

New Canadian sales tax regime cast on digital goods and services catches non-resident businesses, both big and small

Moodys Private Client
August 13, 2021

This blog is written by Rhéal Plamondon, Of Counsel to Moodys Private Client Law.

The explosion of non-resident companies using the internet to sell their digital products and services without having the need for a permanent establishment in any country has been a topic of tax policy concern for quite some time. Up until just recently, Canadian consumers 'enjoyed' receiving tax-free digital services provided by large non-resident multinationals – think Netflix, Amazon Prime, Disney+, Spotify, Airbnb, and so on.

Debates ensued about the unfairness of the unlevel playing field for Canadian-based businesses offering similar services. Ottawa and the provinces also maintained that millions in tax revenues have been lost on services provided by these multi-nationals. What resulted was the casting of a new digital economy tax net that might catch smaller fish than initially advertised.

What's New?

Prior to July 2021, Canada did not have a right to impose a value added tax on such supplies. Federally, this changed as of July 1, 2021. Contrary to what many may have assumed, the new rules do not just apply to the multi-national giants of digital commerce. They apply to many businesses, big and small.

Prior to July 2021, non-resident vendors without a physical presence in Canada were not required to register for GST/HST purposes. This meant their supply of digital products or services to Canadian consumers (i.e., individuals/persons not registered for GST/HST) was not subject to GST/HST.

However, as of July 1, 2021, the new GST/HST rules apply to any sellers of –

- digital products or services (e.g., sale & licensing of software, online music streaming, etc.)
- distribution platform operators (i.e., businesses who facilitate supplies of goods including goods delivered or made available in Canada, such as goods located in a fulfillment warehouse), or
- short-term accommodation platform operators (i.e., facilitators of accommodations through their online accommodation platforms)

whose sales to Canadian consumers **exceed CDN \$30,000 over a 12-month period**. This is a *very low threshold* which will, in effect, catch more than one business unaware.

Four non-participating provinces (B.C., Saskatchewan, Manitoba and Quebec) have also cast their own nets, each with their own threshold limits. Not only are they catching businesses operating outside Canada but also those operating in Canada but in other provinces.

What Hasn't Changed?

Canada amended the *Excise Tax Act* (GST/HST) and the four non-participating provinces each introduced new rules to make the new taxes a reality.

As with any new legislation, it is never simply about adding one new section and being done with it. The reality is that a brand-new subdivision was added to the *Excise Tax Act* for GST/HST purposes and this new subdivision is chock full of special place of supply rules for both Canada and participating provinces. Of course, provincial tax measures introduced by the four non-participating provinces are not identical to each other – implementation dates, thresholds, etc., are not harmonized and must be analyzed separately.

None of these are as straightforward as any of us would have preferred. It will be a challenge for anyone other than dedicated GST specialists to find the time to become familiar with the new tax measures.

What Does this Mean for You and Your Clients?

The call to action has already sounded. If you haven't already done so, these new tax measures ought to be reviewed now to identify the impact on your domestic and/or foreign based client businesses. With each new tax measure, we move away from tax certainty, simplicity and the avoidance of costly and extended disputes.

What happens if there is a slip-up? The Canada Revenue Agency has indicated that if affected businesses and platform operators are able to show reasonable steps to meet their new obligations, the Agency will exercise discretion in administering the new rules during a 12-month transition period ending June 2022.

What Does the Future Hold?

In addition to the E-commerce measures described above, Ottawa has been working with the Organisation for Economic Co-operation (OECD), G20 countries and other countries to reach an integrated approach to fairly tax the digital economy. Absent the consensus, several countries introduced their own taxes on digital goods and services.

Canada's turn to implement a tax on the digital economy was formally announced in the November 2020 Fall Economic Statement. Budget 2021 proposes to implement an "interim" 3% Digital Sales Tax (DST) that will come into effect on January 1, 2022. For now, the DST proposed will only be imposed on the gross revenues of large multinationals operating search engines, social medial platforms and online marketplaces to the extent that their revenues are linked to the participation of Canadian users.

The DST is targeted at large businesses foreign or domestic that generate (including a member of business group), within a calendar year, both of the following thresholds:

- global revenue from all sources of €750 million or more (the threshold for country-by-country reporting under an OECD standard) in the previous calendar year; and
- in-scope revenue associated with Canadian users of more than \$20 million in the particular

calendar year.

As the OECD points out, it is difficult to put borders around the digitalised economy.

“Failure to deliver, however, will ultimately lead to a patchwork of unilateral actions, which in a fragile global economy, would harm investment and economic growth hampering the ability of governments to collect revenues and invest in programmes.”

For businesses and their advisors, the lack of a predictability and a patchwork of different rules creates compliance risks and increases the cost of doing business internationally. Proceed with care.

References

Department of Finance, Budget 2021, *Annex 6: Tax Measures – Supplementary Information*

Department of Finance, Budget 2021, *Annex 7: Consultations on Other Tax Measures – Supplementary Information*

An Act to Implement Certain Provisions of the Budget Tabled in Parliament on April 19, 2021, and Other Measures, Royal Assent 2021-06-29, Statutes of Canada 2021, c. 23

Notice of Ways and Means Motion to implement certain provisions of the budget tabled in Parliament on April 19, 2021 and other measures, R.S, c. E-15

Provincial Sales Tax Act of British Columbia

Provincial Sales Tax Act of Saskatchewan

Retail Sales Tax Act of Manitoba

La Loi sur la taxe de vente du Québec

Canada Revenue Agency, *GST/HST for digital economy businesses: Overview*

The Organisation for Economic Co-operation and Development (OECD), *BEPS – Inclusive Framework on Base Erosion and Profit Shifting*