Minimisation of profits tax by MNEs and the effect on the measurement of global production

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Group of Experts on National Accounts

My role as a user is as a consultant to countries on national accounts

I want

- **good standards that can be explained**
- **clear guidelines that can be followed**
- **Standards and guidelines that are implementable**

Introduction

What's the paper about?

- **Do the standards and guidelines on measuring production by MNEs meet the needs to be credible and implementable in country national accounts?**

Multinationals avoid tax on profits by recording profits in low tax countries

Two common methods are

- **Artificial transfer pricing**
- **Establishing intellectual property holders as separate companies in low tax countries**

Artificial transfer pricing in a multinational

Affiliate Company A delivers semi-finished goods to parent company B

The semi-finished goods have a market value of 100, and both companies make profits of 50

Raise the value of semi-finished goods to 100

Then Company A makes 100 profit, B makes no profits at all

A multinational holds patents for its processes and shows no charges for the internal use of the patents to make goods for sale

An SPE is set up in a low tax country, to hold the patents of intellectual property that are the essence of the company's ability to earn

All the affiliate companies that use the patents pay the SPE for access to the intellectual property

The affiliate company profits go down, and the SPE profits rise

In both these cases, the economic reality is different from the arrangements necessary to lower global tax burden.

What does the global production guide recommend?

For transfer pricing, depend on the diligence of the tax authorities and assume that the transfer prices used are on an "arm's length" basis.

For SPEs holding intellectual property patents, recognise the SPEs as institutional units and recognise the payments as payments for services, resulting in higher profits in the low tax country

Profits are a balancing item between sales and costs, and so are determined by the assumptions made on these values where they reflect imputations for non-market transactions between affiliate companies

Where there are no comparable transactions in the market for these inter-affiliate transfers, the valuation is determined by the company accountant, often to mitigate global tax burden

Message 1

A strong convention is needed to avoid artificial transfer values.

A suggested one is to value the semi-finished goods at the cost of inputs of goods and services, labour and that part of profits needed to cover capital consumption used on the production site.

This would imply allocating all profits not needed to cover capital consumption, to the beneficial owner of the multinational assets and sales.

Message 2

See through artificial arrangements such as an IPP patent-holding SPE to receive royalty payments, and reflect all the transactions of the SPE in the accounts of the parent / ultimate beneficial owner of the MNE

OR

Treat IPPs as non-produced, and return to (the good old days) of recognising royalties as income transfers, not service payments

Message 3

The task force on Global Production has demonstrated that the SNA / ESA BPM6 require further updating.

To ensure that SPE transactions and assets are wholly reflected in the accounts of the parent company of a multinational, drop the requirement that SPEs are institutional units through residency alone. Rename them statistical units, which are obliged to report on assets and transactions so that they can be subsumed in the parent's accounts

Message 4

Governments are concerned that through tax avoidance schemes, GDP is being mis-measured between countries

MNE parents report to NSIs the situation reflecting the tax avoidance arrangements as economic reality, and show a low contribution to GDP through profits

Countries where the SPEs are resident will not record the corresponding high contribution to GDP of profits placed offshore

Last message

National accounts must reflect economic reality – if the Guide on measuring global production does not take this on board, then it will be the prisoner of the current standards.

The lesson learned should be that tackling the measurement of global production has exposed weak areas of the standards.

Change the standards so that the guide can do its job.

Questions

Can we defend significant changes to measures of country GDP as multinational artificial tax arrangements change?

Can we explain how an SPE in an offshore island is taken to produce services contributing to offshore measures of GDP?

And if the office is moved to a neighbouring offshore country, country GDPs change?