UNITARY TAXATION: A FIT FOR PURPOSE INTERNATIONAL TAX ARCHITECTURE FOR TRANSNATIONAL CORPORATIONS

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ABSTRACT

The Pandora Papers were a timely revelation of years of persistent, nefarious actions of some Transnational Corporations (TNCs). The outcome of this leak, coupled with dissatisfaction towards the "Arm's Length Principle"(ALP) and the impetus from scholars' efforts in the field of international taxation and tax justice activists, legitimise the current discourse around unitary taxation. There is no doubt that the current international taxation framework reeks of 20th century relics. Upon this premise, Prof Sol Picciotto doubled down on a unitary taxation approach for TNCs. Central to his work is the need to rethink the traditionally structured Corporate Income Taxes (CIT), which did not respond to the proliferation of TNCs. Notably, his role and contribution in this field are nearing success and are similarly being validated through the "Unified Approach " being enshrined in Pillar One of the Organisation of Economic Cooperation and Development's (OECD) Two-Pillar solution. With the inadequacies of the current tax regime being exploited by devious TNCs through: the creation of holding companies in tax havens under aggressive tax planning schemes, debt shifting and manipulation of transfer pricing (TP), we appreciate the departure from the ALP towards a system that taxes genuine economic activity, despite its political implications and general difficulty in implementation. With developing countries gravely affected by the ALP approach, which treats transnational corporations as separate entities, it goes without saying that the unitary approach presents real benefits for developing countries. This paper seeks to rely on Africa's extractive sector and the specific Kenyan experience relating to transfer pricing amongst TNCs as a case study to demonstrate need for a unitary taxation regime.

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1. INTRODUCTION

The Pandora Papers leak cracked down on years of nefarious actions not only by wealthy individuals but also by some Transnational Corporations(TNCs) (Guardian Investigations Team, 2021). The leak was a timely exposure of various avenues exploited in engaging in aggressive tax avoidance. Specifically, TNCs, utilising hybrid entities, financial instruments, and derivatives were highlighted as avenues exploited to avoid tax (International Consortium of Investigative Journalists, 2021). For years, TNCs have exploited qualification mismatches between different jurisdictions to achieve tax advantages (OECD, 2023). By using extremely complex financial structures and instruments under the guise of tax planning, TNCs can allocate income and expenses to minimise their tax liability (Henn M, 2013, pg.1). The most commonly utilised method is the establishment of hybrid entities that are treated differently for tax purposes in different jurisdictions, allowing them to take advantage of the stark differences in tax treatment and reduce their overall tax burden (International Consortium of Investigative Journalists, 2021).

The widespread reliance on otherwise legitimate tax havens was at the heart of the expose. Through the abuse of preferential tax regimes and low-tax countries, TNCs have managed to save on their tax payments (Fuglsang, 2023, pg.6). This is through the strategic establishment of subsidiaries or affiliate branches in jurisdictions with low or no corporate tax rates in the tax havens (Henn M, Page 5). TNCs have significantly reduced their tax liability through the years by channelling their profits through these entities. This has had detrimental effects on developing countries, as they often have a dearth of resources and capacity to combat tax avoidance by TNCs effectively (Piciotto,2013).

Additionally, TNCs avoid taxation through tax deferrals. Worldwide taxation norms dictate that income tax is imposed from profit attained. Corporations thus circumvent this lacuna and retain their profits abroad. In this way, they can avoid their tax obligations (Beer,2018). Corporations can similarly avoid tax by transferring the patent ownership to countries that tax at a lower rate while conducting research and development in higher-taxing nations (Beer,2018).

Observantly, some TNCs have similarly found ways to exploit the Arm's Length Principle (ALP) to engage in large-scale tax avoidance. This can be seen through various avenues they utilise to manipulate TP and shift profits to low-tax jurisdictions. TNCs notoriously manipulate the pricing of goods, services, and intangible assets transferred between related entities within a TNC (OECD, 2017). This allows for artificial shifting of profits from high-tax jurisdictions to low-tax jurisdictions. By setting ridiculous artificial and inflated prices for goods or services sold between related entities, TNCs can reduce their taxable income in high-tax jurisdictions and increase it in low-tax jurisdictions (Greil, 2019). This allows them to take advantage of the discrepancies in tax rates between countries and minimise their overall tax liability.

When it comes to negotiations that involve profit-shifting by TNCs, developed countries have the upper hand (Mailey,2015). Advanced economies enjoy intrinsically higher bargaining power compared to emerging markets and developing economies. Developing countries are at a predisposed disadvantage when it comes to bilateral tax treaties' negotiations because the tax models in place were made exclusively by and for developed countries. (Tran, 2019) . Due to this, developing countries tend to get the short end of the stick (Kolstad,2013). The ALP entails the separate tax treatment of TNCs. Since different jurisdictions have different taxing systems(Cobham, 2021),TNCs avoid some of their tax obligation by investing in jurisdictions that

either do not tax at all or have low taxation rates. With the ALP allowing for a wider latitude in interpretation, it welcomes negotiations. To this end, the ALP can lead to corruption and arbitrariness, where such negotiations are left to the whims of discretionary judgment. (Picciotto, 2013)

These factors, coupled with years of dissatisfaction towards the otherwise well-meaning ALP in reforming the 20th century international taxation system, led to reflection about TNC taxation. Additionally, owing to years of scholarship, commendably by Prof. Sol Picciotto, this essay evaluates the highly criticised approach towards taxation of TNCs to benefit developing countries that have been prejudiced from reaping optimally from TNCs.

This paper primarily reflects on the input of Prof. Picciotto's work in determining the suitability of the current international taxation regime of TNCs, for developing countries. It highlights alternative approaches deployed in US states which Kenya can borrow a leaf from. Through examining Africa's extractive sector in general , with emphasis on the Kenyan experience , it highlights the shortfalls of the ALP framework and simultaneously legitimises the OECD's Two Pillar proposals. Conclusively, this paper champions the unitary taxation model as best suited for the maximum benefit of developing countries.

2. THE ALP APPROACH AND DEVELOPING COUNTRIES

Since time immemorial, the suitability of the international tax system for developing countries has been a subject of debate (Henn, 2013). At the heart of these conversations is the taxation of TNCs, which have significant implications for the economic development and fiscal stability of these nations owing to their dependence on CIT (Albertin et al., 2021, pg.3). In this critical reflection, we will explore how the international tax system has so far proven to be unfit for developing countries in relation to the taxation of TNCs.

The Carroll Report of 1983 recommended that TNCs should be treated as separate entities from the parent (Piciotto, 2013, p.12). According to Prof. Picciotto's analysis of the Carroll Report, on the matter of profits, it is stated that '*Accounts should be based on what became known as the Arm's Length Principle (ALP): attributing to the entity 'the net business income which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions.*'

One of the main challenges faced by developing countries that use the ALP approach is the issue of tax avoidance and profit-shifting by TNCs. These corporations often exploit loopholes and inconsistencies in the international tax system to minimise their tax liabilities in developing countries. This deprives these nations of much-needed revenue for public services and infrastructural development (Piccioto,2013). Furthermore, the international tax system is characterised by inadequacies in coordination, transparency and cooperation among countries. Developing countries often face difficulties in accessing relevant information about the operations and profits of TNCs, making it challenging to enforce tax regulations effectively (Piccioto, 2013). This information asymmetry puts these nations in a significantly unconscionable position in negotiating fair tax arrangements with TNCs (Piccioto, 2013).

Another aspect highlighting the unfitness of the international tax system for developing countries is the longstanding TP practice. TNCs often manipulate the prices of goods, services, and intellectual property rights within their corporate structures to shift profits to low-tax jurisdictions.

This practice distorts the allocation of taxable income and undermines the ability of developing countries to collect their fair share of taxes (Picciotto, 2013). Moreover, the current system of international tax treaties, which are primarily designed to prevent double taxation, often works against the interests of developing countries. These treaties tend to prioritise the concerns of developed countries and their TNCs, leaving developing nations with limited taxing rights and reduced ability to generate revenue from TNCs operating within their borders (Picciotto, 2013). In light of these challenges, there have been calls to reform the international tax system to serve better developing countries' interests. One proposed solution is the introduction of unitary taxation or formulary apportionment, which aims to allocate the taxable profits of TNCs based on a formula that will be discussed at length in this paper.

3. TRANSFER MISPRICING IN THE EXTRACTIVE SECTOR IN AFRICAN COUNTRIES

There is no doubt that tax revenue has the inherent capacity to alleviate developing countries from poverty and further strengthen the social contracts between governments and their citizens through providing quality services (Albertin et al., 2021, pg. 4).It thus cannot be gainsaid that tax revenue plays a significant role in economic growth but also improving governance(Mawejje,2019). Nonetheless, it has become increasingly important for developing countries to curve out niche industries through which they can generate revenue. With Africa housing 30% of the world's mineral reserves (United Nations Environmental Programme,2017), approximately $6.5 trillion worth of natural resources, there has been a greater focus towards the extractive industry (Albertin et al., 2021, pg. 3).Since many developing countries, especially in Africa are resource-rich, there has been a greater focus towards the extractive industry (Albertin et al., 2021, pg. 3). However, this contingency has been fraught with a myriad of challenges of which illicit financial flow is core. One of the leading components of capital flight from African nations more so those that have faced or are currently facing raging war and conflict, is inextricably linked to the exportation of extractive commodities (Brown,2017). Such countries heavily rely on domestic revenue sourced from avenues such as natural resources and custom revenue. These States lack transparent systems and mechanisms that would ensure government revenue is well utilised and managed thus creating space for capital flight, tax evasion, tax avoidance among other issues. (Edward K. Brown, 2017)

From their inception in the 20th century, TNCs have come under increasing global surveillance linked with their dominant position in the global economy (Picciotto, 2011, pgs. 133-137). However, it goes without saying that the international tax framework with respect to taxing TNCs is crippled with deep-seated limitations (Piccioto, 2021). This is evident in the mining industry in developing countries, which has largely been enabled by direct foreign investment, mainly from TNCs (Narula, 2018). This is attributed to the fact that resource-rich countries face financial constraints, necessitating capital investment support through FDIs (Oshionebo, 2018). With TNCs wielding a considerable measure of power and expertise from tax advisors, some have been notoriously exploiting developing countries through profit-shifting from high to relatively low tax jurisdictions, leading to egregious loss of revenue from Base Erosion and Profit Shifting (BEPS) (Crivelli et al., 2015). Alluding to ATAF, issues relating to transfer pricing represent one of the highest risks to the tax base of African countries. Furthermore, conducting audits of TP issues is marred with complexities and requires a significant amount of resources (Africa Tax Administration Forum, 2022).

African countries are estimated to be losing an estimated value of approximately $450–730 million in CIT revenue a year on average from mining TNCs' tax avoidance (Albertin et al., 2021). In addition to the above, through smuggling, source states are deprived of not only tax revenue but also royalties, which are constitutive of legitimate government revenue (Martin A, 2014). Mali, Senegal, Mauritania, Burkina Faso, Cote D'Ivoire and Guinea are examples of gold-rich countries that have been prejudiced by TNCs in this regard (Grynberg et al., 2019).

Dr. Lyla Latif specifically highlights the sorry state in Mali. Despite being a gold-rich country, it lacks the infrastructural capacity to mine and export gold, thus allowing for licensing of TNCs in gold mining in exchange for taxes that the government invests in financing for development and provision of public goods '(TED-Ed, 2022). However, this has not been the reality. Converse to the expectation, the TNCs have served to "underdevelop" Mali. Dr Latif argues, and rightfully so, that this is the direct outcome of unconscionable agreements resulting from state contracting with TNCs and TP (TED-Ed, 2022). Whereas the license allows multinationals to mine and export gold, the country remains in shambles owing to a variety of factors (Mainguy,2011).

To begin with, exploitative clauses establish a corporate tax exemption regime for these TNCs, thus prescribing for loss of tax revenue (Oshionebo,2018). Additionally, the contracts allow TNCs to sample gold without a set limitation, which has equally been exploited to smuggle gold from the country to the United Arab Emirates (UAE) without being subject to tax under the guise of "samples" (Hunter, 2019, pg.10).Furthermore, revenue is lost when these corporations collude with corrupt government officials and smuggle gold to the UAE (Hunter,2019, pg. 11). Similarly, corporations in Mali exaggerate expenses by engaging in intra-group trading with other subsidiaries thus leading to deductions from overall profits leaving the taxable amount very minimal characteristic to many other TNCs (Picciotto, 1992).

The case of developing countries' extractive industries being run predominantly by TNCs, coupled with other factors, including administrative challenges in the mining industry, demonstrate their vulnerabilities (Albertin et al., 2021). Due to years of longstanding overdependence on CIT, developing countries are observantly greatly prejudiced by TP limitations arising from a separate entity approach entrenched by the ALP (Moore et al.,2018). This is directly linked to TP's shortcomings, whose inadvertent outcome is misaligning profits with economic activity(Kabbala et al.,2018).

Most developing countries find it too expensive to apply checks on TP, which the OECD approach expects of them (Chege, 2013). These processes are often time-consuming and complex, which is unfavourable to developing countries (Grange, 2017). Having strict TP laws can pose challenges to a country whereby TNCs may view business in that particular country as unprofitable. India is a prime example of a nation that instituted strict TP mechanisms that TNCs were required to follow (Picciotto, 2018). In 2001, India enacted specific TP regulations. This led to the rise of many litigation cases to the extent that approximately 3000 TP cases were pending before the Income Tax Appeal tribunal. There was a dire need to overhaul this TP system(Picciotto, 2013).

In addition to the above, complex company structures with anonymous owners threaten the extractive sector (Phoya et al.,2023, pg.29). In the Democratic Republic of Congo for instance, between the 2010-2012 period , there was a record USD 1.36 billion in revenue leakages from mining deals with complex and secretive ownership.

To effectively curb the leakages in the extractive sector in Africa, beneficial ownership requirements should be indivisible to the operations in the mining sector. Beneficial ownership disclosures are critical in improving: public accountability in resource governance, allow for information sharing which is critical for tax administrators and reduces capital flight and corruption associated with the sector (Extractive Industry Transparency Initiative, 2016).

4. THE KENYAN EXPERIENCE: TRAGEDY OF AN ALP CONFORMING JURISDICTION

Kenya is recognized as a foreign investments' hub in Africa and is a country that is keen on fostering and maintaining international trade. It has a number of international tax treaties that assist in propelling international trade such as treaties with Denmark, Zambia, Luxembourg among other countries. (Waris, 2017) TNCs that are in operation in Kenya include Kentucky Fried Chicken (KFC), Cadbury, Toyota and many others. Kenya also houses homegrown TNCs such as Bidco Oil Refineries, Nation Media Group, Britam, East Africa Breweries Limited to mention a few. (The East African, 2020).

It is second habit within Kenya's tax legislation to entrench a provision requiring transactions between non-resident and resident-related parties to be conducted at arm's length (Obuya, 2021). The ALP of taxation is beneficial to TNCs due to the fact that it enables redistribution of tax obligations by trading with the same entity in differing tax jurisdictions. TNCs in these different countries are then taxed in accordance with their tax bases therein. Some TNCs have explored loopholes and exploited gaps arising from the application of the transfer pricing rules to avoid taxes. Prior to the enactment of the TP rules in 2006, TNCs exploited the gaps in the Income Tax Act to avoid taxes through manipulation of TP (Wangui, 2016). In 2013, after the enactment of TP rules, 10 TNCs in Kenya were discovered to have avoided taxes amounting to 8 billion shillings by using the TP mechanism to declare losses, enabling them to avoid the payment of income tax. (Business Daily, 2013). It is prudent to note that, despite there being TP rules in Kenya, TNCs are granted too much latitude in determining their TP further creating room for tax avoidance.

The Kenyan case of Sher Karuturi, a company engaged in selling flowers, is a controversial case that brought to light how TNCs partake in transfer mispricing in an effort to avoid taxes. Between the year 2012 and 2016, the KRA TP team conducted audits as per the revised TP regulations and found Karuturi to be in default of TP rules. The TNC took the negotiation route and managed to lower its taxation bill from 2 billion Kenya Shillings to 500 thousand Kenya Shillings. The full details of this case have been kept away from public scrutiny therefore there is not a lot of information on it. (Waris, 2017) Nevertheless, this serves as a prime example of how TNCs have deprived the Kenyan jurisdiction of much need revenue as a result of TP-linked tax avoidance.

Kenya has embarked on the formulation of laws that seek to seal the loopholes that would otherwise facilitate tax avoidance by TNCs. The Income Tax Act (ITA), Chapter 470 Laws of Kenya, through its different provisions seeks to prevent tax avoidance. *The General Anti Avoidance Rules* further seek to curb tax avoidance by corporations. These Rules grant the Commissioner authority to make necessary adjustments so as to deal with aggressive tax avoidance. Their aim is to prevent lawful tax avoidance which abuse the spirit of the law and go against the intended purpose of statute (Obuya, 2021, p. 6). Section 23 (1) of the ITA grants the Commissioner the power to direct adjustments in taxation that he/she deems necessary once the Commissioner is satisfied that a corporation is involved in tax avoidance. However, these

adjustments should not be arbitrary but must be in line with the law. The case of ***Primarosa Flowers Ltd V Commissioner of Income Tax [2017] eKLR*** held that the imposition of taxes by the Commissioner-General as addressed in Section 23(1) of the ITA can only be done in strict compliance with the law. Section 18(5) of the ITA enunciates that interest expenses, forex losses, royalties and management fees are to form part of the profit gained by TNCs. This prevents TNCs from getting away with tax avoidance through claims that they are paying for interests, royalties or management fees (Obuya, 2021).

Section 85 of the Tax Procedures Act penalises tax avoidance. It is prudent to note that Kenya's taxation system relies on the honesty of the taxpayer as they are the ones expected to file tax returns. The Commissioner only steps in if there is cause. The penalties to be imposed under Kenyan law are there to compel Kenyans and foreigners alike to comply with the taxation laws. The ITA (Transfer Pricing Rules) 2006 sets the rules required to be followed by corporations when setting transfer prices. These rules require corporations to prepare their own TP policy. These policies are then availed to the Commissioner, who performs an audit in order to ascertain that TNCs comply with the ALP (Obuya, 2021). Whereas tax avoidance is under strict scrutiny, the TP rules are silent on the penalties arising for failure to furnish TP documentation and any errors that may arise in valuation. This is a lacuna in the law which can be misused by the TNCs for tax avoidance purposes.

The TP Regulation in Kenya grants TNCs autonomy but simultaneously sets limitations whereby the transfer prices must align with the ALP. The Finance Act, 2022 requires members of a TNC to file CbC reports as well as Master and Local files. The Finance Act contains rules to this effect. Section 18 D of the Finance Act, 2022 stipulates that, '*An ultimate parent entity or a constituent entity of a multinational enterprise group with a gross turnover of ninety-five billion shillings (including extraordinary or investment income) that is resident in Kenya shall file a country-by-country report with the Commissioner of its financial activities in Kenya and for all other jurisdiction where the group has taxable presence*….'.This seeks to ensure accountability and transparency by TNCs in Kenya. This also ensures that tax avoidance can be prevented by guaranteeing strict monitoring of TNCs' affairs.

5. THE "LEGAL FICTION" OF THE ARM'S LENGTH PRINCIPLE

The ALP is a critical concept in international taxation that aims to ensure that transactions between related entities within a transnational corporation are conducted at fair market value. Even so, the taxation of TNCs under the arm's length regime is a complex and multifaceted issue that involves indeterminacy, complexity, and technocracy (Picciotto, 2015). At the heart of this is its foundation which entrenches the ideals of a "separate entity approach" towards international taxation of TNCs (Wilkie, 2012) embedding an isolated approach instead of integrated, holistic measures. This assessment will explore ALP's effectiveness through various attributes: its indeterminacy, complexity, resource constraints in implementation and imposition of burdensome responsibility within the context of international corporate taxation.

Indeterminacy is a fundamental challenge in the taxation of TNCs under the arm's length regime. The ALP aims to ensure that the prices and terms of transactions between related entities within a transnational group are determined as if they were independent entities dealing at arm's length (Picciotto, 2015). However, the interpretation and application of this principle often leads to

ambiguity and uncertainty as evidenced in the issues determined by the Kenyan High Court in ***Unilever Kenya Ltd v Commissioner of Income Tax [2005] eKLR***.

The matter before the court was raised by the Commissioner of Income Tax against Unilever Kenya Limited, part of the TNC, Unilever group of Companies, incorporated in the UK. It involved a related-party transaction between Unilever Kenya Limited and Unilever Uganda Limited where the former was to manufacture on behalf of, and supply to the latter. Evidently, there was a disparity in prices charged by UKL to UUL in relation to the same goods in domestic export sales and local domestic sales. This formed the basis of the contention raised by the Commissioner in assessment regarding the years 1995 and 1996. The commissioner argued their case on the basis of Sec 18(3) which provided that,

"*8(3) where a non-resident person carries on business with a related resident person and the course of that business is so arranged that it produces to the resident person either no profits or less than ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of that resident person shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length*"

In their submission UKL highlighted, and rightfully so that there were no set guidelines at the time on how to comply with the TP requirements. In the absence of such guidelines, they were guided by international best practices in determining the prices. Whereas it was the commissioner's argument that the nature of arrangement was such that it resulted to less taxable profit, the court found that the reliance of any other method, as long as it is lawful is permissible as long as there is no fraudulent trading with a view to evade tax. From the above example, indeterminacy arises from the lack of proper guidelines that elucidate how to determine the ALP and address the difficulty in assessing the economic substance of complex transactions (Brauner, 2008). This indeterminacy opens the door for TNCs to engage in aggressive tax planning and profit shifting, exploiting the gaps and inconsistencies in the rules (Picciotto, 2015). In Kenya, for instance, it was not until Justice Alnashir Visram's dictum in the classical Unilever case that guidelines were put into place with regards to TP. Nevertheless, this has not been fully resolved as the guidelines prescribe several methods in computing TP.

Complexity is another significant challenge in the taxation of TNCs. The international nature of TNCs' operations, involving multiple jurisdictions with different tax laws and regulations, adds layers of complexity to the tax compliance process. The complexity arises from various factors, such as the need to allocate profits among different entities within the group, the treatment of intangible assets, and the use of TP mechanisms (Piccioto,2015). These complexities create opportunities for TNCs to exploit loopholes and mismatches in tax systems, leading to tax avoidance and tax base erosion.

The ALP can be subjectively interpreted by TNCs , enabling them to sell at low prices for exports coming from countries with high taxation rates to low-taxing countries and alternatively charge high prices for imports from low-tax countries(Beer, 2018).

It is impossible to overstate the crucial role of technocracy in the taxation under the arm's length regime. Tax authorities rely heavily on technical proficiency and specialised knowledge to evaluate and apply tax laws. Understanding TP methodology, economic research, and industry-specific aspects deeply is necessary to determine ALPs (Piccioto, 2015). Tax authorities

sometimes struggle to find and keep such talent, particularly in emerging nations with few resources. A power imbalance between TNCs and tax authorities may result from the technical nature of international corporation taxes, as TNCs have greater access to resources and knowledge, allowing them to negotiate the system's intricacies better. Addressing the ambiguity, complexity, and bureaucracy of TNC taxation under the arms' length regime requires a comprehensive and coordinated approach. Efforts should be made to enhance the clarity and consistency of TP guidelines, providing more explicit rules and examples to guide taxpayers and tax authorities. Simplification of tax rules and procedures can also help reduce complexity and enhance compliance.

In some instances, the ALP may result in an administrative burden for the taxpayer and the tax administrations to evaluate significant numbers and types of cross-border transactions (Greil,2019). Although associated enterprises typically establish the conditions for a transaction when it is undertaken, at some point, the enterprises may be required to demonstrate that these are consistent with the ALP. TP approaches can be challenging to apply and can quickly swamp the capacity of tax authorities to assess the related transactions. Both tax administrations and taxpayers often have difficulty obtaining adequate information to apply the ALP (Greil,2019) because the ALP usually requires taxpayers and tax administrations to evaluate uncontrolled transactions and the business activities of independent enterprises and to compare these with the transactions and activities of associated enterprises, it can demand a substantial amount of data. The accessible information may be incomplete and difficult to interpret; other information, if it exists, may be challenging to obtain because of its geographical location or that of the parties from whom it may have to be acquired. In addition, it may not be possible to obtain information from independent enterprises because of confidentiality concerns (Greil,2019).

Whereas States see the need to sign double taxation treaties to create a uniform taxation model for transnational corporations that are likely to be taxed in more than one jurisdiction, it is not without shortcoming(Waris,2021). States view double taxation agreements as beneficial because they can attract foreign investors and are avenues for development. However, in their application, some of these foreign investors participate in what is termed 'treaty shopping' to find treaties that enable them pay as little as possible. TNCs are able to avoid tax while African States end up suffering losses. The ALP creates an avenue for tax avoidance because some jurisdictions have lower taxation rates than others. Corporations can invest in these jurisdictions for the sole purpose of avoiding taxation (Waris,2021).

Nonetheless, double taxation agreements are highly unconscionable favouring the interests of one country over another. For instance, the Kenya-Mauritius agreement was brought before the High Court of Kenya challenging the legality of some provisions which favoured Mauritius and in turn disproportionately affecting revenue collection in Kenya (Obuya, 2021, pg.3).

6. A FOCUS ON PILLAR ONE: THE UNITARY TAXATION MODEL

Pillar One of the international talks and agreements on BEPS intends to redistribute taxing rights and the implementation of new profit allocation regulations (Latif et al., 2022, pg.1). Pillar One aims to allocate a share of TNCs' global revenues based on where their actual economic activity occurs by going beyond the ALP and the conventional "permanent establishment" definition (Latif et al., 2022, Page 1).

Ideally, a unitary taxation model means that governments treat TNCs as a group with local branches. The profits gained by the branches of these TNCs are grouped and apportioned to each country based on the country's economic contribution. This creates a better taxation system whereby taxes are based on actual profit(Piciotto,2012). To effectively apply a unitary taxation model for TNCs , the economic needs and situational circumstances of the different members of the OECD must be taken into account so that the system is fair. Developing countries face more economic hardship than developed countries or rather First World Countries. Therefore, a unitary taxation system will benefit countries where these TNCs operate. Sustainable Development Goal 10 aims at reducing inequalities. A unitary taxation approach towards transnational corporations will help reduce inequalities among States.

Emphatically, the authors of this paper argue for a taxation system focused on assessing the income of TNCs based on where value is created and where their activities occur. Taxation should also be done equitably making, it acceptable by the relevant stakeholders. Taxation methods should also be simple and transparent since complexities in the taxing model create confusion, enabling tax avoidance. (Cobham, 2021). The model is welcomed as it does not require any changes to be made to tax treaties; if taxation rights are allocated fairly among all States, countries can introduce them in their municipal laws. Conclusively, it creates room for international convergence (Cobham, 2021).

A unitary taxation model can be achieved through a gradual shift from ALP. This is not a completely nascent model as it imbues some elements of the arms-length approach and can be built upon to achieve a form of taxation that will benefit countries in the Global South (Picciotto,2012). Prof. Picciotto opines that unitary taxation can be achieved through two ways. First, companies operating their business in more than one country should submit a combined and CbC report to the tax authority in each jurisdiction they are based in(Picciotto,2013). Kenya has embraced this method through Section 18D of the Finance Act, 2022 which requires TNCs to submit CbC reports.

The second method to ensure that unitary taxation is well applied is through proper profit apportionment by TNCs. As mentioned earlier in this paper, profit should be apportioned based on where value is created. Countries can come together to set proper TP mechanisms, which will ensure that TNCs do not get away with mispricing or tax avoidance. The United Nation's Practical Manual on TP for Developing Countries (UN 2021) and the OECD's Draft Handbook on TP Risk Assessment of 2013 are instruments that require TNCs to produce TP data and present it to the tax authorities. Developing countries that are yet to adopt this system can do so. Countries can come up with an agreed template of Transfer Pricing for TNCs. TP should not be too rigid as to discourage transnational corporations from setting up business in a jurisdiction. They should also not be too flexible which can be subject to exploitation by TNCs (Piciotto,2013).

The formulary apportionment method adopted by US, stands as a successful model for addressing the challenges posed by TNCs and their tax practices. This approach allocates profits across jurisdictions based on factors such as capital base, payroll, and sales, recognizing the globalized nature of modern business and the interconnectedness of economic activity (Clausing,2014). By departing from the traditional separate-entity treatment and focusing on economic substance rather than legal structures, unitary taxation offers a pragmatic solution to combat profit shifting and ensure fair tax contributions.

The US experience with unitary taxation provides valuable insights that the international community can look into in their venture to shift from an ALP approach to a unitary taxation system. Over decades of implementation, evidence suggests that unitary taxation has effectively curbed the practice of TNCs reporting their income in low-tax jurisdictions (Kraemer & Van Tulder, 2009). By requiring TNCs to file consolidated tax returns and apportion income based on factors reflecting economic activity, unitary taxation promotes transparency, fairness, and compliance.

However, it's crucial to acknowledge that unitary taxation is not without its challenges. Critics argue that the approach may not fully consider all factors generating income and may not completely resolve the problem of tax avoidance (Kraemer and Van Tulder,2009). Whether TNCs are taxed under separate accounting or formula apportionment, disparities in tax rates and bases across jurisdictions can incentivize tax minimization strategies. For instance, companies may manipulate transfer pricing or adjust the valuation of apportionment factors to reduce their tax burden.

Despite these challenges, the benefits of unitary taxation outweigh the drawbacks. By shifting the focus from legal structures to economic substance, unitary taxation fosters a more equitable distribution of tax revenue, promotes transparency, and enhances compliance. Kenya as well as other jurisdictions can benchmark from best case practices from the US experience and other adopting countries to inform the implementation of unitary taxation principles laying the groundwork for a fairer and more effective approach to taxing TNCs. re

Smooth Transition towards a Unitary Taxation System

To effectively apply a unitary taxation model, tax administrators must be adequately trained on this new model. This will ensure a smooth transition from the previous taxation system: the arms-length approach (Picciotto, 2012). Citizens can also be educated on the different taxation systems because taxes affect them. Public participation is paramount when the government wants to embark on signing double taxation agreements. The Kenya-Mauritius agreement was condemned for its inadequate public participation.

An effective tax legal framework is one that incorporates general rules and specific rules. (Picciotto, 2015).The Income Tax Act and Finance Act 2022 have sought to achieve this. Tax rules should be clear, concise, and precise. These rules should not leave room for different interpretations because this will create room for tax avoidance by TNCs (Picciotto, 2015). Reducing tax avoidance is essential to achieve the sustainable development goals in developing countries. The OECD has established a programme known as 'Tax Inspectors Without Borders', which assists developing countries in monitoring and overseeing how tax treaties are implemented. This helps in curtailing tax avoidance (Waris, 2021).

7. CONCLUSION

Following the above, we have established the threat posed by the ALP approach towards the taxation of TNCs. This is linked to a host of factors, including reduced revenue collection due to profit-shifting and, specific to the extractive industry, loss of royalties, which are an essential part of non-tax government revenue. In the taxation of TNCs in the mining sector, Indonesia sets a stellar precedent in its approach that developing countries in the African region can emulate. Through establishing a strict "local processing" of ores requirement before exportation, this has

solved the perennial challenge of under-developing mineral source states (World Trade Organization, 2022). With nascent mining opportunities arising in the field of rare earth minerals, it is incumbent for developing country states (Achuthan, 2016) to undertake heightened institutional, legal, policy and regulatory processes to crack down on factors leading to underperformance of the extractive sector. One effective measure that this article exhaustively highlights is the introduction of unitary taxation measures that ensure that TNCs are taxed based on actual activity taking place in a specific jurisdiction. It is possible to achieve a unitary system of taxing TNCs which will mitigate the problems that have been in place in the ALP taxation era. This is not only beneficial to the economy and development but also instrumental in the prevention of tax avoidance by TNCs.

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