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PROGRESS REPORT OF THE EUROSTAT TASK FORCE ON MULTINATIONAL ENTERPRISES

CASES OF INTRA-GROUP TRANSACTIONS IRRESPECTIVE OF THE KIND OF ENTITY INVOLVED

<u>Note by Eurostat</u>

Summary

The Task Force on the recording of certain activities of multinationals in national accounts was set up by Eurostat in 2007 on request of the Gross National Income Committee. In the following text, the results of the fact-finding exercise on the recording of some cases of intra-group transactions in the European Union countries participating in the Task Force will be presented. 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 research and development imports and export.

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I. INTRODUCTION

1. The Conference of European Statisticians decided at its 2007 plenary session that a Group of Experts on the Impact of Globalisation on National Accounts be created to review the main distortions in the compilation of national accounts caused by the growing globalisation of economies and to develop recommendations on how to deal with these distortions. The election of the Group of Experts was approved by the Executive Committee of the United Nations Economic Commission for Europe (UNECE) at its twentieth session (27 February 2008). The Group of Experts will work in cooperation with Eurostat and the Organisation for Economic Co-operation and Development (OECD). The present document contains an input for the preparation of the Recommendations.

A. Intra-group transactions

2. 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:

(a) Transfer pricing;

(b) Recording of transactions related to the so-called global manufacturing; and

(c) Intra-group research and development (R&D) imports and export.

B. Transfer pricing

3. 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.

4. The Task Force discussed the guidance contained in the fifth edition of the Balance of Payments Manual (BPM), fifth edition, and related International Monetary Fund (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.

5. The Task Force also discussed the BPM, sixth edition, which does not change the treatment of transfer pricing, but goes in more detail as to the description of the typical cases. For instance, paragraph 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".

6. The BPM, sixth edition also recognises the difficulties that compilers encounter in imputing market prices to intra-group transactions. Paragraph 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.

7. 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.

8. Luxembourg reported that in some cases related to companies managing non-incorporated investment funds or Société d’Investissement A Capital Variable (SICAV), dividends paid are reclassified as imports of management fees.

9. 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-European Union (EU) countries.

10. The Task Force also considered that transfer pricing can have an impact on gross domestic product (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 gross national income (GNI), by an opposite difference in property income (distributed or not distributed). Nevertheless, in a specific case mentioned by the IMF Balance of Payments (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.

11. 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.

12. 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.

C. Global manufacturing

13. The term global manufacturing[1] 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 product and in general the goods may not enter the country of the group head[2]. 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.[3]

14. 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.

1. International statistical standards with reference to global manufacturing, goods for processing and merchanting

15. 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 BPM, sixth edition 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

[1] Global manufacturing and its treatment in statistics has been discussed during the revision of the System of National Accounts (SNA) 1993 and BPM. This discussion took place under the topics of merchanting and goods for processing (background papers can be found under issue 41 of the Advisory Expert Group on National Accounts (AEG) in the UN website dedicated to the SNA update).

[2] This aspect makes global manufacturing organisation similar to traditional merchanting in terms of transactions and change of ownership.

[3] 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.

manufacturing, goods for processing and merchanting according to the latest available version of the BPM, sixth edition and System of National Accounts (SNA) 2008, Rev.1 is given below.

16. 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)

17. ESA (European System of Accounts) 95 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[4]. 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)[5]. In this case a change of ownership is imputed even if the transaction takes place between unaffiliated enterprises.

18. The BPM, sixth edition contains substantial innovations concerning these principles of ESA95 3.133. In particular, paragraph 10.24 of the BPM, sixth edition 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:

(a) 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;

(b) 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.

19. BPM, sixth edition 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.

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[4] ESA95 3.133 (b) corresponds to paragraph 14.59 of the 1993 SNA and 205 of BPM, fifth edition.

[5] In the present system of BPM, fifth edition 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 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.

20. Concerning more specifically the case of goods for processing, the ESA95, the 1993 SNA and the BPM, fifth edition 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.

21. 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 BMP, sixth edition stipulates that gross values of goods sent abroad for processing should be identified as supplementary items.

22. Some relevant paragraphs of the draft BPM, sixth edition 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 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."

23. 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.

24. 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).

25. A summary table 1 below provides a synthesis of the recording of goods for processing under BPM, fifth edition and a comparison with the proposals made for the revision of BPM.

Table 1. Recording of goods processed abroad under BPM, fifth edition and BPM, sixth edition

BPM, fifth edition	Goods sent abroad for processing and…		
	re-imported	sold to residents of the processing country	sold to residents of a third country
Sending country	**Goods exports** before processing and **goods re-import** after processing	**Goods exports** **Import of services** of the value of the processing	**Goods exports** **Import of services** of the value of processing
Processing country	**Goods imports** before processing and **goods re-exports** after processing	**Goods imports** **Export of services** of the value of processing	**Export of services** of the value of processing
Third country			**Goods imports**

BPM, sixth edition			
Sending country	**Import of services** of the value of processing	**Goods exports** **Import of services** of the value of processing	**Goods exports** **Import of services** of the value of processing
Processing country	**Export of services** of the value of processing	**Goods imports** **Export of services** of the value of processing	**Export of services** of the value of processing
Third country			**Goods imports**

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

26. BPM, fifth edition paragraph 262 defines merchanting 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. Merchanting 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.

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

(a) The acquisition of goods by merchants is shown under goods as a negative export of the economy of the merchant;

(b) The sale of goods is shown under goods sold under merchanting as a positive export of the economy of the merchant;

(c) 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

(d) Merchanting entries are valued at transaction prices as agreed by the parties, not free on board (FOB).

28. The net exports so calculated should be matched by an output of trade services on the resource side[6].

29. Furthermore, the BPM, sixth edition 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.[7] 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).

30. A summary table 2 below provides a synthesis of the recording of merchanting under BPM, fifth edition and a comparison with the proposals made for the revision of BPM.

Table 2. Recording on merchanting under BPM and SNA

	Economy in which the merchant is resident	Economy of ultimate purchaser
BPM, fifth edition	Merchanting **service** provided (when not the same accounting period: import and negative import) (paragraph 262)	Imported goods shown at full value including merchant's margin.
	Recording of merchanting transactions is asymmetrical: Exports of merchanting services are recorded in the economy in which the merchant is resident. Practical difficulties in compiling regional breakdowns for merchanting 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.

[6] See the AEG recommendations on merchanting for more detail.
[7] 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

	Economy in which the merchant is resident	Economy of ultimate purchaser
		The difference is accounted for by the value of merchanting services supplied by a third country, e.g. economy in which the merchant is resident.
	No change of ownership: change of ownership occurs but is ignored.	
BPM, sixth edition	Trade in **goods** on a net basis. Negative exports/positive exports in the economy of the merchant: "net exports of goods under merchanting" (paragraph 10.44c).	Imported goods shown at full value including merchant's margin.
	Change of ownership	
SNA 1993	Import or export of **services** (net basis) (paragraph 14.60).	Imported goods shown at full value including merchant's margin.
	No change of ownership: Change of ownership may occur but is ignored in the accounts (paragraph 14.60).	
SNA 2008	Merchanting will now be recorded on a gross basis as trade in **goods** (paragraph14.73, chapter 26, A3.154).	Imported goods shown at full value including merchant's margin.
	Change of ownership	

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)

31. The Task Force examined cases (Netherlands, Finland, Austria) 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.

32. 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

33. 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 Sweden and Finland).

34. The Task Force agreed that this case should be recorded in the same way as merchanting. 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 (see section on page 4).

35. 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.

36. 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.

37. As already pointed out before, draft BPM, sixth edition 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.

3. Intra-group research and development imports and exports

38. 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 point B 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.

39. 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.

40. 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.

41. 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 (see page 8 point (ii) of this report) also shows that the recording of transactions linked to global manufacturing if recorded as R&D exports would may be a source of asymmetries, because it is unlikely that the counterpart economy would record R&D imports.

D. Main conclusions concerning intra-group transactions

42. 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 intermediate conclusions on intra-group transactions were agreed by the Task force:

(a) The increased importance of merchanting or merchanting-like transactions[8], as compared to traditional merchanting 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 versus services) are increased;

(b) 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;

(c) 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;

(d) BPM, sixth edition 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;

(e) BPM, sixth edition contains important innovations in terms of recording of merchanting, which is described as covering "commodity dealing", "wholesale trade" and also "global manufacturing". To avoid inflating the values recorded under merchanting 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 merchanting;

(f) Recording of intra-group transaction in R&D does not pose conceptual problems, but presents important practical difficulties in terms of coverage and valuation:

(g) Concerning transfer pricing, users would benefit from a separate identification (including for merchanting) of intra-group imports and exports of goods and services (which may be affected by transfer pricing). In general, systematic imputation of market prices is not considered feasible.

43. As a result of the meeting of the GNI Committee in July 2008 these conclusions will be part of the final report to be used as input for further work, in particular for the implementation of the revised system.

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[8] Of the kind referred as "global manufacturing" in the draft BPM, sixth edition.

II. APPROACHES TO CONSISTENT RECORDING OF THE ACTIVITIES OF THE MULTINATIONALS AND SPECIAL PURPOSE ENTITIES

A. Data Consistency Unit

44. 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.

45. 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.

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

(a) 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;

(b) 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.

47. 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.

48. 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.

49. 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.

50. 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.

B. Euro Groups Register Project

51. The Euro Groups 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 national statistical offices, Netherlands, Denmark, Hungary and United Kingdom, (both ways) to complement their national business registers with relevant data on multinational enterprises (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.

52. For the moment the EGR only includes multinational enterprise groups consisting in legal units. The new European Community (EC) regulation also covers natural persons as ultimate owners of enterprises. In addition, the inclusion of specific data on special purpose entities (SPEs) in the EGR is planned. The new EC regulation has not touched on some issues concerning the classification of and terminology relating to SPEs. However, on Member State level, future Statistical Nomenclature of Economic Activities in the European Community (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 SPEs is necessary. The EGR will adopt a definition, even if it is formulated "outside" the project.

53. 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 information technology (IT) development. The aim is that in 2009 all the largest enterprise groups are included in the EGR.

54. 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. SE is now moving on to more consistent quarterly accounts.

[ENGLISH ONLY]

ANNEX

National accounts issues concerning intra-group transactions

Issues	Relevance in Member States	Treatment in national accounts
GOODS FOR PROCESSING		
	FI In this case, goods do not change ownership as they cross a national border for further processing and are later returned to the owner. The important valuation issue is to ensure the fee for services, is approximately equal to the net difference in the values recorded for export and re-import. A foreign enterprise delivers raw materials it has acquired and owns to a Finnish enterprise, which processes the raw materials into products for sale. The foreign enterprise sells the finished products to customers both in FI and abroad. Often this concerns foreign groups which have both a processing subsidiary and a commercial branch in FI.	**FI** In the Customs statistics, imports of raw materials and exports of finished products are generally recorded to the branch. In practice, monetary and goods flows may be even more varied. A Finnish subsidiary manufactures products as processing, purchases “its own” products from the parent company and resells them mainly to FI. The export volumes of both the parent company and the subsidiary are small. In addition, the Finnish subsidiary sells its affiliates’ products, which it has purchased from the parent company (shows up as imports). The Finnish company’s margins from sales are small; the value added is comprised mostly of contract work. As concerns processing, problems with the data availability are caused especially by a foreign parent company’s acquisition of raw materials from FI, the sale of the products to FI and possible changes in inventories.
TOLL MANUFACTURING		
Concept: This is similar to processing. An enterprise in country A sends goods to country B for further processing without changing ownership. The goods are then often delivered from B to a third country C having been sold by the enterprise in A.	**SE** The enterprise in A includes the final value in its turnover. However, the exports from A are valued initially only at standard cost price (as the final selling price may not be known at the time of export from A to B) leading to a difference between turnover and export values.	**SE** The trade statistics export value must be replaced in BOP with the final sales value when the change of ownership is known.

Issues	Relevance in Member States	Treatment in national accounts
MERCHANTING		
Concept: Merchanting is defined 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 physically entering the country.	**FI** The transaction does not appear in import and export statistics. The merchanting fee received from this should be included as export of services in the statistics on foreign trade in services.	**FI** This treatment will change in the revised *SNA*/ESA. Merchanting will now be recorded as trade in goods, imports will be recorded as negative exports.
Special case of merchanting: RE-INVOICING Concept: In this case a resident parent company invoices the sales of its foreign subsidiaries' products. The sale itself may be arranged by the parent company or the subsidiary. The goods do not enter the economy, nor do they appear in the imports or exports of goods.	**FI** The profits from these sales are recorded into the parent company's turnover.	**FI** The purchases of merchanted goods should be deducted from the parent company's turnover when calculating the output (gross value of production), which should include only the margin from merchanting. The problem is that not all instances are recognised, and data on which to evaluate the margin from merchanting are not always available.
Special case of merchanting: TRIANGULAR TRADE Concept: An enterprise in country A sells goods to a distributor in FI that then sells on to a customer in C. However, the goods are shipped directly from A to C and the accompanying invoices show the final price charged to the customer.		**FI** The company in FI should record part of that fee as a service export to country C while country A must ensure that the export value accords with the turnover recorded. This should be the sale price to Finland. In all the above mentioned cases the parent company's turnover includes the sales of the products and cost of sales includes the acquisitions. Under the circumstances profit entry as income takes place in the parent company.

Issues	Relevance in Member States	Treatment in national accounts
GLOBAL MANUFACTURING		
Concept: MNE moves either its entire manufacturing or parts thereof abroad but keeps other functions (research and development, sales and marketing) in their host country.	**FI** These enterprises are classified into manufacturing in the business register and in structural business statistics.	**FI** Generally the gross value should only include the margin, i.e. activities abroad should be treated as purchases and sales of goods for resale. Sales may, however also be included in industrial deliveries and purchases of raw materials correspondingly in purchases of materials and supplies. Purchases may also be treated as processing or sub-contracting and as imports of services in the statistics on foreign trade in services. By contrast, the margin should be recorded as exports of services. According to the revised *SNA* recommendation, goods should be recorded as exports and imports only when ownership is transferred. For global manufacturing, the acquisition of goods is to be recorded as an import (shown as a negative export) by the merchant. The subsequent resale of the goods is recorded as exports by the merchant. The net effect will be an export of goods but appears as a production of a service in the global manufacturers/wholesalers economy.
	SE These enterprises are classified as manufacturing enterprises, if they have manufacturing in Sweden and abroad. If enterprises do no manufacturing abroad, their activities are classified as R&D.	
		SE The approach in SE is to treat the income of these transactions as merchanting which mean that the margin between the selling price on the world market and the price paid to the producer is registered as a margin in the domestic economy. The change of ownership when trading the goods justifies an output value if the selling price is higher than the acquisition price. This will result in an increase of GDP in the country in which the manufacturer/wholesaler is registered.

Issues	**Relevance in Member States**	**Treatment in national accounts**
TRANSIT TRADE		
	BE Independent trading companies (accounting desks operating only internationally on behalf of foreign companies) are classified as non-residents. Affiliates of foreign groups working also with other resident affiliates of the same group in Belgium are classified as residents. Because of the community concept defined by the European statistical regulation in foreign trade cross-border flows of goods are recorded even though there is no change of ownership regardless of the residence of the operators.	Transit trade which involves an accountant's office (which are considered non-residents) is excluded from the merchandise trade in the external trade statistics of Belgium. Exports and imports made by the affiliates of foreign companies belong effectively to the local economy. The integration of external trade statistics in the National Accounts requires some corrections to be made on the trade for non-residents. Only those using an accountant's office must be corrected. These transit trade structures increase the importance of intra-firm transactions where transfer pricing may be an issue.
TRANSFER PRICING		
Concept: The pricing of products traded between affiliated firms may not correspond to prices that would be charged to independent parties. There will be some departure from the market price principle if transfer prices are different from those charged to enterprises outside the group.	**UK** Transfer pricing to avoid tax is illegal in the UK so the distortions in the international accounts caused by transfer pricing are not considered widespread.	**UK** For both reasons, adjustments to account for transfer pricing are rarely made in practice (ONS 2006). However, there are practical difficulties in identifying and suitably adjusting individual cases.
		FI In practice, it is difficult to supervise that enterprises apply correct transfer pricing, even if there is doubt that market prices have not been applied. The compiler of statistics will in any case have to rely, and act, on the data provided by the enterprises.
	UK Most of the sources for trade in services data, including those for Royalties, do not identify explicitly whether the counterpart is a related company, so analysis of intra-group imports and exports of services is very limited.	**UK** One exception is for banks, where the Bank of England is looking to carry out some work to try to identify the effects of transfer pricing on exports of financial services. Another area where some information is available is sea freight transportation services, where it is known that some multi-national companies take advantage of

Issues	Relevance in Member States	Treatment in national accounts
		the UK taxation regime and have ships owned by UK branches, which are chartered out to parent companies in other countries for the actual carriage of freight. The UK treatment in the national accounts for royalties and licence fees is that, transactions between counterpart companies in royalties and licence fees are treated gross under imports and exports of services.
PROFIT SHIFTING		
Concept: Transfer pricing may also be defined so that **profits** from a foreign subsidiary are entered as revenue of a domestic parent company or vice versa, e.g. in research and development expenditure, contracting out and re-export.	**SE** Goods are bought from a non-resident affiliated company and sold to a third country without ever physically entering the country. The practice adopted is to treat the net margin earned on merchanted goods as a service export which is captured in the BOP surveys. It is supposed that the recorded net margins covers R&D and transfer pricing of intra-firm trade, which constitutes a channel to shift taxable profits between the Swedish parent company and the non-resident affiliate companies and is also included in the margin.	**SE** The part of the margin covering shifted profits should be excluded from the margin. The goods transferred under such arrangements are be treated as arm-length transactions at full market value. However, this can change over time and it would be difficult to impute market prices that differ from what is recorded by the non-resident affiliated company. Crucial issues are the identification of the non-resident subsidiary and the transfer of data, because of its confidentiality on national level. A solution is the Swedish enterprise produces and exports R&D.
	FI Transfer pricing becomes a problem when and if enterprises apply artificial transfer prices, in which case the prices of goods and services (e.g. unit prices) are not real.	**FI** In practice, it is difficult to supervise that enterprises apply correct transfer pricing. The compiler of statistics will in any case have to rely, and act, on the data provided by the enterprises. In practice, it is impossible to correct such data, even if there is doubt that market prices have not been applied. Transfer pricing may also be defined so that profits from a foreign subsidiary are entered as revenue of a domestic parent company or vice versa, e.g. in research and development expenditure, contracting out and re-export. This becomes a problem when and if enterprises apply artificial transfer prices, in which case the prices of goods and services (e.g. unit prices) are not real.

Issues	Relevance in Member States	Treatment in national accounts
PROFIT SHIFTING		
	AT Undistributed profits contribute as "reinvested earnings" to the stock of equity of FDI. If distributed to the direct investor, they are recorded as "negative reinvested earnings". Extraordinary profits should not be included in the calculation of annual profits, but they might well be included in actual dividends paid.	**AT** To clarify how such transactions should be recorded in BoP and NA ("dividends paid" or "deduction of equity")?
	AT Payments of tax authorities to foreign parent companies: In the settlement system payments of national tax authorities to non-resident parent companies of resident affiliates were recorded. non-resident parent company distributes its earnings after having paid taxes and has the right to refunding of these taxes because of double tax treaties	**AT** Tax refunding belongs to the resident affiliate; the cross boarder payment is an additional distribution of earning to the investor
RESEARCH AND DEVELOPMENT		
Concept: Within most MNE, major R&D efforts are centralised and strategically located. This often means that enterprises belonging to MNEs will contribute to R&D through international transfer payments but will show no R&D current expenditure or personnel on their territory of residence.	**SE** Enterprises do R&D in SE and buy goods from a non-resident manufacturing (affiliated) enterprise abroad and sell it to a non-resident customer in a third country without the good ever physically entering the country. The goods are sold with a net margin. The margin is often seen as pay for R&D made in SE, but this is not entered in the enterprise accounts.	**SE** The practice adopted is to treat the net margin earned on R&D as merchanting. The margin compensate for development of new products. According to *SNA*, an imputation of production of R&D with production costs but could be made. But a corresponding export has to be imputed. This export of a service has no recorded counterpart import to another country.
LICENSES AND ROYALTIES		
	AT Examples of an enterprise which produces and sells copies of DVD/CD on behalf of a foreign parent company. The parent company is paid for the use of licenses. These payments are not deemed to be intermediate consumption and are not reported as import of services in the cross border services survey. Exports in Foreign trade statistics and output for the VAT declaration are recorded.	**AT** Solution of STATISTICS AUSTRIA: Imputation of imports of royalties and license fess, corresponding adaptation of intermediate consumption and output.

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