ibfed International Banking Federation

5th Floor, 1 Angel Court
London EC2R 7HJ
United Kingdom
+44 7725 350 259
www.ibfed.org

3 May 2019

Tax Policy and Statistics Division
Centre for Tax Policy and Administration, OECD
Email: TFDE@oecd.org

Addressing the Tax Challenges of the Digitisation of the Economy – Public Consultation Supplementary Submission

Dear Sir/Madam

We refer to our letter dated 5 March 2019 in response to the OECD's consultation document *"Addressing the Tax Challenges of the Digitalisation of The Economy – 13 February – 1 March 2019",* herein referred to as the "Consultation Document".

We further refer to meetings held between our representatives and the OECD on 19 March 2019. The purpose of this letter is to provide supplementary information relevant to the position set out in our letter of 5 March 2019. Below, we provide our further comments in relation to why banks' operating models are different from other industries. We believe these differences should be carefully considered in any reform measures. We also discuss below why banks do not develop and use marketing intangibles in the same way that other multinationals do so. We appreciate your ongoing consideration of the concerns raised by our members and efforts to address these concerns as part of the drafting of the OECD's second interim report and final report and recommendations.

1. Considerations for Banks

Banking services should receive appropriate consideration in proposed reform that has as its objective, the appropriate taxation of cross-border digital business. Banks are different to other corporates and other financial service providers that are not regulated under banking laws. For definitional purposes, a bank refers to a regulated deposit taking institution licenced to operate in a jurisdiction (and its related group subsidiary entities or branches).

Banks differ from other businesses in several key ways. Specifically, banks:

- are required to obtain a licence to conduct banking and other financial services (see Appendix 1) even if they propose to use a digital banking model. For the most part, banks

headquartered in one jurisdiction cannot simply rely on their home state banking licence when operating cross-border;[1]

- are required to hold loss-absorbing regulatory capital imposed by (one or more) prudential regulators in respect to their global operations;[2]
- have prudential limits on intra-group exposure between entities in the group;
- must maintain buffers of high-quality liquid assets to cope with instability and liquidity shortages;
- must maintain net stable funding ratios;
- are subject to additional monitoring requirements by domestic regulators;
- are subject to specifically targeted tax rules in jurisdictions including targeted anti-avoidance rules, tailored thin capitalisation rules and additional levies to support risk of failure;
- are subject to various laws, privacy, transparency and other reporting requirements particular to their industry; and
- are subject to heightened government and media scrutiny post global financial crisis.

Accordingly, these provide a natural barrier to banks using artificial or contrived methods to establish a presence in a particular jurisdiction. Further, in certain tax jurisdictions where the offshore branch business is not supported, or inadequately supported by capital, an adjustment is required to be made to the offshore branch operation's corporate income tax computation, thereby ensuring that the taxable profits are more closely aligned with those which would be achieved by similar banking activities carried out by a bank in the same or similar conditions. This means that banks pay tax in the right jurisdictions because their operations in each jurisdiction generally require a taxable presence to be established. In fact, banks are subject to higher overall rates of tax in the form of bank levies and surcharges in many OECD countries (these taxes are applied in addition to corporate taxes), and are usually calculated by reference to balance sheet positions in jurisdictions where a bank is present.

Again, we refer to the OECD Report on the Attribution of Profits to Permanent Establishments (2010), which is well accepted guidance for banks on the attribution of profit between their head office and offshore branch operations. Transfer pricing methodologies work effectively to allocate profits to the correct jurisdiction in which multinational banks operate. Revenue authority guidance and industry practice is well understood and established on profit attribution principles as they apply to banks.

Non-bank entities within the same corporate or tax group as the entity holding the banking licence should also be considered as part of banking because regulators require the banking groups to hold capital in relation to the whole group (including non-bank entities), and there are limits on the exposure that can be allocated between entities in a group. Non-bank entities are typically engaged

[1] An exception is the EU passporting system. Once a bank is established and authorised in one EU country, it can apply for the right to provide certain defined services throughout the EU, or to open branches in other countries across the EU, with relatively few additional authorisation requirements. Non-EU firms face significant regulatory barriers to providing cross-border banking and investment services to customers in many EU Member States. Even if the non-EU firm does obtain a licence to establish a branch in a Member State, that licence will only authorise it to do business in that Member State.

[2] Most capital is held in the form of non-tax deductible equity instruments. Accordingly, banks are not prone to high-risk debt leveraged capital structures like other businesses.

in the provision of financial services rather than a completely unrelated business. To require that banking entities be separated from other entities in their group would not be reasonable and would create an undue and disproportionate compliance burden. For example, many banking groups have a holding company structure, with the bank and difference business lines in separate entities carrying out leasing, funds management or insurance activities related to the primary bank. Regulators recognise this organisational structure and, in turn, structure their prudential requirements to cover such groups.

However, we acknowledge that other unregulated financial service providers including those smaller digital enterprises which benefit from the use of customer data, and which are not part of a licenced banking group may need a separate evaluation. As support for the position as to why banks differ from other businesses, please refer to two IBFed documents from 2016 provided as additional Appendices to this letter. The first document is entitled *"Why International Banks are Different*), and the second document is entitled *"Public Discussion Draft – BEPS Action 4: Approaches to Address BEPS Involving Interest in the Banking and Insurance Sectors"*.

2. Marketing intangibles

We refer to the marketing intangibles proposal in section 2.2.2 of the Consultation Document.

As set out in footnote 4 to the Consultation Document, the term "marketing intangibles" has the same meaning as is set out in the OECD Transfer Pricing Guidelines:

> *"an intangible . . . that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers." (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 (OECD TPG), p. 27).*

We discuss the aspects of the definition below. As a general point, however, we would like to emphasize initially that the banking industry substantially remains a traditional business, even though it is undergoing a profound digitalisation process. The core value creating factors of the banking industry keep being rather "traditional" factors such as entrepreneurial risk, economic substance, product development and innovation. These factors are closely associated with the jurisdictions where a bank is regulated and taxed. Therefore, the value creation of a financial institution generally takes place in the same location where the regulator oversees the banking operations.

Trade names and brand

It is our view that banks do not develop and utilise marketing intangibles in a cross-border context in a comparable manner to other multinationals (e.g. consumer goods companies).

As discussed in our letter of 5 March 2019, the primary users of brand and trade name would be retail and consumer banks, many of which limit their operations to a single market jurisdiction. A bank's brand and trade name can be important for individual customers and small businesses who

partner with a financial institution (often through a personalised manager) to manage their banking affairs and fund their business/investments. Individual and small business customers are perceived to be more sensitive to positive (and negative) sentiment toward banks based on their brand. Of the banks that have global operations, it is commonplace for each of their retail banking operations to service a single jurisdiction, whilst at the same time providing wholesale banking services to other offshore locations. It would be highly unusual for a bank to actively develop marketing intangibles (e.g. by having strong brand recognition through promotion and marketing) in a jurisdiction in which they are not also licenced to operate (and where they do not already have a taxable presence through a branch or subsidiary). You would not therefore expect to see a bank “reach in” to a jurisdiction either remotely or otherwise to develop marketing intangibles, where they do not have a local presence.

Where a bank is not licenced to provide services to a customer in another jurisdiction, there is little benefit from developing or using marketing intangibles in such other locations. Typically, local regulations prevent banks from freely accessing a foreign market. Consequently, if a bank is not allowed to be active in a certain market, no valuable marketing intangibles can be actively developed in or attributed to this market. The location of intangible assets related to brand for a bank should therefore align with the location of the head company or home jurisdiction of the bank or its foreign subsidiaries or permanent establishments, and not artificially in another jurisdiction.

Wholesale banking operations such as financial market trading, clearing, broker/dealer and trade finance services are largely based on market capabilities and margins rather than brand or marketing. In the sphere of institution or investment banking advisory, corporate decisions are less influenced by advertising and marketing than established relationships and expertise/capabilities. Accordingly, marketing intangibles have little if any relevance to banks providing business to business products and services in the wholesale and institutional markets.

Customer lists, customer relationships, and proprietary market and customer data

Similar to other industries, banking is undergoing a digital transformation both in the way they interact with their customers and the way they internally conduct their operations. This has led to progression, and future anticipated development of technologies including (but not limited to):

- Advanced analytic tools and products for customers and internal use;
- Artificial intelligence, machine learning and digital interfaces;
- Open application programming interfaces (APIs);
- Process automation and robotics;
- Mobile devices and wearable technology;
- Platforms; and
- Utilisation of cloud-based technology.

As technology develops, it is important to consider to what extent, if any, they could result in marketing intangibles that are the focus of the Consultation Document.

The second group of marketing intangibles in the Consultation Document (customer data, customer relationship and customer lists) are described as being derived from activities targeted at customers and users in the market jurisdiction and support the treatment of such intangibles as being created in the market jurisdiction. As mentioned above, domestic regulation often restricts market access for foreign banks and prevents them from remotely creating marketing intangibles through activities directed at this market.

Some of the technologies listed above will result in retention and analytics or development of customer data that is obtained. However, these are generally relevant for marketing to customers in the jurisdictions in which they are licensed to operate, and already have a taxable presence. This analysis is typically conducted to enhance product offerings and services to customers or to identify opportunities for further growth in locations where banks are licensed to operate.

Banks are not in the business of collecting customer data for on-sale to third parties for a profit as they are bound by privacy and data laws. Data may only be shared under mandatory legal requirements, such as tax reporting or anti-money laundering rules, or, via an established (mandatory) open-banking interface and with the permission of customers. In such cases it is not the analytics that are shared, rather the raw data.

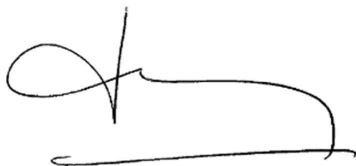
3. Conclusion

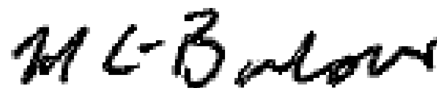
It is the firm view of the IBFed that banks do not engage in the types of activities which create a tax erosion or profit shifting outcome and, as such, should not be the focus of the current consultation.

We request that regulated banks receive due consideration due to the nature of their businesses model in the proposed OECD recommendations. In addition, we recommend and request confirmation that the application of the OECD Report on the Attribution of Profits to Permanent Establishments (2010) should not be disturbed.

We thank you for taking our comments into consideration, and we look forward to the planned discussions with you on the 17th of May 2019.

Yours sincerely,





Hedwige Nuyens
Managing Director IBFed

Michael Barbour
Chair of the IBFed Tax WG

Appendices: IBFed papers of April and September 2016