



Canadian Chamber of Commerce Digital Services Tax submission

February 2022

Summary

The Canadian Chamber of Commerce welcomes the opportunity to participate in Finance Canada's consultations on Digital Services Tax (DST) legislation. The Chamber supports the modernization of Canada's tax system. However, it is essential for our tax rules to remain aligned with global standards, including as it relates to DST.

The Chamber underlines its position for the government to standstill on the Digital Services Tax Act, drop its retroactive application, and fully support the implementation of the G20/OECD two-pillar plan that has been agreed to by over 130 countries.

Background

In the 2020 Fall Economic Statement, the Government of Canada announced its intent to move forward with a made in Canada DST. Since the DST announcement, Canada joined 136 countries in agreeing to a two-pillar plan put forward by the G20/Organization for Economic Cooperation and Development (OECD) in October 2021.ⁱ Through this multilateral plan, all countries agreed to remove and standstill all DST like measures.ⁱⁱ Yet, the government reaffirmed through the 2021 Economic and Fiscal Update its intention to move ahead a *Digital Services Tax Act* to enact the DST. The new tax would be imposed as of January 1, 2024, if the established multilateral plan were not implemented by then, and retroactively tax revenues earned as of January 1, 2022.

While having submitted input to the government's initial DST consultation in spring 2021, the Chamber is taking the opportunity to provide further input on our concerns regarding the proposed legislation.

Comments

General

Canada's outdated tax system has resulted in regulatory complexity and a skewed tax revenue mix that drags on Canada's global economic competitiveness and recovery. To rectify this economic millstone, the Chamber has repeatedly called on the government to conduct a comprehensive review of Canada's tax system. In light of several indicators, including the forthcoming integration of a new international tax regime with Canada's domestic tax structure, as well as [the snapshot of Canada's tax competitiveness](#) published by the Chamber in January 2022, the government should not postpone a comprehensive tax system review any longer.

The government's intent to move forward with a DST is of significant concern to the Chamber's members. The legislation:

- invites unneeded trade retaliation;
- undermines efforts to implement the new two-pillar plan agreed by the G20/OECD;
- further complicates regulatory predictability and tax compliance given businesses need to prepare for retroactive collection;



- opens the potential of double taxation of business revenue; and
- affects a wider swath of businesses than conceived.

Risk of trade retaliation

Throughout the G20/OECD process to develop an Inclusive Framework on Base Erosion and Profit Shifting (BEPS), the United States has consistently opposed unilateral tax measures adopted by countries targeted at non-resident multinational corporations – particularly those with highly digitized business models. The government must take the United States' opposition to unilateral measures seriously. In 2021, the Office of the United States Trade Representative (USTR) threatened retaliatory action on no fewer than eight countries, including Canada, for DST measures. The USTR singled out Canada's Ways and Means Motion on December 15, 2021 and issued a public warning:

*"USTR continues to strongly oppose any new DSTs adopted by our trading partners... If Canada adopts a DST, USTR would examine all options."*ⁱⁱⁱ

In recent years, the United States has increased its use of tariffs, and other retaliatory actions, to advance its economic interests, including Section 301 investigations on countries that proposed unilateral DSTs. The Chamber urges the government to consider the economic consequences of DST-induced retaliatory tariffs, particularly given the current strain on supply chains.

Undermines G20/OECD Efforts to Implement the Two-Pillar Plan

The government has invested significant efforts through the G20/OECD to develop an Inclusive Framework on BEPS. The Chamber has long supported the G20/OECD process for seeking a multilateral BEPS solution. After much work, a consensus-based two-pillar plan was reached on October 8, 2021, with the G20/OECD to address tax challenges arising from the digitalization of the economy. Among other actions, the plan agreed to by the government called for the removal and standstill of all DST like measures. The OECD's statement on the two-pillar plan 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."^{iv}

Consequently, the Chamber is concerned that the government's intention to move forward with a DST could undermine the effort of the G20/OECD to implement the new two-pillar plan by encouraging other jurisdictions to introduce unilateral measures.

Regulatory Predictability and Complexity

The Chamber believes one of the easiest and most effective ways to grow the economy is to reduce the burden of paperwork and administrative complexities needed to run a business – of any size. The Chamber's members strongly favour a multilateral solution on BEPS for this reason. Unlike a patchwork of unilateral tax actions, a multilateral tax regime is more predictable and less complex for businesses operating across international borders. A retroactive DST harms



regulatory predictability and increases administrative complexity for a wide swath of businesses operating in Canada.

Additionally, a two-year retroactive application of a new tax - particularly on a subset of the economy - sets a worrisome precedent for the Canadian businesses.

The administrative challenges of this should not be underestimated given companies will need time to design and establish new compliance systems to track transactions that would fall under the scope of the tax. This lead-in time is essential given internal structures for administering this type of tax are not in place as of today. The ability to administer the tax – particularly retroactively – is made complex by uncertainties in the legislation. There are a number of instances in the proposed legislation where definitions and revenue allocations are unclear. These issues are material and significant for companies to be able to accurately calculate taxes owed. (e.g. just two examples for illustrative purposes i) whether ancillary services normally associated with storage and shipping services are included in the definition of storage and shipping; or ii) whether sponsored product listings on an online marketplace are considered online marketplace or advertising revenue).

When administrative guidance is eventually issued, companies covered by the tax will need to calculate their tax liability for months during which they were not collecting the right information and nor did they have the internal processes and IT systems to collate the information. Another example is having the IT mechanisms in place for user location data as outlined in the explanatory notes. The absence of preparedness underlines the unprecedented nature of a tax of this magnitude being retroactively applied in such a manner.

The result of retroactive application will be to force businesses to accrue for this potential liability and set aside funds that could otherwise be deployed productively. This, in effect, means applying the tax now, which as noted earlier goes against the spirit of the two-pillar agreement. This will ultimately have a chilling effect in a variety of sectors.

Possibility of Double Taxation

Presently conceived, the DST may lead to double taxation for qualifying businesses. Without an income tax credit for DST amounts to apply against income tax owed, businesses offering digital services would essentially have their revenue taxed twice – once based on in-scope revenue under DST and again based on taxable income earned from such digital services.^v The OECD has acknowledged this problem and warned:

Possibility of over-taxation: In order to comply with its international obligations, a country may be required to apply the tax to both residents and non-residents, and to limit any credit mechanism against other taxes. This may create issues of over-taxation, (for instance, payments for certain e-services may be subject to both an interim measure and corporate income tax) and run counter to the underlying narrative for the introduction of the tax, which is to target supplies of cross border digital services that are not subject to income taxation in the market jurisdiction under existing rules.^{vi}

Furthermore, if other countries are encouraged to proceed with their own DST, businesses could become liable for DSTs in multiple jurisdictions on the same revenue.



The Chamber notes that the possibility of double taxation contravenes the spirit of the basic principle of fairness underlying section 248(28) of the *Income Tax Act*, which prohibits taxation of the same income twice in the same entity.^{vii}

Affecting a wider swath of businesses than conceived

Digital technology has resulted in new business models being adopted by both digital and non-digital businesses to scale-up and compete globally. Presently, the DST would affect a wider swath of resident businesses than perhaps conceived. For instance, large businesses with digital-based loyalty programs may be possibly liable. Not only might a Canadian DST reduce the incentive of resident businesses to invest in digital models, but a Canadian DST might also set-up DST liabilities for resident businesses operating in other jurisdictions. Underscoring the problematic approach of having unilateral DST legislation is that even the converse approach of narrowly defining the application would present further risks for trade retaliation.

There is also the possibility the new tax would flow through to Canadian small and medium-sized enterprises (SMEs), whom have increased the use of digital services offered by multinational's since the pandemic. With input costs already significantly inflated in Canada, a knock-on DST would make things even more difficult for recovering SMEs.

Recommendation

The government should standstill on the Digital Services Tax Act, drop its retroactive application, and fully support the implementation of the G20/OECD two-pillar plan that has been agreed to by over 130 countries.

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ⁱ Finance Canada, October 8, 2021. *Statement by the Deputy Prime Minister on new international tax reform agreement*

ⁱⁱ OECD, October 8, 2021. *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*

ⁱⁱⁱ USTR, December 15, 2021. *Statement by USTR Spokesperson Adam Hodge on Canada's Digital Services Tax As Described in Canada's Notice of Ways and Means Motion to Introduce an Act to Implement a Digital Services Tax.*

^{iv} Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy

^v Note: Such a credit is consistent with the OCED's recommendation for resolving the matter of double taxation.

^{vi} *OCED, 2018. Tax Challenges Arising from Digitalisation. Chapter 6*

^{vii} Government of Canada, *Income Tax Act*.