Intelligence MEMOS

From: Rosalie Wyonch, Bill Robson, and Alex Laurin

To: The Hon. Bill Morneau, Federal Minister of Finance

Date: March 9, 2017

Re: **Redressing Canada's Tax Disadvantage in the Digital Economy**

The Internet is revolutionizing how people access entertainment, order taxis, find accommodations, shop and meet each other. In many cases, consumers can buy these services from a supplier located outside Canada as easily as if the company were domestic. This development raises concerns about tax revenue and competition for Canadian suppliers of digital services.

Foreign providers of digital products and services do not have to collect and remit sales tax if they are not "carrying on business" in Canada. This gives them a 5 to 15 percent price advantage over Canadian providers of similar products, who must charge and remit GST/HST. This imbalance affects a wide range of services, including video streaming, digital books, games and myriad fees for digital platform and network services.

Statistics Canada recently estimated that 9.5 percent of Canadian adults participated in the so-called "sharing economy" and spent around $1.31 billion on ride-sharing and accommodation services from November 2015 to October 2016. Further, Netflix has reached almost 50 percent market penetration, generating $620 million in annual sales on which taxes are not collected in Canada under current rules.

At the issue's core is what, exactly, is meant by "carrying on business." A non-resident operating a business in Canada that is sufficiently large and supplies taxable goods, services or other intangibles must register for GST/HST purposes.

However, if a non-resident does not "carry on business" in Canada, the consumers of its services are expected to account for and remit the taxes that should be paid on those items. Most consumers are not aware of this requirement, and many who are aware of it do not comply. The impracticality of enforcement means significant amounts of potential tax revenues go uncollected.

To address both problems, the C.D. Howe Institute's 2017 Shadow Budget recommends amending the *Excise Tax Act* to reflect international VAT/GST guidelines regarding the taxation for cross-border services and intangibles. The main focus of the guidelines is neutrality; ideally, businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation, meaning foreign businesses should not be disadvantaged or advantaged compared to domestic businesses. Therefore, all service providers should be obligated to charge GST on sales made to consumers in Canada, no matter where the provider is located. The main goal of the reform is to level the playing field for domestic and foreign providers of digital products and services in Canada by requiring that foreign sellers remit tax on sales in the jurisdiction where the final consumer is located.

A consensus is building internationally around addressing the issue of value-added taxation of cross-border digital trade. Multiple countries have amended their own policies, demonstrating that action is possible. The 2017 budget should move Canada in the right direction and level the taxation playing field in Canada's digital economy.

William B.P. Robson, Alexandre Laurin and Rosalie Wyonch are the co-authors of the recently released C.D. Howe Institute report, "Getting Real: A Shadow Federal Budget for 2017"