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Issue Note: D.17 Identifying Superdividends and Establishing the Boundary Between Dividends and Withdrawal of Equity in the Context of Direct Investment

Prepared by the SNA and BPM Update Editorial Teams

ISSUE NOTE

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D.17 Identifying Superdividends and Establishing the Boundary Between Dividends and Withdrawal of Equity in the Context of Direct Investment

The issue

1 In May 2022 the Guidance Note (GN) D.17 on "Identifying Superdividends and Establishing the Borderline Between Dividends and Withdrawals of Equity in the context of [Foreign] Direct Investment", which has been prepared by the Balance of Payments Direct Investment Task Team, was circulated to the AEG for its review. The GN noted "the recommendations outlined in this GN were approved by the Committee [that is, BOPCOM] in February 2021 meeting". The GN was circulated to AEG in accordance with the BOPCOM action "to consult with the AEG to ensure consistency with national accounts".

2 The GN proposes three alternative treatments for "superdividends" in the recording of foreign direct investment (FDI) equity income: (A1) maintain the status quo (i.e., identifying superdividends as disproportionately large compared to past levels); (A2) adopt the treatment in *ESA 2010*, which is to treat any distribution out of accumulated reserves as a superdividend; (A3) discard the concept of superdividends for foreign direct investment enterprises and treat any distributions of accumulated reserves from ordinary earnings as dividends.

3 The GN recommends Option A3. This option best preserves the integrity of the measurement of DI income in BOP statistics and reduces the potential for misinterpretation of DI equity income, recognising that the distribution of income of DI enterprises is recorded on a full accrual basis. This is because, for FDI enterprises, unlike other enterprises, reinvested earnings (RIE) is also recorded as income. Furthermore, Option A3 overcomes difficulties in operationalization, which may lead to international inconsistencies.

4 The GN discusses the issue of consistency with the national accounts. It concludes "since there is no proposal to change how DI income is measured, the consistency with the National Accounts will be retained, even if DI dividends will not be measured in the same way as other dividends" (paragraph 20).

5 Six AEG members responded to the May 2022 review. Of these, five did not support Option A3, preferring Option A2 instead for reasons of consistency with the treatment of other (super) dividends in the accounts and because of concerns about the practicality of

Option A3. The *SNA 2025* editor (Peter van De Ven) expressed similar concerns. One AEG member supported Option A3.

6 At the 6 June 2022 meeting of the ISWGNA/TT leads, it was decided that there were sufficient concerns from the AEG regarding GN D.17 to warrant discussion between the SNA and BPM update editorial teams to identify a way forward.

7 Regarding the issue of consistency, the concern is that even though under Option A3 the definition of total FDI income is unchanged, under this option one of the components of FDI income—dividends—would be recorded on a different basis to dividends distributed by other corporations in the national accounts. The concept of "superdividends" is explicitly addressed in the *2008 SNA*. Paragraph 7.131 of the *2008 SNA* states the following: "if the level of dividends declared is greatly in excess of [past practice], the excess should be treated as a financial transaction, specifically the withdrawal of owners' equity from the corporation". Paragraph 7.132 states "this treatment applies to all corporations, whether incorporated or quasi-corporate and whether subject to public, foreign or domestic private control". While GN D.17 now proposes a different treatment for FDI enterprises, there is currently no proposal to change the treatment of dividends for other corporations.

8 Regarding the issue of practicality, the concern is that without a detailed analysis of corporations' financial accounts, it could be difficult to distinguish dividends paid out of operating activities from dividends paid from non-operating activities (e.g., sales of fixed assets, liquidations of branches, etc.), or from dividends paid out from accumulated profits in the past.

9 The February 2021 BOPCOM meeting also requested that the final decision on GN D.17 should consider discussion on GNs F.2 and D.16. GN F.2 addresses the asymmetric treatment of reinvested earnings. Regarding the future treatment of RIE for corporations other than FDI enterprises, the joint AEG/BOPCOM meeting in March 2022 agreed on Option 2 for balance of payments (that is leaving the core balance of payments accounts unchanged but adding supplementary information on portfolio investment RIE to the balance of payments). The decision on the part of Option 2 related to national accounts (that is leaving the core national accounts unchanged but providing supplementary information on public corporations RIE and overall investment in resident enterprises RIE) will be subject to national accounts testing. In GN D.16, the treatment of retained earnings remains basically unchanged—at least as far as it concerns the discussion in GN D.17.

Options

10 It is considered that there are 5 possible options for dealing with this issue:

> 1 Keep the definition of FDI dividends unchanged—that is Option A1: retain existing treatment of "superdividends" in the measurement of FDI equity income.

2 Adopt Option A3 for FDI equity income and leave the treatment of "superdividends" unchanged for other corporations (an alternative to this option would be to adopt the *ESA 2010* treatment of dividends (Option A2) for dividends payable from non-FDI enterprises).

3 Adopt Option A2 for both FDI equity income and for dividends payable from non-FDI enterprises.

4 Change the treatment of dividends payable from non-FDI enterprises to that proposed for FDI enterprises—that is record dividends paid out of accumulated ordinary earnings as dividends for all corporations.

5 Expand the scope of RIE beyond foreign direct investment enterprises.[1]

11 Option 1 is rejected because it fails to address the concerns with the current recording of FDI equity income.

12 Option 2 creates an inconsistency in the recording of dividends between FDI enterprises and other corporations, which may be justified by FDI equity income being recorded differently to other income (because of the recording of RIE) in the core accounts. Yet, it may be important to have consistency in the measurement of dividends as an identified component of income across the system to enhance comparability and to avoid possible confusion and misinterpretation.

13 Option 3 is rejected because it does not adequately address the concerns with the current recording of FDI equity income.

14 Option 4 is very problematic. There are two particular concerns with this option. The first relates to the treatment of dividends from public corporations. The *Government Finance Statistics Manual 2014* (*GFSM 2014*), like the *2008 SNA*, excludes "dividends declared greatly in excess of the recent level of dividends and earnings" from the recording of dividends (paragraph 5.115). Dividends from public corporations can potentially be distributed based on political as well as economic considerations. To allow any distributions of the accumulated reserves from ordinary earnings for public corporations to be recorded as dividends could enable manipulation of key fiscal measures. The second concern is the practical one mentioned above—that is without a detailed analysis of corporations' financial accounts (not just public corporations), it could be difficult to distinguish dividends paid out of operating activities from dividends paid from non-operating activities.

15 Option 5 is the most appealing conceptually. As mentioned above, it is only by recording RIE that the equity income of corporations is properly accounted for on a full accrual basis. As mentioned above, when RIE is recorded, total equity income is unchanged

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[1] This option was already considered and rejected (as Option 4) in GN F.2

regardless of how dividends are recorded (because RIE is derived residually). This eliminates the scope for manipulating equity income for non-economic purposes by way of decisions on the distribution of dividends. Also, Option 5 would resolve an inconsistency that is already in the system—namely the treatment of foreign direct investment equity income versus the treatment of other equity income. At the same time, this option would entail important challenges both on the practical side and on the interpretation of aggregates such as the current account balance, national saving and household saving (paragraph 36 of F.2)

The way forward

16 It is considered that Option 5 should be strongly pursued.

17 The Research Agenda (Annex 4) of *SNA 2008* states "it has been proposed that [the treatment of RIE] could be extended to other units, particularly public corporations".[2] As noted, this issue is being addressed by GN F.2, where the current thinking is not to change the core accounts. Instead, it has been agreed to add supplementary information on portfolio investment RIE to the balance of payments and national accounts and supplementary information on public corporations RIE and overall investment in resident enterprises RIE to the national accounts, with the latter subject to testing.[3]

18 Previous discussions have been restricted to recording RIE for all equity investments (i.e., including portfolio investments) versus keeping the recording of RIE as recommended in the *2008 SNA* and *BPM6*. It did not address the possibility of partially extending the recording of RIE, that is to (some) domestic-to-domestic direct investment relationships (understood as those where the direct investor is a resident entity or a group of related entities that is able to exercise direct[4] or indirect[5] control or a significant degree of influence over another resident entity). Moreover, it has so far occurred in isolation of the discussion on "superdividends". Considering the two issues of RIE and "superdividends" together greatly strengthens the case for recording RIE in the core accounts, particularly for public enterprises.

19 Measuring RIE for domestic direct investment relationships (as described in paragraph 18 of this note), including public corporations, would enhance consistency with the BOP and would not require any changes to the BPM. The practical drawback of this alternative is that RIE would be extended to a potentially large number of corporations,

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[2] *SNA 2008* Annex 4 also states that "the saving of corporations would always be zero, with serious implications for interpretation of the accounts since it would be built on a different paradigm from the current treatment of dividends and corporate saving".

[3] Option 2 in GN F.2

[4] By owning equity that entitles the direct investor to 10 percent or more of the voting power in the direct investment enterprise.

[5] By owning voting power in one direct investment enterprise that owns voting power in another enterprise or enterprises, that is, an entity is able to exercise indirect control or influence through a chain of direct investment relationships.

especially corporations owned by households, for which information may not be readily available.

20 Evidently, extending RIE to public corporations would also require a change to the GFSM. Accordingly, the IMF Government Finance Division has been consulted. It does not support including RIE in the core accounts for public corporations, at least in the next update of the SNA and BPM. Its view is that this would bring “new, and serious, conceptual and practical challenges, both for users of fiscal data and compilers of the data”.[6] However, the IMF Government Finance Division believes that it “could be beneficial to encourage countries that are able to do so to begin to compile supplementary data on an RIE basis.” This would allow the approach to be tested and a body of knowledge built up on how to interpret the statistics within a fiscal context, as well as to help users get accustomed to analyzing and interpreting these data.

21 **While conceptually it would be desirable to extend RIE to all corporations or to domestic direct investment relationships, it is clear that from a GFS perspective it would involve major challenges for fiscal interpretation should RIE for public corporations be included into the core accounts at the present time, and it would make little sense to introduce RIE for private corporations in a domestic direct investment relationships in the absence of introducing it for public corporations.**

22 Therefore, it is considered that **the “least-worst” alternative option would be to adopt Option A3 for FDI equity income and Option A2 for other equity income**. While this would lead to an undesirable inconsistency in the treatment of income, this could be justified by the fact that FDI investments are generally treated differently in the system to other forms of equity investment, so that there is already an inconsistency.

23 Furthermore, given the support for including RIE information (beyond FDI enterprises) as supplementary items in the balance of payments and national accounts (subject to testing), it is proposed that, the next editions of the SNA and BPM foreshadow a possible extension of the concept of RIE to all equity positions, the implementation of which will be subject to extensive testing and gaining practical experience. In this way, the inconsistency in treatment of dividends between FDI equity income and other equity income will be resolved and, importantly, all equity income will be measured on a full-accrual basis. In the meantime, through the preparation of supplementary information, countries will be able to resolve any practical issues with measuring RIE on all equity positions (including public corporations) and users will be able to become accustomed to analyzing and interpreting the data.

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[6] Several GFS concerns were referenced, both including challenges for fiscal policy, such as the creation of potential new fiscal policy incentives regarding loss-making and profitable public corporations; and implementation challenges for the large number of countries who currently report their GFS on a cash basis.

Consultation

24 This Issue Note was circulated to the Balance of Payments Task Team (BPTT) and the ISWGNA/SNA Task Team Leads for their comments.

25 The majority of the BPTT members were supportive of the approach recommended in the Note. However, two voiced concerns; one on the grounds of the practicality of applying A3 for foreign direct investment and the other because of concerns about inconsistency in the treatment of dividends between foreign direct investment and other forms of investment.

26 There were three responses from the ISWGNA/SNA Task Team leads who expressed concerns about inconsistency in the treatment of dividends (one of these responses was also a response to the BPTT). The remaining responses from the ISWGNA/SNA Task Team leads supported the approach recommended in this Note.

27 Three alternative suggestions were made. First, one respondent proposed to include a new item under direct investment income called "distribution of accumulated reserves" (and to record dividends on the basis of A2). Second, another respondent proposed to record only total equity income for foreign direct investment (i.e., to remove the disaggregation into dividends and reinvested earnings) and in the financial account, show entries for total equity income as an increase in foreign direct investment liabilities and "repatriation of capital" (equal to dividends—including superdividends—and withdrawals of income from quasi corporations) as a decrease in foreign direct investment liabilities. Finally, the possibility to discontinue the RIE treatment from FDI was also mentioned by one respondent.

Outcomes of the Discussions at the October 2022 Committee and AEG Meeting

28 The Committee and the AEG agreed with the recommendations of the SNA and BPM editorial teams presented in this Issue Note. Therefore, the GN D.17 has been finalized, reflecting the outcomes of the Issue Note. The SNA and BPM editors will incorporate the recommended treatment, taking into consideration the comments made by the members during the discussion, into the updated versions of the manuals. In particular, the editors will consider the advantages of a voluntary breakdown of DI income to separately identify superdividends to provide users with consistent information on dividends and RIE across the statistics.