IMF Committee on Balance of Payments Statistics

BPM6 Update
Current Account Task Team (CATT)

APPROVED/FINAL VERSION

C.8 Recording of Fines and Penalties

C.8 Recording of Fines and Penalties[1]

This Guidance Note (GN) discusses several issues related to the recording of fines and penalties in the balance of payments. Although the Balance of Payments and International Investment Position Manual, sixth edition (BPM6) *covers these concepts, some uncertainties remain, and as these transactions have become large and more frequent, compilers have asked for further clarification. The GN discusses these issues and proposes that the international standards be revised to (i) define a fine/penalty payment as one that is "punitive in nature" and to more clearly distinguish these payments from payments of compensation, which are intended to compensate for injury or damages; (ii) indicate that major compensation payments should be recorded as capital transfers (instead of current transfers) if they are "intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial)"*; (iii) *not record fine/penalty transactions until the unit issuing the fine has an "unconditional claim to the funds" and if a judgment or ruling is subject to further appeal, an unconditional claim exists "when the appeal is resolved"; (iv) account fines/penalties impacting direct investment income—as in the U.S. treatment described in Annex III—when direct investment enterprises are the responsible party in these transactions; (v) treat contingent fines and penalties in contracts of M&A as price adjustments/updates—and therefore direct investment (or portfolio investment) transactions, and not as transfers; and (vi) include details on how compilers can use public information, such as court documents, to identify fines/penalties as well as related direct investment transactions be included in the* BPM7 Compilation Guide. *Further, the GN also recommends including the scenarios for fines and penalties transactions (Annex I) and the decision tree (Annex II) in the* BPM7 Compilation Guide.[2]

SECTION I: THE ISSUE

BACKGROUND

1. *Fines and Penalties*: **Cross-border fines and penalties imposed on institutional units by courts of law or other government bodies[3] are treated as miscellaneous current transfers in the secondary income account of the balance of payments (*Balance of Payments and International Investment Position Manual, sixth edition (BPM6),* paragraph 12.54).[4,5]** Fines and penalties have

[1] Prepared by Ms. Kristy Howell (in her previous capacity at the U.S. Bureau of Economic Analysis) and Mr. Thiago Vieira (Brazil) with input from Ms. Jessica Hanson and Mr. C. Omar Kebbeh (United States), and Mr. Renan Sousa (Brazil).

[2] The recommendations outlined in this GN were approved by the IMF Committee on Balance of Payments Statistics (Committee) in February 2021 meeting, and the *Summary of Discussions* of this meeting can be accessed here. These recommendations were endorsed by the Advisory Expert Group on National Accounts (AEG) in May 2022 through written procedure.

[3] This includes international or supranational governing bodies, which may issue fines against government units, for example, in the case of a European Union institution issuing a fine against a member country's government.

[4] However, penalties agreed to as part of a contract are not included in current transfers and instead should be treated along with the associated good, or service, or income, as appropriate (*BPM6* paragraph 12.54).

become more frequent and are sometimes very large.[6] There are an increasing number of large transactions involving fines related to corruption, banking supervision, and antitrust.

2. *Role of Multinational Enterprises*: **These transactions often involve multinational enterprises, which introduces additional complexity in terms of implementing the methodological guidance, mainly the identification of the institutional unit responsible for settling the fine or penalty.** Complete information on the enterprise involved, such as the unit responsible for the fine (headquarter or affiliate/subsidiary), the timing of the ruling, the amount of the fine, the appeals process, etc., can be difficult for compilers to obtain. Absent complete information, compilers must make assumptions, which can result in large bilateral asymmetries depending on the amounts of the fines.

3. *Time of Recording*: **These transfers are to be recorded "when a legal claim to the funds is established, which may be when a court renders judgment or an administrative ruling is published" (*BPM6,* paragraph 12.18).** However, significant fines are often appealed after they are issued, such that the final amount due may not be known until many years after the judgement is announced. To further complicate the matter, the company subject to the fine may recognize either a provision and a contingent liability or an expense and a liability in their financial accounting before the judgement has been finalized. Therefore, compilers may have difficulty determining when the fine should finally be recorded and, again here, the likelihood of introducing large bilateral asymmetries is great. Often in the case of large fines/penalties, amounts may be deposited in escrow accounts following the initial court judgment and pending exhaustion of appeals.[7]

4. *Classification*: **The classification of fines and penalties can be compared to the classification of taxes—which are also compulsory payments and are recorded as current or capital transfers—and to payments of compensation for injury or damages—which can be either "compulsory payments awarded by courts of law" or "ex gratia payments agreed to out of court" (*GFSM 2014,* paragraph 6.123), and are recorded in the current or the capital account, depending upon the nature of the damages.** According to the *BPM6*, payments of compensation for damages are to be recorded as capital transfers instead of current transfers when the payments are "for extensive damages (e.g., oil spillages or side effects of pharmaceutical products)" (*BPM6,* paragraph 12.56). The *BPM6* further defines these capital transfers as "major nonrecurrent payments in compensation for extensive damages or serious injuries" (paragraph 13.29).

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[5] Similarly, the *2014 Government Finance Statistics Manual (GFSM 2014)* defines fines and penalties as "compulsory current transfers imposed on units by courts of law or quasi-judicial bodies for violations of laws or administrative rules" (paragraph 5.142). This same treatment is also described in the *2008 System of National Accounts* (*2008 SNA*), paragraph 8.135, such that all three manuals are consistent.

[6] For example, in 2015 the U.S. Department of Justice announced the final settlement against BP for the Deepwater Horizon oil spill totaling $20.8 billion, which included a penalty of $5.5 billion for Clean Water Act violations (see https://www.justice.gov/opa/speech/attorney-general-loretta-e-lynch-delivers-remarks-press-conference-announcing-settlement). In 2018, Petrobrás agreed to pay $2.95 billion to settle a corruption scandal (https://www.nytimes.com/2018/01/03/business/dealbook/brazil-petrobras-corruption-scandal.html). In 2015, Deutsche Bank was fined $7.2 billion over an investigation into mortgage-backed securities (https://www.bbc.com/news/business-38412816).

[7] The recording of escrow accounts was considered as part of GN F.10 on cash collaterals. Currently, recording of deposits was recommended.

5. **In the international standards, fines and penalties are treated similarly to current taxes on income, wealth, etc. However, in practice they are often more closely tied to payments for compensation for damages.** For example, following a major event such as an oil spill, fines owed by the responsible party to the government and compensation owed by the responsible party to the affected parties are often determined in the same settlement; sometimes these amounts are reported indistinguishably.

ISSUES FOR DISCUSSION

Role of Multinational Enterprises

6. **Where a fine is issued against a multinational enterprise (MNE), identifying which part of the MNE (resident or nonresident entity) is liable for the fine can be challenging.**[8] These legal cases can be quite complex and difficult for compilers to unravel.[9] The part of the MNE that actually pays the fine is not necessarily the part of the MNE that responds to the court. It has been the drafting team's experience that some regulatory authorities explicitly issue fines against the nonresident direct investor or ultimate beneficial owner, while others issue fines against the resident subsidiary; in certain cases, joint liability between an immediate owner and a direct investment enterprise (DIE) may be assessed.[10]

7. **Given the differences in treatment of fines and penalties that could arise when MNEs are involved, this GN catalogues them in Annex I.** For each case, the table identifies whether the fine or penalty would be recorded in secondary income and whether other accounts in the balance of payments would be impacted. The table provides a listing of scenarios where the entity issuing the fine/penalty *is a resident*; however, each of the scenarios in reverse, where the issuing entity *is nonresident*, would also apply.

8. **Identifying which part of the MNE is liable and which part pays the fine is crucial for determining the proper treatment of these transactions in the balance of payments.** For example, if the fine is imposed on the resident DIE (scenario 2 in Annex I), there is no current transfer because it would be a resident-to-resident transaction. However, the profits earned by the DIE—which are recorded in the primary income account of the balance of payments—could be affected by the payment of the fine (see below). Other balance of payments accounts could also be impacted. For example, the DIE can pay the fine using resources from the direct investors (scenario 4). In this case, the fine is still a resident-to-resident transaction, but it would result in another transaction, between resident and nonresident, recorded in the financial account as direct investment. A decision tree, presented in Annex II, aims to provide clear guidance for compilers on how to classify these transactions in the balance of payments.[11]

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[8] Given the relevance for MNEs, this GN will need to be considered along with GNs related to direct investment.

[9] See section 3.1 of Karavias, M., "Shared Responsibility and Multinational Enterprises," *Netherlands International Law Review* 62 91–117 (2015) https://link.springer.com/article/10.1007/s40802-015-0008-z.

[10] The 2013 *External Debt Statistics Guide* (*EDS 2013*) raises the issue "about whether a government has jurisdiction to impose such charge on nonresidents" (see Chapter 2, footnote 2).

[11] The decision tree was added to the GN at the suggestion of the Committee.

9. **Direct investment income is measured according to the Current Operating Performance Concept (COPC) described in the *Benchmark Definition of Foreign Direct Investment, fourth edition* (*BMD4*) (see paragraph 208)**. *BMD4* Box A.6.2 includes a list of extraordinary items that should be excluded from COPC; fines and penalties are not listed explicitly. Some compilers, including the U.S. Bureau of Economic Analysis (BEA), allow fines and penalties to negatively impact DIE income. However, other compilers, including the U.K. Office for National Statistics (ONS), take the alternative interpretation that fines/penalties incurred by a DIE should be considered extraordinary items and thus be excluded from COPC. Case studies provide more information about the current treatment applied by compilers in the United States (Annex III), United Kingdom (Annex IV), and Brazil (Annex V), in the form of hypothetical case studies applied to scenario 2 from Annex I and the reverse scenario (where the DIE is a nonresident owned by a resident direct investor).

10. **The treatment of fine/penalty imposed on a resident MNE also has implications for the national accounts.** In the national accounts, when a fine is levied on a resident unit it will be recorded in the secondary distribution of income account, with no direct impact on gross domestic product (GDP) or gross national income (GNI). However, when the resident unit is part of an MNE, there can be impacts on GDP and GNI, depending on whether the fine/penalty is recognized as COPC. The impact on the national accounts is also covered in the case studies in Annexes III–V.

Time of Recording

11. **Considering the legal dimension of the matter, the recognition of the obligation on an accrual basis after the first decision will not necessarily hold.** Even with a court decision settling the payment of a fine or penalty, the subsequent appealing courts may rule against this obligation. Thus, recording the transaction may backfire because of the multiple appeals and its contingent liability nature. The act of effective payment, though, cannot be disputed. Therefore, a cash-basis approach to the time of recording of fines and penalties transactions has some appeal. However, recording these transactions on a cash basis would introduce other inconsistencies within the balance of payments and with national accounts and government finance statistics.

12. **As the counterpart entity of fines/penalties is classified inside general government, a time of recording similar to taxes may be envisaged in order to avoid distorting government finance statistics.** For taxes, only amounts that are irrevocable (unconditional) should be regarded as government revenue and the recording of uncollectible amounts as government revenue should be avoided. In fact, *GFSM 2014* already specifies that fines and penalties should be recorded "when the general government unit has an unconditional claim to the funds" (paragraph 5.144).[12] The reference to an "unconditional claim" is only included in the *GFSM 2014*; it is missing from the similar passages in the *System of National Accounts 2008 (2008 SNA)* and *BPM6*. Regarding judgments or rulings that may not be final, the *GFSM 2014* states that if the "judgment or ruling is subject to further appeal, then the time of recording is *when the appeal is resolved*" (paragraph 3.85, emphasis added). Both clarifications should be made in SNA and BPM to bring the standards into alignment.

[12] Regarding the time of recording, the specific rules in the *European System of Accounts (ESA*) 2010 paragraph 20.189 may also be useful to consider: "when the claimants have an automatic and incontrovertible right for a given amount that can be individually determined."

13. **If a fine/penalty is accrued in the current period but not paid, the corresponding entry should be recorded as other accounts receivable/payable.**[13] In practice, the compiler will need to consider whether the amounts are already captured in their source data, or whether additional adjustments are necessary.

Classification

14. **A fine/penalty levied against a company for a major event, such as an oil spill, could be rather large and result in a significant impact on the country's current account, which has implications for policy analysis.** For this reason, there may be some appeal to treating significant fines and penalties transactions as capital transfers instead of as current-account transactions (in the same way that major payments for compensation of damages can be treated as capital transfers instead of current transfers, under the current standards). However, despite the benefit of reducing volatility from the current account, only conceptual definitions should be taken into account to record a transaction.

15. **Another complexity to consider is that in certain cases an amount identified as a fine/penalty may still be used to compensate for damages in some manner.** In the Deepwater Horizon settlement, the payment for violation of the Clean Water Act was referred to as a penalty, whereas the payment for damages under the Oil Pollution Act and payments to state and local governments were referred to as payments of damages. However, the statement continues that "80 percent of the Clean Water Act penalty will go to help the Gulf recover from the injuries it has suffered."[14]

16. **Since fines/penalties are compulsory, and payments of compensation for damages can also be compulsory, it may be helpful to expand the definition of fines and penalties to further distinguish the two types of transactions.** Fines/penalties could be defined as compulsory payments that are punitive in nature, that is, are intended to punish and/or deter certain activities or behavior, while compensation payments are intended to remedy specific harms, such as property damage or loss of income. Under these new definitions, it may be appropriate for a compiler to treat certain fine/penalty payments that are identified in legal documents as a fine/penalty, but are actually intended to compensate for damages, as payments for compensation of damages for the purposes of recording the transaction in the balance of payments.

17. **Clarification on the economic meaning of "major compensation payments for extensive damages" would also be welcome to identify properly a capital account transaction.** The current guidelines provide some examples (e.g., oil spills or side effects of pharmaceutical products) but do not provide clear rationale for what aspects of these damages should be considered in making the determination. Using a Pigouvian approach,[15] "extensive damages" can be interpreted as negative

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[13] *EDS 2013* also discusses penalties arising from commercial contracts and recommends that "The debt should be recorded from the time when the resident becomes liable under the contract for penalty," following the accrual basis recording (see Appendix 1, part 2).

[14] Note that this penalty was not cross border, but if it was, would be a good example of a compulsory payment identified as a penalty that was intended to provide some compensation to third parties.

[15] The externality concept was first introduced in the 1920s by Arthur Pigou in "The Economics of Welfare." Since then, economists have studied extensively the resolution of externality problems through the design of taxation and the imposition of fines and penalties.

externalities with impacts across several sectors or the whole economy. In this sense, major compulsory payments related to antitrust and competition laws, for example, that also seek compensation to the negative widespread effects of one-off events on society, could also be treated as capital account transfers. However, this definition may be difficult to apply in practice. The drafting team considered this and, drawing on the experience of compilers, determined that a more practical way to determine which payments meet the threshold of being classified as capital transfers are those that are linked to the recovery of losses incurred over a multi-year period, or to the replacement of an asset (financial or nonfinancial).[16] This criterion is consistent with the definition of a capital transfer in the *BPM6* as a transfer that "results in a commensurate change in the stocks of assets of one or both parties to the transaction" (paragraph 12.13). The *GFSM 2014* already includes accumulated losses as part of the definition of major compensation payments (paragraph 3.16), while the *BPM6* and *2008 SNA* do not, so there is room for closer alignment.

18. **Considering the interplay between this issue of classification of compensation payments, which are often related to fines/penalties, and the earlier discussion on the involvement of MNEs, the drafting team sought to clarify the treatment of compensation payments where an MNE is involved.** While Annex I focused only on fine/penalty transactions, the analogous scenarios can apply in the case of compensation payments. However, in the case of compensation payments, the further distinction of "major" compensation payments must also be considered in the context of MNEs. In order to be consistent with the classification of major compensation payments as capital transfers instead of current transfers, major compensation payments involving MNEs should also be classified out of the current account. Therefore, rather than being allowed to impact DI earnings, a major compensation payment should be included in other changes in volume and valuation within the direct investment account.[17]

19. **Some fines and penalties established in contracts (not imposed by courts of law) of mergers and acquisitions (M&A) may also be difficult to classify.** Many M&A transactions are not entirely settled immediately, and contracts may include contingent fines or penalties. For instance, as performance criteria, if the profitability or the revenue of the enterprise is above a threshold, the nonresident buyer must pay an additional value to the resident seller. On the other hand, if the enterprise loses a lawsuit, the resident seller must pay the same amount for the nonresident buyer, as compensation. In these cases, the fines and penalties would be interpreted as an adjustment/update of the market price of the acquired enterprise, and therefore a direct investment (or a portfolio investment if the buyer has less than 10 percent of the voting power) transaction, instead of a current transfer.

SECTION II: OUTCOMES

20. **The draft GN with a preliminary set of recommendations, including on the definition of fine/penalty, the time of recording, classification of compensation payments, and impact of**

[16] This definition is incorporated in the decision tree shown in Annex II.

[17] While the value of the major compensation payment by a DIE does not impact DI earnings, it would impact the value of the DIE as recorded in the international investment position (IIP). This treatment is reflected in the decision tree in Annex II.

fines/penalties involving MNEs on primary income, was discussed during the February 2021 IMF Committee on Balance of Payments Statistics (Committee) meeting.[18]

21. **Further, the Advisory Expert Group on National Accounts (AEG) broadly agreed with the draft GN during the initial review.** However, it was indicated there was no full consensus that fines and penalties involving DIEs should impact their earnings and therefore the primary income account. The AEG also highlighted the practical challenges of implementing the proposed time of recording and requested more guidance be provided (as noted in the recommendations above, more guidance can be provided in the next Compilation Guide).

22. **Following the suggestions from the Committee, the drafting team revised the GN to include a decision tree (Annex II) to help compilers determine the appropriate treatment of fines/penalties and related payments of compensation as well as case studies (Annexes III–V) that provide examples of the current treatment of fines/penalties involving MNEs to highlight the differing treatments that exist currently.**

FINAL RECOMMENDATIONS

23. **The final recommendations of the GN are:**

- *Revise the international standards to define a fine/penalty payment as one that is "punitive in nature" and to more clearly distinguish these payments from payments of compensation, which are intended to compensate for injury or damages.*
- *Revise the international standards to indicate that major compensation payments should be recorded as capital transfers (instead of current transfers) if they are "intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial)."*
- *Given the number of appeals that often follow an initial ruling, clarify that fine/penalty transactions should not be recorded until the unit issuing the fine has an "unconditional claim to the funds" and clarify that if a judgment or ruling is subject to further appeal, an unconditional claim exists "when the appeal is resolved."* The *BPM6/2008 SNA* could also be modified to state that the corresponding entry to fines/penalties accrued but not yet paid should be recorded as other accounts receivable/payable. As noted, an MNE subject to a fine/penalty may recognize the liability in their financial accounting before the judgement has been finalized, so in cases of large fines/penalties that would have a material impact on the accounts, compilers may need to make adjustments to ensure the transactions are recorded in the appropriate period. Further practical guidance on this issue should be provided in the next *BPM7 Compilation Guide*.
- *As there was not agreement on whether fines/penalties should impact direct investment income when DIEs are the responsible party in these transactions, compilers should make a determination about whether to include fines/penalties as part of COPC based on the specific characteristics of the fine/penalty, including whether it is considered extraordinary.* Examples should be provided in the Compilation Guide. Any clarification to the treatment of fines and

[18] See the draft GN at https://www.imf.org/external/pubs/ft/bop/2021/pdf/VM1/21-03.pdf and the *Summary of Discussions* at https://www.imf.org/external/pubs/ft/bop/2021/pdf/VM1/21-12.pdf.

penalties would need to be incorporated subsequently into the updates of the *BMD4* and *GFSM 2014* as well, to maintain consistency.

- *Explicitly treat contingent fines and penalties in contracts of M&A as updates to the market value of the acquired enterprises—and therefore direct investment (or portfolio investment) transactions (flows), and not as transfers.*
- *Add guidance regarding possible fines and penalties related transactions.* For the next Compilation Guide, provide details on how compilers can use public information, such as court documents, to identify fines/penalties as well as related direct investment transactions (as described under “indirectly impacted accounts” in Annex I). The table in Annex I and the decision tree in Annex II could both be included in the *BPM7 Compilation Guide*.

24. **The recommendations will require additions or clarifications to BPM, SNA, and GFSM in order to maintain consistency across the sets of accounts.** A preliminary list is in Annex VI.

Rejected Proposals

25. **The drafting team considered a proposal to change the recording of fines and penalties from accrual to cash basis to address concerns about the multiple appeals that often occur before a fine/penalty is finalized.** This proposal was rejected because it would deviate from the existing standards of accrual recording and introduce other inconsistencies within the balance of payments and with other accounts.

26. **The drafting team also considered but rejected a proposal to reclassify certain fines and penalties from the current account to the capital account,** to align the treatment of fines and penalties with the treatment of other compulsory payments, such as payments of compensation for damages. While this proposal had some appeal given that settlements for major events often include compulsory payments of both fines/penalties (meant to be punitive) and damages (meant to be compensatory), the team determined that all fine/penalty payments should be treated as current transfers because they are recorded as current income of the general government unit that payment is received.

27. **The drafting team considered defining compensation payments that should be recorded as capital transfers according to whether the payments were “meant to alleviate negative externalities,”** but concluded that this definition would not be easy to put in practice. Instead, the team decided to use the definition of a payment that is “intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial)” since this is what many compilers already use in practice.

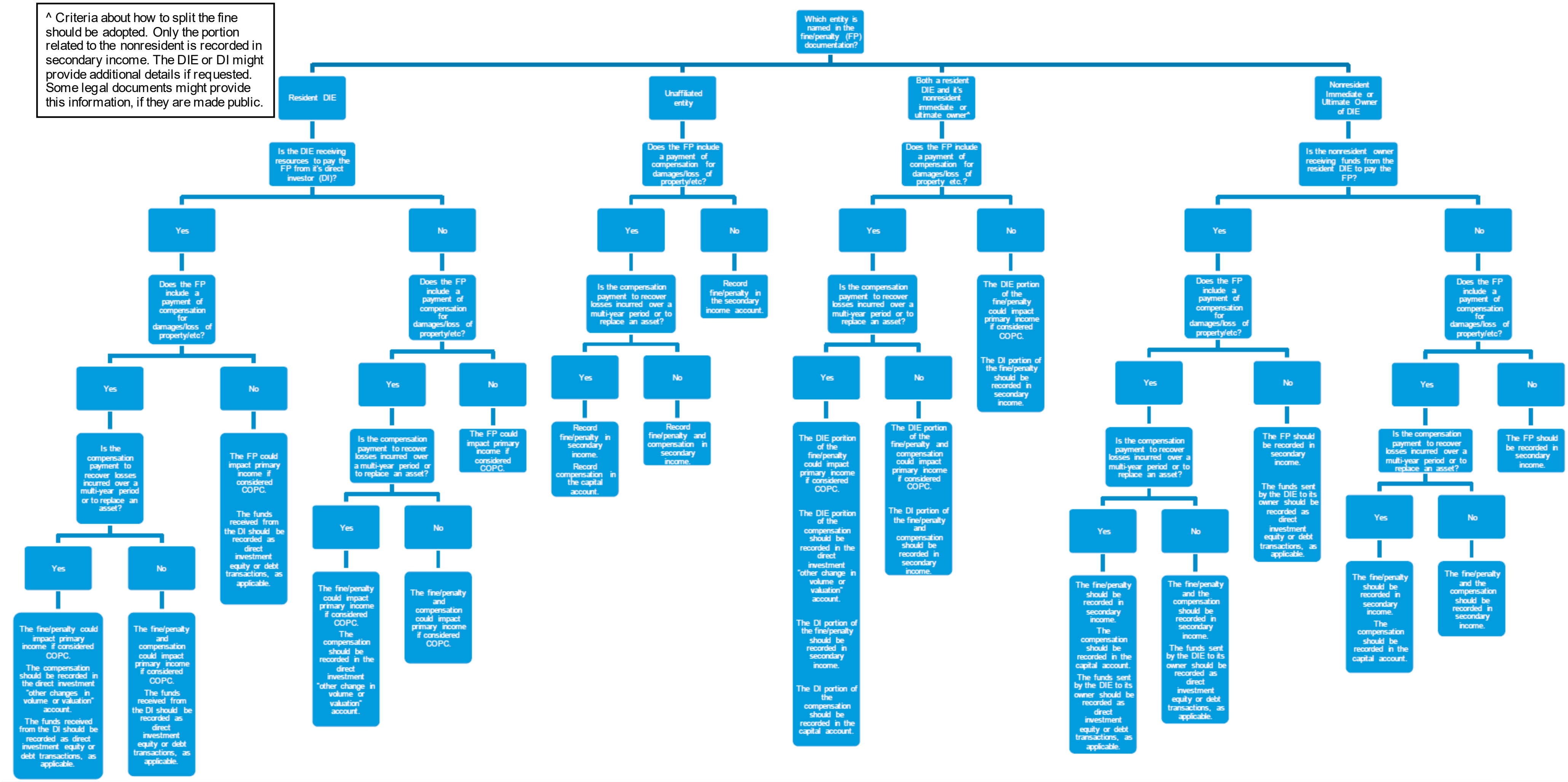
28. **The drafting team initially proposed to clarify in updates to *BMD4* and *BPM6* that fines/penalties should impact COPC,** then later considered whether the Benchmark Definition Technical Expert Group (BTEG) should undertake a more thorough review of COPC and the definition of income throughout the manuals to clarify. However, the drafting team ultimately revised the recommendation to indicate that SNA and BPM should be explicit on this issue.

Annex I. Scenarios for Fines and Penalties (FP) Transactions

	Scenario	Recorded as FP in Secondary Income	Indirectly Impacted Accounts	Notes
1	Unaffiliated nonresident entity named (as the responsible party) and paying	Yes	None	“Classic” cross-border FP scenario
2	Resident direct investment entity (DIE) named; DIE pays using its own resources	No	Primary income, potentially	The FP is a resident-to-resident transaction, so it is not recorded in the balance of payments. Although the fine/penalty itself is not recorded in the balance of payments, it could affect the primary income account if the expense of the fine is considered COPC.
3	Resident DIE and nonresident immediate or ultimate owner of DIE both named	Yes	Primary income potentially	Criteria about how to split the fine should be adopted. Only the portion related to nonresident is recorded in secondary income. DIE or ultimate owner of DIE might provide additional details if requested. Some legal documents might provide this information, if they are made public. Although the portion related to the resident would not be recorded in the balance of payments, it could affect the primary income account if the expense of the fine is considered COPC.
4	Resident DIE named; Nonresident immediate or ultimate owner sends the resources to the DIE	No	Direct investment	Since the DIE was named in the legal documents, the FP is a resident-to-resident transaction. If the direct investors send the resources for the DIE to pay, this is a direct investment transaction, in equity or in intercompany lending. It could affect the primary income account if the expense of the fine is considered COPC.
5	Nonresident immediate or ultimate owner of DIE named; DIE pays	Yes	Direct investment	Since the immediate or ultimate owner of the DIE was named in the legal documents, the FP transaction should be recorded in secondary income as a transaction between the issuer (resident) and the direct investor (nonresident). If the resident DIE did not receive resources to make the payment on behalf of the direct investor, this is equivalent to a withdrawal in the DIE capital.
6	Nonresident immediate or ultimate owner of DIE named and paying	Yes	None	Since the immediate or ultimate owner was named in the legal documents, the FP transaction should be recorded in secondary income. There would be no direct investment flows related since the DIE is not involved.

Annex II. Decision Tree for Classifying Transactions Related to Fines/Penalties and Associated Payments of Compensation

*The following decision tree includes scenarios where the entity issuing the fine/penalty is a resident; however, the same criteria would apply for the reverse scenarios where the issuing entity is nonresident (*i.e., the decision tree can be used to inform whether there are cross-border transactions—credits or debits). *The decision tree covers fines/penalties and associated payments of compensation. It begins by assuming there is a fine/penalty transaction; in a scenario where there is no fine/penalty, but only a compensation payment, compilers should follow the decision tree as if there is a fine/penalty, and then ignore the concluding statements about where the fine/penalty part of the transaction would be classified.*



Annex III. Examples of How Fines and Penalties Impact Direct Investment Earnings in the U.S. Economic Accounts[1]

Example 1 – Income Payments (Inward Direct Investment)

Direct investment enterprise (DIE) 1 is resident in the United States and is wholly owned by its direct investor resident in Country B. DIE 1 is fined $1 billion by the U.S. government for violating an aspect of U.S. banking regulations.[2] DIE 1 recognizes the fine as a cost in its financial statements and reports its earnings, which are reduced by the higher costs as a result of the fine, on its direct investment (DI) survey report to the U.S. Bureau of Economic Analysis (BEA). BEA recognizes fines and penalties as part of the Current Operating Performance Concept (COPC) and does not exclude the fine as extraordinary, thereby allowing it to impact DI earnings (income on equity) for DIE 1. The aggregate DI income payments for the United States therefore reflects the impact of the fine, which reduces the income payments from U.S. DIEs to their foreign owners by $1 billion (ceteris paribus). U.S. balance of payments primary income payments decrease by $1 billion (ceteris paribus). This increases the Rest of World (ROW) balance on income since receipts are unchanged and payments are reduced. U.S. **domestic** corporate profits would decrease $1 billion (ceteris paribus) since DIE 1 is resident in the United States.[3] However, total U.S. gross domestic income (GDI) would not be impacted because within operating surplus the decrease in corporate profits would be offset by a $1 billion increase in net current business transfer payments reflecting the business transfer to government. U.S. **national** corporate profits, which are calculated as domestic corporate profits plus ROW income receipts less ROW income payments, would not be impacted by the fine since the fine reduced both domestic corporate profits and ROW income payments. Total U.S. gross national income (GNI) would increase by $1 billion since payments to ROW decreased due to the fine.

The fine would also reduce U.S. direct investment liabilities financial transactions by $1 billion through reduced reinvestment of earnings for DIE 1. The U.S. direct investment liabilities position in the international investment position (IIP) accounts would also decrease by $1 billion as the value of lower reinvestment of earnings impacts the equity position of DIE 1.

Example 2 – Income Receipts (Outward Direct Investment)

DIE 2 is resident in Country C and is wholly owned by its direct investor resident in the United States. DIE 2 is fined $0.5 billion by Government C for violating an aspect of Country C's banking regulations.[2] DIE 2 recognizes the fine as a cost in its financial statements and its U.S. parent reports the earnings of DIE 2, which are reduced by the higher costs as a result of the fine, on its DI survey report to BEA. BEA recognizes fines and penalties as part of the COPC and does not exclude the fine as extraordinary, thereby allowing it to impact DI earnings (income on equity) for DIE 2. The aggregate DI income receipts for the United States therefore reflects the impact of the fine, which reduces the income receipts from nonresident DIEs to their U.S. owners by $0.5 billion (ceteris paribus). U.S. balance of payments primary

[1] Prepared by the U.S. Bureau of Economic Analysis.

[2] There are many types of banking regulatory violations including price fixing, anticorruption, disclosure irregularities, etc.

[3] U.S. corporate profits are equivalent to SNA entrepreneurial income inclusive of net current business transfer payments.

income receipts decrease by $0.5 billion (ceteris paribus). This decreases the ROW balance on income (receipts are decreased, and payments are unchanged) in the U.S. national economic accounts, which decreases **national** corporate profits by $0.5 billion (ceteris paribus). Overall U.S. GNI would also decrease by $0.5 billion. U.S. **domestic** corporate profits and GDI would not be impacted since DIE 2 is not a resident of the United States.

The fine would also reduce U.S. direct investment assets financial transactions by $0.5 billion through reduced reinvestment of earnings for DIE 2. The U.S. direct investment assets position in the IIP accounts would also decrease by $0.5 billion as the value of lower reinvestment of earnings impacts the equity position of DIE 2.

Annex IV. Examples of the U.K. Approach to Compiling Direct Investment Earnings on the Current Operating Performance Concept after Accounting for Fines and Compensation Payments[1]

Example 1 – Private Non-Financial Corporation Income Payments (Inward Direct Investment)

Direct investment enterprise (DIE) 1 is resident in the UK and is wholly owned by a multinational resident in Country B (USA). DIE 1 is fined £3 billion by the U.K. government for violating a regulation for contamination to the environment.

DIE 1 recognizes the fine as a cost in its financial statements and reports its earnings, which are reduced by the higher costs because of the fine.

On its direct investment (DI) survey report to the U.K. Office for National Statistics they are advised by the data clearing team to not recognize fines and penalties as part of the Current Operating Performance Concept (COPC) and to exclude the fine as extraordinary, thereby not allowing it to impact DI earnings (income on equity) for DIE 1.

The aggregate DI income payments for the UK therefore removes the impact of the fine.

In the U.K. national economic accounts, government receipts would increase by £3 billion.

The loss is reflected in the unquoted equity value reduced by £3 billion reported by the respondent and features in the calculation of IIP.

Example 2 – Private Non-Financial Corporation Income Receipts (Outward Direct Investment)

Direct investment enterprise (DIE) 1 is resident in France and is wholly owned by a multinational resident in Country B (The UK). DIE 1 is fined £15 billion by the French government for violating a regulation for contamination to the environment.

DIE 1 recognizes the fine as a cost in its financial statements and reports its earnings, which are reduced by the higher costs because of the fine amounting to the £15 billion loss.

On its direct investment (DI) survey report to the U.K. Office for National Statistics they are advised by the data clearing team to not recognize fines and penalties as part of the Current Operating Performance Concept (COPC) and to exclude the fine as extraordinary, thereby not allowing it to impact DI earnings (income on equity) for DIE 1.

The aggregate DI income payments due to the UK from France, therefore, removes the impact of the fine.

The loss is reflected in the unquoted equity value reported by the respondent and feature in the calculation of IIP for outward foreign direct investment in France.

[1] Prepared by the U.K. Office For National Statistics and the Bank of England.

Example 3 – U.K. Monetary Financial Institutions Income Payments (Inward Direct Investment)

Data Sources: The profit and loss of U.K. resident monetary financial institutions is collected by the Bank of England on Form PL. Form PL is in two parts with part 1 providing granular information on both income and expenditure while part 2 provides a breakdown of payment and receipts to and from non-residents including direct investment profit and loss. A related form (Form BG) provides a geographical breakdown of some of the part 2 items.

Part 1 of Form PL identifies holding gains (PL item 8), net provisions for bad and doubtful debts (PL item 20A) and exceptional items (PL item 14) during the reporting period. PL item 14 has a breakdown that includes fines and compensation payments (PL item 14A). Total profit/loss due to non-resident parent is reported in PL item 32 with further breakdowns for the profit/loss of U.K. branches (PL item 32A) and U.K. subsidiaries and associated companies (PL item 32B). PL item 32 is reported on an all-inclusive basis.[2]

Form BG collects a geographical breakdown of the non-resident company's share of the U.K. reporting institutions' profit/loss earned during the period (BG item 7 for branches and BG item 8 for subsidiaries) on an all-inclusive basis. Form BG also collects a geographical breakdown of the non-resident parent's share of the U.K. reporting institution's holding gains/loss, exceptional items and provisions (BG item 14). In most instances the relationship is one-to-one with the parent.

Data Aggregation: Total inward payments are calculated on a Current Operating Performance Concept as follows:

- Inward branch payments (total) = Branch profits/loss (PL32A) less holdings gains/losses (PL8),[3] less exceptional items (PL14) plus provisions (PL20A)
- Inward branch payments (geog) = Branch profits/loss (BG7) less holdings gains/losses, exceptional items and provisions (BG14)
- Inward subsidiary payments (total) = Subsidiary profits/loss (PL32B) less holdings gains/losses (PL8),[3] less exceptional items (PL14) plus provisions (PL20A)
- Inward subsidiary payments (geog) = Subsidiary profits/loss (BG8) less holdings gains/losses, exceptional items and provisions (BG14)

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[2] See *OECD Benchmark Definition of Foreign Direct Investment*, *fourth edition*, paragraph 210.

[3] The aggregation has been simplified as PL item 8 also includes a breakdown of spread earnings from trading on behalf of customers and clients (PL items 8AA, 8BA, and 8CA) which are added back as they are an implicit fee so should be include on a COPC basis.

Example 4 – U.K. Monetary Financial Institutions Income Receipts (Outward Direct Investment)

Data Sources: The profit and loss of U.K. resident monetary financial institutions is collected by the Bank of England on Form PL. Form PL is in two parts with part 1 providing granular information on both income and expenditure while part 2 provides a breakdown of payment and receipts to and from non-residents including direct investment profit and loss. A related form (Form BG) provides a geographical breakdown of some of the part 2 items.

Form PL part 2 includes items for the profit/loss of UK-owned foreign branches (PL31A) and foreign subsidiaries and associated companies (PL31B). Part 2 also collects the holding gains/losses, exceptional items and provisions of non-resident branches (PL items 33A) and subsidiaries and associated companies (PL item 33B). PL item 31 is reported on an all-inclusive basis.

Form BG collects a geographical breakdown on the profits of foreign branches (BG item 3) and foreign subsidiaries and associated companies (BG item 4) on an all-inclusive basis. Form BG also collects a geographical breakdown of the holding gains/losses, exceptional items and provision of foreign branches (BG item 13A) and foreign subsidiaries (BG item 13B).

Data Aggregation: Total outward receipts are calculated on a Current Operating Performance Concept as follows:

- Outward branch payments (total) = Branch profits/loss (PL31A) less holdings gains/losses exceptional items and provisions (PL33A)
- Outward branch payments (geog) = Branch profits/loss (BG 3) less holdings gains/losses, exceptional items and provisions (BG13A)
- Outward subsidiary payments (total) = Subsidiary profits/loss (PL321B) less holdings gains/losses exceptional items and provisions (PL33B)
- Outward subsidiary payments (geog) = Subsidiary profits/loss (BG 4) less holdings gains/losses, exceptional items and provisions (BG13B)

Forms PL and BG Reporting Template and Definitions

- Form PL template - https://www.bankofengland.co.uk/-/media/boe/files/statistics/data-collection/pl/form_pl2016.xls
- Form PL definitions - https://www.bankofengland.co.uk/-/media/boe/files/statistics/data-collection/pl/def_pl2016.pdf
- Form BG template - https://www.bankofengland.co.uk/-/media/boe/files/statistics/data-collection/bg/form_bg2016.xls
- Form BG definitions - https://www.bankofengland.co.uk/-/media/boe/files/statistics/data-collection/bg/def_bg2016.pdf

Annex V. Examples of How Fines and Penalties Impact Direct Investment Earnings in Brazil's Economic Accounts[1]

In Brazil, there is an ongoing work to assess the impact of fines and penalties on primary income and the key issue is to differentiate COPC and non-COPC items in the earnings of DIEs.

Our main view is that fines and penalties are closer to non-COPC, which would mean they would not impact primary income. Until reference year 2018, direct investment surveys in Brazil would capture only total earnings and therefore could not be used to separate COPC from non-COPC items. Compilers had to manually collect and inspect financial statements of the main DIEs, looking for non-COPC items to exclude them from direct investment earnings. In years such as 2015, when many resident DIEs recorded impairments and exchange rate losses, both of which probably related to an economic recession, this kind of adjustment was more relevant. This was also the year of a natural disaster related to mining activities involving a firm partly owned by a resident DIE, whose losses related to fines and provisions for reconstruction of the affected areas were regarded as non-COPC items.

For reference year 2019, three fields were introduced in the direct investment liabilities survey to address the shortcoming of not capturing non-COPC items: (i) net income (loss) from non-recurring transactions; (ii) net income (loss) from revaluations of assets and liabilities; and (iii) net income (loss) from exchange rate changes. In the survey manual, no exhaustive list of items is provided for the respondents, and fines and penalties are not among the given examples. However, for reference year 2020, the same three fields were introduced in the assets survey and fines were explicitly mentioned as a non-recurring item to be informed in the respective field.

[1] Prepared by the Central Bank of Brazil.

Annex VI. List of Proposed Updates

*Changes marked in **bold***

BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

12.13 Capital transfers are transfers in which the ownership of an asset (other than cash or inventories) changes from one party to another; or that oblige one or both parties to acquire or dispose of an asset (other than cash or inventories); or where a liability is forgiven by the creditor. Cash transfers involving disposals of noncash assets (other than inventories) or acquisition of noncash assets (other than inventories) are also capital transfers. A capital transfer results in a commensurate change in the stocks of assets of one or both parties to the transaction without affecting the saving of either party. Capital transfers are typically large and infrequent, but capital transfers cannot be defined in terms of size or frequency. A transfer in kind without a charge is a capital transfer when it consists of (a) the transfer of ownership of a nonfinancial asset (other than inventories, i.e., fixed assets, valuables, or nonproduced assets) or (b) the forgiveness of a liability by a creditor when no corresponding value is received in return. However, capital equipment provided by a direct investor to its direct investment enterprise is not a capital transfer, but involves a transaction in direct investment equity. A transfer of cash is a capital transfer when it is linked to, or conditional on, the acquisition or disposal of a fixed asset by one or both parties to the transaction (e.g., an investment grant). **Major nonrecurrent payments in compensation for accumulated losses or extensive damages or serious injuries not covered by insurance policies are also capital transfers.**

12.18 Taxes and other compulsory transfers should be recorded when the activities, transactions, or other events occur that create the government's claim to the taxes or other payments. The time of recording of taxes is the time at which tax liability arises. Accordingly, the amount of taxes is determined by the amount due for payment as evidenced by tax assessments, declarations, or other instruments, such as sales invoices or customs declarations, that create liabilities in the form of obligations to pay on the part of taxpayers. Some compulsory transfers, such as fines, penalties, and property forfeitures, are determined at a specific time. These transfers are recorded **on an accrual basis** when **the general government unit has an unconditional legal** claim to the funds **or property**, which may be when a court **provides** judgment or a administrative ruling is published. **If such judgement or ruling is subject to further appeal, then the time of recording is when the appeal is resolved.** If data on taxes are on a cash basis, adjustments should be made for large differences to approximate the accrual basis of recording.

12.54 Fines and penalties imposed on institutional units by courts of law or other government bodies **(including international bodies) for violations of laws or administration rules, which are generally punitive in nature,** are treated as miscellaneous current transfers**.** (**However, fines and penalties imposed by courts of law or other government bodies that are actually intended to compensate for damages should be considered as payments for compensation of damages for the purposes of recording in the balance of payments, and recorded as either current or capital transfers as explained in paragraph 12.55 and 12.56.)** Early or late repayment penalties agreed as part of the original contract are not included in current transfers; they should be treated along with the associated good, or service, or income, as appropriate.

Payments of Compensation

12.55 Payments of compensation consist of current transfers paid by institutional units to other institutional units in compensation for injury to persons or damage to property caused by the former that are not settled as payments of nonlife insurance claims. Payments of compensation could be either compulsory payments awarded by courts of law or settlements agreed out of court. Compensation may cover nonfulfillment of contracts, injuries to persons, damages to property, or other losses that are not covered by insurance policies. This heading covers compensation for injuries or damage caused by other institutional units. It also includes ex gratia payments made by government units or NPISHs in compensation for injuries or damages caused by natural disasters.

12.56 Major compensation payments related to extensive damages (e.g., oil spillages, side effects of pharmaceutical products**, or anti-competitive behavior**) are treated as capital rather than current transfers (see also paragraph 13.29). **Major compensation payments are intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial).**

13.29 Major nonrecurrent payments in compensation for extensive damages or serious injuries not covered by insurance policies are included in capital transfers. **Major compensation payments are intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial).** The payments may be awarded by courts of law or by arbitration, or settled out of court. They include payments of compensation for damages caused by major explosions, oil spillages, the side effects of pharmaceutical products, and so forth. However, if an amount payable under a court order or settlement is identifiable to a specific unpaid debt, it should be recorded under the relevant financial account item. See also paragraphs 12.55–12.56 for payments of compensation included in current transfers.

SYSTEM OF NATIONAL ACCOUNTS

8.135 Fines and penalties are compulsory payments imposed on institutional units by courts of law or quasi-judicial bodies**, which are punitive in nature**. However, fines or other penalties imposed by tax authorities for the evasion or late payment of taxes cannot usually be distinguished from the taxes themselves and are, therefore, grouped with the latter in practice and not recorded under this heading; nor are payments of fees to obtain licenses, such payments being either taxes or payments for services rendered by government units (see paragraph 8.54). **Fines and penalties imposed by courts of law or other government bodies that are actually intended to compensate for damages should be considered as payments for compensation of damages for the purposes of recording in the national accounts, and recorded as either current or capital transfers as explained in paragraphs 8.140 and 10.212(a).**

8.140 Payments of compensation consist of current transfers paid by institutional units to other institutional units in compensation for injury to persons or damage to property caused by the former that are not settled as payments of nonlife insurance claims. Payments of compensation could be either compulsory payments awarded by courts of law, or ex gratia payments agreed out of court. This heading covers compensation for injuries or damages caused by other institutional units and ex gratia payments made by government units or NPISHs in compensation for injuries or damages caused by natural disasters. **Major compensation payments related to extensive damages (e.g., oil spillages or side**

effects of pharmaceutical products) are treated as capital rather than current transfers (see also paragraph 10.212(a)). Major compensation payments are intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial).

10.212 Capital transfers may take various other forms, of which some examples are given below:

(a) Major payments in compensation for extensive damages or serious injuries not covered by insurance policies. **Major compensation payments are intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial).** The payments may be awarded by courts of law or settled out of court. They may be made to resident or nonresident units. They include payments of compensation for damages caused by major explosions, oil spillages, the side effects of drugs, etc.;

GOVERNMENT FINANCE STATISTICS MANUAL

3.16 Capital transfers are transfers in which the ownership of an asset (other than cash or inventories) changes from one party to another, or that oblige one or both parties to acquire or dispose of an asset (other than cash or inventories), or where a liability is forgiven by a creditor. Cash transfers involving disposals of noncash assets (other than inventories) or acquisition of noncash assets (other than inventories) are also capital transfers. A capital transfer results in a commensurate change in the stock position of assets of one or both parties to the transaction. Capital transfers are typically large and infrequent, but capital transfers cannot be defined in terms of size and frequency. A transfer in kind without a charge is a capital transfer when it consists of: the transfer of ownership of a nonfinancial asset (other than inventories); and the forgiveness of a liability by a creditor when no corresponding value is received in return. Major nonrecurrent payments in compensation for **losses incurred over a multi-year period** or extensive damages or serious injuries not covered by insurance policies are also capital transfers. A transfer of cash is a capital transfer, when it is linked to, or conditional on, the acquisition or disposal of an asset by one or both parties to the transaction.

5.142 Fines and penalties are compulsory current transfers imposed on units by courts of law or quasi-judicial bodies for violations of laws or administrative rules**, which are punitive in nature**. Out-of-court agreements are also included. Forfeits are amounts that were deposited with a general government unit pending a legal or administrative proceeding and that have been transferred to the general government unit as part of the resolution of that proceeding. **Fines and penalties imposed by courts of law or other government bodies that are actually intended to compensate for damages should be considered as payments for compensation of damages for the purposes of recording in the accounts, and recorded as either current or capital transfers as explained in paragraphs 6.123–6.124.**

6.124 The most important types of capital transfers included here are:

• [second bullet] Major, nonrecurrent, exceptional payments in compensation for extensive damages or serious injuries such as those arising from catastrophes not covered by insurance policies are included as a capital transfer. **Major compensation payments are intended to recover losses incurred over a multi-year period or to replace an asset (financial or nonfinancial).**