SwissBanking

OECD Secretariat
Per e-mail:
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Discussion draft on Action 1 (Tax Challenges of the Digital Economy) of the BEPS Action Plan

Dear Sir or Madam,

The Swiss Bankers Association, the leading professional organisation of the Swiss financial centre, would like to take the opportunity to comment on Action 1 of the BEPS action plan.

We recognize that the Task Force has received a difficult mandate and that it does its best to present solutions. We note that the draft does not offer any definition of the "digital economy". This lack of definition creates some confusion and uncertainty. We are of the opinion that a distinction should be made between the two following trends: (i) the increased impact of information and communication technology (ICT) on traditional business models leading to a digitalized economy and (ii) the development of new business models not linked to the traditional economy. We suggest that the draft gives a definition of the "digital economy" that we would rather call "virtual economy". As far as the digitalization of the existing real economy is concerned, we strongly advise to refer to the other actions of the BEPS action plan and not create new rules for the purpose of Action 1. Concerning the virtual economy, there might be a need for a deeper discussion and an evaluation on whether or not a new action point is necessary.

For the financial sector, cost could be reduced thanks to digitalization: for example outsourcing is possible typically in the fields of IT development, call centers and back-office. Outsourcing takes place mainly from high cost countries to emerging countries such as India, Poland and the Philippines, to the benefit of the customers and of these emerging economies. In order to comply with consumer protection policies, the financial sector has to perform data mining: this allows a better assessment of consumer needs, of consumer product knowledge and of consumer risk profiles. To comply with various regulatory initiatives (in particular in the field of money laundry), the financial sector must also invest in data mining to prevent and detect money laundry activity. In addition, recent developments towards automatic exchange of information, e.g. FATCA, require substantial new efforts in the collection of client/consumer data. Similar devel-

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opments in the area of consumer protection are also observed in other economic sectors as well and not only in the highly regulated financial sector.

Taxation is traditionally levied on the proceeds of flows of goods and services, on labor and assets in a real economy. When and where the e-commerce interfaces with the real economy then there is taxable substance. The interface between the e-commerce and the exchange of goods or services is generally linked to a payment. For example when the result of e-commerce is the cross-border flow of goods, such a delivery is subject to VAT when entering the country of the customer and sale proceeds are subject to direct tax at the place of incorporation of the provider.

For payments on the Internet the consumer can choose between credit cards or debit cards. To a certain extent there is a combination between the use of debit cards and vouchers like units (like iTunes cards). All these cards have in common the fact that they are linked to a legal tender or a bank account. The account is credited and the debit card is charged with a reference to a legal tender.

Latest developments in the digital world have however created opportunities to develop business in a completely virtual environment. These developments are primarily supported by a payment system using "credit-units" that are independent from any legal tender. Conventional payment systems including credit and debit cards are always linked to a real "account". Credit-units like "Bitcoin" are created or "mined" in a pure digital environment. Whereas a legal tender reflects to a certain extent the value of a "real" national economy, virtual credit units do not. The detachment of a virtual credit unit from any real national economy is to a certain degree manifested in the "hyper-volatility" of for example Bitcoin vs. a legal tender like the EURO. As an effect of these developments the question of the link to a tax residence might arise.

We therefore recognize that there might be an actual "virtual economy", dematerialized and with basically no link or interface with the "real economy". Such activities might have to be examined carefully and there might be a need in this respect for a new set of rules for taxation purposes. Action 1 should not address however traditional activities, which have been digitalized thanks to ICT; for those activities, BEPS concerns are better dealt with in the framework of other actions.

You will find in the annex a more detailed analysis of selected issues contained in the discussion draft.

We thank you for taking due consideration of our submission.

Yours sincerely,
Swiss Bankers Association

Urs Kapalle   Jean Brunisholz

Annex

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Discussion draft on Action 1 (Tax Challenges of the Digital Economy) of the BEPS Action Plan

1. **<u>Comments on point 10., page, 7</u>**

- ***Whether it is possible to ring-fence the digital economy from the rest of the economy, and if not, whether specific types of digital transactions could be identified and addressed through specific rules;***

  It seems to us that, basically it is not possible to ring-fence the digital economy from the rest of the economy according to the understanding of the digital economy that seems to be adopted in the discussion draft.

  We did not find a clear definition of what one should understand under “digital economy”. Is it an “economy” that is purely digital (“virtual”) with no link to the physical world (i.e. no physical delivery of goods or services happen, but typically transactions would only take place over the Internet) no stream of payments, or is it a “classical economy” enhanced by technology, in particular information and communication technology (ICT)?

  > If we take the example of the delivery of goods: goods could be ordered by mail or by telephone, long before the Internet was widely spread. Does it mean that ordering goods over the Internet makes the whole process including the physical delivery of goods an activity of the digital economy? We recognize that the use of ICT greatly facilitates the ordering of goods, and enhanced this kind of transactions (volume increased dramatically), we however strongly put into question the fact that the very nature of the transactions themselves changes because a new technological means is available to perform them.
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  > In the finance industry, financial orders where traditionally given in writing by mail, or by telephone. Nowadays financial orders can be given over the Internet. Like for the delivery of books, we do not see that the very nature of the financial orders has changed. Here again, the use of ICT has greatly influenced the way the transactions are performed, the nature of the transactions however is still the same: a bank needs to process the order received, regardless of the fact that this order was mailed, e-mailed or given over the phone.

  We therefore call for a clear definition of the digital economy, which according to us is not an ICT enhanced classical economy.

- ***The key features of the digital economy identified by the Task Force and whether there are other key features that should be taken into account;***

  We prefer a clear definition of the digital economy (see above).

- ***The examples of new business models in the digital economy and whether (and if so which) other business models should be considered;***

  We need to know first what digital economy is precisely meant with.

- ***The ability of the measures developed in the course of the BEPS Project and the current work on VAT/GST to address BEPS concerns in the digital economy;***

  Issues to be addressed in the current work of VAT/GST should be addressed regardless of the work related to Action 1: measures to prevent VAT avoidance. For example, deliveries performed from abroad to avoid VAT/GST should be tackled properly; this is not only or specifically related to the use of ICT to perform the order of the delivery.

- ***Whether other measures should be developed during the course of the work on other aspects of the BEPS Action Plan to address BEPS concerns in the digital economy and if so which ones;***

  See above.

- ***The broader tax challenges raised by the digital economy which have been identified by the Task Force and how these challenges should be addressed, taking into account both direct and indirect taxation;***

  We recognize that ICT has generally contributed to increase the volume of business performed in a number of sectors. With increased volumes the need to address properly some issues may appear more clearly (VAT/GST collection/avoidance). The principles on which such issues have to be addressed should not be technology driven but based on principles also valid for the economy at large.

- ***The options to address these broader tax challenges discussed by the Task Force and summarised in the discussion draft;***

  The basic question is to define what is exactly meant by digital economy. We think that the definition should be narrow. Once the concept is clearly defined, it should be examined whether special taxation rules are needed to tackle issues such as VAT/GST avoidance for example.

- ***The potential cost of compliance arising from the options proposed to address the tax challenges of the digital economy and suggestions for more cost efficient alternatives;***

  We cannot give any estimate on this.

- ***Whether the Ottawa taxation framework principles identified above are an appropriate framework for analysing options to address the tax challenges, and whether and how they should be supplemented.***

  We think that the Ottawa taxation framework principles are still valid and should not be supplemented each time a new technological step occurs. We in particular support the neutrality principle according to which *"Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. […] Taxpayers in similar situations carrying out similar transac-*

tions should be subject to similar levels of taxation." (see discussion draft, point 203., page 63).

2. <u>Comment on point 59., page 24</u>

"59. […] Attempting to isolate the digital economy as a separate sector would inevitably require arbitrary lines to be drawn between what is digital and what is not. As a result, the tax challenges and BEPS concerns raised by the digital economy are better identified and addressed by analysing existing structures adopted by MNEs together with new business models and by focusing on the key features of the digital economy and determining which of those features raise or exacerbate tax challenges or BEPS concerns, and developing approaches to address those challenges or concerns."

We are of the opinion that it is necessary to be able to draw a line, which is not arbitrary, between what is digital and what is not. For that reason a clear definition of what is a digital economy is necessary. If no clear definition of what is a digital economy can be given, then arbitrary tax treatment might prevail.

3. <u>Comment on page 28, before (*2.2. App Stores*)</u>

We think that a definition of "digital economy" vs. "virtual economy" or "shadow economy" (including its implication for example in the field of black labor) should be inserted.

4. <u>Comment on point 128., page 44</u>

"128. Once a taxable presence in the market country has been established, another common technique to reduce taxable income is to maximise the use of deductions for payments made to other group companies in the form of interest, royalties, service fees, etc. […] Many structures put in place by digital businesses appear to make use of these techniques, with the taxable income from the local operations being reduced to extremely low amounts.

Tackling tax avoidance is a concern of BEPS, which is not specific for a sector or a type of business, including what is referred here as digital business. These issues, which are relevant, should be handled in the appropriate BEPS actions.

5. <u>Comments on Part VII. Potential options to address the broader tax challenges raised by the digital economy</u>

<u>To point 211.</u>, pages 64-65 (*3.1. Modifications to the Exemptions from Permanent Establishment Status)*

"211. One potential option discussed by the Task Force would modify the exceptions contained in paragraph 4 of Article 5 of the OECD Model Tax Convention. […]"

As long as the digital economy has not been clearly defined, it is unwise to modify the exceptions contained in paragraph 4 of Article 5 of the OECD Model Tax Convention.

To points 212-216, pages 65-66 (*3.2. A New Nexus based on Significant Digital Presence*)

We recognize the difficulty of trying to define a nexus based on a digital presence and its potential arbitrary nature. The criteria set out in the bullet points of point 213. might serve as a basis for a definition of the digital economy. According to us the issue of the payment is one of the key element to be able to state that one is confronted with a truly "digital economy", that we have designated as "virtual economy". When dematerialized goods and services are paid with a virtual currency, then we have an issue to be addressed, because there are no traceable flows that could be taxed. Such activities might have to be examined carefully and there might be a need in this respect for a new set of rules for taxation purposes.

To point 217, pages 65-66 (*3.3. Virtual Permanent Establishment*)

As long as the digital economy has not been clearly defined, it is premature to develop a concept of virtual permanent establishment in that context.

To point 218, pages 66-67 (*3.4. Creation of a Withholding Tax on Digital Transactions)*

We doubt that the introduction of a withholding tax would be appropriate to serve BEPS purposes. Such a tax would create an additional burden and might not lead to taxing the customers fairly: it would in particular not respect the neutrality and equitability criteria set out in Ottawa.