Australian Banking Association

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Principal Adviser
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Via email: corporatetax@treasury.gov.au

Dear Principal Adviser

ABA response to Treasury DP: The digital economy and Australia's corporate tax system

The Australian Banking Association (**ABA**) appreciates the opportunity to provide comments on Treasury's Discussion Paper: *ABA response to Treasury DP: The digital economy and Australia's corporate tax system October 2018* (**discussion paper**).

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

General Comments:

The ABA is of the view that the activities of banks in Australia are appropriately taxed in Australia and the offshore jurisdictions in which they operate. Banks in Australia contribute a significant quantum of total corporate taxes paid in Australia and do not structure their tax affairs through low taxing jurisdictions. They were, therefore, not the obvious target of the recent OECD Base Erosion and Profit Shifting (**BEPS**) actions. In addition, banks in Australia are highly regulated entities and do not, as an ordinary course of business, engage in providing digital services that are not already subject to tax.

If there is to be any substantive change to the taxation rules impacting digital business, the ABA is of the view that this should be done with consensus of the OECD member nations and as a result of due consideration and consultation between member states and their taxpayers. The OECD is due to release its final report in 2020 which will provide the Government with clarity around what reform, if any, is required. Until the OECD publishes its view, the ABA does not support any interim measure, including the introduction of a digital services tax. If unilateral action is pursued in Australia or any other country, this could result in taxpayers being subject to double taxation.

Other jurisdictions have considered introducing a digital services tax to target services such as digital advertising, online intermediation and transmission of data. Financial services do not fall within the scope of those services targeted by recent announcements in Europe.

We attach for your reference, two separate papers prepared by banking groups:

- International Banking Federation (**IBFed**) paper dated 25 September 2018
- European Banking Federation (**EBF**) letter to the EC dated 15 November 2018

The ABA welcomes the discussion paper and our response follows:

1) Is user participation appropriately recognised by the current international corporate tax system? If not, how should value created by users be quantified and how should it be taxed?

The ABA is of the view that the existing corporate tax framework adequately captures profits earned by banks. Banks utilise data that they obtain from their customers to provide services which in turn are subject to tax. Accordingly, to the extent that there is any monetisation of data by a bank, this will be reflected in the profits subject to taxation. Where data is mandated to be exchanged for no value between a bank and third party for no fee, for example under an Open Banking framework, this transaction should not be subject to tax. Where a value added service in respect to customer data is provided to a third party, the profit should be subject to tax under ordinary principles.

2) Is the value of intangible assets including 'marketing intangibles' appropriately recognised by the current international corporate tax system? If not, how should value associated with intangibles be quantified and how should it be taxed?

3) Are the current profit attribution rules 'fit for purpose'? If not, how should profits be attributed?

The OECD Report on the Attribution of Profits to Permanent Establishments (2010) is well accepted guidance for banks on the attribution of profit between their head office and offshore branch operation. The ABA is of the view that these rules function appropriately to provide for the correct arm's length allocation. Australian Taxation Office (**ATO**) guidance and industry practice is well understood and established on profit attribution principles. Accordingly, any deviation from those principles would cause significant impact to banks and their operations. For example, a lengthy consultation was required to determine the appropriate methodology for allocation of profits from global derivative trading activities by banks.

4) What are your views on allocating taxing rights over residual profits associated with: (i) user contribution to 'user' countries, or (ii) 'marketing intangibles' to market countries?

5) Should existing nexus rules for determining which countries have the right to tax foreign resident companies be changed? If so, how?

6) From a tax perspective, do you consider that the digitalised economy is distinguishable from traditional economy? If yes, are there economic features of the digitalised economy that present special challenges in the context of taxation? How are these features relevant for assessing the costs and benefits of various models of taxation?

7) Can and should any changes to the international nexus and profit attribution rules be ring-fenced to apply only to highly digitalised businesses? If so, how?

The ABA considers that changes to the international nexus and profit attribution rules should only be undertaken with international consensus, which may or may not apply on a ring-fenced basis to highly digitalised businesses. If any unilateral measures are adopted, these should be very specific, targeted and clear that they do not have application to banks.

8) Are there changes other than to nexus and profit attribution rules that should be made to the existing international corporate tax framework and/or Australia's tax mix to address the challenges presented by globalisation and digitalisation?

The ABA understands that there is growing consensus among some jurisdictions (e.g. Germany) in relation to the introduction of a global minimum tax. Whilst little detail is available, it is possible that such tax may operate as:

- Adoption of a minimum tax rate which no state can avoid applying (and no multinational can avoid paying); or

- A disallowance of tax deductions (or similar adjustment) within a jurisdiction where there is a mismatch in the equivalent minimum tax applicable in the other jurisdiction.

From the ABA's perspective, this has the potential to impact all multinationals (not only banks) which have operations in low tax jurisdictions. It would be important to identify the appropriate base and rate for a global minimum tax. The tax should apply to the existing base to avoid double taxation, and currently there is significant divergence between the corporate tax rates of many OECD member countries (such as the UK), and Australia. Banks in Australia should not be unfairly penalised because of the relatively high corporate tax rate in Australia relative to its major trading partners. Again, the Government should not seek to implement such measures without global consensus.

9) What does the experience of other countries that have introduced interim measures or that are contemplating them mean for Australia?

To the extent to which other countries implement interim measures that impact financial services, there is the potential for unintended tax consequences for banks in Australia. Accordingly, as outlined in our response for question 13 interim measures should be limited in scope to exclude financial services, and this exclusion should be comprehensive.

Banks make their commercial decisions with consideration of various factors, including operating costs / risks in other countries (such as capital, funding and taxation). In the absence of international consensus, to the extent to which banks in Australia are subject to any digital tax on the provision of their financial services, this may influence / impact the extent to which they provide services within a particular jurisdiction. Banks in Australia largely operate through branch structures in offshore jurisdictions, therefore any implementation of measures offshore could result in a disconnect between banks onshore and offshore operations (where financial services are not excluded).

10) Should Australia pursue interim options ahead of an OECD-led, consensus-based solution to address the impacts of the digitalisation of the economy on the international tax system?

No, Australia should not pursue interim options ahead of the OECD-led, consensus-based solution.

If unilateral action is pursued, this could result in taxpayers being subject to double taxation (where credits are not available). If the Australian Government ultimately decide to pursue an interim measure, in addition to an exclusion for financial services, the Government should not require banks to become a withholding agent. The cost and complexity of such a feature in any interim measure would result in unreasonable and significant regulatory costs being placed on banks which would not be commensurate with any benefit.

11) What indicators could be used to identify businesses that benefit most from user-created value? Would an interim measure applied to digital advertising and/or intermediation services accurately target that value? How broadly or narrowly should 'digital advertising' and 'intermediation services' be defined?

12) The choice of 'nexus' for an interim measure (or a longer-term 'virtual' PE proposal) involves significant trade-offs between ease of administration and the risk of avoidance. Which nexus option strikes the best balance between these considerations?

13) What are your views on thresholds for an interim measure, taking into account the need to meet Australia's international trade obligations?

The ABA does not support the implementation of an interim measure and is of the view that reform should be actioned with international consensus following the OECD's final report in 2020.

Should an interim measure be introduced such as a digital services tax, all financial services should be excluded from the scope of such measures. It is the expectation that all financial services and peripheral services provided by banks would be excluded including all traditional online and digital services provided to customers, and trading/execution platforms, clearing house and collateral services.

The accurate targeting of such measures is essential given that the rules are generally revenue based and could (based on revenue) apply to large multinational banks.

Based on the existing European Commission rules to date, it is unclear whether certain types of financial services will be excluded under the rules. Article 3(4) of the Directive[1] provides for an exemption from financial services, however certain services may not be included within the exemption. Some concern has been raised in relation to:

- Trading facilitation (pre and post), trading venues and execution platforms for financial market transactions – these may allow members to buy and sell financial products and securities, commodities or foreign exchange. The platforms may operate to provide an interface for matching of transactions between members.
- Portfolio compression – where counterparties to derivative transactions can net off their positions via a digital platform.
- Trading venues established in the EU facilitating the trading of non-MiFID[2] products or trading venues established outside the EU.
- Fees charged by non-EU trading venues to members in the EU.

The ABA broadly supports the view of the EBF, as noted in their submission (attached), a "clear exemption must be provided not only for ad hoc payments, trading venues or crowdfunding, but for all types of financial and banking services".

We note the that the UK has announced that it will exclude financial services, with the business activities specifically considered not in scope of a digital services tax to include "the provision of financial or payment services - these activities are not considered to derive significant value from user participation and are often subject to unique tax and regulatory regimes already. Financial and payment services will not therefore be in-scope of the DST". The ABA will await further guidance on the precise scope as to what will be included. Consultation on the measures closes on 28 February 2019 and details will become available thereafter.

Yours faithfully

Signed by

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[1] Council Directive COM (2018) 148
[2] Markets in Financial Instruments Directive

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Taxation of the Digital Economy

This paper considers the recent consultation on the taxation of the Digital Economy, insofar as relevant to banks. It provides comments on the structure of banking businesses, key risks to the banking sector and cautions against applying some of the digital tax solutions to banking activities.

1. Summary

- In the Digital Economy, a main concern and potential source of disagreement between countries is the question of where value is created. While countries agree that a multinational's profits should be taxed in the jurisdictions in which it creates value, some countries argue that the value for companies in the Digital Economy derives from factors such as user participation or user location.
- No clear consensus has been reached, with the OECD calling for further consultation and a consensus approach.
- The European Commission and the UK Government are seeking to implement specific tax measures.
- The international tax framework needs to be responsive and flexible to the changing nature of the Digital Economy. Whilst banks are experiencing changes to the way that they operate as a result of the Digital Economy, they should be differentiated from "pure" digital companies.
- Measures taken to address the tax challenges identified must be internationally coordinated in order to avoid the danger of double or multiple-taxation. In that respect, the Digital Services Tax proposed by the Commission would result in double taxation.

Jurisdiction-specific comments are provided in the Appendix to this paper.

2. Background

The Digital Economy is experiencing dramatic growth and is altering the way that multinational organisations interface with their customers. Many jurisdictions are concerned that their taxation systems do not cater well enough to the Digital Economy, and accordingly revenues could be diluted.

Following on from a 2015 report "*Addressing the Tax Challenges of the Digital Economy"* as part of the OECD/G20 Base Erosion and Profit Shifting (BEPS) package, the Task Force on the Digital Economy (TFDE), sought input from the public on a number of key issues including:

- Digitalisation, Business Models and Value Creation;
- Challenges and Opportunities for Tax Systems;
- Implementation of the BEPS package; and
- Options to address the broader direct tax policy challenges.

The 2015 report acknowledged that it would be difficult to 'ring-fence' the Digital Economy from the rest of the economy for tax purposes, and other BEPS measures would need to be considered. Following on from this, a new interim report on the implications for taxation of digitalisation was delivered to G20 Finance Ministers in March 2018.

OECD interim report

On 16 March 2018, the OECD published its interim report[1] following on from the abovementioned consultation. It sets out the agreed direction of work on digitalisation and the international tax rules through to 2020.

The OECD members agree that there needs to be a "coherent and concurrent review of the 'nexus' and 'profit allocation' rules" which are fundamental concepts relating to the allocation of taxing rights between jurisdictions. A consensus-based approach is preferred given differing views, and the goal will be to produce a final report in 2020, with an update to the G20 in 2019.

The report also sets out the framework of design considerations for countries in favour of introducing interim measures.

[1] http://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm

European Commission response

On 21 March 2018 the European Commission proposed the introduction of a Digital Services Tax imposable on revenues resulting from the provision of certain digital activities, as well as the introduction of a new regime relating to the corporate taxation of companies "with a significant digital presence", aimed at addressing the tax challenges of the Digital Economy in the European Union.[2] These legislative proposals are to be submitted to the Council for adoption and to the European Parliament for consultation. It is understood that the parliaments of 4 EU Member States have submitted formal objections to the European Commission's proposals to tax the Digital Economy. The national parliaments that are formally opposed to the proposals are understood to include those of Denmark, Ireland, and Malta, and the House of Representatives of the Dutch Parliament.

The European Commission has said the current tax rules were not designed for the recent boom in global digital business that has little or no physical presence. As a result, there is, according to the European Commission, a disconnect / mismatch - between where value is created and where taxes are paid.

The European Commission has put forward an approach involving two distinct legislative proposals:

- A reform to corporate tax rules (long-term solution) - so that profits are taxed where businesses have significant interaction with users through digital channels, even if a company does not have physical presence in the jurisdiction in question.
- A Digital Services Tax (interim solution) - covers the digital activities that escape tax altogether in the EU. The tax will apply to revenues created from activities where users play a major role in value creation and which are the hardest to capture with current tax rules. These include revenues (which are not immediately obvious as banking services):
    - created from selling online advertising space;
    - created from digital intermediary activities which allow users to interact with other users and which can facilitate the sale of goods and services between them; and
    - created from the sale of data generated from user-provided information.

In its interim report, the OECD did not directly address Digital Economy concerns from the perspective of the banking industry. However, the importance of customer data is a key focus by both the OECD and European Commission (albeit it is acknowledged that data itself does

[2] https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en
http://europa.eu/rapid/press-release_MEMO-18-2141_en.htm

not drive value creation). Rather, it is reflected in the profit generated by specific client transactions that may utilise available data.

It is therefore important to consider how banks differ from other organisations utilising and providing services within the Digital Economy and to what extent tax reform may be required for the Digital Economy from the perspective of banks.

3. Structure of banking business and identification of value drivers

Banking vs other digital business

- Banks are similar to non-bank organisations in that they provide services and products to their customers. However, there are also fundamental differences. Banks are generally regulated with scrutiny in jurisdictions in which they operate, and exercise their activities under a licence and applicable banking laws. Banks must meet ongoing and increasing regulatory capital requirements, they are subject to information disclosure requirements and transparency laws, and must deal with increasing threats to data security. In turn, the highly regulated industry allows access to capital markets and a low cost of funds.
- Non-banking digital organisations, on the other hand, are generally not subject to such onerous legal and regulatory barriers, such as those applied to banks. Some jurisdictions have introduced rules to specifically encourage non-banks to challenge the established banking industry.

Agile structure of banks

- To respond to competition from outside the industry, banks are adopting more customer-centric strategies to engage with digitally-aware customers (e.g. in the retail banking space, digital apps and platforms now offer a broad range of solutions). The ways that customers bank have changed vastly in the last 5-10 years, and will continue to do so. Banks are also improving productivity and reducing cost by closing physical branches, reducing the number of ATMs / cashpoints and ushering customers onto digital service points, on phones, wearables, tablets and online. Automated systems deal with telephone banking as staff numbers are reduced. With a reduction in ‘bricks and mortar’ banking, customers may ‘consume’ financial services at their place of choosing. This could be in any jurisdiction, i.e. bank customers could be located anywhere at the point of consumption. However, it would be unusual for a bank’s retail customer base to not be mainly located in jurisdictions where the bank is licenced to operate.
- Additionally, banks are making substantial technology investments to explore the next series of value networks and systems, e.g. with the use of Blockchain technology or Artificial Intelligence.

Location of banking services

- As noted above, banks are regulated in the jurisdictions in which they operate. This does not always mean that banks, particularly in a retail banking context will be providing their services cross-border. Many banks operate in a purely domestic market, whilst others provide ‘global’ services. Accordingly, this is one structural difference between many banks and other digital businesses that seek to service their customers across many jurisdictions.

Adoption of technology

- Banks are adopting technology at different speeds. Some banks are embracing collaboration and co-innovation, actively investing in FinTechs, start-ups and making other strategic investments. Accordingly, there is an interrelationship between the two, where banks look to FinTechs for speed and agility to develop products and target customers, and FinTechs can leverage off a bank’s infrastructure, scale and client base.
- The use of platforms is key to driving banking value in the digital economy. Platforms bring together products and services for consumption. Banks are in a good position to build partnerships within the industry and outside of the industry.
- More generally, there is a movement toward an ‘open’ banking landscape whereby products, services and data (including customer data) can be shared with third parties. Regulators and lawmakers have already implemented frameworks for requirements, for example in the EU around third party sharing of customer data and payments information.

Use of data

- Typically for digital business, users can form strong relationships with online platforms with which they engage and participate. This interaction between customers and service providers, which characterises the Digital Economy, allows businesses to generate data on users’ behaviours, interests and consumption habits through direct information that users provide and the monitoring of their engagement with a platform. Value is often then created using a combination of algorithms, user data, sales functions and market knowledge.
- Whilst value may be derived from data, the collection of the data itself does not result in the users participating in a value creation activity. The UK government agrees with this view, stating that “sourcing of data from the UK, through what could be considered

passive or transactional relationships with UK customers" should not "entitle the UK to a taxing right on business profit."[3]

- In a banking context, data may allow banks to derive value from its use to produce useful information on how best to tailor/complement the banking experience for customers, and ability to cross-sell products. Banks are increasingly investing in analytics to best drive value from the data they hold.
- Digital companies often choose to offer a 'free' service, and collect data associated with this service with the objective or tailoring their service/monetising. Banks generally charge a fee for banking products either directly or via margins. Banking activities are different to those types of services that can be considered targeted by a Digital Services Tax (as noted above) such as the selling of advertising and intermediary activities.

Non-retail activities

Notwithstanding the change to how banks interact with customers, they continue to carry on other traditional banking activities, particularly in their wholesale and treasury businesses. Bank funding is sourced locally and globally, and is dependent on market conditions and availability of credit. The tax rules that apply to banks, including the residence / source principles, as well as attribution rules around profits to permanent establishments should continue to apply to these transactions.

4. Key risks to the banking sector

Banks face risks of revenue loss from non-bank entities competing for share of customers and the provision of traditional banking and other financial services. Examples of competitive threats include:

- Fintech start-ups and disruptors;
- Large technology companies offering traditional banking products;
- Digital payment platforms;
- Social media companies;
- Financial service aggregators; and
- Peer to peer lending.

- With customers having access to comparison sites and independent 'aggregators', a bank's brand loyalty and competitive opportunities can be diminished. This is particularly so in respect to their lending business, where customers may access the cheapest pricing through digital means. At the same time, banks face regulatory pressure on sales

[3] https://www.gov.uk/government/consultations/corporate-tax-and-the-digital-economy-position-paper

and pricing models, reflected by recent scrutiny in many countries on incentive-based branch sales, cross-subsidies, and mis-selling of services such as insurance and financial advisory products.

- Within the industry, those banks that are agile enough meet customer requirements by enhancing systems and platforms, and may be able to successfully partner with smaller FinTechs to achieve greater efficiencies and success.

Tax law reform

- Banks recognise the need for a fair and flexible tax system which appropriately allocates taxing rights based on where value is created. Tax reform to the Digital Economy has the potential to impact different banks by differing scales (e.g. local vs global banks, and retail vs wholesale banking).
- An approach that is not global, poorly considered and perceived as revenue-raising could bring jurisdictions out of line with each other. Particularly where the majority of jurisdictions are still applying established residence and source taxation principles.
- Banks have traditionally safeguarded important private customer data and continue to do so. To the extent that this information is required to be shared in an ‘open’ banking ecosystem with third parties, the protection of data is paramount.
- Challenges remain with global transfer pricing rules, however these are not limited to the Digital Economy.
- The successful implementation of BEPS initiatives globally needs time to properly have impact. Any inconsistency in global tax rules could discourage investment and growth due to uncertainty. A greater risk of uncertainty arises from interim solutions that are not applied consistently for global banks.

5. Recommendations / observations

- Banks are inherently different from other businesses, including ‘pure’ digital corporates and generally have a regulated / licenced presence in the jurisdictions in which they operate. Retail banking customers are typically located in these same jurisdictions in which they operate. It is therefore important to differentiate between banks and other participants in the digital economy with regard to any changes to the taxation laws.
- The Digital Economy has developed dramatically in a short number of years however and there is a significant further way to go. There are potentially unknown and new ways in which the Digital Economy may develop. Accordingly, well thought out measures are important and there is a need for flexibility as the landscape changes.
- Measures taken to address the tax challenges identified must be internationally coordinated in order to avoid the danger of double or multiple taxation. The OECD BEPS

project with its inclusive framework has a very broad base and is well placed to facilitate international coordination. The BEPS measures can already be seen to have meaningful impact with multinational corporates ensuring their structures are in alignment with BEPS principles. Short-term solutions could have an adverse impact as conflicting rules apply between countries and cut across existing established principles

- Banks play a large role with respect to data management but their business models remain essentially the same. Any rules seeking to tax the use of data must be closely aligned with the actual value creation model for banks, which does not include data monetisation.
- Banks use data to better provide products and services to their customers and not by directly monetising that data. Therefore, banks should continue to be taxed on the profits arising from those products and services.
- The impact of the digital changes will likely initially be more visible for retail banking activities. This is because customers now consume banking services from various locations and jurisdictions. However, as banks will typically only provide services where they are licensed to do so (and have a presence), there continues to be an important role to play for existing tax rules around residence / source and the attribution of profits to permanent establishments.
- Technology advancement by itself has not fundamentally changed how businesses generate revenues. Rather technology and automation may increase operational efficiencies or replace certain business functions that are becoming more mobile. The speed of uptake of technologies will differ between types of banks and financial services providers.
- Any interim solution (e.g. a Digital Services Tax) should proceed with careful consideration of its potential scope, nexus, rate, collection mechanism and detailed design. It should not result in additional taxes for banks as all banking activities are already fully taxed according to the rules set by the OECD. It should also be ensured that such measures do not create, by over-charging banks, distortion of competition between traditional banks and certain players entering banking markets and resulting from the Digital Economy. Furthermore, the risk of double taxation with regard to existing corporate income taxation and Value Added Tax/Goods and Services Tax (VAT/GST) should be carefully considered.
- The OECD “2010 Report on the Attribution of Profits to Permanent Establishments” focused on the Key Entrepreneurial Risk-Taking functions (KERTS) and provides a robust and appropriate basis on which to attribute profits to bank branches. If the concept of a digital permanent establishment is developed and accepted, it must take into account and respect the 2010 report to ensure a consistent and coherent basis of taxation for banks.

APPENDIX

Specific actions by jurisdictions

UK

The UK Treasury[4] have set out their views which align closely with the European Commission position, i.e.:

- the participation and engagement of users is an important aspect of value creation for certain digital business models; and
- the preferred and most sustainable solution to this challenge is reform of the international corporate tax framework to reflect the value of user participation.

The UK is seeking a multilateral solution from the OECD / G20 that will confirm this approach. However, it will impose a unilateral revenue based tax in the interim – which will apply to digital businesses (wherever located) deriving significant value from UK user participation. The scope is to be determined.

The UK draws a distinction between the position of active user participation creating value for certain digital businesses, and product / service supply profit under traditional value chain models.

US

The US enacted significant tax reform measures in late 2017. These measures are drafted broadly and are far reaching in their scope of taxation, including the base erosion and anti-abuse tax (BEAT) provisions. It is not yet clear what additional position they may adopt with regard to taxation of the digital economy.

The US Supreme Court handed down its decision on 21 June 2018 for *South Dakota v Wayfair, Inc.* that US States may force online retailers to collect sales taxes, despite having no physical presence in a state. The decisions could also affect non-US businesses that make sales to the United States but do not have a physical presence there. Given the Court's conclusion that *"physical presence is not necessary to create substantial nexus",* this decision may impact other US state taxes, such as corporate income taxes, which could apply to the income of an entity conducting significant business activities in a state without having a physical presence there.

[4] https://www.gov.uk/government/consultations/corporate-tax-and-the-digital-economy-position-paper

Australia

The Australian Government held an initial public consultation in late 2017 ahead of the proposed Digital Economy Strategy which is to be released in 2018.

The Australian Government has separately announced that a consultation will be under ken into the taxation of the Digital Economy.[5]

The Netherlands

The Dutch House of Representatives endorses the importance of taxing the Digital Economy and of reforming the tax system in order to achieve this and takes the view that only a global approach would be an appropriate solution.

For that reason, and especially since Member States are already working on a joint approach in the OECD context, the Dutch House of Representatives drew a "yellow card" on 15 May 2018 against the plans of the European Commission to introduce a tax for international companies providing digital services in the EU.

The House of Representatives believes that taxation and policy are primarily a matter for the Member States themselves, and that Member States can implement this reform even without European harmonisation or interference.

South Africa

South Africa has, since 1 June 2014, implemented VAT on the supply of electronic services by any supplier from a place in an export country (any country other than South Africa) where at least two of the following factors are present:

- the recipient is a South African resident,
- payment for such electronic services originates from a registered South African bank; and/or
- the recipient of the supply has a business, residential or postal address in South Africa.

Foreign suppliers of such electronic services are required to register for VAT where supplies made exceed R50 000.

The Minister of Finance announced in the Budget Speech 2018 that the VAT base for the supply of electronic services by foreign businesses to South African consumers would be

[5] As announced in the Federal Budget on 8 May 2018

broadened. The Draft Regulations state that "electronic services" will be defined as: *"…any services to be supplied by means of an electronic agent, electronic communication or the internet for any consideration…"* subject to certain exclusions for educational services provided by a person regulated by an educational authority in the export country and telecommunication services. This now includes anti-virus software, online advertising, broadcasting, online gaming, cloud computing, online consulting, online software supplies and training services. With this new regulation, every possible supply of services by means of electronic agent, electronic communication or the internet including financial services and the banking sector except for telecommunications and educational services would fall within the ambit of electronic services.

The proposed effective date of the regulation is 1 October 2018.

Furthermore, in March 2018, the Davis Tax Committee made the following recommendations to the Minister of Finance in relation to VAT and electronic commerce transactions. These include that:

- supplies qualifying as electronically supplied services should be categorised and explained in a guide or interpretation note;
- a distinction should be made between supplies made between businesses, business-to-business (B2B) and business-to-consumer supplies (B2C), with only the latter being subject to the e commerce rules;
- the invoice basis of accounting for VAT be the default position; and
- the VAT registration threshold for foreign electronic suppliers (as defined) be made the same as the compulsory VAT registration threshold i.e. a taxable turnover of R1 million in any 12 month period.

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EBF comments on the proposal for a Digital Services Tax

Executive summary

The EBF recognises that the digitalisation of the economy questions the standard international taxation principle based on the concept of "Permanent Establishment", which requires a physical presence.

Such a challenge definitely needs to be addressed in a consistent and coherent way and from a global perspective. The efforts of the OECD in order to elaborate comprehensive solutions need to be supported much more than short term reactions with possibly unintended negative consequences for the European economy.

European banks are fully taxed according to prevailing international standards and, due to applicable regulations, their taxable profits arise where the real economic activity is undertaken. Any additional taxes for European banks would eventually affect their ability to compete globally and to finance the European economy and households.

It is the EBF's understanding that Article 3(4)(b) of the proposed Directive on the common system of a digital services tax (DST) on revenues resulting from the provision of certain digital services contains an exemption for "the supply by a trading venue or a systematic internaliser of any of the services referred to in points (1) to (9) of Section A of Annex I to Directive 2014/65/EU (MiFID)". However, we are concerned that this exemption appears to be limited in scope, especially since it applies only to trading venues that are regulated under MiFID. Consequently, any venues which are not regulated by MiFID, including all third country venues, would remain under the scope of the DST. This would appear to bring into scope non-MiFID instruments where they are traded via such venues.

If a DST were introduced in the EU as an interim measure, then a clear exemption must be provided not only ad hoc for payments, trading venues or crowdfunding, but for all types of financial and banking services. In respect of the latter, consideration should notably be given to the list of activities subject to mutual recognition in Annex 1 of the CRD IV. We urge the Council to carefully consider the wording of this exemption to avoid any legal uncertainty and ensure that it is future-proof.

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As an alternative for ensuring that only large digital service providers would be subject to the DST, the EBF recommends that the calculation of the thresholds should only take into account the activities and commissions targeted by the taxation, and not the global turnover of companies.

Need for global actions

Digitalisation creates widespread changes in the economy and the way businesses operate. As large digital corporations develop new valuable business models that allow them to supply new digital services or products, they are featured by a limited physical presence. However, where value mainly stems from user interaction and the use of data from such interaction, it is acknowledged that existing principles of international taxation may fall short to appropriately tax income derived from such new business models, i.e. to tax income in those jurisdictions where value is actually created.

In order to ensure a fair taxation of revenues generated by such new business models, a thorough rethinking and redesign of the principles of international taxation (in particular nexus and profit allocation) as embedded in international tax treaties is needed. The DST, as it is currently proposed, does not sufficiently cover the risks of double taxation.

The EBF welcomes the idea that a reform is needed in the corporate tax rules, but would like to underline that any initiatives taken to address the tax challenges should preferably be internationally coordinated and aligned with the work performed by the OECD in the context of the BEPS Action Plan. The taxation of the digital economy is a global issue and it should be considered as such by the legislator. Non-global actions will cause legal uncertainty and fragmentation to the applicable international tax rules.

We therefore urge the Council to consider in priority the development of a global framework at the level of the OECD so as to align any European initiatives with the work performed in the context of Action 1 of the BEPS Action Plan.

Why banks are different

If it is still considered necessary to introduce short term measures, as is the case with the proposed DST, the EBF urges that such an interim measure is applied in a targeted manner and does not impact the European banking industry.

Banks, are indeed inherently different from other businesses, including "pure" digital corporates, in the sense that they have, as a rule, a regulated / licenced presence in the jurisdictions in which they operate. In addition, retail banks generally do not seek to service their customers across many jurisdictions. There is therefore no need for an additional gross revenue-based tax on income from banking services and products and any concerns that are raised regarding a fair taxation of revenue generated from new digital business models by large digital players do not apply to banks.

Technology advancement by itself has not fundamentally changed how banks generate their revenues. Rather technology and automation may increase operational efficiencies or replace certain business functions that are becoming more mobile:

- Banks, acting in an agile way, are currently adapting the way in which they address their clients by using new technological means and, as such, are responding to quickly evolving market circumstances proper to the Digital Economy. However, their functions and main operations remain the same, regardless of whether they operate online or in the physical world. Digital transformation allows banks to keep pace with new digital developments and to provide financial services in a way that best suits rapidly changing clients' needs in the digital world (e.g. by offering online applications next to 24/7, call centre access and traditional physical distribution channels).

- In a banking context, data may allow banks to derive value from its use to produce information on how to best tailor/complement the banking experience for customers and the ability to offer other useful banking services and products. For that reason, banks are increasingly investing in analytics to best drive value from the data they hold. But while digital developments allow banks to make better use of data (ex. construction of brands' reputation online, better customer experience), the collection and analysis of data by banks is not new and keeps being ancillary to the business of selling financial services and products. The recitals of the draft Directive also explicitly confirm that the DST is not meant to be "a tax on the collection of data, or the use of data collected by a business for the internal purposes of that business, or the sharing of data collected by a business with other parties for free".

Given the fact that the proposed DST takes the form of a non-creditable gross revenue based tax, it is absolutely key that the measure is appropriately targeted and that the DST scope does not include any revenues from financial services or products that are already appropriately taxed. If this were not the case, the DST would lead to actual double taxation and to an additional administrative burden for the financial sector in Europe.

We encourage the Council to recognise that the provision of financial services does not derive significant value from user participation. Therefore, revenues derived from these activities should not be within the scope of any EU DST as they are often subject to unique tax and regulatory regimes already.

As an alternative for ensuring that only large digital service providers would be subject to the DST, we encourage the Council to consider calculating the €750 million consolidated turnover threshold based on revenue from digital services only. This would meet the initial intention of the proposal to target large digital players only and it would avoid that industries for which existing principles of international taxation already lead to an appropriate taxation of their revenue would unintentionally be targeted by the DST.

Trading venues and other financial services platforms

The proposal for a Directive on a DST covers under its scope revenues from online advertising, the sale of raw data and intermediation services.

Particular concerns arise with regard to the exemption for listed intermediation services, which are currently considered to be too narrow to exclude the different types of digital platforms and interfaces through which banks provide financial services and products (while any revenues from such digital platforms or interfaces are already subject to regular corporate income taxation).

It is the EBF's understanding that Article 3(4)(b) of the proposed Directive contains an exemption for "the supply by a trading venue or a systematic internaliser of any of the services referred to in points (1) to (9) of Section A of Annex I to Directive 2014/65/EU (MiFID)". However, we are concerned that this exemption appears to be limited in scope, especially since it applies only to trading venues that are regulated under MiFID. Consequently, any venues which are not regulated by MiFID, including all third country venues, would remain under the scope of the DST. This would appear to bring into scope non-MiFID instruments where they are traded via such venues.

In the explanatory memorandum, the Commission stated that "multi-sided digital interfaces which allow users to receive or to know about the existence of trade execution services, investment services or investment research services", and, in particular, those which "provide a safe environment for financial transactions" should not fall within the scope of the DST. Indeed, reference is made to the importance of such financial services, as they facilitate transactions between buyers and sellers of financial products "which would not occur otherwise" and provide the "specific conditions" needed to achieve the "essential and distinct objective of facilitating funding, investments or savings". It is therefore apparent from the explanatory memorandum that the Commission does not intend the DST to apply to services supplied by trading venues.

We encourage the Council to extend the existing exemption under Article 3(4)(b) to cover venues which are not regulated by MiFID, including all third country venues. This appears to be in line with the Commission's intention to carve out all financial services, as stated in its explanatory memorandum and would avoid a position where the rules could discriminate between services provided by EU and non-EU trading venues.

In the same line of thinking, the scope of exclusions must further be expanded in order to ensure that all types of financial services platforms that are operated by banks (including trade finance platforms, M&A platforms, securities brokerage platforms etc.) are clearly excluded.

If a DST were introduced in the EU as an interim measure, then a clear exemption should be provided not only ad hoc for payments, trading venues or crowdfunding, but for all types of financial and banking services. In respect of the latter, consideration should notably be given to the list of activities subject to mutual recognition in Annex 1 of the CRD IV. We urge the Council to carefully consider the wording of this exemption to avoid any legal uncertainty and ensure that it is future-proof.

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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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