Economic Ownership and Changes in Ownership

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Ownership in statistical standards

- What is ownership in context of SNA 2008 and BPM6?
- Why is it so important?
- What are we trying to identify?
- Is it feasible?
Outline of Presentation

- Review of ownership in statistical standards
- Economic ownership in accounting standards
- Transfer pricing and Ownership
- Ownership in Global Production Chains
- Conclusions
Changes in Economic Ownership

- At IMF BOPCOM in Pretoria October 2004 paper presented on adoption of:
  
  *Concept of Change in Economic Ownership*

  The Advisory Expert Group had already accepted the issue as part of the review of SNA’93 leading ultimately to SNA2008
Why is this concept so important?

- Impacts the calculation of statistical aggregates
- A transaction can only occur where there is a change of economic ownership for existing assets and liabilities
- All transactions - purchases and sales of goods and services are as a result of changes in economic ownership
- The timing of the recording of the transactions is when the change in economic ownership occurs
What do the statistical standards have to say?

- There are no longer any exceptions to the recording basis of the change in economic ownership.
- The time of recording of the acquisition of goods is the moment when the economic ownership changes hands.
- In general within the SNA when the expression ownership or owner is used and the legal and economic owners are different the reference should be understood to be the economic owner.
Within a large enterprise with several specialized establishments it is not immediately obvious whether a delivery of goods from one establishment to another is to be recorded or not. Since all establishments have the same ownership the distinction between economic and legal ownership needs refining.

The criterion used is to record a delivery or transaction when the receiving unit assumes the responsibility in terms of risks and rewards of the items delivered....
Economic ownership within MNEs

- When transactions or deliveries occur between entities in a MNE
  - Has a change in economic ownership taken place?
  - The parent ultimately owns the group so is the parent the owner in all cases?
  - If not the parent what is the basis for recording these types of transactions?
and SNA 2008 on Economic ownership within MNEs

- In BPM6 “the change in economic ownership is considered to occur ...by the time the parties to the transaction record it in their books or accounts”

- If an affiliate of an MNE prepares a separate set of accounts and a balance sheet this also indicates a level of autonomy

- For branches although they are the same legal entity as the parent - in practice it is treated as a separate entity from the parent - each branch is treated as a direct investment enterprise – a complete set of accounts exist.
Institutional Units

- The availability of separate records indicates that a unit exists and makes it practical to prepare statistics.
- If the production does not involve physical presence - banking insurance etc. Should be recognized as being in the territory by virtue of registration or legal domicile or subject to income taxes.
- SPEs are treated as separate institutional units if they are resident in a different territory to that of their owners.
Institutional Units

- Capable of owning goods and assets
- Incurring liabilities
- Engaging in economic activities and transactions with other units in its own right
Ownership and Business Accounting

- Reporting for Business accounts is sometimes less detailed than statistical reporting—geography, activity, transactions etc.
- In UKGAAP - FRS5 accounts are required to reflect the substance of a transaction rather than its legal form.
- IAS 8 states that for information to be reliable it must be reported in accordance with economic substance rather than strictly in adherence with legal form.
- IAS 27 – Leasing; requires recognition of economic ownership of a leased asset—similar treatment for repurchase agreements.
Ownership and Transfer Pricing

- Pricing of goods and services between related entities of an MNE
- Historically the view is that the tax paying entity in some scenarios is not the economic owner
- Importance of OECD Transfer Pricing Guidelines
- Arms length pricing for intra firm transactions
- Series of tests to determine if transactions are at market or off market prices
Ownership in Global Production Chains

- Ownership structure – subsidiaries, associates and other affiliates
- Ownership of output of goods and services along the production chain
- Entities in these chains not necessarily related companies or part of the MNE Group
- Nature of the relationship with Contract Manufacturers (CMEs)
- Case of Branches of corporations
Identification of Change in Ownership

- Difficulties associated with identification and recording of Goods for processing and Merchanting
- Often a feature of production chains
- Recognition of the change in economic ownership in relation to these activities in SNA 2008 and BPM6
- Previous standards did not always recognise the change in economic ownership
Merchanting and Processing in Global Production Chain

**Physical movement**

- R&D / Design - US
- Raw Materials - US
- Intermediate inputs - FR
- Semi-finished goods - DE
- Final Good Assembly and Packaging - UK
- Warehouse - BE
- Retail/Delivery - EMEA
- Customer Service

**Economic Ownership**

- Principal - NL
- Merchant - IE
**Flows associated with Global Production Chain**

<table>
<thead>
<tr>
<th>Role</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>Input supplier</td>
<td>Raw materials</td>
</tr>
<tr>
<td>France, Germany &amp; UK</td>
<td>Manufacturer</td>
<td>manufacturing service fee (NL)</td>
</tr>
<tr>
<td>Netherlands (economic owner)</td>
<td>Principal</td>
<td>Raw materials (US)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Manufacturing services (FR, DE, UK)</td>
</tr>
<tr>
<td>Belgium</td>
<td>Warehousing</td>
<td>Fees for warehousing &amp; logistics services (IE)</td>
</tr>
<tr>
<td>Ireland (economic owner)</td>
<td>Merchant</td>
<td>Branded goods (NL)</td>
</tr>
<tr>
<td>EMEA</td>
<td>Final consumption</td>
<td>Branded goods (IE)</td>
</tr>
</tbody>
</table>
Factoryless Production and Economic Ownership

- Factoryless Producer - produces a product but critically does not engage in the production process itself.
- Factoryless producer (FP) may or may not own the material inputs used in the production process.
- In line with ISIC 4 if the FP owns the material inputs it is classified as a manufacturer.
- If not, the FP is classified as a trader – simply purchasing a finished or semi-finished product from a CME and selling it on to a customer.
- This treatment ignores the ownership of the IP being used in the process - which is in many cases more significant than the material inputs.
Factoryless Production and Economic Ownership – Contract Manufacturer relationship

- Relationship between principal (FP) and CME can be complex
  - Principal might fund working capital of CME
  - Principal might be sole customer of CME
  - Principal might sell components to CME and buy back finished product
  - Principal retains IP ownership and rights

- What is the status of the Principal and CME?
Factoryless Production and Economic Ownership

- Opinion of TF is that the Factoryless Producer is a manufacturer and should be classified to this activity
- Irrespective of whether the FP owns the material inputs
- The key ownership relates to ownership of the IP being used in production process
- If the FP does not own the IP then it can be considered to be a trader
Inventories Abroad – change in economic ownership

- Arising from adoption of the change in economic ownership inventories recording has changed
- Formerly inventories abroad might have ended without an owner in the statistical accounts
- The change in merchanting recording where transactions are recorded gross means that if one of the transactions is unsettled there is a negative export only recorded
- In the national accounts this is recorded also under change in stocks and the overall impact is neutral for GDP
Inventories Abroad – change in economic ownership

- In the case of processing if the goods produced by the CME are still on site they are recorded under changes in stocks on the expenditure side of the National Accounts.
- On the value added side they are recorded as output of manufacturing (adjusted for the processing fee etc.).
- Overall the inventories are recorded as part of the capital formation where the resident or merchant is resident.
Conclusions

- Importance of the concept of change in economic ownership
- Application of the concept in the case of inter affiliate transactions in a MNE Group
- Consistency between business accounts - IAS and statistical standards
- Case of Factoryless Production - classification based on ownership of inputs
- Treatment of inventories abroad - need to be recorded under new standards
Merchanting

Movement of goods/services

Germany - affiliate exporter/seller

Japan – third party importer/buyer

Change in ownership

Ireland - affiliate Merchant

Cash settlement