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# Impacts of Canada's Proposed Digital Service Tax on the United States



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## I. Executive Summary

- ❖ Canadian [Bill C-59](#) would [impose a digital services tax](#) (DST) of 3% on revenues from online marketplaces, online advertising, social media, and user data services.
- ❖ Bill C-59's 3% DST would target activities in which U.S. businesses have a leading position and which drive a large share of potentially ICT-enabled U.S. services exports to Canada, while not targeting analogous activities in which Canadian businesses have a leading role, even when those activities directly compete for customers.
- ❖ The DST uses thresholds that appear gerrymandered to target leading U.S. digital service providers while excluding most of their Canadian competitors.
- ❖ The DST would cost U.S. businesses between \$0.9 billion and \$2.3 billion annually, which would not only reduce export revenues and income for U.S. businesses and their shareholders, but would also reduce the U.S. tax base correspondingly, harming U.S. government fiscal outcomes.
- ❖ These DST costs would lead to U.S. job losses that would impact between 1,207 and 3,140 American workers.
- ❖ The DST would operate as a gross receipts tax narrowly applied to disfavored activities (i.e., those in which U.S. businesses have a leading position), creating larger economic distortions and inefficiencies than raising comparable revenue through a corporate income tax with a broad base.
- ❖ Moreover, if the United States fails to protest, investigate, or retaliate in response to the Bill C-59 DST, a precedent will have been set that increases the risk of global contagion for DSTs targeting U.S. digital exporters. Such contagion risks significantly increasing the costs to U.S. businesses, workers, exports, and tax base.

This study estimates impacts to U.S. interests from the Canada Bill C-59 DST under 4 distinct scenarios:

Scenario	Lost U.S. Export Revenues (USD)	Lost U.S. FTE Jobs
Canada Parliamentary Budget Officer ( <a href="#">PBO</a> )	\$0.9 Billion	1,207
CCIA Lower-bound Scenario	\$1.0 Billion	1,368
CCIA Middle Scenario	\$1.4 Billion	1,884
CCIA Upper-bound Scenario	\$2.3 Billion	3,140

## II. Background

Digital Service Taxes (DSTs) are effectively gross receipts taxes (turnover taxes), applied to a narrow subset of economic activity. Economists almost universally consider DSTs regressive taxes that are more distortionary than corporate income taxes. In practice, DSTs considered by foreign governments tend to gerrymander quantitative thresholds and covered activities in order to target leading U.S. digital services providers with tax liabilities while excluding many of their domestic competitors, using DSTs as *de facto* tariffs. In many cases, as with the Canadian DST proposed in Bill C-59, compliance with the DST also is likely to impose significant administrative compliance costs on targeted (mostly U.S.-based) firms but not on domestic competitors, which could result in non-tariff barriers to trade. DSTs imposed by foreign governments are expected to harm the competitiveness of U.S. exporters, to decrease the quantity of U.S. exports, to cost U.S. jobs in targeted sectors and firms, and to reduce the size of the U.S. tax base with concordant negative fiscal impacts.

A 2019 Congressional Research Service (CRS) report on DSTs noted that “DSTs are structured as a selective tax on revenue” rather than “a tax on corporate profits” as in a broad-based corporate income tax, and as such “DSTs are turnover taxes that apply to the revenue generated from taxable activities regardless of costs incurred by a firm.”<sup>1</sup> As a result, the CRS report concluded that “DSTs are likely to have the economic effect of an excise tax on intermediate services[,]” “economic theory and the general body of empirical research on excise taxes predict that DSTs are likely to increase prices in affected markets, decrease quantity supplied, and reduce investment in these sectors[,]” and be more regressive than a corporate income (profits) tax, as DSTs can raise prices for “a broad range of consumer goods and services” whereas a corporate profits tax “tends to be borne by higher-income shareholders.”<sup>2</sup> The CRS report also noted that scholars “argue that the high-revenue thresholds for taxation” in foreign DSTs and “the exclusion of certain revenues earned by” domestic firms “effectively discriminate against the digital exports of U.S. firms.”<sup>3</sup>

The Tax Foundation describes gross receipts taxes (turnover taxes), which include DSTs, thusly in a discussion of the risk of distortions and “tax pyramiding” (double taxation across intermediate stages of production) under turnover taxes:

<sup>1</sup> Sean Lowry, “Digital Services Taxes (DSTs): Policy and Economic Analysis”, Congressional Research Service, February 25, 2019, p. Summary, <https://crsreports.congress.gov/product/pdf/R/R45532/2>

<sup>2</sup> Sean Lowry, “Digital Services Taxes (DSTs): Policy and Economic Analysis”, Congressional Research Service, February 25, 2019, p. Summary, <https://crsreports.congress.gov/product/pdf/R/R45532/2>

<sup>3</sup> Sean Lowry, “Digital Services Taxes (DSTs): Policy and Economic Analysis”, Congressional Research Service, February 25, 2019, p. 22, <https://crsreports.congress.gov/product/pdf/R/R45532/2>

“Because these taxes are imposed at intermediate stages of production and do not allow deductions for costs, they are not based on profits or net income (like a corporate income tax) or final consumption (like a well-constructed sales tax). They provide an advantage to businesses with high profit margins or considerable vertical integration, while they penalize companies with narrow margins or multiple transacted stages of production. This distorts economic decision-making, incentivizing firms to vertically integrate, adjust production to gain a more favorable industry classification, or move stages of production outside the taxing jurisdiction. This introduces inefficiency, to the extent that businesses make economic decisions hinging on tax planning and avoidance strategies, and inequity, to the extent that businesses are unable to respond in this manner. [] The adverse effects of having to pay these taxes can be particularly severe for startups which post losses in early years. To the extent that most or all businesses in a given market are subject to these taxes, much of the pyramiding tax costs are ultimately passed along to consumers.”<sup>4</sup>

Similarly, a 2018 PwC report on digital services taxes agreed in its conclusion with a 2018 OECD report: digital turnover taxes are “likely to generate some economic distortions, double taxation, increased uncertainty and complexity, and associated compliance costs for businesses operating cross-border” while disadvantaging “smaller, younger, and less profitable firms” who are above coverage thresholds.<sup>5</sup>

A 3% tax on revenues (turnover) has a very different impact on businesses with different profitability: for less profitable firms and startups with limited capital runway, it can easily mean the difference between continuing to operate and exiting the market, whereas for more profitable firms such a tax can be costly but manageable.

However, this analysis becomes more complex when DSTs gerrymander around business activities in ways that create significant competitive disadvantages for covered firms, violating the tax policy best practice of neutrality. Depending on market-specific factors, this could lead to total negative impacts to U.S. digital exporters and exports that significantly exceed the tax revenues collected by the government of Canada. For example, it is possible that a 3% DST applied to a covered digital service but not its non-covered competitors could create a price increase for the digital service causing a significant shift in customers away from digital services and toward non-digital competitors, e.g., away from online

<sup>4</sup> “Gross Receipts Tax”, Tax Foundation, <https://taxfoundation.org/taxedu/glossary/gross-receipts-tax/>

<sup>5</sup> PwC, “Economic and Policy Aspects of Digital Services Turnover Taxes: A Literature Review,” December 2018, p. 19, <https://www.pwc.com/gx/en/tax/tax-policy-administration/assets/pwc-dtsg-literature-review-final.pdf>

advertisements or marketplaces and toward offline advertisements and marketplaces. In extreme cases, it could lead to market exit by covered digital service providers, for example in cases where the non-digital competitors are seen as offering close substitutes and the DST creates a persistent price disadvantage for the digital services relative to the non-digital competitors.

There is a plausible risk of a significant impact in excess of the tax revenues collected under the DST proposed in Bill C-59, which covers many online activities while excluding close brick-and-mortar analogues:

- ❖ Online marketplace services are covered, while competing brick-and-mortar marketplaces and non-digital intermediaries are not.
- ❖ Online advertising is covered, while competing advertisement space on television, radio, print, and billboards and other physical mediums are not.
- ❖ Online social media services are covered, while competing non-digital social networking services are not.
- ❖ The monetary thresholds are not only set high, but include a requirement of significant Canadian digital services revenue for coverage. In other words, not only are Canadian competitors focused on analogous services via non-digital means carved out of coverage, but very large non-digital competitors would be excluded from obligations even as they entered digital services until they reached scale. This amounts to aggressive protectionism in a country essentially as advanced and wealthy as the United States.

Given the leading position of many U.S. digital services businesses in covered activities, the design of the Canadian DST in Bill C-59 will likely place U.S. digital exports at a significant competitive disadvantage.

### III. Modeling DST Job Loss Impacts

Assuming that workers represent variable costs, a simple estimation methodology for job losses from lost revenues is to divide the lost revenues by the marginal revenue per employee, assuming that marginal revenue equals average revenue per employee. Based on analysis of financials from leading U.S. digital services firms, this study estimates average revenue per employee at covered digital service offerings of approximately \$744,000.

As a result, for each scenario, this study estimates job losses by dividing U.S. digital exporters' lost revenues by \$744,000.

## IV. Impact Scenarios

### SCENARIO 1:

#### Canada Parliamentary Budget Officer (PBO) Scenario, Assuming No Pass Through

Canada's Office of the Parliamentary Budget Officer [estimated](#) the 5 year fiscal impact of the DST at 7,231 (Millions CAD), meaning net tax collections equal to about \$5.3 billion USD over five years.

The PBO methodology was described as follows:

“The tax base was determined using data from the financial statements of public companies meeting the criteria set out above for 2022. The tax base was then projected using the average growth rate of 9.3% forecasted by various sources for the relevant sectors.

The data were adjusted to account for revenues in scope that relate to Canada. Whenever those were not explicitly disclosed in companies' annual reports, the proportion of relevant global revenues was estimated using the relative size of the Canadian economy or web traffic data. The tax base was further adjusted to account for a potential behavioural response from affected businesses, which would gradually reduce revenues by 30% by 2027-28. An effective tax rate of 2.59% was then applied to the adjusted tax base to reflect the expected reduction in corporate income tax, as businesses paying the DST can deduct the expense from their taxable income.”<sup>6</sup>

As there is a retroactive component to the DST in the first year, this study began its analysis in the second year of the PBO scenario, which estimated a 1.23 billion CAD revenue for 2024-2025, equal to about \$0.9 billion USD. Assuming that these revenues are overwhelmingly collected from U.S. digital exporters, and further assuming that the U.S. digital exporters do not pass any of these costs through to Canadian customers, the total lost U.S. digital export revenues equal \$0.9 billion per year, and a corresponding reduction in the U.S. tax base.

At \$744,000 in revenue per job, this amounts to 1,207 lost jobs at U.S. digital exporters.

<sup>6</sup> Canada PBO, “Digital Services Act”, <https://www.pbo-dpb.ca/en/publications/LEG-2324-013-S--digital-services-tax--taxe-services-numeriques#:~:text=The%20DST%20would%20be%20equivalent,%247.2%20billion%20over%20five%20years.>

**SCENARIO 2:**

**CCIA Lower-bound Estimate, Bottom-up Estimation from U.S. Digital Exporter Financials, Assuming No Pass Through**

The CCIA lower-bound estimate is a bottom-up estimate using known U.S. digital exporter financials, assuming a 3% effective DST tax rate on Canada turnover, and an assumption of zero pass-through to Canadian consumers or businesses. The bottom-up analysis is most likely an underestimate, as DST application to any firms not included in the bottom-up estimation could significantly increase export and jobs losses.

2023 Canada Revenues of Covered U.S. Digital Exporters	2023 Canada DST Tax Obligation at 3%	Revenue per Employee	Lower-bound Estimate of Trade-affected Workers
\$33.9 Billion	\$1.02 Billion	\$744,000	1,368

**SCENARIO 3:**

**CCIA Middle Estimate, Top-Down Estimation from BEA Data on Potentially ICT-Enabled Services Exports to Canada, Assuming No Pass Through**

The CCIA middle estimate is a top-down estimate using BEA data on potentially ICT-enabled services exports to Canada,<sup>7</sup> a 3% effective DST tax rate on Canada turnover, and an assumption of zero pass-through to Canadian consumers or businesses. The 3% tax is applied to a base consisting of all U.S. potentially ICT-enabled services exports to Canada, which in 2022 totaled \$46.7 billion.

Potentially ICT-enabled Exports to Canada in 2022	Middle Estimate of Export Impact at 3%	Revenue Per Employee	Middle Estimate of Trade-affected Workers
\$46.7 Billion	\$1.40 Billion	\$744,000	1,884

<sup>7</sup> BEA, <https://apps.bea.gov/iTable/?reqid=62&step=9&isuri=1&product=4#eyJhcHBpZCI6NjIsInN0ZXBzIjpbMSw5LDZdLCJkYXRhIjpbWyJwcm9kdWNOIiwjNCJdLFsiVGFiVGVMaXNOIiwjMzU5Il1dfQ==>; See also <https://apps.bea.gov/iTable/?reqid=62&step=9&isuri=1&product=4>

**SCENARIO 4:**

**CCIA Upper-bound Estimate, Top-Down Estimation from BEA Data on Potentially ICT-Enabled Services Exports to Canada, Assuming 100% Pass Through**

The CCIA upper-bound estimate is a top-down estimate using BEA data on potentially ICT-enabled services exports to Canada,<sup>8</sup> a 3% effective DST tax rate on Canada turnover, an assumption of 100% pass-through to Canadian consumers or businesses, and an assumption that the resulting effective price increase to Canadian customers causes a 2.1% decline in U.S. potentially ICT-enabled services exports to Canada. The 2.1% decline is applied to a base consisting of all U.S. potentially ICT-enabled services exports to Canada, which in 2022 totaled \$46.7 billion. The remaining potentially ICT-enabled services exports are assumed to have a 3% DST levied against them.

Potentially ICT-enabled Exports to Canada in 2022	Upper-bound Estimate of Export Impact at 3%	Revenue Per Employee	Upper-bound Estimate of Trade-affected Workers
\$46.7 Billion	\$2.34 Billion	\$744,000	3,140

## V. Contagion Risk as an Unquantified Additional Impact

Canada is the United States' closest trading partner and is considered both an ally and a friend, with the two countries maintaining the world's longest undefended border. If we allow our closest trading partner, with whom we have strong, binding commitments to not discriminate against U.S. companies, to enact a DST policy like Bill C-59, costing U.S. digital exporters north of a billion dollars and north of a thousand jobs, a precedent will have been set. If Bill C-59 goes into effect without protest, investigation, or retaliatory response from the United States, nothing can stop any other countries, even those with whom we have free trade agreements, from doing the same by citing the Canadian precedent, which would expand the cost to U.S. companies, workers, exports, and tax base further.

<sup>8</sup> BEA, [https://apps.bea.gov/iTable/?reqid=62&step=9&isuri=1&product=4](https://apps.bea.gov/iTable/?reqid=62&step=9&isuri=1&product=4#eyJhcHBpZCI6NiIsInN0ZXBzIjpbMSw5LDZdLCJkYXRhIjpbWyJwcm9kdWN0IiwiaWwiNCJdLFsiVGFiVGVMaXN0IiwiaWwiMzU5Ii1dfQ==); See also <https://apps.bea.gov/iTable/?reqid=62&step=9&isuri=1&product=4>



## VI. Conclusion

The Canadian DST proposal in Bill C-59 would cost U.S. businesses between \$0.9 billion and \$2.3 billion annually, which would not only reduce export revenues and income for U.S. businesses and their shareholders, but would also reduce the U.S. tax base correspondingly, harming U.S. government fiscal outcomes. These DST costs would lead to U.S. job losses that would impact between 1,207 and 3,140 American workers. Moreover, if the United States fails to protest, investigate, or retaliate in response to the Bill C-59 DST, a precedent will have been set that increases the risk of global contagion for DSTs targeting U.S. digital exporters. Such contagion risks significantly increasing the costs to U.S. businesses, workers, exports, and tax base.