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# Tax Alert – Canada

## BC amends the definition of software for PST purposes

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.

The 2024-25 British Columbia (BC) budget, tabled on 22 February 2024, announced retroactive amendments to the *Provincial Sales Tax Act* (PSTA)<sup>1</sup> that seek to expand the definition of *software* and the taxability of the “use” of software in BC.<sup>2</sup> The proposed amendments are consistent with the BC government’s current administrative position with respect to the interpretation of the term *software*, which stems primarily in response to a 2023 BC Supreme Court (BCSC) decision.<sup>3</sup>

The proposed amendments are included in Bill 3, *Budget Measures Implementation Act, 2024*, which received second reading in the BC legislative assembly on 5 March 2024.

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<sup>1</sup> *Provincial Sales Tax Act*, [S.B.C. 2012] Chapter 35.

<sup>2</sup> For more information on the 2024-25 BC budget, see EY Tax Alert [2024 Issue No. 7](#).

<sup>3</sup> *Hootsuite Inc. v. The King*, 2023 BCSC 358.

## Pre-budget definition of the term *software*

Prior to the proposed amendments provided in Bill 3, the definition of *software* in section 1 of the PSTA was restrictively defined to mean the following:

- (a) A software program that is delivered or accessed by any means;
- (b) The right (whether exercised or not) to use a software program that is delivered or accessed by any means; or
- (c) A contractual right to receive modifications to or new versions of software programs described in paragraph (a) or (b) above if modifications or new versions become available (whether or not that right is exercised), and to which section 15(2)(h)<sup>4</sup> does not apply.

However, the term *software program* has never been defined, and this ambiguity became a key factor in the BCSC's decision in which the court disagreed with the BC government's statutory interpretation.

## BCSC decision in *Hootsuite Inc.*

On 10 March 2023, the BCSC issued a judgment on the application of the provincial sales tax (PST) in which the court effectively distinguished software as a service (SaaS) and infrastructure as a service (IaaS) from taxable "software" under the PSTA.

In this case, the taxpayer had engaged a web services company (WCo) to host, run and operate its digital platform. In doing so, the taxpayer specifically received the following services from WCo (collectively, the WCo services):

- ▶ Online chat support (support services);
- ▶ Cloud computing and simple storage, which allowed remote virtual access via a "software stack" (cloud computing/simple storage); and
- ▶ Dedicated telecommunication direct connect services (direct connect) through the US.

Agreements with WCo provided the taxpayer with a right to use the WCo services, the underlying software, and a web interface management console (the console).

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<sup>4</sup> Section 15(2)(h) of the PSTA is effectively a maintenance or warranty charge on software.

The BC Minister of Finance assessed the taxpayer for failure to self-assess PST in relation to the WSCo services; however, the court held that the purchases of WSCo services were not taxable for the following primary reasons:

- ▶ Not all *software*, under an ordinary definition of the term, constitutes a software program, which is taxable under the definition of *software* in the PSTA.
- ▶ The fundamental nature of the support services was technical expertise; the services did not contain a software program, and the services were not used in BC.
- ▶ The taxpayer's use of the console for the cloud computing/storage services was opaque and did not allow the taxpayer to access, modify or interact with the software to create any outputs; accordingly, the fundamental nature was IaaS and not software.
- ▶ While the direct connect services could be characterized as a taxable telecommunication service, they were provided outside of BC, as transmissions were solely contained outside of BC within the confines of a virtual machine. Therefore, the transmissions were not used in BC and were not taxable.

## Administrative response from the BC Ministry of Finance

In quick response to the BCSC's decision, the BC Ministry of Finance (BC Finance) issued [Information Notice 2023-005](#), *Notice to Providers and Purchasers of Cloud Software Services*, in June 2023, clarifying that it had always administratively considered cloud computing services (including SaaS and remote storage and computing capacity, which may effectively be considered IaaS) as a right to access a taxable software program, a taxable telecommunication service, or both. In addition, BC Finance clarified that support services, which included "a non-incidental" right to use software or a telecommunication service, were considered taxable either in whole or in part.

The Information Notice further states that the BC government intended to introduce legislation that "will retroactively support how the PST was administered prior to the court decision".

## The 2024-25 BC budget

The budget proposes to expand the definition of *software*. Most notably, it intends to modify the definition of software to an inclusive definition. In addition to the existing three items noted above (i.e., (a), (b), and (c) in "Pre-budget definition of the term *software*") software would be defined to include the following new items:

- ▶ Coded instructions or a right to use coded instructions (whether exercised or not) designed to cause an electronic device to perform a task;
- ▶ Infrastructure as a service;
- ▶ Software as a service; and
- ▶ An application programming interface.

*Infrastructure as a service* is added to the PSTA and is defined to include “access to computational services or the right to access computational services, including computing or processing capacity and electronic storage”. This definition effectively eliminates the BCSC’s distinction with respect to a recipient’s ability to create outputs.

*Software as a service* is also added to the PSTA and is defined to include “software or the right to use software when possession of the software is maintained by the provider of the software or another person other than the person to whom the software is being provided”.

The specific inclusion of “application programming interface” (API) appears to be as a result of statements made in the 2023 BCSC court decision by the parties that APIs did not constitute software.

The use of the word “include” denotes that the expanded definition of “software” will no longer be exhaustive.

The definition of *use* has also been amended to broadly encapsulate a wider range of cases where software is part of a supply. The definition now includes the following:

- ▶ “the sending, receiving, downloading, viewing, or accessing of software by any means, including
  - ▶ if possession of the software is maintained by the provider of the software or another person other than the person to whom the software is being provided, or
  - ▶ if the software is accessed directly or indirectly, including on, through or with other software or electronic devices;
- ▶ the holding of a right described in the definition of “software”.”

The expanded definition is specifically geared to apply to cloud-based computing products or any other service where customers are paying to access computer resources on demand.

## **Changes are retroactive**

Provided that Bill 3 passes through the legislature, the amendments to the definition of *software* and *use* of software will be effective as of 1 April 2013. Although the effect is clearly retroactive, it remains the BC government’s position, as stated in Information Notice 2023-005, that the legislative amendments only serve to provide “certainty” and support for how PST was administered by BC Finance prior to the court decision.

Of note, BC Finance has already moved forward with updating its administrative position in [PST Bulletin 105](#), *Software*, and [PST Bulletin 107](#), *Telecommunication Services*, to reflect the proposed amendments.

It remains to be seen whether further changes or clarification will be provided with respect to the amended definition of software (e.g., computational services), either administratively or through the courts. Nevertheless, based on the expansive nature of the new definition, practitioners and participants are advised to err on the side of caution and assume that BC Finance intends to apply PST on “software”, notwithstanding new and novel developments in the digital landscape.

Given these changes, it is advisable that taxpayers review their organization’s consumption of online cloud-based services to determine whether additional self-assessment of tax may be necessary, and for providers of cloud-based services, to determine whether registration for BC PST purposes may be necessary.

## **Learn more**

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