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New Eurostat decision on deficit and debt

TREATMENT OF TAXES ON CAPITAL GAINS REALISED BY A PUBLIC HOLDING COMPANY IN THE CONTEXT OF PRIVATISATION

Eurostat, the Statistical Office of the European Communities in Luxembourg, has decided that a payment to the State, by a public holding company, of taxes on capital gains realised at the time of disposal of public enterprise shares, must be treated as a financial transaction. This payment does not therefore have an impact on the calculation of public deficit for the purpose of the excessive deficit procedure.

This new decision[1] aims to clarify the rules for ensuring a better comparability of public deficit and debt data of the Member States, while respecting the European System of Integrated Economic Accounts (ESA 79)[2].

As before, Eurostat has undertaken a wide consultation process at EU level with the relevant technical groups involved.[3]

The decision taken is consistent with the opinion of a large majority of members of the Committee on Monetary, Financial, and Balance of Payments Statistics (CMFB)[4].

The decision

Eurostat's decision is based on the need for consistency of treatment between what may be termed direct and indirect privatisation.

In the case of direct privatisation, the State disposes shares which it holds in public enterprises. The disposal is a financial transaction and the proceeds must be recorded as a financial transaction in the national accounts. There is therefore no impact on the State's borrowing requirement; it is in fact a straightforward restructuring of the State's balance sheet.

In certain cases, privatisation takes place in an indirect way: the State transfers to a public holding company public enterprise shares which, in the framework of a privatisation programme, are sold on the market. The holding company may then give the State back all or part of the sale proceeds.

Eurostat considers that the treatment of indirect privatisation should be consistent with that of direct privatisation, and that it should have the same impact on the State's borrowing requirement. In both cases, therefore, the receipts from privatisation given to the State cannot reduce the public deficit.

This conclusion applies whatever form the payment to the State takes, including dividends or taxes, whether levied at a normal or exceptional rate.

Eurostat already gave its view on the question of dividends in a ruling made in 1996, following privatisation transactions undertaken by the holding company CGER in Belgium.

The decision taken today thus clarifies the case of payments to the State in the form of tax.

Two remarks:

- The decision also applies to cases of partial privatisation, whereby the State continues to hold majority control, directly or indirectly, in the enterprises concerned.
- The decision does not bring into question the usual treatment of taxes on capital gains realised by public enterprises during their day-to-day activities. These taxes are classified as taxes on income and wealth, that is, as non-financial transactions reducing the public deficit.

The decision applies to all Member States which undertake indirect privatisations. It concerns in particular Portugal, where in 1998 the public holding company Partest paid the Portuguese State taxes on capital gains resulting from disposals realised in 1997 during a process of privatisation. These taxes, amounting to PTE 45.7 billion or 0.2% of Portuguese GDP, should therefore be classified as a financial transaction without reducing the public deficit.

1 For the earlier decisions, see press releases of 3 February, 21 February, 26 March, 30 April, 17 December 1997 and 27 January 1998, available on Internet (http://europa.eu.int/eurostat.html).

2 See regulation 3605/93 on the excessive deficit procedure.

3 For the procedure, see annex 2.

4 For CMFB's opinion and role, see annexes 1 and 3.

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Annex 1

CMFB's opinion on the decided case

Excessive deficit procedure – CMFB opinion on the statistical treatment of taxes on capital gains in the context of indirect privatisation

Issue

A government owned holding company sells shares and pays the proceeds to government. Among the proceeds are receipts of capital gains tax levied on the sale of shares. The issue is how the recording of the tax payment to government should be treated in national accounts – the capital gains tax may be recorded as contributing to a reduction in the deficit, or as a transaction which does not reduce the deficit.

CMFB opinion

Taking account of ESA79, and in addition ESA95, a large majority of CMFB felt that the transaction should be recorded as a financial transaction, which would not reduce the government deficit. Other reasons for this view include:

- Consistency with previous Eurostat decisions.
- The national accounts should record the economic reality of a transaction when it is different from the legal form (even when the legal form is a tax receipt).

Annex 2

A long process of prior consultation

The convergence criteria on public deficit and debt are an essential element for the admission of Member States into Economic and Monetary Union. In conformity with the Treaty on European Union[a], the European Commission monitors the development of the budgetary situation in Member States and the extent to which the criteria are respected. The statistical data used for evaluation[b] are provided by the directorate-general responsible, Eurostat, the Statistical Office of the European Communities in Luxembourg.

The statistics required to measure the convergence indicators clearly have to be strictly comparable. This is why Eurostat, in close collaboration with the statistical institutes of the Member States and statisticians of the central banks, has compiled **texts** setting out the **accounting treatment for transactions**, and put in place a **consultation procedure** to prepare rulings.

Evaluation on the basis of ESA79

Statistical information on Member States' budgetary transactions are presented by Member States and evaluated[c] by Eurostat on the basis of the national accounts manual **ESA79**. Following a decision of the Council the new version (ESA95) will not enter into force before the year 1999. In certain cases, however, the ESA95 is being used as the basis for classifying certain budgetary transactions.

The final decision belongs to Eurostat

In recent years problems have arisen when trying to classify, in a harmonized way in all the Member States, economic and financial transactions which are not clearly defined in the ESA79. Therefore, with the aim of assuring good comparability between the statistics, Eurostat has for several years been engaged in **consultations** with Member States, in the framework of a well-defined procedure.

This **consultation over methodology** is prepared by a task force. The issues are then submitted to two groups of experts: the national accounts working party and financial accounts working party. Following this, Eurostat consults the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB)[d], comprising senior representatives of the central banks, national statistical institutes, the European Central Bank, and Eurostat.

After having heard the position of its members on each point for consultation, the CMFB formulates its opinion in conformity with its rules of procedure and presents it to Eurostat. As a consultative committee, the CMFB's **opinion is not binding on Eurostat**. In its final decision Eurostat does, however, take the utmost account of the opinions expressed by the CMFB and the other consultative expert groups on the accounting treatment of a transaction. The decision is made in complete **independence** and **neutrality**, according to **purely technical criteria**.

Eurostat does not decide on the individual cases of Member States, but on the **principles** of accounting treatment of specific budgetary transactions. Every decision in this area applies automatically to similar cases in all the Member States.

The decision on each issue is recorded in a **methodological note** addressed to the institutions concerned, notably the Commission, CMFB, central banks, and national statistical offices.

a Article 104c of the Treaty on European Union

b Protocol on the excessive deficit procedure

c Regulation EC 3605/93

d See annex 3

Annex 3

Committee on monetary, financial and balance of payments statistics (CMFB)

Principles and procedures for assessing the opinion of the CMFB (advisory committee of senior statisticians from government statistical offices, central banks, the Commission and the ECB) when an opinion is required from Eurostat on the calculation of government debt and deficit:

- Eurostat makes the final decision on debt and deficit statistics.
- Gross domestic product estimates are approved by the Gross national product committee.
- Member States provide the Commission with an early warning of transactions that are likely to raise questions concerning statistical treatment; and provides full information about those transactions.
- Eurostat draws up a timetable for consideration of each case which is consistent with timetables set up by the Council. This leads to a work plan for the totality of cases.
- The work plan is given to the Statistical programme committee, to CMFB and other official institutions and regularly updated.
- Eurostat consults widely as it thinks fit.

Consultation of CMFB

- Eurostat consults the CMFB and notifies its proposals including a timetable.
- The process aims to identify the ”best” technical solution for which there is a large support.
- The CMFB seeks advice from its working party, Financial accounts working party, from National accounts working party and from any other expert source it considers appropriate.
- The CMFB opinions are based on three criteria:
    - the solution must be in conformity with ESA79;
    - when ESA79 does not describe the problem or cannot lead to a solution, reference should be made to ESA95.
    - if two or more solutions satisfy the previous criteria, reference should be made to the guiding principles of economic accounts as outlined in the opening chapters of the world-wide systems of national accounts 1993.
- The CMFB consults its members, analyses results and informs Eurostat of the outcome of the consultation.

The process is transparent

- Eurostat makes its decision and informs at the same time, the Commissioner, the National statistical institutes (NSIs) concerned and the CMFB.
- Eurostat informs the CMFB and the NSIs on which methodological grounds the decisions are based.
- The outcome of the consultation of CMFB and the final decision of Eurostat are made publicly available at the same time.