Comments of
INTERNET ASSOCIATION

Before the
DEPARTMENT OF FINANCE CANADA
Ottawa, Ontario, Canada

Digital Services Tax Consultation

Internet Association (IA)[1], which represents over 40 of the world's leading internet companies, respectfully submits comments to the Department of Finance Canada consultation on views and feedback on the proposed approach to implementing the Digital Services Tax (DST) outlined in Budget 2021.[2]

IA is the only trade association that exclusively represents leading global internet companies on matters of public policy. IA supports policies that promote and enable internet innovation, ensuring that information flows freely and safely across national borders, uninhibited by restrictions that are fundamentally inconsistent with the open and decentralized nature of the internet.

The global economy has become increasingly digitized and the global tax rules should be updated for the digital age, but go-it-alone taxes strictly targeting digital companies are not the solution. Unilateral measures such as the Canadian proposal threaten the progress of multilateral, collaborative work that considers all aspects of the changing global economy. Canada has historically been a champion of multilateralism, and we are disappointed that it is proposing to undermine the ongoing process at the Organization for Economic Cooperation and Development (OECD). The OECD process is focused on developing a long-term solution for global taxation that levels the playing field for all sectors, is clear to administer, and avoids the double taxation of digital industries.

Although the internet industry appreciates that Canada's Budget 2021 reaffirms Canada's strong preference for a multilateral approach to taxation in the digital age, Canada is signaling it expects the failure of an international solution by proceeding with the planning of a unilateral DST. IA encourages the Canadian government to keep engaging in the OECD process, and to work with other nations to get a deal as soon as possible.[3]

The proposed tax would replicate other countries' measures, which actively discriminate against U.S. companies, by imposing a 3 percent digital services tax on advertising services and digital intermediation services with global revenue of €750 million and Canadian revenue over C$20 million. Specifically, the DST will apply to revenue from online marketplaces, social media platforms, and online advertising and user data, but will fail to take into account other industries that operate in the global digital economy. Today, companies of all industries are digital companies; this spectrum is broad, reaching all the way to companies in sectors such as manufacturing and agriculture. The structure of the proposal specifically targets only one sector.

Unilateral DSTs are bad tax policy. Taxing corporate revenue, rather than income, is inconsistent with international tax principles. This is reflected in the OECD Model Tax Convention on Income and on Capital[4] and in over 3,000 bilateral tax treaties. Taxing on corporate revenue penalizes low-margin and loss-making companies, and subjects affected companies to potential multiple taxation as well as significant compliance costs.[5] These taxes penalize growth and

[1]https://internetassociation.org/our-members/
[2]https://www.budget.gc.ca/2021/report-rapport/anx7-en.html
[3] http://www.oecd.org/tax/beps/
[4]Model Tax Convention on Income and on Capital 2017 (Published on April 25, 2019).
https://www.oecd.org/tax/model-tax-convention-on-income-and-on-capital-full-version-9a5b369e-en.htm
[5]To illustrate how DSTs as gross receipts taxes compare to corporate income taxes, a DST of 3 percent applied to a company with a 10 percent profit rate equates to a 30 percent effective corporate income tax rate, with limited to no availability for credits. A DST of 3 percent applied to a company with a 2 percent profit rate equals a 150 percent effective corporate income tax rate. Many taxpayers that will be subject to this DST have profit rates well below 10 percent. This is applied in addition to corporate income taxes paid by the company. The double taxation and subsequent effective corporate income tax rate are especially impactful to companies with lower profit margins and companies with losses.

would have the anti-competitive effect of benefiting the most profitable companies, who have both the pricing power and the positive operating cash flow to pay the tax. Moreover, companies have shown they pass the tax directly to their customers, meaning the burden of the tax mostly falls on in-country consumers.

We are particularly concerned that due to how the tax is structured, it would only target U.S. companies, thus Canada may violate compliance with commitments under the World Trade Organization (WTO) and the Canada-United States-Mexico Agreement (CUSMA).[6] Our industries strongly support the new commitments made on digital free trade in the CUSMA,[7] and are disheartened to see the Canadian Government pursue a measure that goes against the spirit of that new chapter. It is worth noting that the U.S. government has demonstrated a willingness to push back on the unilateral DSTs after which the Canadian DST is modeled. It can be expected that if Canada moves forward with this discriminatory tax, the Office of the United States Trade Representative will initiate a 301 investigation that could result in the levy of sanctions.[8] This would be counterproductive to the progress made in the signing of the CUSMA.

In conclusion, we believe that global tax rules should be updated for the digital age, but discriminatory taxes targeting a handful of U.S. firms is not the right approach. Unilateral measures such as the Canadian proposal threaten to undermine the ongoing progress at the OECD to develop a long-term solution for global taxation that does not disproportionately focus on one sector of the global economy, or single out U.S. companies for unique treatment. Canada agreed to the G7 communique on coordinated reforms of the international tax system, which came out in support of the OECD solution on June 5, 2021. In view of the upcoming G20 meeting, IA strongly suggests that Canada pause any work on its unilateral DST and instead focus on achieving a global solution.

[6] The Agreement between Canada, the United States of America, and Mexico, is commonly known as the United States–Mexico–Canada Agreement (USMCA) in the United States; Tratado entre México, Estados Unidos y Canadá (T-MEC) in Mexico; and the Canada–United States–Mexico Agreement (CUSMA) in Canada.
[7] CUSMA/USMCA/T-MEC text.
https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between
[8] USTR Section 301 investigations of Digital Services Taxes.
https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-digital-services-taxes