Global Corporate Income

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Paper Prepared for the IARIW 33rd General Conference

Rotterdam, the Netherlands, August 24-30, 2014

Session 7C

Time: Friday, August 29, Morning

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Introduction

At the end of 2012, Reuters released a report[2] on a four month enquiry into the level of taxes paid by Starbucks in the UK over the previous 14 years. Despite having 735 outlets in the UK and having had sales of £3 billion since opening in 1998, the company had only paid £8.6 million in tax over the period, while simultaneously assuring investors of the profitability of the UK market. Starbucks executives (and some from other major multi-nationals) were questioned by the Public Accounts Committee of the UK House of Commons and while it was agreed that no laws had been broken, a number of interesting practices emerged from the testimony.

A Starbucks affiliate in Switzerland purchased green coffee beans and sold them to another affiliate in the Netherlands for roasting, charging a twenty per cent mark-up on the price. The roasted beans were then sold to the UK Starbucks company with another mark-up. A fee of six per cent of the value of sales was paid by the UK company to a different Dutch affiliate to cover "royalties and licence fees". The UK company had negative equity throughout the period covered by a loan from another Starbucks company, this time in the USA, which charged interest at Libor plus 4 per cent at a time when Starbucks bonds offered investors Libor plus 1.3 per cent. Much was made of this information in the UK press and elsewhere[3]. Subsequently, Starbucks reduced the royalty levy from six to 4.7 per cent and agreed a tax payment of £10 million for 2011.

Similar stories (though not always on such a carefully researched basis) are not uncommon and are generally accepted as a feature of "gobalisation". Attempts to capture globalisation in statistical terms typically look at aspects that are more amenable to quantification. Statistics on the Activities of Multi-National Enterprises (AMNE) and Foreign Affiliate Trade Statistics (FATS) concentrate on identifying the number of enterprises controlled from abroad, how much they produce, how many people they employ, how much they export and import and so on. This is useful and interesting information but has no direct consequence for the tax authorities. Similarly, information in the balance of payments showing how much is invested by UK enterprises in enterprises in the rest of the world and vice versa in the form of Foreign Direct Investment (FDI) gives valuable insights into income and capital flows

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[1] The author was the editor of the 2008 SNA. Thanks are due to Robert Dippelsman of the IMF, who was one of the authors of the BPM6, for helpful comments on an earlier draft.

[2] Tom Bergin, *Special report: How Starbucks avoids UK taxes* Reuters October 15, 2012. Downloaded from http://uk.reuters.com/article/2012/10/15/us-britain-starbucks-tax-idUKBRE89E0EX20121015

[3] See for example *Through a Latte Darkly: Starbuck's Stateless Income Planning* by Edward D Kleinbard , USC Gould School of Law, *Tax Notes*, June 24 2013, pp 1515 - 1535

involving foreign affiliates, which is analytically helpful in terms of monitoring exchange rates but has no direct fiscal consequences.

In national accounting terms, AMNE and FATS relate to different aspects of the goods and services account, FDI relates to primary income and financial stocks and flows. The goal of this paper is to explore how far it is possible to situate the sort of information included in these data sets within a complete national accounting framework in order to be able to draw out information that reflects, for the economy as a whole, the sort of behaviour detailed in the Starbucks enquiry.

There are three main sections to the paper. The first starts by reviewing the principles underlying the sectorisation of corporations within the System of National Accounts (SNA) and considers an alternative, drawing on the principles underlying the Balance of Payments Manual (BPM). The second looks at the implications of such a sub-sectoring of the conventional sequence of accounts, drawing largely on FDI information. The third section looks at cross-border production and considers how some AMNE/FATS statistics can be exploited in this context. It is followed by a brief concluding section.

Sub-sectoring corporations in the SNA

The SNA recommends sub-sectoring both financial and non-financial corporations into those that are publicly controlled, those that are foreign controlled and those that are purely domestic private corporations. Financial corporations are also sub-sectored according to different types of unit depending on the scope of financial activities these units undertake. While this type of sub-sectoring is generally followed, the broader one into public, foreign and private sub-sectors is less often observed.

At the time of the 1993 revision of the SNA, this three way split was discussed at some length. Discussion involving national accountants and government finance statisticians suggested that there was little problem in determining public control; if government owned at least half of the equity of a company then it could control it. There may be other exceptional circumstances when control could be exercised with a lower holding but this would not be common. Discussions between national accountants and balance of payments compilers was less straightforward. It was recognised that subsidiaries and branches were wholly owned by non-residents and clearly controlled by them. Enterprises that had more than fifty per cent foreign ownership were also held not to be a problem[4]. However, for enterprises with less than fifty per cent ownership, the balance of payments compilers drew a distinction between ownership and a more nuanced view of control. They argued that if an enterprise held at least ten[5] per cent of the shares of another, it indicated a lasting interest in that company and sufficient influence to be able to affect company policy. National accountants were reluctant to introduce the idea of influence as well as control in determining sectorisation, in large part because of the possibility that an enterprise might have more than fifty per cent ownership by government and more than ten per cent ownership by a non-resident. To which of the two categories would

[4] As emerged later, even in this case there may be a problem.

[5] In earlier versions of the international manuals the criterion had been twenty per cent rather than ten.

such an enterprise be allocated? The distinction between foreign ownership and foreign influence or control is important in the BPM context because of the distinction made there between direct investment and portfolio investment, but this distinction does not feature in the SNA. The solution therefore was to maintain a strict criterion of ownership in the SNA. The key paragraph in the 1993 SNA is 4.30 which reads:

> ..the sub-sectors of the system require private corporations to be separated from public corporations subject to control by government units: and also private corporations controlled by non-resident units to be separated from other private corporations. In both cases, control is defined as the ability to determine general corporate policy by appointing appropriate directors, if necessary. Owning more than half the shares of the corporation is evidently a sufficient, but not a necessary, condition for control. Nevertheless, because it may be difficult to identify those corporations in which control is exercised by a minority of shareholders, it is recommended that, in practice, corporations subject to public or foreign control should normally be confined to those in which governments or non-residents own a majority of the shares. This recommendation is intended only as a practical guideline, however, to which exceptions can be admitted if there is other evidence of control. For example, a corporation which government is able to control as a result of special legislation should be treated as a public corporation even if the government does not own a majority of the shares.

By the time of the 2008 revisions, in many countries, many public corporations had been entirely or largely privatised though sometimes with safety clauses to allow government to intervene in particular circumstances. A fifty per cent ownership criterion for control was clearly no longer sufficient. Extensive discussion between national accountants, government finance statisticians and public sector accountants agreed a much less rigid approach, summarised in paragraph 22.27 of the 2008 SNA.

> To be classified as a public corporation, a corporation must not only be controlled by another public unit, but it must also be a market producer. Control is defined as the ability to determine the general policy or program of an institutional unit. Government in a position to exercise control over many kinds of units: miscellaneous extrabudgetary agencies, non-profit institutions and corporations (non-financial or financial). The criteria for control of a corporation are described in paragraphs 4.77 to 4.80. The key factors to be considered are:
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> a. Ownership of the majority of the voting interest;
> b. Control of the board or other governing body;
> c. Control of the appointment and removal of key personnel;
> d. Control of key committees of the entity;
> e. Golden shares and options;
> f. Regulation and control;
> g. Control by a dominant customer; and
> h. Control attached to borrowing from the government.
>
> Although a single indicator could be sufficient to establish control in some cases, in others a number of separate indicators may collectively indicate control. A decision based on the totality of all indicators must necessarily be judgemental in nature, but the judgements should be consistent similar cases.

Ownership and control

Within the balance of payments, the purpose for which investment is undertaken is recognised as being crucially important. The five purposes, or functions, are direct investment, portfolio investment, financial derivatives, other investment and reserve assets. The distinction between direct and portfolio investment is central to the topic under discussion. Direct investment is undertaken by a unit that wishes to have a lasting involvement with the enterprise in which they are investing and to be able to exercise significant influence on management decisions on how the unit is run. In order to do so, they must have a significant holding of equity in the unit, the level

being set by convention at ten per cent of the total. It is an active form of investment and is generally undertaken on a reasonably long, often indefinite, timescale. By contrast, portfolio investment is a passive form of investment. It may consist of acquisition of shares in a non-resident enterprise or of securities issued by them. The investor makes no commitment about the length of time for which he will hold the shares or securities which may be extremely short. The decision about whether to continue to hold them or not is made solely on the return they offer the holder relative to alternative investment opportunities. Portfolio investment in equity may involve ownership, but never influence on the management of the enterprise, unlike direct investment which always involves both.

The year 2008 also saw a revision to the manual defining foreign direct investment, leading to the fourth version of the Benchmark Definition for Foreign Direct Investment, commonly referred to as BD4. Two sorts of relationships between enterprises were recognised, direct investors and direct investment enterprises. A domestic direct investor is an enterprise that holds more than ten per cent of the equity of an enterprise in another economy; this is called outward direct investment for the domestic economy. A direct investment enterprise is one in the domestic economy where ten per cent or more of its equity is owned by a single non-resident or a single family of related enterprises (defined below); this is inward direct investment.

BD4 spells out in great detail how control can be exercised through a hierarchy of related enterprises. For example, if A holds 50 per cent of the equity of B, which in turn holds 25 per cent of the equity in C, then A in effect holds 12.5 per cent of the equity in C so also has a direct investor relationship to C. If C holds 20 per cent of the equity of D, C is a direct investor of D but A and B are investors in D but not direct investors. Because of the complicated way in which enterprises are related across borders it is conceptually possible for an enterprise to be a direct investment enterprise relative to country X but a director investor in country Y. In other words, direct investors and direct investment enterprises are over-lapping, not distinct, sets.

BD4 uses the term "affiliated enterprises" for both direct investors and direct investment enterprises; here the term "foreign affiliates" is used to emphasis the non-resident aspect of the relationship. As noted above, some direct investment enterprises are subsidiaries or branches and will be one hundred per cent owned by non-residents. Equally some direct investors will be the parent of a subsidiary or branch and so exercise one hundred per cent ownership of these enterprises. These foreign affiliates exercising or being subject to one hundred per cent ownership will be referred to in this paper as "multi-nationals"[6].

The term "affiliated enterprises" also includes "fellow enterprises". If A is a direct investor in both B and C, B and C are fellow enterprises even though there is no direct holding between B and C. If A is thought of as a parent to B and C, then fellow

[6] In BPM6, the term "subsidiaries" is used to cover both incorporated subsidiaries and unincorporated branches that are one hundred per cent owned as well as any direct investment enterprise where the degree of ownership is between fifty and one hundred per cent. BPM6 used the term "associates" to cover direct investment enterprises where the degree of ownership is between ten and fifty per cent. The expression "multi-nationals" is used here in the narrower sense to permit only 100 per cent ownership and thus complete control.

enterprises represent siblings or cousins. Related enterprises can be referred to collectively as a single family of enterprises.

The only enterprises that engage in direct investment are foreign affiliates. From this perspective, it is clear that the percentage of equity owned by non-residents is not sufficient by itself to determine whether a unit is foreign controlled or not. As long as a single foreign affiliate (or family of affiliates) holds at least ten per cent of the equity in an enterprise, it is subject to foreign control or at least significant influence. However, it is possible for a number of non-resident units to hold shares in excess of fifty per cent of the total so that the enterprise is majority foreign owned but for it not to be foreign controlled if none of those non-resident units holds as many as ten per cent of the shares. There are thus two cases where the BD4/BPM definition of foreign influence or control differs from that in the 1993 SNA; one where foreign ownership is less than fifty per cent but control or influence exists and one where foreign ownership exceeds fifty per cent but neither control nor influence exists.

The reason it is important to distinguish direct investment from other forms of foreign investment is because of the flows that are associated with foreign affiliates but not with other enterprises even if they have significant overseas holdings. Only foreign affiliates make and receive loans with their affiliates rather than with financial institutions; only they make and receive payments of reinvested earnings and have some or all of this being transmitted via the rest of the world to a change in equity owned by the foreign affiliates.

An alternative sub-sectoring for corporations?

During the update of the SNA in 2008, there was a strict limit on the number of issues that were open for revision and the question of defining foreign control of corporations was not one of these. The wording in chapter 4 of the 2008 SNA on the control of a corporation by a non-resident (given in paragraphs 4.81 and 4.82) is very close to that in the 1993 SNA though there is reference to the revised definitions of foreign direct investment enterprises. These revised definitions are used in chapters 7 (where flows of reinvested earnings are discussed) and 26 (where links to the balance of payments are discussed). Consistency with BPM means these later chapters include the idea of significant influence by non-residents, though the sub-sectoring in chapter 4 is based solely on majority equity ownership, assuming this translates into control. As noted above, this assumption is not always justified.

The foregoing considerations suggest that an alternative classification of corporations could be used to highlight key transactions between foreign affiliates and in particular multinationals. This is suggested as a complimentary classification rather than a replacement. However, it allows for the fact that majority foreign ownership may not necessarily imply foreign control as well as for extending the idea of control to include significant influence.

The first step is to separate foreign affiliates from other corporations and quasi-corporations. A second is to separate foreign affiliates into the multi-nationals (those where ownership is one hundred per cent) from the others. Where necessary other corporations could be further sub-divided into those which are publicly controlled (thus avoiding the conflict of whether to treat such a unit as either foreign controlled or government controlled) and other private foreign affiliates.

This disaggregation would be sufficient to identify flows involving foreign affiliates, many of which, in total at least, are available from within balance of payments and foreign direct investment statistics. However, it would be possible to go further and sub-sector other corporations to distinguish other (mainly large) enterprises that make shares available to the general public from small and medium enterprises (SMEs) that limit shares (if any) to individuals connected with the enterprise. This further disaggregation would have two benefits, the first being to show the relative importance of redistribution of corporate income by size of corporation and the second to show the significance of SMEs in the economy. Given the data sources available for SMEs, it might be sufficient to assume none of these are publicly controlled or foreign controlled. For completeness, a category for market NPIs should be added and, if it were possible and desirable, this could also be sub-divided into those that are publicly controlled, foreign controlled and other private units. The possible full classification follows.

- Foreign affiliates
  - Multinationals
  - Publicly controlled foreign affiliates
  - Other private foreign affiliates
- Large domestic enterprises
  - Publicly controlled
  - Private
- SMEs
- Market NPIs
  - Publicly controlled
  - Foreign controlled
  - Other private

The allocation of primary income account

The allocation of primary income account in the SNA shows how the total of income generated in the domestic economy is converted to the amount of income available to the domestic economy after obligations to and from the rest of the world in the form of investment income[7] have been met. Within the SNA, investment income is classified according to

- Interest
- Distributed income of corporations
  - Dividends
  - Withdrawal from income of quasi-corporations
- Reinvested earnings on foreign direct investment
- Investment income disbursements.

Within the balance of payments, each of interest and dividends are split to show how much pertains to direct investment, portfolio investment, financial derivatives, reserve assets and other investment. What is of interest here is the amount attributable to direct investment only. Table 1 shows what the allocation of primary income accounts might look like with this disaggregation of corporations and with investment

[7] For clarity of exposition, payments of compensation of employees to and from the rest of the world are ignored.

income flows arising from direct investment distinguished from other investment income flows. (Again for simplicity of exposition, no distinction is made between financial and non-financial corporations; neither other sectors nor rent is shown. Introducing these further details would be straightforward. In order to allow a compact presentation, resources are shown as X; uses as –X. Lower case x denotes a partial counterpart in the rest of the world.)

Table 1: Allocation of primary income account with foreign affiliates and direct investment flows shown explicitly

	Foreign affiliates			Large domestic enterprises		SMEs	Market NPIs			ROW	
	Multi-nationals	Public foreign affiliates	Other private foreign affiliates	Public	Private		Public	Foreign	Other private	Foreign affiliates	Other ROW
Gross operating surplus	X	X	X	X	X	X	X	X	X		
Direct investment income flows											
Resources											
Interest on loans to affiliates	X	X	X							-X	
Dividends	X	X	X							-X	
Reinvested earnings on FDI	X	X	X							-X	
Uses											
Interest on loans to affiliates	-X	-X	-X							X	
Dividends	-X	-X	-X							X	
Reinvested earnings on FDI	-X	-X	-X							X	
Other primary income flows											
Resources											
Interest	X	X	X	X	X	X	X	X	X		-x
Dividends											
ROW Portfolio investment	X	X	X	X	X						-X
Domestic	X	X	X	X	X	X					
Investment income disbursements	X	X	X	X	X	X	X	X	X		-x
Uses											
Interest	-X	-X	-X	-X	-X	-X	-X	-X	-X		x
Dividends											
ROW Portfolio investment	-X	-X	-X	-X	-X						X
Domestic	-X	-X	-X	-X	-X	-X					
Withdrawals from quasi-corporations						-X					
Investment income disbursements	-X	-X	-X	-X	-X	-X	-X	-X	-X		x
Balance of primary incomes	X	X	X	X	X	X	X	X	X		

The basis of the suggested classification of corporations means that there is a high concentration of flows associated only with foreign affiliates. This suggests rearranging the table to show the other primary income flows before those relating to direct investment. For all enterprises other than foreign affiliates, these rows are sufficient to lead to the balance of primary income as normally calculated. For foreign affiliates, the balance of primary income before direct investment flows are included is also of interest. It still includes some transactions with the rest of the world, those relating to all forms of foreign investment other than direct investment, in particular portfolio investment. For the economy as a whole, the balance of primary income at this level, which might be referred to here as leading to a version of GNI excluding foreign affiliate income (suppose this is described as GNI ex FAI), is of interest as it can be contrasted with the usual figure for GNI to see how significant direct investment flows are relative to other foreign investment and indeed to domestic activity. In countries where there are many direct investment enterprises and few direct investors, GNI is likely to be lower than the version excluding foreign affiliate flows. Table 2 shows a rearrangement of table 1 on this basis. The net effect

of direct investment flows is described as the balance of affiliate income (say, BAI). Thus we have

GNI = GNI exFAI +BAI

Table 2: Rearrangement of the allocation of primary income account with foreign affiliates and direct investment flows shown explicitly

	Foreign affiliates			Large domestic		SMEs	Market NPIs			ROW	
	Multi-nationals	Public foreign affiliates	Other private foreign affiliates	Public	Private		Public	Foreign	Other private	Foreign affiliates	Other ROW
Gross operating surplus	X	X	X	X	X	X	X	X	X		
Other primary income flows											
Resources											
Interest	X	X	X	X	X	X	X	X	X		-x
Dividends											
ROW Portfolio investment	X	X	X	X	X						-X
Domestic	X	X	X	X	X	X					
Investment income disbursements	X	X	X	X	X	X	X	X	X		-x
Uses											
Interest	-X	-X	-X	-X	-X	-X	-X	-X	-X		x
Dividends											
ROW Portfolio investment	-X	-X	-X	-X	-X						X
Domestic	-X	-X	-X	-X	-X	-X					
Withdrawals from quasi-corporations						-X					
Investment income disbursements	-X	-X	-X	-X	-X	-X	-X	-X	-X		x
Balance of primary income excluding direct investment flows (GNI exBAI)	X	X	X	X	X	X	X	X	X		
Direct investment income flows											
Resources											
Interest on loans to affiliates	X	X	X							-X	
Dividends	X	X	X							-X	
Reinvested earnings on FDI	X	X	X							-X	
Uses											
Interest on loans to affiliates	-X	-X	-X							X	
Dividends	-X	-X	-X							X	
Reinvested earnings on FDI	-X	-X	-X							X	
Balance of affiliate income (BAI)											
Balance of primary incomes	X	X	X	X	X	X	X	X	X		

Not only does such a table allow a supplementary version of GNI to be derived, it also allows direct comparison between the amount of dividends and reinvested earnings paid by foreign affiliates to their related enterprises to be contrasted with payments by them to the rest of the world under other arrangements and to the domestic economy and all of these amounts to be contrasted with dividends paid by large domestic enterprises (remembering that SMEs are defined to exclude general dividend payments). It also allows the flows of interest paid to affiliates to be compared to the flows paid within the domestic economy or via other forms of foreign investment. By comparing the flows with the corresponding stocks of loans (described below), this part of the table can show whether the implicit interest rate on loans between affiliates differed markedly from the rate charged by financial institutions, for example.

The balance of primary income excluding direct investment flows relates to that part of primary income that is the result of the activities of domestic enterprises before the issue of control is considered. Adding the balance of affiliate income excludes from the balance of primary income that part of the income of domestic enterprises that is foreign controlled. The income of those that are wholly foreign owned and controlled will be completely excluded. Those that are partially foreign controlled will be partially excluded. At the same time, adding in the balance of

affiliate income brings in that part of the income of non-resident enterprises that are subject to domestic control. This leads to a somewhat surprising insight. The balance of primary income, therefore, no longer corresponds strictly to the income of a set of *resident* institutional units but is the income of the institutional units, resident and non-resident, that are *controlled domestically*. This conclusion holds whatever disaggregation of the corporate sectors is used, or if there is none, because the SNA figures for investment income are strictly consistent with those in the BPM and even if direct investment is not shown explicitly, these flows are intrinsic to the balance of payment data and use the BPM definition of control rather than the SNA fifty per cent foreign ownership criterion.

Other accounts

For most of the rest of the sequence of accounts also, the suggested disaggregation of corporations allows the importance of foreign affiliates to be easily seen. The production account is important since it leads to the figure for operating surplus at the head of table 2 but for reasons that will become clear it is discussed in the next section.

The secondary distribution of income account shows the taxes on income, wealth etc. payable by corporations. It is usually assumed that the balance of primary income is closer to the taxable income of an enterprise than the operating surplus since investment income receivables are generally taxable and payables allowable as deductions. The format suggested in table 2, however, allows the amount of tax payable to be compared with the balance of primary income both before and after flows to foreign affiliates are taken into account thus allowing a clearer picture of the impact of these flows on the implicit tax rate payable by foreign affiliates. Following on from the consideration of units above, the first of these would relate the tax payable to income generated by domestic enterprises and the second to income attributed to domestically controlled enterprises.

The capital account shows two interesting features. One is simply the proportion of gross fixed capital formation undertaken by foreign affiliates. The second relates to how this capital formation is financed. The elementary economic identity that saving and investment are equal is strictly only true in a closed economy. In an open economy, it is the sum of net domestic saving plus net borrowing from abroad that, in the absence of capital transfers with the rest of the world, is equal to capital formation. If a domestically owned enterprise has net saving of 100 and capital formation of 100, in the absence of capital transfers, saving is equal to investment for the enterprise and it has no net borrowing or lending. If the enterprise is one hundred per cent foreign owned and controlled, it has zero net saving because reinvested earnings on foreign direct investment is calculated in such a way as to ensure this. Its capital formation of 100 is funded by the reinvestment of earnings, the financial account counterpart to the primary income use of income. Thus all capital formation by foreign affiliates can be seen to be necessarily funded in part from abroad; for multinationals, capital formation is wholly funded from abroad. Once this is taken into account, the extent to which remaining capital formation is domestically funded can be seen.

Just as there is a difference in classification of investment income flows between the SNA and BPM, there is an analogous difference in respect of the financial account and balance sheet where BPM classifies financial instruments by function also. Table 3 shows a schematic account for the balance sheet. The first part of the table includes all assets and liabilities other than those associated with direct investment. The resulting figure for net financial worth, like the balance of primary income excluding direct investment flows, relates to the net financial worth of all resident enterprises. Once assets and liabilities associated with direct investment (as in the international investment position part of the balance of payments) are included, the net financial worth relates to those (parts of) enterprises that are domestically controlled[8].

Table 3: A schematic balance sheet including information on foreign affiliates.

Foreign affiliates	Other sectors	Foreign affiliates	Other ROW		Foreign affiliates	Other sectors	Foreign affiliates	Other ROW
				Assets and liabilities excluding direct investment				
	X			Monetary gold and SDRs				X
X	X		X	Currency and deposits				X
X	X		X	Debt securities				X
X	X		X	Loans				X
X	X		X	Equity and investment fund shares				X
X	X		X	Insurance, pension and standardized guarantee schemes				X
X	X		X	Financial derivatives and employee stock options				X
X	X		X	Other accounts receivable/payable				X
X	X			**Net financial worth excluding direct investment**				
				Outward direct investment				
X				Loans			X	
X				Debt securities			X	
X				Equity			X	
				Inward direct investment				
		X		Loans	X			
		X		Debt securities	X			
		X		Equity	X			
X				**Net worth due to direct investment**				
X				**Net financial worth**				

It is perhaps worth noting that branches of foreign affiliates are treated as quasi-corporations and thus have zero net worth, the equity of the owner being determined to ensure this. Very many foreign affiliates may be either branches or subsidiaries and thus wholly foreign controlled. The choice between whether to set up one or the other also depends on tax considerations and varies country by country according to institutional arrangements.[9].

[8] For simplicity of exposition, the complications of reverse investment are ignored in the schematic table.

[9] An interesting case study of banks in a number of countries appears in *Subsidiaries or branches: Does one size fit all?* IMF staff discussion note SDN/11/04 by Fietcher et al.

Cross-border production

The previous sections described how measures of income and balance sheet entries can be adapted to reveal the role of foreign affiliates relative to other enterprises in the economy. Equally important is how goods and services are exchanged and how assets are used among foreign affiliates. The attention paid during the 2008 revisions to the question of merchanting and goods sent abroad for processing were conducted in the context of transactions between unrelated enterprises. These issues are also relevant for related enterprises but the issue of the valuation of goods and services and the definition of what is an asset become more difficult. These issues are briefly reviewed before some suggestions about ways forward are made. The key issue is that the value of transactions agreed between related enterprises in different economies is not determined by normal market considerations but according to where it is beneficial for taxable income to be recorded. This affects not only the way in which macro-economic accounts can be assembled on a basis that is consistent within and across countries but crucially how relevant the resulting accounts will be for policy analysts, especially for fiscal policy.

Transfer pricing

The practice of transfer pricing, that is transacting goods and services at other than prevailing market prices, has always been a matter of concern to both accounting and tax authorities. The motivation for using a distorted price is one of relocating income from one economy to another or disguising capital injections or withdrawals. BD4 discusses the issue in paragraphs 306 to 311 and BPM6 in paragraph 11.101. Table 3 shows the implicit hidden, transactions that take place when either the direct investor (DI) or the direct investment enterprise (DIE) supplies goods and services to the other and either over-invoices or under-invoices them.

Table 3: Impact of transfer pricing between foreign affiliates

	Over-invoices	Under-invoices
DI supplies goods and services to DIE	Hidden dividend from DIE to DI	Injection of capital from DI to DIE
DIE supplies goods and services to DI	Injection of capital from DI to DIE	Withdrawal of capital from DIE to DI

While the situation is clear conceptually, making any necessary adjustments in practice is delicate and will lead to inconsistencies across countries if these are not done in consultation with counterpart accountants. The difficulty of associating what a corporation declares as the value of goods imported and exported with the sort of arm's length price required for customs purposes is illustrated by the fact that the Reuters investigation for Starbucks could not find these figures.

The recommendations for goods, where transactions in similar items between unrelated enterprises might be taken as guidance on the appropriate price to use, is much more straightforward than for services. A particular case concerns head office services. Within the domestic economy, the SNA recommends that head office costs should be treated as ancillary services and valued at cost. If necessary, they should be allocated across establishments based on an indicator such as turnover or employment. It is difficult to see how such a recommendation could be insisted on for head office services provided to units in different economies. Why would a head office feel obliged to limit the amount charged to its subsidiaries to the sum of actual

costs incurred? Transfer pricing in this case is even easier to adopt and with less chance of a legitimate challenge. BPM6 accepts that the recommendation for valuation at "arm's length" prices for services might have to be be abandoned as impracticable but the Reuters report on Starbucks illustrates that this might be a significant data problem.

Merchanting

An example of a merchanting operation is where an enterprise in economy A acts to ensure an enterprise in B can purchase items from an enterprise in C without the items ever being present in economy A. The process whereby an enterprise in Switzerland buys green coffee beans and sells them, unprocessed to an enterprise in the Netherlands may be a straightforward case of imports and re-exports, in which case the customs valuation should be such as to exclude transfer pricing at source, entry into Switzerland, departure from Switzerland and entry to the Netherlands. For related enterprises, this may give rise to a difference between the customs-based values of trade and the values in the enterprise group's accounts for both Switzerland and the Netherlands. However, it is not clear that the beans necessarily would enter Switzerland in which case the operation would be pure merchanting. The recommendations in the BPM on valuation involving merchanting[10] prescribe the same valuation on export from the source and import to the Netherlands (that is FOB and CIF respectively, adjusted if necessary to remove a transfer pricing element) but for transactions prices to be used for entry to and departure from Switzerland. Thus the customs based figures for Switzerland would agree with those of the enterprise group, but there might still be a difference for the Netherlands. In the case of merchanting between unrelated enterprises as at the head of this paragraph, B wants the price to be as low as possible, C for it to be as high as possible and A has to broker a deal whereby B and C both find the price acceptable and yet A gets a satisfactory return also. Again the Starbucks example shows that between related enterprises, A's margin might not be considered "reasonable" by economic accountants.

Goods sent abroad for processing

The revised treatment of goods sent abroad for processing, where the items are now deemed to stay in the ownership of the original owner unless and until they are sold to a third party after processing, was discussed in the context of unrelated enterprises. The entry in the balance of payments account is specified as the fee agreed between the owner of the goods and the processor. However, if the owner of the goods and the processor, despite being resident in different economies, are affiliated enterprises, the agreed fee might again be artificial in order to locate taxable income away from the higher tax economy.

Although the topic of goods sent abroad for processing is normally discussed in the context of manufacturing, it could also be seen to apply to retailing, where, for example, the owner of the goods for resale in in economy A, the goods are in economy B and the customers may be in economy B or a third economy.

[10] See BPM6 paragraphs 10.44, 10.45 and 10.30

Assets used by related enterprises in different economies

The SNA definition of non-financial assets specifies that an asset is a product that is used repeatedly in production for more than a year. If it is not used in that economy, it is not an asset. The product may have been imported, but if it is exported, it leaves the economy and thus the balance sheet of the economy where it was previously located. The introduction of intellectual property products (IPP) into the SNA, combined with multinational behaviour raises some complicated issues. Suppose an enterprise in economy A develops an IPP. The headquarters of the multinational, in economy B, to which the enterprise in A belongs, allows enterprises in economies C and D to make use of the IPP in return for a fee from each. One possibility is to record the IPP as capital formation in A with payments from B and C representing operational leasing payments. This may be reasonable if A remains responsible for maintenance of the IPP, but what should happen if A no longer has any responsibility for the product? And if the payments by C and D to A are routed via B, how are these to be regarded?

One possibility is to record the IPP as produced in A but sold initially to B. The question then arises of whether the asset remains on the balance sheet of B or passes to those of C and D. To remain on the balance sheet of B and have the payments from C and D as payments of a service, the terms of use would have to be those of an operational lease. If the enterprise in B is only a headquarters operation, it is unlikely that it undertakes any production activity connected with the maintenance of the IPP and it would seem that the terms of use by C and D are closer to those of a financial lease. This implies that the asset is now held jointly by enterprises in C and D but this is not without precedent in the SNA and would seem to most closely mirror the economic substance of what is happening.

"Marketing assets" used in several economies

Some part of "management fees" as cited in the Starbucks case, for example, may be said to cover royalties in respect of intangible assets such as franchise rights and other marketing assets. The SNA is very cautious about treating such items as assets in the absence of clear market prices. On the other hand, the SNA does now recognise assets such as research and development and some payments of "royalties" may represent payments to use these assets and thus be covered by the previous discussion. It does seem probable, though, that a multinational's interpretation of what could be considered an intangible asset might be more elastic than that of the SNA. This then is an area where close co-ordination with international accounting standards would be beneficial for future SNA recommendations.

Even if the "marketing asset" met the SNA criteria to be considered as an asset, the question of which economy carries it on a balance sheet still arises. To continue the example from above, if C and D make payments to a head office in B for the use of a marketing asset, how should these be treated? Only if B has a productive process linked to the maintenance of the asset, protecting an infringement of copyright for example, can the payments be in respect of an operational lease and so reduce the value of operating surplus. If the payments are not in respect of an operational lease, as long as marketing assets are still treated as non-produced, the payments would seem to be for rent and rent for an asset that does not appear in the balance sheet of the economy from whence the payments are made. This is possible in the present

system but is not helpful for productivity studies nor would it accord with the accounting practice of the foreign affiliates who treat it in the same way as (and possibly combined with) payments for the use of R&D or head office services.

It is clear, though, that the leasing of "assets" in whatever form the lease takes provides the opportunity to embed hidden payments in much the same way as the provision of goods and services using transfer pricing. Another way of achieving the same transmission of revenue is via loans between related enterprises where an interest rate different from prevailing market rates is specified, as instanced in the Starbucks example again.

How to move forward?

It is easier to spell out the problems associated with valuation of transactions in goods and services and in the identification of assets than to propose solutions. Nevertheless, some initial practical steps can be suggested.

A first step is to compile a production account with the same sectorisation as suggested above. This alone would show how far foreign affiliates dominate (or not) activity in the domestic economy. It would be desirable to enhance the account by showing how much of production was destined for related enterprises and how much of intermediate consumption was sourced from related enterprises. Such information may be available from AMNE/FATS data-sets. To the extent that these data-sets use company reporting practices, any artificially inflated values will still be included where the imports and exports corresponding to balance of payments sources should be adjusted to arm's length prices. Nevertheless, confronting these alternative valuations in a single table would be useful. As long as national accounts appear in one "publication"(whether paper or electronic) and AMNE/FATS in another, the question of consistency or lack of it is obscure. The sectorisation proposed here makes an immediate comparison much more straightforward with obvious benefits to compilers and analysts alike.

The question of an enterprise in economy A using an asset on the balance sheet of economy B needs careful consideration. As long as the terms of use are consistent with payments representing a rental payment, there is little problem (assuming these payments are caught as imports of services in the balance of payments). When the asset is held by a head office with no connected productive activity, the appropriate recording is less obvious. Can something be recorded as a non-financial asset by an enterprise that makes no use of it but only delegates use to affiliates? If a single asset such as a piece of R&D should be regarded as being as an asset of several enterprises, can it be partitioned among them and how should it be valued? If a further subsidiary is set up and also uses the asset, does that reduce the value of the asset attributed to the earlier users?

The question of marketing assets need further examination. The position adopted in the course of the 2008 revision to the SNA was essentially a holding one. When such items are sold, the proceeds clearly need to be recorded and the purchaser receives something in return it seems inappropriate to call intermediate consumption. The AEG did not feel able to go further than this at the time, largely because of the very real difficulties of valuing such "assets". However, implying that global franchises derive no benefit from their brand is difficult to defend. This must be a

matter of concern to the International Accounting Standards Committee also and close consultation with them may help find a solution.

Conclusion

The motivation for this paper was to explore how the sort of facts that emerged from the Reuters report into Starbucks could be seen within the accounting structure of the SNA without doing any violence to the existing accounting conventions. The first issue was consideration of the difference between the BPM/BD concept of effective control or significant influence over an enterprise rather than the simple SNA option of majority equity ownership. Accepting this as an alternative basis for sectoring enterprises led to a number of possibilities.

The most fundamental issue to emerge was the realisation that using BPM consistent data within the SNA in effect means that income aggregates from the balance of primary income onwards, and net financial worth relate not to the income or net worth of all resident enterprises but of all enterprises controlled domestically. However, it is possible by a simple rearrangement of the accounts to show how this transition occurs and extremely useful to be able to examine the magnitude and direction of the difference.

The alternative sectorisation proposed here allows fruitful analysis of the relative importance of foreign affiliates as compared to their domestic counterparts and indeed to contrast information with groups of large and small domestic enterprises also. Further, the tax implications for foreign affiliates can be drawn out directly. All such insights are of considerable interest to policy analysts and tax authorities and respond to frequent recent commentary on the tax avoiding behaviour of multinationals in particular. These proposals could be implemented with little extra resource cost since the relevant information on foreign direct investment exists in balance of payments and foreign direct investment accounts.

It is suggested that an augmented production account, combining the proposed sectorisation with AMNE/FATS data would not only be analytically useful but would help to illustrate how far creative accounting was diverting income and wealth from one tax administration area to another. Again, incorporating information currently appearing in different data-sets into a single presentation strongly reinforces the integration of the various economic accounting system to the advantage of both compilers and users.

There are a number of questions still to be resolved concerning the practice of a single asset being used by a number of enterprises in a family group. These need to be explored with some urgency and should be done in close connection with the international accounting standards community.

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