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**Task Force on the recording of certain activities of  
multinationals in national accounts**

*Final report*

## ***Executive summary***

*The final mandate of this Task Force was approved by the GNI Committee in April 2007. The Task Force started working in June 2007 and consisted of members of national statistical offices, one member of the ECB external statistics and Eurostat staff from national accounts and BoP units. The Member States who took part in the Task Force were: Belgium, Ireland, Portugal, Luxembourg, Italy, Germany, Malta, United Kingdom, Finland, Austria, Sweden, the Netherlands and Cyprus.*

*The Task Force held five meetings between June 2007 and May 2009. Following the mandate, the work of the Task Force concerned three issues, namely: 1) Treatment of entities with little or no physical presence belonging to multinational groups. 2) Recording of some cases of intra-group transactions, irrespective of the kind of entity involved. 3) Areas and forms of possible co-operation in order to ensure a complete and consistent recording of the activities of multinationals, in particular for entities with little or no physical presence.*

*After the presentation of a progress report in July 2008 containing an overview of the case studies considered (GNIC/117), the GNI Committee concluded that for points 1) and 3), the Task Force should give specific recommendations. For point 2), which is related to intra-group transactions, the GNI Committee concluded that the final report of the Task Force would include the preliminary conclusions reached in the progress report to be used as input for further work.*

*The Task Force concluded its final report in June 2009 and agreed on the following 12 recommendations:*

***R1*** *Entities with little or no physical presence are to be classified as institutional units when they are not resident in the same country as the country of their parent. Consolidation within the parent company occurs only within domestic economy, when they do not comply with the general criteria for institutional units.*

***R2*** *The Task Force recommends that some elements of the treatment of SPEs contained in the SNA of 2008 chapters 4 and 26 are clarified for their application in the EU. This concerns in particular:*

- The use of the criterion of registration for identifying institutional unit. VAT registration is not a sufficient condition in the EU for identifying a resident institutional unit.*
- The treatment of truncated groups containing both SPEs and normal units.*
- The notion of "activities not requiring physical presence", in particular of "virtual manufacturing", introduced by the SNA of 2008.*

***R3*** *The Task Force recommends that the production of SPEs is to be allocated to sector and industry according to their principal activity. In determining the production activity*

*of SPEs, the underlying economic nature rather than the legal appearance should be the reference for national accounts.*

**R4** *For valuation of SPEs output, the Task Force recommends that when the SPEs has transactions only with its foreign parent or with other units of the same group a market valuation cannot be identified and output should be valued at cost.*

**R5** *The Task Force recommends that the treatment of SPEs in member states conform to table 1 of this report. The decision tree shown in figure 1 of this report may represent an operational tool for national compilers.*

**R6** *The Task Force recommends fostering cooperation and exchange of information on SPEs among national producers of statistics in the EU in order to tackle risks of omissions, double counting and inconsistent recording of SPEs operations which may lead to asymmetries.*

**R7** *The Task force recommends the separate identification of intra-group imports and exports of goods and services in a systematic fashion.*

**R8** *The Task Force recommends that member state set up a "consistency unit" or a similar organisational structure in their NSI for a consistent recording in national accounts and in balance of payments of items related to multinationals. This may require the involvement of the national central bank and of other national statistical authorities. The MEETS project may represent an opportunity to support such a development in member states.*

**R9** *The Task Force recommends that Eurostat organize exchange of data between national accounts compilers for multinational enterprises and SPEs in particular. The organisational structure of the FDI Network may serve as a reference for such an exercise. Such a type of organisation is considered useful to foster cooperation between national compilers and alleviate the problem of confidential information.*

**R10** *The Task Force recommends that the data on SPEs are included in the European Group Register, clearly flagging such entities in the business register and if production is included in the country of residency, taking into account the classification of SPEs given in the final report of the Task Force. A sub-sector (institutional) classification would need to be created for better harmonisation.*

**R11** *The types of SPEs observed in economic reality may change over time. Member states should provide information to the NAWG and to the BOPWG as soon as they observe new types of SPEs.*

**R12** *The NAWG and the BOPWG should regularly monitor the evolution of initiatives on statistics for multinationals of international bodies such as the OECD and the UN and inform the participants.*

## Introduction

The Task Force on the recording of certain activities of multinationals in national accounts (Task Force MUNA) was set up by Eurostat in 2007 on request of the GNI Committee<sup>1</sup>. The mandate given by the GNI Committee was the following:

- (i) Prepare an overview of the current situation covering the various cases/flows and accounting practices identified as problematic by the Member States; this overview will be part of a progress report which will be submitted to the National Accounts Working Group and to the GNI Committee; the Task Force will also take into account the results and ongoing developments of other related work and studies as far as they are relevant for GNI measures.
- (ii) Propose guidance on possible ways of identifying specific entities and measuring their operations, including entities located in regions or sub-regions within a Member State that have a special tax-exemption jurisdiction;
- (iii) Develop rules for deciding on the inclusion of these entities for national accounts and on the classification of their flows and stocks. Developments on the update of the 1993 SNA, the Fifth IMF Balance of Payments Manual and of the OECD Benchmark definition for FDI will be also taken into consideration;
- (iv) Examine the treatment in national accounts of intra-group imports and exports (including royalties), and of intra-group income transactions. The Task Force will analyse typical cases derived from countries' experience and will propose recommendations for the treatment in national accounts of intra-group transactions. The treatment of transactions between affiliated enterprises described by the IMF Balance of Payments Manual (§§ 97-103) may represent a starting point for the work of the Task Force;
- (v) Examine possible areas and forms of co-operation between the national statistical institutes of the different countries in order to ensure a consistent recording of the activities of the multinationals and the special purpose entities;
- (vi) In its work and proposals, the Task Force must give due consideration and importance to the issue of confidentiality.

The Task Force started its work with a fact-finding exercise (point (i) above). A number of case studies - considered representative and important in the respective countries – were supplied by the participating countries. These case studies were grouped according to the three main issues mentioned in the mandate, namely: 1) Treatment of *entities with little or no physical presence* belonging to multinational groups. 2) Recording of some cases of *intra-group transactions*, irrespective of the kind of entity involved. 3) Areas and forms of possible *co-operation* in order to ensure a complete and consistent recording of the activities of multinationals, in particular for entities with little or no physical presence.

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<sup>1</sup> The Task Force consisted of members of national statistical offices with practical experience in national accounts in the area of special purpose entities and multinationals. The ECB external statistics division also participated in the Task Force. Eurostat participants were from national accounts and BoP units. The Member States who took part in the Task Force were: Belgium, Ireland, Portugal, Luxembourg, Malta, United Kingdom, Finland, Austria, Sweden, Netherlands, Germany, Italy and Cyprus. The Task Force held five meetings, between June 2007 and May 2009.

Given that the mandate required taking into account the ongoing developments as far as they were relevant for GNI measures, a particular aspect of the work of the Task Force was that the ongoing revisions of the SNA93 and of the BPM had to be considered. The changes introduced in the new manuals have in fact in several cases concerned the subject matter covered by the Task Force, especially the recording of transactions between affiliated enterprises. This implied that in most of the cases the Task Force had to discuss the various topics both in the framework of the present system and in the framework of the new system. An additional difficulty was that the Task Force had to base its discussion of the new SNA on versions that were not yet final.

In July 2008, the Task Force presented a progress report to Eurostat GNI Committee (GNIC/117), which contained an overview of the case studies collected and some preliminary conclusions on the three topics listed under 1) to 3) above. As a result of the discussion at the GNI Committee, for points 1) and 3), the Task Force was asked to complete a final report by June 2009 with more specific guidance and recommendations. For point 2), which is related to intra-group transactions, the GNI Committee concluded that the final report of the Task Force would include the preliminary conclusions to be used as input for further work. Concerning point 1) the Task Force was also asked to take into account chapter 4 of the SNA 2008, to give more concrete guidance on valuation and to advance on a possible decision tree for the treatment of units with little or no physical presence.

The Task Force continued its work in the second half of 2008 and in the first half of 2009. The fifth and final meeting of the Task Force took place in May 2009. The Task Force reached conclusions and proposed recommendations on parts 1 and 3 that are presented in this final report. For part 2 the conclusions reached by the Task Force are part of this final report to serve as input for further work, in particular for the implementation of the revised system.

## 1. Entities with little or no physical presence

In 2007, several EU member states signalled the need of clarifications on the treatment in national accounts of foreign controlled entities having little or no physical presence. Clarifications were requested concerning the identification of institutional units, residence, valuation, classification by sector and by activity. The characteristics that create difficulties are that, although these foreign controlled units are very small in terms of employment and structure (in many cases limited to an address and a *brass plate* without any person employed), they have important cross-border flows and positions. The cases presented at the Task Force show example of purely financial operations, of flows and stocks related to the acquisition of non-financial assets (tangible and intangible) of income flows and of flows linked to trade in goods, in most cases without physical transit of the goods (*merchanting*).

This kind of entities have since years been known with various names, such as (at least): "special purpose entities", "special purpose vehicles", "shell companies", "special financial institutions", "brass plate/mailbox companies" and "international business companies". However, countries have more recently reported an increased importance and new forms of use of this kind of organisational structures by multinational groups. The term "special purpose entities" is now used in the SNA 2008 (4.55-4.67) and in the BPM6 (see 4.50-4.52 and also 4.82-4.87)<sup>2</sup>.

While collecting contributions from countries for the fact-finding exercise, the Task Force also reviewed and discussed the methodological background in respect of entities with little or no physical presence. This concerned in particular the concepts of institutional unit, residence, classification by sector/activity and valuation. After the approval of the SNA 2008 and BPM6, it is now possible in this final report to give an overview of the guidance foreseen in the present and in the revised system for entities with little or no physical presence. This is followed by a summary of the discussion held at the Task Force and its conclusions concerning the methodological background.

### 1.1. Methodological background

#### 1.1.1. Current and revised statistical standards for institutional units and their residency – Special purpose entities in the 2008 SNA and in the BPM6

Concerning the identification of institutional units, with relation in particular to foreign-owned units, the Task Force considered that the revisions of the manuals have not introduced important changes in respect of the general principles. However, the SNA of 2008 contains some new paragraphs on SPEs considered as a special case.

To recall, ESA95 § 2.12 states that "the institutional unit is an elementary economic decision-making centre characterized by uniformity of behaviour and decision-making autonomy in the exercise of its principal function and either keeps a complete set of accounts or it would be possible and meaningful, from both an economic and legal

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<sup>2</sup> This was not the case when the Task Force started its work.

viewpoint, to compile a complete set of accounts if they were required." Indicators of autonomy of decision in respect of its principal functions are: owning assets in its own right, taking economic decisions for which it is held directly responsible and accountable by law, incurring liabilities on its own behalf, to take on other obligations or further commitments and to enter into contracts (see also SNA93 §4.2, which has remained the same in the SNA 2008).

Quasi-corporations, such as branches of foreign direct investors, are also considered institutional units in the system even if they do not have an independent legal status (see ESA95 2.13 (f) and SNA93 4.49). Furthermore, ESA95 2.15 defines as notional resident units: a) those parts of non-resident units which have a centre of economic interest in the compiling country; b) non-resident units in their capacity as owners of land or buildings. Notional resident units, even if they keep only partial accounts and may not always enjoy autonomy of decision, are treated as institutional units.

Looking at the SNA of 2008, while the reference framework has remained the same, a number of special cases have been introduced in paragraphs 4.51-4.67, of which one refers to Special purpose entities (4.55-4.67).

The main characteristics of an SPE in the SNA 2008 4.56 and 4.57 are as follows:

- They have often no employees and no non-financial assets. They may have little physical presence beyond a "brass plate" confirming their place of registration.
- They are always related to another corporation, often as a subsidiary, and SPEs in particular are often resident in a territory other than the territory of residence of the related corporations.
- They are commonly managed by employees of another corporation which may or may not be a related one. The unit pays fees for services rendered to it and in turn charges its parent or other related corporations a fee to cover these costs. This is the only production the unit is involved in though it will often incur liabilities on behalf of its owner and will usually receive investment income and holding gains on the assets it holds.

The SNA 2008 (4.58) concludes that *such units are treated in the same way as other institutional units* by being allocated to sectors and industry according to its principal activity *unless* they fall in one of the following three categories:

a. *Captive financial institutions (4.59-4.61)*<sup>3</sup>: financial corporations that cannot act independently of their parents and are simply passive holders of assets and liabilities. Examples given are holding companies, investment and pension funds, securisation vehicles, conduits.

- *These entities are treated as separate institutional units only if resident in an economy different from its parent.*

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<sup>3</sup> See also BPM6 4.82-4.87.

- *If they are resident in the same economy as its parent, they are treated as "artificial subsidiaries", which are the second exception (point b of 4.58 cited above) to the general rules for identification of institutional units:*

b. *Artificial subsidiaries (4.62-4.66):* subsidiaries wholly owned by a parent corporation created in order to avoid taxes, to minimise liabilities in the event of bankruptcy, or to secure other technical advantages under the tax or corporation legislation in force in a particular country. For example, the parent may create a subsidiary to which ownership of land, buildings or equipment is transferred and whose sole function is to lease it back again to the parent corporation; be the nominal employer of all the staff of the group; keep the accounts of the parent. In general, *these sorts of corporations do not satisfy the definition of an institutional unit because they lack the ability to act independently from their parent corporation.* Artificial subsidiaries are therefore not treated as separate institutional units in the SNA but are treated as an integral part of the parent and their accounts are consolidated with those of the parent. As said, consolidation of accounts applies also to the "passive SPEs" under point a., if they reside in the same country as their parent.

An important feature of artificial subsidiaries and of captive financial institutions according to the SNA 2008 is that *their level of output and the price they receive for it are determined by the parent that (possibly with other corporations in the same group) is their sole client* (see SNA 2008 4.64).

c. *Special purpose units of general government.* See SNA 2008 (4.67): the Task Force was not concerned with this case.

Residency of institutional units is determined, in both the current and the revised systems, as the economic territory in which the unit has its *centre of economic interest*. The SNA 2008 states in 4.12 that the economic territory has the dimensions of physical location as well as legal jurisdiction. In particular, each member of a group of affiliated enterprises is resident in the economy in which it is located, rather than being attributed to the location of the head office (see also 4.51). Furthermore, "for entities such as many special purpose entities, that have few if any attributes of location, the location is determined by their place of incorporation" (see SNA 2008 4.15-f. and BPM6 4.115 (d))<sup>4</sup>. The SNA 2008 also clarifies that in the case of extraction of subsoil resources, "an enterprise that will undertake extraction is deemed to become resident when the requisite licences or leases are issued, if not before" (see 4.15-e.).

Chapter 26 of the SNA 2008 concerns the Rest of the world account and the links to the Balance of payments. This chapter gives additional clarifications on the criteria for determining the residency of institutional units, including branches. In particular, if the production process involves physical presence, then the operations should be physically located in the economic territory for the unit to be considered resident. For production activities that do not involve physical presence, such as some cases of banking, insurance, other financial services, ownership of patents, merchanting and "virtual manufacturing", residency is determined according to the economic territory under whose laws the entity is

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<sup>4</sup> In this respect, the SNA93 § 4.16 (c) – which has also been kept in the 2008 revision as § 4.15 (c) - says that "corporations and NPIs may normally be expected to have a centre of economic interest in the country in which they are legally constituted and registered".



incorporated or registered<sup>5</sup>. 26.41 is the only other paragraph in the SNA of 2008 mentioning virtual manufacturing, to say that in virtual manufacturing all the physical processes are outsourced to other units.

### **1.1.2. Subsector and activity classification of entities with little or no physical presence**

Although the SNA 2008 gives particular attention to the case of SPEs that are *captive financial institutions*, it also says that SPEs should be in general treated in the System in the same way as any other institutional unit by being allocated to sector and industry according to its principal activity (see 4.58 already referred to before). Even though this is not explicitly stated in the SNA 2008, it appears from its text that a unit resident in a different country than its parent and having the other characteristics of an *artificial subsidiary* (particularly, in terms of activities – see the examples contained in 4.63 and quoted before) should be treated as an institutional unit and classified according to its own activity/sector, just like a *captive financial institution*.

The examples produced by the country reports confirm that in the EU Member States SPEs with little or no physical presence are encountered in financial as well as in non-financial activities. Another empirical result that will be described in more detail in point 1.2 of this report is that SPEs with little or no physical presence owning non-financial assets (tangible and intangible) are not a limited exception in the EU. This appears in concordance with the examples given by § 26.30 and § 26.41 and cited in the last paragraph of section 1.1.1.

### **1.1.3. Valuation**

Concerning principles for valuation of production of SPEs with little or no physical presence, the Task Force referred to the one of the recommendations of the AEG in 2007 saying that the output of SPEs should be valued at cost if no market valuation is available<sup>6</sup>. As already observed in 1.1.1, the SNA 2008 refers to the absence of a market as a distinguishing feature of captive financial institutions and of artificial subsidiaries, for which the level of output and its price are determined by the parent that (possibly with other corporations in the same group) is their sole client (see 4.64).

### **1.1.4. Discussion of the Task Force**

The Task Force discussed at length the methodology related to SPEs, particularly their treatment in the SNA of 2008.

The Task Force agreed that SPEs with little or no physical presence should be considered resident institutional units when they are not resident in the same country as the country of their parent. Consolidation of the SPEs with the parent company should occur within

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<sup>5</sup> See 26.30 for branches (that refers to registration or legal domicile) and 26.41 for enterprises (that refers to incorporation or registration).

<sup>6</sup> Statistical Commission Background document, Thirty-eighth session, 27 February - 2 March 2007, Item 3 (f) of the provisional agenda: Items for discussion and decision: National accounts. The Full Set of Consolidated Recommendations made by the Advisory Expert Group for the Update of the System of National Accounts, 1993. Prepared by the Intersecretariat Working Group on National Accounts.

the domestic economy. However, more complex cases in which there is a part of a group in a country (so-called "truncated group") containing both SPEs and normal units should be further investigated in the follow up work. In addition, the Task Force observed that the lack of ownership of non-financial assets is not a distinguishing feature of SPEs in the EU, contrary to what is said in SNA 2008 4.56 (see part 1.2 for more on this point).

Concerning production by SPEs, the text of the SNA of 2008 4.57 quoted before<sup>7</sup> is not particularly clear and it is not sufficient to describe all the cases of SPEs that can be found in the case studies produced by the Task Force. Indeed, the SNA of 2008 (4.47a and 26.30b) gives also a list of examples of production activities that do not involve physical presence and that therefore should be considered in connection with SPEs. These are: some cases of banking, insurance, other financial services, ownership of patents, merchanting and "virtual manufacturing"<sup>8</sup>. According to the Task Force, this part needs further clarification in the ongoing revision of the ESA. The SNA does not give a close list of activities and the case studies show examples of SPEs without physical presence in the EU with activities that are similar but not the same as those listed by the SNA 2008. For example: ownership of copyrights or other intangible assets different from patents. In addition, although 26.41 of the SNA 2008 contains some explanations on the characteristics of the activities that do not involve physical presence, it appears that further clarifications are needed. In particular, "virtual manufacturing" is potentially a very important issue that seems to deserve more analysis, also in connection with the case of "global manufacturing" introduced in the BPM6, but not in the SNA 2008 (see part 2 of this report).

Some members of the Task Force argued that, in the case of units with no or very little employment, production activity can only consist in an activity of ownership of assets. They consider that the list of activities given in 26.30 and 26.41 of SNA 2008 is too extensive if the unit has no employment at all or insignificant employment compared with its activity in terms of transactions and balance sheet value. The majority of the members of the Task Force did not endorse this opinion and referred to the principles of acquisition of the ownership of the output and responsibility for the production process used in national accounts for defining the production boundary (see for instance SNA 2008 6.24). However, the Task Force agreed that the economic nature of the activities and of the transactions carried out should be the reference in national accounts<sup>9</sup>. In many cases it is observed that SPEs are used by groups precisely to disguise the nature of the activity and/or of their transactions. A more detailed description of the main cases observed, based on the studies produced by the participants, was prepared by the Task Force and is presented in part 1.2 of this report.

Concerning the conditions for determining residency for activities that do not involve physical presence, the Task Force observed that the SNA 2008 makes reference to "incorporation" in chapter 4 (4.15f) and to "incorporation or registration" in chapter 26 (26.41). The Task Force considered that also this point should be clarified in the ongoing

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<sup>7</sup> "The unit pays fees for services rendered to it and in turn charges its parent or other related corporations a fee to cover these costs. This is the only production the unit is involved in ....".

<sup>8</sup> SNA 2008 4.47a, referring to branches, gives however a shorter list for production that does not involve physical presence, limited to financial services. But this is not consistent with the list given for branches in 26.30b and quoted in the text.

<sup>9</sup> See for instance the distinction between economic and legal ownership in the SNA 2008.

revision of the ESA. In particular, the Task Force agreed that VAT registration in a member state is not a sufficient element for identifying an institutional unit.

The Task Force agreed that in case of absence of true market transactions, the output of SPEs should be valued at cost.

### **1.1.5. Conclusions to 1.1**

At the end of its discussion of this part on the methodological background, the Task Force drew some conclusions on SPEs with little or no physical presence.

First, SPEs with little or no physical presence are to be classified as institutional units when they are not resident in the same country as the country of their parent. Consolidation with the parent company occurs only within the domestic economy, when the SPEs do not comply with the general criteria for institutional units. More complex cases in which there is a part of a group in a country (so-called "truncated group") containing both SPEs and normal units are not considered by the SNA of 2008 and should be further investigated. For incorporated entities that have few if any attributes of location, the location should be determined by their place of incorporation. For unincorporated entities, such as branches, the Task Force considered that they normally have a physical presence, although examples of branches with little or no physical presence were mentioned for the financial sector. In this case, the registration with the national supervisory authority could be used as a criterion. On the other hand, the Task Force agreed that VAT registration is not a sufficient element for identifying an institutional unit in EU member states.

Secondly, production of such entities is to be allocated to sector and industry according to their principal activity. In determining the production activity of SPEs, the underlying economic nature rather than the legal appearance should be the reference for national accounts. The Task Force worked in more detail on the most important cases that are observed in the EU, which are presented in part 1.2 of this report.

Thirdly, concerning the valuation of SPEs transactions, the lack of the ability to act independently from its parent corporation is often reflected in the absence of a genuine market price for the output of the entities concerned. In such cases, valuation of the SPEs output at cost is recommended.

## **1.2. Classification of the SPEs emerging from the case studies collected by the Task Force and decision tree**

The experts participating in the Task Force provided a number of national case studies concerning entities having little or no persons employed, limited operations or limited physical presence in their country. The case studies concern entities that are foreign-controlled and thus resident in a territory other than the territory of residence of their parent companies<sup>10</sup>. A more detailed description of the case studies can be found in GNIC/117 – Progress report of the Task Force of July 2008.

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<sup>10</sup> In general, their originators can also belong to the government sector. However such entities were not analysed by this Task Force.

Based on the case studies an overview of the different types of entities with little or no physical presence is given in table 1.

One of the main common characteristic of typical SPEs emerging from the case studies is that the value of the stocks in their balance sheets is above any reasonable proportion with their employment and their physical structure (if any). For that reason, the Task Force worked following a first-level classification of SPEs in terms of the kind of asset in their balance sheet (financial, non-financial tangible and non-financial intangible assets)<sup>11</sup>. Inside each group of SPEs so defined, an indication of the sector and activity classification is given in table 1, together with a short summary of the purpose for which the SPE is usually set up. The activity classification is given in both NACE Rev 1.1 and in NACE Rev 2. The last column contains a summary of the conclusions of the Task Force concerning valuation of the output of the SPEs.

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<sup>11</sup> Table 1 however contains a residual category "others", see below.

**Table 1: Classification of SPEs in the EU**

Type	Institutional sector	Activity		Purpose	Valuation of production	
		NACE Rev. 1.1	NACE Rev. 2			
<b>Ownership of financial assets</b> <i>(Captive financial institutions)</i>						
1a	Holding companies	Other financial intermediaries, except insurance corporations and pension funds (S.123)	65.23 Other financial intermediation n.e.c.	64.20 Activities of holding companies	owning subsidiaries, concentration of group profits in favourable countries/jurisdictions, group financing	sum of costs
1b	Holding companies owning claims on notional units abroad (buildings, natural resources )	Other financial intermediaries, except insurance corporations and pension funds (S.123)	65.23 Other financial intermediation n.e.c.	64.20 Activities of holding companies	owning subsidiaries, concentration of group profits in favourable countries/jurisdictions, group financing	sum of costs
2a	Trusts, funds and similar financial entities	Other monetary financial institutions (S.122)	65.23 Other financial intermediation n.e.c.	64.30 Trusts, funds and similar financial entities	return on financial investment with fiscal advantages	sum of costs
2b	Trusts, funds and similar financial entities	Other financial intermediaries (S.123)	65.23 Other financial intermediation n.e.c.	64.30 Trusts, funds and similar financial entities	return on financial investment with fiscal advantages	sum of costs
3	Securitization companies <sup>(*)</sup>	Other financial intermediaries (S.123)	65.23 Other financial intermediation n.e.c.	64.99 Other financial service activities, except insurance and pension funding n.e.c.	assets securitisation for fund raising	sum of costs
4	Captive financial leasing companies (usually, for aircrafts and vessels)	Other financial intermediaries (S.123)	65.21 Financial leasing	64.91 Financial leasing	financial leasing within a group (the SPE is not considered the economic owner of the equipment).	sum of costs
5	Captive insurance and re-insurance companies	Insurance corporations and pension funds (S.125)	66.03 Non-life insurance	65.12 Non-life insurance 65.20 Reinsurance	insurance and re-insurance within a group	sum of costs
6	Invoicing companies	Other financial intermediaries (S.123)	65.23 Other financial intermediation n.e.c.	64.99 Other financial service activities, except insurance and pension funding n.e.c.	invoicing sales of the group worldwide	sum of costs
<b>Ownership of non-financial tangible assets</b>						
7	Renting of mobile equipment	Non-financial corporations (S.11)	71.00 Renting of machinery and equipment without operator (exclud. 71.40)	77.00 Renting of machinery and equipment without operator (exclud. 77.20)	register the ownership of the asset and the rents in low tax jurisdictions	These cases are treated as financial leasing if the SPE is not the economic owner of the asset and they are valued at cost (row 4). If conditions for such treatment are not satisfied, the unit is treated as operational leasing producer and output valued with rentals received
8	Merchanting companies	Non-financial corporations (S.11)	51.00 Wholesale trade and commission trade	46.00 Wholesale trade	distribution company for a group without goods going through the territory of the SPE	margin
9	Trading companies	Non-financial corporations (S.11)	51.00 Wholesale trade and commission trade	46.00 Wholesale trade	distribution company for a group	margin
<b>Ownership of non-financial intangible assets</b>						
10	Licensing and royalty companies	Non-financial corporations (S.11)	74.8 Miscellaneous business activities n.e.c.	74.90 Other professional, scientific and technical activities n.e.c.	concentration of group receipts concerning royalties and similar flows received from intellectual property rights and trademarks.	margin
<b>Others</b>						
11	Offices of airlines in airport hubs abroad	Non-financial corporations (S.11) if a branch is identified	62.10 Scheduled air-transport	51.10 Passenger air transport	transfer locus used by airline carriers to get passengers to their intended destination	prorata of airline output if no branch is identified

(\*) The statistical data on SPEs (or financial vehicle corporation) engaged in securitisation transactions are to be reported under the Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30)

SPEs owning financial assets correspond to the *captive financial institutions* described in the SNA of 2008 and in the BPM6. The Task Force identified six different types in the case studies, two of which have two further sub-cases (rows 1 and 2). The Task Force concluded that, on the basis of the discussion of the methodology described in 1.1, the output (financial services) of captive financial institutions should be valued at the sum of the costs.

For holdings, if the SPE receives fees (eg, management services) from its affiliates, these are to be reclassified as distributed income (D42). Fees received from the foreign owner are to be reclassified as financial transactions (FDI flows). For the other types of captive financial institutions in table 1, the Task Force concluded that it is generally unusual to observe in their accounts fees received for services. If fees are observed in the accounts (the case of lines 2 of table 1 – Trusts, funds and similar financial entities<sup>12</sup> was mentioned as a possible example), then the output is valued at the maximum between the fees and the costs.

Concerning financial leasing, this is usually observed in the case studies for aircrafts and vessels, or other mobile equipment. The Task Force concluded that the SPEs generally acquire the legal ownership of the non-financial assets, but the foreign owner of the SPE should be considered as the economic owner when it is the sole client of the SPE, possibly together with other affiliates of the group. If some of the conditions for qualifying the entity as captive financial institution are not met, the unit is considered as economic owner and therefore operating leasing producer and its output is measured by the rentals received (row 7).

For merchanting and trading companies, as distinguished from invoicing companies, the relevant feature is that they acquire the ownership of the goods traded. These SPEs are used as "distribution companies" by groups for making sales to any kind of clients worldwide. The Task Force concluded that the output should in this case be measured by the trade margin<sup>13</sup>. Some participants in the Task Force mentioned that, according to their experience, the accounts of SPEs that are trading or merchanting companies and those of SPEs that are invoicing companies may look similar to each other. Furthermore, the same participants expressed a reservation against using the trade margin as a valuation method for output and advocated valuation at cost. They maintained that this kind of SPEs may show very large amount of purchases and sales which will be disproportional with economies of small countries and will affect important economic indicators such as productivity.

Licensing and royalty SPEs act as intermediaries between the original owner and/or creator of intellectual property (e.g. in the form of a patent, film rights, copyrights or trademarks) who is not resident in the country hosting the SPE and the licensees which are also in general resident outside the country hosting the SPE. The SPE which owns the

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<sup>12</sup> These are defined as follows by the explanatory text of NACE Rev. 2 64.30: "This class includes legal entities organised to pool securities or other financial assets, without managing, on behalf of shareholders or beneficiaries. The portfolios are customised to achieve specific investment characteristics, such as diversification, risk, rate of return and price volatility. These entities earn interest, dividends and other property income, but have little or no employment and no revenue from the sale of services."

<sup>13</sup> For merchanting, the treatment in the SNA93/ESA95 system and the treatment in the revised system have been discussed by the Task Force in its work on intragroup transactions. See part 2 of this report.

intellectual property is usually located in a low taxation country and is owned by the original owner of the intellectual property. The Task Force agreed that the preferred approach is to treat the unit as non-financial corporation and the transactions related to the licences/royalties as imports and re-exports of services. Output is consequentially measured as the difference between re-exports and imports. If the payments to the foreign owner take the form of income transactions (eg dividends) or repayments of debt, these should be reclassified as imports of services. In principle, treatment as financial leasing producer of the SPE owning the intangible assets could also be conceived, which would lead to valuation at cost of the SPE's output. However in the cases observed by the Task Force experts, these types of SPEs usually do not lend themselves to such a treatment.

The last block of table 1 identifies two residual cases that were also presented by participants. The first one (row 11) refers to the activities of airlines in airport hubs abroad. The Task Force concluded that in this case, if no branch can be identified for the operations at the hub, the treatment provided for multi-territory enterprises by SNA 2008 (26.35) should be applied. Namely, the operations should be prorated according to an appropriate enterprise specific indicator of the proportions of operations in each territory.

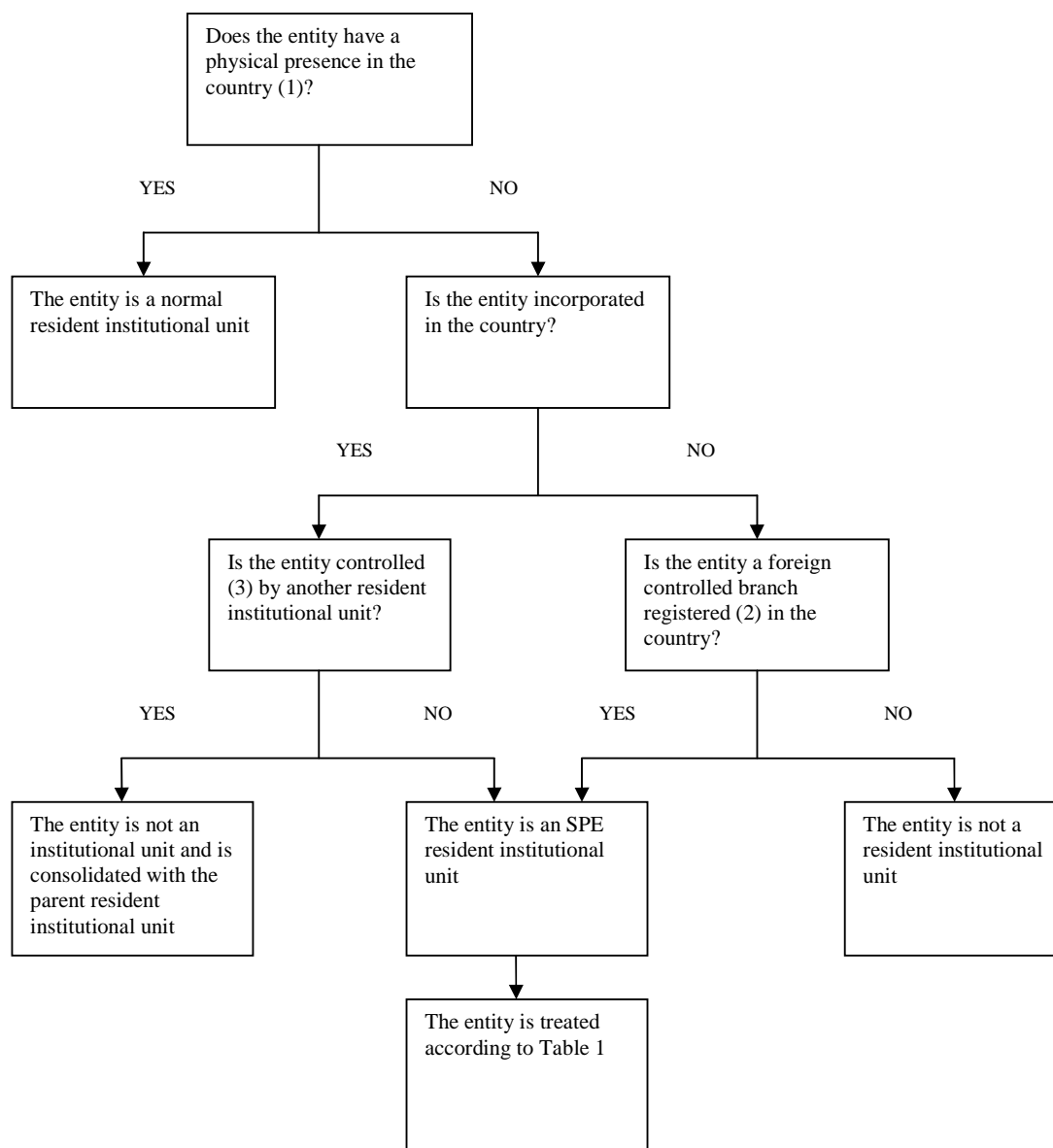
"Quasi transit trade" (row 12) is a term introduced to distinguish a specific kind of transaction different from "simple transit trade" and "re-exports". It is a peculiar kind of transit trade where goods are declared as imports in one EU member state and dispatched (without any major transformation or treatment) to another member state. The characteristic that differentiates this example from simple transit trade is that the declared value of the goods entering the EU is substantially lower than the declared value of the same goods dispatched to the other EU member state, even though no change in ownership or material change occurs. The importer from extra-EU in the first member state has a registration number for the VAT in that member state but should not be considered an institutional unit according to the conclusions of the Task Force. As a consequence, the Task Force agreed that the member state of entry of the goods from extra-EU should not record imports and exports in their national accounts and BOP. As concern the recording for the EU/Euroarea aggregates, member states transmit data on quasi transit trade to Eurostat and the ECB and these data are taken into account in the compilation of the aggregates. Further discussion on this topic concerning the European aggregates is taking place at the Eurostat/ECB Task Force on the Rest of the World<sup>14</sup>.

The Task Force also discussed and agreed on a decision tree to be used for allocating units between SPEs and normal units (see figure 1). The proposed decision tree takes into account the various elements presented above in this report. The Task Force recommends that units that are classified as SPEs are treated according to table 1.

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<sup>14</sup> See also "Transit trade and re-exports – Quasi transit trade in Europe when value added does not belong to the reporting economy", note by Eurostat and the European Central Bank presented at the Group of Experts on the Impact of Globalisation on National Accounts, Geneva, May 2009.

**Figure 1: Decision tree for SPEs**



(1) The main indicators of physical presence is a sufficient level of employment compared to balance sheet value and/or transaction values. If employment exists in the SPE, typical ratios can be derived by type of activity for the country. Additional indicators may be developed at national level, see for example the approach of the Netherlands CBS, described in "Recording of SPEs in the Dutch national accounts" – by Jorrit Zwijnenburg

(2) Mainly, registration at the supervisory authority for banks and insurance branches. VAT registration in the EU is not sufficient for defining an institutional unit.

(3) More than 50% of equity capital



### 1.3. Main conclusions and Task Force recommendations

As said in the introduction, the work of the Task Force until the spring of 2008 was concentrated on the collection of case studies in the EU member states and on the review of the methodological background on the recording of entities with little or no physical presence in national accounts. As it was requested at the GNI Committee meeting of July 2008, the remaining part of the work of the Task Force concentrated on the problems of classification of the case studies collected, valuation of the SPEs output, and on the proposed decision tree.

Concerning the impact on GDP and GDP components deriving from the inclusion of SPEs in the national accounts, the Task Force confirmed the preliminary conclusions reached in the progress report, namely that the impact on GDP may be important in some cases, notably for small member states.

For GNI, as long as these units are fully foreign-owned (which is usually the case), the impact on the GNI of the member state of residence is nil or very low, because of the compensating effect of property income (distributed or not distributed) with the rest of the world.

The review of the national practices on SPEs also confirmed that the treatment of such entities is not uniform across member states. This concerns in particular the identification and inclusion of the units concerned for national accounts purposes and the valuation of their operations.

The implementation of the recording of SPEs operations according to the conclusions described above should be accompanied by an adequate exchange of information between member states' NSIs and NCBs in order to tackle risks of omissions, double counting and inconsistent recording of SPEs operations leading to asymmetries between member states. The issue of cooperation and exchange of information is addressed in part 3 of this report.

In conclusion, the Task Force adopted the following **recommendations** concerning part 1 related to entities with little or no physical presence.

**R1** Entities with little or no physical presence are to be classified as institutional units when they are not resident in the same country as the country of their parent. Consolidation within the parent company occurs only within domestic economy, when they do not comply with the general criteria for institutional units.

**R2** The Task Force recommends that some elements of the treatment of SPEs contained in the SNA of 2008 chapters 4 and 26 are clarified for their application in the EU. This concerns in particular:

- The use of the criterion of registration for identifying institutional unit. VAT registration is not a sufficient condition in the EU for identifying a resident institutional unit.
- The treatment of truncated groups containing both SPEs and normal units.

- The notion of "activities not requiring physical presence", in particular of "virtual manufacturing", introduced by the SNA of 2008.

**R3** The Task Force recommends that the production of SPEs is to be allocated to sector and industry according to their principal activity. In determining the production activity of SPEs, the underlying economic nature rather than the legal appearance should be the reference for national accounts.

**R4** For valuation of SPEs output, the Task Force recommends that when the SPEs has transactions only with its foreign parent or with other units of the same group a market valuation cannot be identified and output should be valued at cost.

**R5** The Task Force recommends that the treatment of SPEs in member states conform to table 1 of this report. The decision tree shown in figure 1 of this report may represent an operational tool for national compilers.

**R6** The Task Force recommends fostering cooperation and exchange of information on SPEs among national producers of statistics in the EU in order to tackle risks of omissions, double counting and inconsistent recording of SPEs operations which may lead to asymmetries. Concerning cooperation and exchange of information additional specific recommendations are given at the end of part 3 of this report.

## **2. Intra-group transactions**

The Task Force identified three problematic areas linked to the operations of multinational companies, irrespective of the fact that these transactions may involve entities with little or no physical presence. These are: 1) *transfer pricing*; 2) recording of transactions related to the so-called *global manufacturing*, and 3) *intra-group R&D imports and export*.

### **2.1. Transfer pricing**

Transfer pricing refers to the valuation of transactions between affiliated enterprises. Usually, the use of transfer prices (as opposed to market prices) for transactions between affiliated enterprises is motivated by income distribution or equity build-ups or withdrawals.

The Task Force discussed the guidance contained in the BPM5 and related IMF Balance of Payments Compilation Guide. These recommend that where transfer prices differ from market prices, in principle compilers should impute market prices to the transactions involved. In addition to the adjustment to the flow itself, there should be a counterpart entry in dividends or equity/direct investment equity flows. In practice, only in rare cases compilers are in a position to make the required adjustments.

The Task Force also discussed the BPM6, which does not change the treatment of transfer pricing, but goes in more detail as to the description of the typical cases. For instance, § 10.150 refers to "Services for the general management of a branch, subsidiary, or associate provided by a parent enterprise or other affiliated enterprise are included in other business services, often under professional and management consulting services. However, reimbursements of ancillary services supplied by affiliated enterprises, such as transport, purchasing, sales and marketing, or computing, should be shown under the relevant specific heading. Management fees are included in other business services. However, disproportionately large values of services between affiliated enterprises should be examined for signs that they are disguised dividends, for example, indicated by large fluctuations that do not reflect actual changes in the services provided".

The BPM6 also recognises the difficulties that compilers encounter in imputing market prices to intra-group transactions. § 3.78 states that the exchange of goods between affiliated enterprises may often be one that does not occur between independent parties (for example, specialised components that are usable only when incorporated in a finished product). Similarly, the exchange of services, such as management services and technical know-how, may have no near equivalents in the types of transactions in services that usually take place between independent parties. Thus, for transactions between affiliated parties, the determination of values comparable to market values may be difficult, and compilers may have no choice other than to accept valuations based on explicit costs incurred in production or any other values assigned by the enterprise.

Countries participating in the Task Force reported that adjustments for transfer pricing are made in very rare cases in their compilation practices, because of the difficulties involved in identifying cases and in imputing market prices. Only in the case of one country (the

Netherlands) a significant adjustment made for transfer pricing was reported and described to the Task Force.

Luxembourg reported that in some cases related to companies managing non-incorporated investment funds or SICAV, dividends paid are reclassified as imports of management fees.

The case study of Belgian non-independent transit trade companies (described in section 2 of this report) could also be considered as an instance of transfer pricing practices, because the price of the re-exported good is usually considerably higher than the price of the same good at the import, without the good undergoing a significant transformation. This practice may be motivated by the objective of reducing the import duties to be paid on imports from extra-EU countries.

The Task Force also considered that transfer pricing can have an impact on GDP, compared to a valuation of imports and exports that would prevail if transactions took place between independent parties rather than being intra-group imports/exports. However, the impact is balanced, at the level of GNI, by an opposite difference in property income (distributed or not distributed). Nevertheless, in a specific case mentioned by the IMF BoP Textbook (see 5.38-5.40), there may be an impact on GNI because the counterbalancing entry to the adjustment in goods and services is booked in the financial account and not in income.

The Task Force considered that it could be useful to investigate on the legal sanctions of transfer pricing practices, which exist in some member states, in order to examine how transfer pricing is identified and if the criteria adopted may be used for statistical purposes.

In general, however, the Task Force was of the opinion that users could benefit more from a separate identification of intra-group imports and exports of goods and services (which may be affected by transfer pricing) than from intensified efforts to make imputations of market prices. It might be difficult to compile data on intra-group imports and exports of goods and services in practice, but the availability of such data would be very important for analytical purposes.

## ***2.2.Global manufacturing***

The term *global manufacturing*<sup>15</sup> refers to production activities within multinational groups in which the different parts of the production process take place in different countries. Output is also generally sold in more than one country. Typically, R&D and design and marketing activities are carried out in one country, while physical production take place in other countries. In some cases, physical production is organised as goods sent for processing abroad and returned to the same country after processing, without change of ownership. In other cases the affiliate acting as physical producer acquires the ownership of the inputs (which may in turn be produced in the country of the affiliate or imported) and sells the output to the group head, which invoices directly the final sales to the customers. Costs and profit of the group head are paid through the sales of the final

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<sup>15</sup> Global manufacturing and its treatment in statistics has been discussed during the revision of SNA93 and BPM. This discussion took place under the topics of *merchanted* and *goods for processing* (background papers can be found under issue 41 of the AEG in the UN website dedicated to the SNA update).

product and in general the goods may not enter the country of the group head<sup>16</sup>. Separation of activities may be such that trade and administration activities of the group are located in still different countries, usually for minimising taxes by concentrating profits in lower taxation countries. In this case one affiliate of the group specialised in trade may acquire the ownership (but not necessarily the physical possession) of the products and distribute them worldwide.<sup>17</sup>

The Task Force particularly discussed various case studies that were presented by the experts. Two typical cases and problems associated with their treatment were identified: a) physical delivery of goods between resident units and affiliated enterprises abroad, with no change of ownership; b) no delivery of goods between resident units and affiliated enterprises abroad, but the resident unit acquires the ownership of goods delivered abroad. The next section analyses these two cases.

### **2.2.1. International statistical standards with reference to *global manufacturing, goods for processing and merchanting***

Although the report primarily concentrates on the present accounting system, the Task Force discussed the state of advancement of the discussion on recording of *global manufacturing, goods for processing and merchanting* in the framework of the revision of BPM and SNA. The Task Force considered that the changes proposed in the present last draft version of BPM6 have important implications in respect of the subject matter covered in this report. A brief outline of the present and new international statistical standards for *global manufacturing, goods for processing and merchanting* according to the latest available version of the BPM6 and SNA 2008, Rev.1 is given below.

The main underlying element is that the proposed revised manuals eliminate the exceptions to the change of ownership principle.

#### **a) Deliveries of goods between resident units and affiliated enterprises abroad without change of ownership (including *goods for processing*)**

ESA95 paragraph 3.133 lists the exceptions to the application of the change of ownership principle for identifying imports and exports transactions. Point (b) of 3.133 concerns deliveries between affiliated enterprises, for which a change of ownership is to be imputed even if it does not take place<sup>18</sup>. Another exception of ESA95 3.133 concerns goods sent for processing abroad and returned to the same country after processing (see ESA95 3.133 (c) – in short *goods for processing*)<sup>19</sup>. In this case a change of ownership is imputed even if the transaction takes place between unaffiliated enterprises.

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<sup>16</sup> This aspect makes *global manufacturing* organisation similar to traditional *merchanting* in terms of transactions and change of ownership.

<sup>17</sup> This aspect of the problem is related to what is discussed in part 2 of the report about entities with no or little physical presence.

<sup>18</sup> ESA95 3.133 (b) corresponds to paragraph 14.59 of the 1993 SNA and 205 of BPM5.

<sup>19</sup> In the present system of BPM5 there is a practical problem of valuation when the goods after processing do not return to the country of origin. The final value of the exports is not only equal to the value of the goods exports before processing initially declared and the cost of the processing but will also include in the selling price the margin realized by the country of origin on the final export. In theory, a notional re-import to the country of origin from the processing country for balancing the export before processing and another

The BPM6 contains substantial innovations concerning these principles of ESA95 3.133. In particular, § 10.24 of the BPM6 states that in cases where there is a change of possession of goods between affiliated enterprises, but whether there is a change in ownership is unclear:

- When affiliated enterprises are separate legal entities, their transactions should be treated according to the parties' own arrangements as to whether there is a change of ownership or not.
- Between a quasicorporation and its owner, legal title is not usually available as evidence of the nature of the movement of goods. The preferred treatment in this case is to identify which part of the legal entity assumes the risks and benefits of ownership, based on evidence such as which location has the goods recorded in its accounts. The treatment should be consistent with reporting by the branch in business accounts and enterprise or establishment surveys.

BPM6 foresees that cross-border deliveries of goods between affiliated enterprises should be recorded according to a strict application of the change of ownership principle. But change of ownership can be a very blurred concept in the case of multinational groups.

Concerning more specifically the case of *goods for processing*, the *ESA95*, the *1993 SNA* and the *BPM5* record goods sent abroad for processing and the goods resulting from such processing when returned to the country of origin on a gross basis, although no change of ownership occurs. The goods are therefore recorded in exports when they leave the country and in imports when they return to it.

In the revision of the *1993 SNA* and *BPM* it has been decided to follow the change of ownership principle also for the recording of *goods for processing*. When there is no ownership transfer, the processing-related transactions will be recorded as trade in processing services instead of trade in goods. However, the *BPM6* stipulates that gross values of goods sent abroad for processing should be identified as supplementary items.

Some relevant paragraphs of the draft *BPM6* are quoted below.

10.63. Examples of processes that are often undertaken under arrangements for manufacturing services on physical inputs owned by others include oil refining, liquefaction of natural gas, assembly of clothing and electronics, assembly (excluding assembly of prefabricated constructions, which are included in construction), labeling, and packing (excluding those incidental to transport included in transport services).

10.64. Manufacturing services on physical inputs owned by others is an item that covers the transaction between the owner and processor, and only the fee for the service rendered is included under this item. If the processed goods are subsequently sold by the owner to a resident of the processing economy or a third economy, the sale of the good is recorded as an export of a good (in general merchandise or merchanting, depending on the arrangements for movement of the good) by the economy of the owner and as an import of a good by the importing economy. If the goods to be processed are purchased from a

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export to the final country at the selling price has to be imputed. In practice, if these imputations are not done, there may be inconsistencies between the various statistics concerned.

resident in the same economy as the processor or from a resident in a third economy, the owner of the goods to be processed records the acquisition of goods (most probably an import of goods under general merchandise, but possibly a negative export of the goods is recorded as merchanting). Manufacturing services on physical inputs owned by others refers to all work done on goods by a resident of one economy for the owner of goods who is resident in another economy; the treatment of these services is not conditional on whether the goods were previously or subsequently in the physical possession of the owner or not.

10.67. The gross values of goods associated with these services can be identified as supplementary items in economies where they are significant. While the manufacturing service is consistent with what is recorded in business accounts and actual transactions, the gross values of these goods are useful for analysis of processing activities. Values of the following items may be identified:

- (a) for customers of manufacturing services on goods processed abroad (with no change of ownership to the processor):
  - goods supplied for processing (goods sent);
  - goods dispatched after processing (goods returned);
- (b) for providers of manufacturing services on goods processed in the compiling economy (with no change of ownership to the processor):
  - goods received for processing (goods received);
  - goods dispatched after processing (goods sent).

10.68. A market-equivalent valuation for goods supplied/received might be required. Gross values of the goods are shown after processing, and again a market-equivalent valuation might be required. The value of goods input and dispatched could be reported either by the customer or supplier of manufacturing services, or from customs data."

In synthesis, the current treatment of goods sent abroad for processing and sold to non-residents after processing is that the sending country treats the charges for processing as imports of services and its original export is re-valued at the transaction value. For goods sent abroad for processing and then sold on to another economy, a service payment from the sending economy is entered under *merchanting* and trade related services.

With the update of BPM and SNA, imports and exports of goods for processing will no longer be recorded and instead a fee for processing service will be recorded. The proposed treatment of goods which are sent abroad for processing and which are not re-imported by the sending country (either sold to a resident of the processing country or exported to a third country) will not change. The sending country records goods exports under the general merchandise item (value of the processed good including value of processing) and the payment for processing is entered as a debit under services (credit for country providing services).

A summary table 2 below provides a synthesis of the recording of goods for processing under BPM5 and a comparison with the proposals made for the revision of BPM.

**Table 2: Recording of goods processed abroad under BPM5 and BPM6**

<b>BPM5</b>	Goods sent abroad for processing and...		
	re-imported	sold to residents of the processing country	sold to residents of a third country
Sending country	<b>Goods exports</b> before processing and <b>goods re-import</b> after processing	<b>Goods exports</b>  <b>Import of services</b> of the value of the processing	<b>Goods exports</b>  <b>Import of services</b> of the value of processing
Processing country	<b>Goods imports</b> before processing and <b>goods re-exports</b> after processing	<b>Goods imports</b>  <b>Export of services</b> of the value of processing	   <b>Export of services</b> of the value of processing
Third country			<b>Goods imports</b>
<b>BPM6</b>			
Sending country	   <b>Import of services</b> of the value of processing	<b>Goods exports</b>  <b>Import of services</b> of the value of processing	<b>Goods exports</b>  <b>Import of services</b> of the value of processing
Processing country	   <b>Export of services</b> of the value of processing	<b>Goods imports</b>  <b>Export of services</b> of the value of processing	   <b>Export of services</b> of the value of processing
Third country			<b>Goods imports</b>

**b) No delivery of goods between resident units and affiliated enterprises abroad, but the resident unit acquires the ownership of the goods (including *merchanted*)**

BPM5 § 262 defines *merchandising* as the purchase of a good by a resident (of the compiling economy) from a non-resident and the subsequent resale of the good to another non-resident, without the good entering or leaving the merchant's economy during the process. *Merchandising* is recorded among services and valued with the trade margin realised. The difference between the value of goods when acquired and the value when sold is recorded as the value of services provided. If the commodities are not resold in the same accounting period, an import of goods is recorded in the first period, and a negative import entry is recorded in the later period. ESA95 (3.133 (d)) and 1993 SNA (14.60) provide for the same treatment.



The last available version of the draft BPM6 does not change the definition of merchanting (see § 10.41 of draft BPM6), but changes the way in which it is recorded. In § 10.44 the proposed treatment of merchanting is that:

- The acquisition of goods by merchants is shown under goods as a negative export of the economy of the merchant;
- The sale of goods is shown under goods sold under merchanting as a positive export of the economy of the merchant;
- The difference between sales over purchases of goods for merchanting is shown as the item “net exports of goods under merchanting.” This item includes merchants’ margins, holding gains and losses, and changes in inventories of goods under merchanting. As a result of losses or increases in inventories, net exports of goods under merchanting may be negative in some cases; and
- Merchanting entries are valued at transaction prices as agreed by the parties, not FOB.

The net exports so calculated should be matched by an output of trade services on the resource side<sup>20</sup>.

Furthermore, the BPM6 also refers specifically to the case of *global manufacturing*. Paragraph 10.42 mentions that "Merchanting arrangements are used for wholesaling and retailing. They may also be used in commodity dealing and for the management and financing of global manufacturing processes. Merchanting is increasingly used for the management and financing of global manufacturing processes. For example, an enterprise may contract the assembly of a good among one or more contractors, such that the goods are acquired by this enterprise and resold without passing through the territory of the owner.<sup>21</sup> If the physical form of the goods is changed during the period the goods are owned, as a result of manufacturing services performed by other entities, then the goods transactions are recorded under general merchandise rather than merchanting. In other cases where the form of the goods does not change, the goods are included under merchanting, with the selling price reflecting minor processing costs as well as wholesale margins. In cases where the merchant is the organizer of a global manufacturing process, the selling price may also cover elements such as providing planning, management, patents and other knowhow, marketing, and financing. This description corresponds well to the case studies that have been reported to the Task Force (see next section).

A summary table 3 below provides a synthesis of the recording of merchanting under BPM5 and a comparison with the proposals made for the revision of BPM.

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<sup>20</sup> See the AEG recommendations on merchanting for more detail.

<sup>21</sup> If there is no change of ownership of the goods, there is no merchanting transaction, but there may be manufacturing services on physical inputs owned by others for a fee, as discussed in paragraphs 10. 62-10.64

**Table 3: Recording on *merchandising* under BPM and SNA**

	<i>Economy in which the merchant is resident</i>	<i>Economy of ultimate purchaser</i>
BPM5	<i>Merchandising service</i> provided (when not the same accounting period: import and negative import) (§ 262)	<i>Imported goods shown at full value including merchant's margin.</i>
	Recording of merchandising transactions is asymmetrical: Exports of merchandising services are recorded in the economy in which the merchant is resident. Practical difficulties in compiling regional breakdowns for merchandising services can also arise.	Neither the country exporting the good nor the country importing the good will record these services; however, the value of the goods will be reported differently in the merchandise trade and balance of payments statistics of the two countries. The difference is accounted for by the value of merchandising services supplied by a third country, e.g. economy in which the merchant is resident
	<b>No change of ownership:</b> change of ownership occurs but is ignored.	
BPM6	Trade in <b>goods</b> on a net basis. Negative exports/positive exports in the economy of the merchant: "net exports of goods under <i>merchandising</i> " (§ 10.44c).	<i>Imported goods shown at full value including merchant's margin.</i>
	<b>Change of ownership</b>	
SNA 1993	Import or export of <b>services</b> (net basis) (§ 14.60).	<i>Imported goods shown at full value including merchant's margin.</i>
	<b>No change of ownership:</b> Change of ownership may occur but is ignored in the accounts (§ 14.60).	
SNA 2008	<i>Merchandising</i> will now be recorded as trade in <b>goods</b> in the same way as in BPM6 (Chapter 26, § 26.21).	<i>Imported goods shown at full value including merchant's margin.</i>
	<b>Change of ownership.</b>	

### **2.2.2. Summary of typical problematic cases examined in the Task Force on *global manufacturing***

#### **a) Deliveries of goods between resident units and affiliated enterprises abroad, without change of ownership (including *goods for processing*)**

The Task Force examined cases (NL, FI, AT) in which intra-group transactions in goods are not recorded in source enterprise statistics, and therefore are to be imputed by national accounts. Source statistics record a sale of processing services from the affiliate to the parent company (or between two affiliates of the same group). Imputations made in the case presented to the Task Force used cross-border trade statistics data, other information available from the enterprises and structural information on the kind of activity taken from supply and use tables. The margin between the valuation of imports and exports is kept equal to the service value, so that there is no impact on the value added generated in the operation. How these transactions are recorded is however important for supply-use/input-output tables.

The Task Force observed that the application of the revised standards would change the kind of treatment required in these cases, because the change in ownership principle would be applied and therefore no imputations of transactions in goods would be associated to the physical flows of goods. From the point of view of goods and service classification and, more generally, supply and use tables, the impact of such a change in recording is likely to be important. In practice, the fact of whether there is change in ownership may be difficult to ascertain, or the concept itself may become purely conventional inside multinational groups. This may lead to differences between countries and/or fluctuations over time in how physically identical production processes are classified.

#### **b) No delivery of goods between resident units and affiliated enterprises abroad, but the resident unit acquires the ownership of the goods**

As mentioned above, there are cases described in countries reports to the Task Force in which the group head mainly performs R&D, design and marketing activities which result in a product specification. In these examples the group head typically covers its costs and makes profits by buying the output produced with the given specifications by the affiliates, and selling it worldwide with a margin. A large part of the output does not physically transit in the country of residence of the group head, which however acquires the ownership of the product. (See in particular the case studies presented by SE and FI).

The Task Force agreed that this case should be recorded in the same way as *merchandising*. This means that it is recorded as a service in the present system, but the revised SNA and BPM recommend a gross recording in terms of goods exports, negative and positive.

However, the Task Force also noted that in terms of activity classification, allocation to trade activities of the service output is not considered adequate in the case of global manufacturing.

From the practical point of view, it is also likely that the importance of the case described under this section of the report is in certain economies much higher than that of traditional

merchanting activities, such as commodity dealing. Since there have traditionally been difficulties in recording merchanting in BoP and national accounts, the Task Force considered important to observe that the impact of these difficulties is likely to be higher than in the past. It is therefore advisable that the present state of play of EU Member States as concerns recording of merchanting is reviewed.

As already pointed out before, draft BPM6 contains important innovations in terms of recording of merchanting, which is described as covering "commodity dealing", "wholesale trade" and also "global manufacturing". Following this definition, the activity of the mother company which makes R&D (used to define the technical specification of a product) and outsources to another country all the production would be considered merchanting. To avoid inflating the values recorded under merchanting and to avoid mixing up R&D (or marketing, planning, training, financial services offered by mother headquarters) with pure trade services, it would be more suited to keep "global manufacturing" separate from merchanting. "Global manufacturing" could possibly be considered a new kind of transaction.

### **2.2.3. Intra-group R&D imports and exports**

Especially in multinational groups, it may be frequent that R&D results are transferred to different affiliates without counterpart payments or at values which might be distorted by transfer price practices (see also 2.1. on transfer pricing). In fact, the Task Force did not identify any conceptual problem concerning cross-border transactions in R&D, which should be recorded as imports/exports of services only if there is a quid pro quo counterpart provision of value (payment). However, member states encounter considerable problems in getting reliable data about these transactions, particularly when intra-group transfers of R&D results are involved.

Some of the member states participating in the Task Force presented their approaches and experiences to derive R&D import and export data from R&D surveys and foreign trade in services statistics. The R&D survey is seen as a suitable source to collect R&D internationalisation data. However, in R&D surveys there is no differentiation between sales/purchases and transfers, and a significant amount of R&D may be transferred within multinationals. Other shortcomings are the low frequency of R&D surveys and the lack of long time series in the service industries.

Another possible source for the estimation of R&D imports and exports are statistics on the international trade in services. When the observed financial flows comprise payments of R&D services, the statistics on international trade in services seem to be a reasonable source for the estimation of an R&D trade-balance. However, it is unlikely that trade statistics are able to capture all the intra-group transfer of R&D services.

Comparisons of import and export data on R&D from the foreign trade of services statistics with the results of R&D surveys for R&D contract from abroad (approximately equal to R&D import) and the amount of in-house R&D financed from abroad (compared with R&D export data) show an underestimation in the R&D survey of R&D imports, since most R&D is financed with companies' funds. Differences exist between the two data sources as to population, survey design and definitions. The experience of SE also shows that the recording of transactions linked to *global manufacturing* if recorded as

R&D exports may be a source of asymmetries, because it is unlikely that the counterpart economy would record R&D imports.

### 2.3. Main conclusions concerning intra-group transactions

The case studies show that manufacturing activity makes increasing use of outsourcing, which often takes place across national borders. The transfer of goods between businesses often takes place without legal ownership changing hands. The motivation for such arrangements could be various, notably specialisation, access to global markets and minimisation of the tax burden. Some conclusions on intra-group transactions were agreed by the Task Force:

- The increased importance of *merchanted* or *merchanted*-like transactions<sup>22</sup>, as compared to traditional *merchanted* activities such as commodity dealing and wholesaling, requires a deeper analysis of how these transactions are recorded in member states statistics. There can be in this a case a clear impact on GDP and GNI depending on the full inclusion of these transactions for the countries concerned. At the same time, the risks of asymmetric recording in BoP (goods vs services) are increased.
- In terms of activity classification, allocation to trade activities of the service output is not considered adequate in the case of global manufacturing. At least in one of the practical cases discussed at the Task Force, output is allocated to R&D activities.
- Recording of cross-border deliveries of goods between affiliates when there is no change in the ownership, according to ESA95 3.133 (b), requires imputations based on sources other than enterprise statistics (trade in goods statistics, structural information on the kind of activity). GDP and GNI are not affected by the imputations, as long as the value added derived from enterprise statistics as transactions in services is not altered. How these transactions are recorded is however important in terms of activity classification and for supply-use/input-output tables in general.
- BPM6 foresees that cross-border deliveries of goods between affiliated enterprises should be recorded according to a strict application of the change of ownership principle. But change of ownership may be a very blurred concept in the case of multinational groups and the practical application of the principle may be subject to a certain degree of arbitrariness.
- BPM6 contains important innovations in terms of recording of *merchanted*, which is described as covering "commodity dealing", "wholesale trade" and also "global manufacturing". To avoid inflating the values recorded under *merchanted* and to avoid mixing up R&D, marketing and other services offered by mother headquarters with pure trade services, it would be more appropriate to record "global manufacturing" separate from *merchanted*.

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<sup>22</sup> Of the kind referred as "global manufacturing" in the draft BPM6.

- Recording of intra-group transaction in R&D does not pose conceptual problems, but presents practical difficulties in terms of coverage and valuation.
- The Task Force concluded that a separate identification (including for *merchandising*) of intra-group imports and exports of goods and services would be important because of the peculiarities that characterise such transactions.
- Concerning transfer pricing, users would particularly benefit from such separate identification. In general, systematic imputation of market prices is not considered feasible by the Task Force.

### **3. Approaches to consistent recording of the activities of the multinationals**

This part of the final Task Force report concerns possible approaches to cooperation and exchange of information within a given EU member state (eg: national accounts and BoP compilers; NSI and NCB) and between EU member states. It is divided in three parts: national experiences, cooperation between member states and European initiatives.

#### **3.1 National experiences**

##### **3.1.1 Data Consistency unit in the CSO of Ireland**

To deal with the problems posed by multinationals, it seems very promising the initiative taken by the Central Statistics Office (CSO) of Ireland, which in mid-1990s has established a Data Consistency Unit.

The Data Consistency Unit carries out checks on the consistency of quarterly and annual data returned by individual large manufacturing and non-financial services companies to various divisions within the CSO including the BOP Division. The Data Consistency Unit liaises on an ongoing basis with these divisions and with any company concerned to determine the reasons for any significant discrepancy or inconsistency. In an ongoing effort to improve data quality the Data Consistency Unit operates a programme of company visits and liaison so that the CSO becomes aware as early as possible of any material change in companies' operational, accounting or reporting practices affecting the data returned.

There are some important features in the Irish statistical system which facilitate the consistency analysis:

- The CSO publishes the merchandise trade and BOP data (based on statistical surveys) which means that, when adjustments are required, they can be applied at the most appropriate source;
- The CSO's unique access to company accounting records held by the Revenue Commissioners (tax authorities) allows a detailed comparison of the operating surplus calculations for large companies with their equity incomes data from the BOP source. This allows for a reconciliation of operating surplus and primary income at a very detailed level, so that GDP and GNI calculations for 'consistency' companies can be balanced.

The Consistency Unit brings together a wide range of data for the top 75 individual exporters, including monthly turnovers, annual turnovers, purchases, stocks, imports, exports, value added, service imports and exports and Balance of Payments profit variables. A limited number of variables are compared each quarter but the more detailed examinations are only possible on an annual basis since the detailed Census of Production results and tax accounts for each company are only available annually.

The majority of the large companies export all of their outputs and also import most of their raw materials. It is therefore possible to build up a coherent picture of each

company, comparing turnover with exports, purchases with imports, research and development costs, royalties and other large service payments with Balance of Payments service imports. Ultimately value added from statistical sources can be compared with operating surplus based on tax returns.

Where the data appear to be inconsistent, the company is contacted and very often visited by CSO staff to identify reasons for possible problems. These visits usually take the form of lengthy and detailed discussions with senior financial personnel covering all aspects of the company from legal structure through to complex trading arrangements and pricing policy, including issues concerned with inter-affiliate activity. There are usually several follow-on contacts to establish precisely what is being recorded in the various statistical returns.

### **3.1.2 Working Group ‘*Mothers & Daughters*’ in the CBS of the Netherlands**

The CBS of the Netherlands has also started experimenting something similar to the Irish Consistency Unit. Statistics Netherlands in 2003 set up the Working Group ‘*Mothers & Daughters*’ (‘M&D’). The central objective was to design a theoretical framework on multinationals, develop a database and a procedure to chart the possible distortions in the source statistics and the national accounts, and subsequently to conceive solutions and implement these at the beginning of the statistical process. The actions of the Working Group Mothers and Daughters were more reactive than proactive. In 2007 Statistics Netherlands started the CONGO (Consistent data on large companies) project. The aim of this project is securing consistent data on large companies from different sources (e.g. production statistics, international trade statistics, business statistics). CONGO started out with the 150 largest companies. Account managers monitor consistency on the basis of a consistency matrix, consistency rules and personal expertise.

### **3.1.3 Data Consistency unit in Statistics Sweden**

In Sweden a unit was created in 2004 to coordinate contacts with the 50 biggest enterprises. One of the most important tasks for this unit is to insure the consistency of different sources. Among these sources are Structural Business Statistics, Manufacturing Statistics and Foreign Trade Statistics for Goods and Services. Many of the covered enterprises are MNE's. So far more consistent sources have been achieved for annual accounts. Sweden is now moving on to use the same approach for quarterly accounts.

### **3.1.4 Internal co-ordination group in Statistics Finland**

This is project that started in January 2008 in Statistics Finland and groups participants from different economic statistics in the institute. The project addresses quarterly data collection from big multinational enterprises, in order to exchange experiences among producers of various economic statistics and improve their coherence. The activity of this group in 2008 concerned 5 enterprise groups. 7 enterprises belonging to those groups were visited by Statistics Finland. Different economic variables were reviewed and compared for consistency among the various statistical domain concerned: domestic sales, sales abroad, exports of goods, exports of services, value and volume of production, producer prices. Special issues analysed were also: outsourcing, borderline between goods and services, treatment of foreign subsidiaries and branches, data collection from the point



of view of big enterprises (use of reasonable units, easily compiled forms, clear and unambiguous definitions).

### **3.1.5 Coordination in Belgium within the National Bank**

The National Bank of Belgium (NBB) is in charge of compiling the Bop, the Foreign trade statistics and the national accounts. The statistical department of the NBB has always tried to guarantee high consistency between data collected at the enterprise level for those different purposes. In the case of multinationals, the surveys made to affiliates for FDI and Bop statistics contain information on the structure of the group, the control of the group and the type of investment. This information is used for controlling the FTS declarations and also used in the compilation of national accounts. Unfortunately it is not possible to address this survey to the "quasi transit trade" units that are not incorporated but just use a mailbox and a VAT number in Belgium.

### **3.1.6 Overview of the current situation in the UK concerning exchange of data and cooperation for producing statistics on multinationals**

The Office for National Statistics (ONS) is the national statistical institute responsible for the production and dissemination of national accounts, including balance of payments statistics. The source data used to compile the accounts is based primarily on monthly, quarterly and annual surveys. In terms of the balance of payments, while some survey information is available for the household sector; for example, the International Passenger Survey; most of the source information comes from business surveys. Most of these business surveys are conducted at the Newport office of the ONS, using the Inter-Departmental Business Register (IDBR) as the sampling frame.

The IDBR is the comprehensive list of UK businesses that is used by government for statistical purposes. It provides a sampling frame for surveys of businesses carried out by the ONS (Office for National Statistics) and by other government departments. It is also a key data source for analyses of business activity.

It is based on inputs from three administrative sources: traders registered for Value Added Tax (VAT) purposes with HM Revenue & Customs (Customs); employers operating a Pay As You Earn (PAYE) scheme registered with the HM Revenue & Customs (Revenue); and incorporated businesses registered at Companies House. The ONS Business Register Survey and other surveys supplement these administrative sources, identifying and maintaining the business structures necessary to produce detailed industry and small area statistics.

The IDBR covers businesses in all parts of the economy, other than some very small businesses (self-employed and those without employees and low turnover) and some non-profit making organisations. With 2.1 million businesses listed it provides nearly 99% coverage of UK economic activity. It holds a wide range of information on business units including; standard industrial classification, employment and employees, turnover, legal status (company, sole proprietor, partnership, public corporation/nationalised body, local authority or non-profit body), country of ownership and aggregates for Intrastat data on

the value of goods and services that are traded (imports & exports) between the EU member states and the UK.

The Foreign Direct Investment surveys (FDI) use a historical list of key investors supplied by the Department of Trade and Industry several years ago, each of which is identified on the IDBR. This list is supplemented by enterprise groups that the IDBR identifies through its annual update of enterprise group structures. Dun and Bradstreet is the main provider of the group linkage information that is used for the IDBR updating. This is supplemented by the Mergers and Acquisitions Survey and HM Revenue and Customs VAT group linkages.

The preferred reporting structure for surveys using the IDBR is based on the enterprise. Where an enterprise group has a complex structure it is subject to business profiling within the Business Registers Unit, which determines an appropriate structure that can be used for most, if not all, ONS business surveys. In the case of the FDI, however, the domestic UK (truncated) enterprise group may be more appropriate and in some cases, with the agreement of the business, a specific reporting arrangement can exist within the enterprise group. During the survey contact procedures, in which the new Annual and Quarterly survey selections are validated, the ONS Data Validation Branch (DVB) and Intelligence Gathering Unit (IGU) in Newport negotiate with the companies to ascertain which parts of the group should receive the questionnaires and which parts of the overall structure should be reported on under the fully consolidated system. This contact can continue throughout the life cycle of the survey contributor. The IGU, DVB and Business Profiling Team work in close cooperation to minimise the compliance on the business while still satisfactory these complex statistical demands. The IGU has a further role in communicating with survey contributors the concepts behind the FDI.

In the UK, trade in services are derived from a number of survey sources. The main source is the International Trade in Services (ITIS) Survey, which is run by the ONS and covers imports and exports by private non-financial companies, excluding transportation surveys. The ITIS survey is a sample survey run using the IDBR. Financial companies' trade in services are covered by a number of surveys run by the ONS and the Bank of England. The main surveys for exports of transportation are run by the Civil Aviation Authority, the UK regulatory body for the airline industry and the UK Chamber of Shipping the UK's trade association for sea transportation companies.

Trade in goods data are derived principally from data provided by HM Customs and Revenue on the physical goods exported from and imported to the UK.

### **3.1.7 Data consistency in Portuguese National Accounts**

Statistics Portugal (INE) compiles the Foreign Trade Statistics (Goods) and the National Accounts and the Bank of Portugal compiles the Balance of Payments (BoP), including foreign trade services. Coherence and consistency of each enterprise on transactions carried out abroad are checked by using different available sources.

First, the analysis was made in the internal division and a very detailed level (individual data) and the following sources were used:

- a. Universe of the National Accounts taken from the Central Register of Enterprises and Establishments;
- b. Foreign trade statistics for goods;
- c. VAT – Value Added Tax (administrative data) - sales carried out abroad;
- d. ITC – Income Tax of Corporations (administrative data). This source includes information on transactions carried out abroad.

Whenever the data analysed seem to be inconsistent a direct contact with the enterprise is made.

Secondly, there are regular contacts between Statistics Portugal and the Bank of Portugal in order to harmonise the Rest of World Account and BoP, especially the item “services”, which is taken out of the BoP.

### **3.1.8 The case of Cyprus: changing the residence status of Brass Plate Companies in co-operation with the Central Bank of Cyprus (CBC)**

Statistical Service of Cyprus (CYSTAT) is currently using the practice to consider resident units for statistical purposes those companies which are registered in Cyprus, have their center of economic interest within the economic territory and also have physical presence in Cyprus.

In the beginning of 2007, the European Central Bank (ECB) informed the CBC that the residency definition should be changed and we should consider resident units all the companies which are registered in Cyprus, independently if they have premises in Cyprus or they are conducting business outside Cyprus. In February 2007, CYSTAT and the CBC agreed to the setting up of a joint technical group in order to coordinate, in the best possible way, the efforts towards the achievement of the aforementioned task and the impact of such amendment on National Accounts and Balance of Payment statistics. This joint technical group is composed of officers from National Accounts Division of CYSTAT and officers from the Statistics department of CBC. Furthermore, CBC accepted the proposal of the ECB to employ an expert for technical assistance on the subject.

The main source of information for Brass Plates (BP) data treated as residents is the Banking Settlements system (ITRS). Monetary Financial Institutions (MFIs) report transactions of their BP customers using bank accounts in Cyprus. Since the MFI source can give only a limited picture of BP’s overall transactions, two new survey forms (one for BPs shipping companies and one for other BP companies) are about to be sent. The first survey is addressed to ship owners whose registered companies are BPs. The half-yearly form requires information on the entity’s Share Capital, its Direct Investment links with non-resident entities, information on the ship owned and information on various revenues and expenses associated with it, broken down by country.

The other survey is addressed to BPs non-shipping companies in which non-residents have a direct stake, seeking information about the ownership structure and the BPs’ revenue and expenditure incurred in Cyprus and abroad with country breakdown.

The Central Bank of Cyprus is currently producing two set of data concerning BoP Statistics. The official set of data (the one still used in NA) is treating BP as non-resident

and simultaneously another set of including BP is produced and sent to ECB for the production of Euro area statistics. This practice is in force from the 2008q3 and onwards.

The National Accounts division is planning to include BP's data according to the recommendation of the current final report of the Task Force of Multinationals when the data from the two new surveys mentioned above will be available.

## **3.2 Cooperation between Member States**

### **3.2.1 UK ONS and the co-operation between national statistical institutes**

Various projects are taking place within the ONS to improve the quality of Intra-EU statistics:

- 1.1. Recently the UK agreed to participate in the bilateral exchange of FDI data with the Central Banks of the Netherlands and Luxembourg, to investigate reasons behind asymmetrical reporting, and to improve the quality and interpretation of intra-European Union balance sheet data and financial flows. The legal framework used to exchange the data appears under article 8(3) of the Regulation (EC) No 184/2005. Confidentiality is discussed further in section 6.
- 1.2. Member States have agreed that business registers need to provide the base for measuring the impact of globalisation. The new business registers Council regulation that is close to adoption includes a requirement to hold data on enterprise groups. In preparation for the proposed register of multinational enterprise groups, the EuroGroups Register (EGR), Eurostat set up a project in 2006 that the Netherlands led with the UK, Germany and Hungary participating to generate a pilot EGR. The project used as its starting point a previous informal project led by Statistics Canada with participation from the UK and other EU Member States. The Eurostat project team completed the work in December 2006 using data from Dun and Bradstreet (DnB) and Bureau van Dijk.

The project generated global enterprise group structures for 600 enterprise groups operating within the European Union together with the share ownership relationships. For each global group the industrial classification and employment of the group members is also held. The final system will also hold information on special purpose entities. The project identified three types: Financial Vehicle Corporation, Financial Corporation engaged in lending and Financial Holding Corporation. The operational system will provide information that will support fully the foreign direct investment and foreign affiliate's trade statistics.

The EGR project is described more in general under point 3.3.1 below.

### ***Confidentiality***

The National Statistics (NS) Code of Practice sets out the professional principles and standards which official UK statisticians are expected to follow and uphold. It is

supported by twelve Protocols which describe how those principles and standards are to be implemented in practice (National Statistics 2004).

The Protocol on data access and confidentiality states that, “the National Statistician will set standards for protecting confidentiality, including a guarantee that no statistics will be produced that are likely to identify an individual unless specifically agreed with them. ...The only circumstances in which the confidentiality guarantee may not apply in principle... [includes where] access is given, subject to confidentiality constraints, to the Statistical Office of the European Communities (Eurostat), or to other international organisations, as specified in legislation or by treaty and/or under the direction of the Responsible Statistician, and where the Responsible Statistician retains by agreement, contract or regulation full control over the further use of the confidential data.” (ONS, 2004).

There are a number of EC Regulations that can be used for the exchange of disclosive aggregate information. The business registers Council Regulation that should be implemented by the end of 2007 makes provision for the exchange of a limited range of variables for individual businesses. This is a sensitive subject that will be implemented only through specific subsequent Commission Regulations. The wider issue of access to confidential microdata is the subject of a wider EU review of statistical confidentiality.

### **3.2.2 Cooperation between National Bank of Belgium and CBS Netherlands**

In order to solve big discrepancies between trade flows reported from some "quasi transit trade" units whose direct headquarter is located in Netherlands, a meeting has been organized between the NBB and Statistics Netherlands for screening the data from the headquarter company in the Netherlands with those of the "quasi transit trade" unit in Belgium. This data comparison was successful and it led to the conclusion that in the majority of the cases the data sets were consistent and that further investigation can be limited to the remaining cases.

## **3.3 European initiatives**

### **3.3.1 Euro Groups Register Project<sup>23</sup>**

The EuroGroups Register (EGR) project was launched at the end of 2005, covering a feasibility study on creating and maintaining the EGR at Eurostat. At the end of 2006 Eurostat finalised the pilot project. The pilot project tested a mechanism of exchange of confidential data between the central EGR and 4 NSI's, NL, DE, HU and UK, (both ways) to complement their national business registers with relevant data on MNE's operating on their territory. The pilot project was successful. At this point in time the EGR includes 600 MNE's with at least one group member (in total about 80,000 group members) inside the EU. In 2008 the national statistical agencies of all Member States will be involved.

For the moment the EGR only includes multinational enterprise groups consisting in legal units. The new EC regulation also covers natural persons as ultimate owners of

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<sup>23</sup> The EGR project is managed by Eurostat Unit G-1: Structural business statistics (Business registers, Prodcum and SBS). For the most recent developments, this part draws on a document presented at the end of March 2009 to the BoP Working Group by Unit G-1.

enterprises. In addition, the inclusion of specific data on SPE in the EGR is planned. The new EC regulation has not touched on some issues concerning the classification of and terminology relating to Special Purpose Entities. However, on Member State level, future NACE Rev.2 codes 6420 (activities of holding companies) and 6430 (trusts, funds and similar financial entities) are attributed to entities which could be characterized as SPEs. A harmonised definition of SPE is necessary. The EGR will adopt a definition, even if it is formulated "outside" the project.

The new EC regulation on business registers (published in the Official Journal on 20 February (177/2008)) specifies the data exchange, but does not cover all technical details to leave room for flexibility. A technical recommendation manual will include these issues and an update on a yearly basis is foreseen. In 2007 calls for tenders were launched for further data acquisitions and IT development. The aim is that in 2009 all the largest enterprise groups are included in the EGR.

Concerning the most recent activity of the EGR, Eurostat received at the beginning of January 2009 data sets with 5000 MNEs (Multi-National Enterprise groups) from two commercial data providers: Dun and Bradstreet and Bureau van Dijk, of which 2700 are pre-selected in cooperation with the Member States.

The EGR operations have started with the loading of the data from the mentioned providers, the standardisation and the linking of the legal units from both sources. In this process also a unique identifier for legal units is created.

The results of the linking process were sent to the National Statistical Institutes (NSIs) of the Member States (MS) (including EFTA countries) in the beginning of February for validation and for linking the provided legal units to their own statistical business register. This is a crucial part of the process. First reports look promising, e.g. the UK reported that nearly 97% of the legal units could be linked automatically to their statistical business register. However, other countries like Germany will need more efforts/resources to achieve comparable results. On 19 and 20 February the ESSnet on EuroGroups registers had a workshop on this work flow. The MS have sent their feedback to the central EGR during the period March-April.

The next step is the integration in the central EGR of information on legal units and their (control) relationships as available in the national registers. In May another workshop will be organised for the MS.

One of the main aims of the activity in 2009 is to define the right UCI (Ultimate Controlling Institutional unit) for at least 500 MNEs which are statistically the most relevant for Inward and Outward FATS and FDI. To support this aim a Task Force on UCIs (with NSIs as well NCBs) has been established.

At the end of April 2009 a preliminary population of global enterprise groups was established, among which an indicator on the top 500 (most important MNEs for FATS/FDI). Data sets on these preliminary enterprise groups are available for MS from the beginning of May onwards, with reference year 2008. Variables covered are for the moment turnover and employment. NSI have access to the information contained in the EGR provided that the group has at least one unit in their member state. Data for SPEs are also being integrated in the EGR, but this process is not yet completed.

Members of interested working groups will be informed about this delivery and about the contact persons within the NSIs. Because these data are still based on the integration of the data from the commercial sources, there exist no confidentiality issues. It is agreed with the data providers that NSIs and NCBs may use the data only for statistical purposes.

### ***Implementing Commission Regulations on EuroGroups Register***

The first implementing Commission Regulation (EC) 192/2009 on the mandatory data exchange between Eurostat and the NSIs was published on 12 March 2009 in the Official Journal of the European Union.

In the Business Register Working Group of September 2008 it was agreed to make a questionnaire regarding the present co-operation and exchange of data between the NSI and the NCB, known differences between the registers, legal restrictions and possibilities of authorisation of the data exchange, minimum/maximum set of characteristics that should be shared. This questionnaire was sent out at the end of 2008.

The results were discussed in the working group on Business registers on 4 March 2009. NCB's were invited to take part. The outcome will be used to work on the second Commission Regulation on the data exchange with ECB and NCBs. One of the outcomes was a need for a common strategy on the future interaction of registers on the European level, like EGR and RIAD, as well as national registers.

### ***Involvement of the ECB and of NCBs***

In cooperation with the ECB an outline has been drafted for an agreement on cooperation between the ESS and ESCB concerning the EGR. This draft was discussed in the ECB/Eurostat management meeting at the end of March.

The quality of the EGR would benefit from national cooperation between NSIs and NCBs. The future organisation of the work and data flow will be developed in the coming years on the basis of the following elements:

1. the Commission Regulations on data exchange;
2. the national model(s) for cooperation between NSIs and NCBs on data quality management;
3. the use of the EGR data in statistical production processes.

## **3.3.2 Exchange of data in FDI statistics – FDI Network of EU BOP compilers**

### ***Background***

Pilot exercises run by Eurostat and the ECB in the field of FDI statistics indicated a lack of bilateral matches of the FDI transactions collected by the Member States. As a result, it was suggested that a way to improve the coverage of the FDI transactions would be to exchange information on larger transactions on a regular basis instead of limiting data exchanges on transactions to ad-hoc exercises.

One of the proposals was to establish a network for the exchange of micro data related to larger FDI transactions, wherever legally possible, in order to tackle the asymmetries in FDI and reduce the net errors and omissions of the euro area b.o.p. Furthermore, it was proposed to organise a workshop to exchange information on larger FDI positions that would also allow updating the sample of reporting corporations used in FDI statistics across Member States.

Eurostat investigated the possibility to use the available IT tools that would enable such data exchange in the secured environment without large scale investments and identified eDAMIS as a possible solution. In October 2008, the ECB's WGES and Eurostat's BOP WG supported the joint Eurostat/ECB proposals to organize a workshop for national FDI compilation experts with the aim of agreeing on the technical solution, the scope and the process, including a template, for the exchange of data on FDI transactions. It was decided that work will initially focus on FDI transactions and that exchange of data on FDI positions will be prepared in a further workshop.

### ***FDI Network workshop***<sup>24</sup>

To prepare for the efficient workshop discussion, Eurostat and the ECB provided participants a number of background documents/presentations describing the main aspects of the data exchange scheme, the main features of eDAMIS, analysis of bilateral asymmetries and a questionnaire to collect necessary input information for the workshop.

It is understood that, whereas participation in a data sharing scheme will be voluntary, it lies in the very nature of such a scheme that quality of the statistics at both the national and European levels will strongly increase with the number of participants. The FDI Network workshop participants developed and agreed on the following main aspects of the data exchange scheme:

#### 1. Scope of the FDI Network

- a. Information and data to be included in the exchange template;
- b. Identification of transactions;
- c. Threshold concerning the value of the transaction.

#### 2. Implementation of the FDI Network

- a. Procedures (initiative, timeliness, frequency);
- b. Reconciliation of non-matching transactions;
- c. User requirements for technical infrastructure (including actions to prepare the technical infrastructure for data exchange using eDAMIS);
- d. Mechanisms to ensure data protection.

The issue of confidentiality was thoroughly addressed in the workshop. According to the responses to the questionnaire, the vast majority of Member States are in a position to exchange data classified as confidential at national level in a secure way with the aim of safeguarding the quality of b.o.p. statistics of the European Union/Euro area. It has been clarified that Article 8 of the Regulation (EC) No 184/2005 is an enabling clause, i.e. it

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<sup>24</sup> The workshop was jointly organized by Eurostat/ECB on 25-26 November 2008 at Eurostat's premises in Luxembourg and attended by participants from 23 EU Member States.



allows for the exchange of confidential information between Member States for quality improvement and safeguarding purposes. The Regulation overrides national legislation (even if national law would prevent exchange of confidential information); hence for the purposes of quality improvement of balance of payments figures of the European Union, the exchange of confidential data is allowed. The Regulation on European Statistics (adopted by the Council on 19.2.2009) and the updated Regulation No 2533/98 concerning the collection of statistical information by the European Central Bank are also expected to contain respective provisions on the permitted exchange of confidential data.

### *The state of play and the way forward*

1. In its meeting of 4<sup>th</sup> of February 2009, The Balance of Payments Committee endorsed the FDI Network Workshop conclusions and supported its future work. The Committee considered the work on reducing asymmetries very important and several delegates encouraged all countries to participate.
2. Eurostat and the ECB DG-Statistics will draft a document (guidelines) describing the agreed upon working practices of the FDI Network. That draft was circulated to the FDI Network for comments in early March.
3. A technical testing took place in January/February 2009, where Italy, Denmark and Austria transmitted dummy data through eDAMIS. The tests were successfully carried out.
4. A contact list of persons authorised to send/receive files via the FDI Network has been drawn up (with a maximum of three persons from each Member State).
5. The actions by the Member States to prepare the technical infrastructure for data exchange using eDAMIS are expected to be carried out in March 2009.
6. The start-up phase of the actual FDI Network and the first exchanges of actual data are expected to take place in late March or April 2009. Already 20 countries have indicated that they will participate in the FDI Network; a few others are still contemplating.

### *Next workshops*

It was agreed to organise a follow-up workshop to discuss the experiences gained from the initial exchanges of data. This workshop will take place in the course of 2009 and will also address the possibilities for the exchange of data on FDI positions as suggested in the STC Report. Actual exchange and comparison of data on FDI positions is expected to be carried out in a separate workshop.

Furthermore, the International Monetary Fund is organising a Coordinated Direct Investment Survey (CDIS) in 2010 focusing on country bilateral positions as of the end 2009. The results of that survey will expose worldwide the asymmetries between mirror data. That date could thus be agreed as a target for completion of a first wave of improvement to FDI figures at European level.

### **3.3.3 MEETS project: Modernisation of European Enterprise and Trade Statistics**

The objective of this project is to support member states' NSIs and NCBs initiatives targeted at developing appropriate structures or programmes for an improved treatment of the statistical reports of multinationals. A promising way for improving the statistics related to large enterprises operating on an international/global scale is checking the consistency of statistics reported by multinationals in different statistical domains.

### **3.4 Main conclusions and Task Force recommendations**

At the end of its discussion on possible approaches to consistent recording of the activities of the multinationals, the Task Force agreed on the following **recommendations**:

**R8** The Task Force recommends that member state set up a "consistency unit" or a similar organisational structure in their NSI for a consistent recording in national accounts and in balance of payments of items related to multinationals. This may require the involvement of the national central bank and of other national statistical authorities. The MEETS project may represent an opportunity to support such a development in member states.

**R9** The Task Force recommends that Eurostat organize exchange of data between national accounts compilers for multinational enterprises and SPEs in particular. The organisational structure of the FDI Network may serve as a reference for such an exercise. Such a type of organisation is considered useful to foster cooperation between national compilers and alleviate the problem of confidential information.

**R10** The Task Force recommends that the data on SPEs are included in the EGR, clearly flagging such entities in the business register and if production is included in the country of residency, taking into account the classification of SPEs given in the final report of the Task Force. A sub-sector (institutional) classification would need to be created for better harmonisation.

**R11** The types of SPEs observed in economic reality may change over time. Member states should provide information to the NAWG and to the BOPWG as soon as they observe new types of SPEs.

**R12** The NAWG and the BOPWG should regularly monitor the evolution of initiatives on statistics for multinationals of international bodies such as the OECD and the UN and inform the participants.