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**PROGRESS REPORT OF THE EUROSTAT TASK FORCE ON MULTINATIONAL  
ENTERPRISES**

TREATMENT OF ENTITIES WITH LITTLE OR NO PHYSICAL PRESENCE  
BELONGING TO MULTINATIONAL GROUPS

Note by Eurostat

*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. The participating countries in the Task Force contributed with case studies which they considered representative and important in the respective countries. The final report of the Task Force will be prepared in the spring 2009 and presented at the Gross National Income Committee in July 2009. In the text below, the results of the fact-finding exercise on the treatment of entities with little or no physical presence in the European Union countries participating in the Task Force will be pointed out.

## 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.

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

(a) Prepare an overview of the current situation covering the various cases/flows and accounting practices identified as problematic by the Member States; this overview will be part of a progress report which will be submitted to the National Accounts Working Group and to the GNI Committee; the Task Force will also take into account the results and ongoing developments of other related work and studies as far as they are relevant for GNI measures;

(b) Propose guidance on possible ways of identifying specific entities and measuring their operations, including entities located in regions or sub-regions within a Member State that have a special tax-exemption jurisdiction;

(c) Develop rules for deciding on the inclusion of these entities for national accounts and on the classification of their flows and stocks. Developments on the update of the System of National Accounts 1993 (SNA93), the Fifth International Monetary Fund (IMF) Balance of Payments Manual and of the Organisation for Economic Co-operation and Development (OECD) Benchmark definition for foreign direct investment (FDI) will be also taken into consideration;

(d) Examine the treatment in national accounts of intra-group imports and exports (including royalties), and of intra-group income transactions. The Task Force will analyse typical cases derived from countries' experience and will propose recommendations for the treatment in national accounts of intra-group transactions. The treatment of transactions between affiliated

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<sup>1</sup> The Task Force consisted of members of national statistical offices with practical experience in national accounts in the area of special purpose entities and multinationals. The European Central Bank (ECB) external statistics division also participated in the Task Force. Eurostat participants were from national accounts and Balance of Payments (BoP) units. The Member States who took part in the Task Force were: Belgium, Ireland, Portugal, Luxembourg, Malta, United Kingdom, Finland, Austria, Sweden, Netherlands, Germany, Italy and Cyprus. The Task Force met four times until now. The first meeting was in June 2007, the second in December 2007, the third meeting in March 2008 and the fourth in December 2008, after the progress report had been discussed at the GNI Committee in July 2008. The final report of the task force will be prepared in the spring 2009 and presented at the GNI Committee in July 2009.

enterprises described by the IMF Balance of Payments Manual (paragraphs 97-103) may represent a starting point for the work of the Task Force;

(e) Examine possible areas and forms of cooperation between the national statistical institutes of the different countries in order to ensure a consistent recording of the activities of the multinationals and the special purpose entities;

(f) In its work and proposals, the Task Force must give due consideration and importance to the issue of confidentiality.

3. The Task Force started its work with a fact-finding exercise (point (a) above). A number of case studies - considered representative and important in the respective countries – were supplied by the participating countries. These case studies were grouped according to the three main issues mentioned in the mandate, namely:

(a) Treatment of entities with little or no physical presence belonging to multinational groups;

(b) Recording of some cases of intra-group transactions, irrespective of the kind of entity involved;

(c) Areas and forms of possible cooperation in order to ensure a complete and consistent recording of the activities of multinationals, in particular for entities with little or no physical presence.

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

5. In July 2008, the Task Force presented a progress report to Eurostat GNI Committee, which contained an overview of the case studies collected and some preliminary conclusions on the three topics listed under (a) to (c) above. As a result of the discussion at the GNI Committee, for points (a) and (c), the Task Force is expected to complete a final report by June 2009 with more specific guidance and recommendations. For point (b), which is related to intra-group transactions, the final report of the Task Force will include preliminary conclusions to be used as input for further work. Concerning point (a) the Task Force should take also into account chapter 4 of the SNA 2008 and give more concrete guidance on valuation. In addition, the Task Force needs to focus on possible decision trees for deciding on the treatment of units with little physical presence.

6. The final report of the Task Force will be presented in July 2009. Therefore, at the present moment (February 2009), the work has not yet been completed. In the following, we give a presentation of some of the results reached by the Task Force so far. These include in particular the results of the fact-finding exercise on the treatment of entities with little or no physical presence and on the recording of some cases of intra-group transactions in the European Union (EU) countries participating in the Task Force (see the annex).

## **II. ENTITIES WITH LITTLE OR NO PHYSICAL PRESENCE**

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

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

9. While collecting contributions from countries for the fact-finding exercise, the Task Force also reviewed, during the initial part of its activity, the state of play with respect to the methodological background in respect of entities with little or no physical presence. This concerned in particular the concepts of institutional unit, residence, classification by sector and activity and valuation. After the approval of the SNA 2008 (first volume) and BPM6, it is now possible to give an overview and a comparison of the guidance foreseen in the present and in the revised system for entities with little or no physical presence.

### **A. Methodological background**

1. Current and revised statistical standards for institutional units and their residence – Special purpose entities in the 2008 SNA and in the BPM6

10. Concerning the identification of institutional units, with relation in particular to foreign-owned units, the Task Force considered that the revisions of the manuals have not introduced important changes in respect of the general principles. To recall, ESA95 paragraph 2.12 states

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

that "the institutional unit is an elementary economic decision-making centre characterized by uniformity of behaviour and decision-making autonomy in the exercise of its principal function and either keeps a complete set of accounts or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were required." Indicators of autonomy of decision in respect of its principal functions are: owning assets in its own right, taking economic decisions for which it is held directly responsible and accountable by law, incurring liabilities on its own behalf, to take on other obligations or further commitments and to enter into contracts (see also SNA93 paragraph 4.2, which has remained the same in the SNA 2008).

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

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

13. The main characteristics of a special purpose entity (SPE) in the SNA 2008 paragraph 4.56 are as follows:

(a) They have often no employees and no non-financial assets. They may have little physical presence beyond a "brass plate" confirming their place of registration;

(b) They are always related to another corporation, often as a subsidiary, and SPEs in particular are often resident in a territory other than the territory of residence of the related corporations;

(c) They are commonly managed by employees of another corporation which may or may not be a related one. The unit pays fees for services rendered to it and in turn charges its parent or other related corporations a fee to cover these costs. This is the only production the unit is involved in though it will often incur liabilities on behalf of its owner and will usually receive investment income and holding gains on the assets it holds.

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

(a) Captive financial institutions (4.59-4.61)<sup>3</sup>: financial corporations that cannot act independently of their parents and are simply passive holders of assets and liabilities. Examples

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

given are holding companies, investment and pension funds, securisation vehicles, conduits. These entities are treated as separate institutional units only if resident in an economy different from its parent. If they are resident in the same economy as its parent, they are treated as "artificial subsidiaries", which are the second exception (b of 4.58) to the general rules for identification of institutional units;

(b) Artificial subsidiaries (4.62-4.66): subsidiaries wholly owned by a parent corporation created in order to avoid taxes, to minimise liabilities in the event of bankruptcy, or to secure other technical advantages under the tax or corporation legislation in force in a particular country. For example, the parent may create a subsidiary to which ownership of land, buildings or equipment is transferred and whose sole function is to lease it back again to the parent corporation; be the nominal employer of all the staff of the group; keep the accounts of the parent. In general, these sorts of corporations do not satisfy the definition of an institutional unit because they lack the ability to act independently from their parent corporation. Artificial subsidiaries are therefore not treated as separate institutional units in the SNA but are treated as an integral part of the parent and their accounts are consolidated with those of the parent. As said, consolidation of accounts applies also to the "passive SPEs" under point a., if they reside in the same country as their parent. An important feature of artificial subsidiaries and captive financial institutions according to the SNA 2008 is that their level of output and the price they receive for it are determined by the parent that (possibly with other corporations in the same group) is their sole client (see 4.64);

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

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

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

16. Although the SNA 2008 gives particular attention to the case of SPEs that are captive financial institutions, it also says that SPEs should be in general treated in the System in the same way as any other institutional unit by being allocated to sector and industry according to its

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

principal activity (see 4.58 already referred to before). In fact, although this is not explicitly stated in the SNA 2008, it appears from its text that a unit resident in a different country than its parent and having the other characteristics of an artificial subsidiary (particularly, in terms of activities – see the examples contained in paragraph 4.63) should be treated as an institutional unit and classified according to its own activity/sector, just like a captive financial institution.

17. The examples produced by the country reports confirm that in the EU Member States entities with little or no physical presence are encountered in financial as well as in non-financial activities. Another empirical result that will be described in more detail in point B of this paper is that entities with little or no physical presence owning non-financial assets (tangible and intangible) are not a limited exception in the EU.

### 3. Valuation

18. Concerning principles for valuation of flows and stocks of entities with little or no physical presence, the Task Force referred to the one of the recommendations of the Advisory Expert Group on National Accounts (AEG) in 2007 which concerned SPEs: "Resident SPEs will not be treated as separate institutional units unless they satisfy the criteria for qualifying as institutional units. Their output should be valued at cost if no market valuation is available. Non-resident SPEs are always to be classified as separate institutional units. SPEs are to be classified by sector and industry according to the principal activity of the SPE."<sup>5</sup> As already observed in the text above, the SNA 2008 refers to the absence of a market as a distinguishing feature of captive financial institutions and of artificial subsidiaries, for which the level of output and its price are determined by the parent that (possibly with other corporations in the same group) is their sole client (see 4.64).

### 4. Conclusions to A

19. At the end of this introductory part on the methodological background, it can be concluded that SPEs and other entities with little or no physical presence are to be classified as institutional units when they are not resident in the same country as the country of their parent. Consolidation with the parent company occurs only within the domestic economy, when the SPEs do not comply with the general criteria for institutional units. For entities that have few if any attributes of location, the location is determined by their place of incorporation.

20. Secondly, such entities are to be allocated to sector and industry according to their principal activity.

21. Finally, concerning the valuation of their transactions, the lack of the ability to act independently from its parent corporation is reflected in the absence of a genuine market price for the output of the entities concerned. In such cases, valuation at costs of the output may be

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<sup>5</sup> Statistical Commission Background document, Thirty-eighth session, 27 February - 2 March 2007, Item 3 (f) of the provisional agenda: Items for discussion and decision: National accounts. The Full Set of Consolidated Recommendations. The Recommendations Made by the Advisory Expert Group for the. Update of the System of National Accounts, 1993. Prepared by the Intersecretariat Working Group on National Accounts, <<http://unstats.un.org/unsd/nationalaccount/AEG/recommendations/fscr.pdf>>

preferable. However, on the issue of valuation the Task Force should still continue its work and formulate recommendations.

## **B. Overview of Task Force Member States case studies with respect to entities with little or no physical presence**

22. The Task Force discussed a number of national case studies concerning entities having little or no persons employed, limited operations or limited physical presence in the jurisdiction in which they are created. The case studies concern entities that are foreign-controlled and thus resident in a territory other than the territory of residence of their parent companies<sup>6</sup>.

23. Based on the case studies provided by the experts an overview of the different types of entities with little or no physical presence that have been discussed at the Task Force is given in table 1. A more detailed summary description of the various cases is given in the annex.

24. One of the main common characteristic of typical SPEs is that usually the value of the stocks in their balance sheets is above any reasonable proportion with their employment and their physical structure (if any). For that reason, the Task Force worked following a first-level classification of SPEs in terms of the kind of asset they own in their balance sheet (financial, non-financial tangible and non-financial intangible assets)<sup>7</sup>. Inside each group of SPEs, an indication of the sector and activity classification is given in table 1<sup>8</sup>, together with a short summary of the purpose for which the SPE is usually set up.

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<sup>6</sup> In general, their originators can also belong to the government sector. However the statistical treatment of this last kind of entities was not analysed by this task force.

<sup>7</sup> Table 1 however contains a residual category "others". In these cases, the task force is still discussing on whether an institutional unit can be identified.

<sup>8</sup> Table 1 refers for the moment only to the NACE Rev. 1 activity classification and not yet to the NACE Rev.2 classification, which has still to be developed by the task force. Concerning "licensing and royalties companies" the double classification shown (financial or non financial corporations) reflects diverging practices of the countries contributing the case studies.



**Table 1: Overview table on entities with no or little physical presence in the European Union**

<b>Type</b>	<b>Institutional sector</b>	<b>Activity (NACE Rev. 1.1)</b>	<b>Purpose</b>
<b>Ownership of financial assets</b> (Captive financial institutions)			
Holding companies	Other financial intermediaries, except insurance corporations and pension funds (S.123)	<ul style="list-style-type: none"> <li>• other financial intermediation n.e.c. NACE 65.23</li> </ul>	<ul style="list-style-type: none"> <li>• owning subsidiaries, concentration of group profits in certain countries/jurisdictions</li> <li>• group financing</li> </ul>
Trusts, funds and similar financial entities	Other monetary financial institutions (S.122)/  Other financial intermediaries (S.123)	<ul style="list-style-type: none"> <li>• investment in securities, e.g. shares, bonds, bills, unit trust units, etc. NACE 65.23</li> <li>• dealing for own account by securities dealers NACE 65.23</li> </ul>	<ul style="list-style-type: none"> <li>• return on financial investment with fiscal advantages</li> </ul>
Securitization companies	Other financial intermediaries (S.123)	<ul style="list-style-type: none"> <li>• Other financial intermediation n.e.c NACE 65.23</li> </ul>	<ul style="list-style-type: none"> <li>• assets securitisation - fund raising</li> </ul>
Fiscal engineering companies	Other financial intermediaries (S.123)	<ul style="list-style-type: none"> <li>• Other financial intermediation n.e.c NACE 65.23</li> </ul>	<ul style="list-style-type: none"> <li>• providing fiscal advantages to the mother company, in particular:</li> <li>• routing financial flows of a particular type through third countries in order to reduce or avoid withholding taxes</li> </ul>
Captive financial leasing companies (usually, for aircrafts and vessels)	Other financial intermediaries (S.123)	<ul style="list-style-type: none"> <li>• Financial leasing NACE 65.21</li> </ul>	<ul style="list-style-type: none"> <li>• financial leasing within a group (The SPE is not considered the economic owner of the equipment).</li> </ul>
Captive re-insurance companies	Insurance corporations and pension funds (S.125)	<ul style="list-style-type: none"> <li>• Non-life insurance NACE 66.03</li> </ul>	<ul style="list-style-type: none"> <li>• re-insurance within a group</li> </ul>

<b>Type</b>	<b>Institutional sector</b>	<b>Activity (NACE Rev. 1.1)</b>	<b>Purpose</b>
Factoring and re-invoicing companies	Other financial intermediaries (S.123)	<ul style="list-style-type: none"> <li>other financial intermediation n.e.c. NACE 65.23</li> <li>other business activities n.e.c. NACE 74.84</li> </ul>	<ul style="list-style-type: none"> <li>factoring</li> <li>performance of re-invoicing</li> <li>treasury management</li> </ul>
<b>Ownership of non-financial tangible assets</b>			
Shipping companies	Non-financial corporations (S.11)	<ul style="list-style-type: none"> <li>sea and costal water transport NACE 61.10</li> <li>inland water transport NACE 61.20</li> <li>renting of machinery and equipment NACE 71.</li> </ul>	<ul style="list-style-type: none"> <li>owning assets (ships) or bareboat charter the ship flying under flag of convenience/low tax jurisdictions</li> </ul>
Operation/renting of other equipment	Non-financial corporations (S.11)	<ul style="list-style-type: none"> <li>extraction of natural resources NACE 11</li> <li>renting of machinery and equipment NACE 71.</li> </ul>	<ul style="list-style-type: none"> <li>register the extraction activity in low tax jurisdictions</li> </ul>
Merchanting companies	Non-financial corporations (S.11)	<ul style="list-style-type: none"> <li>wholesale trade and commission trade NACE 51</li> <li>other business services NACE 74</li> </ul>	<ul style="list-style-type: none"> <li>distribution company for a group without goods going through the territory</li> </ul>
Trading companies	Non-financial corporations (S.11)	<ul style="list-style-type: none"> <li>wholesale and retail trade NACE 51</li> </ul>	<ul style="list-style-type: none"> <li>distribution company for a group</li> </ul>
<b>Ownership of non-financial intangible assets</b>			
Licensing and royalty companies	Non-financial corporations (S.11)	<ul style="list-style-type: none"> <li>miscellaneous business activities n.e.c. NACE 74.8</li> </ul>	<ul style="list-style-type: none"> <li>concentration of group receipts concerning royalties and similar flows received from intellectual property rights and trademarks.</li> </ul>
	Other financial intermediaries, except insurance corporations and pension funds (S.123)	<ul style="list-style-type: none"> <li>other financial intermediation n.e.c. NACE 65.23</li> </ul>	<ul style="list-style-type: none"> <li>concentration of group receipts concerning royalties and similar flows received from intellectual property rights and trademarks.</li> </ul>
<b>Others</b>			
Transit trade	Non-financial	<ul style="list-style-type: none"> <li>wholesale trade</li> </ul>	<ul style="list-style-type: none"> <li>'entry point' for goods imports</li> </ul>

<b>Type</b>	<b>Institutional sector</b>	<b>Activity (NACE Rev. 1.1)</b>	<b>Purpose</b>
companies	corporations (S.11) ?	and commission trade NACE 51	that are then distributed within the group inside the EU.
Offices of airlines in airport hubs abroad	Non-financial corporations (S.11) ?	<ul style="list-style-type: none"> <li>• scheduled air-transport NACE 62.10</li> </ul>	<ul style="list-style-type: none"> <li>• transfer locus used by airline carriers to get passengers to their intended destination</li> </ul>

### C. Main preliminary conclusions and remaining work to be done

25. As said in the introduction, the work of the Task Force until the spring of 2008 was concentrated on the collection of case studies in the EU member states and on the review of the methodological background on recording of entities with little or no physical presence in national accounts.

26. The case studies show that such entities are increasingly used by multinational groups in a wide range of organisational structures which go beyond the traditional control chains of holdings owning financial shares of a group of subsidiaries. In many cases, the SPEs involved have only financial assets and liabilities in their balance sheets, but in other cases the ownership of non-financial assets and the receipts derived from them may be transferred by the group head to an SPE abroad. Especially in the case of receipts deriving from the exploitation of intellectual property rights, but also in other cases, the entire turnover of a group or a large part of it can be concentrated in one SPE.

27. As a result of the GNI Committee meeting of July 2008 the Task Force is expected to complete its final report by June 2009 with more specific guidance and recommendations on the treatment of entities with little or no physical presence in national accounts and in particular on the valuation of their output in the various cases identified in the initial part of the work. In addition, the Task Force needs to focus on possible decision trees on the treatment (including valuation) of units with little physical presence. Another conclusion derived from case studies was in fact that the treatment of SPEs is not fully harmonised in EU member states (see the annex for some more detail). This may have some impact on the GDP recorded by a particular country, depending on the treatment of the SPE. However, from the point of view of GNI, if the entity is 100% foreign owned the impact on GDP would be compensated by the property income attributed to the foreign owner. Another related issue are the possibilities of exchange of information between national compilers. This is more related to the aspects of the work of the Task Force that are described in document ECE/CES/GE.23/2009/7 section II.

[ENGLISH ONLY]

## **ANNEX**

### **SUMMARY OF THE CASE STUDIES COLLECTED ON SPECIAL PURPOSE ENTITIES**

#### **I. HOLDING COMPANIES AND INVESTMENT FUNDS**

1. Such companies are used to take advantage of double tax treaties by providing loans in treaty countries or other countries where withholding tax on interest is low or nil. An international holding company can be the parent for companies registered abroad as well as of other registered international business companies in the host country.
2. Special purpose entity (SPE) incidence in Luxembourg is highest among entities usually organized under the legal umbrella of 1929 Holdings and SOPARFIs (Sociétés de participation financière). Most SOPARFIs and 1929 Holding companies are financial corporations and classified in sector S123 "other financial intermediaries, except insurance corporations and pension funds" and attributed to Statistical Nomenclature of Economic Activities in the European Community (NACE) 65.23 (other financial intermediation n.e.c.). They are considered being resident institutional units even without persons employed and physical offices in Luxembourg and are fully included in national accounts. The financial service fees paid to the resident banking sector are estimated on bases of the deposits and credits with this sector. The domiciliation fees and the management fees for 1929 Holdings paid to resident trust companies are estimated at 0.05% and 0.01% of the value of the capital. The total amount of capital of 1929 Holdings is published by the VAT administration. The statistical business survey data is used to complement the estimation of intermediate consumption of the SOPARFIs. Employment and compensation of employees is taken from social security files. The subscription tax paid by the 1929 Holdings is estimated on the basis of 0.2% of the capital. To determine the total production, the sum of costs approach is used.
3. In the Netherlands, units acting as financing vehicles or holding companies on behalf of their non-resident parent companies are considered as SPEs (Bijzondere Financiële Instellingen – BFIs) and classified in sector S.123 (other financial intermediaries, except insurance corporations and pension funds). The term refers to entities that manage participations outside the Netherlands, distribute dividends gained from participations to the parent company and perform acquisitions on behalf of the parent company. Their economic activities are considered as the provision of financial services. The Netherlands do not use the sum of costs approach as in Luxembourg. Value added of SPEs had negative value for the period 2001 - 2005.
4. The Maltese international trading company is a company resident in Malta and set up with the purpose of holding overseas investments and distributing the income to non-residents. The international holding company is similar to the Maltese international trading company, except that it holds participations in foreign companies. International holding companies are not considered in Malta for national accounts.

5. In the UK, financial holding companies and securitisation vehicles are treated as SPEs. If the SPE is treated as an institutional unit and is a non-bank, it will be included in the sector S.123 (other financial intermediaries, except insurance corporations and pension funds). SPEs owned or controlled by a bank are deemed not to be an institutional unit, and their accounts are consolidated with those of its parent company.

## **II. SECURITIZATION COMPANIES**

6. Some entities are constructed to route financial flows of a particular type through a third country in order to reduce or avoid withholding taxes. In other cases, the aim is to obtain loans from affiliated companies for lending the funds raised to other affiliates, or that they pool different types of income received from affiliates, such as dividends and interest payments, and reinvest this within the group - those entities might be called treasury centres. The capital can possibly be supplemented with funds obtained from external parties in international capital markets through the issuance of stocks and bonds, entities performing such transactions might be called conduits.

7. In this progress report, the term securitization company is associated with different organisational constructions which have the purpose to securitize non-tradable financial assets (e.g. receivables). The securitization company is a legal construct that protects those financial assets and so their role as collateral is improved. As a result, the original company receives cheaper financing due to better collateral.

8. In the Netherlands these securitization companies are classified in sector S.123. They issue mostly mortgage backed securities. Production, intermediary consumption are valued at market prices, mainly based on information from the Dutch Central Bank (DNB). Financial Intermediation Services Indirectly Measured (FISIM) is included.

9. Besides financial holding companies securitisation vehicles are the only “visible” type of SPEs operating in the United Kingdom.

## **III. CAPTIVE RE-INSURANCE COMPANIES**

10. A captive re-insurance company is a type of organized self-insurance program in which a firm or a group sets up its own insurance company (usually in conjunction with a re/insurer) to fund and manage its retained risks.

11. In Luxembourg, captive re-insurance companies are considered being resident companies even if without employment and offices. They are considered in national accounts. The production and income accounts are compiled in the same way as for direct insurance companies.

#### **IV. LICENSING AND ROYALTY COMPANIES**

12. Licensing and royalty companies act as intermediaries between the original owner or creator of intellectual property (e.g. in the form of a patent, film rights, copyrights or trademark) who is not resident in the host country and an entity (licensee) which wants to use that patent under licence, resident in a third country. The company which owns the intellectual property is located in a low taxation country and is owned by the original owner of the intellectual property. Furthermore, the distribution of income from the host country of the licensing and royalty company to the home country of the owner of the licensing and royalty company will not be subject to any withholding taxes. In addition, because of the system of double tax treaties, royalty fees paid to the licensing and royalty companies by the subsidiary or independent licensee will have no or very low withholding taxes applied to them. This might not be the case if the royalties were paid straight to the home country of the intellectual property owner. The licensing activities can be combined with holding, financing or actual operating activities such as trading or manufacturing.

13. For the time being in Luxembourg licensing and royalty companies are not classified as SPEs. SOPARFIs dealing with the management of patents and trademarks are mostly classified in NACE 74.80 (miscellaneous business activities n.e.c.), a smaller number of units being still classified in NACE 65.23 (other financial intermediation n.e.c.). The units classified in NACE 74.80 are only included if they have employment and offices in Luxembourg. In the case of brass plate companies (without employment and offices) the production account relates only to the costs incurred on the territory, i.e. the domiciliation costs, indirect taxes etc. The production equals costs. In the primary income account, the income flows between branch/subsidiary companies and parent companies are considered. The units classified in NACE 65.23 are treated together with financial holdings.

14. In the Netherlands, licensing and royalty companies are considered as SPEs and classified in sector S.123 as other financial intermediaries. They own non-financial assets and exploit licences, patents and film rights for their parent companies. The non-financial assets are seen as investment assets and define this entity as investment vehicle, even if the investment is done on behalf of the parent company and not for a large public.

#### **V. TRADING COMPANIES AND MERCHANTING COMPANIES**

15. There is very wide scope for the use of trading companies in Member States. This is indicated by the numerous international trading companies used by persons and entities of various nationalities. In some Member States these trading companies referred to as international trading companies (Malta) or international business companies (Cyprus) and are adopted to receive commission income, management or operational fees, to hold patents and copyrights and to perform re-invoicing operations.

16. In some Member States the use of entities with little or no physical presence is high among the following activities:

- (a) wholesale and commission trade services (NACE 51);

(b) renting of machinery and equipment (NACE 71);

(c) business services (NACE 74), especially management of patents, trademarks and other licenses and management activities of holding companies.

17. In Luxembourg these companies are not classified by the Service Central de la Statistique et des Etudes Economiques (STATEC) as SPEs, but as normal commercial companies, and subject to Luxembourgish income tax. Often these companies "commercialize" the products of a multinational group in a greater geographic area or perform re-invoicing operations and are classified in NACE 51. The incentives to create this type of companies might be numerous, among others also fiscal engineering like the use of non double taxation treaties with non-EU countries. In this latter case the company has a branch in this non-EU-country where all activity takes place and where taxes are paid. For all companies without any employment and office in Luxembourg the production account relates only to the costs incurred on the territory, i.e. the domiciliation costs, indirect taxes etc. and the production is evaluated by the costs.

18. For trading companies operating in different countries, that means companies with offices and employment in Luxembourg and branches outside Luxembourg (which have no separate accounts) STATEC applies the pro rata method, i.e. the production account is compiled on the basis of the relation: turnover of the local unit/total turnover of the company.

19. In Portugal trading companies with physical presence and with operations in the region are considered under NACE 51 (wholesale and retail trade) and NACE 74 (other business services) for national accounts. For units without physical presence and without economic activity in the territory only the gross value added is considered as a proxy for output, because these units are involved in direct reporting for balance of payments statistics. In fact all of them declare their transactions as merchanting. The option for considering the gross value added was due to the fact that the output of the wholesale and retail trade is the sum of the trade margins on the various products and merchanting is similar recorded.

20. Maltese merchanting companies are considered resident in the economy and their activity is recorded as merchanting service (NACE 51) for national accounts. For Balance of payments (BOP) compilation the merchanting service is recorded for the current account, but no exports or imports of goods, as the resident merchant did not acquire the goods. In the case of Maltese trading companies imports and exports of goods are recorded in INTRASTAT und BOP, as well as the margin earned by the resident trading company in the current account and in NACE 51 for national accounts. These types of merchanting and trading companies are considered by the NSO as different from companies formally known as Maltese international trading companies. Maltese international trading companies are registered in Malta and doing business exclusively with non-residents. They are not eligible to own assets situated in Malta. The economic decisions regarding such Maltese international trading companies are taken by a parent company located outside Malta. Profits generated from these activities abroad are transferred to the Maltese international trading company with the purpose of benefiting from tax incentives. Companies being registered as Maltese international trading company classified in NACE 51 are regarded as non-residents, and their activities and transactions are neither considered for national accounts nor for balance of payments statistics.

21. A similar legal construct exists in Cyprus, where the term Cyprian international business company refers to as legal entities whose beneficial ownership and business activities lie outside the country of registration. These international business companies are not considered for national accounts, as they have business activities outside the territory and no physical presence.

22. With regard to the current treatment of trading companies in Luxembourg, Malta and Cyprus, there is a possibility that the profits made by those companies are not recorded (captured) anywhere in the European national accounts or balance of payments as a value added creation. There's also a need to investigate the consistency between valuing output of those trading companies at costs (domiciliation costs, indirect taxes etc) and their subsequent income distributions to parent companies.

23. The case study of Belgium discusses discrepancies arising from the treatment of transit trade in national accounts and in external trade statistics under the community regime. Although transit trade companies operate in the national economy and are registered with a VAT number, they often have no or very few staff employed. In the Belgian treatment, a distinction is made between, on the one hand, the independent trading companies (accounting desks operating only internationally on behalf of foreign companies) and affiliates of foreign groups working also with other resident affiliates of the same group in Belgium on the other hand. The former are not considered resident in the Belgian economy, the latter are considered resident.

24. Trade flows administered by independent transit trade companies are not included in the trade in goods flows compiled according to the national concept. However, they are included in the community concept of the external trade in goods (and BOP) which results in a significant gap in absolute value between BOP and rest-of-the-world (ROW) statistics. Furthermore, when flows of exports and imports of independent transit trade companies are not balanced, this results in a non negligible gap in net terms. In particular, it is often observed that the reported prices of the exported goods are considerably higher than the prices of the same goods at the moment of their import.

25. In the Netherlands, if a unit is considered to be the owner of imported or exported goods, it is included in the foreign trade statistics and in national accounts. If not, the goods are included in transit trade statistics (but not used for national accounts) and are included in the community concept of the trade in goods (and BOP) which results, as for Belgium, in a significant gap between BOP and ROW statistics.



## **VI. MULTI-TERRITORY ENTITIES WITH MARITIME AND AIR TRANSPORT OPERATIONS**

### **A. Shipping companies and vessel management companies**

26. "Flags of convenience" and "bareboat chartering" are expressions that refer to the case in which non-resident entities can register ships in certain countries and operate the ship under that country's flag, although the administrative headquarters are sited and real business carried on elsewhere. There are a number of significant non-tax reasons for using flags of convenience such as low registration fees, lower wage costs, reduced technical standards required and a lack of other operational controls from government. However, "open registration" may also give rise to significant opportunities for tax avoidance. Generally, low or no income taxes are paid in the country of registration on profits from shipping operations, as the "open registration" country may be a tax haven, or the profits can be routed through a tax haven jurisdiction commonly by using leasing and chartering arrangements.

27. The complexity of the statistical treatment of shipping activities needs further clarification on different aspects such as residence, nature of shipping companies' activities, mechanism employed in registration. The complexity arises due to the fact that the registration, the ownership and the management of the transport equipment as well as the organisation of provision of transport service using this transport equipment can all be performed by different entities in different economies.

28. The administration of ship registration services needs no physical contact with the state. Within these registration procedures, all interested parties in the ventures (owners, investors, insurers, etc.) incorporate a shipping company (ship-owner), and a vessel management company in the flag state. The shipping company acquires the vessel in its name and registers the vessel under a flag of convenience. Vessel management companies offer full management services (including chartering, crewing, ship broking and similar activities) to ship owners having their vessels flying under various flags. Concerning the financing of a ship, it has to be determined whether the ship is being leased or effectively sold to the institution which owns it.

29. The registered owners of almost all "Flags of convenience" ships are entities with little or no physical presence set up for the sole purpose of owning that particular ship.

30. In draft BPM, sixth edition, Chapter IV (Economic Territory, Units, Institutional Sectors, and Residence) the problem of residence for enterprises involved in mobile production is discussed in paragraph 4.136 (draft December January 2008): "For example, an institutional unit that operates ships on the high seas and various territorial waters has its residence determined according to the criteria in paragraphs 4.131–4.135, and the economy of residence is not necessarily the same as where the ships spend the most time or the territory of registration of the ships. As well, the enterprise that operates the ships is not necessarily the same as the enterprise that owns the ships, such as where the ship operator has an operating lease from the ship owner, who is resident in another economy. The residence of the enterprise that owns the ship is determined according to the criteria in paragraphs 4.131–4.135. Flag(s) of convenience used by the enterprise do not determine the residence of the operator, and indeed a single shipping

operator may have ships registered in several economies. Similarly, the residence of an enterprise that charters ships is determined by the location of its own base of operations, rather than the flag(s) or locations of particular ships. "

31. In the IMF Balance of Payments Compilation Guide (BPCG), paragraphs 442 - 450 deal with the "Treatment of the operations of mobile equipment". paragraph 442 states that "the key to correct treatment of this (shipping) equipment lies in determining the residence of the operator of the equipment" and paragraph 449 considers a further complication that arise when "the operating enterprise may be registered in two or more countries as a result of special legislation". The BPCG suggests that "in such cases, the earnings, expenses, assets and other activities of the operator could be split between the countries in proportion to shares held in the operating enterprise" or that "...the country where the head office of the enterprise is located could be considered the operator's country of residence, and the other countries could be considered shareholders in the operation".

32. BPCG paragraphs 705 – 707 states that "of particular concern are brass plate companies, such as those established to register ownership of shipping vessels or to raise capital through the issuance of securities... To take advantage of various legislation, certain companies may register in a country but, for all practical purposes, have no operational presence in that country. ... That is, the companies do not carry out production, have no employees, and do not pay income tax. Many companies established for the purpose of issuing securities may have no other presence in a host country. Brass plate companies may pay a fee to register in a host country and may share an office or directors with similar enterprises. However, books or accounts may be maintained elsewhere and, thus, be unavailable to the host country compiler."

33. The OECD Benchmark definition of foreign direct investment - 4<sup>th</sup> edition (February 2008) cites in paragraph 335 "An owner may establish an incorporated or unincorporated enterprise that operates the ship. The country of the (affiliated) operator may differ from that of the owner, in which case a direct investment relationship exists. When the ship operations occur in international waters, the activities should be attributed to the economy in which the operator maintains residence".

34. Concerning the case studies supplied by the participants in the Task Force, Luxembourg considers only those shipping companies which activities actually take place on the national territory, given the fact that Luxembourg does not have either direct sea access or a sea port. Activities which are actually performed on the national territory are vessel management, international crew rental services, taxation, legal and ship financing consulting, incorporation and domiciliation of shipping companies. These activities are performed either through a subsidiary for a group as a whole located outside Luxembourg, by a management company or by an accounting firm. Other activities are considered to have no economic effect on the economy of Luxembourg. The evaluation of the production account of the shipping activities is mainly based on ship management fees and the associated costs. The production accounts of inland water transport services of passengers and goods includes only those companies considered as having substance on Luxembourgish territory. Other activities such as sea transport or chartering activities are typically performed by a non-resident branch or by a parent company and are hence excluded. Consequently, seamen affiliated to the Luxembourg social security are excluded from

national labour force figures, as well as land men employed by companies which are not in the scope, i.e. not working on the national territory.

35. Data on shipping companies and vessel management companies is not compiled in Cyprus and Malta. These companies are registered in these countries, but have no physical presence and perform their maritime operations outside the economic territory.

**Table 1. Merchant fleets of the world by flags of registration of 1 January 2007 in 1000 gross tons<sup>9</sup>**

	Total fleet	In % of world total
Greece	32,048	4.44
UK	13,448	1.86
Italy	12,571	1.74
France	6,096	0.85
Germany	11,364	1.58
Cyprus	19,032	2.64
Malta	24,850	3.45
Luxembourg	780	0.11
Portugal	1,224	0.17
World total	721,130	

36. The case study of Cyprus shows the usual practice of non-resident investors to establish a shipping company in the economy which register for flying flags of convenience for their assets (vessels). Because the shipping company has no physical presence beyond a brass plate, these Foreign Direct Investment (FDI) relations are not considered in balance of payments statistics. Besides vessel management companies registered having no physical presence beyond a brass plate, fully fledged vessel management companies are operating in Cyprus. This type of company is fully considered in national accounts and balance of payments statistics.

## **B. Vessel and aircraft leasing companies**

37. The ability to raise capital and keep it off the balance sheet of its originator has been the main driving force in the large-scale use of entities with little or no physical presence in leasing. These entities are widely used to finance the acquisition of large-valued equipment such as vessels and airplanes, and to finance the construction and use of commercial real estate. Many lease transactions are structured to place lessors in form of entities with little or no physical presence to obtain tax benefits passing a part of the benefits to the lessees. These entities buy or construct the assets, take title to the property, and lease the properties to the lessee/corporate user, or one of its subsidiaries.

<sup>9</sup> United Nations Conference on Trade and Development (UNCTAD): Review of Maritime Transport 2007, pages 146 – 147.

38. In Cyprus, vessel and aircraft leasing companies are not considered for national accounts and balance of payments purposes, because they are registered in the host country, but have no physical presence and their operations are carried out outside the territory.

39. In MT the leasing company buys the asset (aircraft) and leases it to a lessee in a third country, where the aircraft is registered in the civil aviation register, although the asset is recorded in the balance of the Maltese leasing company. The acquisition of the aircraft is not recorded as import in the Maltese trade statistics, because the aircraft is registered in a third country.

40. The following example illustrates the impact of financial versus operational leasing on GDP and GNI. Operational leasing is treated as a service, unlike financial leasing, which is treated as loans.

41. Shipping companies of country A under the flag of B, which is also the lessor:

- (a) Acquisition of ships (by import from a third country) = 1000;
- (b) Consumption of Fix Capital = 100;
- (c) Payments from A to B:
  - Operating Leasing: payment 150;
  - Financial Leasing: payment 150, of which Interest=60, FISIM = 15 (included in the payment of 60).

**Table 2. Acquisition of the ships (by import from a third country)**

Kind of Leasing	Operating Leasing		Financial Leasing	
	A	B	A	B
GFCF		1000	1000	
External balance of goods and services (Exports – Imports)		-1000	-1000	
<b>GDP</b>		<b>0</b>	<b>0</b>	<b>0</b>

**Table 3. Impact on main aggregates**

<b>Kind of Leasing</b>	<b>Operating Leasing</b>		<b>Financial Leasing</b>	
	<b>A</b>	<b>B</b>	<b>A</b>	<b>B</b>
Output		<b>150</b>		<b>15</b>
Intermediate consumption	<b>150</b>		<b>15</b>	
Exports		<b>150</b>		<b>15</b>
Imports	<b>150</b>		<b>15</b>	
<b>GVA / Operating surplus/ External balance of goods and services</b>	-150	150	-15	15
<b>GDP</b>	-150	150	-15	15
Balance of the primary income from the rest of the world			<b>-45</b>	<b>45</b>
<b>GNI</b>	-150	150	-60	60
CFC		<b>100</b>	<b>100</b>	
<b>Entrepreneurial income</b>	<b>-150</b>	<b>50</b>	<b>-160</b>	<b>60</b>

### C. Offices of airlines in airport hubs abroad

42. Hub services generate statistical flows which need to be recorded in the Balance of Payments and National Accounts. Most notable among these flows are revenues generated from flights into and out of the hubs, fees paid by the airline to the airport authorities and wages paid to staff (which may be employed by a third party, such as an aviation service company).

43. The IMF's Balance of Payments Textbook 1996 states in paragraph 103: "The attribution — in terms of the residence — of services provided by mobile equipment (such as aircraft, ships, highway and railway rolling stock, fishing vessels, and gas and oil drilling rigs) is based on the resident status of the enterprise operating the equipment in the production process. (The enterprise owning the equipment may or may not be the operator.) The residence of an enterprise operating mobile equipment outside any national territory (that is, in international waters or air space) is attributed to the economy in which the mobile equipment is, in some sense, based. In determining the residence of such an enterprise, consideration should be given to such attributes as the location of the company directing enterprise operations; whether the equipment is subject to the laws, regulations, and protection of a particular national economy; or whether the equipment is linked more closely to one economy than to another."

44. Draft BPM6 paragraph 4.136 reads as follows: "In some cases, an enterprise has a location that is used as a base to deliver services to other locations. For example, this mode is used for

transport (discussed under mobile equipment in paragraph 4.31) and may also be used for delivery of many kinds of services, such as on-site repairs, short-term construction, and many types of business services. In such cases, the residence of the enterprise is determined from its base of operations, rather than the point of delivery or location of mobile equipment, unless the activities at the point of delivery are sufficiently substantial to amount to a branch, as defined in paragraph 4.27 above."

45. Based on the case study of Ireland, a practical approach is to record all revenues received from services provided and fees paid to sub-contractors involved in an internationally organized hub-spoke-structure as domestic contributions to the economy where the operator of the airline network is resident (Ireland in the specific case).

**Table 4. Summary of entities with little or no physical presence and their current treatment in some Member States**

Country	Label	Economic activity	Included/ Excluded in production	Valuation
Belgium	Transit trade companies	<ul style="list-style-type: none"> <li>international trading of goods by units that are independent affiliates in Belgium of foreign companies</li> </ul>	excluded	
Cyprus	Brass plate companies (Special purpose entities)	<ul style="list-style-type: none"> <li>investment services</li> <li>commission, trading, merchanting</li> <li>management, operational or consultancy services</li> <li>holding patents and copyrights</li> <li>re-invoicing operations</li> <li>ship registration and maritime operations</li> <li>leasing</li> </ul>	excluded	
Ireland	Offices of airlines in airport hubs abroad	<ul style="list-style-type: none"> <li>operations of airline networks</li> </ul>	included	Revenues and fees
Luxembourg	Special purpose entities (Other financial intermediaries)	<p>"1929 holdings"</p> <ul style="list-style-type: none"> <li>financial holding</li> <li>holding patents and copyrights</li> </ul>	included	Sum of costs

Country	Label	Economic activity	Included/ Excluded in production	Valuation
		Soparfi (sociétés de participation financière) <ul style="list-style-type: none"> <li>• financial holding</li> <li>• investment funds</li> </ul>	included	Sum of costs
		<ul style="list-style-type: none"> <li>• captive re-insurance companies</li> </ul>	included	Same way as direct insurance
	Brass plate companies which are non-financial corporations (companies with no employment on the territory)	<ul style="list-style-type: none"> <li>• management, operational or consultancy services</li> <li>• holding patents and copyrights</li> <li>• commission, trading, merchanting</li> </ul>	only for the costs incurred on the territory	
Malta	Brass plate companies	<ul style="list-style-type: none"> <li>• investment services</li> <li>• commission, trading, merchanting</li> <li>• management, operational or consultancy services</li> <li>• holding patents and copyrights</li> <li>• re-invoicing operations</li> <li>• ship registration and maritime operations</li> <li>• leasing</li> </ul>	excluded	
Netherlands	Special financial institutions (SFIs) — Bijzondere financiële instellingen (BFIs) (Other financial intermediaries)	<ul style="list-style-type: none"> <li>• holding patents and copyrights</li> <li>• financial holding</li> <li>• re-invoicing operations</li> <li>• financing</li> <li>• securitisation vehicles</li> </ul>	included	Market price
Netherlands	Securitisation vehicles	<ul style="list-style-type: none"> <li>• securitisation, mostly mortgage backed securities</li> </ul>	included	Market price. FISIM is included

Country	Label	Economic activity	Included/ Excluded in production	Valuation
Netherlands	Transit trade companies	<ul style="list-style-type: none"> <li>import/export services without acquisition of the ownership of the goods</li> </ul>	excluded	
Portugal (Madeira)	Brass plate companies	<ul style="list-style-type: none"> <li>ship registration and maritime operations</li> <li>commission, trading, merchanting</li> </ul>	included	GVA/ margin
United Kingdom	Special purpose entities (Other financial intermediaries)	<ul style="list-style-type: none"> <li>financial holding</li> <li>securitisation vehicles</li> </ul>	included	Sum of costs

## VII. REFERENCES TO THE CASE STUDIES

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