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EBF response to the OECD public consultation on the tax challenges of digitalisation

The European Banking Federation (EBF), which is the voice of European banks, welcomes the opportunity to provide comments in view of the OECD public consultation on the document "Addressing the tax challenges of the digitalisation of the economy".

Digital taxation is a relevant issue in the context of the current economic environment and has been included in the work of the OECD/G2O Inclusive Framework on the BEPS project since its elaboration in 2013. In that regard, a consultation period of three or four weeks is considered insufficient for such a far-reaching debate. Therefore, we would like to note that the comments outlined below are of general nature.

Nevertheless, the EBF supports the continuing efforts of the OECD in addressing this topic. We agree on the need to revisit the challenges that arise from digitalisation in the current international taxation framework and to adapt the rules that would apply in an international level, allowing jurisdictions to tax in a fair and efficient manner the profits that derive from both "old" and "new" business models.

The existing corporate tax framework adequately captures profits earned by financial institutions, irrespectively of the specific activities through which they are generated. Any elaboration in the field of the taxation of the Digital Economy should focus on value creation that is not captured by the current tax framework. The EBF takes the view that the project launched by the OECD on the taxation of new types of business models should be limited to having a better understanding of companies with highly digitalised business models, where the traditional principles of value creation and profit allocation do not apply.

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General comments on scope

The initiative at stake was launched with the aim to address the tax challenges of the digitalisation of the economy. However, the EBF observes that the project has emerged into a general attempt to overhaul well-established international taxation rules beyond truly digitalised companies, with wide-ranging consequences for the broader economy. The current proposals, as they are described in the consultation document, with the exception of the core principles of the "user participation" approach, no longer serve their initial purpose but rather have significant repercussions on the economy as a whole.

The objective of the proposals appears to be the reallocation of taxing rights. However, the EBF believes that the established principle that taxation takes place in the jurisdiction where value is actually created should prevail and that any new concepts and principles of international taxation should leave the functioning of existing concepts and principles unaffected to the extent that they already lead to appropriate taxation

The approaches brought forward in the consultation document are very broadly formulated and generally remain silent on critical details regarding their modus operandi. The EBF is concerned that substantial additional compliance and administrative costs would arise from each of the proposals presented. Irrespectively of any assessment of the individual approaches, the EBF believes that the proposals should be evaluated from the point of view of the cost consequences for businesses.

In general terms, the proposals appear to ignore the existing international tax framework which is based on international consensus and appear to be overly optimistic regarding the virtues of dispute resolution mechanisms. In order to be meaningful, any reform of the international tax system should continue to be based on international consensus and agreement to provide legal certainty and effective mechanisms to avoid double taxation.

"User participation" proposal

The "user participation" proposal as described in the consultation document specifically targets social media platforms, search engines and online marketplaces. The characteristics of this proposal, therefore, seem to apply only to new and truly digitalised companies whose business models completely overrule the traditional value creation models.

Such companies have highly digitalised business models which are based on the collection and processing of large quantities of data ("Big Data"), that are primarily produced by users and monetised through user contribution for no direct compensation. Furthermore, these business models are inherently dependent on software and algorithms and provide services to users free of charge, as monetisation takes place through the utilisation of customers data. The "user participation" approach aims at these specific characteristics of the digitalised economy.

Even though several industries of the "brick-and-mortar" economy are currently experiencing some sort of digital transformation, their core business models genuinely remain the same and the value drivers do not shift to Big Data and algorithms.

This is the case of the banking industry, understood in its broadest sense as the supervised and regulated financial activity. The banking industry remains substantially a traditional business, even though it is undergoing a profound digitalisation process. For example, financial institutions may open new communication channels to interact with their customers, seek to automate certain back-office processes and employ robotic assistants to support customers advisors. However, these processes are only gradually evolving and in spite of these innovations, the financial services sector still fundamentally relies on traditional value creating factors, in particular the relationship between a customer and its advisor, the reputation and stability of a financial institution, as well as the investment knowledge of its investment specialists.

Moreover, financial services and the associated value creation largely derive from routine functions. In the banking industry, digitalisation merely supports traditional mechanisms of value creation, e.g. through efficiency improvements of routine functions or new ways of interacting with the customer. In general terms, the services offered by a financial institution are not substantially determined by user contribution or user interaction.

Furthermore, the interaction between financial institutions and their "users" is very distinctive compared to other industries due to the fact that the financial services sector is highly regulated. In particular, data protection and privacy provisions generally require banks to safely store customer data and prohibit them from selling this data to any third parties on an individualised basis.

The EBF points out that the existing corporate tax framework adequately captures profits earned by banks, irrespectively of the specific activities through which they are generated. Consequently, banking services are not affected by the "user participation" proposal. We therefore call for a broad carve-out of all banking activities from any new tax regime based on the "user participation" proposal.

As stated above, it is essential that any analysis of the digitalised economy clearly differentiates between truly "new" digital services and any other services and commercial transactions which inherently remained the same irrespectively of the digitalisation of certain aspects of the service provision. Consequently, any elaboration in this field should focus on value creation that is not captured by the current tax framework, i.e. on truly new business models inherently characterised by digitalisation. The EBF takes the view that the project launched by the OECD on the taxation of new types of business models should be limited to gaining a better understanding of companies with highly digitalised business offerings where traditional principles of value creation and profit allocation do not apply.

The "user participation" proposal is limited to truly digitalised companies. Contrary to that, financial institutions offer traditional services where user interaction does not play a significant role in the value creation. Therefore,

financial institutions should be explicitly carved out from any "user participation" proposal.

"Marketing intangibles" proposal

While banks might make use of certain intangible assets in their business activities, these significantly differ from those used by highly digitalised companies or consumer good companies. The EBF, therefore, generally questions whether the underlying principles of the "marketing intangibles" proposal are applicable in the context of financial services. For banking services the brand value or trade name do not play a core role in the value creation and cannot be considered as having been created through an active interaction with customers. Important factors of value creation in the banking environment are rather the political and economic stability of the jurisdiction in which a company is established or its legal and regulatory framework. These value drivers are clearly determined domestically rather than by influences from abroad.

With regard to financial institutions, the value creation pattern has not changed significantly with digitalisation. Instead, as outlined above in the context of the "user participation" proposal, value creation for financial institutions continues to take place in the location where the advisors, analysts and investment specialists conduct their business. Hence, the value drivers of the banking industry remain the same and any efforts towards digitalisation merely make some existing processes more efficient. Consequently, the location where a financial institution's value creation takes place is the country where the financial institution has its permanent establishment and the jurisdiction where its profits are taxed.

Both the "user participation" and the "marketing intangible" approaches ignore the value creating factors of a traditional business, in particular entrepreneurial risk, economic substance, product development and innovation. These factors are generally not associated with the customer but instead with the bank in the jurisdictions where it is regulated and taxed. Therefore, the value creation of a financial institution generally takes place in the same location where the regulator closely oversees the banking operations.

With regard to the practical application of the "marketing intangibles" proposal, the EBF points out that any new approach should be reasonable in terms of additional administrative and compliance burden for the taxpayers. This includes in particular the interaction with the existing international tax and transfer pricing rules for the value chain analysis. There would need to be clear rules for the assessment of the relevant taxation basis in the country where value is created (home country), legally binding principles that apply to the market jurisdictions, and well-defined processes for the allocation of profits to the various jurisdictions. Furthermore, the much broader permanent establishment definition and the more complex profit allocation mechanisms would require an established judicial escalation process allowing taxpayers to defend themselves against any double taxation.

If elements of the “marketing intangibles” proposal should advance any further, the EBF nevertheless finds useful to emphasise on the link between this proposal and the concept of permanent establishment under traditional tax rules. For example, the broadening definition of what constitutes a permanent establishment with regard to “habitually playing a principal role leading to the conclusion of contracts” (according to the 2017 OECD Model Agreement) overlaps with the “marketing intangibles” concept. Similarly, any type of taxation linked to “marketing intangibles” would make the requirements regarding dependent agents obsolete.

Finally, the “marketing intangibles” proposal supposedly aims at taxing marketplaces in new ways. Such efforts overlap with existing and planned unilateral Financial Transaction Taxes (FTTs), therefore imposing a significant risk of additional double taxation.

The EBF generally questions the underlying rationale of the “marketing intangibles” approach as it ignores well-established international taxation principles and would imply fundamental changes in the way multinational corporations are taxed far beyond the so-called Digital Economy. Therefore, financial institutions should be explicitly carved out from any “marketing intangibles” proposal.

“Significant economic presence” proposal

The “significant economic presence” proposal, which includes the introduction of some sort of withholding tax, does not provide a sufficient level of details on how it would actually be applied in practice. Therefore, the EBF cannot provide any comment on specific aspects of the proposal.

As mentioned above, the value creation of a financial institution generally takes place where the financial institution is licensed and performs its core functions. On a very high level, the EBF is concerned that there is a substantial risk that any application of the “significant economic presence” proposal would create numerous new permanent establishments which would not generate any actual profits.

In order to seriously discuss any alteration of the existing tax principles based on digital presence, the determining factors of such a new regime would need to be defined specifically.

The EBF cannot provide comments on the “significant economic presence” approach in its present form because of the uncertainty caused by inadequately defined concepts.

“Minimum taxation” / “Global Anti-Base Erosion” proposal

The “Global Anti-Base Erosion Proposal” (GABEP) aims at preventing profit shifting leading to no or low taxation. The proposal envisages an income inclusion rule and a tax on base eroding payments.

Overall, a global bank's decision on where to allocate profits across jurisdictions is usually not mainly driven by tax considerations, but rather by the existing regulatory framework and in particular by ambitious regulatory capital requirements. Moreover, as stated above, banks are generally supervised and regulated in the jurisdictions where they operate, ensuring that they are subject to taxation in the jurisdictions where they do business. Therefore, the EBF takes the view that the premises of the "minimum taxation" proposal do not apply to the banking industry.

Nevertheless, we would like to raise our concerns regarding the operational administration of such a regime. In our view, it is entirely unclear what the appropriate base would be for a global minimum tax and how it were to be determined. Even if an adequate level for minimum taxation was internationally agreed upon, for a multinational company, different rates in different jurisdictions, including tax rebates, would need to be aggregated to determine whether the total rate is appropriate in view of the minimum tax.

The EBF considers that the "minimum tax" proposal would cause many allocation disputes which could not be handled by existing dispute resolution mechanisms. Even though such dispute resolution mechanisms have evolved over time, we point out that their overall functioning is purely reactive, often slow and inefficient from the perspective of a multinational company. In addition, it has been proven that countries unilaterally breach the provisions of double taxation agreements despite the existence of dispute resolution mechanisms, which demonstrates that the latter are largely ineffective.

The EBF takes the view that the OECD BEPS initiative already sufficiently addresses the ultimate goal of the GABEP. The Inclusive Framework on BEPS brings together over 115 developing and developed countries to collaborate on the implementation of the OECD/G20 BEPS measures. As such, the OECD BEPS initiative already is a truly global platform considering different interests of participating States. Consequently, even though it is too early to specify the final impact of the BEPS measures, we would like to point out that the current international tax framework is clearly evolving into the direction envisaged by GABEP. It might, therefore, be preferable to first make a thorough evaluation of the impact and effectiveness of existing BEPS measures and recommendations, before continuing any further work on developing any new and potentially far-reaching BEPS anti-tax avoidance measures as described in the consultation paper. This would ensure that the need for any new measures is carefully considered and that the design of such measures is sufficiently targeted to tackle actual BEPS situations and does not affect ordinary business that is already fairly taxed.

Finally, the EBF rejects the underlying logic of the GABEP since de facto it would limit the sovereign right of each country to set its own tax rates. Instead, the EBF believes that, following the allocation of profits based on the agreed international tax framework, the taxing rights should keep falling to the allocated State which has the right to tax at a rate deemed appropriate.

The EBF rejects the "Minimum Taxation" / "Global Anti-Base Erosion" proposal because the BEPS project is already addressing the concerns around base erosion and profit shifting. Before any new regime with the same aim is initiated, an evaluation of the effectiveness of BEPS must be conducted, once fully rolled out. If nevertheless some kind of minimum taxation measures were to be adopted, banks should be carved out due to their special role as regulated financial intermediaries.

Concluding remarks

According to the existing international tax framework, corporate income tax rules aim primarily at the taxation of profits and potential double taxation is avoided as a result of a widespread network of double tax treaties. The EBF considers that there is a substantial risk that an overhaul of this system would lead to double taxation, additional administrative and compliance costs for businesses and would ultimately have negative consequences for the provision of cross-border services, investment and economic growth. The new proposals to address the tax challenges of the digitalisation of the economy brought forward by the OECD run contrary to these concerns.

Moreover, the EBF believes that the underlying rationale of these proposals does not apply to the banking sector because the value creation of banking services is not significantly altered by digitalisation. In other words, financial institutions do not create value by sustained user contribution or intangible marketing effects. Furthermore, banks are highly regulated and face stringent regulatory capital requirements, which largely prevents them from shifting profits offshore simply for tax planning purposes.

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About the EBF

The European Banking Federation is the voice of the European banking sector, bringing together 32 national banking associations in Europe that together represent a significant majority of all banking assets in Europe, with 3,500 banks - large and small, wholesale and retail, local and international – while employing approximately two million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that reliably handle more than 400 million payment transactions per day. Launched in 1960, the EBF is committed to a single market for financial services in the European Union and to supporting policies that foster economic growth.

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