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Tax Alert – Canada

Canada moving ahead with its own digital services tax: revised draft legislation released

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.

Canada is moving ahead with enactment of its own digital services tax (DST). It is anticipated that Canada's DST will be enacted by 1 January 2024, with effect back to 1 January 2022.

The new rules may result in a filing obligation and tax liability for any entity – Canadian or otherwise – whose corporate group has global consolidated revenues of €750 million or more and who earns Canadian digital services revenue from providing online marketplace services, online advertising, social media services or the monetizing of user data in excess of \$20 million CAD.

Impacted entities will need to be registered for Canada's DST by 31 January 2025 and will have to file returns and remit DST for both 2022 and 2023 by 30 June 2025.

On 4 August 2023, the Department of Finance released a revised draft of the *Digital Services Tax Act* (DSTA) for public consultation. The revised draft legislative proposals came shortly after Canada's decision not to further extend a multilateral freeze on the imposition of any new domestic DSTs by another year. Interested parties are invited to provide comments on the draft DSTA by 8 September 2023.

In this Tax Alert, we provide a brief overview of Canada's introduction of the DST as well as a summary of certain changes included in the revised DSTA.

Background

For the past decade, the Organisation for Economic Co-operation and Development (OECD) has been working with its members to obtain international consensus to adopt a solution to address the challenges of tax base erosion and profit shifting of multinational enterprises. To combat this issue in the interim, several countries, including France, Austria, Spain, Italy and the United Kingdom, took a unilateral approach and enacted a domestic DST aimed at taxing certain services performed by large companies and consolidated corporate groups that met certain revenue thresholds. In the fall of 2020, the Canadian federal government announced its intention to do the same and unilaterally implement a Canadian DST. However, Canada concurrently announced that it would delay enactment of its DST until the end of 2023 in the event multilateral measures were implemented by the end of 2023.

In July 2021, a statement was issued by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (the Inclusive Framework) describing the key components of a two-pillar approach. Pillar One would allocate a portion of the consolidated profits of large consolidated groups to the jurisdiction from which revenues were earned, and Pillar Two would introduce an agreed global minimum effective tax rate for such consolidated groups. By 8 October 2021, a statement on the implementation of the international tax reform was issued with the intent that the new reforms would come into effect by the end of 2023. One of the conditions of the implementation of Pillar One, however, would be the removal by member states of any unilateral DST or similar measure.

Although supportive of the two-pillar proposal, the Canadian government introduced proposed DST legislation in December 2021 for public consultation. It was understood that the proposed DST legislation would not be declared in force until at least 1 January 2024, or it may never be declared in force if the Pillar One measures were implemented by the end of 2023 as planned. In the event that the multilateral approach did not come into force by 2023, Canada's DST would be payable in respect of taxable Canadian digital services revenue earned as of 1 January 2022.

On 11 July 2023, the Inclusive Framework released an Outcome Statement,¹ which included an additional one-year standstill on imposing any new DST legislations as it was becoming clear that Pillar One would not be fully implemented by the end of 2023. Although 138 member countries approved of the Outcome Statement, Canada did not. Instead, on 12 July 2023, Canada's Deputy Prime Minister and Minister of Finance, Chrystia Freeland, issued a public statement confirming that Canada will be moving ahead with the implementation of its domestic DST if no multilateral agreement is reached by the end of 2023. Shortly thereafter, on 4 August 2023, the Department of Finance published a revised draft DSTA. Although various changes were made to the draft DSTA, the bulk of the proposed measures remains consistent with its previous iteration.

¹ [Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy - 11 July 2023 - OECD.](#)

Draft DSTA released on 4 August 2023

The proposed DST continues to apply to large domestic and foreign businesses where their:

1. Total revenue from all sources (or the total revenue of a consolidated group² 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
2. Canadian digital services revenue (or the total of all Canadian digital services revenue for all entities in a consolidated group if they are a constituent entity³ of a consolidated group at any time in the calendar year) is greater than \$20 million CAD in the calendar year.

If a taxpayer or its consolidated group meets these conditions, the taxpayer(s) will be required to pay a tax equal to 3% on their taxable Canadian digital services revenue in excess of \$20 million CAD in a calendar year.

The four categories of taxable Canadian digital services revenue continue to consist of Canadian online marketplace services revenue, Canadian online advertising services revenue, Canadian social media services revenue and Canadian user data revenue:

- a. Canadian online marketplace services revenue 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 includes revenue generated from systems facilitating online targeted advertisements and digital spaces that display online targeted advertisements;
- c. Canadian social media services revenue 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

² A consolidated group is defined in the DSTA as two or more entities that are required to prepare consolidated financial statements for financial reporting purposes under acceptable accounting principles or would be required to do so if equity interests in any of the entities were traded on a public securities exchange that requires the use of acceptable accounting principles.

³ A constituent entity of a consolidated group is defined in the DSTA as any entity of the group that (i) is included in the consolidated financial statements of the group (prepared in accordance with acceptable accounting principles), or (ii) if consolidated financial statements are not required to be prepared by the group (or are not prepared in accordance with acceptable accounting principles), would be required to be included in the consolidated financial statements of the group if equity interests in any of the entities in the group were traded on a public securities exchange that requires the use of acceptable accounting principles. A constituent entity also includes any entity that is excluded from the group's consolidated financial statements solely because of size or materiality.

- d. Canadian user data revenue 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.

However, Canadian online marketplace services revenue is expanded to include a supply of a service between users of an online marketplace:

- (a) Physically performed and received in Canada;
- (b) In respect of real property located in Canada; or
- (c) In respect of tangible personal property that is normally located in Canada and that is situated in Canada at the time the service is performed.

Income that could be included in multiple revenue streams is restricted to a single revenue stream with priority going first to online marketplace services revenue, then to online advertising services revenue, then to social media services revenue, and then to user data revenue.

The draft DSTA also includes the following modifications to various definitions:

- ▶ “Bankrupt” is added and is relevant for newly added section 26, Trustee as agent, which establishes an agency relationship between a trustee in bankruptcy and a taxpayer who has become bankrupt;
- ▶ “Digital content” now excludes a “financial instrument”;
- ▶ “Financial instrument” has been modified to exclude (i) property that confers a right to be exchanged, redeemed or converted into specific property or services; (ii) property primarily used in a gaming, affinity or reward platform; or (iii) other property prescribed by regulation;
- ▶ “Online marketplace” now excludes digital interfaces that have as their main purpose the making of advances or the lending of money;
- ▶ “Online targeted advertisement” is expanded to refer to an advertisement that is “predominantly placed for the purpose of promotion”; and
- ▶ The defined term “reporting period” was removed from the draft DSTA in its entirety and replaced with “calendar year” where applicable.

In addition, the revised draft DSTA also includes the following notable changes:

- ▶ Subsection 4(1) now focuses on the determination of revenue rather than the meaning of revenue, and subsection 4(2) now focuses on the conversion of currency of revenue in respect of euros.

- ▶ The revised draft DSTA introduces subsections 12(2) and 12(3), which allow taxpayers to elect for a simplified, formula-based method of computing Canadian digital services revenue for years prior to the first year of application. Under this election, Canadian digital services revenue of years prior to the first year of application can be approximated by using the ratio of Canadian digital services revenue to total revenue of the first-year application multiplied by the revenue in the earlier year. The election is not available for taxpayers who could have made election under subsection 12(2) in a previous year but decided not to do so. The election must be filed by 30 June of the calendar year following the first year of application.
- ▶ Section 21 is expanded to add subsections 21(1) and 21(2) to clarify the rules surrounding new constituent entities. In general, revenue that a taxpayer earns prior to the period when it joins a consolidated group would not be subject to DST, and revenue earned by the taxpayer after it joins a consolidated group would be subject to DST.
- ▶ Sections 25 to 32 are replaced with provisions that set out the rules in respect of bankruptcy and receivership.
- ▶ Section 33 now sets out the rules related to partners of a partnership.
- ▶ Subsection 54(2) has been added to allow the Minister to waive the requirement in subsection 54(1) (formerly in subsection 45(1)) for payment to be made in Canadian dollars so that other currencies may be accepted.
- ▶ Section 55 now imposes a requirement to make payments electronically if the payment is \$10,000 or more unless the taxpayer cannot reasonably pay that amount in that manner.
- ▶ Former section 86, which set out the due diligence defence provision, has been removed.
- ▶ Section 88 now sets out a new penalty in respect of avoidance planning.
- ▶ Subsection 100(4) has been amended to increase the limitation of prosecutions from five years to eight years (formerly in subsection 90(4)).

Implications

Businesses and consolidated groups that are above the threshold for DST should review the revised DSTA in close detail and be informed of the following key features:

- ▶ **Registration:** A taxpayer or an affected member of a consolidated group is required to register under the DSTA if it earns Canadian digital services revenue, it meets the €750 million threshold, and it earns more than \$10 million CAD of Canadian digital services revenue. Notably, the threshold required to register (\$10 million CAD) is lower than the threshold required for taxation (\$20 million CAD). If a taxpayer or an affected member of a consolidated group is required to be registered, they must apply to register by 31 January of the following calendar year.
- ▶ **Returns:** Returns are due annually on or before 30 June of the following calendar year.

- ▶ **Payments:** Payments must be paid on or before 30 June of the following calendar year. As noted above, any payments that are \$10,000 or more must be paid electronically unless the taxpayer cannot reasonably pay that amount electronically.
- ▶ **Consolidated groups:** Since the applicable thresholds are computed on a consolidated basis, unless they elect otherwise, a registration, filing obligation and tax liability will result for each member of a consolidated group with any Canadian digital services revenue. For example, consider a corporate group consisting of the following three entities with consolidated revenue of more than €750 million: (i) France Co., (ii) US Co., and (iii) London Co. Taxable Canadian digital services revenue for each entity for the year is \$1 million, \$30 million and \$15 million, respectively. All three entities will be required to register and file Canadian DST returns and pay the DST since the consolidated Canadian digital service revenue is in excess of \$10 million CAD and \$20 million CAD, respectively. The Minister may waive registration, and an election is available for a single affected member to report DST on behalf of others within the consolidated group.

It is anticipated that Canada's DST legislation will be enacted by 1 January 2024, taking into consideration the comments the Department of Finance receives on its 4 August 2023 revised DSTA. Impacted or potentially impacted persons should review the draft DSTA and provide feedback by 8 September 2023.

Learn more

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