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22 June 2019

Tax Policy and Statistics Division
Centre for Tax Policy and Administration, OECD
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Addressing the Tax Challenges of the Digitisation of the Economy – Public Consultation Supplementary Submission

Dear Sir/Madam

We refer to our letters dated 3 May 2019 and 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 our meeting held between our representatives and the OECD on 17 May 2019. The purpose of this letter is to provide supplementary information requested in that meeting. Below, we provide our further comments on the functions and operations of various types of cross-border banking activities and consideration as to whether such activities give rise to a distribution function. Additionally we have provided some initial thoughts on some aspects of the OECD's recent programme of work document.

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.

OECD's programme of work

We look forward to further engagement in relation to the issues set out in the recent document *"Programme of Work to Develop a Consensus Solution to the Tax Challenge Arising from the Digitalisation of the Economy."*

By way of an initial observation, we note that as part of the design scoping limitations (set out in section 1.6 of Pillar One - discussing revised nexus and profit allocation rules), the programme of work will explore different limitations that could operate, such as negative exclusions, safe harbours and/or other screening criteria. As set out in paragraph 37, *"due consideration will be given to whether or to what extent any new taxing right would apply to certain items such as… financial instruments."* For the reasons outlined in our previous correspondence and this letter, we are of the view that global banks do not conduct activities that result in a misallocation of profits amongst jurisdictions in which they operate. Accordingly, financial services should be excluded, or as a minimum, should be subject to a safe harbour formula which accommodates typical global banking activities.

We are still considering the implications arising from Pillar Two, although as preliminary comment, regardless of the outcome under this Pillar, we are strongly of the view that normal investment and client flows made cross-border that are undertaken on arm's length terms should not be subject to additional administrative burden. Banks are already subject to significant administrative burden in complying with global tax and legal regimes and this should not be increased.

Limited risk distribution models

We are aware of the heightened focus by tax authorities in relation to multinational groups operating on an inbound basis into their markets through limited risk distributor models. The risk typically arises where a subsidiary or branch imports and distributes products or services purchased from overseas related entities (such as goods for resale, or the distribution of digital products or services), where the intellectual property in those products or services is held by international related parties. In such instances the distributor may derive a lower profit margin than their related party suppliers offshore based on the functions undertaken and assets / risks assumed in the distributor's jurisdiction. Banks do not operate under this type of model.

Banking business

As outlined in our previous letters, banks must operate under licence and meet regulatory requirements in the jurisdictions in which they operate. Banks are required to hold at-risk capital relevant to the business activities and locations where they operate. Their activities may be retail in nature (e.g. private, individual and small business customers) or wholesale/institutional (business to business). Retail and institutional banking activities do not adopt limited risk distribution models in a cross-border context. A few examples are considered below:

- Where banks have an on-line presence, local regulators still require them to hold sufficient capital at risk, therefore it would be unusual to for such services to be provided without the bank also having a taxable presence. In the unusual circumstance where a customer can access a trading / online platform in a jurisdiction where the bank does not have a significant presence via a branch or subsidiary, this should not be seen as a limited risk distribution model. This would generally be as a direct service provided a customer in another location rather than a redistribution of an existing product or service. As the service is provided directly, it is not a model which adopts an on-sell mechanism.

- Where a bank's relationship manager facilitates services or credit in another jurisdiction provided by a foreign branch or associated foreign entity (such as trade finance services). In such cases, the foreign bank entity providing the service to the customer would normally be operating under a licence in that jurisdiction and have an existing taxable presence. That entity would be expected to derive an arm's length profit margin commensurate with the risks assumed and functions performed in providing the service. The activities are not a re-distribution of an existing product or service.

The banking operations conducted by a local subsidiary or branch of a global bank can vary in terms of the scope and function. However, due to the nature of banking activities, the primary types of income derived by banks i.e. net interest margin and fee income, are largely dictated by market conditions in that jurisdiction. Interest rates set for customers are influenced by benchmark rates set by central banks, risk premiums and capital margins set by the debt capital market cost of funds. Similarly, fees charged for services provided to customers are commensurate with services provided and the profit margin on fees should align with the product profile or level of service provided by the bank. In some jurisdictions, bank fees charged to customers may not be determined freely since they can be regulated by local regulation.

You will find a table in annex summarising a number of key banking functions that may be provided cross-border by a global bank. Our comments provided in the table attached are generic in nature and are consistent with accepted transfer pricing methodologies applied by global banks, usually under the OECD report on the attribution of profits to permanent establishments dated 2010. Whilst the functions of global banks are largely consistent, their global operations and structures can differ. Furthermore, the functions in the table relate to core banking services and do not include other financial services such as funds management or insurance businesses.

We thank you once again for our fruitful discussion on the 17th of May and look forward to stay in touch.

Yours sincerely,

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