Direct Investment Income

In this section:

Coverage and definitions

The direct investment income accounts (lines 14 and 31) cover international transactions in income earned on U.S. direct investment abroad and on foreign direct investment in the United States. Income measures the return that direct investors receive on their equity and debt investments in affiliates abroad or in the United States; it consists of the parents' shares of the earnings and losses of affiliates plus interest received and paid on intercompany debt. Income includes both earnings distributed to parent companies and earnings reinvested in affiliates. The inclusion of reinvested earnings in direct investment income recognizes that the earnings of affiliates are income to parents, whether or not a portion is reinvested.

Estimation methods overview

The estimates are based on BEA's quarterly and benchmark surveys of direct investment. The surveys collect information on income flows between parents and their affiliates as well as related financial flows and positions between parents and their affiliates. Income, earnings, and distributed earnings are reported directly on the surveys; reinvested earnings are derived as a residual amount. A direct investment relationship is considered to exist if the parent owns 10 percent or more of the voting securities of an incorporated business enterprise or the equivalent interest in an unincorporated business enterprise. Less than 10 percent ownership is considered as other private investment.

1 **U.S. Receipts** (line 14)

2 **U.S. Payments** (line 31)

U.S. receipts of direct investment income measures the return on U.S. direct investment abroad—that is, the U.S. parents' return on their equity and debt investments in their foreign affiliates (see table 10). U.S. payments of direct investment income measures the return on foreign direct investment in the United States—that is, the foreign parents' return on their equity and debt investments in their U.S. affiliates, plus the return of other members of the foreign parent group on their debt investments in their U.S. affiliates (see table 10).

Direct investment income consists of earnings from current operations, which may be distributed in the form of dividends or reinvested in the enterprise, plus interest on intercompany debt. Interest is interest received by, or credited to, parents on intercompany debt owed to them by their affiliates, less interest paid or credited by parents on intercompany debt owed by them to their affiliates.

1.1 Earnings

1.1.1 Direct investment earnings are parents' shares in the net income of their affiliates, after provision for income taxes. A parent's share in net income is based on its directly held equity interest in the affiliate; a parent's directly held debt in the affiliate is not considered in determining the parent's share because debt is not an indication of ownership. Debt is, however, a major component of direct investment.

1.1.2 Direct investment earnings are recorded as they accrue, in accordance with the accrual principles of accounting. Earnings are recorded before deduction of withholding taxes on dividends. These taxes are treated as payable by the recipients of such income, even though as an administrative convenience, they may be withheld at the source.

1.1.3 Direct investment earnings measure earnings from productive activities during the current period. This concept of earnings is sometimes referred to as net operating earnings or net operating surplus. Because earnings are related to current production, they exclude several items that may be included in the financial accounting statements of the corporation. Examples of such exclusions are (1) parents' shares of capital gains and losses of affiliates, such as realized or unrealized gains and losses that result from the sale or other disposition of affiliates' assets and liabilities, (2) realized gains or losses on plant and equipment that result from the closures of part or all of a business, (3) gains and losses from write-ups or write-downs of the book values of assets and liabilities, (4) write-offs of intangible assets, including goodwill, (5) write-offs of research and development expenditures capitalized in a prior period, and (6) gains and losses from changes in the dollar value of foreign-currency-denominated assets and liabilities, or from the translation of affiliates' financial statements from local currencies into dollars due to changes in exchange rates. These capital gains and losses are, however, included as valuation adjustments to outstanding assets and liabilities in the international investment position accounts.

1.1.4 In the international accounts, direct investment earnings are measured at *current cost* (or *replacement cost*), that is, after adjustments to the depreciation, depletion, and exploration and development costs reported in the financial statements of corporations. These adjustments are made primarily to ensure that these charges reflect current-period prices, as well as to more closely align income earned in a given period with charges against income in the same period, as required by economic accounting principles. The adjustment converts depreciation charges valued for financial accounting purposes at historical cost to a valuation at current cost, or replacement cost; it adds charges for depletion of natural resources back to income and reinvested earnings because these charges are not treated as production costs in the national income and product accounts; and it reallocates expenses for mineral exploration and development across periods, so that they are written off over their economic lives rather than all at once. Estimates for the adjustments are available only on a global basis; estimates by country or by industry are not possible because of a lack of appropriate source data.

1.1.5 The two major components of direct investment earnings are *distributed earnings (dividends)* and *reinvested earnings.*

1.1.6 Distributed earnings are the payment of dividends to the owners of equity for placing funds at the disposal of corporations. They are the returns to the shareholders or owners. In most situations, dividends are paid out of the current period's *net operating earnings* (or *net operating surplus*), though dividends may be paid out of surplus earned in earlier periods, or corporations may smooth out dividends, sometimes paying out less than operating earnings and other times paying out more.

1.1.7 In addition to dividends from corporations, distributed earnings from unincorporated affiliates, subsidiaries, and branches are included in earnings. These entities usually engage in the same type of economic and financial activities and maintain separate financial statements, just as do corporations, but are not legally incorporated. Therefore, in legal terms, they cannot distribute income in the form of dividends. Nevertheless, the owner, or owners, may choose to withdraw some or all of the income earned by the enterprise, and some are entities formally organized as trusts, partnerships, or other institutions which may formally distribute some or all of their earnings. From an economic point of view, the withdrawal of such income is equivalent to the distribution of corporate income through dividends and is treated the same way in the accounts.

1.1.8 Payments by corporations and unincorporated entities to their shareholders or owners that are made out of accumulated capital reserves or equity capital, or from sales of assets, are not treated as dividends. Such payments are treated as withdrawals of equity, and are therefore recorded in the financial account. Stock dividends are also excluded from dividends because they are not considered as a remittance of earnings, but rather a capitalization of retained earnings and thus a substitution of one type of equity (capital stock) for another (retained earnings). Liquidating dividends are also excluded from dividends because they are a return of capital, rather than a remittance of earnings.

1.1.9 Dividends are recorded at the time they are either received from (paid to), or entered into, intercompany accounts with the foreign affiliate, whichever occurs first. Withdrawals of income from unincorporated entities are recorded when they are withdrawn by their owners. Dividends and withdrawals of income are recorded before the deduction of withholding taxes. These taxes are treated as payable by recipients of such income.

1.1.10 Reinvested earnings are the earnings that remain after distributions have been made to owners of the enterprise. They represent the owners' share of reinvested earnings, or net savings, of the enterprise in the period. Because reinvested earnings, or net savings, represent an addition to owners' capital, a corresponding entry of equal magnitude, but opposite sign, is made in the direct investment financial accounts, where reinvested earnings are listed separately along with equity and intercompany debt as components of owners' investment in the enterprise.

1.1.11 Reinvested earnings are recorded in the quarter in which they accrue. Reinvested earnings are measured after deduction of income taxes charged on the income earned by the enterprise. Such taxes are payable by the enterprise and not by its owners. Reinvested earnings are also calculated after the depreciation of fixed assets has been restated at replacement cost and the adjustments described earlier have been made to depletion and exploration and development costs.

1.1.12 Reinvested earnings can be negative when a direct investment enterprise has a loss on its operations or the dividends declared in a period are larger than net earnings in that period. If direct investment abroad generates negative earnings, the entry is shown as negative income receipts by the direct investor.

1.2 **Interest**

1.2.1 Interest is interest received by, or credited to, parents on intercompany debt owed to them by their affiliates, less interest paid or credited by parents on intercompany debt owed by them to their affiliates, both before the deduction of withholding taxes. Interest includes net interest on capitalized leases between parents and affiliates.

1.2.2 Interest is recorded on an accrual basis; that is, interest is recorded as accruing continuously over time to the creditor on the amount of debt outstanding, in accordance with the principles of accrual accounting. Under the accrual basis, as interest accrues, the amount of debt outstanding increases; that is, accrued interest not yet paid becomes part of the amount of debt owed to the creditor. What are commonly referred to as interest payments, therefore, are financial account transactions that reduce the debtor's existing liability.

1.2.3 Interest received and paid on intercompany debt excludes receivables and payables on intercompany debt between parents in the finance industry and affiliated financial corporations. This exclusion derives from the treatment in the financial accounts of intercompany debt transactions among certain nonbank *financial* corporations, where the transactions are classified as nonbank claims and liabilities rather than direct investment claims and liabilities because the nature of the transactions is related to the underlying activity of financial intermediation rather than to activity typical of a direct investment relationship. Therefore, the related interest received and paid on the debt is excluded from direct investment interest and included in other private interest. The financial intermediary accounts consist of transactions between firms in a direct investment relationship where both the U.S. and foreign firms are classified in the finance industry (excluding insurance), but the firms area neither banks nor securities brokers.

1.2.4 Interest received and paid among banks and their affiliates, and among securities brokers and dealers and their affiliates, is also excluded from direct investment interest and combined with these institutions' transactions with unaffiliated entities as other private interest. The combination groups together transactions related to the underlying activity of financial intermediation, regardless of the affiliation of the enterprises.

1.2.5 Interest and distributed earnings are based primarily on the U.S. parents' books in the case of U.S. direct investment abroad and primarily on the U.S. affiliates' books in the case of foreign direct investment in the United States. Interest and distributed earnings may be paid in cash, through debt creation, or in kind. For U.S. direct investment abroad, when funds are owed but not actually transferred to U.S. parents, an offsetting entry is made in the financial account under U.S. direct investment abroad (line 51). For foreign direct investment in the United States, when funds are owed but not actually transferred to foreign parents, an offsetting entry is made in the financial account under foreign direct investment in the United States (line 64).

Table 10. Direct Investment Income, 2009 (Line 14 and Line 31)
[Millions of dollars; credits +, debits –]

Receipts of income on U.S. direct investment abroad (line 14)	**346,073**
Earnings	339,292
Distributed earnings	99,393
Reinvested earnings	239,899
Reinvested earnings without current-cost adjustment	219,293
Current-cost adjustment	20,606
Interest on intercompany debt	6,782
U.S. parents' receipts	9,975
U.S. parents' payments	–3,193
Payments of income on foreign direct investment in the United States (line 31)	**–94,010**
Earnings	–68,715
Distributed earnings	–40,230
Reinvested earnings	–28,485
Reinvested earnings without current-cost adjustment	–23,661
Current-cost adjustment	–4,824
Interest on intercompany debt	–25,295
U.S. affiliates' payments	–30,055
U.S. affiliates' receipts	4,760