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Updated System of National Accounts (SNA):

Chapter 7: The distribution of income accounts

Chapter 7: The Distribution of Income Accounts........................3

Chapter 7: The Distribution of Income Accounts

A. Introduction

7.1 There are four accounts that record how income arising from involvement in processes of production or from ownership of assets needed for production are distributed among institutional units:

a. The generation of income account;

b. The allocation of primary income account;

c. The entrepreneurial income account; and

d. The allocation of other primary income account.

7.2 Basic to all these accounts is the concept of primary income. ***Primary incomes are incomes that accrue to institutional units as a consequence of their involvement in processes of production or ownership of assets that may be needed for purposes of production.*** Primary incomes are payable out of the value added created by production. A major item of primary income is compensation of employees that represents the income accruing to individuals in return for their labour input into production processes. Property income is that part of primary incomes that accrues by lending or renting financial or natural resources, including land, to other units for use in production. Receipts from taxes on production and imports (less subsidies on production and imports) are treated as primary incomes of governments even though not all of them may be recorded as payable out of the value added of enterprises. Primary incomes do not include the payments of social contributions to social insurance schemes and the receipt of benefits from them, current taxes on income, wealth, etc. and other current transfers, such current transfers being recorded in the secondary distribution of income account.

1. The generation of income account

7.3 The generation of income account represents a further extension or elaboration of the production account in which the primary incomes accruing to government units and to the units participating directly in production are recorded. Like the production account, it may be compiled for establishments and industries as well as for institutional units and sectors. The generation of income account shows the sectors, sub-sectors or industries in which the primary incomes originate, as distinct from the sectors or sub-sectors destined to receive such incomes. For example, the only compensation of employees recorded in the generation of income account for the household sector consists of the compensation of employees payable by unincorporated enterprises owned by households. This item is very different from the compensation of employees receivable by the household sector, which is recorded in the account below, the allocation of primary income account.

7.4 The resources, listed on the right-hand side of the generation of income account, consist of only a single item, value added, the balancing item carried forward from the production account. As stated in chapter 6, value added may be measured before the deduction of consumption of fixed capital (gross) or after the deduction of consumption of fixed capital (net). Provision must also be made throughout the remaining accounts of the System for the relevant balancing items to be measured gross or net of consumption of fixed capital. The concept and measurement of consumption of fixed capital have already been explained in detail in chapter 6. For simplicity, it will be assumed that value added is measured net, except when the context requires gross value added to be referred to explicitly.

7.5 The left-hand side of the generation of income account records the uses of value added. There are only two main types of charges that producers have to meet out of value added: compensation of employees payable to workers employed in the production process and any taxes, less subsidies, on production payable or receivable as a result of engaging in production. ***Compensation of employees is defined as the total remuneration, in cash or in kind, payable by an enterprise to an employee in return for work done by the latter during the accounting period. Taxes less subsidies on production consist of taxes payable or subsidies receivable on goods or services produced as outputs and other taxes or subsidies on production, such as those payable on the labour, machinery, buildings or other assets used in production.*** Taxes on production do not include any income taxes payable by the recipients of incomes accruing from production, whether employers or employees. Both compensation of employees and taxes on production may be payable by resident producers to non-residents or receivable by residents from non-resident producers.

7.6 The content of the item taxes less subsidies on production payable out of value added varies according to the way in which output is valued. Value added tax (VAT), or other similar deductible tax, invoiced on output is never treated as part of the price receivable by the producer from the purchaser. Invoiced VAT is always omitted from value of output, whether output is valued at producers' or basic prices. Hence, invoiced VAT is not a charge against value added and is not recorded as a payable in the producer's generation of income account. However, when output is valued at producers' prices, any other tax on product payable on the output is treated as an integral part of the price receivable by the producer from the purchaser. The tax is recorded as being payable by the producer out of value added at producers' prices in the generation of income account, that is, as a component of the item "taxes less subsidies on production". Similarly, any subsidy on product receivable on the output is recorded as being receivable by the producer from government in the generation of income account as a supplement to value added at producers' prices. By convention, it is not recorded under resources but as a component of "taxes less subsidies on production" as if it were a negative tax on output.

7.7 As explained in chapter 6, the basic price is obtained from the producer's price by deducting any tax on product payable on a unit of output (other than invoiced VAT already omitted from the producer's price) and adding any subsidy on product receivable on a unit of output. In consequence, no taxes on products or subsidies on products are to be recorded as payables or receivables in the producer's generation of income account when value added is measured at basic prices, the preferred valuation basis in the System. When basic prices are used to value output, the item "taxes less subsidies on production" refers only to other taxes or subsidies on production.

7.8 After deducting compensation of employees and taxes, less subsidies, on production from value added, the balancing item of the generation of income account is obtained. The balancing item is shown on the left-hand side of the account under uses. It measures the surplus or deficit accruing from production before taking account of any interest, rent or similar charges payable on financial assets or natural resources borrowed or rented by the enterprise, or any interest, rent or similar receipts receivable on financial assets or natural resources owned by the enterprise.

The balancing item and GDP

7.9 The balancing item is described as operating surplus except for unincorporated enterprises owned by households in which the owner(s) or members of the same household may contribute unpaid labour inputs of a similar kind to those that could be provided by paid employees. In the latter case, the balancing item is described as mixed income because it implicitly contains an element of remuneration for work done by the owner, or other members of the household, that cannot be separately identified from the return to the owner as entrepreneur. In many cases, though, the element of remuneration may dominate the value of mixed income. In practice, all unincorporated enterprises owned by households that are not quasi-corporations are deemed to have mixed income as their balancing item, except owner-occupiers in their capacity as producers of housing services for own final consumption and households employing paid domestic staff. For owner-occupiers, all value added is operating surplus and for domestic staff all value added is compensation of employees.

7.10 As noted in chapter 6, gross domestic product (GDP) at market prices is equal to the sum of the gross value added of all resident enterprises plus those taxes, less subsidies, on products that are not payable on the values of the outputs of those enterprises, that is, taxes or subsidies on imports plus non-deductible VAT when output is valued at producers' prices, and all taxes or subsidies on products when output is valued at basic prices. For this reason, taxes and subsidies on imports and VAT must also be recorded under uses of GDP in the generation of income account for the total economy, even though they do not appear in the generation of income account for individual institutional units or sectors.

7.11 As already noted, the preferred measure of value added is after deducting consumption of fixed capital, that is, net value added. However, provision is made in the accounts of the System for value added, and all subsequent balancing items that depend on value added, to be measured gross or net of consumption of fixed capital. Operating surplus and mixed income may therefore both be expressed as gross or net.

Table 7.1: The generation of income account - uses (concise version)

Uses

Code	Transactions and balancing items	S11 Non-financial corporations	S12 Financial corporations	S13 General government	S14 Households	S15 NPISHs	S1 Total economy	S2 Rest of the world	Goods and services	Total
B1g										
B1n										
D1	Compensation of employees	549	15	142	39	24	769			769
D2	Taxes on production and imports						235			235
D3	Subsidies						- 44			- 44
B2g	Operating surplus, gross	254	55	44	92	7	452			452
B3g	Mixed income, gross				442		442			442
P61	Consumption of fixed capital on gross operating surplus	137	10	30	32	3	212			
P62	Consumption of fixed capital on gross mixed income				10		10			
B2n	*Operating surplus, net*	117	45	14	60	4	240			240
B3n	*Mixed income, net*				432		432			432

7.12 Operating surplus/mixed income is a measure of the surplus accruing from processes of production before deducting any explicit or implicit interest charges, rents or other property incomes payable on the financial assets, land or other natural resources required to carry on the production. It is, therefore, invariant as to whether:

a. The land or other natural resources used in production are owned or rented by the enterprise; and

b. The inventories, fixed assets, land or other natural resources owned by the enterprise and used in production are financed out of own funds (or equity capital) or out of borrowed funds (or loan capital).

7.13 Although operating surplus/mixed income is invariant to the extent to which land is owned or assets in general are financed, it needs to be sufficient to cover both any explicit, or implicit, rents on land and the explicit, or implicit, interest charges on the value of all the assets owned by the enterprise in order to justify their continued use in production. The implicit interest costs of using the enterprise's own funds to purchase inventories, fixed assets or other assets are the opportunity costs of using the funds in this way rather than to acquire financial assets on which interest could be earned. These costs are captured in estimates of capital services. The amounts of rents and interest actually payable on rented land and borrowed funds are recorded in the allocation of primary income account and the entrepreneurial income account.

7.14 The operating surplus/mixed income of an individual producer unit is not invariant, however, to the extent to which the fixed assets used in production are owned or rented. When buildings, other structures, machinery or equipment are rented by an enterprise, the payments of rentals under an operating lease are recorded as purchases of services. These services form part of intermediate consumption. Thus, as explained in chapter 17, the payment of the rental on a fixed asset tends to reduce gross value added below what it would be if the producer owned the asset. The impact on net value added is mitigated by the fact that a tenant, or lessee, incurs no consumption of fixed capital. However, even net value added will tend to be lower when a fixed asset is rented as the rental has to cover the lessor's operating and interest costs. At the level of the total economy, the lower surpluses accruing to tenants or lessees will tend to be counterbalanced by the operating surpluses earned by the lessors.

2. The allocation of primary income account

7.15 Whereas the generation of income account focuses on resident institutional units or sectors in their capacity as producers whose activities generate primary incomes, the allocation of primary income account focuses on resident institutional units or sectors in their capacity as recipients of primary incomes. The allocation of income account shows where the items payable in the generation of income account are receivable and also includes the amounts of property incomes receivable and payable by institutional units or sectors. As already noted, the generation of income account, being related to production activities, can be compiled for establishments and industries as well as for institutional units and sectors. However, the allocation of primary income account has no such direct link with production and can only be compiled for institutional units and sectors.

7.16 Enterprises may invest surplus funds in financial assets or even land, especially in times of uncertainty and high interest rates. Considerable property income may be received from such investments. The property income paid out by a corporation will be influenced by the amount of property income received as well as by its operating surplus. Thus, it is not appropriate to record all the property income paid out by an enterprise as if it were chargeable against operating surplus. Some interest costs, especially implicit costs, may be attributable to assets other than those used in production. For this reason, the explicit and implicit interest costs payable by an enterprise ought not to be recorded in the generation of income account in which the resources consist only of value added accruing from production. They are recorded in the allocation of income account along with any property income receivable as well as the operating surplus.

Table 7.1: The generation of income account - resources (concise version)

										Resources
		S11	S12	S13	S14	S15	S1	S2		
Code	**Transactions and balancing items**	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
B1g	Value added, gross / Gross domestic product	854	73	188	575	31	1 854			1 854
B1n	*Value added, net / Net domestic product*	717	63	158	533	28	1 632			1 632
D1	Compensation of employees									
D2	Taxes on production and imports									
D3	Subsidies									
B2g										
B3g										
P61										
P62										
B2n										
B3n										

7.17 There are two kinds of income listed under resources on the right-hand side of the allocation of primary income account. The first shows where primary incomes already recorded in the generation of income account are receivable, as follows:

a. Compensation of employees receivable by households or non-resident households;

b. Taxes (less subsidies) on production or imports receivable (or payable) by government units or a foreign government;

c. Operating surplus, or mixed income, of enterprises carried forward from the generation of income account.

The second kind of income consists of property incomes receivable from the ownership of financial assets or natural resources:

d. Investment income receivable by the owners of financial assets from either resident or non-resident units;

e. Rents receivable by owners of natural resources leased to other units.

The balancing items and national income

7.18 The uses, listed on the left-hand side of the allocation of primary income account, consist only of the property incomes payable by institutional units or sectors to creditors, shareholders, landowners, etc. Except for rents on natural resources, these may be payable to non-residents as well as residents. The remaining item recorded under uses is the balancing item, ***the balance of primary incomes, defined as the total value of the primary incomes receivable by an institutional unit or sector less the total of the primary incomes payable.*** At the level of the total economy it is described as national income.

7.19 The composition of the balance of primary incomes varies considerably from one sector to another as certain types of primary incomes are receivable by certain sectors only or by non-residents. In particular, taxes are received only by the general government sector and non-residents while compensation of employees is received only by the household sector and non-residents. These balances are described below.

a. The balance of primary incomes of the non-financial and financial corporate sectors consists only of operating surplus plus property income receivable less property income payable

b. The balance of primary incomes of the general government sector consists of taxes, less subsidies, receivable or payable on production and on imports, plus property income receivable less property income payable. It may also include a small amount of operating surplus from unincorporated enterprises undertaking market production.

c. The balance of primary incomes of the household sector consists of compensation of employees and mixed incomes accruing to households, plus property income receivable less property income payable. It also includes the operating surplus from housing services produced for own consumption by owner-occupiers.

d. The balance of primary incomes of the non-profit institutions serving household (NPISHs) sector consists almost entirely of property income receivable less property income payable.

Table 7.2: The distribution of primary income account – uses (concise version)

	Uses									
		S11	S12	S13	S14	S15	S1	S2		
Code	**Transactions and balancing items**	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
D1	Compensation of employees							6		6
D2	Taxes on production and imports									0
D3	Subsidies									0
D4	Property income	135	189	42	41	6	413	63		476
B5g	Balance of primary incomes, gross / National income, gross	208	15	226	1 426	8	1 883			1 883
B5n	Balance of primary income, net / National income, net	71	5	196	1 384	5	1 661			1 661

Net national income and gross national income (B5n, B5g)

7.20 ***Net national income (NNI) is the aggregate value of the net balances of primary incomes summed over all sectors***. Similarly***, gross national income (GNI) is the aggregate value of the gross balances of primary incomes for all sectors.***

7.21 Gross value added is strictly a production measure defined only in terms of output and intermediate consumption. It follows that GDP is also a production measure as it is obtained by summing the gross value added of all resident institutional units, in their capacities as producers, and adding the values of any taxes, less subsidies, on production or imports not already included in the values of the outputs, and value added, of resident producers. GNI is obtained by summing the balance of primary incomes of the same resident institutional units. It follows that the difference between the numerical values of GNI and GDP is equal to the difference between the total primary incomes receivable by residents from non-residents and the total primary incomes payable by residents to non-residents (that is, net income from abroad). However, as both GDP and GNI are obtained by summing over the same set of resident institutional units, there is no justification for labelling one as "domestic" and the other as "national". Both aggregates refer to the total economy defined as the complete set of resident institutional units or sectors. The difference between them is not one of coverage but the fact that one measures production while the other measures income. Both have an equal claim to be described as domestic or as national. However, as the terms " gross *domestic* product" and "gross *national* income" are deeply embedded in economic usage, it is not proposed to change them. Emphasis should be given, however, to the third rather than second letter of the acronym to emphasize the fact that GDP refers to production (output) and GNI to income.

3. The entrepreneurial income account

7.22 The allocation of primary income account may be partitioned into two sub-accounts: the entrepreneurial income account and the allocation of other primary income account. The purpose is to identify an additional balancing item, entrepreneurial income, that may be useful for market producers. Like operating surplus and mixed income, it is a balancing item that is relevant only to producers, but one that can be calculated only for institutional units and sectors and not for establishments and industries.

7.23 Entrepreneurial income is calculated by deducting from operating surplus any interest and rents payable and adding property incomes receivable. For the non-financial and financial corporations sectors, the only difference between entrepreneurial income and the balance of primary incomes is that entrepreneurial income is measured before the payment of dividends the withdrawals of income from quasi-corporations and investment income disbursements.. Entrepreneurial income is not calculated for other sectors. Although government and households may contain unincorporated enterprises undertaking market production, the fact that the assets attributed to this activity cannot be distinguished from the entirety of assets of the institution means that identification of property income relating to the activity is also difficult . (If the assets and property income could be identified, it is probable that the unincorporated enterprise could be treated as a quasi-corporation and included in one of the corporate sectors.)

7.24 Entrepreneurial income is an income concept that is close to the concept of profit and loss as understood in business accounting (at least when there is no inflation). On the other hand, it should be remembered that when profits are calculated at historic costs in business accounts, they also include nominal holding gains on the inventories and other assets owned by the enterprise that may be quite substantial during inflationary conditions.

Table 7.2: The distribution of primary income account – resources (concise version)

										Resources
		S11	S12	S13	S14	S15	S1	S2		
Code	Transactions and balancing items	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
	Operating surplus, gross	254	55	44	92	7	452			459
	Mixed income, gross				442		442			442
	Operating surplus, net	117	45	14	60	4	240			247
	Mixed income, net				432		432			432
D1	Compensation of employees				773		773	2		775
D2	Taxes on production and imports			235			235			235
D3	Subsidies			- 44			- 44			- 44
D4	Property income	89	149	33	160	7	438	38		476
B5g										0
B5n										0

4. The allocation of other primary income account

7.25 When the entrepreneurial income account is compiled for an institutional unit or sector, it is followed by the allocation of other primary income account in order to arrive at the balance of primary incomes. In the allocation of other primary income account, the first item listed under resources is entrepreneurial income, the balancing item carried forward from the entrepreneurial income account instead of operating surplus or mixed income, which are the balancing items carried forward from the generation of income account. The remaining primary incomes listed under resources in the allocation of other primary income account consist of the following items:

a. Compensation of employees receivable by households;

b. Taxes, less subsidies, on production and imports receivable or payable by government units;

c. Property incomes receivable on assets owned except those receivable by enterprises and included in entrepreneurial income.

Under uses, the only items recorded are property incomes payable, except the interest or rents payable by enterprises. The balancing item of the allocation of other primary income account is identical with the balancing item of the allocation of primary income account.

B. Compensation of employees (D1)

1. Identifying employees

7.26 It is not always self-evident whether a person is an employee or self-employed: for example, some workers paid by results may be employees while others may be self-employed. The boundary also affects the sub-sectoring of the household sector. The definitions in the SNA are broadly consistent with those in the *Resolution*

Table 7.3: The entrepreneurial account and allocation of other primary income accounts - uses

Entrepreneurial account
Uses

Code	Transactions and balancing items	S11 Non-financial corporations	S12 Financial corporations	S13 General government	S14 Households	S15 NPISHs	S1 Total economy	S2 Rest of the world	Goods and services	Total
D4	Property income	87	106				193			193
D41	Interest	56	106				162			162
D43	Reinvested earnings on direct foreign investment									
D45	Rent	31	0				31			31
	Entrepreneurial income, gross	256	98				354			354
	Entrepreneurial income, net	119	88				207			207

Allocation of other primary income account
Uses

Code	Transactions and balancing items	S11 Non-financial corporations	S12 Financial corporations	S13 General government	S14 Households	S15 NPISHs	S1 Total economy	S2 Rest of the world	Goods and services	Total
D1	Compensation of employees							6		6
D2	Taxes on production and imports									
D3	Subsidies									
D4	Property income	48	83	42	41	6	220	63		283
D41	Interest			35	14	6	55	13		68
D43	Reinvested earnings on direct foreign investment	0	0				0	14		14
D45	Rent			7	27	0	34			34
B5g	Balance of primary incomes, gross / National income, gross	208	15	226	1 426	8	1 883			1 883
B5n	Balance of primary income, net / National income, net	71	5	196	1 384	5	1 661			1 661

concerning the International Classification of Status in Employment (ICSE) adopted by the fifteenth International Conference of Labour Statisticians (ICLS) in January 1993 and with other resolutions of the ICLS concerning the definitions of the economically active population. For the System, though, the main objective is to clarify the nature of the employment relationship in order to fix the boundary between compensation of employees and other kinds of receipts. Some persons who in labour statistics may be included with the self-employed, in particular some owners of quasi-corporations and owner-managers of corporations, are treated in the System as employees.

The employment relationship

7.27 In order to be classified as employed, that is, either as an employee or self-employed, the person must be engaged in an activity that falls within the production boundary of the System. Non-employed persons consist of the unemployed and persons not in the labour force. The relationship of employer to employee exists when there is a written or oral agreement, which may be formal or informal, between an enterprise and a person, normally entered into voluntarily by both parties, whereby the person works for the enterprise in return for remuneration in cash or in kind. The remuneration is normally based on either the time spent at work or some other objective indicator of the amount of work done.

7.28 The self-employed are persons who work for themselves, when the enterprises they own are neither distinguished as separate legal entities nor separate institutional units in the System. They may be persons who are the sole owners, or joint owners, of the unincorporated enterprises in which they work; a member of a producers' cooperative or a contributing family worker (that is, a family member who works in an unincorporated enterprise without pay).

a. Workers engaged in production undertaken entirely for their own final consumption or own capital formation, either individually or collectively, are self-employed. Although a value may be imputed for the output of own-account production based on costs, including estimated labour costs, no imputation is made for the wages of workers engaged in such production, even in the case of collective, or communal, projects undertaken by groups of persons working together. The surplus of the imputed value of the output over any monetary costs or taxes on production explicitly incurred is treated as gross mixed income;

Table 7.3: The entrepreneurial and allocation of other primary income accounts – resources

Entrepreneurial account

										Resources
		S11	S12	S13	S14	S15	S1	S2		
Code	**Transactions and balancing items**	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
	Operating surplus, gross	254	55	44	92	7	452			452
	Mixed income, gross				442		0			0
	Operating surplus, net	117	45	14	60	4	240			240
	Mixed income, net				432		0			0
D4	Property income	89	149				238			238
D41	Interest	33	106				139			139
D43	Reinvested earnings on direct foreign investment	4	7				11			11
D45	Rent	41	3				44			44

Allocation of other primary income account

										Resources
		S11	S12	S13	S14	S15	S1	S2		
Code	**Transactions and balancing items**	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
	Entrepreneurial income, gross	256	98				354			354
	Entrepreneurial income, net	119	88				207			207
D1	Compensation of employees				773		773	2		775
D2	Taxes on production and imports			235			235			235
D3	Subsidies			- 44			- 44			- 44
D4	Property income			33	160	7	200	38		238
D41	Interest			14	49	7	70	21		91
D43	Reinvested earnings on direct foreign investment			0	3	0	3	0		3
D45	Rent			0	21	0	21			21
B5g										
B5n										

b. Contributing family workers, including those working without pay in unincorporated enterprises engaged wholly or partly in market production, are also treated as self-employed;

c. The whole of the equity of a corporation may be owned by a single shareholder or small group of shareholders. When those shareholders also work for the corporation and receive paid remuneration other than dividends, the shareholders are treated as employees. The owners of quasi-corporations who work in those quasi-corporations and receive paid remuneration other than withdrawal of earnings from the quasi-corporation are also treated as employees;

d. Outworkers may be either employees or self-employed depending on their exact status and circumstances. The treatment of outworkers is specified in more detail below.

7.29 Students in their capacity as consumers of educational or training services are not employees. However, if students also have a formal commitment whereby they contribute some of their own labour as an input into an enterprise's process of production, for example, as apprentices or similar kinds of worker trainees, articled clerks, student nurses, research or teaching assistants, hospital interns, etc., they are treated as employees, whether or not they receive any remuneration in cash for the work that they do in addition to training received as in-kind payment.

Employers and own-account workers

7.30 Self-employed persons may be divided into two groups: those who do and those who do not engage paid employees on a continuous basis. Those who do engage employees on a continuous basis are described as employers and those without paid employees are described as own-account workers. The distinction is used for purposes of sub-sectoring the household sector. Own-account workers may be further subdivided into outworkers who are under some kind of formal or informal contract to supply goods or services to a particular enterprise, and ordinary own-account workers who may be engaged in either market production or production for own final consumption or own capital formation.

Outworkers

7.31 An outworker is a person who agrees to work for a particular enterprise or to supply a certain quantity of goods or services to a particular enterprise, by prior arrangement or contract with that enterprise, but whose place of work is not within any of the establishments that make up that enterprise. The enterprise does not control the time spent at work by an outworker and does not assume responsibility for the conditions in which that work is carried out, although it may carry out checks on the quality of work. Most outworkers work at home but may use other premises of their own choice. Some outworkers are provided by an enterprise with the equipment or materials, or both, on which they work, but other outworkers may purchase their own equipment or materials, or both. In any case, outworkers have to meet some production costs themselves: for example, the actual or imputed rent on the buildings in which they work; heating, lighting and power; storage or transportation; etc.

Table 7.4: Generation of income account – uses – compensation of employees

									Resources	
		S11	S12	S13	S14	S15	S1	S2		
Code	Transactions and balancing items	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
	Operating surplus, gross	254	55	44	92	7	452			459
	Mixed income, gross				442		442			442
	Operating surplus, net	117	45	14	60	4	240			247
	Mixed income, net				432		432			432
D1	Compensation of employees				773		773	2		775
D11	Wages and salaries				573		573	2		575
D12	Employers' social contributions				200		200	0		200
D121	Employers' actual social contributions				181		181	0		181
D1211	Employers' actual pension contributions				168		168	0		168
D1212	Employers' actual non-pension contributions				13		13	0		13
D122	Employers' imputed social contributions				19		19	0		19
D1221	Employers' imputed pension contributions				18		18	0		18
D1222	Employers' imputed non-pension contributions				1		1	0		1
D2	Taxes on production and imports			235			235			235
D3	Subsidies			- 44			- 44			- 44
D4	Property income	89	149	33	160	7	438	38		476
B5g										0
B5n										0

7.32 Outworkers have some of the characteristics of employees and some of the characteristics of self-employed workers. The way in which they are to be classified is determined primarily by the basis on which they are remunerated. A distinction can be drawn between two cases that, in principle, are quite different from one another:

a. The person is remunerated directly, or indirectly, on the basis of the amount of work done, that is, by the amount of labour that is contributed as an input into some process of production, irrespective of the value of the output produced or the profitability of the production process. This kind of remuneration implies that the worker is an employee.

b. The income received by the person is a function of the value of the outputs from some process of production for which that person is responsible, however much or little work was put in. This kind of remuneration implies that the worker is self-employed.

7.33 In practice it may not always be easy to distinguish between employees and self-employed on the basis of these criteria. Outworkers who employ and pay others to work for them must be treated as the self-employed owners of unincorporated enterprises: that is, as employers. The issue, therefore, is to distinguish own-account workers from employees.

7.34 An outworker is considered an employee when an employment relationship exists between the enterprise and the outworker. This implies the existence of an implicit or explicit employment contract or agreement whereby it is agreed that the outworker is remunerated on the basis of the work done. Conversely, an outworker is considered to be an own-account worker when there is no such implicit or explicit employment contract or agreement and the income earned by the outworker depends on the value of the goods or services supplied to the enterprise. This suggests that decisions on markets, scale of operations and finance are likely to be in the hands of self-employed outworkers who are also likely to own, or rent, the machinery or equipment on which they work.

7.35 The status of an outworker has important implications for the accounts. When the outworker is an own-account worker, the payment from the enterprise to the outworker constitutes a purchase of intermediate goods or services. When the outworker is an employee, the payment constitutes compensation of employees and so is paid out of the value added of the enterprise. Thus, the outworker's status affects the distribution of value added between enterprises as well as the distribution of incomes between compensation of employees and net mixed income.

2. The components of compensation of employees

7.36 Compensation of employees is recorded under uses in the generation of income account and under resources in the allocation of primary income account. As noted above, compensation of employees is defined as the total remuneration, in cash or in kind, payable by an enterprise to an employee in return for work done by the latter during the accounting period.

Table 7.5: Distribution of primary income account – resources – compensation of employees

										Resources
		S11	S12	S13	S14	S15	S1	S2		
Code	Transactions and balancing items	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
	Operating surplus, gross	254	55	44	92	7	452			459
	Mixed income, gross				442		442			442
	Operating surplus, net	117	45	14	60	4	240			247
	Mixed income, net				432		432			432
D1	Compensation of employees				773		773	2		775
D11	Wages and salaries				573		573	2		575
D12	Employers' social contributions				200		200	0		200
D121	Employers' actual social contributions				181		181	0		181
D1211	Employers' actual pension contributions				168		168	0		168
D1212	Employers' actual non-pension contributions				13		13	0		13
D122	Employers' imputed social contributions				19		19	0		19
D1221	Employers' imputed pension contributions				18		18	0		18
D1222	Employers' imputed non-pension contributions				1		1	0		1
D2	Taxes on production and imports			235			235			235
D3	Subsidies			- 44			- 44			- 44
D4	Property income	89	149	33	160	7	438	38		476
B5g										0
B5n										0

7.37 Compensation of employees is recorded on an accrual basis; that is, it is measured by the value of the remuneration in cash or in kind that an employee becomes entitled to receive from an employer in respect of work done during the relevant period, whether paid in advance, simultaneously or in arrears of the work itself. No compensation of employees is payable in respect of unpaid work undertaken voluntarily, including the work done by members of a household within an unincorporated enterprise owned by the same household. Compensation of employees does not include any taxes payable by the employer on the wage and salary bill, for example, a payroll tax; such taxes are treated as taxes on production in the same way as taxes on buildings, land or other assets used in production.

7.38 Compensation of employees has two main components:

a. Wages and salaries payable in cash or in kind;

b. Social insurance contributions payable by employers, which include contributions to social security schemes; actual social contributions to other employment-related social insurance schemes and imputed social contributions to other employment-related social insurance schemes.

Social insurance schemes and the nature of benefits they provide are discussed in section D of chapter 8.

Wages and salaries (D11)

7.39 Wages and salaries include the values of any social contributions, income taxes, etc., payable by the employee even if they are actually withheld by the employer for administrative convenience or other reasons and paid directly to social insurance schemes, tax authorities, etc., on behalf of the employee. Wages and salaries may be paid in various ways, including goods or services provided to employees as remuneration in kind instead of, or in addition to, remuneration in cash.

Wages and salaries in cash

7.40 Wages and salaries in cash include the following kinds of remuneration:

a. Wages or salaries payable at regular weekly, monthly or other intervals, including payments by results and piecework payments; enhanced payments or special allowances for working overtime, at nights, at weekends or other unsocial hours; allowances for working away from home or in disagreeable or hazardous circumstances; expatriation allowances for working abroad; etc.;

b. Supplementary allowances payable regularly, such as housing allowances or allowances to cover the costs of travel to and from work, but excluding social benefits (see below);

c. Wages or salaries payable to employees away from work for short periods, for example, on holiday or as a result of a temporary halt to production, except during absences due to sickness, injury, etc. (see below);

d. Ad hoc bonuses or other exceptional payments linked to the overall performance of the enterprise made under incentive schemes;

e. Commissions, gratuities and tips received by employees: these should be treated as payments for services rendered by the enterprise employing the worker, and so should also be included in the output and gross value added of the employing enterprise when they are paid directly to the employee by a third party.

7.41 Wages and salaries in cash do not include the reimbursement by employers of expenditures made by employees in order to enable them to take up their jobs or to carry out their work. For example:

a. The reimbursement of travel, removal or related expenses made by employees when they take up new jobs or are required by their employers to move their homes to different parts of the country or to another country;

b. The reimbursement of expenditures by employees on tools, equipment, special clothing or other items that are needed exclusively, or primarily, to enable them to carry out their work.

The amounts reimbursed are treated as intermediate consumption by employers. To the extent that employees who are required by their contract of employment to purchase tools, equipment, special clothing, etc., are not fully reimbursed, the remaining expenses they incur should be deducted from the amounts they receive in wages and salaries and the employers' intermediate consumption increased accordingly. Expenditures on items needed exclusively, or primarily, for work do not form part of household final consumption expenditures, whether reimbursed or not.

7.42 Wages and salaries in cash also do not include social insurance benefits paid by employers in the form of:

a. Children's, spouse's, family, education or other allowances in respect of dependants;

b. Payments made at full, or reduced, wage or salary rates to workers absent from work because of illness, accidental injury, maternity leave, etc.;

c. Severance payments to workers or their survivors who lose their jobs because of redundancy, incapacity, accidental death, etc.

In practice, it may be difficult to separate payments of wages or salaries during short periods of absence due to sickness, accidents, etc., from other payments of wages and salaries, in which case they have to be grouped with the latter.

7.43 In some instances a benefit such as a car or extra pension contributions may not be provided free but be "purchased" from the employer by foregoing some salary. The attraction of such schemes lies in the tax advantages of doing so. A car bought by the employer and sold to the employee may be taxed at a lower rate than a car purchased by an individual; pension contributions may be taxed differently from other income if deducted at source. In these cases, the full salary should be recorded as payable in cash with the cost to the employee shown as consumption expenditure or pension contribution etc. as appropriate

Wages and salaries in kind

7.44 Employers may remunerate their employees in kind for various reasons. For example:

a. There may be tax advantages for the employer, the employee, or both by avoiding payments in cash;

b. The employer may wish to dispose of outputs that are periodically in excess supply;

c. The nature of the work may require frequent, or prolonged, absence from home so that the employee has to be provided with accommodation, travel, etc.

7.45 Income in kind may bring less satisfaction than income in cash because employees are not free to choose how to spend it. Some of the goods or services provided to employees may be of a type or quality that the employee would not normally buy. Nevertheless, they must be valued consistently with other goods and services. When the goods or services have been purchased by the employer, they should be valued at purchasers' prices. When produced by the employer, they should be valued at producers' prices. When provided free, the value of the wages and salaries in kind is given by the full value of the goods and services in question. When provided at reduced prices, the value of the wages and salaries in kind is given by the difference between the full value of the goods and services and the amount paid by the employees.

7.46 Goods or services that employers are obliged to provide to their employees in order for them to be able to carry out their work are treated as intermediate consumption by the employer: for example, special protective clothing. A list of such items is given in paragraph 6.216. Remuneration in kind, on the other hand, consists of goods and services that are not necessary for work and can be used by employees in their own time, and at their own discretion, for the satisfaction of their own needs or wants or those of other members of their households.

7.47 Almost any kind of consumption good or service may be provided as remuneration in kind. The following includes some of the most common types of goods and services provided without charge, or at reduced prices, by employers to their employees:

a. Meals and drinks provided on a regular basis including any subsidy element of an office canteen (for practical reasons, it is unnecessary to make estimates for meals and drinks consumed as part of official entertainment or during business travel);

b. Housing services or accommodation of a type that can be used by all members of the household to which the employee belongs;

c. The services of vehicles or other durables provided for the personal use of employees;

d. Goods and services produced as outputs from the employer's own processes of production, such as free travel for the employees of railways or airlines, or free coal for miners;

e. Sports, recreation or holiday facilities for employees and their families;

f. Transportation to and from work, car parking;

g. Child-care for the children of employees.

7.48 Some of the services provided by employers, such as transportation to and from work, car parking and child-care have some of the characteristics of intermediate consumption. However, employers are obliged to provide these facilities to attract and retain labour, and not because of the nature of the production process or the physical conditions under which employees have to work. On balance, they are more like other forms of compensation of employees than intermediate consumption. Many workers have to pay for transportation to and from work, car parking and child-care out of their own incomes, the relevant expenditures being recorded as final consumption expenditures.

7.49 A frequent item provided as income in kind is a car. The car may be provided free to the employee but for tax purposes an imputed cash amount is attached to the benefit. In a country where many cars are provided as a fringe benefit to employees, the purchasing power of the employer may be such as to obtain a significant discount on the purchase price of the car. Thus the employee receives a higher quality car than the cash equivalent would buy for an individual. The value of the car to the employee should be estimated at the actual cost to the employer.

7.50 Remuneration in kind may also include the value of the interest foregone by employers when they provide loans to employees at reduced, or even zero rates of interest for purposes of buying houses, furniture or other goods or services. Its value may be estimated as the amount the employee would have to pay if average mortgage, or consumer loan, interest rates were charged less the amount of interest actually paid. The sums involved could be large when nominal interest rates are very high because of inflation but otherwise they may be too small and too uncertain to be worth estimating.

Stock options

7.51 Another form of income in kind results from the practice of an employer giving an employee the option to buy stocks (shares) at some future date. The details of valuing and recording of stock options are described in part 6 of Chapter 17.

Employers' social contributions (D12)

7.52 ***Employers' social contributions are social contributions payable by employers to social security funds or other employment-related social insurance schemes to secure social benefits for their employees.*** Social security funds are operated by general government; other employer-related social insurance schemes may be operated by the employers themselves, by an insurance corporation or be an autonomous pension scheme.

7.53 As employers' social contributions are made for the benefit of their employees, their value is recorded as one of the components of compensation of employees together with wages and salaries in cash and in kind. The social contributions are then recorded as being paid by the employees as current transfers to the social security funds or other employment-related social insurance schemes. Although it is administratively more efficient for employers to pay the contributions on behalf of their employees, this must not be allowed to obscure the underlying economic reality. The payment made by the employer to the social security fund or other employment-related social insurance schemes is not, in fact, a current transfer to the fund on the part of the employer. The transfer takes place between the employee and the social security fund or other employment-related social insurance schemes out of remuneration provided by the employer. The situation is parallel to one in which income taxes payable by employees are deducted by employers from the wages or salaries and paid directly to the tax authorities. In this case, it is evident that the taxes are not current transfers payable by the employers. It is customary to describe the employers' social contributions as being re-routed in the accounts via the employees' primary and secondary distribution of income accounts. However, the accounts depict the various payables and receivables correctly. The direct payment of social contributions, or income taxes, by employers to social security funds, other employment-related social insurance schemes or tax authorities is merely a short cut taken on grounds of administrative convenience and efficiency.

7.54 An amount equal in value to employers' social contributions is first recorded in the generation of income account as one of the components of compensation of employees and then recorded either in the secondary distribution of income account as being transferred by households to social security funds or other employment-related social insurance schemes as the case may be, or is recorded in the use of income account as the payment by households for the financial services associated with running the scheme. The transactions are recorded simultaneously in all three accounts at the times when the work that gives rise to the liability to pay the contributions is carried out. The contributions paid to social security funds may be fixed amounts per employee or may vary with the levels of wages or salaries paid. The amounts paid under other employment-related social insurance schemes depend on the arrangement agreed between employers and employees.

7.55 Social insurance schemes in respect of pensions are of two types, described as defined contribution schemes or defined benefit schemes. A defined contribution scheme is one where the benefits are determined by the contributions actually made to the scheme. Under a defined benefit scheme, the ultimate benefit is calculated by means of a formula embodied in the terms of the social insurance scheme. Similarly, the increase in the employee's entitlement due to the period of employment in the current accounting period can also be determined by the formula.

7.56 The contributions made by employers to social insurance schemes are divided into actual and imputed contributions.

Employers' actual contributions to social insurance schemes (D121, D1121, D1122)

7.57 The actual contributions by employers to social insurance schemes consist of actual contributions made to both social security and other employment-related schemes. The contributions relating to pensions and other benefits are shown separately.

Employers' imputed contribution to social insurance schemes (D122)

Employers' imputed pension contributions (D1221)

7.58 There are no imputed contributions to social security funds.

7.59 For both actual and imputed contributions, the components relating to pensions and other benefits are shown separately.

7.60 For a defined contribution pension scheme, there are no imputed contributions unless the employer operates the scheme himself. In that case, the value of the costs of operating the scheme is treated as an imputed contribution payable to the employee as part of compensation of employees. This amount is also recorded as final consumption expenditure by households on financial services.

7.61 For a defined benefit pension scheme, there is an imputed contribution by the employer calculated as a residual. It must be such that the sum of the employer's actual contribution plus the sum of any contribution by the employee plus the imputed contribution by the employer is equal to the increase in benefit due to current period employment plus the costs of operating the scheme.

7.62 Some pension schemes may be so well run that the funds available to the scheme exceed the liabilities of the scheme to present and past employees. It is possible that in this case the employer may take a "contribution holiday" and not make actual contributions for one or more periods. Nonetheless, an imputed contribution by the employer should be calculated and recorded as described here.

7.63 Some schemes may be expressed as non-contributory because no actual contributions are ever made by the employee. Nevertheless, an imputed contribution by the employer is calculated and imputed as just described.

Employers' imputed non-pension contributions (D1222)

7.64 Some employers provide non-pension benefits themselves directly to their employees, former employees or dependants without involving an insurance enterprise or autonomous pension fund, and without creating a special fund or segregated reserve for the purpose. In this situation, existing employees may be considered as being protected against various specified needs or circumstances, even though no reserves are built up to provide future entitlement. Remuneration should therefore be imputed for such employees equal in value to the amount of social contributions that would be needed to secure the de facto entitlements to the social benefits they accumulate. These amounts take into account any actual contributions made by the employer or employee and depend not only on the levels of the benefits currently payable but also on the ways in which employers' liabilities under such schemes are likely to evolve in the future as a result of factors such as expected changes in the numbers, age distribution and life expectancies of their present and previous employees. Thus, the values that should be imputed for the contributions ought, in principle, to be based on the same kind of actuarial considerations that determine the levels of premiums charged by insurance enterprises.

7.65 In practice, however, it may be difficult to decide how large such imputed contributions should be. The enterprise may make estimates itself, perhaps on the basis of the contributions paid into similar funded schemes, in order to calculate its likely liabilities in the future, and such estimates may be used when available. Otherwise, the only practical alternative may be to use the unfunded non-pension benefits payable by the enterprise during the same accounting period as an estimate of the imputed remuneration that would be needed to cover the imputed contributions. While there are obviously many reasons why the value of the imputed contributions that would be needed may diverge from the unfunded non-pension benefits actually paid in the same period, such as the changing composition and age structure of the enterprise's labour force, the benefits actually paid in the current period may nevertheless provide the best available estimates of the contributions and associated imputed remuneration.

C. Taxes on production and on imports (D2)

1. Classification of taxes on production and on imports

7.66 ***Taxes are compulsory, unrequited payments, in cash or in kind, made by institutional units to government units***. They are described as unrequited because the government provides nothing in return to the individual unit making the payment, although governments may use the funds raised in taxes to provide goods or services to other units, either individually or collectively, or to the community as a whole.

7.67 The full classification of taxes on production and on imports consists of:

- Taxes on products
  - Value added type taxes (VAT)
  - Taxes and duties on imports excluding VAT
    - Import duties
    - Taxes on imports excluding VAT and duties
  - Export taxes
  - Taxes on products, excluding VAT, import and export taxes
- Other taxes on production

7.68 At the highest level of the classification, taxes on production and on imports consist of taxes on products and other taxes on production. Taxes on products consist of taxes on goods and services that become payable as a result of the production, sale, transfer, leasing or delivery of those goods or services, or as a result of their use for own consumption or own capital formation. The way in which taxes on products are recorded in the System depends on the valuation used for the recording of output as described below. Other taxes on production consist mainly of taxes on the ownership or use of land, buildings or other assets used in production or on the labour employed, or compensation of employees paid. Whatever the valuation of output used, other taxes on production are always recorded as a charge on value added in the generation of income account.

7.69 A full explanation of the content of each of the categories of taxes on production and on imports is given below after a discussion of the rules of recording taxes. This explanation provides links to the main publications of data on tax yields, the *Government Finance Statistics Manual, 2001,* or GFSM2001, of the International Monetary Fund (IMF), and *Revenue Statistics* an annual publication of the Organisation for Economic Co-operation and Development (OECD).

7.70 In business accounting, taxes on production, except invoiced VAT, are usually regarded as costs of production that may be charged against sales or other receipts when calculating profits for tax or other purposes. They correspond to "indirect taxes" as traditionally understood, indirect taxes being taxes that supposedly can be passed on, in whole or in part, to other institutional units by increasing the prices of the goods or services sold. However, it is extremely difficult, if not impossible, to determine the real incidence of different kinds of taxes, and the use of the terms "direct" and "indirect" taxes has fallen out of favour in economics and is not used in the System.

The recording of taxes on production and on imports in the accounts

7.71 Taxes on production and imports are recorded under uses in the generation of income account and under resources in the allocation of primary income account.

7.72 In the generation of income account, taxes on imports are recorded only at the level of the total economy as they are not payable out of the value added of domestic producers. Moreover, at the level of an individual institutional unit or sector, only those taxes on products that have not been deducted from the value of the output of that unit or sector need to be recorded under uses in its generation of income account. These vary depending upon the way in which output is valued. When output is valued at basic prices, all taxes (subsidies) on products payable (receivable) on the goods or services produced as outputs are deducted from (added to) the value of that output at producers' prices. Therefore they do not have to be recorded under uses in the generation of income account of the units or sectors concerned, being recorded only at the level of the total economy, in the same way as taxes on imports. When output is valued at producers' prices, all taxes or subsidies on products payable or receivable on outputs have to be recorded under uses in the generation of income accounts of the units or sectors concerned, except invoiced VAT or similar deductible taxes as invoiced VAT is never included in the value of output. Non-deductible VAT and similar taxes are recorded under uses only at the level of the total economy, like taxes on imports.

7.73 Other taxes or subsidies on production, that is, taxes payable on the land, assets, labour, etc., employed in production are not taxes payable per unit of output and cannot be deducted from the producer's price. They are recorded as being payable out of the value added of the individual producers or sectors concerned.

7.74 In the allocation of primary income account, taxes on production and imports appear under resources only for the general government sector and the total economy, apart from any such taxes payable to non-residents.

Taxes versus fees

7.75 One of the regulatory functions of governments is to forbid the ownership or use of certain goods or the pursuit of certain activities, unless specific permission is granted by issuing a licence or other certificate for which a fee is demanded. If the issue of such licences involves little or no work on the part of government, the licences being granted automatically on payment of the amounts due, it is likely that they are simply a device to raise revenue, even though the government may provide some kind of certificate, or authorization, in return. However, if the government uses the issue of licences to exercise some proper regulatory function, for example, checking the competence, or qualifications, of the person concerned, checking the efficient and safe functioning of the equipment in question, or carrying out some other form of control that it would otherwise not be obliged to do, the payments made should be treated as purchases of services from government rather than payments of taxes, unless the payments are clearly out of all proportion to the costs of providing the services. The borderline between taxes and payments of fees for services rendered is not always clear-cut in practice (see paragraph 8.54 (c) below for a further explanation of this matter in the case of households).

Table 7.6: Generation of income account – uses – taxes and subsidies on production

Uses

Code	Transactions and balancing items	S11 Non-financial corporations	S12 Financial corporations	S13 General government	S14 Households	S15 NPISHs	S1 Total economy	S2 Rest of the world	Goods and services	Total
B1g										
B1n										
D1	Compensation of employees	549	15	142	39	24	769			769
D2	Taxes on production and imports						235			235
D21	Taxes on products						141			141
D211	Value added type taxes (VAT)						121			121
D212	Taxes and duties on imports excluding VAT						17			17
D2121	Import duties						17			17
D2122	Taxes on imports excluding VAT and duties						0			0
D213	Export taxes						1			1
D214	Taxes on products except VAT, import and export taxes						2			2
D29	Other taxes on production	86	3	2	3	0	94			94
D3	Subsidies						- 44			- 44
D31	Subsidies on products						- 8			- 8
D311	Import subsidies						0			0
D312	Export subsidies						0			0
D319	Other subsidies on products						- 8			- 8
D39	Other subsidies on production	- 35	0	0	- 1	0	- 36			- 36
B2g	Operating surplus, gross	254	55	44	92	7	452			452
B3g	Mixed income, gross				442		442			442
P61	Consumption of fixed capital on gross operating surplus	137	10	30	32	3	212			
P62	Consumption of fixed capital on gross mixed income				10		10			
B2n	*Operating surplus, net*	117	45	14	60	4	240			240
B3n	*Mixed income, net*				432		432			432

Links with the IMF and OECD tax classifications

7.76 The coverage of taxes in the SNA coincides with that of "tax revenue" as defined in the GFSM2001, and also with "taxes" as defined in *Revenue Statistics*. In contrast to the latter, the SNA includes imputed taxes or subsidies resulting from the operation of official multiple exchange rates, imputed taxes and subsidies resulting from a central bank imposing interest rates above or below the market rate and does not classify social security contributions under the heading of taxes. Chapter 5 of the GFSM2001 contains a detailed listing and classification of taxes according to the nature of the tax. Annex A of *Revenue Statistics* contains a closely related classification.

7.77 The categories of tax distinguished in the System depend on the interaction of the following three factors, of which the nature of tax is only one:

a. The nature of the tax, as specified in the GFSM2001/OECD classification;

b. The type of institutional unit paying the tax;

c. The circumstances in which the tax is payable.

7.78 Thus, payments of exactly the same tax may be recorded under two different headings in the System. For example, payment of an excise duty may appear under "taxes on imports, except value added taxes (VAT) and duties" or under "taxes on products, except VAT, import and export taxes" depending upon whether the excise duty is paid on an imported or domestically produced good. Similarly, payments of an annual tax on automobiles may be recorded under "taxes on production" or under "current taxes on income, wealth, etc." depending upon whether the tax is paid by an enterprise or by a household. For this reason, it is not possible to arrive at the SNA categories simply by regrouping the GFSM2001/OECD classifications. However, in order to take advantage of the existence of these detailed classifications, each category of tax listed below contains a cross-reference to the corresponding GFSM2001 and OECD classifications. It should be noted, though, that the SNA categories are included within the GFSM2001 and OECD categories but may not be identical with them.

The accrual basis of recording

7.79 All taxes should be recorded on an accrual basis in the System, that is, when the activities, transactions or other events occur that create the liabilities to pay taxes. However, some economic activities, transactions or events, which under tax legislation ought to impose on the units concerned the obligation to pay taxes, permanently escape the attention of the tax authorities. It would be unrealistic to assume that such activities, transactions or events give rise to financial assets or liabilities in the form of payables and receivables. For this reason the amounts of taxes to be recorded in the System are determined by the amounts due for payment only when evidenced by tax assessments, declarations or other instruments, such as sales invoices or customs declarations, that create liabilities in the form of clear obligations to pay on the part of taxpayers. (In assessing the amount of tax

Table 7.7: Distribution of primary income account – resources – taxes and subsidies on production

										Resources
		S11	S12	S13	S14	S15	S1	S2		
Code	Transactions and balancing items	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
	Operating surplus, gross	254	55	44	92	7	452			459
	Mixed income, gross				442		442			442
	Operating surplus, net	117	45	14	60	4	240			247
	Mixed income, net				432		432			432
D1	Compensation of employees				773		773	2		775
D2	Taxes on production and imports			235			235			235
D21	Taxes on products			141			141			141
D211	Value added type taxes (VAT)			121			121			121
D212	Taxes and duties on imports excluding VAT			17			17			17
D2121	Import duties			17			17			17
D2122	Taxes on imports excluding VAT and duties			0			0			0
D213	Export taxes			1			1			1
D214	Taxes on products except VAT, import and export taxes			2			2			2
D29	Other taxes on production			94			94			94
D3	Subsidies			- 44			- 44			- 44
D31	Subsidies on products			- 8			- 8			- 8
D311	Import subsidies			0			0			0
D312	Export subsidies			0			0			0
D319	Other subsidies on products			- 8			- 8			- 8
D39	Other subsidies on production			- 36			- 36			- 36
D4	Property income	89	149	33	160	7	438	38		476
B5g										0
B5n										0

accruing, care must be taken not to include tax unlikely ever to be collected.) Nevertheless, in accordance with the accrual principle, the times at which the taxes should be recorded are the times at which the tax liabilities arise. For example, a tax on the sale, transfer or use of output should be recorded when that sale, transfer or use took place, which is not necessarily the same time as that at which the tax authorities were notified, at which a tax demand was issued, at which the tax was due to be paid or the payment was actually made. Some flexibility is permitted, however, as regards the time of recording of income taxes deducted at source.

7.80 In some countries, and for some taxes, the amounts of taxes eventually paid may diverge substantially and systematically from the amounts due to be paid to the extent that not all of the latter can be effectively construed as constituting financial liabilities as these are understood within the System. In such cases, it may be preferable for analytic and policy purposes to ignore unpaid tax liabilities and confine the measurement of taxes within the System to those actually paid. Nevertheless, the taxes actually paid should still be recorded on an accrual basis at the times at which the events took place that gave rise to the liabilities.

Interest, fines or other penalties

7.81 In principle, interest charged on overdue taxes or fines, or penalties imposed for the attempted evasion of taxes, should be recorded separately and not as taxes. However, it may not be possible to separate payments of interest, fines or other penalties from the taxes to which they relate, so that in practice they are usually grouped with taxes.

1. Taxes on products (D21)

7.82 ***A tax on a product is a tax that is payable per unit of some good or service.*** The tax may be a specific amount of money per unit of quantity of a good or service (the quantity units being measured either in terms of discrete units or continuous physical variables such as volume, weight, strength, distance, time, etc.), or it may be calculated ad valorem as a specified percentage of the price per unit or value of the goods or services transacted. A tax on a product usually becomes payable when it is produced, sold or imported, but it may also become payable in other circumstances, such as when a good is exported, leased, transferred, delivered, or used for own consumption or own capital formation. An enterprise may or may not itemize the amount of a tax on a product separately on the invoice or bill that it charges its customers.

Value added type taxes (D211)

7.83 ***A value added type tax (VAT) is a tax on goods or services collected in stages by enterprises but that is ultimately charged in full to the final purchasers.*** It has already been described in paragraphs 6.54 to 6.61. It is described as a "deductible" tax because producers are not usually required to pay to the government the full amount of the tax they invoice to their customers, being permitted to deduct the amount of tax they have been invoiced on their own purchases of goods or services intended for intermediate consumption or fixed capital formation. VAT is usually calculated on the price of the good or service including any other tax on the product. VAT is also payable on imports of goods or services in addition to any import duties or other taxes on the imports. (GFSM2001 11411; OECD, 5111)

Taxes and duties on imports, excluding VAT (D212)

7.84 ***Taxes and duties on imports consist of taxes on goods and services that become payable at the moment when those goods cross the national or customs frontiers of the economic territory or when those services are delivered by non-resident producers to resident institutional units***.

7.85 Imported goods on which all the required taxes on imports have been paid when they enter the economic territory may subsequently become subject to a further tax, or taxes, as they circulate within the economy. For example, excise duties or sales taxes may become due on goods as they pass through the chain of wholesale or retail distribution, such taxes being levied on all goods at the same point, whether those goods have been produced by resident enterprises or imported. Taxes payable subsequently on goods that have been already imported are not recorded as taxes on imports but as taxes on products, excluding VAT, import and export taxes.

Import duties (D2121)

7.86 ***Import duties consist of customs duties, or other import charges, that are payable on goods of a particular type when they enter the economic territory.*** The duties are specified under customs tariff schedules. They may be intended as a means of raising revenue or discouraging imports in order to protect resident goods producers (GFSM2001, 1151; OECD, 5123).

Taxes on imports, excluding VAT and duties (D2122)

7.87 ***Taxes on imports, excluding VAT and duties consist of all taxes (except VAT and import duties) as defined in the GFS/OECD classifications that become payable when goods enter the economic territory or services are delivered by non-residents to residents.*** They include the following:

a. *General sales taxes*: these consist of general sales taxes (excluding VAT) that are payable on imports of goods and services when the goods enter the economic territory or the services are delivered to residents (GFSM2001, 11412; OECD, 5110-5113);

b. *Excise duties*: excise duties are taxes levied on specific kinds of goods, typically alcoholic beverages, tobacco and fuels; they may be payable in addition to import duties when the goods enter the economic territory (GFSM2001, 1142; OECD, 5121);

c. *Taxes on specific services*: these may be payable when non-resident enterprises provide services to resident units within the economic territory (GFSM2001, 1156; OECD, 5126);

d. *Profits of import monopolies*: these consist of the profits transferred to governments of import marketing boards, or other public enterprises exercising a monopoly over the imports of some good or service. The justification for treating these profits as implicit taxes on products is the same as that shown in paragraph 7.89 (e) for fiscal monopolies (GFSM2001, 1153; OECD, 5127);

e. *Taxes resulting from multiple exchange rates:* these consist of implicit taxes resulting from the operation of multiple exchange rates by the central bank or other official agency (GFSM2001, 1154).

Export taxes (D213)

7.88 ***Export taxes consist of taxes on goods or services that become payable when the goods leave the economic territory or when the services are delivered to non-residents.*** They include the following:

a. *Export duties*: general or specific taxes or duties on exports (GFSM2001, 1152; OECD, 5124);

b. *Profits of export monopolies:* these consist of the profits transferred to governments of export marketing boards, or other public enterprises exercising a monopoly over the exports of some good or service. The justification for treating these profits as implicit taxes on products is the same as that shown in paragraph 7.89 (e) for fiscal monopolies (GFSM2001, 1153; OECD, 5124);

c. *Taxes resulting from multiple exchange rates*: these consist of implicit taxes on exports resulting from the operation of an official system of multiple exchange rates. (GFSM2001, 1154).

Taxes on products, excluding VAT, import and export taxes (D214)

7.89 ***Taxes on products, excluding VAT, import and export taxes, consist of taxes on goods and services that become payable as a result of the production, sale, transfer, leasing or delivery of those goods or services, or as a result of their use for own consumption or own capital formation***. They include the following commonly occurring taxes:

a. *General sales or turnover taxes*: these include manufacturers', wholesale and retail sales taxes, purchase taxes, turnover taxes, and so on, but exclude VAT and other systems of deductible taxes (GFSM2001, 11412-11413; OECD, 5110-5113);

b. *Excise duties*: these consist of taxes levied on specific kinds of goods, typically alcoholic beverages, tobacco and fuels (GFSM2001, 1142; OECD, 5121);

c. *Taxes on specific services*: these include taxes on transportation, communications, insurance, advertising, hotels or lodging, restaurants, entertainments, gambling and lotteries, sporting events, etc. (GFSM2001, 1144; OECD, 5126);

d. *Taxes on financial and capital transactions*: these consist of taxes payable on the purchase or sale of non-financial and financial assets including foreign exchange. They become payable when the ownership of land or other assets changes, except as a result of capital transfers (mainly inheritances and gifts) (GFSM2001, 1134; OECD, 4400). They are treated as taxes on the services of the unit selling the asset;

e. *Profits of fiscal monopolies*: these consist of the profits of fiscal monopolies that are transferred to government. Fiscal monopolies are public corporations, public quasi-corporations, or government-owned unincorporated enterprises that have been granted a legal monopoly over the production or distribution of a particular kind of good or service in order to raise revenue and not in order to further the interests of public economic or social policy. Such monopolies are typically engaged in the production of goods or services that may be heavily taxed in other countries, for example, alcoholic beverages, tobacco, matches, petroleum products, salt, playing cards, etc. The exercise of monopoly powers is simply an alternative way for the government to raise revenue instead of the more overt procedure of taxing the private production of such products. In such cases the sales prices of the monopolies are deemed to include implicit taxes on the products sold. While in principle only the excess of the monopoly profits over some notional "normal" profits should be treated as taxes, it is difficult to estimate this amount and, in practice, the value of the taxes should be taken as equal to the amount of the profits actually transferred from fiscal monopolies to government (GFSM2001, 1143; OECD, 5122). When a public enterprise is granted monopoly powers as a matter of deliberate economic or social policy because of the special nature of the good or service or the technology of production (for example, public utilities, post offices and telecommunications, railways, etc.) it should not be treated as a fiscal monopoly. As a general rule, fiscal monopolies tend to be confined to the production of consumer goods or fuels. As the profits of a fiscal monopoly are calculated for the enterprise as a whole, it is not possible to estimate the average amount of the tax per unit of good or service sold when the enterprise has more than one good or service as output without introducing an assumption about the rates of tax on the different products. Unless there is good reason otherwise, it should be assumed that the same ad valorem rate of tax is applied to all products, this rate being given by the ratio of the total value of the implicit taxes to the value of total sales less the total value of the implicit taxes. It is necessary to establish this rate in order to be able to calculate the basic prices of the products concerned.

f. *Taxes resulting from the central bank imposing a higher rate of interest than the market rate*: These taxes are described in paragraphs 7.114 to 118. (These taxes are not mentioned in GFSM2001.)

2. Other taxes on production (D29)

7.90 ***Other taxes on production consist of all taxes except taxes on products that enterprises incur as a result of engaging in production.*** Such taxes do not include any taxes on the profits or other income received by the enterprise and are payable irrespective of the profitability of the production. They may be payable on the land, fixed assets or labour employed in the production process or on certain activities or transactions. Other taxes on production include the following:

a. *Taxes on payroll or work force*: these consist of taxes payable by enterprises assessed either as a proportion of the wages and salaries paid or as a fixed amount per person employed. They do not include compulsory social security contributions paid by employers or any taxes paid by the employees themselves out of their wages or salaries (GFSM2001, 112; OECD, 3000);

b. *Recurrent taxes on land, buildings or other structures*: these consist of taxes payable regularly, usually each year, in respect of the use or ownership of land, buildings or other structures utilized by enterprises in production, whether the enterprises own or rent such assets (GFSM2001, 1131; OECD, 4100);

c. *Business and professional licences*: these consist of taxes paid by enterprises in order to obtain a licence to carry on a particular kind of business or profession. Licences such as taxi and casino licences are included. In certain circumstances, licences to use a natural resource, however, are treated not as a tax but as the sale of an asset. These circumstances are described in part 5 of Chapter 17. However, if the government carries out checks on the suitability, or safety of the business premises, on the reliability, or safety, of the equipment employed, on the professional competence of the staff employed, or on the quality or standard of goods or services produced, as a condition for granting such a licence, the payments are not unrequited and should be treated as payments for services rendered, unless the amounts charged for the licences are out of all proportion to the costs of the checks carried out by governments (GFSM2001, 11452; OECD, 5210). (See also paragraph 8.54 (c) for the treatment of licences obtained by households for their own personal use.);

d. *Taxes on the use of fixed assets or other activities*: these include taxes levied periodically on the use of vehicles, ships, aircraft or other machinery or equipment used by enterprises for purposes of production, whether such assets are owned or rented. These taxes are often described as licences, and are usually fixed amounts that do not depend on the actual rate of usage (GFSM2001, 11451-11452 and 5.5.3; OECD, 5200);

e. *Stamp taxes*: these consist of stamp taxes that do not fall on particular classes of transactions already identified, for example, stamps on legal documents or cheques. These are treated as taxes on the production of business or financial services. However, stamp taxes on the sale of specific products, such as alcoholic beverages or tobacco, are treated as taxes on products (GFSM2001, 1161; OECD, 6200);

f. *Taxes on pollution*: these consist of taxes levied on the emission or discharge into the environment of noxious gases, liquids or other harmful substances. They do not include payments made for the collection and disposal of waste or noxious substances by public authorities, which constitute intermediate consumption of enterprises (GFSM2001, 11452; OECD, 5200);

g. *Taxes on international transactions*: these consist of taxes on travel abroad, foreign remittances or similar transactions with non-residents (GFSM2001, 1156; OECD, 5127).

D. Subsidies (D3)

7.91 ***Subsidies are current unrequited payments that government units, including non-resident government units, make to enterprises on the basis of the levels of their production activities or the quantities or values of the goods or services that they produce, sell or import***. They are receivable by resident producers or importers. In the case of resident producers they may be designed to influence their levels of production, the prices at which their outputs are sold or the remuneration of the institutional units engaged in production. Subsidies have the same impact as negative taxes on production in so far as their impact on the operating surplus is in the opposite direction to that of taxes on production.

7.92 Subsidies are not payable to final consumers; current transfers that governments make directly to households as consumers are treated as social benefits. Subsidies also do not include grants that governments may make to enterprises in order to finance their capital formation, or compensate them for damage to their capital assets, such grants being treated as capital transfers.

1. Subsidies on products (D31)

7.93 ***A subsidy on a product is a subsidy payable per unit of a good or service.*** The subsidy may be a specific amount of money per unit of quantity of a good or service, or it may be calculated ad valorem as a specified percentage of the price per unit. A subsidy may also be calculated as the difference between a specified target price and the market price actually paid by a buyer. A subsidy on a product usually becomes payable when the good or service is produced, sold or imported, but it may also be payable in other circumstances such as when a good is transferred, leased, delivered or used for own consumption or own capital formation.

Import subsidies (D311)

7.94 ***Import subsidies consist of subsidies on goods and services that become payable when the goods cross the frontier of the economic territory or when the services are delivered to resident institutional units.*** They include implicit subsidies resulting from the operation of a system of official multiple exchange rates. They may also include losses incurred as a matter of deliberate government policy by government trading organizations whose function is to purchase products from non-residents and then sell them at lower prices to residents (see also export subsidies in paragraph 7.96).

7.95 As in the case of taxes on products, subsidies on imported goods do not include any subsidies that may become payable on such goods after they have crossed the frontier and entered into free circulation within the economic territory of the country.

Export subsidies (D312)

7.96 ***Export subsidies consist of all subsidies on goods and services that become payable when the goods leave the economic territory or when the services are delivered to non-resident units.*** They include the following:

a. *Direct subsidies* on exports payable directly to resident producers when the goods leave the economic territory or the services are delivered to non-residents;

b. *Losses of government trading organizations*: these consist of losses incurred as a matter of deliberate government policy by government trading organizations whose function is to buy the products of resident enterprises and then sell them at lower prices to non-residents. The difference between the buying and selling prices is an export subsidy (see also paragraph 7.98 (b));

c. *Subsidies resulting from multiple exchange rates*: these consist of implicit subsidies resulting from the operation of an official system of multiple exchange rates.

Exclusions from export subsidies

7.97 Export subsidies do not include the repayment at the customs frontier of taxes on products previously paid on goods or services while they were inside the economic territory. They also exclude the waiving of the taxes that would be due if the goods were to be sold or used inside the economic territory instead of being exported. General taxes on products such as sales or purchase taxes, VAT, excise taxes or other taxes on products are usually not payable on exports.

Other subsidies on products (D319)

7.98 ***Other subsidies on products consist of subsidies on goods or services produced as the outputs of resident enterprises that become payable as a result of the production, sale, transfer, leasing or delivery of those goods or services, or as a result of their use for own consumption or own capital formation.*** The most common types are the following:

a. *Subsidies on products used domestically*: these consist of subsidies payable to resident enterprises in respect of their outputs that are used or consumed within the economic territory;

b. *Losses of government trading organizations*: these consist of the losses incurred by government trading organizations whose function is to buy and sell the products of resident enterprises. When such organizations incur losses as a matter of deliberate government economic or social policy by selling at lower prices than those at which they purchased the goods, the difference between the purchase and the selling prices should be treated as a subsidy. Entries to the inventories of goods held by such organizations are valued at the purchasers' prices paid by the trading organizations and the subsidies recorded at the time the goods are sold;

c. *Subsidies to public corporations and quasi-corporations*: these consist of regular transfers paid to public corporations and quasi-corporations that are intended to compensate for persistent losses (that is, negative operating surpluses) incurred on their productive activities as a result of charging prices that are lower than their average costs of production as a matter of deliberate government economic and social policy. In order to calculate the basic prices of the outputs of such enterprises, it will usually be necessary to assume a uniform ad valorem implicit rate of subsidy on those outputs determined by the size of the subsidy as a percentage of the value of sales plus subsidy.

d. *Subsidies resulting from the central bank accepting a lower rate of interest than the market rate*: These subsidies are described in paragraphs 7.114 to 118. (These subsidies are not mentioned in GFSM2001.)

1. Other subsidies on production (D39)

7.99 ***Other subsidies on production consist of subsidies except subsidies on products that resident enterprises may receive as a consequence of engaging in production.*** Examples of such subsidies are the following:

a. *Subsidies on payroll or workforce*: these consist of subsidies payable on the total wage or salary bill, or total workforce, or on the employment of particular types of persons such as physically handicapped persons or persons who have been unemployed for long periods. The subsidies may also be intended to cover some or all of the costs of training schemes organized or financed by enterprises;

b. *Subsidies to reduce pollution*: these consist of subsidies intended to cover some or all of the costs of additional processing undertaken to reduce or eliminate the discharge of pollutants into the environment.

E. Property incomes (D4)

1. Defining property income

7.100 Property income accrues when the owners of financial assets and natural resources put them at the disposal of other institutional units. The income payable for the use of financial assets is called investment income while that payable for the use of a natural resource is called rent. ***Property income is the sum of investment income and rent.***

7.101 ***Investment income is the income receivable by the owner of a financial asset in return for providing funds to another institutional unit.*** The terms governing the payment of investment income are usually specified in the financial instrument created when the funds are transferred from the creditor to the debtor. Such arrangements are typically made only for a limited period of time, after which the funds must be returned. The period of time may be several months or several years, though the arrangements may be renewed.

7.102 ***Rent is the income receivable by the owner of a natural resource (the lessor or landlord) for putting the natural resource at the disposal of another institutional unit (a lessee or tenant) for use of the natural resource in production.*** The terms under which rent on land is payable is expressed in a resource lease. ***A resource lease is an agreement whereby the legal owner of a natural resource that has an infinite life makes it available to a lessee in return for a regular payment recorded as property income and described as rent.*** A resource lease may apply to any natural resource recognised as an asset in the System. For resources such as land it is assumed that, at the end of the resource lease, the land is returned to the legal owner in the same state as when the lease started. For resources such as subsoil assets, though the resources potentially have an infinite life, they are not all returned to the legal owner at the end of the lease since the purpose of the lease is to permit extraction and disposal of the resource.

7.103 The regular payments made by the lessees of natural resources such as subsoil assets are often described as royalties, but they are treated as rents in the System. The term "rent" is reserved in this manual for rents on natural assets, payments under operating leases being described as "rentals".

7.104 Property incomes are classified in the following way in the System:

- Investment income
  - Interest
  - Distributed income of corporations
    - Dividends
    - Withdrawals from income of quasi-corporations
    - Reinvested earnings on foreign direct investment
  - Investment income disbursements
    - Attributed to insurance policyholders
    - Payable on pension entitlements
    - Attributed to collective investment fund shareholders
- Rent

Each of these items is described in more detail below.

1. Interest (D41)

7.105 ***Interest is a form of property income that is receivable by the owners of certain kinds of financial assets, namely: deposits, debt securities, loans and (possibly) other accounts receivable for putting the financial asset at the disposal of another institutional unit.*** Income on SDR holdings and allocations is also treated as interest. The financial assets giving rise to interest are all claims of creditors over debtors. Creditors lend funds to debtors that lead to the creation of one or other of the financial instruments listed above. The amount the debtor owes the creditor is known as the principal. Over time, the amount due to the creditor declines as the debt is repaid and increases as interest accrues. The balance at any time is referred to as the principal outstanding.

7.106 Interest may be a predetermined sum of money or a fixed or variable percentage of the principal outstanding. If some or all of the interest accruing to the creditor is not paid during the period in question, it may be added to the amount of the principal outstanding or it may constitute an additional, separate liability incurred by the debtor. However, the interest may not necessarily be due for payment until a later date and sometimes not until the loan, or other financial instrument matures.

The accrual basis of recording

7.107 Interest is recorded on an accrual basis, that is, interest is recorded as accruing continuously over time to the creditor on the amount of principal outstanding. The interest accruing is the amount receivable by the creditor and payable by the debtor. It may differ not only from the amount of interest actually paid during a given period but also the amount due to be paid within the period. Some financial instruments are drawn up in such a way that the debtor is obliged to make regular interest payments, period by period, as the interest accrues but in other cases there may be no such requirement. As explained in part 4 of chapter 17, there are many different kinds of financial instruments and new instruments are continually being developed. Interest may therefore be paid in various different ways, not always explicitly described as interest. However, streams of net settlement payments under a swap or forward rate agreement contract (possibly described as "interest" in the contract) are not considered as property income but are to be recorded as transactions in financial derivatives in the financial account (see paragraphs 11.34 to 11.43).

Interest payable and receivable on loans and deposits

7.108 As explained in chapter 6, the amounts of interest on loans and deposits payable to and receivable from financial corporations include a margin that represents an implicit payment for the services provided by the financial corporations in providing loans and accepting deposits. The actual payments or receipts to or from financial corporations, described as bank interest, need to be partitioned so that SNA interest and the service charges may be recorded in the System separately. The amounts of SNA interest paid by borrowers to financial corporations is less than bank interest by the estimated values of the charges payable, while the amounts of SNA interest receivable by depositors is higher than bank interest by the amount of the service charge payable. The values of the charges are recorded as sales of services in the production accounts of financial corporations and as uses in the accounts of their customers.

7.109 Any charges levied on borrowers that are not paid also increase the amount of principal outstanding along with interest unpaid. (That is to say that it is unpaid bank interest that adds to the amount of principal outstanding or the amount of SNA interest unpaid plus the unpaid service charge, since if bank interest is unpaid it must be the case that both SNA interest and the service charge are unpaid.)

Interest payable on debt securities

7.110 Certain financial instruments, for example, bills and zero coupon bonds, are such that the debtor is under no obligation to make any payments to the creditor until the asset matures. In effect, no interest becomes due for payment until the end of the asset's life at which point the debtor's liability is discharged by a single payment covering both the amount of the funds originally provided by the creditor and the interest accumulated over the entire life of the asset. In such cases the amount of interest payable over the life of the security is derived as the difference between the value at which the instrument is acquired and its value when it matures.

Further elaboration

7.111 Chapter 17 contains in part 4 a section detailing how all the transactions and other flows associated with financial instruments are to be recorded in the accounts. It contains, in particular, specific recommendations on how interest on each of the relevant financial instruments is to be calculated.

Nominal and real interest

7.112 When a debtor discharges the principal by making payments equal in money value to the funds borrowed plus the interest accruing at the agreed rate over the time the debt exists, the associated interest payments are described as "nominal". Such interest payments do not represent the "real" return to the creditor when, as a result of inflation, the purchasing power of the funds repaid is less than that of the funds borrowed. In situations of chronic inflation the nominal interest payments demanded by creditors typically rise in order to compensate them for the losses of purchasing power that they expect when their funds are eventually repaid.

7.113 In practice, the interest recorded in the allocation of primary income account is not partitioned in this way. The interest recorded is always the amount of nominal interest receivable or payable (plus or minus the charges for services of financial intermediaries for which no explicit charges are made, when relevant). However, the information needed to calculate real interest is provided within the System as a whole since the real holding losses incurred by creditors should be recorded in the revaluation account.

The special case of interest rates set by the central bank

7.114 The central bank's main responsibility is to formulate and carry out part of economic policy. It therefore often acts differently than other financial corporations and generally has received the authority from government to enforce its views. In cases where the central bank uses its special powers to oblige market participants to pay transfers without a direct *quid pro quo,* it is appropriate to record the proceeds as implicit taxes . Conversely, in cases when the central bank makes payments that are clearly for policy rather than commercial purposes, it may be argued that implicit subsidies are paid. Three cases are considered:

a. The central bank is able to dictate below market rates for reserve deposits;

b. The central bank pays above market rates in a situation where the external value of the currency is under pressure;

c. The central bank acts as a development bank offering loans at below market rates to priority industries.

7.115 If the interest rates are determined for policy reasons and not by commercial forces, then the difference between flows calculated using the reference rate and the actual rate set by the central bank should be recorded not as market output, specifically FISIM, but as implicit taxes and subsidies as described immediately below. This procedure is analogous to and consistent with the practice of treating the difference between the market exchange rate and an alternative exchange rate imposed by the central bank as an implicit tax or subsidy.

Below market rates on reserve deposits

7.116 Suppose the central bank pays only three per cent to a commercial bank on reserve deposits when the market rate is five per cent. The following recording is made in the System:

a. Although the commercial bank actually receives only three per cent as "interest", it is recorded as receiving five per cent as interest and paying two per cent to government as a tax on production;

b. Government is recorded as receiving two per cent from the commercial bank as a tax on production and as making a payment of a current transfer of two per cent to the central bank (both these flows are notional); and

c. The central bank actually pays three per cent to the commercial bank but is recorded as paying five per cent to the commercial bank and receiving two per cent from government in the form of a current transfer.

No financial account transactions are involved with this re-routing.

Above market rates for currency support

7.117 Suppose the central bank pays seven per cent to a commercial bank for a limited period when the currency is under pressure at a time when the market rate is five per cent. The following recording is made in the System:

a. Although the commercial bank actually receives seven per cent as "interest", it is recorded as receiving five per cent as interest and receiving another two per cent from government as a subsidy on production;

b. Government is recorded as paying two per cent to the commercial bank as a subsidy on production and as receiving a current transfer of two per cent from the central bank (both these flows are notional); and

c. The central bank actually pays seven per cent to the commercial bank but is recorded as paying five per cent to the commercial bank and paying two per cent to government in the form of a current transfer.

No financial account transactions are involved with this re-routing.

Below market rates to priority industries

7.118 Suppose the central bank charges only three per cent to a priority industry when the market rate is five per cent. The following recording is made in the System:

a. Although the priority industry actually pays only three per cent as "interest", it is recorded as paying five per cent as interest but receiving two per cent from government as a subsidy on production;

b. Government is recorded as paying two per cent to the priority industry as a subsidy on production and as receiving a current transfer of two per cent from the central bank (both these flows are notional); and

c. The central bank actually receives three per cent from the priority industry but is recorded as receiving five per cent from the priority industry and paying two per cent to government in the form of a current transfer.

No financial account transactions are involved with this re-routing.

Table 7.8: Distribution of primary income account – uses - property income

	Uses									
		S11	S12	S13	S14	S15	S1	S2		
Code	Transactions and balancing items	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
D1	Compensation of employees							6		6
D2	Taxes on production and imports									0
D3	Subsidies									0
D4	Property income	135	189	42	41	6	413	63		476
D41	Interest	56	106	35	14	6	217	13		230
D42	Distributed income of corporations	48	36				84	36		120
D421	Dividends	24	36				60	0		60
D422	Withdrawals from income of quasi-corporations	24	0				24	36		60
D43	Reinvested earnings on direct foreign investment	0	0				0	14		14
D44	Investment income disbursements		47				47	0		47
D441	Property income attributed to insurance policy holders		25				25	0		25
D442	Payable on pension entitlements		8				8	0		8
D443	Property income attributed to holders of investment fund units		14				14	0		14
D45	Rent	31	0	7	27	0	65			65
B5g	Balance of primary incomes, gross / National income, gross	208	15	226	1 426	8	1 883			1 883
B5n	Balance of primary income, net / National income, net	71	5	196	1 384	5	1 661			1 661

2. Distributed income of corporations (D42)

Dividends (D421)

7.119 Corporations obtain funds by issuing shares in their equity that entitle the holders to shares both of distributed profits and the residual value of the assets of the corporation in the event of its liquidation. Shareholders are the collective owners of a corporation.

7.120 ***Dividends are a form of property income to which shareholders become entitled as a result of placing funds at the disposal of corporations***. Raising equity capital through the issue of shares is an alternative to borrowing as a way of raising funds. In contrast to loan capital, however, equity capital does not give rise to a liability that is fixed in monetary terms and it does not entitle the holders of shares of a corporation to a fixed or predetermined income.

7.121 Just as corporations are understood in the System to cover a set of institutional units engaged in production that may be described by different names such as private or public corporations, private or public companies, cooperatives, limited liability partnerships, so dividends must also be understood to cover all distributions of profits by corporations to their shareholders or owners, by whatever name they are called. Dividends may occasionally take the form of an issue of shares, but this excludes issues of bonus shares that represent the capitalization of own funds in the form of reserves and undistributed profits.

Time of recording

7.122 Although dividends represent a part of income that has been generated over a substantial period, often six or twelve months, dividends are not recorded in the System on a strict accrual basis. For a short period after a dividend is declared but before it is actually payable, shares may be sold "ex dividend" meaning that the dividend is still payable to the owner at the date the dividend was declared and not to the owner on the date payable. A share sold "ex dividend" is therefore worth less than one sold without this constraint. The time of recording of dividends in the System is the time at which the share price starts to be declared ex dividend.

Super-dividends

7.123 Although dividends are notionally paid out of the current period's operating surplus, corporations often smooth the payments of dividends, often paying out rather less than operating surplus but sometimes paying out a little more, especially when the operating surplus itself is very low. For practical reasons, no attempt is made in the System to align dividend payments with earnings except in one circumstance. The exception occurs when the dividends are disproportionately large relative to the recent level of dividends and earnings. In order to asses whether the dividends are disproportionately large, it is helpful to introduce the concept of distributable income. ***Distributable income of a corporation is equal to entrepreneurial income plus all current transfers receivable less all current transfers payable plus the adjustment for pension entitlements.*** From this it is possible to look at the ratio of dividends to distributable income over the recent past and assess the plausibility that the current level of dividends declared is in line with past practice, accepting some degree of smoothing from year to year. If the level of dividends declared is greatly in excess of this, the excess should be treated as a financial transaction, specifically the withdrawal of owners' equity from the corporation.

Table 7.8: Distribution of primary income account – resources - property income

										Resources
		S11	S12	S13	S14	S15	S1	S2		
Code	Transactions and balancing items	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
	Operating surplus, gross	254	55	44	92	7	452			459
	Mixed income, gross				442		442			442
	Operating surplus, net	117	45	14	60	4	240			247
	Mixed income, net				432		432			432
D1	Compensation of employees				773		773	2		775
D2	Taxes on production and imports			235			235			235
D3	Subsidies			- 44			- 44			- 44
D4	Property income	89	149	33	160	7	438	38		476
D41	Interest	33	106	14	49	7	209	21		230
D42	Distributed income of corporations	3	25	18	57	0	103	17		120
D421	Dividends	3	25	5	13	0	46	14		60
D422	Withdrawals from income of quasi-corporations			13	44		57	3		60
D43	Reinvested earnings on direct foreign investment	4	7	0	3	0	14	0		14
D44	Investment income disbursements	8	8	1	30	0	47	0		47
D441	Property income attributed to insurance policy holders	5	0	0	20	0	25	0		25
D442	Payable on pension entitlements				8		8	0		8
D443	Property income attributed to holders of investment fund units	3	8	1	2	0	14	0		14
D45	Rent	41	3	0	21	0	65			65
B5g										0
B5n										0

7.124 This treatment applies to all corporations, whether incorporated or quasi-corporate and whether subject to public, foreign or domestic private control. There is more discussion on the case of publicly controlled corporations in chapter 22.

Withdrawals of income from quasi-corporations (D422)

7.125 ***Withdrawal of income from a quasi-corporation consists of that part of distributable income that the owner withdraws from the quasi-corporation***. The income that the owners of quasi-corporations withdraw from them is analogous to the income withdrawn from corporations by paying out dividends to their shareholders. It is therefore treated as property income accruing to the owners of quasi-corporations. The withdrawal of income by the owners of quasi-corporations needs to be identified in order to be able to establish a full set of accounts for the entity and to treat it as an institutional unit separate from that of its owner.

7.126 Withdrawals of income from a quasi-corporation do not include withdrawals of funds realized by the sale or disposal of the quasi-corporation's assets: for example, the sale of inventories, fixed assets or land or other non-produced assets. Such sales would be recorded as disposals in the capital account of the quasi-corporation and the transfer of the resulting funds would be recorded as a withdrawal from the equity of quasi-corporations in the financial accounts of the quasi-corporation and its owner(s). Similarly, funds withdrawn by liquidating large amounts of accumulated retained savings or other reserves of the quasi-corporation, including those built up out of provisions for consumption of fixed capital, are treated as withdrawals from equity. This situation corresponds to the treatment of super-dividends payable by listed enterprises described immediately above.

Conversely, any funds provided by the owner(s) of a quasi-corporation for the purpose of acquiring assets or reducing its liabilities should be treated as additions to its equity. Just as there cannot be a negative distribution from the distributable income of corporations in the form of negative dividends, it is not possible to have a negative distribution from the distributable income of quasi-corporations in the form of negative withdrawals. However, if the quasi-corporation is owned by government, and if it runs a persistent operating deficit as a matter of deliberate government economic and social policy, any regular transfers of funds into the enterprise made by government to cover its losses should be treated as subsidies, as explained in paragraph 7.98 (c) above.

Reinvested earnings on foreign direct investment (D43)

7.127 As explained in chapter 22, a foreign direct investment enterprise is a corporate or unincorporated enterprise in which a foreign investor has made a foreign direct investment. A foreign direct investment enterprise may be either:

a. The (unincorporated) branch of a non-resident corporate or unincorporated enterprise: this is treated as a quasi-corporation; or

b. A corporation in which at least one foreign investor (which may, or may not, be another corporation) owns sufficient shares to have an effective voice in its management.

7.128 Actual distributions may be made out of the distributable income of foreign direct investment enterprises in the form of dividends or withdrawals of income from quasi-corporations. The payments made in these ways to foreign direct investors are recorded in the accounts of the SNA and in the balance of payments as international flows of investment income. However, both systems also require the retained earnings of a foreign direct investment enterprise to be treated as if they were distributed and remitted to foreign direct investors in proportion to their ownership of the equity of the enterprise and then reinvested by them by means of additions to equity in the financial account. The imputed remittance of these retained earnings is classified in the System as a form of distributed income that is separate from, and additional to, any actual payments of dividends or withdrawals of income from quasi-corporations.

7.129 The rationale behind this treatment is that, since a foreign direct investment enterprise is, by definition, subject to control, or influence, by a foreign direct investor or investors, the decision to retain some of its earnings within the enterprise must represent a deliberate investment decision on the part of the foreign direct investor(s). In practice, the great majority of direct investment enterprises are subsidiaries of foreign corporations or the unincorporated branches of foreign enterprises, which are completely controlled by their parent corporations or owners.

7.130 ***Retained earnings of a corporation or quasi-corporation are equal to the distributable earnings less the dividends payable or withdrawal of income from the quasi-corporation respectively***. If the foreign direct investment enterprise is wholly owned by a single foreign direct investor (for example, a branch of a foreign enterprise), the whole of the retained earnings are deemed to be remitted to that investor and then reinvested, in which case the saving of the enterprise must be zero. When a foreign direct investor owns only part of the equity of the direct investment enterprise, the amount that is deemed to be remitted to, and reinvested by, the foreign investor is proportional to the share of the equity owned.

Retained earnings of domestic enterprises

7.131 A suggestion has been made to extend the treatment of distributing retained earnings to the owners of other corporations, in particular of public corporations. Investigation of this suggestion is part of the research agenda.

3. Investment income disbursements (D44)

Investment income attributed to insurance policyholders (D441)

7.132 Investment income attributable to insurance policyholders should be divided between holders of non-life and life policies.

7.133 For non-life policies, the insurance corporation has a liability towards the policyholder of the amount of the premium deposited with the corporation but not yet earned, the value of any claims due but not yet paid and a reserve for claims not yet notified or notified but not yet settled. Set against this liability, the insurance corporation holds technical reserves. The investment income on these reserves is treated as income attributable to the policyholder, then distributed to the policyholder in the allocation of primary income account and paid back to the insurance corporation as a premium supplement in the secondary distribution of income account. The reserves concerned are those where the insurance corporation recognises a corresponding liability to the policyholders.

7.134 For an institutional unit operating a standardised guarantee scheme against fees, there may also be investment income earned on the reserves of the scheme and this should also be shown as being distributed to the units paying the fees (who may not be the same units who stand to benefit from the guarantees) and treated as supplementary fees in the secondary distribution of income account.

7.135 For life insurance policies and annuities, the insurance corporations have liabilities towards the policyholders and annuitants equal to the present value of expected claims. Set against these liabilities, the insurance corporations have funds belonging to the policyholders of bonuses declared for with profits policies as well as provisions for both policyholders and annuitants of the payment of future bonuses and other claims. These funds are invested in a range of financial assets and possibly non-financial assets such as property and land. The insurance enterprises receive investment income from the financial assets and land, and earn net operating surpluses from the renting or leasing of residential and other buildings. In addition they make holding gains or losses on the financial assets held. The bonuses declared to holders of life policies should be recorded as investment income receivable by the policyholders (resident and possibly non-resident households) and are treated as premium supplements paid by the policyholders to the insurance corporations. As with interest and dividends, the source of the investment income payable may not be investment income itself, but for the System, the decisive criterion for recording this as investment income is that of the recipient who regards these payments as the rewards for putting financial assets at the disposal of the insurance corporation.

7.136 The investment income attributed to life insurance policyholders is recorded as payable by the insurance company and receivable by households in the allocation of primary income account. Unlike the case of non-life insurance or pensions, the amount carries through to saving and is then recorded as a financial transaction, specifically an increase in the liabilities of life insurance corporations, in addition to new premiums less the service charge offset by claims payable.

Investment income payable on pension entitlements (D442)

7.137 As explained in part 2 of chapter 17, pension entitlements arise from one of two different types of pension schemes. These are defined contribution schemes (sometimes described as money purchase schemes) and defined benefit schemes.

7.138 A defined contribution scheme is one where contributions by both employers and employees are invested on behalf of the employees as future pensioners. No other source of funding of pensions is available and no other use is made of the funds. The investment income payable on defined contribution entitlements is equal to the investment income on the funds plus any net operating surplus earned by renting land or buildings owned by the fund.

7.139 A defined benefit scheme is one where the benefits payable are defined in terms of a formula. The formula often takes the form of a link to final salary (hence the alternative terminology final salary schemes) or average salary over some defined period. The formula may be expressed in many ways including, for example, a variation on a defined contribution scheme such as the growth in earnings of the funds or a minimum percentage growth.

7.140 Because the benefits are calculated according to a formula, it is possible to determine the level of entitlements necessary at any point in time to meet future obligations. The value of the entitlements is the present value of all future payments, calculated using actuarial assumptions about life lengths and economic assumptions about the interest or discount rate. The investment income payable on defined benefits schemes derives from the fact that one fewer discount factor is applied to the level of entitlements existing at the start of the year. The amount is not affected by whether the pension scheme actually has sufficient funds to meet all the obligations nor by the type of increase in the funds, whether it is investment income or holding gains, for example. The increase in value treated as investment income does not include escalation in entitlement value due to indexation of previous entitlements nor changes coming from the changing demographics of the beneficiaries. These increases (or possibly decreases) are treated as other changes in assets. Chapter 17 spells out the exact distinction between changes treated as investment income and those treated as other changes.

Investment income attributed to investment fund shareholders (D443)

7.141 Investment income attributed to investment fund holders (including mutual funds and unit trusts) is shown as two separate items. The first of these is the dividends distributed to investment fund shareholders. The second is retained earnings attributed to investment fund shareholders.

7.142 The dividend component is recorded in exactly the same manner as dividends for individual corporations, as described above. The retained earnings component is recorded using the same principles as those described for foreign direct investment enterprises. That is to say, it is distributed to the shareholders (leaving the investment fund with no saving) and is re-injected into the fund by the shareholders in a transaction recorded in the financial account.

4. Rent (D45)

Rents distinguished from rentals

7.143 The distinction between rent and the rentals receivable and payable under operating leases is basic to the System as rent is a form of property income and rentals are treated as sales or purchases of services. Rentals are payments made under an operating lease to use a fixed asset belonging to another unit where that owner has a productive activity in which the fixed assets are maintained, replaced as necessary and made available on demand to lessees. Rent is a payment made under a resource lease for the use of a natural resource. Not only is the type of asset leased different as between rents and rentals, so is the nature of the lease. The distinction between different types of leases is explained in part 5 of chapter 17.

Rents on land

7.144 ***Rent is the income receivable by the owner of a natural resource (the lessor or landlord) for putting the natural resource at the disposal of another institutional unit (a lessee or tenant) for use of the natural resource in production.*** Rent is recorded as accruing continuously to the landowner throughout the period of the contract agreed between the landowner and the tenant. The rent recorded for a particular accounting period is equal to the value of the accumulated rent payable over that period of time, as distinct from the amount of rent due to be paid during that period or the rent actually paid.

7.145 Rent may be paid in cash or in kind. Under share-cropping or similar schemes, the value of the rent payable is not fixed in advance in monetary terms and is measured by the value at basic prices of the crops that the tenants are obliged to provide to the landowner under the contract between them. Rents on land also include the rents payable to the owners of inland waters and rivers for the right to exploit such waters for recreational or other purposes, including fishing.

7.146 A landowner may be liable to pay land taxes or incur certain maintenance expenses solely as a consequence of owning the land. By convention, such taxes or expenses are treated as payable by the tenant who is deemed to deduct them from the rent that he would otherwise be obliged to pay to the landowner. Rent reduced in this way by taxes or other expenses for which the landowner is liable is described as “after-tax rent”. By adopting the convention that the tenant pays only the after-tax rent, the taxes or expenses are recorded in the production or generation of income accounts of the tenant. This treatment does not change the income of the tenant. The convention avoids the necessity to create a notional enterprise for the landowner as the lessor.

7.147 Rentals payable on buildings or other structures are treated as purchases of services. In practice, however, a single payment may cover both rent and rentals when an institutional unit rents land that consists of land improvements and land in its natural state and may include any buildings situated on it in a single contract, or lease, in which the two kinds of payments are not differentiated from each other. For example, a farmer may rent a farmhouse, farm buildings, cultivated and grazing farmland in a contract in which only a single payment is required to cover all four. If there is no objective basis on which to split the payment between rent on land and rental on the buildings, it is recommended to treat the whole amount as rent when the value of the grazing land is believed to exceed the value of the buildings and cultivated land, and as a rental otherwise.

Rents on subsoil assets

7.148 The ownership of subsoil assets in the form of deposits of minerals or fossil fuels (coal, oil or natural gas) depends upon the way in which property rights are defined by law and also on international agreements in the case of deposits below international waters. In some cases the assets may be owned by the owner of the ground below which the deposits are located but in other cases they may be owned by a local or central government unit.

7.149 The owners of the assets, whether private or government units, may grant leases to other institutional units permitting them to extract such deposits over a specified period of time in return for the payment of rents. These payments are often described as royalties, but they are essentially rents that accrue to owners of the assets in return for putting them at the disposal of other institutional units for specified periods of time and are treated as such in the System. The rents may take the form of periodic payments of fixed amounts, irrespective of the rate of extraction or, more likely, they may be a function of the quantity or volume of the asset extracted. Enterprises engaged in exploration may make payments to the owners of surface land in exchange for the right to make test drillings or investigate by other means the existence and location of subsoil assets. Such payments are also to be treated as rents even though no extraction may take place.