CCIA Comments: Department of Finance Canada Consultations on Budget 2023 measures

8 September 2023

The Computer & Communications Industry Association (CCIA) submits the following comments regarding the Department of Finance Canada's Budget 2023 Measures. CCIA is an international, not-for-profit trade association representing a broad cross section of communications and technology firms. For more than 50 years, CCIA has promoted open markets, open systems, and open networks.[1] CCIA appreciates the opportunity to provide its views on the revised proposed Digital Services Tax Act released on August 4, 2023.

The United States and Canada have a vibrant digital trading relationship, representing two strong digital economies whose mutually beneficial interactions are undergirded by comprehensive trade rules, most notably the Canada United States Mexico Agreement (CUSMA). According to Stats Canada up to 68 % of Canada's $16.4 billion digitally-delivered service exports are to the United States; and of service exports to the U.S. generally (Canada's biggest services trade partner), up to 82% are digitally-delivered.[2] This trade relationship and the economic well-being of both the United States and Canada are threatened by the proposed DST.

Rather than adopting a flawed digital services tax (DST) that distorts a vibrant economic relationship and invites trade conflicts, CCIA encourages Canada to work with its international partners on implementing the OECD/G20 Inclusive Framework Two-Pillar Solution reached in October 2021.[3]

CCIA strongly opposes the imposition of DSTs and similarly discriminatory digital taxation measures that depart from long-standing taxation norms. DSTs and other unilateral measures threaten to undermine the solution reached at the global level on international tax reform. A long-term, multilateral solution remains the only path forward to provide certainty, and reduce trade tensions caused by countries' decisions to enact unilateral measures. DSTs conflict with international commitments and international agreements these countries are party to. The consistency of DSTs with commitments under tax treaties and WTO obligations has been questioned by the OECD and other stakeholders.[4]

Discriminatory taxes, especially ones that the United States have made clear will be met with trade scrutiny, conflict with the spirit of this partnership, and are inconsistent with renewed commitments to rules-based trade under the CUSMA. A Canadian DST and potential retaliation by the United States would harm the economies of both countries and the relationship between them.

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[1] For more, visit ccianet.org

[2] Statistics Canada, *Canada's Services Exports Through the Lens of Digital Trade* (Dec. 15, 2020), https://www150.statcan.gc.ca/n1/pub/13-605-x/2020001/article/00005-eng.htm.

[3] OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy (Oct. 8, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax- challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf [hereinafter "OECD Agreement"].

[4] OECD, Tax Challenges Arising from Digitalisation – Interim Report 2018, *available at* http://www.oecd.org/tax/taxchallenges-arising-from-digitalisation-interim-report-9789264293083-en.htm at 183.

I. Conflicts with Canada Trade Obligations to the United States

The Canadian DST is inconsistent with Canada's obligations under CUSMA. These commitments make Canada's actions to move forward with a tax more egregious than that of European countries (including France) that do not have the breadth of commitments to the United States as contained in the CUSMA.[5]

The DSTs predominately apply to U.S. firms. The covered activities (including online marketplaces, social media, online advertising services, and user data sales and licensing services), combined with the revenue thresholds (at worldwide revenues of at least €750 million and Canadian revenues of more than $20 million) would disproportionately impact a handful of U.S. companies. The Parliamentary Budget Officer (PBO) estimates to extract $1 (CAD) billion annually from covered services.[6]

The targeted nature of the DST, based both on revenue thresholds and the definitions of the covered services, places Canada in conflict with its commitments under the CUSMA including Article 15.3 (national treatment) of the services chapter. Article 15.3 of CUSMA requires Parties to "*accord to services and service suppliers of another Party treatment no less favorable that that it accords, in like circumstances, to its own services and service suppliers*."

This provision prevents Canada from implementing measures that accord less favorable treatment to non-Canadian service suppliers compared to its own service suppliers. Because the proposed DST would disproportionately apply to U.S. service suppliers, it would violate Article 15.3: creating arbitrary thresholds to distinguish between service suppliers is not a sufficient basis to justify treating one set of (predominantly U.S.) suppliers less favorably than another (predominantly Canadian) set of suppliers.

For example, in the advertising space, only firms that offer online advertising will be subject to the 3 percent tax while other advertising services in Canada will not (despite the fact that traditional advertising in Canada is over a billion-dollar industry).[7] Additionally, it would not cover other digital services where Canadian firms are also significant actors (e.g., financial services, payment services, broadcasting and other video services, communications services, etc.). Furthermore, digital marketplaces compete with brick-and-mortar marketplaces where Canadian firms operate, so targeting digital-only services gives rise to similar issues of discrimination that Article 15.3 is designed to prevent.

A DST would also conflict with CUSMA Article 15.4 which provides that Parties "*shall accord to services or service suppliers of another Party treatment no less favorable than it accords, in like circumstances, to services and service suppliers of another Party or a non-Party*." This provision obligates Canada to provide equal treatment to service suppliers regardless of county of origin. As the proposed DST would apply disproportionately to U.S. service suppliers vis-à-vis service suppliers from other countries (including Parties and non-Parties), it would violate Article 15.4,

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[5] Because CUSMA service commitments are structured on the basis of a "negative list," and Canada did not exempt the specific services targeted by its DST, Canada's exposure is greater than what would apply based on narrower WTO commitments.

[6] Legislative Costing Note (may 27, 2021), https://distribution-a617274656661637473.pbo-dpb.ca/51a742cdc76393dd561f7034436ef62a624d25887b6d1ef39665a25d188b13fa. Further clarity is warranted on how this estimate was created, including who is expected to be within scope.

[7] Advertising in Canada, Statista https://www.statista.com/topics/1837/advertising-in-canada/#topicOverview.

by creating a burden U.S. firms would bear, to the exclusion of numerous other foreign firms providing like services in the Canadian market.

Canada's DST also breaches World Trade Organization (WTO) commitments, which include the same national treatment and most-favored-nation (MFN) obligations to WTO members. The discriminatory nature of the DST conflicts with commitments under the General Agreement on Trade in Services (GATS) for a range of specific services (e.g., for distribution, which would cover marketplaces), notably the non-discrimination principles under Article II and Article XVII. Article II mandates that members offer "treatment no less favorable than it accords to like services and suppliers of any other country."

While CUSMA Article 32.3 exempts certain taxation measures, Article 32.3(6)(a) explicitly states that, notwithstanding this exemption, Article 15.3 applies to taxation measures on income related to the purchase or consumption of particular services. As a result, Canada would not be able to even invoke this exception for the national treatment claim. Additionally, the WTO includes no such exemptions for similar national treatment and MFN claims.

The DST is also subject to scrutiny under Section 301 of the Trade Act of 1974. Section 301 of the Trade Act sets out three types of acts, policies, or practices of a foreign country that are actionable: (i) trade agreement violations; (ii) acts, policies or practices that are unjustifiable (defined as those that are inconsistent with U.S. international legal rights) and burden or restrict U.S. commerce; and (iii) acts, policies or practices that are unreasonable or discriminatory and burden or restrict U.S. commerce. To emphasize, the United States can find a DST actionable without a clear trade commitment violation.

The United States has found on multiple occasions that DSTs similar to what Canada is proposing are clearly discriminatory against U.S. firms and were actionable under these standards, making clear that any unilateral digital services tax measures will be met with scrutiny by the Office of the U.S. Trade Representative.[8] As the Canada DST is closely based on the French DST, the U.S. Trade Representative is likely to also find it to be actionable under Section 301 of the Trade Act of 1974 as discriminatory and burdensome for U.S. multinationals.[9]

The current U.S. Administration has made clear its concerns regarding Canada's decision to pursue a DST, noting that USTR would "examine all options, including under our trade agreements and domestic statutes" if Canada adopted a DST.[10] U.S. Congressional trade leaders have also raised concerns, noting that a Canada DST would risk "setting a troubling precedent that could undermine years of work by negotiators at the OECD."[11]

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[8] Office of the U.S. Trade Rep., Section 301 – Digital Services Taxes, https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-digital-services-taxes.

[9] Office of the U.S. Trade Rep., Section 301 Investigation Report on France's Digital Services Tax, *available at* https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf.

[10] Press Release, Statement by USTR Spokesperson Adam Hodge on Canada's Digital Services Tax, Dec. 15, 2021, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/december/statement-ustr-spokesperson- adam-hodge-canadas-digital-services-tax-described-canadas-notice-ways; https://www.politico.com/news/2023/08/08/canadas-tech-tax-biden-00109844.

[11] *U.S. Trade Official Raises Concerns About Canada's Proposed Digital Services Tax*, Reuters (Jan. 12. 2022), https://www.reuters.com/business/us-trade-official-raises-concerns-about-canadas-proposed-digital-services-tax-2022-01-12/; *U.S. Warns of Trade Fight Over Canada's Digital-Tax Plan*, Wall Street Journal (Aug. 5, 2023), https://www.wsj.com/articles/u-s-warns-of-trade-fight-over-canadas-digital-tax-plan-751ffa30.

II. Conflicts with the OECD/G20 Inclusive Framework

The Organization for Economic Cooperation and Development (OECD) and the Group of 20 (G20) carefully negotiated a consensus-based solution to the tax challenges arising from the digitalization of the economy. The Statement on a Two-Pillar Solution was released on October 8, 2021 and agreed to by 137 countries. The agreement was subsequently endorsed by G20 Leaders. Industry remains committed to this important process as focus turns to implementations and is optimistic that the result will provide certainty needed to enhance investments, trade, and growth globally.

The pursuit of a unilateral tax under the Digital Services Tax Act, particularly when the implementing details of Pillar I have yet to be finalized, is inconsistent with Canada's participation in the OECD/G20 Two-Pillar Solution. As part of the agreement announced on October 8, 2021, parties made a commitment not to enact new discriminatory digital services taxes and instead focus on implementation of the global agreement.

On unilateral measures, the agreement states:

> The Multilateral Convention (MLC) will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC.

It is discouraging that Canada immediately welcomed the global agreement with an announcement that the Canada DST would move forward nonetheless, albeit with a delayed timeline.[12] Further, the retroactive component where companies are still obligated to pay the tax accrued since January 1, 2022 is an extremely concerning framework for other countries to follow and adds to the uncertainty faced by covered firms. Canada further detracted from the global consensus by its decision not to agree to the extension reached in July 2023.[13]

III. Flawed Justifications for Unilateral Digital Services Taxes

Studies demonstrate that the firms that would fall into the scope of the Canada DST "pay taxes at rates equal or higher than the average large Canadian company."[14] The notion that digital firms are undertaxed compared to physical counterparts has also been challenged in the European context.[15]

[12] Statement by the Deputy Prime Minister on new international tax reform agreement, Oct. 8, 2021, *available at* https://www.canada.ca/en/department-finance/news/2021/10/statement-by-the-deputy-prime-minister-on-new- international-tax-reform-agreement.html.

[13] *Countries Agree to Extend Digital Services Tax Freeze Through 2024*, Reuters (Jul. 12, 2023), https://www.reuters.com/business/finance/countries-agree-extend-digital-services-tax-freeze-through-2024-2023-07-12/

[14] Montreal Economic Institute (MEI), Taxing the Tech Giants – Why Canada Should Not Follow the French Example (2020), available at https://www.iedm.org/wp-content/uploads/2020/01/cahier012020_en.pdf.

[15] Understanding the ZEW-PwC Report, Digital Tax Index, 2017, https://www.pwc.com/us/en/press-releases/2018/understanding-the-zew-pwc-report.html.

The costs of the Canada DST are likely to be passed onto Canadian consumers and businesses.[16] The Canada DST would result in higher costs to users of these services, including small and medium-sized enterprises who rely on these services for business operations. One report estimated that under an optimistic scenario in which only 33% of the tax is passed on to consumers, it would still represent a loss of over one billion dollars a year to consumers.[17]

If changes are warranted to corporate tax rules to reflect the nature of global business, these changes should be pursued at the multilateral level and pursued on a non-discriminatory basis relative to specific business models. To this end, CCIA supports the timely implementation of the OECD/G20 Inclusive Framework Two-Pillar solution to provide a future-proof framework and speed economic recovery around the world.

Additionally, claims that Canada is at a “disadvantage” compared to its counterparts that are collecting on DSTs are inaccurate. Domestic taxation is not a means for competition with trading partners through collecting money from foreign services. Canada is not losing revenue by virtue of other countries enacting a DST stop-gap measure until the global framework is finalized and implemented because in-scope firms can eventually credit back any DST payments made to those countries.[18]

IV. Digital Services Taxes are Unreasonable Tax Policy

DSTs are unreasonable tax policy for a number of reasons. First, thresholds that were created (largely based on European DSTs) were set at arbitrary levels, with the apparent goal of ensuring that foreign companies shouldered the vast majority of the tax burden. The global thresholds follow the once-abandoned EU proposal (even adopting the euro currency in its calculation), while in-country thresholds either follow the EU approach or are crafted in a manner to exclude leading domestic companies that would be within scope.

Second, the taxation of revenue rather than profits departs from international norms. Historically, corporate taxes have been levied where value is created, not where it is consumed. If this were to change, governments should seek consensus on the methodology and degree to which taxation rights (on profits) should shift. With narrow definitions and targeted policy instruments, the risk is that every country could seek to impose new taxes on whatever products and services they import, while maintaining direct taxes on those that they export.

V. Conclusion

Rather than adopting a DST that invites trade conflicts, CCIA encourages Canada to work with its international partners on implementing the OECD/G20 Inclusive Framework Two-Pillar Solution reached in October 2021.

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[16] Montreal Economic Institute (MEI), Taxing the Tech Giants – Why Canada Should Not Follow the French Example (2020), available at https://www.iedm.org/wp-content/uploads/2020/01/cahier012020_en.pdf.

[17] Montreal Economic Institute (MEI), The Digital Tax Will Cost Canadian Consumers More Than $1.1 Billion a Year According to a New MEI Study (Oct. 2022), https://www.iedm.org/the-digital-tax-will-cost-canadian-consumers-more-than-1-1-billion-a-year-according-to-a-new-mei-study/.

[18] U.S. Dep’t of Treasury, Joint Statement Regarding Compromise on a Transitional Approach to Existing Bilateral Measures During the Interim Period Before Pilar 1 is in Effect (Mar. 21, 2021), https://home.treasury.gov/news/press-releases/jy0419; U.S. Dep’t of Treasury, Joint Statement Regarding Compromise on a Transitional Approach to Existing Bilateral Measures During the Interim Period Before Pilar 1 is in Effect (Nov. 22, 2021), https://home.treasury.gov/news/press-releases/jy0500.