunities that encourage profit shifting through TPM. See, for example, Bartelsman and Beetsma (2003), Clausing (2003, 2009, 2016), Eden and Rodriguez (2004), Li and Balachandran (1996), Fisman and Wei (2004), Goetzl (2005, Grubert and Mutti (1991), Jansky and Palansky (2019), Swenson (2001), Tomohara (2004), Vincent (2004), and the articles included in Eden (2019c).

ethically and in accordance with the social responsibility of business if they maximize shareholder returns (i.e., use TPM to maximize worldwide after-tax profits) if transfer pricing stays within the rules of the game.

In the moral ethics view, ethics requires more than technical compliance with the rules of the game. This view argues that even if tax avoidance is legal and meets the test of the tax ethics view, MNE executives must be concerned with the broader implications for societal well-being, including the impacts of their transfer pricing policies.[4] Socially responsible MNEs should pay their 'fair share' of tax, especially in developing countries (see, for example, Valor, 2012; Richter, 2010; and Windsor, 2018). Global tax fairness is seen as a moral imperative needed for social justice and economic development (Pogge and Mehta, 2016) and MNEs that engage in TPM are therefore seen as socially irresponsible.

The moral ethics view sees transfer pricing as morally wrong because it harms society (Mehafdi, 2000; Christian Aid, 2009; Sikka and Willmott, 2010). Mehafdi (2000) provides detailed lists of the physical, economic, and psychological harm to the MNE itself and to the host country that can be caused by transfer pricing. The potential negative impacts identified by Mehafdi (2000, 371), in addition to the loss of income tax and custom duties, include: depletion of natural resources, environmental damage, health hazards, increased national debt and poverty, psychological feelings of betrayal and loss of trust in MNEs, and economic colonialism. He argues that transfer pricing can "abuse the trust and hospitality of the host country", "rob the local workforce", "reinforce politics of greed" and "tarnish the TNC's image" (p. 374).

Other examples of the moral ethics view can be found in Bird, Smucker, and Velasquez (2009), who condemn MNEs that use abusive transfer pricing to evade the firms' ethical responsibility of paying the correct amount of taxes. The 'dark side' of transfer pricing is further explored in Sikka and Willmott (2010), where transfer pricing is viewed as a vehicle employed by corporations to avoid taxes and facilitate capital flight. The authors focus on the politics of transfer pricing and provides multiple examples of the ways that transfer pricing can facilitate tax avoidance and transfer wealth transfers. The authors conclude that transfer pricing is "not just an accounting technique, but also a method or resource allocation and avoidance of taxes that affects distribution of income, wealth, risks and quality of life" (Sikka and Willmott, 2010, 352).

A few scholars have compared the tax ethics and moral ethics views. For example, McGee (2010) reviews the literature on the ethics of transfer pricing and compares the arguments made by Mehafdi (2000) and Hanson et al. (1992), finding merit in both. McGee argues, however, that a country's resources are better spent by the private sector than the public sector so that, on efficiency grounds, the tax ethics view has a stronger justification. He concludes that MNEs have no moral duty to pay governments more than is legally owed.

Both the tax and moral ethics views are widely held views, with MNEs and tax professionals favoring the tax ethics view (i.e., legal TPM is ethical) and NGOs, the general public and many governments, particularly in developing countries that host foreign MNEs, favoring the moral ethics view (i.e., even legal TPM can be unethical). Thus, the ethicality of TPM depends partly on its legality, to which we now turn.

4. The Legality of Transfer Pricing

To explore the legality of transfer pricing, we examine TPM as a form of tax planning within the global tax advisory industry. We differentiate among four concepts: tax planning, tax avoidance, tax evasion, and tax fraud. We then create parallel definitions for the legality of transfer pricing. We argue that translating tax planning terms into transfer pricing planning terms is both appropriate and useful because transfer pricing services are normally included within tax services. For example, one estimates show that, on a global basis, the transfer pricing services industry represents about one-quarter of the global tax advisory market.[5]

4.1. The Legality of Different Forms of Tax Planning

"Tax planning involves conceiving of and implementing various strategies in order to minimize the amount of taxes paid for a given period" (U.S. Legal, 2022). Tax planning involves the shifting of income from high to low tax, either by converting income from one type to another, shifting income over time, or shifting income from one jurisdiction to another

[4] An analogy can be drawn with environmental regulations; that is, if an MNE operates in a country with no laws against pollution, it would be unethical for the firm to emit dangerous levels of pollution, even if there were no law against doing so.
[5] An analysis of the global tax advisory market by Source Global Research, reported that, in 2018, the transfer pricing services market was the "fastest growing area of tax advice", worth $9.2 billion or 26.7% of the $34.4. billion global tax advisory market (reported in Cohn, 2020). The report also noted that the Big Four accounting firms performed 67% of global tax work.

(Shevlin, 2020, p. 9).[6] Tax law differentiates among tax avoidance, tax evasion and tax fraud, although the specific definitions vary somewhat across countries (UN, 2011).

Tax avoidance is tax planning that stays within the constraints of tax law where the firm takes advantage of existing legal opportunities to reduce its taxes (Prebble and Prebble, 2010, 112). Judge Learned Hand made this point very clearly, "Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." (Hand, 1934, 809) He later reaffirmed this position (Hand, 1947, 850–851). Similar statements have been made by governments in other countries (United Nations, 2011). For example, the UK House of Lords in *Inland Revenue Commissioner v. Westminster* (1936) affirmed that a taxpayer can legally arrange one's affairs to minimize the tax payable regardless of motive, in what is now referred to as the 'Duke of Westminster principle.'

Tax fraud involves "intentional deception, lying, deceitful pretenses, cunning, willing misrepresentation of material fact, and deliberate trickery intended to gain an unfair and dishonest advantage ... fraud occurs when a victim incurs damages by relying on the false representation supplied by the fraud perpetrator who possesses the intention to deceive the victim" (Chui, 2010, 8). Deliberately providing false or incomplete information or not informing tax authorities about tax-relevant facts, if these actions reduce the taxes paid, is tax fraud.[7]

Tax evasion consists of "willful and conscious non-compliance with the laws of a taxing jurisdiction …where a taxpayer tries to escape legal obligations by fraudulent or other illegal means" (UN, 2011, par. 71). Prebble and Preeble, (2010, 112) provide a similar definition: tax evasion is "willful violation or circumvention of applicable tax laws in order to minimize tax liability", which "generally involves either deliberate under-reporting or non-reporting of receptions, or false claims to deductions." From a legal standpoint, "tax evasion is a type of fraud" (Lederman, 2019, 1). In the United States, the IRS separates tax evasion into two categories: the willful attempt to evade or defeat the (i) assessment or the (ii) payment of a tax (IRS, 2009: p.2). To establish tax evasion, the government must prove that there was an affirmative, willful act to evade a tax assessment or payment of a tax that was assessed, and that the additional tax is rightfully still owed. To win a case that charges a taxpayer with tax evasion and/or fraud therefore depends on the government's ability to prove deliberate intent.

The boundary between tax avoidance and tax evasion is apparently straightforward: tax evasion is illegally reducing tax whereas tax avoidance legally follows the law to minimize tax (McBarnet, 1991). Tax avoidance falls on the "safe side" of the law; tax evasion falls on the "wrong side" (Prebble and Prebble, 2010, 122). However, distinguishing the boundary may difficult if what the MNE sees as tax avoidance, the tax authority sees as tax evasion (McBarnet, 1991, 1992). In other words, perception—and the perceiver—both matters.[8] McBarnet (1992, 64–65) argues that the difference between avoidance and evasion is that "it's not what you do but the way you do it". Both tax avoidance and tax evasion are motivated by the desire to escape tax. Both have the same effects, that is, lower taxes paid and less money to the government. The key difference, McBarnet argues, is the means used. Tax evasion abuses (breaks or ignores) the law; tax avoidance uses the law (its rules, loopholes, or gray areas) to avoid tax. By using rather than abusing the law, the MNE can avoid risk of tax penalties or damaged reputation.

4.2. The Legality of Transfer Pricing

The legal concepts of tax planning can be translated into similar legal concepts for transfer pricing. We start with transfer price manipulation (TPM). From a tax perspective, TPM is designed to arbitrage differences in tax rates between countries, take advantage of lower or zero tax rates in tax havens, and profit from tax preferences such as tax holidays.

The key decision points that determine the legality of TPM, drawing insights from the tax planning literature, are therefore two issues: (i) whether the TPM is legal (the MNE uses the law) or illegal (the MNE abuses the law); and (ii) if the latter, whether the illegal behavior was accompanied by willful and conscious non-compliance with the law. The answers

[6] Surveys of the tax planning literature can be found in Wilde and Wilson (2018), Cooper and Nguyen (2020), Shevlin (2020) and Schwab (2022).

[7] A partial list of criminal activities that violate U.S. tax law is provided at https://www.irs.gov/compliance/criminal-investigation/types-of-fraudulent-activities-general-fraud.

[8] For example, thin capitalization rules were created when tax authorities determined that MNEs were manipulating their debt/equity ratios to reduce their overall tax burden, taking advantage of the arbitrage opportunity that interest costs are tax deductible, but equity costs are not (Brean, 1985).

to these two questions shape our view of the legality and ethics of TPM.

First, assume that the MNE's transfer pricing policy is designed to reduce taxes but does satisfy the ALS in the MNE's respective tax jurisdictions, as outlined in OECD (2022a), UN (2021) and national regulations (e.g., Section 482 of the U.S. Internal Revenue Code). In this situation, TPM is like legal tax avoidance; the MNE is using the international tax and transfer pricing regulations (i.e., the rules, including loopholes and gray areas) to maximize its global after-tax profits.

Assume, on the other hand, that the TPM is designed to abuse the rules by willfully and consciously evading the assessment or payment of taxes on its related party transactions in one or more tax jurisdictions. TPM 'moves over the line' from legal and ethical TPM into abusive transfer pricing (abusive TPM). Abusive transfer pricing includes both illegal (and therefore unethical) pricing and pricing that is legal but unethical. Abusive TPM is therefore akin to tax evasion. Some examples may be helpful.

As a first example, assume the MNE wants to shift profits from its manufacturing affiliate to its related party distributor through under invoicing. Suppose the manufacturer makes 10% of its total sales to outside parties at an artificially low price, with the deliberate intent that the tax authority accepts those sales as comparables for the related party transaction. The MNE's losses on the outside sales would be more than offset by the gains from reduced taxes on sales to its related party distributor. In this situation, the transfer price is both unethical and illegal.

Second, assume the MNE's transfer price is legal (i.e., meets the ALS) in one jurisdiction but illegal in the other jurisdiction. If both governments follow the tax ethics view, transfer pricing is legal and ethical in the first jurisdiction but illegal and unethical in the second; as a result, the second government views transfer pricing as abusive while the first does not.

A third example is a situation where both governments agree that transfer pricing meets the ALS (i.e., is legal) but consumers or NGOs perceive the profit shifting generated by transfer pricing as unethical on moral ethics grounds and therefore, from their perspective, abusive. This area may be one of the biggest risk problems facing MNEs, i.e., public and NGO concerns over the social (ir)responsibility of business, which are often exacerbated by the public's and NGOs' lack of knowledge of accounting, in general, and transfer pricing, in (Gilbert, 2020; Brass et al., 2018; Swanson, 2015).

5. Linking the Ethics and Legality of Transfer Pricing

The tax planning literature provides clear definitions for tax avoidance, evasion, and fraud, which we have used to create parallel definitions in the transfer pricing sphere. The clarity of the definitions, however, masks the difficulties of implementing these definitions in practice where often the legality of tax planning is confounded with the ethicality of tax planning. We argue that the same confounding of legality and ethics also affects transfer pricing.

5.1. The Ethics and Legality of Tax Planning

First, consider tax avoidance. If tax avoidance is legal, is it also ethical? One can view the forms of tax planning as arranged along a horizontal line where acceptable tax avoidance is at one end (legal) and tax evasion is at the other (illegal). Somewhere along the line, legal behavior becomes illegal, and ethical behavior becomes unethical. The 'bright line' test is to distinguish the boundary when tax planning moves from legal to illegal, and from ethical to unethical. The boundary, however, is not necessarily the same in tax law and ethics (Freedman, 2008). Prebble and Prebble (2010,127) note that, "While it is true by definition that tax avoidance is legal and evasion is illegal, it is a logical confusion to draw moral conclusions from legal facts."

Some scholars see all forms of tax avoidance as unethical; others differentiate between acceptable and unacceptable tax avoidance. Self (2008,151), for example, distinguishes the boundary between acceptable and unacceptable tax avoidance based on whether the activity is related to a business transaction and carried out in a commercial manner.[9] Avi-Yonah (2009) examines corporate philosophy and finds strategic tax-minimizing behavior as problematic. Prebble and Prebble (2010) conclude that both tax avoidance and tax evasion are immoral, regardless of their different legality. There is also literature linking tax avoidance with corporate social responsibility, which argues that firms engaging in both activities are involved

[9] Whether the activity takes place within a country or between countries also may matter. For example, acceptable tax avoidance might involve a firm moving from one state to another within a country (e.g., from California to Texas) to reduce its taxes. Corporate inversions between countries, however, are less likely to be acceptable and often draw negative consequences such exit taxes and reputation loss (Godar, O'Connor, and Taylor, 2005).

in organized hypocrisy that can lead to consumer backlash (see for example, Sikka, 2010). Other scholars argue that the tax avoidance is merely doing business in a way that is legal and minimizes taxes—paying what one owes and nothing more. For example, Okoye and Akenbor (2010, 42) argue that "management should always consider the accounting policies that are prudent to avoid recognition of income that will attract high tax cost." [10]

Despite the almost universal acknowledgement of Judge Learned Hand's statements and the Duke of Westminster principle, tax avoidance has had a somewhat mixed history in tax court cases. Likhovski's (2004) study of U.S. tax court decisions concludes that culture and politics have played key roles in judicial decisions about the legality of tax avoidance. Prebble and Prebble (2010, 113) note that tax avoidance is not well-defined, especially in countries such as the United States where there is no statutory definition. As a result, the courts often look to economic substance, and use concepts such as artificiality, undue complexity and circularity or lack of business reality to define tax avoidance (p. 119). Arnold (2001) goes so far as to argue that the Westminster principle is inappropriate and inconsistent with the general anti-avoidance rules now built into many national tax systems.

5.2. The Ethics and Legality of Transfer Pricing

Now consider transfer price manipulation. If TPM is legal, is it also ethical? Starting with the tax ethics view, if TPM is legal it is also ethical. Regardless of how aggressive, any amount of TPM—if it complies with the ALS—is legal and ethical. If the MNE 'steps over the line' and engages in abusive TPM, however, the tax ethics view clearly views TPM as excessively aggressive and unethical.

In practice, though, significant differences exist across countries in how governments define legal versus illegal TPM, and their rules are implemented, even when all governments are committed to the ALS. Transfer pricing tax disputes with multiple tax authorities are not uncommon for global MNEs and the costs of tax disputes and penalties are high. Thus, the line between legal and illegal TPM likely varies from country to country, when viewed from an MNE's global perspective.

Under the moral ethics view, even legal TPM is likely to be viewed as unethical since mere compliance with legal norms is not necessarily ethical. TPM—whether aggressive or not—imposes costs on society and should be discouraged. Ethical behavior requires more than simple compliance with the rules of the game. MNEs and tax professionals must also be concerned with the broader implications of TPM for societal well-being. MNEs should therefore, from a moral ethics view, also determine whether their TPM meet the 'do no societal harm' criterion; meeting the ALS alone is insufficient.[11]

6. The Fraud Triangle

We now turn to the antecedents of abusive transfer pricing, using the fraud triangle (Cressey, 1953) as a theoretical lens to better understand what motivates MNEs to engage in abusive TPM. We argue that the fraud triangle can provide useful insights, both in terms of the antecedents of abusive TPM and of policies to discourage such activities**.**

6.1. The Fraud Triangle at the Individual Level

The fraud triangle (Cressey, 1953) was developed to explain fraudulent behavior by individuals, e.g., white collar crimes (theft, embezzlement). Cressy argued that three conditions need to be present when fraud occurs: opportunity, pressure/incentive, and rationalization. First, the individual must have the opportunity to commit fraud, for example, where controls are missing or weak. Second, the individual must have a motivation, a financial need, pressure, or incentive to commit fraud. Third, the individual must rationalize the fraudulent act, either ex ante or ex post, as consistent with their personal code of ethics. Fraudulent acts are more common when opportunities and pressures are high, and individuals are more predisposed to rationalize their actions. The fraud triangle has been applied and tested multiple times, receiving broad

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[10] An analogy could be made in the case of a citizen choosing between renting or buying a home by taking out a mortgage loan. If mortgage interest can be deducted on her tax return, buying a home could reduce her tax liability. The tax avoidance benefit of buying a house with a mortgage is neither illegal nor unethical but merely taking advantage of a tax preference that encourages people to own homes. Similarly, corporations can reduce their taxes by taking advantage of tax incentives created by governments for social engineering purposes.

[11] What if neither government has transfer pricing rules to regulate the MNE's intrafirm transactions? MNEs in this situation would be likely to engage in the maximum possible regulatory arbitrage. While this situation would be legal (since there are no rules), it is hard to see this situation as ethical under either the tax or moral ethics perspectives.

but not unanimous support.[12] Homer (2019, 172), for example, in a review of 33 fraud triangle studies, concluding that, "Of the 33 studies included, 32 found support for at least one element of the fraud triangle and 27 found support for all three elements."

Cressy (1953)'s insights have been extended in several directions. First, while the general premise of the fraud triangle holds, fraudulent behavior can be explained either as a sum—or a multiplication—of the three elements (opportunity, motivation, and rationalization) where absence of any one element makes fraud much less likely. Second, researchers now view the three elements of the fraud triangle as potentially overlapping. Motivation can arise from rationalization, and opportunity affects rationalization. Blanthorne and Kaplan (2008), for example, apply the fraud triangle to individuals' incentives to underreport their taxable income, finding that opportunity affects rationalization; individuals with high opportunity to underreport are more likely to rationalize their actions and therefore engage in tax evasion. Third, a simple extension to the fraud triangle is to separate the motivation element into two sub-elements, incentive and pressure (that is, carrots and sticks). Fourth, opportunity may be a necessary condition for fraudulent behavior since without opportunity, fraud cannot occur. The literature views opportunity as being caused by weak or missing internal or organizational controls, generated by activities such as lack of monitoring, poor tone at the top, ability of management to override controls, negligence, and absence of anti-fraud programs (Schuchter and Levi, 2013). The weaker are existing controls, the greater the opportunity for fraud.

While the fraud triangle has been incorporated throughout fraud-related literature, the triangle also has been heavily debated and criticized (cf., Morales et al., 2013). Some researchers believe it necessary to augment the triangle with complementary theoretical models (cf., Ramamoorti, 2008 and Dorminey et al., 2010.) or incorporate extra dimensions, such as the fraud square (Cieslewicz, 2012), fraud diamond (Wolfe and Hermanson, 2004), and fraud cube (Doost, 1990). For example, in their extension, Wolfe and Hermanson (2004) argue that the fraud triangle should be redefined as a fraud diamond, where the fourth element is capability. The authors view capability as "having the necessary traits and abilities to be the right person to pull it off" (p. 39); that is, to recognize the opportunity and to turn it into reality.

In summary, the fraud triangle is not universally accepted; it may be useful for some types of fraud (e.g., a lone embezzler) but deficient at encapsulating all fraud types. Some researchers view the fraud triangle is a kind of "fraud" itself because it does not explain all parameters or types of fraud (cf., Crumbley and Ariail, 2020; Huber, 2017; and Lokana, 2015) and thus "presents an overly parsimonious explanation" (Free and Murphy, 2015, 47).

6.2. The Fraud Triangle at the Corporate Level

While Cressey developed the fraud triangle to explain illegal behavior of individuals, the concept has also been applied at the firm level to analyze issues such as corruption and financial fraud. Aguilera and Vadera (2007), for example, use the fraud triangle to study corruption in organizations. They find that opportunity arises when organizations can engage in illegal or unethical behavior without detection or punishment. Motivation pressures can be individualistic (self-interest), collectivistic (for the good of the corporation) or relational (for the good of the group). Rationalization for illegal or unethical behavior can spring from many sources including denial of illegality or harm (no victims or injury) and socialization (everyone else is doing it).

The fraud triangle has been empirically tested at the firm level by McKendall and Wagner (1997) who argue that internal and external factors create both opportunity and motivation for firms to engage in illegal activities to achieving corporate objectives. Whether motive and opportunity lead to action depends on choice, which is shaped by the presence or absence of effective internal and/or external controls to prevent or punish illegality. Their model of motive, opportunity and choice receives strong empirical support in a study of serious violations of U.S. environmental regulations by 80 firms over 1983–87.

Hogan, Rezaee, Riley, and Velury (2008) provide a useful literature review on the fraud triangle and financial fraud at the organization level. Opportunity, when applied to firms, comes from positions of power within organizations where individuals have greater control over decision-making and lower accountability to others for those decisions. Research indicates that organizational structure that allows individuals to dominate decision making; for example, senior managers have greater opportunities to engage in fraud (see, for example, Beasley et al., 2000, 2000; Abbott et al., 2000; Dunn, 2004;

[12] See the literature reviews in Dorminey, Fleming, Kranacher, and Riley, Jr. (2012), Trompeter, Carpenter, Desai, Jones and Riley, Jr. (2013), and Schuchter and Levi (2013).

Skousen, Smith, and Wright, 2009).

Motivation typically arises from poor firm performance or failure or where firms are in debt, need funds, and are worried about negative analyst forecasts (Hogan et al., 2008). Success also, interestingly, can be a pressure for fraud. Mishina et al. (2010) find that high performing firms are more likely to engage in illegal activities due to loss aversion and hubris. Desai and Dharmapala (2006) find that incentive compensation for managers is also an important determinant; higher incentive compensation discourages rent diversion by managers and encourages aggressive use of tax shelters.

Since rationalization also matters, an unethical 'tone at the top,' where senior management promote the view that making money at all costs is acceptable, can generate fraudulent behavior within the organization (Hogan et al., 2008). While the negative consequences of unethical behavior are well documented, its occurrence persists as human beings are often short-term focused and make irrational decisions that jeopardize personal and organizational reputation, even where their acts can lead to both civil and criminal penalties (see Blazovich and Smith, 2011; Smith et al., 2010; and Murphy and Dacin, 2011).

Cressey's three-fold characterization of fraud has been used to explain financial statement fraud (see, for example, Wells, 1997; Montgomery, Beasley, Menelaides and Palmrose, 2002; Coenen, 2007; Skousen et al., 2009; Trompeter, Carpenter, Desai, Jones, and Riley, 2013; Crumbley and Fenton, 2021), which occurs when a firm deliberately issues materially misleading financial statements that injure investors and creditors (Elliott and Willingham, 1980, 4). Schrand and Zechman (2012) find that executive overconfidence can trigger an unintentional financial misstatement, but that attempts to fix the problem can lead to intentional misreporting (earnings management). The authors also find that unintentional, overly optimistic mistakes can be a slippery slope, which led to corporate fraud in one-quarter of the cases in their sample of 49 firms subject to SEC Accounting and Auditing Enforcement Releases since 1990.

Post-structuralist perspectives, especially regarding expansion of social theory to accounting issues, also have examined financial statements fraud through the lens of the fraud triangle. For example, Macintosh et al. (2009) give for consideration a financial statement preparer who may abide by accounting rules, but who has little interest in objectivity and correspondence to reality. Macintosh (1995) studies the manipulation of profit (earnings management) phenomenon in which corporate executives of large MNEs make self-beneficial choices of accounting methods in addition to activities that affect reported profits. His study considers research that examines the problem from an "ethics perspective" and concludes that such efforts are only quasi-ethics based; rather, they examine "socially-acceptable" behavior.

Tax fraud in organizations also has been analyzed using the fraud triangle (e.g., Braithwaite, 2005). An elegant analytical model that includes the fraud triangle is developed in Ulph (2008), where firms choose to purchase tax schemes based on their costs, risks, and benefits. Opportunity is measured by the arbitrage opportunities within the tax structure and the cost of acquiring and implementing tax schemes. Motivation depends on the net gains, which depend on the size of the firm's tax base. Rationalization depends on the firm's reputational concerns and perception of risks. Ulph argues that firms will purchase varying degrees of risky tax schemes depending on their tax base and reputational concerns, and that even firms with high reputational concerns will purchase risky tax schemes if the returns are sufficiently large. For government regulation to reduce tax fraud, Ulph (2008) concludes that regulators must better understand how regulatory changes will affect the costs, benefits, and risks.

6.3. Fraud Action, Detection, and Deterrence

Another way in which the fraud triangle has been extended is to decompose the fraud outcome; this work is referred to as the triangle of fraud action or the fraud action triangle (Dorminey, et al., 2012; Trompeter et al., 2013). The fraud triangle is viewed as pre-fraud and provides a measure of the risk or likelihood of fraud. Fraud itself is ex post and can be decomposed into three components, the act and two post-fraud activities, concealment, and conversion.

The triangle of fraud action provides auditors and researchers with a framework for gathering evidence that fraud occurred. Concealment refers to efforts to conceal the act of fraud through, for example, creating false journal entries or destroying files. Conversion refers to the process of converting the fraud act into benefits (e.g., bonuses, laundered money). All three components can be documented—the act, the concealment, and the conversion. Evidence on concealment is particularly useful because the cover-up points help to differentiate unintentional from intentional actions. Fraud can therefore be viewed in an ex-ante sense (the fraud triangle) and from ex post perspective (the fraud action triangle).

The fraud triangle implies that the incidence of fraud can be reduced through reducing its three elements:

opportunity, motivation, and rationalization (Dorminey et al., 2012; Schuchter and Levi, 2013). In Trompeter et al. (2013), the link between ex-ante fraud risk and ex-post fraud is moderated by anti-fraud policies that can reduce fraud risk and therefore the likelihood of fraudulent activity. The recommended responses are deterrence (ex-ante) and detection (ex post).

Fraud deterrence, in the accounting literature, has traditionally focused on reducing ex-ante opportunities for fraud (Dorminey et al., 2012). To reduce opportunity, setting up an effective internal control structure is perhaps the most important way to reduce actual opportunities for fraud since lack of or weakness in internal and external monitoring increases the likelihood of fraud (Loebbecke, Eining, and Willinham, 1989; Nestor, 2004). On the other hand, internal controls "grow stale" and can be circumvented (Dorminey et al., 2012, 572). To reduce this likelihood, the literature suggests that firms should design work environments that create ethical sensitivity and an ethical corporate culture, including a corporate code of ethics that provide accountability for decisions. McBarnet (2006, 1105) argues that firms should adopt company-wide Codes of Ethics and Compliance, where "evidence of code implementation and a culture of integrity" are required.

Fraud detection, on the other hand, focuses on ex-post collecting evidence—typically through an audit plan—that fraud occurred. A good policy example is AU Section 316. AU 316 defines fraud as an intentional act that results in a material misstatement in a firm's financial statements. The fraud must be intentional; misstatements that are not intentional are not fraud. AU 316 breaks fraud into two types, misstatements arising from (i) fraudulent financial reporting such as deliberate falsification of accounting records such that they do not comply with Generally Accepted Accounting Principles (GAAP), and (ii) misappropriation of assets by methods such as theft or the creation of false documents.

Auditing Standards AU Section 316 argues that the three fraud triangle conditions are usually present when fraud occurs: motivation (reason to commit fraud), opportunity (absence of controls to prevent or detect fraud) and attitude (ability to rationalize fraud). AU Section 316 includes a detailed appendix identifying risk factors associated with greater likelihood of an organization's committing fraud. Hogan et al. (2008, 246) review the literature linking fraud auditing standards to audit practice and conclude that "the focus areas of SAS 99 (now incorporated into AU 316) (incentives, opportunity, and rationalization) are grounded in empirical evidence." Empirical work by Skousen et al. (2009), using proxies for the fraud triangle components, also provides support for the risk framework used in AU 316.

A second approach to detection is targeted risk assessment whereby fraud risk is evaluated in terms of probability and size. Certain industries or firms may have more opportunities to commit fraud, or may offer greater potential rewards from fraud acts, than other firms or industries. Some individuals or firms may be repeat offenders or predators, with a history of fraudulent acts, suggesting a need for closer monitoring (Dorminey et al., 2012).

7. Abusive Transfer Pricing: Insights From the Fraud Triangle

Given the extensive literature that has applied the fraud triangle to organizations with respect to a variety of corporate behaviors (e.g., corruption, tax evasion, financial fraud), we argue that the fraud triangle is also an appropriate lens for studying how and why MNEs engage in abusive TPM. Below we examine each component of the fraud triangle as an explanation for why MNEs may 'step over the line', moving from legal and ethical (from a tax ethics view) TPM to abusive transfer pricing. We also explore how governments can reduce MNE incentives to engage in abusive TPM.

7.1. Opportunity and Abusive Transfer Pricing

Opportunity in the fraud triangle comes from positions of power and the absence of controls or monitoring that would deter fraudulent behaviors. The opportunities provided by TPM to engage in profit shifting and base erosion across countries have been a major concern of national tax authorities for many decades, one that prompted the development of the ALS (Picciotto, 1992) and led to the OECD's BEPS project (OECD, 2013). Our view, however, is that the opportunities to engage in abusive TPM have significantly fallen over the past 10–15 years.

At the start of the 21st century, government regulations were viewed as largely ineffective at preventing abusive TPM. Governments had difficulty monitoring or controlling TPM because of the absence of global rules, problems in coordinating and harmonizing national regulations, and reluctance to share information between governments. In addition, tax competition among governments to attract inward foreign direct investment (e.g., tax havens) encouraged MNEs to engage in unethical behaviors, for example, where local conventions tolerate morally questionable practices such as abusive transfer pricing (Bird, 2009). MNEs were able to play a 'cat and mouse' game with national governments, taking advantages of weaknesses in the global regulatory framework. Transfer pricing enforcement was particularly weak in developing countries (Eden, 2012). As a result, MNEs had multiple opportunities to engage in abusive TPM, the rewards were large, and the likelihood of getting caught and punished was low.

Tang (2002, 42), for example, in his 1997–98 survey of 86 MNEs, found that maximizing after-tax profits was listed by 42% of respondents as their most important transfer-pricing objective; second was determining the performance of domestic and foreign divisions at 24% followed by tax minimization at 11%. Tang concluded that government regulations and corporate profits were the "two overriding considerations" (2002, 155).

The tax consulting services industry also encouraged MNEs to engage in TPM by providing the tax knowledge and capabilities (Wolfe and Hermanson, 2004; Dellaportas, 2013) to recognize and exploit tax arbitrage opportunities and help MNEs develop their global tax planning strategies. These tax capabilities enabled MNEs to see tax opportunities that other firms did not (scanning) and to create tax opportunities that others could not (entrepreneurship).[13]

Developing capabilities in tax planning, however, also generated accusations by NGOs and the general public that MNEs were 'crossing the line' from legal and ethical tax planning to unethical and/or illegal tax strategies (Sikka and Willmott, 2010; Unger, Rossel, and Ferwerda, 2021; Killian, O'Regan, Lynch, and Laheen (2021). As TPM grew more aggressive, more governments introduced transfer pricing regulations and the number of transfer pricing disputes, penalties and court cases all began to rise around the world.

For example, the U.S. Internal Revenue Service made significant revisions to its transfer pricing regulations (Treas. Reg. §1.482-1 to §1.482-9) to deter aggressive transfer pricing:[14]

- New regulations for cost sharing arrangements (CSAs) were proposed in 2005 and effective in 2011 (Treas. Reg. §1.482-7). The regulations were designed to deter U.S. parent firms from using CSAs to transfer valuable intellectual property that had been developed in the United States, to offshore affiliates. The new regulations also required that stock-based compensation be included in CSA contribution costs.
- New regulations for intragroup services were proposed in 2006 and adopted in 2009 (Treas. Reg. §1.482-9). The regulations include a direct benefit test and clarify that services that provide only indirect or remote benefits, or are duplicative or shareholder services, do not typically warrant a service charge. A new transfer pricing method was added for low-margin services.
- Treas. Reg. §1.367(d)), proposed in 2015 and adopted in 2016, expanded the scope of intangible property to include soft intangibles such as workforce in place, goodwill, and going concern value.[15]
- The 2017 Tax Cuts and Jobs Act (TCJA) added a third sentence to IRC Section 482 to allow the IRS to aggregate transactions when valuing transfers of intangible property and included that language in Treas. Reg. §1.367(d)).

By 2010, an EY survey of 877 MNEs across 25 countries reported that transfer pricing was the most important tax issue for MNE executives because of its potential for conflict with national governments (EY, 2011, 7). Two-thirds of respondents had been audited by national tax authorities in 2010 (up from 52% in 2006), and 20% of audit adjustments included tax penalties (EY, 2011, 3). The EY (2011, 9) report concluded that, "The heightened scrutiny of transfer pricing, the widening range of jurisdictions with documentation requirements and the increased level of transfer pricing disclosure all increase a taxpayer's transfer pricing risk." MNE executives saw transfer pricing as an area fraught with risks, where aggressive national governments (particularly new entrants from emerging economies) were "targeting intercompany transactions in an attempt to protect and increase their tax bases" (EY, 2011, 6).

Another survey by Alverez and Marsal Tax (2011) found that more than 80% of 300 plus CFOs (chief financial officers) reported a marked increase in tax audits and rising costs of tax compliance. Transfer pricing was now their greatest

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[13] For example, in 2001, Ernst & Young argued that transfer pricing should be treated as a strategic decision for MNEs, noting that firms "can realize significant financial and efficient benefits by integrating tax and operations at every step of the [value] chain" which included "the ability to enhance shareholder value by preemptively driving out unnecessary tax costs within the boundaries of the arm's-length principle, via a close alignment of tax and business structures" (EY, 2001, 8).That is, aggressive TPM should be used to minimize taxes, up to legal boundaries.

[14] For detailed analyses of the historical and current U.S. transfer pricing regulations, see Byrnes (2023).

[15] For a recent U.S. court case involving the valuation of offshore transfer of intangible assets under Treas. Reg. §1.367(d)), see *TBL Licensing LLC v. Commissioner* (2022); https://www.jdsupra.com/legalnews/the-tax-court-in-brief-tbl-licensing-1539574/.

risk, according to 30% of MNE respondents with more than $1 billion sales revenues, just behind global compliance at 32%. Transfer pricing topped the list of "most challenging tax areas" for CFOs in all three regions, Asia, Europe, and the Americas.

The trend to greater regulation of transfer pricing has continued. For example, in 2009, the United Nations Tax Committee created a Transfer Pricing Subcommittee, tasked with developing a practical manual on transfer pricing for developing countries. The first manual, released in 2013 and now in its third edition (UN, 2021), was the springboard that led many developing countries tax authorities to adopt their own transfer pricing regulations.

New regulatory initiatives also were launched by the OECD, most importantly, the Base Erosion and Profit Shifting (BEPS) project (OECD, 2013, 2015). The BEPS Action Items (2015; Remeur, 2016) were designed specifically to reduce loopholes in the international tax system, increase tax transparency and reporting, and ensure that MNE profits reported for tax purposes were aligned with where value was created. National adoption of key BEPS Action Items, such as country-by-country reporting and the BEPS Multilateral Instrument, have reduced profit shifting and aggressive TPM, according to the 2021 assessment of the first round of BEPS reform results (OECD, 2021).

Olsen (2023) provides a long list of various types of transfer pricing risks now facing MNE executives, arguing that "the sky is no longer the limit when it comes to transfer pricing risks". He argues that the risks are now cumulative due to potential double taxation, penalties, and late interest fees, and that transfer pricing has the potential to become the most complex area of international taxation.

EY (2021a) provides a catalogue of the ways that changing tax laws and regulations are disrupting transfer pricing. More than three-quarters of the survey respondents report that the "sheer volume, pace and complexity of global tax reforms" is significantly raising their transfer pricing costs; two-thirds of the respondents expect more transfer pricing audits (EY, 2021a, 5). The report shows increasing numbers of countries with transfer pricing regulations; for example, the EY transfer pricing guide covered 60 countries ten years ago (EY, 2012) and now covers 131 countries (EY, 2021b). The more tax authorities, the greater the potential for MNEs to be caught in the middle. These regulatory changes are reflected in the 2020 Global MNC Tax Complexity Survey where 650 tax consultants in 110 countries report that transfer pricing is the most complex of 15 tax issues (Harst, Schanz, Siegel, and Sureth-Sloan, 2021).

Financial reporting requirements are already placing new burdens on MNEs, and on the accounting, legal, economic, and consulting firms that provide them with financial advice. Over half of respondents and 66% of U.S. respondents in EY (2008) reported that new financial reporting requirements had increased their costs of transfer pricing compliance; 87% of parent respondents believed that transfer pricing was a financial statement risk for their firm, with 21% seeing it as the largest risk issue (EY 2008, 22–23). The more complex the transfer pricing issues, the greater the perceived financial risk.

The breadth and depth of regulatory changes over the past 20 years have significantly reduced the opportunities for abusive transfer pricing. Could more be done? Some possibilities are suggested by the appendix in AU 316, which identifies risk factors for fraud. The appendix lists several 'opportunity' factors that are closely related to transfer pricing, and the linkages to TPM could be made more explicit. In terms of opportunity, MNEs should strive to establish transfer pricing practices such that individuals within the MNE—and their outside advisors—have accountability and as little opportunity as possible to engage in abusive transfer pricing. Eden (2019a) also provides a list of additional regulatory changes to further reduce income shifting opportunities including adopting common definitions of corporate residency and stronger controlled foreign corporation (CFC) rules for taxing passive income.

7.2. Motivation and Abusive Transfer Pricing

Why and when do MNEs shift from TPM to abusive TPM? Motivation, the second component of the fraud triangle, provides a second explanation. We argue that the motivation (pressures and incentives) are like those for tax and financial statements fraud: the additional global after-tax profits and managerial bonuses that come from abusive TPM and higher analysts' forecasts and stock market valuations, coupled with low risk of being punished.

Reducing the motivation for abusive TPM may best be accomplished through national and international accounting standards. Governments can build on the changes in accounting standards that are already bringing transfer pricing under the U.S. Securities and Exchange Commission (SEC) umbrella through the 2002 Sarbanes-Oxley Act. Sarbanes-Oxley requires that firms certify they have established internal controls to ensure accurate financial reporting, and that the firms' external auditors attest they have assessed these controls.

Section 302 of Sarbanes-Oxley requires that the principal executive and financial officers review the financial reports and attest that they present fairly all material information, including the valuation of intrafirm transfers. This requirement means that the chief executive officers of all MNEs must now state that their firm's transfer pricing policies accurately reflect all material information that could affect the firm's financial statements. Section 404 requires the MNE to include in its annual report filings a report on these internal controls over financial reporting, together with an independent auditor's assessment of the firm's internal controls. The implication is probably greater central control of transfer pricing, and a closer synchronization between an MNE's finance and tax departments.

Since January 2007, all firms using U.S. GAAP rules, including non-U.S. firms registered with the SEC, must comply with Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48). FIN 48 mandates a framework for the recognition, measurement, and disclosure in U.S. GAAP financial statements of the impact of uncertain tax positions taken or to be taken in a company's tax returns. FIN 48 requires firms to determine whether a tax position they have taken will be more or less likely to be sustained upon examination by a tax authority, including foreign tax authorities if the company files tax returns outside the U.S. Tax positions must be identified, documented, subject to a recognition test and measured. Timing issues (e.g., with respect to depreciation of assets) also must be considered. The required documentation and analyses under FIN 48 also are subject to the internal control standards required by the Sarbanes-Oxley Act. FIN 48 has likely increased firms' tax burdens (Tomohara, Lee, and Lee, 2012) since these initiatives force the executives of MNEs and their advisors and auditors to pay more attention to fraudulent activities inside the corporation.

7.3. Rationalization and Abusive Transfer Pricing

A third antecedent of abusive TPM is rationalization. MNE managers may be tempted to rationalize abusive TPM on the grounds that shareholders benefit from TPM and 'everyone is doing it' (Braithwaite and Braithwaite, 2006). In the tax ethics view, the social responsibility of business is to maximize the long-run returns to shareholders while staying within the rules of the game (i.e., inside the legal limits of the law), without deception or fraud. From a tax ethics view, morality is equated with legality, that is, if the tax-minimizing activity is legal, it is also moral. Corporations are under no moral obligation to pay a 'fair share' of taxes but only to pay the legal required amount (Datt, 2010, 35).

In terms of transfer pricing, the tax ethics view argues that if TPM stays within the boundaries set by national tax regulations implementing the ALS, the MNE is behaving ethically. The MNE should maximize global after-tax returns for its stockholders, within the legal limits of the law, without deception or fraud. "However, 'within the law' now becomes more complicated since related-party transactions likely involve multiple tax authorities and differences among national laws provide profitable opportunities for MNE arbitrage. Since MNE executives have historically supported their TPM activities using the tax ethics view that TPM benefits shareholders and everyone is doing it (Braithwaite and Braithwaite, 2006), changing the 'conversation' is likely to be much more difficult than changing policies.

One way to change the conversation could be to encourage MNE executives to see their roles in society through the lens of stakeholder theory. In stakeholder theory, the firm has responsibilities to all its stakeholders; that is, to any group that can affect or is affected by the achievement of the MNE's goals (Freeman, 1984), or more generally, any persons or groups with legitimate interests in procedural and/or substantive aspects of the firm's activities (Donaldson and Preston, 1995). Stakeholder theory assumes that values are a necessary part of conducting business, and managers disclose their values, preferences, and biases by engaging in corporate social activities (Evan and Freeman, 1988). Therefore, the moral responsibility of business includes being socially responsible (Freeman, Wicks, and Parmar, 2004).

Some scholars attempt to link the shareholder and stakeholder views of the firm by arguing that Friedman (1970) has been interpreted too narrowly, and that a broader reading of Friedman implies that a firm can both maximize profits and be ethical in the market process (Wagner-Tsukamoto, 2005, 2007; Cosans, 2008). In the business ethics literature (see for example Schweiker, 1993; Macintosh, 1995; Braithwaite, 2005; Macintosh et al., 2009; Windsor, 2018) a corporation is an entity, just like an individual, with ethical obligations. Windsor (2018, 165), for example, argues that corporate tax responsibility is one component of MNEs being socially responsible and MNEs should therefore refrain from aggressive tax avoidance.

Other scholars argue that corporate law does not restrict or require firms to maximize shareholder returns. Johnson (2011, 13), for example, notes that "no state has enacted any legislation imposing on business managers a duty to maximize investor wealth or business profits", and corporations are permitted to make "donations for the public welfare or for charitable, scientific, or educational purposes" (p. 17). Blair and Stout (2007,7) agree, noting that "Corporate law does not define the purpose of the corporation beyond restricting it to 'lawful' activities". Corporations can choose to pay greater amounts of taxation or engage in corporate philanthropy if so, doing raises the wealth-creating potential for the firm's stakeholders, even if its shareholders suffer lower financial returns in the short run.

Changing the conversation also could be helped if there were more two-way dialogue between MNEs and NGOs on the legality and ethics of transfer pricing. Many cases of abusive transfer pricing involve TPM that is legal in one jurisdiction but seen as illegal and/or unethical, either by another tax authority or by the general public or NGOs. The gap between the tax ethics and the moral ethics views suggests that changing the rationalization antecedent for abusive TPM could be enhanced not only by focusing on MNE behaviors but also by providing NGOs and the general public with a better understanding of transfer pricing. Transfer pricing is a highly complex activity run by professionals who have typically spend decades learning their craft. However, little of this knowledge is shared outside of the tax profession, which encourages a 'dialogue of the deaf' and the moral ethics view that all transfer pricing is unethical.

Another way to discourage firms' rationalization of abusive TPM is changing the 'tone at the top.' Executives responsible for setting the MNE's transfer pricing and tax policies should adhere to the highest standards of ethics, which should be communicated from the top down. Ethical leadership has positive impacts on a firm's ethical climate (Shin, 2012).

Providing MNE executives and their consultants with a "checklist for multinationals" that outlines a detailed strategy for transfer pricing compliance, for example, could prove to be highly useful at reducing transfer pricing risks. Such a checklist is offered by Byrnes and Salis (2023); ten of their recommended strategies are summarized below:

1. Clarify the MNE's transfer pricing goals.
2. Assign functions, ownership of intangibles, and allocate risks according to those goals.
3. Enter into clear written contracts among the related parties.
4. Construct business, functional, and transaction profiles for the related parties.
5. Use the relevant intermediate markets to identify potential comparable transactions between independent parties that could provide a basis for arm's length transfer prices.
6. Group the MNE's products, markets, and functions into economically meaningful business segments.
7. Choose a transfer pricing method that complies with local regulations and takes account of foreign acceptability of the method.
8. Set up internal procedures for complying with the transfer pricing method.
9. Make an independent judgment on what is arm's length.
10. If the MNE does not have an advance pricing agreement (APA) with the tax authority, consider negotiating one, and make sure that it has clear procedures for cases where the transfer pricing results might fall outside of the APA.

Including ethical training with respect to TPM as part of the tax planning community's professional recertification activities also would help strengthen the rationalization corner of the abusive TPM triangle. Such training could focus on comparing tax and moral ethics, determining the 'bright line' where a TPM action becomes unethical. The ethics of transfer pricing also could be included in business school classes, particularly in accounting and MBA courses.

A third deeper change would be to change the underlying norms and rules of the game. A hypernorm is a "principle seen as so fundamental to human existence that they should guide evaluating lower-level moral norms" (Donaldson and Dunfee, 1994, 265). Examples of hypernorms include universal injunctions against murder as well as business hypernorms informing employees of health hazards in their workplace (Spicer, Dunfee, and Bailey, 2004). Could governments encourage the development of a transfer pricing hypernorm whereby abusive transfer pricing would be seen as socially irresponsible?

We suggest some ways that might lead to the development of a transfer pricing hypernorm. First, the UN Global Compact offers a set of hypernorms for firms in areas of human rights, labor standards, environment protection and corruption (UNGC, 2007).[16] Of the Global Compact hypernorms, the one most closely related to TPM is the anti-corruption norm, which focuses on corrupt governments and firms' efforts to avoid paying bribes. One possible action could be for the UN Tax Committee to propose broadening the Global Compact anti-corruption norm to include corrupt behaviors of firms

[16] https://www.unglobalcompact.org/what-is-gc/mission/principles.

in the form of tax evasion and abusive TPM.[17]

A second route to creating a global hypernorm could be to extend the work being done by the Financial Action Task Force (FATF), an intergovernmental body set up to protect the international financial system against money laundering and other forms of illegal financing. The most useful FATF policies from a transfer pricing perspective are its work (2006, 2020, 2021) on trade-based money laundering, which is "the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origin or finance their activities" (FATF, 2020, 11). FATF (2020) recommends that governments identify and assess their risks and implement preventative measures to deter trade-based money laundering, and FATF (2021) provides a list of these risk indicators. Also relevant is work by the Wolfsberg Group (2019) building on FATF (2006) to develop a series of principles to guide the banks involved in providing trade finance. The Wolfsberg Principles outline seven types of mispricing that can facilitate money laundering, over/under-invoicing, multiple invoicing, short shipping, over shipping, deliberate obfuscation of the type of goods and phantom shipping. While the purpose of these norms is only to deter money laundering activities through trade mispricing, one could imagine something like the FATF and Wolfram Principles being used to create a set of more general hypernorms to deter abusive TPM.

A third route would be for an international organization to create an accreditation process whereby MNEs sign a set of commitments to "fair transfer pricing" like the Women's Empowerment Principles created by the UN Global Compact and UN Women (https://www.weps.org/about). A possible example could be to extend the new 2021 Global Multinational Business Standard established by Fair Tax Mark (https://fairtaxmark.net/) to also cover transfer pricing. Another option proposed in Olsen (2023), would be for MNEs should adopt a new form of ISO 9001 certification, which would apply to taxation and transfer pricing, to mitigate transfer pricing risks.

8. Conclusions

Transfer pricing is one of the "most socially important aspects of accounting practice" (Arnold, 2009, 804) and a legitimate means by which firms can manage internal operations and evaluate managerial performance. The purpose of this article was to develop a framework for understanding the ethics of transfer pricing through the lens of the fraud triangle.

Our article contributes to the literature on business ethics in taxation and accounting by examining the ethics of TPM. We extend the literature on tax fraud in organizations in two ways: first, by focusing on MNEs rather than organizations in general, and second, by examining transfer pricing, which is an important tax avoidance technique. We also extend the literature on the fraud triangle and organizations, which has focused on corruption, financial fraud, and tax fraud, both to examine the antecedents of abusive transfer pricing and to make policy recommendations tied to each of the fraud triangle's three components.

We argue that the opportunities and motivation for abusive TPM have fallen over the past few years as the number of governments adopting and enforcing the arm's length standard has grown. We expect this trend to continue as the 2015 BEPS Action Items are implemented by more countries and multilateral coordination among tax authorities continues to expand. Additional improvements could come from changing national and international accounting standards along the lines of FIN 48. We argue that rationalization is the most difficult component of the fraud triangle. Rationalization requires extending the conversation on the social responsibility of MNEs to include transfer pricing. We also discuss methods by which an international hypernorm could deter abusive TPM.

A useful extension to our article would be to survey different communities (i.e., transfer pricing professionals, tax authorities, NGOs) on their 'bright lines' between legal/illegal and ethical/unethical TPM. Another extension would be a detailed assessment of how the OECD's BEPS project (OECD, 2015) is affecting opportunity, motivation, and rationalization for abusive TPM at the country and international levels. A third extension would be to consider how the digital economy is likely to affect incentives to engage in abusive transfer pricing. We hope that other scholars will be encouraged to study this important and promising area of research.

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[17] Principle 10 could be rewritten, for example, as "Businesses should work against corruption in all of its forms, including extortion, bribery, tax evasion and abusive transfer pricing."

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