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TRADE IN SERVICES BETWEEN ENTERPRISES OF THE SAME GROUP

16-18 Nomver 2009, OECD Headquarters, Paris

Item 5.6. of the Agenda. For discussion

Data show that a significant share of services is rendered between enterprises of the same group (intra-group), linked to a same transnational corporation (TNC). Different hypotheses can be construed from this, among which: resident affiliates may be rendering services on behalf of their non-resident parent companies or other non-resident affiliates to both domestic and non-resident beneficiaries; non-resident TNCs may be subsidizing the activities of their affiliates in Brazil by means of payments of services; flows related to transfer pricing practices are being registered as services. One hypothesis does not necessarily eliminate the other. It is most likely, in fact, that all three hypotheses find support and that some events support more than one hypothesis. The objective of this study is to assess the relevance of intra-group transactions in Brazil's international trade of selected business services and to present for debate the hypotheses stated above. Further evaluation of these hypotheses should be the object of a future study. Delegates are invited to comment.

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TRADE IN SERVICES BETWEEN ENTERPRISES OF THE SAME GROUP

2nd Meeting of the WPTGS
OECD, Paris, 16-18 November, 2009

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1. Introduction

Data show that a significant share of services is rendered between enterprises of the same group (intra-group), linked to a same transnational corporation (TNC). Different hypotheses can be construed from this, among which: resident affiliates may be rendering services on behalf of their non-resident parent companies or other non-resident affiliates to both domestic and non-resident beneficiaries; non-resident TNCs may be subsidizing the activities of their affiliates in Brazil by means of payments of services; flows related to transfer pricing practices are being registered as services. One hypothesis does not necessarily eliminate the other. It is most likely, in fact, that all three hypotheses find support and that some events support more than one hypothesis. The objective of this study is to assess the relevance of intra-group transactions in Brazil's international trade of selected business services and to present for debate the hypotheses stated above. Further evaluation of these hypotheses should be the object of a future study.

2. Methodology

Data source

The assessment of intra-group transactions was carried out with the use of high-frequency ITRS data, which are based on exchange settlements registered on-line in the Central bank Information System (Sisbacen). There are characteristics of the Brazilian ITRS system that ensure overall data quality and coverage of the data collection system for statistics of services: mandatory registration for each and every

resident to non-resident transactions[1]; absence of a reporting threshold; Central Bank of Brazil's ownership, management and quality surveillance of the database.

Assessment of intra-group transactions

The assessment of intra-group transactions was made for those services for which intra-group transactions in services are more frequently encountered: Communication; Computer and Information; Financial Services; Operational Leasing Services[2]; Other Business Services; Royalties and License Fees.

Brazilian international trade statistics: Selected services (US$ million)

	2006	2007	2008
Revenues			
Communication	205	276	466
Computer and Information	102	161	189
Financial Services	751	1.090	1.238
Operational Leasing	77	31	55
Other Business Services	7.524	10.076	12.915
Royalties and License Fees	150	319	465
Expenses			
Communication	102	96	299
Computer and Information	2.005	2.273	2.787
Financial Services	861	807	1.145
Operational Leasing	2.967	3.846	4.768
Other Business Services	4.964	5.802	7.863
Royalties and License Fees	1.664	2.259	2.697

Transportation, Travel and Government Services, for which intra-group activity are not significant were not considered. Insurance services, for which specific market regulation characteristics determine the existence of intra-group transactions, were not considered as well.

Identifying affiliation

Resident/non-resident pairs of affiliated companies were identified by means of the assessment of all individual exchange settlements of US$ 100.000 or more, a threshold that allows for a broad coverage of the selected accounts, according the following table.

1 As of November, 2006, modifications to the exchange legislation were introduced which allowed for exporters of goods to use the proceeds of their exports to settle payments to non-resident providers of services without the need to channel these proceeds through the domestic exchange market (and hence the ITRS). Data for the main exporting companies that settle services by means of this procedure are therefore reported to the BCB outside of the ITRS.

2 Operational Leasing Services are included under Other Business Services unless presented separately.

Transactions equal to or greater than US$ 100.000 as a share of total

	2006	2007	2008
Revenues			
Communication	84%	93%	96%
Computer and Information	67%	67%	64%
Financial Services	72%	77%	68%
Operational Leasing	90%	81%	65%
Other Business Services	74%	75%	75%
Royalties and License Fees	54%	59%	61%
Expenses			
Communication	78%	76%	91%
Computer and Information	82%	81%	82%
Financial Services	88%	82%	78%
Operational Leasing	96%	62%	64%
Other Business Services	73%	73%	71%
Royalties and License Fees	86%	88%	84%

The assessment covered 26.506 transactions between residents and non-residents, of which 14.960 pairs were selected based on revenues of services, rendered by residents to non-residents, and 11.546 pairs were selected based on the expenses of services, rendered by non-residents to residents.

Based on the names on the exchange contracts, staff searched internal databases and external sources of information to establish the links between parties that were named in the exchange settlement contracts.

The following table shows the results. *Yes* means that there is economic affiliation between parties of a service transaction; *No* means that there is no economic affiliation; *NA* means that the information available was insufficient to determine the existence or not of intra-group relationship.

Intra-group relationship

	Yes	No	NA	Total
Expenses	4.194	7.305	47	11.546
Revenues	9.417	5.135	408	14.960
Total	**13.611**	**12.440**	**455**	**26.506**

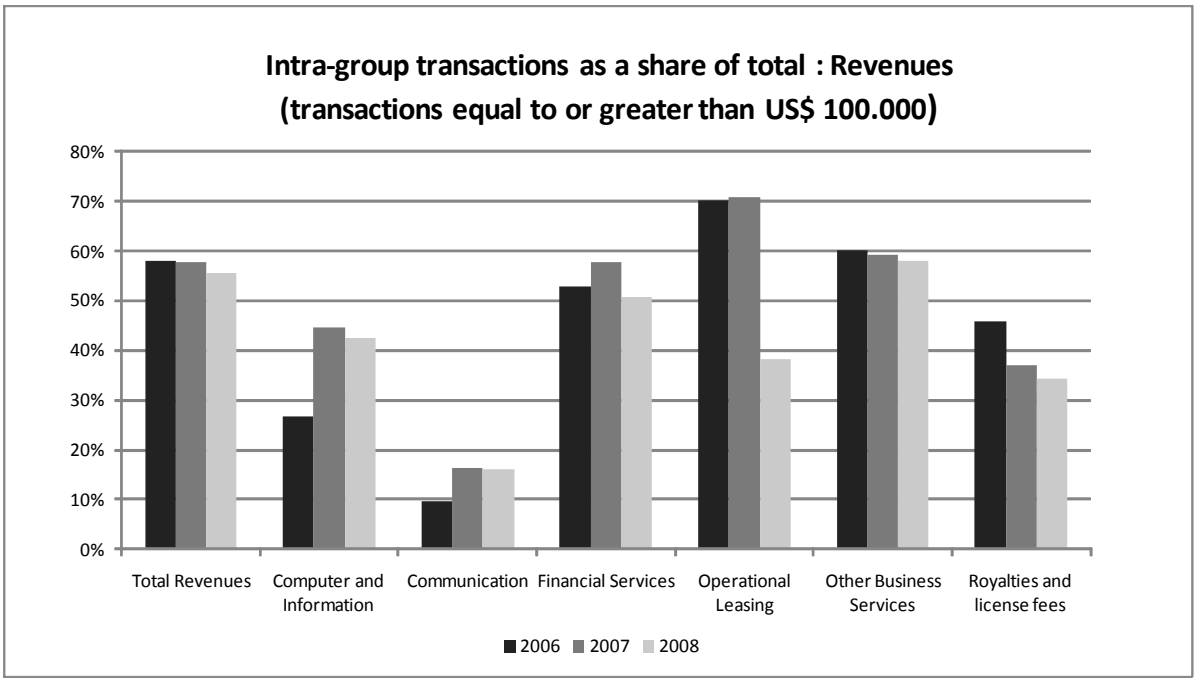
Out of the 26.506 transactions, the number of resident companies that either provided services to or consumed services from non-resident affiliates or parent companies was approximately 2.740. This figure accounts for each resident enterprise that conducted services transactions with a non-resident affiliate. The number of resident companies that both provided services to and consumed services from non-resident affiliates was 1.195. It was easily detected that the vast majority of the resident companies assessed are affiliates of TNCs headquartered abroad.

3. Findings

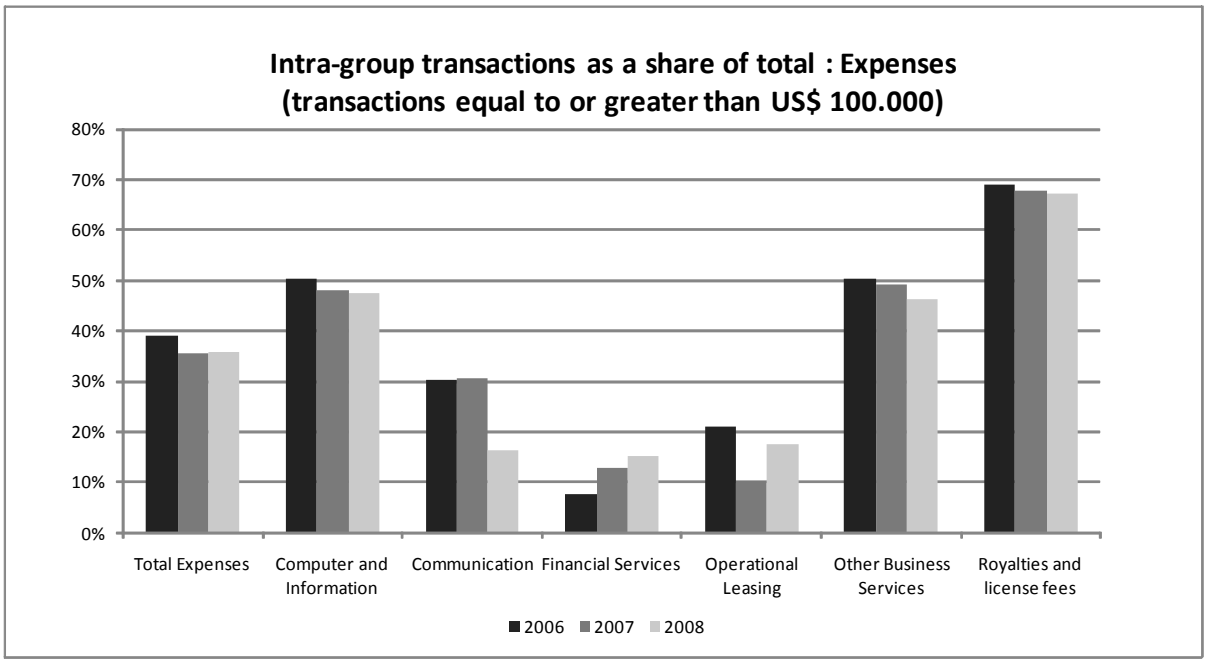
A high share of intra-group transactions, as a percentage of total transactions for the selected services, was found both for revenues or credits (services rendered by resident companies to non-resident affiliates)

and expenses or debits (services rendered by non-resident companies to resident affiliates). Furthermore, the totals for both revenues and expenses for all three years show a very stable performance in terms of intra-group share of transactions, notwithstanding the strong growth in flows, as seen on the first table of this paper. This is also evident in a more detailed assessment. For the services that account for the most significant volumes of flows, namely other business services for revenues and expenses as well as computer and information services, operational leasing and royalties and license fees, for expenses, no significant change over the three years was noticed.

For revenues, intra-group transactions of other business services surpassed 50% in all three years for which data were analyzed. Given that the average annual revenues for other business services were US$ 10 billion from 2006 to 2008 and considering, as stated previously, that the vast majority of service-exporting companies are resident affiliates of TNCs headquartered abroad, Brazilian affiliates rendered US$ 5 billion dollars in business services to their parent companies on average per year in that period.



For expenses, intra-group transactions were also significant; computer and information services, close to 50%, and royalties and license fees, at almost 70%, were the most outstanding.



Data on intra-group transactions by service and country showed somewhat different results for revenues and expenses.

For revenues, with a few exceptions, the intra-group transactions as a share of total transactions do not differ significantly from country to country for a given service. In other words, resident affiliates render, for any given service, a certain share to their parent companies or other affiliated companies regardless of the country of the counterpart's country of residence. Given its relevance, other business services conveys this idea quite efficiently and clearly.

Intra-group transactions as a share of total - by service and country of counterpart (transactions equal to or greater than US$ 100.000)

	Computer and Information	Communication	Financial Services	Other Business Services	Royalties and License Fees
Revenues					
United States	20%	8%	54%	66%	57%
United Kingdom	12%	22%	31%	62%	9%
Germany	20%	19%	70%	58%	46%
Netherlands	72%	0%	30%	67%	18%
France	15%	4%	37%	63%	62%
Switzerland	85%	0%	48%	57%	17%
Japan	3%	32%	77%	46%	18%
Italy	22%	72%	7%	34%	40%
Spain	97%	49%	13%	27%	4%
Argentina	13%	79%	33%	46%	2%
Mexico	40%	0%	29%	53%	15%
Portugal	55%	14%	15%	28%	5%
Denmark	0%	0%	94%	58%	0%
Finland	0%	60%	80%	91%	0%
Sweden	0%	0%	32%	75%	59%

Data for expenses, on the other hand, show that intra-group services consumption vary significantly depending on the service and the country of the counterpart that are analyzed. In the case of counterparts from Germany, Japan and Sweden, for example, computer and information services and royalties and license fees are rendered intra-group, from non-resident affiliates or parent companies to resident affiliates, at a significantly higher rate than in the case of counterparts in other countries.

Intra-group transactions as a share of total - by service and country of counterpart (transactions equal to or greater than US$ 100.000)

	Computer and Information	Communication	Financial Services	Other Business Services	Royalties and License Fees
Expenses					
United States	43%	9%	9%	20%	59%
Netherlands	63%	0%	24%	57%	53%
United Kingdom	19%	2%	6%	27%	44%
Germany	83%	17%	24%	36%	79%
France	26%	3%	22%	20%	78%
Japan	83%	0%	4%	34%	95%
Switzerland	29%	0%	13%	12%	89%
Italy	36%	89%	17%	41%	94%
Spain	60%	41%	26%	44%	9%
Sweden	96%	0%	13%	32%	95%
Canada	41%	0%	58%	39%	0%
Norway	45%	0%	16%	5%	30%
Ireland	63%	0%	6%	5%	47%
Argentina	16%	82%	10%	40%	22%
Denmark	43%	0%	29%	13%	55%

4. Final remarks

Data show that a very significant share of flows of services occurs between affiliated companies. The figures presented, although seemingly sound from the methodological standpoint, seem to challenge common knowledge of the operation of TNCs. The data for intra-group transactions in revenues of services, for example, conveys the idea that resident affiliates are rendering services mostly to their parent companies. This arrangement, although not impossible, seems unlikely unless the resident affiliate is, for example, rendering a service on behalf of a parent company, a case in which a foreign direct investment may actually be the subjacent transaction that is mistakenly not being registered. Likewise, although not as puzzling as the case of revenues, the share of intra-group transactions in expenses with services are significantly high and require further analysis in order to verify if there are taxation or other administrative or cost-related purposes that are serving as an incentive for transactions other than services to be mistakenly registered.

Notwithstanding the doubts raised, information is insufficient at this stage to ensure the trustworthiness of any conclusion. Therefore, the arrangements based on which resident affiliates render such a significant amount of services to their parent companies abroad is yet to be made clear. The assessment made so far only allowed for the identification of the flows. Further research, possibly by means of surveying selected companies, may be a necessary step in order to correctly determine the nature of these flows.