

**Eighteenth Meeting of the  
IMF Committee on Balance of Payments Statistics  
Washington, D.C., June 27–July 1, 2005**

**Intercompany Remittances**

## **DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)**

### **OUTCOME PAPER (DITEG) 21A**

**February 9, 2005**

1. Topic: Intercompany Remittances

2: Issues: See DITEG Issue Paper 21A Intercompany Remittances

DITEG members noted the points raised in the paper and the use of transfer pricing as an accounting entry to zero out funds to parent. DITEG recognized that it was consistent with experience in some other countries with regard to branch accounting.

3. Recommendations

(i) While the revisions to the BoP Manual and the Benchmark Definition of FDI are still in progress the guidance in them relating to this topic will remain under discussion

(ii) DITEG did not support the separate identification for trade in services of the service element of transfer pricing

(iii) DITEG concluded that income redistribution should not be classified as transfer pricing where it was not separated for reporters own purposes and that it should remain as income

(iv) DITEG did not reach a conclusion on whether all transfer pricing should be treated as a hidden dividend/investment if reporters are unable to identify the element that is over or under invoicing

(v) DITEG did not think that it would be appropriate for the issue of transfer pricing to feed into the upcoming SNA revision process

4. Rejected Alternatives

None

5. Questions for the IMF Committee on Balance of Payments and the OECD Workshop in International Investment Statistics

*Do the Committee and the WIIS agree that payments by a branch to its nonresident head office that result in a zero balance in the branch's income account should be treated as income, and not to try to separate any other elements (such as service payments)?*

**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS AND OECD  
WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS**

**DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)**

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**ISSUES PAPER #21A**

**INTERCOMPANY REMITTANCES**

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**December 2004**

**Views expressed in this paper are those of the authors rather than the Bank of England**

## Background information

The general move towards global specialisation in certain financial centres has led to an increase in intra-group payments classified by banks as transfer pricing. This issue is relevant for the UK due to the large number of foreign banks which conduct market operations from a London desk but also clearly affects the home countries of those banks.

In recognition of the increased importance of these intra-group payments, the new BoE reporting form (introduced in Q1 2004) separately identifies transfer pricing income and expenditure within banks' other income and expenditure. The figures reported have been significant and discussions with individual banks have indicated that they may be volatile. It also appears that the items classified as transfer pricing within banks' own accounts go beyond payments for intra-group services. This raises a potential issue for both balance of payments and national accounts data as data will be affected for reasons of financial policy and/or tax policy which may differ between institutions.

A summary of the figures collected thus far is provided below.

	<b>Transfer pricing income</b>	<b>Transfer pricing expenditure</b>	<b>Net transfer pricing</b>
Q1 2004 All Banks	3235	3168	67
<i>of which;</i>			
UK banks	1542	1547	-5
Overseas banks	1693	1621	72
Q2 2004 All Banks	3397	3834	-437
<i>of which;</i>			
UK banks	1653	1541	112
Overseas banks	1744	2293	-549
Q3 2004 All Banks <sup>1</sup>	3265	3047	218
<i>of which;</i>			
UK banks	1381	1537	-156
Overseas banks	1884	1510	374

<sup>1</sup> Q3 2004 Data is provisional

### **BPM guidance on the reporting of transfer pricing**

(See Appendix 1 for BPM5 text and revised guidance within Chapter 10, paragraph 45 of the Annotated Outline for the update of BPM5)

Discussions held with banks have indicated that there are two main areas of intra-group payments that they classify as transfer pricing within their own accounts and which are being collected on the form.

1. Management recharges reflecting payments for services provided by another group entity.
2. Income redistribution around the group mainly resulting from a formula-driven approach to managing profit levels of the various group entities.

The existing BPM5 guidance states “that the method of valuation adopted may not accurately reflect the market price” and proposes the solution that “if the distortions are large, replacement of book values with market equivalents is desirable” but it also recognises that in most cases this is not achievable. The guidance is in line with Inland Revenue requirements and has been adopted in the guidelines for the reporting of transfer pricing by UK banks.

Payments which represent management recharges for services provided by other group entities are currently included within the income and expenditure figures of banks but are not fully included within trade in services as banks have been unable to distinguish between payments for services and income redistribution. We believe that the net effect of this is small but the effect on the gross figures could be significant.

The current BPM guidance does not explicitly deal with the issue of redistributing income between group entities for tax purposes although this could be seen to be addressed in the annotated outline Chapter 10, paragraph 10 dealing with dividends and similar payments or within Chapter 10, paragraph 45 as a form of over/underinvoicing. This guidance suggests that where transfer prices differ from market prices, transfer pricing is acting as either a hidden dividend/investment depending on whether the entity is being over/under invoiced.

This interpretation has theoretical appeal as a bank’s ability to pay a dividend is reduced by any redistribution of income to other entities within the group.

The example below illustrates how transfer pricing seems to be working in practice for some foreign-owned banks in the UK and the effect on the figures used in National Accounts calculations.

A large bank operating in the UK has a transfer pricing policy which effectively uses transfer pricing to give a quarterly net income for the UK branch of 0. The element of net income which is the most changeable quarter on quarter is dealing profits and so the transfer pricing figures are therefore driven by movements in dealing profits. The table below illustrates this using fictional numbers;

<b>Profit and loss item (£m)</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
Net interest	100	150	100	150
Net fees	100	100	100	100
Net other income and expenditure before transfer pricing	-200	-200	-250	-200
Dealing profits	100	-500	500	0
Net dividends	50	-150	50	-150
<b>Net income</b>	<b>150</b>	<b>-600</b>	<b>500</b>	<b>-100</b>
Net transfer pricing	-150	600	-500	100
<b>Reconciliation</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Estimated GDP contribution <sup>2</sup>	-150	650	-550	150
Estimated GDP contribution less transfer pricing	0	50	-50	50

#### **Points for discussion**

- 1. Is the revised guidance within the annotated outline still on the agenda to be discussed?*
- 2. Should the service element of transfer pricing be separately identifiable for trade in services?*
- 3. Can income redistribution be classified as transfer pricing if not separated for reporters own purposes?*
- 4. Should all transfer pricing be treated as a hidden dividend/investment if reporters are unable to identify the element that is over/underinvoicing?*
- 5. Is this issue also feeding into the upcoming SNA revision process?*

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<sup>2</sup> Estimated GTP contribution = Net interest income + Net Fees + Net other income and expenditure

## **Appendix 1: BPM Guidance on Transfer Pricing**

### **Balance of Payments Manual – Paragraph 83**

Transactions of agents should be attributed to the economies of principals on whose behalf the transactions are undertaken and not to the economies of agents representing or acting on behalf of principals. However, services rendered by agents to enterprises represented should be attributed to the economies in which the agents are residents

### **Balance of Payments Manual – Paragraphs 97 – 103**

To the extent that a group of affiliated enterprises desires to allocate its gross earnings in a realistic fashion among its separate units, bookkeeping practices would have to reflect market-related pricing for all purchases and sales by the units. In that situation, the view might reasonably be taken that pricing adopted for bookkeeping purposes (often referred to as transfer pricing) is no different from market valuation.

However, in some cases, the method of valuation adopted may not accurately reflect the market price (for example if pricing is influenced by disparities between taxes and regulations imposed by different countries). If the distortions are large, replacement of book values with market value equivalents is desirable.

In view of the practical difficulties of substituting a market value for an actual transfer value, substitution should be the exception rather than the rule. If the transfer prices are significantly different from the market prices, they should either be replaced (by market prices) or separately identified for analytical purposes.

### **Guidance on transfer pricing given in outline revised BPM on IMF website**

#### c. Transfer pricing<sup>3</sup>

10.45 Transfer pricing is usually associated with shifting resources between related enterprises, so it relates to direct investment income measures. Examples will be given of the provision of goods and services free, or at understated or overstated values, or employee stock options provided to employees of a subsidiary at no charge to the subsidiary. The section will

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<sup>3</sup> Source: Chapter 10 Primary Distribution of Income Account  
<http://www.imf.org/external/np/sta/bop/bopman5.htm>

state that in the relatively rare cases where transfer pricing is identified and quantified, the relevant entry should be adjusted to an arm's length value. (See Chapter 3 Accounting Principles on valuation issues.) In addition to the adjustment to the flow itself, there should be a consequent counterpart entry, as stated below:

(a) If a direct investment enterprise is overinvoiced on a good or service provided by the direct investor;

or

(b) If a direct investor is underinvoiced on a good or service provided by the direct investment enterprise;

then the transfer pricing acts as a hidden dividend from the direct investment enterprise, so dividends should be increased.

(c) If a direct investment enterprise is underinvoiced on a good or service provided by the direct investor;

or

(d) If a direct investor is overinvoiced on a good or service provided by the direct investment enterprise;

then the transfer pricing acts as a hidden investment in the direct investment enterprise, so direct investment equity flows should be increased.

(It will be noted that the adjustments should also be made in a corresponding way in the national accounts and the counterpart economic territories. Reinvested earnings should also be adjusted.)

*[Question: Are these treatments correct?]*