<u>Taxation of the Digital Economy</u>

Issue

The tax challenges arising from the digitalization of the economy have been identified as one of the main areas of focus of the Base Erosion and Profit Shifting (BEPS) Action Plan of the Organization for Economic Co-Operation and Development (OECD).

As the global economy moves to greater levels of digitization, old models of taxing foreign importers and service providers in Canada may no longer be appropriate to capture a fair amount of tax revenue based on profit generated from Canadian consumers.

The impact of this disparity is that local businesses which are subject to income taxation in Canada as a result of their residency here, have an additional layer of cost which a foreign seller may not. This provides a potential competitive disadvantage to domestic businesses. This also results in the Canadian government needed to look elsewhere for taxation revenues to fund public programs, resulting in a higher tax burden on those that fall within the existing tax net.

Background

Currently, tax treaties which Canada has in force with other countries emphasizes that business profits earned in Canada will not be subject to tax on account of income in Canada unless a sufficient amount of physical presence is established. This physical presence is called a permanent establishment, and can be established through such activities as:

- Physical facilities in Canada such as a head office or sales office,
- Equipment located on a stationary worksite for an extended period of time, or
- Employees who are present in Canada for a significant period of time.

These principles helped to simplify the application of income taxes in Canada, and alleviate an undue tax burden where activities in Canada were incidental or ancillary to the primary profit generating activities of a foreign business. However, it is no longer the case that because a foreign business does not have a physical presence in Canada, that their business model does not include a focus on Canada as a significant profit generating location. Consequently, the tax system must be updated to keep pace with the emerging technological focus of today's international commerce.

Currently the International Chamber of Commerce and the OECD are in the process of developing policy statements and principles on taxation in a digital economy. The OECD issued a public consultation document in March, 2019 to solicit commentary on best practices to be included as part of their principles for OECD member countries to use as a guide.

This issue is timely, and as these frameworks are made public, and countries around the world adapt to tax digital commerce within their borders, countries without similar laws will be doubly penalized. Not only will they fail to receive the tax revenue on international commerce for sales to their residents, but their domestic businesses will also be subject to new layers of complexity and taxation when attempting to export through digital means. Canada should prepare themselves to act quickly once international frameworks are published and countries around the world enact their own laws.

Recommendations

That the federal government:

1. Conduct consultations in order to resolve concerns and methods of taxation in the digital economy particularly as the concerns relate to consistency and dispute resolutions.
2. Amend the Canadian Income Tax Act to incorporate international best practices for the digital economy.

Submitted By: Fredericton Chamber of Commerce