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Data users' viewpoint to global production

The minimisation of profits tax by multinational companies and the effect on the measurement of global production

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Summary

There are two common ways that MNEs can minimise global tax on profits. One is through the use of artificial transfer prices for intermediate goods and services supplied across national boundaries in the global production of products. The second way is to register intellectual property patents in countries with low profits taxes. Both of these enable profit allocation to low tax regimes. These policies affect the national accounts measures of value added by allocating profits amongst countries in a way which does not reflect the economic reality of the situation. This paper sets out examples of how accounts are affected by these two policies, and argues that there is no simple rationale for the allocation of global profits amongst contributing countries in a global production function. The conclusion of the paper is that conventions are needed for the robust and repeatable measure of GDP across the countries affected by global production. Two possible conventions are discussed – one for transfer prices which is current practice: to use arm's length prices for intermediate goods, and the other is to allocate global profits according to (a) the use of tangible capital assets and (b) ultimate economic ownership of companies and IPPs. A second conclusion is that recognising SPEs abroad as institutional units separate from the units owning them, and so recognising the holding of assets and associated transaction in the national accounts, gives rise to unacceptable asymmetries between countries in the measurement of GDP.

I. Introduction

1. The Guide to measuring global production goes into detail to help national accountants tackle the difficult problem of allocating profits of multinationals to the economies in which the multinationals operate. But there is an inherent difficulty of country allocation of profits generated through global production chains. The techniques of tax avoidance as practised by multinationals have residency as a key concept: businesses have to be resident in a country to be subject to the tax laws of that country.
2. Chapter 3.3 of the Guide states that “Ownership relations may sometimes suggest that affiliated companies are not acting independently from their parents. The level of independence in their corporate behaviour determines whether or not an affiliated company is holding assets on its own behalf and is therefore engaged in economic transactions.” But the ability of the SNA to handle the residency issues high-lighted by tax avoidance schemes is undermined by the very next sentence: “Yet the ECB, Eurostat, and the OECD task force report of ‘Head Offices, Holding Companies and Special Purpose Entities’ recommends that entities with hardly any autonomy, and owned by non-residents, are always to be considered as separate institutional units.” This enables SPEs to independently own assets and receive income, with subsequent effects on GDP measures.
3. The following excerpts from SNA 2008 have been abbreviated to highlight the ruling with regard to SPEs, but the sense remains unaltered.

A. SNA 2008

4. Paragraph 1.9: Two main kinds of institutional units are distinguished in the SNA; households and legal entities. The defining characteristic of an institutional unit is that it is capable of owning goods and assets, incurring liabilities and engaging in economic activities and transactions with other units in its own right.

5. *Institutional Units*

Paragraph 26.27 As discussed below, in some cases, legal entities are combined into a single institutional unit if they are resident in the same economy, but are not combined if they are resident in different economies.

Paragraph 26.28 Resident special purpose entities are combined with their owners into single legal entities. However, a legal entity that is resident in one jurisdiction is never combined with a legal entity in another. As a result, SPEs owned by non-residents are residents of their territory of incorporation, even though their owners and assets are in another country.

Careful reading of the above reveals that the SNA says that SPEs owned by non-residents are recognised as institutional units, even although they fail the test of independence and control which paragraph 1.9 sets out as defining characteristics.

6. These SNA 2008 concepts and definitions support the recognition of SPEs set up by owners purely for tax avoidance purposes, as institutional units. So the avoidance schemes which artificially register profits offshore, increase the GDP of the offshore country and decrease the GDP of the MNE country. This does not reflect the economic reality, and the GDP measures are subject to distortion as MNEs change their tax avoidance policies.

II. Example of arm's length transfer values

7. An enterprise buys in materials and services to produce output. It does this in a single location, and Table 1 sets out the uses and resources associated with production in a national accounts production account format.

Table 1

Production on one site

<i>Uses</i>	<i>Resources</i>	
Purchases of goods	15	Sales of products 200
Purchases of services	20	
Compensation of employees	50	
Operating surplus to meet costs of capital consumption	65	
Rest of operating surplus (balancing item)	50	
Totals	200	200

8. The calculation of the GDP contribution of production (gross value added in simple terms) is straightforward as the sum of compensation of employees and the two components of operating surplus – one to cover the costs of capital consumption of assets, and the balance to reflect the net operating surplus. All production and ownership of inputs, outputs and assets is located at one location and so the allocation of GDP contribution to site is trivial.

9. Now consider if production is split between two sites, and the semi-finished good of one site A is transferred to the second site B for production and ultimate sale of the final product. The production accounts of the two sites are shown in Table 2.

Table 2

Production on two sites

<i>Uses</i>	<i>Site A</i>	<i>Site B</i>	<i>Resources</i>	<i>Site A</i>	<i>Site B</i>
Purchases of goods	5	10 + ?	Sales of products	?	200
Purchases of services	10	10			
Compensation of employees	20	30			
Operating surplus to meet costs of capital consumption	15	50			
Rest of operating surplus (balancing item)	?	?			
Totals	?	200		?	200

10. The observable inputs on both sites can be measured and capital consumption allocated according to the assets held on each site. However, in order to derive site estimates of the rest of operating surplus, we must estimate the value of the output of Site A. If we assume for the moment that it is an unknown X, we can enter this in to the site production accounts as shown in Table 3.

Table 3

Production on two sites, with value of transfer sales as X.

<i>Uses</i>	<i>Site A</i>	<i>Site B</i>	<i>Resources</i>	<i>Site A</i>	<i>Site B</i>
Purchases of goods	5	10 + X	Sales of products	X	200
Purchases of services	10	10			
Compensation of employees	20	30			
Operating surplus to meet costs of capital consumption	15	50			
Rest of operating surplus (balancing item)	X-50	(200 - X - 100) = 100 - X			
Totals	X	200		X	200

11. It can be seen that if we wish to allocate profits to each site, beyond those implied by the location of capital assets, we must estimate the value of X - the sales of intermediate products from A to B.

12. Where there are sales of similar intermediate products on the market, then we can use these prices and the quantities transferred to estimate the value of X. This is the established practice (Article 9 of the OECD Model Tax Convention) of using “arm’s length” prices to value such trade in semi-finished goods when no market sale or purchase is made. There are obvious difficulties in making robust estimates of value, usually due to the lack of a market in similar goods from which prices can be estimated.

13. When the two sites are in different countries, the MNEs can use the uncertainty regarding the price of the intermediate goods produced on site A to ensure that profit is allocated between sites to reduce liability to profits tax rather than the best possible conceptual solution.

III. The nature of profits

14. Profits are a balancing item in the accounts, derived only if total sales and material and labour costs are known. Profits earned in a production chain controlled by an MNE over many sites are a function of the total production chain, and cannot be allocated with confidence to the component links. When a production chain is spread across different sites, how can we measure the contribution of different parts of the production chain to profits, when the intermediate products are not sold and bought on the market? Transfer pricing of intermediate products between production sites at arm’s length is an inexact science, and subject to manipulation by MNEs which are in charge of the whole chain.

15. The situation has become more difficult as materials and services become a smaller component of costs in the production chain, and intellectual property generates a higher proportion of profits. Now, instead of physical assets whose location determines the allocation of profits to site through local capital consumption, we must decide where the intellectual property contributes to production. But intellectual property is intangible. MNEs can register the patents for intangibles anywhere, and according to the current national accounts standard of SNA 2008, the payments for access to them are scored as service payments. But by their very nature, intangibles are unique and not usually marketed – they are created, developed and held by MNEs to introduce innovation to their business. Their value and the associated service payments are at the mercy of business accountants, and they can use this uncertainty to structure business arrangements to minimise global profit tax. The recognition of intangibles in the national accounts has helped economic analysis of production by recording their value as assets, and allowed examination of their

role in economic development. But their contribution to the production chain reflects their intangible nature – the arbitrary location of the legal instruments that protect access to them results in payments flowing between sites, which can be arranged to minimise tax burden for MNEs.

16. An example is given in Annex A illustrating how profits are handled in the national accounts when production is split across sites.

IV. Example of payments for access to intellectual property

17. In the example, an intangible which determines an innovative production process across sites A and B can have the patent registered at a completely different site C. As the intangible asset is difficult to value, given the uniqueness of the product and the lack of market transactions, MNEs can choose how to value the payments to suit their tax minimisation policies with very little fear of tax authorities questioning the size of payments. This is different from the transfer pricing phenomenon, where there is at least some basis through market comparison to estimate the value of intermediate products transferred between sites.

18. Suppose that instead of B holding the patent for the intellectual property, and no internal payments for consumption of capital registered in the company accounts, the patent is registered at site C. Then we can introduce payments from site B for access to the intangible which are at a company accountant's view of value. If site B is in a high profits tax jurisdiction compared to C, then we can effectively reallocate profits from B to site C through the registration of the patent at C and by valuing the payments at a high level.

19. For simplicity, we will assume that X, the value of semi-finished goods from A to B is 100. The situation is then as shown in Table 4.

Table 4

Production at two sites with sales of semi-finished goods between them valued at 100

<i>Uses</i>	<i>Site A</i>	<i>Site B</i>	<i>Resources</i>	<i>Site A</i>	<i>Site B</i>
Purchases of goods	5	110	Sales of products	100	200
Purchases of services	10	10			
Compensation of employees	20	30			
Operating surplus to meet costs of capital consumption	15	50			
Rest of operating surplus	50	0			
Totals	100	200		100	200

20. Now consider that payments for access to intellectual property of value 40 are paid by B to an SPE at a third site C. This raises the service payment of B from 10 to 50. The production accounts for the three sites are then as shown in Table 5.

Table 5
Introducing payments for access to IPPs

<i>Uses</i>	<i>Site A</i>	<i>Site B</i>	<i>Site C</i>	<i>Resources</i>	<i>Site A</i>	<i>Site B</i>	<i>Site C</i>
Purchases of goods	5	110		Sales of products	100	200	40
Purchases of services	10	50					
Compensation of employees	20	30					
Operating surplus to meet costs of capital consumption	15	50					
Rest of operating surplus	50	-40	40				
Totals	100	200	40		100	200	40

21. The effect is to reduce the gross profits (operating surplus) of site B from 50 to 10, and generate new profits at site C of 40.

22. The effect on GDP is to lower the contribution of site B by 40, and generate a new contribution at site C of 40. If sites B and C are in the same country, then the SPE will not be recognised as a separate institutional unit, the accounts consolidated and the overall estimate of gross profits will remain at 115. If C is in another country and recognised as a separate institutional unit, then GDP of this country will rise by 40 and the GDP of the country of B will fall by 40.

23. However, experience suggests that in practice the country in which the SPE is situated will only record local wages and salaries as the contribution to GDP in their country. So there will be a unilateral reduction of GDP in the country of the parent of the MNE. The net effect of the scheme will be to reduce the true measure of global GDP.

V. Issues

24. Countries with MNEs who operate such schemes should determine the value and country where the captive SPE operates, and ensure that this country is provided with the information necessary to increase its GDP by the appropriate amount. Such problems are likely only to be tackled through the existence of “large company units” in the statistical office of the producing countries, or countries where the head office is situated. Where this does not happen, and given that this rise in GDP in the offshore country where the SPE is situated has no noticeable effect on the economy of the offshore country, and also given the lack of information provided by the local representative of the MNE, the offshore country will not recognise this artificial rise in its GDP.

25. This situation is not restricted to SPEs in traditional small economy offshore tax havens. SPEs can be set up in large economy countries, with the MNE head office in another large economy. The numbers involved can be very big, and large mismeasurements will occur in country measures of GDP.

26. Where does the national accountant turn to for guidance - what does the “Guide to measuring global production” say?

27. Annex B contains a selection of annotated quotations from the “Guide to measuring global production”. The selection is of text which directly affects the tax avoidance issues, and the comments either reinforce the messages, or raise concerns.

Conclusions

28. Writing the current guide has not simply generated guidelines to help measure economies in the face of an increasingly complex world peopled by very large MNEs. It has also generated feedback for the international standards which require action. The outstanding issue is that of the different status of SPEs depending on whether they are located in the same country as the parent company, or whether they are located abroad. In the case of IPP patent holding SPEs, the location of them abroad is invariably a result of tax avoidance schemes.

29. Given that a part of profits of an MNE can only be satisfactorily estimated on a global basis, there is a need for statistical offices to act together to estimate global profits for MNEs, and then allocate these profits to countries according to location of capital assets and ultimate beneficial ownership. This ties in to some extent with the move to concentrating on measures of GNI rather than GDP when measuring the contribution of business to countries – primary income rather than value added may solve some of the problems generated by tax avoidance arrangements.

30. Arrangements to minimise global tax burden, which generate payment flows across national boundaries which are determined by tax rather than economic considerations, should be “seen through”. For example, payments abroad for access to intellectual property should be registered as internal transactions where the MNE controls both the R&D and the production process, and assets allocated to the site of MNE ultimate beneficial ownership.

31. The Guide has chosen to recommend the pragmatic acceptance of company records where IPPs are registered abroad. This unavoidably results in the artificial arrangements for tax avoidance to determine levels of GDP in the countries affected. Asymmetries will be generated, and country and global GDP under-valued.

32. This points to changing this recommendation to one of recording measures that reflect economic reality. This would show IPP assets held by the parent of the MNE where the parent is the ultimate beneficial owner. Given that the records exist to enable asset values and flows to be estimated for the case where the SPE is recognised as an institutional unit, it should not be an insurmountable task to reallocate the assets and service payments to the MNE parent. An exercise to investigate how feasible it is reallocate IPPs from overseas SPEs to the parent MNE would be a fruitful line of research.

Annex A: The nature of “profits” or operational surplus in national accounts

A.1 Example of production account

	Inputs	Output
Products used	35	200
Employment expenses	50	
Operational surplus		115
<i>Of which capital consumption</i>		15
<i>Other profits (including return to capital)</i>		100
Total inputs	200	

A.2 Now consider the production taking place at two different sites, the first site A passing its product to the second site B as a component in the final product. The HQ is at site B, and all assets are owned by the HQ. If we value the product of site A as X, we can show the production accounts for the two sites.

Site A		
	Inputs	Output
Products used	15	X
Employment expenses	20	
Capital consumption	5	
“Other profit”	X - 40	
Building B		
	Inputs	Output
Products used	X + 20	200
Employment expenses	30	
Capital consumption	10	
“Other profit”	200 - X - 60	

“Other profit” across both sites is $200 - X - 60 + X - 40 = 100$

How should we allocate value added between the two sites?

A.3 If A is effectively a “captive” of B, then the transfer value of intermediate products X would reflect all costs except “other profits”: these reflect the return to capital and other profits covering the risks experienced by the beneficial owner.

So $X = 15 + 20 + 5 = 40$, and other profits at site A is scored as zero.

At site B, other profits is $200 - 40 - 60 = 100$.

A.4 Calculating X in this manner is very close to the “arm’s length recommendation” of valuing transfer products. It will be equal to the market value of identical goods but missing the return to capital and other profits that a market value would reflect. But as the transfer goods are not being marketed, there is no need to generate extra profits through the estimation of the value - this will be achieved by the marketing of the final product.

A.5 The main aim of the above example is to demonstrate that profits beyond those needed to cover site capital consumption, belong to the whole production function, and should not be allocated to components of the production chain. It is the beneficial owner located at HQ and controller of the decisions regarding production, which bears the risk and so earns the “other profits”.

A.6 How do intellectual property products feature in this model?

They are shared amongst the total production – they provide the idea of the final product and determine the global production function (but not necessarily how the individual sites should play a part in the production).

A.7 They have no specific location, but they are protected through law by patents, and these instruments of protection can be registered anywhere in the world. But this site of patent registration does not contribute to the generation of profits in the global production chain, they are only the legal protector of the ideas underlying the global production function. So IPPs contribution should be the same as “other profits” in our example – they accrue to the ultimate beneficial owner and should not be registered as intermediate value added components.

Annex B: Extracts from the *Guide to measuring global production which are relevant to tax avoidance, and some comments on them.*

Chapter 1: Introduction

Paragraph 1.2

The purpose of the Guide is to support the implementation of the updated international standards and thereby enhancing international comparability.

Comment: But what if the work reveals the need for changes to the existing standards? Doesn't that require feedback to the AEG and ISWGNA so that the standards can be updated again to enable global production to be measured in a way that reflects economic reality?

Paragraph 1.8

The first [TF] goal was to develop guidance on a number of unresolved conceptual issues arising from 2008 SNA and BPM6 in relation to global production. The second goal was to develop further guidance on implementation aspects.

Paragraph 1.9

Examples of conceptual issues include . . . the identification of ownership of assets, including intellectual property products in global production chains.

Paragraph 1.36

The proper identification of value added in each step of the [global value] chain is fundamental to national accounting.

Comment: This raises issues about the allocation of global profits which have not been addressed in the SNA. Profits from global production chains can only be confidently measured at a global level – conventions are required for allocation of profits to production sites in the chain

Chapter 3 Principles of economic ownership inside the multinational enterprise

Paragraph 3.2

National accounting requires that the value added of MNEs be properly assigned to individual national economies in which MNEs operate their business.

Paragraph 3.19

Par 3.26 of SNA 2008 defines economic ownership as follows: “*The economic owner of entities such as goods and services, natural resources, financial assets and liabilities is the*

institutional unit entitled to claim the benefits associated with the use of the entity in question in the course of economic activity by virtue of accepting the associated risks.”

Paragraph 3.21

In the context of MNEs . . . it is the economic owner that uses the assets in its production process . . . However, for intellectual property products additional clarification may still be needed and this is given in chapter 4.

Paragraph 3.29

It should be noted that the global production arrangements inside MNEs may be tax driven . . . Under such conditions, the supposed transactions between units inside the MNE should be observed carefully as the legal transfer of goods and assets inside the MNE may not necessarily reflect actual economic operation of the MNEs global production. This often requires case-by-case analysis as these arrangements can have unique features. Country case studies 3.1 and 3.2 may give further guidance in this respect.

Case Study 3.2

. . . . The introduction of industrial processing and merchanting in the global value chain leads to the accumulation of profits in the Netherlands and Ireland. It is imaginable that both arrangements are (to some extent) tax driven, and as such are not a true reflection of “economic substance”, particularly since the complete production chain is operated inside one MNE. Again, for national accountants and balance of payments compilers it will not be easy, and perhaps not advisable, to go beyond the reality of company records.

Comment: This sounds contradictory. Are there two realities – the economic one and the one due to company records? Answer: Yes there are, but if company records are drawn up to support the minimisation of global profits taxes, then the company records must be restated so that the accounts reflect the economic reality.

Paragraph 3.40

The OECD (2010) guidelines . . . insist that intra firm transactions are priced, as far as possible, like arm’s length transactions between unrelated third parties.

Paragraph 3.41

Distortions in the use of arm’s length principles are not always tax driven. . . . for transactions between affiliated parties, the determination of values comparable to market values may be difficult, and compilers may have no choice other than to accept valuations based on explicit costs incurred in production or any other values assigned by the enterprise.

Paragraph 3.42 SNA 2008 explains that replacing book values based on transfer pricing with market value equivalents is perhaps desirable in principle but is an exercise calling for cautious and informed judgement. One would expect such adjustments to be enforced in the first place by the tax authorities.

Comment: In the case of transfer pricing, following the tax authorities lead in accepting or rejecting transfer prices does seem an acceptable policy. The accepted values should not be so far away from the economic reality that they significantly undermine allocation of value added.

Paragraph 3.55

SNA 2008 paragraph 4.56 describes Special Purpose Entities (SPEs) through the usual characteristics that they embody. “Such units often have no employees and no non-financial assets. They may have little physical presence beyond a ‘brass plate’ confirming their place of registration. 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. In the absence of any physical dimension to an enterprise, its residence is determined according to the economic territory under whose laws the enterprise is incorporated or registered.”

The UNECE Globalization Guide explains that such SPEs can hold patents for Intellectual Property Products. The task force on Holdings, Head Offices and SPEs confirmed that such units could have non-financial assets on their balance sheets. Their main purpose is to benefit from tax advantages by transferring legal ownership of IPPs to a low tax country. It is difficult to consider these units as autonomous given that their operation and management will be limited to bank account transactions where the receipts from royalties or similar intellectual property services are recorded.

Paragraph 3.56

In other words, while legal ownership of intellectual property is assigned to these SPEs, one may argue that the economic ownership in fact has not changed and is still situated with the parent. Nevertheless, the guidance on the treatment of these IPP-holding SPEs in SNA 2008 does not differentiate between these entities and other SPEs. They are recognised as a separate institutional unit when they are resident in a different economic territory to that of the parent.

Comment: This sounds like reluctantly accepting that we must do the wrong thing. Why not introduce an interpretation of the SNA which allows us to “see through” artificial arrangements to represent the economic reality in the national accounts? When this standard on SPEs threatened to allow the governments of European member states to park debt offshore, text was introduced to the SNA and ESA to make sure that the transactions of the SPE were fully reflected in the accounts of the government controlling the SPE. Why not introduce a similar ruling for private corporations? As Policy-makers, especially in Europe, become aware of the large effect of SPEs on levels of GDP, they may expect similar changes to the standard.

Paragraph 3.57

The rationale behind this treatment is clearly a pragmatic one. The income generated by an SPE is subject to the tax code of its country of residence and this fact cannot be ignored. If (economic) ownership of the IPP was not assigned to the SPE in question a considerable amount of re-routing of transactions and related financial flows would be necessary. In general the SNA 2008 does not encourage such imputations, probably because of the risk of asymmetries, as approaches may diverge between countries. However assuming economic ownership of IPPs in the legal hands of SPEs may also lead to asymmetries. Lipsey (2010) introduces in this context the notion of ‘phantom imports’ referring to services that are domestically produced but attributed by MNEs to SPEs in low tax countries. The latter group of countries may not necessarily report the corresponding of IPP services in their balance of payments.

Comment: This paragraph is weak. The re-routing is simple in that it consists of unbundling the artificial re-routing set up by the companies to reduce global tax burden. The risk of asymmetries is already there, as taking no action will leave the existing asymmetries in GDP allocation between countries – and these asymmetries can be very large. There is a recommendation in the conclusions of this paper to meet this issue.

Chapter 4

Ownership of intellectual property products inside global production

Paragraph 4.7

The OECD Handbook on “Deriving Capital Measures of IPPs” was unfortunately not able to present solutions to these problems [set out in paragraph 4.6 and listing the identification and measurement issues of valuing assets and the associated payments for services].

Paragraph 4.8

Quoting from Chapter 7 of the Globalization Guide, “The intangible nature of IPPs means that they can easily be registered as the property of another unit in one country when they are used in production by an enterprise located in another.”

Paragraph 4.9

Again quoting the Globalization guide, “This characteristic (intangibility) creates an incentive for companies to register their IPPs as owned by a unit in a low tax jurisdiction . . . This shifts the value added from the parent company to the affiliate, although the global production function of the parent company remains the same.

Paragraph 4.12

Comment: Disappointing that there is no mention of the EUROSTAT Manual on measuring Research and Development in ESA 2010. This has been endorsed at the highest level in EUROSTAT by all European Union NSIs, and is now actively used to ensure a harmonised approach.

Paragraph 4.22

R&D is often considered corporate property and its location in terms of economic ownership is for MNEs not necessarily a relevant issue, other than in the taxation driven reallocations of legal R&D ownership.

Comment: I wholeheartedly agree with this statement, and believe it should drive the Guide’s efforts to allocate profits in the production chain in a manner which reflects economic reality.

Paragraph 4.39

Case 1.2.2 is when the unit is part of an MNE, does not produce IPPs itself, and is not a producer of other (non-IPP) goods and services. Its main output is IPP related. Case 1.2.2 reflects those units created by MNEs with the purpose of taking advantage of low tax jurisdictions. The default solution is assigning economic ownership of the IPP to these units, in correspondence with legal ownership. Rerouting of ownership, and corresponding income flows, from the legal to the economic owner is not recommended. However, income received by these units should preferably be classified under a separate heading, as the provision of these services by such “brass-plate” companies have very little economic significance. A separate reporting of these artificial IPP services will provide a clearer view on national accounts and balance of payments statistics.

Comment: In my opinion, this part of the decision tree is wrong. The default option should not be to rubber-stamp the artificial arrangements of the MNEs to reduce tax liability. The default option should be to simply reflect all of the assets and transactions of the SPE in the accounts of the ultimate beneficial owner of the production chain.

Separate reporting is a very poor second best – when users question why the GDP of offshore tax havens are shown in the national accounts as increasing rapidly due to IPP patent registration and receipt of royalties etc., the existence of material to introduce adjustments is unacceptable.

Paragraph 4.45

The recommendations in this chapter are in line with those in Chapter 3 in a sense that compilers are advised to stay close to statistical observation, even in clear cases where legal

ownership does not match with the SNA principles of economic ownership. In this respect a complicating factor is that the administrative reality in terms of IPP control and legal ownership inside MNEs can change rigorously from one day to another. The intangible nature of IPPs allows MNEs to make such changes without substantial costs. Surveys may not easily keep track of such changes. Also it may sometimes be difficult to accept such changes as a true reflection of economic reality.

Comment: The sense of this paragraph is not clear. Aiming at the economic reality solution avoids nonsensical events such as observing the abrupt fall of GDP in one tax haven and the sudden increase in another as an MNE changes its tax avoidance arrangements to benefit from lower taxes in another offshore country. Is the paragraph arguing for or against measurement of economic reality? The confusion is emphasised by the last sentence. It has so many qualifying words that the commitment to the message is undermined. Qualifiers are 'Also', 'may', 'sometimes', 'difficult' 'accept' 'such' and 'true'. Rewriting the sentence without qualifiers results in "These changes do not reflect economic reality".

Paragraph 4.46

A default solution advocated by some compilers is placing economic ownership at the units producing the IPPs. Such a shortcut would also lead to large distortions in the analysis of production based on supply-use or input-output studies such as measuring trade in value added.

Comment: IPPs should be shown as the property of the ultimate beneficial owner of the production chain – this is the only allocation that allows an allocation of the profits component of value added to be allocated by site. In a normal world this would be the head office (but reflecting the real controlling head office location, and not an artificial construct at a site which satisfies the minimum legal requirement for a head office to be recognised).

Paragraph 4.47

Another default solution is allocating IPP ownership according to IPP use in production. Particularly in the case of factoryless production such an approach would simply go beyond economic reality.

Comment: I agree that IPP ownership should not be to specific production sites. But it is difficult to accept an argument of "beyond economic reality" when we are asked to accept extreme artificial arrangements elsewhere with regard to tax avoidance SPEs.

Paragraph 4.48, Country Case Study 4.4

SwiftC (an SPE) in country A is the subsidiary of MNE BIGCOMP with HQ in country B. SwiftC is the registered owner of patented software "Softpat" and is paid royalties by two other subsidiaries in countries C and D. For analytical purposes all income and expenditure linked to Softpat should be recorded separately. The situation of BIGCOMP HQ may not differ very much by the rerouting of IPP related income via SwiftC. Without the existence of this SwiftC, IPP related incomes would probably be obtained directly from the subsidiaries engaged in manufacturing in C and D.

Paragraph 4.55

The income flows received by the IPP-holding SPEs should be classified under a separate heading such as “IPP related series provided by SPEs” as the provision of these services is not really reflecting economic transactions (see chapter 3). Separating these artificial IPP services in the accounts from other output will support a correct interpretation of national accounts and balance of payments statistics.

Comment: This is a choice which will cause problems. As “The provision of these services is not really reflecting economic transactions” why not reflect economic reality directly in the accounts and do away with the need for a separate heading. This recommendation will confirm gross asymmetries at country level between measures of GDP. Tax havens will show receipt of inexplicable large service payments with a resulting increase in GDP according to the view of the country of residence of MNEs, whereas the local statisticians will be unable to register such a change in their surveys, due to the inability (and reluctance) of the local solicitor “in charge” of the SPE to answer any questions regarding economic transactions.

Chapter 5

Country case study 5.6

The 2011 Company Organization Survey (COS) showed that the potential “factoryless” producer population is likely to be small. There is no simple set of criteria that is likely to identify the factoryless producer.

Comment: What effect does this have on the recommendations of the Guide to measuring global production? Where does it leave the recommendations based on the existence of factoryless production? This seems a very important finding for the Guide.
