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Tax Alert – Canada

Finance tables Digital Services Tax NWMM

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 14 December 2021, Canada's Deputy Prime Minister and Minister of Finance tabled in the House of Commons a notice of ways and means motion (NWMM) to implement a Digital Services Tax (DST). Stakeholders have been invited to provide comments by 22 February 2022.

Background

As a precautionary measure, Canada had proposed a DST in its Fall Economic Statement of 30 November 2020 and again in the 2021 Federal Budget tabled on 19 April 2021 in advance of the G7, G20 and the Organisation for Economic Co-operation and Development (OECD) reaching an international multilateral consensus on the OECD's "two-pillar solution" to address the tax challenges arising from the digitalization of the economy. The framework for Canada's proposed DST was outlined in Annex 7 of the Budget Plan. See EY Tax Alert 2021 Issue No. 19.

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In the interim period, the OECD was able to finalize a statement on the core design features of the two-pillar solution (with an implementation plan) that was agreed to 8 October 2021 by 136 jurisdictions (now 137), and subsequently endorsed by the G20 leaders and finance ministers. The first pillar of the solution provides new profit allocation and nexus rules for large profitable multinational enterprises (i.e., those with greater than €20 billion in worldwide revenues and profitability before tax above 10%), including large digital corporations, to provide that they pay a fair share of tax in the jurisdictions in which their users and customers are located. The second pillar is intended to provide that multinational enterprises (i.e., those with more than €750 million in worldwide revenues) are subject to a minimum level of tax of 15%, no matter where their profits are earned.

Under the agreed statement, the multilateral convention through which part of the first pillar will be implemented will require all parties to remove all digital services taxes and other relevant similar measures with respect to all companies and that no new digital services taxes or other relevant similar measures will be imposed on any company from 8 October 2021 until the earlier of 31 December 2023 or the coming into force of the multilateral convention. The implementation of the two-pillar solution is expected to generally come into effect in 2023.

As a consequence, on 8 October 2021, Canada announced that it would still proceed with introducing its own DST legislation, but that the new tax would not be imposed earlier than 1 January 2024 and only if the multilateral convention implementing the first pillar has not come into force within the expected timeline. In the event of a delay or failure of the implementation of the multilateral convention so that it does not come into force prior to 1 January 2024, the DST will be payable in respect of revenues earned as of 1 January 2022, but no earlier than 1 January 2024. See EY Tax Alert 2021 Issue No. 29.

Accordingly, on 14 December 2021, Canada's Deputy Prime Minister and Minister of Finance tabled in the House of Commons a NWMM to introduce an Act to implement a Digital Services Tax (the *Digital Services Tax Act*), which will not come into force until at least 1 January 2024.

The proposed *Digital Services Tax Act*

The DST is proposed to apply to certain types of large businesses (domestic and foreign) operating in the digital space in a calendar year where their:

a. Total revenue from all sources (or the total consolidated group revenue of a consolidated group of which they are a constituent entity at any time in the calendar year or in the preceding calendar year) is at least €750 million during a fiscal year that ends in the preceding calendar year; and

b. Canadian digital services revenue (or, in respect of any consolidated group of which they are a constituent entity at any time in the calendar year, the total of all Canadian digital services revenue for all entities in the group) is greater than $20 million CAD in the calendar year.

The DST is proposed to apply a rate of 3% to taxable Canadian digital services revenue, which is based on the following four sources:

a. Canadian online marketplace services revenue, which includes revenue generated from online marketplace platforms from the provision of access to, or use of, an online marketplace, from commissions and other fees from facilitating supplies between users of the online marketplace, and from providing premium or optional services on the online marketplace (revenue from providing storage or shipping services at a reasonable rate of compensation will be excluded);

b. Canadian online advertising services revenue, which includes revenue generated from systems facilitating online targeted advertisements and digital spaces that display online targeted advertisements;

c. Canadian social media services revenue, which includes the revenue generated on social media platforms from the provision of access to, or use of, the social media platform, from premium or optional services associated with the social media platform, or from the facilitations of interactions either between users or between users and user-generated content on the social media platform (private communication services, such as video calls, will be excluded if the sole purpose of the platform is to provide such services); and

d. Canadian user data revenue, which includes revenue generated from the sale or the granting of access to user data gathered from an online marketplace, a social media platform or an online search engine.

The DST is proposed to apply only to Canadian digital services revenue in excess of $20 million CAD (such deduction is to be shared amongst members of a consolidated group). Revenue earned from a constituent entity of a consolidated group is also excluded from the DST if, at the time the revenue is earned, the taxpayer is a constituent entity of the group.

Canadian digital services revenue is also dependent on whether the revenue described above is associated with users in Canada. The sourcing determination varies according to the nature of the revenue (online marketplace services revenue, online advertising services revenue, social media services revenue and user data revenue) and follows two general methods: revenue tracing to relevant users in Canada on the basis of transactional information or, if tracing is not possible, specific formulaic allocation. For example, for online advertising services revenue, if revenue can be traced to the display of an advertisement to a specific user and that user is located in Canada, the revenue will be entirely sourced to Canada. If such tracing is not possible, the revenue will be sourced to Canada based on the percentage of users to which the advertisement was displayed that are located in Canada. To determine whether a user is located in Canada, user data such as billing, delivery or shipping address; phone number area code; global satellite positioning data; and internet protocol address data ought to be reviewed. In cases where the revenue source is based on the real-time location of the user, then the user must be located in Canada at that time. In all other cases, the determination is based on whether the user is normally located in Canada.

The proposed legislation also contains detailed administration and enforcement provisions (including audit, objections, appeal, and penalties and offences provisions), as well as anti-avoidance rules. Taxpayers will be required, by 31 January of the following year, to register under the *Digital Services Tax Act* if they meet the two tax liability thresholds mentioned above, but after replacing $20 million CAD with $10 million CAD.

Implications

Impacted businesses and consolidated groups should review the NWMM and consider the potential consequences and tax cost to their operations. As the DST, if implemented, will be payable in respect of taxable Canadian digital services revenue earned on and after 1 January 2022, potential taxpayers should determine whether, and to what extent, they are required to make provision in their financial statements for this potential tax.

Finally, as the Canadian federal government has invited comments on the proposed legislation, impacted businesses should take the opportunity to raise any technical issues of concern with the NWMM by making submissions to Canada's Department of Finance during the public consultation period, which ends on 22 February 2022.

Learn more

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