SwissBanking

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Public consultation on the possible solutions to the tax challenges of digitalisation

Dear Madam, Dear Sir,

The Swiss Bankers Association ("SBA") would like to thank you for the opportunity to provide comments on the consultation on possible solutions to the tax challenges of digitalisation. To begin with, we want to point out that in our view a consultation period of three weeks, notably after an extension was granted, is not adequate for such a far-reaching consultation. Providing meaningful and detailed feedback, in particular to the specific questions raised in the consultation document, is not possible within the given timeframe. Our comments are therefore of general nature.

1. General comments on scope

- The initiative at hand started with the aim to address the tax challenges of the highly digitalized economy. However, we believe 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. In other words, we believe that the current proposal, perhaps with the exception of the core principles and initial intentions of the "user participation" approach, no longer serves its initial purpose but instead would have significant detrimental effects on the broader economy as a whole.

- The overall aim of all proposals currently subject to consultation appears to be the re-allocation of taxing rights towards source countries without taxable nexus according to existing international corporate tax allocation rules. We are, however, convinced that the established principle that taxation takes place where value is actually created should prevail. Ultimately, this is one of the major goals of the BEPS initiative.
- The various approaches brought forward in the consultation document are very broadly formulated and generally remain silent on critical details regarding their operationalization. We see a risk that substantial additional compliance and administrative costs would arise from each of the proposals brought forward. Irrespective of our assessment of the individual approaches, we want to point out that the proposals must be evaluated from the point of view of the cost consequences for businesses.
- The proposals generally seem to ignore the existing international tax framework based on international consensus and seem to be overly optimistic regarding the virtues of dispute resolution mechanisms. In order to be meaningful, any reform of the international tax system must continue to be based on international consensus and agreement to provide legal certainty and effective mechanisms to avoid double taxation.
- Overall, we are surprised that the consultation document does not provide a more thorough analysis as to why the current rules no longer work and why the BEPS measures failed to address the identified challenges. We take the clear position that the introduction of such extensive new tax regulations would require a comprehensive global impact analysis and should only be taken into consideration if the failure of the BEPS initiative has been established.

2. “User participation” proposal

- The “user participation” proposal as described in the consultation documents 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 such as Facebook, Google and Amazon whose business models rely on a complete overhaul of traditional value creation models.
- Generally, such companies have highly digitalised business models which are based on the collection and computation of large quantities of data (“big data”), which is primarily produced by users and monetised through user contribution for no direct compensation. Further, such business models are inherently dependent on software and algorithms and provide services to users free of charge because monetisation mainly takes place through the utilisation of data. The “user participation” approach aims at these specific characteristics of the digitalised economy.
- Even though many industries of the “old” economy are currently going through some sort of digital transformation, their business models genuinely stay the same and the value drivers do not suddenly shift to “big data”, “data analytics” and algorithms.

- These characteristics do not apply to banks for many reasons. The banking industry stays a traditional business even though it is going through a profound digitalisation process. We acknowledge that, for example, banks may open new communication channels to interact with their clients, seek to automate certain back-office processes and employ robotic assistants to support client advisors. However, these processes are only gradually evolving and in spite of these innovations, the banking business still fundamentally relies on traditional value creating factors, in particular the relationship between a client and its advisor, the reputation and stability of a banking institution as well as the investment knowledge of its investment specialists. Overall, the services a bank offers are not substantially determined by user contribution or user interaction.
- Furthermore, the relationship between banks and their "users" is very distinctive compared to other industries because the banking business is highly regulated. In particular, provisions regarding data and privacy protection generally require banks to safely store client data and not to sell it to any third parties on an individualized basis.
- Overall, we want to point out that the existing international corporate tax framework adequately captures profits earned by banks, irrespective of the specific activities through which they are generated. Consequently, banking services should not be 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 stayed the same irrespective of the digitalisation of certain aspects of the service provision. Consequently, any elaboration in this field must focus on value creation that is not captured by the current tax framework, i.e. on truly new business models characterised by digitalisation. In other words, we are convinced that the thought process kicked off by the OECD on how to tax new types of business models therefore should be limited on gaining a better understanding of companies with highly digitalised business offerings where traditional principles of value creation and profit allocation do not apply.

<u>Position of the SBA:</u> *The "user participation" proposal should be limited to truly digitalised companies. Contrary to that, banks offer traditional services where user interaction does not play a significant role in the value creation. Therefore, banks should be explicitly carved out from any "user participation" proposal.*

3. "Marketing intangibles" proposal

- We generally question the viability of the "marketing intangibles" concept. In particular, we question the idea that the "assets" have an intrinsic functional link to the market jurisdiction and why these "assets" have to be allocated entirely to the market jurisdiction. In our view, this contradicts with the arm's length principle and the so called DEMPE (development, enhancement, maintenance, protection and exploitation) approach, inevitably leading to tax disputes.

- While banks might make use of certain intangible assets in their business activities, these would differ significantly from those used by highly digitalised companies or consumer good companies. We therefore generally question whether the underlying principles of the "marketing intangibles" proposal are applicable in the context of banking services. For example, for banking services the brand value or trade name does not in itself play a core role in the value creation and cannot be seen as having been created through the active interaction with customers. Important factors of value creation in the banking environment are, among other things, the political and economic stability of the jurisdiction in which a company is domiciled or its legal and regulatory framework. These value drivers are clearly determined domestically rather than by influences from abroad.
- With regard to banks, the value creation pattern has not changed significantly through new technology. Instead, as outlined above in the context of the "user participation" proposal, banks' value creation mainly takes place in the location where the advisors, analysts, and investment specialist are conducting their business. In other words, the value drivers of the banking industry remain the same and digitalisation efforts merely make some existing processes more efficient. Consequently, the place where a bank's value creation takes place is the home country of the bank and the jurisdiction where its profits are taxed.
- Both the "user participation" approach and the "marketing intangible" approach 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 client but instead with the bank in the jurisdictions where it is regulated and taxed. Therefore, the value creation of a bank 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, we want to point out that any new approach must 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 locations. Further, 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, we nevertheless want to highlight the link between this proposal and the concept of permanent establishments 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 around dependent agents obsolete.

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

<u>Position of the SBA:</u> *We generally question the underlying rationale of the “marketing intangibles” approach because 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. In addition, we are convinced that the concept of “marketing intangibles” cannot be applied to the way the banking industry creates value. Therefore, banks should be explicitly carved out from any “marketing intangibles” proposal.*

4. “Significant economic presence” proposal

- The “significant economic presence” proposal, including the introduction of some sort of withholding tax, does not provide a sufficient level of details on how it would actually work in practice. We therefore cannot comment on specific aspects of the proposal.
- As mentioned above, the value creation of a bank generally takes place where the bank is licensed and performs its core functions. On a very high level, we see 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.

<u>Position of the SBA:</u> *We generally cannot provide comments on the significant economic presence approach in its present form because of the uncertainty caused by inadequately defined concepts.*

5. “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.
- We generally do not understand why the OECD already proposes new measures before the BEPS initiative has been fully implemented. If any new measures are required in this

regard, this need should be established through a thorough analysis to determine whether the BEPS measures have worked. In our view, it must be factored in that the international tax framework already is undergoing substantial changes and that any new initiative would bring additional complexities.

- Overall, a global bank's decision where to allocate profits across jurisdictions is usually not mainly driven by tax considerations, rather by the existing regulatory framework and in particular ambitious regulatory capital requirements. Moreover, as stated above, banks are generally regulated in the jurisdictions where they operate, ensuring that they are subject to taxation in the jurisdictions where they do business. Therefore, we believe that the premises of the "minimum taxation" proposal do not apply to the banking industry.
- Nevertheless, we want 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 added up to determine whether the total rate is appropriate in view of the minimum tax.
- We believe 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 want to point out that their functioning is purely reactive, often slow and inefficient from the perspective of a multinational company. Further, it has been shown time and time again that countries unilaterally breach the provisions of DTAs despite the existence of dispute resolution mechanisms, meaning that they are largely ineffective.
- Overall, as stated above, we are convinced that the OECD BEPS initiative already sufficiently addresses the ultimate goal of the GABEP initiative. 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. Therefore, even though it is too early to specify the final impact of the BEPS measures, we want to point out that the current international tax framework is clearly evolving into the direction envisaged by GABEP.
- Finally, we reject 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, we believe 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.

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Position of the SBA: *We reject 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.*

6. Concluding remarks

Overall, we emphasise that according to the existing international tax framework, corporate income tax rules aim primarily at the taxation of profits and potential double taxation is avoided through a widespread network of double tax treaties. We see a substantial risk that an overhaul of this system would lead to double taxation, additional administrative and compliance costs for businesses and ultimately would have negative consequences for cross-border service provision, investment and economic growth overall.

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, we are convinced that the underlying logic of the various proposals does not apply to the banking sector because the value creation of banking services is not significantly altered by digitalisation. In other words, banks are not creating value by sustained user contribution or intangible marketing effects. Furthermore, banks are highly regulated and face stiff regulatory capital requirements, a fact that largely prevents them from shifting profits offshore simply for tax planning purposes.

Yours sincerely,
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