

**Seventeenth Meeting of the
IMF Committee on Balance of Payments Statistics
Pretoria, October 26–29, 2004**

Special Purpose Entities (SPEs) and Holding Companies

**Prepared by the Statistics Department
International Monetary Fund**

The views expressed in this paper are those of the author and should not be attributed to the International Monetary Fund, its Executive Board, or its management.

BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTTEG)

OUTCOME PAPER (BOPTTEG) # 9 AND 10

JUNE 2004

(1) Topic: **Special Purpose Entities (SPEs) and Holding Companies**

(2) Issues – see BOPTTEG Issues Papers #9, #9A, and 10

(3) Recommendations:

(i) The group agreed that SPEs should be treated as separate institutional units.

(ii) The group agreed that SPEs should be classified according to the territory of incorporation or legal domicile. The group urged that the new manual be written to take into account the possible permutations of arrangements identified in Issues Paper #10. There was a general view that it would be useful to give a fuller definition of terms like “territory of incorporation” and “legal domicile”.

(iii) The group did not pursue the idea of an internationally standard definition of SPEs, but agreed that it would be useful if territories that are hosts to SPEs were to identify them separately on the basis of their own definitions. The group agreed that SPEs were used for several different functions and that the institutional sector of SPEs should be determined with reference to the economic function carried out, rather than SPEs being regarded as a separate subsector.

(iv) The group agreed that holding companies should be classified as to institutional sector and industry on the basis of their own activity in that economy, rather than activities in affiliated enterprises in other economies. This decision was supported on both conceptual grounds (that the classification should reflect the role in the economy concerned) and practical reasons (that information about activities in other territories would be more difficult to obtain for multinational group with complex structures and operation in many territories).

- If a holding company owns no enterprises resident in the same economy, the holding company should be included in the financial sector.
 - Further consultation would be needed to determine whether holding companies should be classified as “other financial intermediaries” or “financial auxiliaries.”
- If a holding company owns enterprises resident in the same economy, it was considered that further investigation was needed. The Netherlands and IMF will prepare an issues paper for discussion at the next BOPTTEG meeting.

(4) Rejected Alternatives:

The meeting rejected classification of holding companies by institutional sector and industry according to the characteristics of the global group of affiliated enterprises. It was noted that the current SNA/BPM standards are based on a primary concept of economic territory and that a change in the standards would be required before global group approach could be justified.

(5) Questions for the Committee:

(i) Does the Committee agree that SPEs should be treated as separate institutional units? See 3(i) above.

(ii) Does the Committee agree that SPEs should be treated as resident in their territory of incorporation? See 3(ii) above.

(iii) Does the Committee agree with the approach to separately identifying SPEs on the basis of national definitions as needed, but not having a standard definition or SPE subsector? See 3(iii) above.

(iv) Does the Committee agree with the approach to classifying the institutional sector and industry proposed for holding companies?

(a) Does the Committee have a view on whether holding companies owning resident enterprises should be classified (1) on the basis of its status as a holding company or (2) on the basis of the functions of its affiliated enterprises?

(b) If the answer to question (a) is (1), does the Committee have a view on whether holding companies functions should be classified as (1) other financial intermediaries or (2) financial auxiliaries?

(c) If the answer to question (a) is (2), does the Committee have a view on whether these are related only to the enterprises in the same economy? Or only to enterprises it owns or owns indirectly?

See 3(iv) above.

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

OUTCOME PAPER (DITEG) # 9

(1) Topic: Special Purpose Entities (SPEs) and Holding Companies

(2) Issues – see two DITEG Issues Papers #9 (one prepared by the Australian Bureau of Statistics and one by the IMF)

(3) Recommendations:

(i) The group agreed that, in balance of payments statistics, SPEs should be recognized as separate statistical units resident in the economies in which they are located in those instances where they are established in different economies from the enterprise that created them. However, the group also acknowledged that such a treatment, while being the best practical approach (especially to deal with asymmetries), may distort economic interpretation of direct investment transactions and positions, especially for economies with significant SPE activity. In noting that the balance of payments cannot be everything to everyone, the group indicated that even greater distortions may result from trying to capture all aspects of SPEs within the balance of payments framework. Accordingly, the group noted that there may be a need for a separate dataset for direct investment to address these problems. Nonetheless, the group recognized that SPEs represent a real economic phenomenon and need to be covered in economic statistics, accordingly.

(ii) The group agreed that physical presence is not necessary for an SPE to be considered a resident in the economy in which it is incorporated/registered, noting that SPEs should not be “looked through”. The group agreed that employment, production, technology transfer, etc., are not required for a direct investment relationship to be established. Where there is no physical presence, production, etc., the group agreed that it would be appropriate to classify SPEs as nonbank financial institutions.

(iii) The group considered whether it was worth trying to develop an internationally agreed standard definition of SPEs, but agreed that it would be not be realistic in the time available. However, the group felt that, where material, it would be useful if the compilers in territories that are hosts to SPEs were to identify the SPEs separately on the basis of their own national definitions.

(4) Rejected Alternatives:

The meeting rejected the classification of holding companies by institutional sector and industry according to the characteristics of the global group of affiliated enterprises.

(5) Questions for the Committee and the WIIS:

(i) Do the Committee and the WIIS agree that SPEs should be treated as separate institutional units where they are located in different economies from the enterprise that created them? See 3(i) above.

(ii) Do the Committee and the WIIS agree that SPEs should be treated as resident in their territory of incorporation/registration, even in the absence of employment, production, etc.? See 3(ii) above.

(iii) Do the Committee and the WIIS agree with the approach to classify SPEs, where they have no physical presence, employment, or production, to nonbank financial institutions where they are located in different economies from the enterprise that created them? See 3(ii) above.

(iv) Do the Committee and the WIIS agree with the approach to identifying separately SPEs on the basis of national definitions as needed, but not having a standard definition or SPE subsector? See 3(iii) above.

(v) Do the Committee and the WIIS have a view on whether holding companies owning resident enterprises should be classified (a) on the basis of being a holding company or (b) on the basis of the functions of the enterprises it owns? See 3(ii) and 4 above

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTTEG)

ISSUES PAPER (BOPTTEG) # 9

SPECIAL PURPOSE ENTITIES AND HOLDING COMPANIES

Prepared by Robert Dippelsman, IMF Statistics Department

April 2004

BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

ISSUES PAPER (BOPTEG) # 9:

SPECIAL PURPOSE ENTITIES AND HOLDING COMPANIES

“Special purpose entities,” “special purpose vehicles,” “shell companies,” and “international business companies” (called “SPEs” in this paper, for brevity) are terms used in different ways; in this paper, they are used to cover legal structures that have little or no employment, operations, or physical presence in the jurisdiction in which they are created. They are typically used as devices to hold assets and liabilities, and do not undertake production. As legal devices, SPEs are relatively cheap to create and maintain while offering possible taxation, regulatory burden, and confidentiality benefits. Incorporation of SPEs are often associated with offshore financial centers but may also be found in other jurisdictions. Some holding companies are SPEs as defined in this paper.

Rather than attempt to reconcile the different terms and definitions in use, this paper discusses the activities in terms of four types of economic functions that are undertaken with SPEs, and thus to relate them to the existing institutional sector classification:

- **holding companies**, which are used to own subsidiaries (as in the example in the *Balance of Payments Textbook (BPT)* para. 543). Some holding companies are SPEs (such as those used for round tripping, see *Annotated Outline (AO)* paras. 5.21-22); others may have employees and physical operations;
- **vehicle companies**, which are used for securitization (see *Monetary and Financial Statistics Manual 2000 (MFSM 2000)* para. 100);
- **conduits**, i.e., raising funds on behalf of a parent (see *MFSM 2000* para. 72, *BPT* para. 544); and
- **SPEs for other asset management functions**, including holding business and family wealth, with or without liabilities (as in the example in *BPT* para. 543).

Some issues related to SPEs are not dealt with in *BPM5*, but have become increasingly significant in international transactions and positions.

I. Holding companies

A. Institutional units issues:

Current international standards for the statistical treatment of the issue:

- Holding companies are separate units according to *1993 SNA* paras. 4.37-39 and 4.100, without any mention of a requirement for physical presence or undertaking production. However, undertaking of production would seem to be required from discussions elsewhere (para. 4.23 states that corporations are defined as for the purpose of producing goods or services for the market).

- Holding companies are not covered in *BPM5*, but SPEs are assumed to be separate institutional units in *BPM5* para. 365.

Concerns/shortcomings of the current treatment:

- *BPM5* does not discuss holding companies specifically.

Possible alternative treatments:

- The manual could discuss holding companies specifically and state that they are separate units even if they do not have a physical presence or undertake production.

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- A holding company should be classified by the predominant sector of the group of corporations it owns (*1993 SNA* para. 4.100).
- A holding company should be classified to other financial intermediaries subsector (*MFSM 2000* para. 100).

Concerns/shortcomings of the current treatment:

- *1993 SNA* and *MFSM 2000* seem to differ.
- The discussions do not refer to cases where the holding company is also itself a subsidiary.
- The predominant sector of a group of corporations may be hard to determine when members of the groups are in several different countries.
- The functions undertaken by the group as a whole seem less relevant if they are not undertaken in the economy of the holding company.
- A holding company may be part of two or more groups, making the *1993 SNA* definition possibly ambiguous.

Possible alternative treatments:

- The possibility of treating holding companies as a subsector of financial corporations in their own right is raised in *AO* para. 4.31(c). This would avoid the concerns noted, but might be considered strange if the holding company for a nonfinancial group was included in the financial sector.
- In the case of an economy where the cross-border activities of SPEs are significant relative to those of the rest of the economy, it may be desirable to show SPEs separately to identify their role and also to allow data to be shown on the operations of other enterprises in their own right. In such a case, SPEs could be shown as a supplementary item, along the lines of the proposal in *External Debt Statistics* para. 2.19. Two possibilities are that:
 - (i) the definition of SPEs could follow national legislative provisions; or
 - (ii) a consistent operational definition on an international basis could be developed.

C. Residence issues

Current international standards for the statistical treatment of the issue:

- Many holding companies have a physical presence, so the territory of residence is clear.
- Otherwise, *BPM5* defines residence of SPEs as being where they “are located” (para. 79).
- If there is little or no physical presence, the residence of a corporation is determined by place of incorporation or registration (*External Debt Guide* para. 2.18; *Coordinated Portfolio Investment Guide (CPISG2)* para. 3.9; corporations “normally expected” to be resident where it is created and registered *1993 SNA* para. 4.24(a)).

Concerns/shortcomings of the current treatment:

- The *BPM5* guideline for SPEs lacks clarity and has been interpreted in different ways. Its terms differ from other guidelines.
- The use of place of incorporation can result in a “P.O. Box Headquarters” being the source of investment rather than the location of substantial operations, e.g., in the recent “corporate inversion” cases in the U.S.

Possible alternative treatments:

- *AO* para. 4.45 proposes that incorporation or registration be used to determine residence of entities that have little or no physical presence.
- *AO* paras. 4.58(e) and 5.22 propose ultimate beneficial owner/destination as a possible supplementary (i.e., encouraged, but not required) basis for presentation of direct investment data, which can be seen as a way of “looking through” SPEs. Such supplementary data could be considered for positions and, with more difficulty, transactions. However, there are substantial difficulties in identifying the ultimate ownership when there are long chains, particularly involving ownership by multiple territories.

II. Vehicle companies

A. Institutional units issues

Current international standards for the statistical treatment of the issue:

- SPEs, including vehicles, are taken as separate institutional units in *BPM5* para. 365.
- Vehicle companies are separate entities (*MFSM 2000* para. 100).

No concerns/shortcomings of the current treatment identified.

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- Vehicle companies are specifically included in other financial intermediaries in *MFSM 2000* para. 100 and seem to be within the general definitions of financial intermediation in other manuals.

No concerns/shortcomings of the current treatment identified.

C. Residence issues

As for holding companies.

III. Conduits

A. Institutional units issues

Current international standards for the statistical treatment of the issue:

- Conduits are implicitly recognized as separate institutional units by *BPM5* paras. 365 and 372.
- If created by a parent corporation, conduits appear to meet the definition of “ancillary corporations” (*1993 SNA* paras. 4.40-44), which are not separate institutional units, so should be combined with their owners. However, *MFSM 2000* says that an ancillary corporation that is resident “in a foreign country” is treated as a separate entity (para. 71).

Concerns/shortcomings of the current treatment:

- When the ancillary corporation is in a different jurisdiction to owners, the *1993 SNA* treatment is neither completely conceptually desirable (in that the ancillary is in many ways connected to the jurisdiction in which it was created) or practical.
- On the other hand, the *MFSM 2000* treatment would be unsatisfactory for analysts who wish to “look through” conduits, i.e., treat the flows as going directly rather than via a conduit. This is because partner data for transactions and positions involving SPEs hide the ultimate source/destination.
- The *MFSM 2000* guidance is incomplete if a conduit were owned by several enterprises, which were residents of different economies, some of which could include the economy in which the conduit is resident.

Possible alternative treatments:

- *AO* para. 4.22(c)-(d) proposes to follow and clarify the *MFSM* treatment by stating that an ancillary company is a separate entity if it is resident of a different territory from any of the entities it serves.

- *AO* para. 4.58(e) proposes ultimate beneficial owner/destination as a possible supplementary basis¹ for presentation of direct investment data. Extensions of that approach to portfolio and other investment could also be considered as possibilities. (Note: expressed in terms of the functional classification, the role of conduits is to transform portfolio and other investment flows to reverse direct investment.² Under the ultimate beneficial owner/destination concept, the transformation would not occur.)

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- Conduits are classified as other financial intermediaries in *MFSM* para. 72.
- In the *BPM5* sector classification, all cases other than monetary authorities, banks and general government are classified to “other sectors.”
- In *BPT* para. 544, they are described as financial intermediaries.
- Since they are ancillary corporations, they are not institutional units and so do not need to be classified in the *1993 SNA*.

Concerns/shortcomings of the current treatment:

- The application of the concept of financial intermediation to the case of conduits is not clear:
 - Such activities would not be financial intermediation when the conduit is resident in the same territory as its owners. (Because an entity is an ancillary corporation, and not an institutional unit, it would, therefore, be merged with its owners.)
 - Financial intermediation involves dealing with financial markets for both fund-raising and funds-dispersal. However, for funds dispersal, the conduit is only dealing with affiliated enterprises.

Possible alternative treatments:

- *AO* para 4.30(g) proposes that conduits be classified as other financial intermediaries.
- As noted under holding companies above, SPEs could be shown separately, where their cross-border activities are significant relative to the rest of the economy.

¹ In the new manual, a distinction will be made between memorandum and supplementary items. Memorandum items are considered as a part of the standard components whereas supplementary items are raised as options that may be considered when a particular issue is of interest to analysts and policy makers.

² A related issue is whether transactions and positions between enterprises that are not financial intermediaries and affiliated conduits or other SPEs should be classified as direct investment—see *AO* para. 5.27(b) and DITEG Issues Paper 7/8.

C. Residence issues

As for holding companies.

IV. SPEs for other asset management functions

A. Institutional units issues

Current international standards for the statistical treatment of the issue:

- SPEs in general are assumed to be separate institutional units in *BPM5* para. 365.
- These entities are not discussed in the *1993 SNA*. Possibly they are assumed not to be separate units and combined with their owners.

Concerns/shortcomings of the current treatment:

- If these SPEs are considered artificial, partner data for transactions and positions involving SPEs do not show the ultimate source/destination.
- Combining these SPEs with their owners may not be practical if the units are resident in different territories to its owners, nor will it reflect the connections of the SPE to the territory in which it was created. As well, the owners may also be in more than one territory and/or sectors.

Possible alternative treatments:

- *AO* para. 4.22(d)-(e) proposes that such companies should be treated as separate institutional units if they are resident of a different territory from any of the entities they are owned by.
- If SPEs are considered artificial legal structures, they could be “looked through,” i.e., the owners of the entity would be treated as if they undertook the transactions and held the positions directly. However, the information to do so may be difficult or impossible to obtain in many cases.

B. Institutional sector issues

Current international standards for the statistical treatment of the issue:

- In the *BPM5* sector classification, these functions can be classified to “other sectors.”
- These SPEs have no obvious institutional sector in the *1993 SNA/MFSM 2000* classification, possibly because the *1993 SNA* assumed that such entities would be in the same countries as their owner and therefore able to be combined with the owning institutional unit.

Concerns/shortcomings of the current treatment:

- While the previously discussed cases of SPEs undertake economic functions that are covered by existing sector categories, these SPEs fit no obvious institutional sector (see also *AO* para. 4.31(b)).

Possible alternative treatments:

- AO asks whether entities for holding and managing wealth, which includes some SPEs, should be classified as other financial auxiliaries or need their own sector or subsector (paras. 4.30(f) and 4.31(b)).
- As noted under holding companies above, SPEs could be shown separately, their cross-border activities are significant relative to the rest of the economy.

C. Residence issues

As for holding companies.

IV. Points for Discussion

Institutional units:

(1) Does the group agree that all SPEs should be separate institutional units when the SPEs are in a different economic territory to that of their owners?

Institutional sector (based on 1993 SNA/MFSM 2000 classifications):

(2) How should holding companies be classified as to institutional sector?

(3) How should other wealth management SPEs be classified as to institutional sector?

(4) Can a standard definition of SPEs be developed that would allow them to be identified in an internationally standard way?

Residence:

(5) Should territory of incorporation or registration be adopted to determine the residence of entities that have little or no physical presence?

(6) Does the group support the AO proposal for supplementary data on ultimate beneficial owner/ultimate destination for direct investment? Should this proposal be extended to other cases?

References

BPM5, Chapters IV, XVIII

Balance of Payments Textbook, Chapter IX

1993 SNA, Chapter IV

Annotated Outline, Chapter 4

Coordinated Portfolio Investment Guide, second edition, Chapter 3

External Debt Statistics: Guide for Compilers and Users, Chapter 2

Monetary and Financial Statistics Manual 2000, Chapter 3

Note on the Application of the Residence Concept to Small Economies with International Financial Centers ([BOPCOM-01/13](#))

Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment ([BOPCOM-02/35](#))

Residence ([BOPCOM-02/59](#))

Investment Companies: What are they, and Where Should they be Classified in the International Economic Accounts?—Paper by USA ([BOPCOM-03/22](#))

Borderline Issues Between Direct Investment and Other Types of Investment: Responses to BOPCOM-02/35 *Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment* ([BOPCOM-03/46](#))

IMF Background Paper, *Offshore Financial Centers*, 2000.

**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTG)**

ISSUES PAPER (BOPTG) # 9A

SPECIAL PURPOSE ENTITIES

**Prepared by International and Financial Accounts Branch
Australian Bureau of Statistics
May 2004**

The views expressed in this paper are those of staff within the International and Financial Accounts Branch and do not necessarily reflect those of the Australian Bureau of Statistics.

Balance of Payments Technical Expert Group

Issues Paper (BOPTeg) # 9A

Special Purpose Entities

I. Current international guidelines for the statistical treatment of the issue

The Balance of Payments Manual, Version 5 contains the concept of a Special Purpose Entity (SPE). Typically, a SPE is set up to facilitate the financing of a group's activities worldwide and/ or to contribute to cost minimisation and profit maximisation worldwide by taking advantage of different economic, legal or fiscal regimes. They can take the form of financing subsidiaries, holding companies, or corporations set up in tax havens or in different jurisdictions. Often the activities concern only financial flows and there is no visible activity such as manufacturing or the delivery of tradeable services in the host economy.

SPEs have some or all of the following characteristics:

- set up in an economy other than that in which the main activity of the group takes place
- engaged predominately in international transactions, with few links to the local economy
- can be set up with a very narrow purpose e.g. to channel one large loan or securitisation activity
- are on auto-pilot, with the functions of the SPE agreed by those setting it up and with little or no need for day to day direction or management so that control may not be visible.

SNA/BPM5 recommends that SPEs be treated in the same way as any other unit in the compilation of economic accounts. The standards provide guidelines for the partition of the globe into economic territories, the identification of institutional units, the determination of the relationship between an economic territory and a unit known as residence and the allocation of units to institutional sectors and industries.

The usual steps are:

- (1) Determine if there is an institutional unit.
- (2) If there is an institutional unit, determine in which economic territory the unit is

resident.

(3) Determine to which institutional sector the unit belongs.

(4) Determine to which industry the activities of the unit should be allocated.

This process is straightforward in many cases, for example in the case of a small manufacturing company, privately owned. It can be more complicated in determining residence, sector and industry in the case of SPEs, but the same treatment applies nevertheless.

II. Concerns and shortcomings of the current treatment

Determining whether an SPE is an institutional unit does not pose any particular problems. The normal SNA/BPM criteria can be applied.

There are complications in the allocation of residence to SPEs. However, with the broadening of the criteria used to determine residence to include place of incorporation and legal domicile for enterprises which do not have a physical presence and/or do not undertake production, as proposed as part of the current revisions, this should no longer be a problem. It would be preferable for the additional criteria could be included in an expanded list of criteria to be used as a guide (rather than to be used prescriptively) in determining residence without their restriction to units with no physical presence and/or which do not undertake production (in fact these terms could be challenged - even brass plate companies could be said to have a physical presence and be undertaking production).

There are difficulties in allocating SPEs to institutional sector. The sectors group units with similar economic objectives, functions and behaviour. For example, if an SPE has the sole function of holding equity or channelling funds for a group whose main activity worldwide is manufacturing, questions arise as to the economic objectives, functions and behaviour of the SPE. If viewed in isolation, that is as a unit in its country of residence with no relation to other units in the economic territory, the allocation to sector could be quite different to that decided upon if the SPE is viewed as being part of a broader group which includes units in other economic territories.

There are difficulties in classifying SPEs by industry. The problems are similar to those encountered in allocation to sector, whereby the conclusion reached by considering the unit in isolation may differ from that reached if it is considered as part of a group which includes non-resident units.

The current standards leave room for ambiguity on the allocation of sector and industry. For instance, SNA 4.100 recommends allocating holding companies to sector according to the sector of "the corporations it controls". It does not specify that these corporations must be in the same economic territory as the holding

company

In compiling statistics which will provide the appropriate signals for policy development, there are perceived shortcomings in treating SPEs in the same way as all other units and in recording their transactions and positions indistinguishably from those of other units. The usual reason given is that the legal, ownership and control structures mean that the application of the basic principles will lead to the definition of units and the recording of stocks and flows which do not reflect economic substance. The claim usually made is that artificial arrangements entered into for, for example, taxation purposes, produce units whose transactions and positions are motivated by legal and fiscal incentives rather than "real" economic incentives, and to recognise these units and record their stocks and flows does not give a useful reflection of the economic substance. For instance, in the case of direct investment, it is claimed that, in some cases, SPEs create transactions and positions which have little real impact on the economy in which they are investing, for instance the creation of new productive capacity or employment. It is argued that this could give the wrong policy signals.

An example is of a large economy with a manufacturing company owned by shareholders resident in the same economy. If a holding company is set up in an offshore centre, with the holding company owning the manufacturer and the shareholders having an equity claim on the (non-resident) holding company rather than on a domestic company, FDI in the economy will show an increase. There is an argument that the "real" situation has not changed and that the increase in FDI, if it is not identified as not being "real" FDI, could send the wrong policy signals.

III. Possible alternative treatments

Proposed solutions to the problems of sector and industry classification seem piecemeal and appear to be addressing problems which are not unique to BOP. These include the treatment of holding companies and ancillary units. The fact that the holding company or ancillary unit is an SPE and is resident in a different economic territory from the companies to which it is related results in proposals to adopt different treatments for this case and for the case where the holding company or ancillary is in the same economic territory as the companies to which it is related. This results in some contentious proposals, such as considering SPEs whose sole role is channelling finance as financial intermediaries while their onshore counterparts which perform exactly the same functions are not considered financial intermediaries.

Attempts to remedy the perceived shortcoming of data not representing economic substance fall into two categories. The first is to accept the existence of an institutional unit and a transaction/ position and to reclassify the transaction/ position away from the aggregate it is perceived to be distorting. In the example of direct investment given above, this would mean reclassifying direct investment by SPEs in

another category of investment to give a better measure of "real" direct investment.

In this case, it would be enough to ensure that compiling countries make available data on an SNA/BPM basis. If they choose to present memorandum data for policy and analytical purposes, it should be made clear that the data are not on an SNA/BPM basis and are therefore not comparable internationally. A full reconciliation with data on an SNA/BPM basis should be provided. Exceptions to this would be made only when there is broad agreement that they result in more analytically useful data, such as in the case of \$2 subsidiaries issuing bonds as described in the Balance of Payments Textbook paragraph 544.

The second category is to allow certain transactions/ positions to be ignored when compilers consider that the transactions/ positions arrived at by following the guidelines do not reflect the economic substance of the situation. This option is fraught with difficulty. The SNA/BPM framework has as its basic aim the compilation of consistent, symmetrical economic accounts. Firm guidelines are put forward to ensure that transactions are recorded at the same time, in the same place and at the same value. With few exceptions, each asset must have a corresponding liability, with the residence of the parties recorded in the same way.

Allowing compilers the option of deciding that, in certain cases, the legal manifestation of transactions and positions can be ignored and replaced with transactions and positions which are deemed to have more economic substance introduces an element of arbitrariness into the compilation of the accounts. Because of their very nature, the incidence of SPEs will rise and fall as economic, legal and fiscal relativities change over time. For instance, work by the OECD to expose tax havens has already resulted in several countries applying stricter regimes, with SPEs moving on to other countries. The evolving security situation worldwide could see SPEs moving from one country to another. Allowing each country to interpret each new situation as it arises as they see fit in terms of their view of economic substance seems a poor basis for coherent, symmetrical statistics worldwide.

However, close inspection reveals that the proposals are effectively to net out transactions/ positions where they are deemed to be misleading. In the direct investment example, this means that the investment positions in and out of the offshore centre in the example above would be netted out, leaving an investment position between residents of one economic territory. Investment in a manufacturing company in a third country via an offshore centre would be recorded as direct investment in the third country.

By netting out transactions, compilers are effectively consolidating within a group of units which comprises units resident in different economic territories. The compilers are implicitly constructing a global group. In allocating holding companies, ancillaries etc. to sector and industry in a way which is consistent regardless of their residence, the idea of taking into account the classification of the companies in a

global group also arises. The draft annotated outline of the new BPM implicitly recognises such a group in proposing that, in determining the sector of holding companies based on the preponderant sector of the group of companies of which the company is part, the group include companies resident in other economic territories.

The current standards leave room for ambiguity on this issue. For instance, SNA 4.100 recommends allocating holding companies to sector according to the sector of "the corporations it controls". It does not specify that these corporations must be in the same economic territory as the holding company, although this conclusion may be reached as the recommendation follows a lengthy discussion of the allocation of resident units to sector. If SNA 4.100 and related recommendations are interpreted as referring only to resident units, it follows that the only relationships between residents and non-residents which are to be recorded or taken into account in compiling economic accounts are ownership relationships. In this case, the desire to use characteristics other than ownership relationships to determine sector and industry and to consolidate within a global group indicate that statistics based on a SNA/BPM view of the world which only allows grouping within economic territories have been found wanting in serving policy purposes, and compilers are finding ways around it to reflect a more global view of groups.

If the current standards are interpreted to mean that the group of companies to be taken into account in, for instance, determining sector and industry can include units in different economic territories, questions arise as to the nature of the group and in what cases the group can be taken into account. The group could be taken into account in determining sector and industry and for consolidation purposes. Another option is to use the group to determine sector and industry, then allow consolidation only between related units in the same economic territory.

Regardless of the interpretation of the current standards, a decision needs to be made as to whether a global group is to be recognised as part of the standards. If so, guidance must be provided as to the definition of such a group. There are starting points in the views based on nationality such as that used by BIS and globalisation studies are starting to build up a picture of global groups.

If the possibility of a global group of companies is envisaged, there remain problems in the treatment of ancillary units, head offices, holding companies etc, but the issues will be the same whether the units are in the same economic territory as others in their group or not. Solutions can be found which apply to both cases, rather than having to have separate treatments for each case.

If it is agreed that the standards should recommend the grouping only of units resident in the same economic territory, partial, creeping recognition of such groups and their use to determine sector and industry and as a basis for consolidation in the absence of an agreed definition of such groups must be avoided. In this case, the

only way to produce a consistent set of data is to insist on full observance of the standards. While this may lead to the need for different treatments of SPEs from their domestic counterparts, at least these will be consistent across countries. For instance, in allocating sector and industry of units which, if they were in the same economy as the companies to which they provide services, would be considered ancillary, the unit needs to be considered in isolation.

IV. Points for discussion

Do BOPTEG members agree that the sector and industry allocation of SPEs require the recognition of a global group, that is a group containing units from more than one economic territory?

If so:

Do members agree that the standards need to be explicit on the definition of such a global group?

Do members agree that consolidation of transactions and positions should only be allowed between units in a group in the same economic territory and that work should continue on developing an alternative set of accounts that reflects a view of the world beyond that based on economic territory?

If not:

Do members agree that the standards need to be explicit on the definition of group of companies to make it clear that it is made up only of companies resident in the same economic territory?

Do members agree that, in the absence of a concept of group which includes companies in different economic territories, the determination of sector and industry of SPEs and the consolidation of transactions and positions should only be allowed in groups of companies in the same economic territory, with any data compiled on other bases presented as memorandum items?

Do members agree that work should continue on developing an alternative set of accounts that reflects a view of the world beyond that based on economic territory?

References

European Central Bank, *Foreign Direct Investment Task Force Report, March 2004*, <http://www.ecb.int/pub/pdf/foreigndirectinvestment200403en.pdf>

IMF, *Foreign Direct Investment Statistics, How Countries Measure FDI 2001*, <http://www.imf.org/external/pubs/ft/fdis/2003/fdistat.pdf>

IMF Statistics Department, *Residence*, BOPCOM 02/59,
<http://www.imf.org/external/pubs/ft/bop/2002/02-59.pdf>

IMF Statistics Department, *Statistics on Offshore Financial Centers*, BOPCOM
02/11, <http://www.imf.org/external/pubs/ft/bop/2002/02-11.pdf>

OECD Benchmark Definition of Foreign Direct Investment Third Edition,
<http://www.oecd.org/dataoecd/10/16/2090148.pdf>

Ralph Kozlow, U.S. Bureau of Economic Analysis, *Exploring the Borderline Between
Direct Investment and Other Types of Investment: The U.S. Treatment*, BOPCOM
02/35, <http://www.imf.org/external/pubs/ft/bop/2002/02-35.pdf>

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

ISSUES PAPER (BOPTG) # 10

RESIDENCY OF SPECIAL PURPOSE ENTITIES

**Prepared by Balance of Payments and Financial Accounts Department,
De Nederlandsche Bank**

May 2004

Balance of Payments Technical Expert Group

Issues paper: Residency of Special Purpose Entities

Special Purpose Entities (SPEs) provide financial services, like financing and asset holding, to their own group companies. Most SPEs are established in economies other than the economy of the parent company³. SPEs often have little or no physical presence. Although in recent decades the cross border transactions of SPEs have been increasing to very substantial levels, the concept of SPE is not defined in the IMF's *Balance of Payments Manual* (BPM5). Furthermore the definition of the concept of residency in BPM5 is not always applicable to SPEs involved in cross border transactions with limited or without physical presence in an economy.

In many cases SPEs even do not have personnel in the economy of establishment and are managed and administered in another economy. In other words their activities may have connections to several economies regarding different issues like taxation regime, business laws, location of assets, location of administration and location of management. As a consequence this raises the problem of determination of the residency of these entities.

The present methodology and possible alternative standards for determining the residency of SPEs are subject of this paper. The aim is to formulate clear criteria for the determination of the residency of an institutional unit that will result in:

- a) each institutional unit must be resident of at least one country and no more than one country;
- b) application of the criteria by compilers of different countries leads to the same result with regard to the residency of that institutional unit;

³ Exceptions are so-called Special Purpose Vehicles that are established for e.g. securitisation programmes and financial lease constructions.

- c) the possibility to use the manual on external accounts as a reference for legal purposes.

I. Current international standards for the treatment of the issue

BPM5 recommends determination of the residency of enterprises based on their center of economic interest (paragraph 73). Because of the absence of a physical presence and/or the existence of connections to several economies, the concept of *centre of economic interest* is not unequivocally applicable to SPEs. The issue of the residency of SPEs is not discussed comprehensively though in BPM5. Consequently the specific recommendations on this issue are scant. The economy in which the offshore enterprises are “located” should, according to the BPM5 paragraphs 79 and 381, be decisive in the determination of the residency. This criterion applies also to financial entities/enterprises like SPEs. This means that the residency of the SPEs should be attributed to the economy in which these entities are “located”.

The *External Debt Statistics; Guide for Compilers and Users*⁴ (Guide) and the second edition of the *Coordinated Portfolio Investment Survey Guide*⁵ are more specific on the issue of residency of SPEs for the compilation of external debt statistics. The relevant paragraphs refer to the limited physical presence of SPEs “in the economy in which they are legally incorporated or legally domiciled (for example, registered or licensed)”⁶. According to these guidelines, the residency of SPEs should be determined by their legal incorporation, or in the absence of legal incorporation, their legal domicile.

⁴ Paragraphs 2.17-2.18.

⁵ Paragraphs 3.8-3.9.

⁶ Guide, paragraph 2.18.

II. Shortcomings of the current treatment

Since the center of economic interest of SPEs can not be determined, BPM5 refers to “the economy in which SPEs are located”. In many cases, however, it is unclear what the “location” of these entities is, because:

- a) there are no explicit criteria, like registration, taxation etc specified in BPM5;
- b) SPEs often have no physical presence or they hardly have any economic tie to the economy in which they are established;
- c) SPEs are often economically tied to several economies.

The shortcoming of BPM5 becomes more obvious when there are disagreements between the national compilers and the SPEs regarding the determination of residency of the SPEs, and consequently the reporting obligations about cross border transactions and positions of these entities. BPM5 provides no airtight argument for these particular cases, which illustrates the need for a more obvious clarification/explanation of the concept of residency of SPEs. The need for more explanation of the concept of residency of SPEs is also expressed in the IMF’s note *“the residence of SPEs and offshore enterprises”* prepared for the Working Party on Financial Statistics of the OECD in 2002. The practical example, presented below, can illustrate the need for such a clarification.

III. A Dutch case on the unclear residency of a SPE

Considering the residency of a SPE in the Netherlands for Balance of Payments and International Investment Position purposes, there was a disagreement between De Nederlandsche Bank (DNB) and a SPE engaged in cross border transactions and activities with its own group companies. The SPE was of the opinion that it was not a resident of the Netherlands and consequently was not obliged to report its cross border transactions or positions to DNB. The actual situation in this case can be summarised as follows:

- a) The SPE’s principal place of business are the offices of the group partners outside the Netherlands, where also administration, bookkeeping and other compliance work is done;

- b) The entity itself has neither physical presence, nor personnel in the Netherlands;
- c) The entity only has a mailing address in the Netherlands with a trust company;
- d) The SPE is registered at the Chamber of Commerce in the Netherlands as an unincorporated entity, called ‘dormant or silent partnership’ according to Dutch law (a kind of limited liability partnership⁷);
- e) Despite the registration at the Chamber of Commerce, the tax authorities have decided that the entity is not obliged to pay taxes, although it was legally subject to taxes in the Netherlands.

Considering the above presented facts and from a legal point of view, it is not obvious where the “center of economic interest” or what the “location” of the SPE is. Leaving the registration at the Chamber of Commerce aside, this SPE has more economic connections with other economies than with the Netherlands.

IV. Possible alternative treatment

A general principle in the determination of the residency of enterprises is that a “unit should be a resident of one and only one territory” (paragraph 4.33 of the Annotated Outline). Naturally, this general principle applies also to SPEs. Furthermore in the Annotated Outline, two main changes are proposed regarding the issue of the residency of SPEs with connections to several economies or SPEs without physical presence.

- a) In paragraph 4.45 the center of economic interest is more specifically identified by adding the criterion of *predominance* or the “strongest link”. This may serve as a solution for the entities, which have economic connections with more than one economy. In such a situation the residence of a SPE should be based on the principle of the *predominant* center of economic interest.

⁷ The Dutch legal term for a limited liability partnership is “Commanditaire Vennootschap”.

- b) When the SPEs are not physically present in an economy, the territory of incorporation or registration should be decisive in the determination of the residency (paragraph 4.45 b). This means that the place of incorporation/ registration or (in absence of incorporation or registration) legal domicile, which is the jurisdiction of the laws the SPE is subject to, determines the residency of SPEs.

Paragraphs 4.33 and 4.45 of the Annotated Outline, when taken in combination, may clarify the issue of the residence of SPEs. This means that, for statistical purposes, SPEs should be resident of *at least one and only one* economy. Furthermore their residency should be attributed to the economy of their *predominant center of economic interest*; and in case of difficulties with the identification of the predominant center of economic interest the place of *incorporation, registration or legal domicile* should be considered as the residency of the SPE. Despite these clarifications, there are still some issues that should be discussed.

V. Points for discussion

The concepts of place of incorporation, registration and legal domicile are not always clear and should be defined more precisely.

- a) Country of incorporation: Is this equal to the country under which laws the Articles of Association of the entity are drawn up?
- b) What exactly is meant by legal domicile? Is this the same as the statutory seat of the entity or the seat of the administration of the entity?
- c) In case of migration of the entity the legal form of the entity needs not always (in all countries) be adapted immediately to the laws of the country to which the entity migrates. What should be the decisive factor in this case for determining the residency of the entity?
- d) Country of registration: Is this equal to the registration at the Chamber of Commerce and/or registration with the tax authorities? Are there other criteria for the country of registration?

- e) Could registration in more than one country occur at the same time (for a long period)? If yes, how to determine the residency? Or is multiple registration restricted to branches only?
- f) Does the “Societas Europaea” with which a legal company form is organized under supra-national European law create additional problems for national compilers in determining the residency of entities? If yes, how should the problems be dealt with?

VI. References

Annotated Outline for the Revision of BPM5
Paragraphs 4.44-4.48.

Balance of Payment Manual, fifth edition
Paragraphs 73, 79 and 381.

Coordinated Portfolio Investment Survey Guide
Paragraphs 3.8-3.9.

External Debt Statistics; Guide for Compilers and Users
Paragraphs 2.17-2.18.

The residence of SPEs and offshore enterprises, note by IMF for Working Party on Financial Statistics of the OECD (DAFFE/MC/STAT (2002) 18).