Canada’s unilateral Digital Services Tax forges ahead with retroactive effect

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Key takeaways

- A 3 per cent tax now applies to in-scope Canadian digital service revenues.
- Starting in 2025, certain taxpayers will have new Canadian tax registration, reporting and remittance obligations in respect of revenues earned back to Jan. 1, 2022.
- Impacted businesses should be aware of registration and reporting obligations that exists independent of the tax.
- The *Digital Services Tax Act* (DSTA) may face domestic and international challenges that could impact its final form of application.
- Canadian consumers of digital services are likely to see tax costs passed on in the form of higher user fees.

The DSTA in force

The Canadian government has enacted legislation to impose a Digital Services Tax (DST) on Canadian digital service revenue with retroactive effect. Beginning in 2025, select taxpayers will have reporting and remittance obligations in respect of in-scope revenue earned back to Jan. 1, 2022.

The DSTA affects the previously stated intention of the Canadian government to pursue a DST in the absence of a firm and binding multilateral timeline to implement Pillar One of the ongoing negotiations by the Organization for Economic Co-operation and Development (OECD)/G20 Inclusive Framework for a two-pillar plan on international tax reform.

Bill C-59, including the DSTA and its supporting regulations, received royal assent on June 20, 2024, and entered into force on June 28, 2024, pursuant to an order in council, though the order in council was not made public until July 3, 2024.

The DSTA applies to both foreign and domestic taxpayers that meet or exceed a total revenue threshold of €750,000,000 and a Canadian in-scope revenue threshold of $20,000,000, on an individual or consolidated basis. Taxpayers that meet or exceed both thresholds will be required to pay a 3 per cent tax on Canadian digital services revenue earned from Jan. 1, 2022.

In addition to the imposition of the DST itself, the DSTA also creates a registration and reporting obligation for taxpayers that meet the above revenue thresholds as well as businesses that have €750,000,000 of total revenue and more that $10,000,000 of Canadian in-scope revenue. Taxpayers subject to the registration requirements under the DSTA are required to register by Jan. 31, 2025, and file an annual DST return by June 30 of each year.

Wider context of the DST

While the Canadian government's position is that it continues to support the multilateral negotiations at the OECD, the retroactive imposition of the DST aligns Canada with a group of countries that have adopted a unilateral approach to digital services taxation, including Austria, France, India, and the United Kingdom.

Prior to enactment, opposition to Canada's plan to adopt a DST had primarily arisen from effected businesses and industry groups, particularly in the US. However, despite the timing of the public announcement of the DSTA ahead of the Independence Day long weekend in the U.S., the U.S. government has already received increased pressure for a formal response, which could include retaliatory trade measures and potentially have impacts beyond the digital services industry. Regardless of a formal response from the U.S. government, it is likely that targeted taxpayers will pass on new DST costs to consumers and Canadians should anticipate higher user fees for digital streaming, marketplace platforms, food delivery, and other digital services that are increasingly ubiquitous in everyday life.

Public notice of the DSTA entering into force also elicited a response from both the Canadian Chamber of Commerce and the U.S. Chamber of Commerce calling for a reconsidering of the DST and Canada's return to the table at multilateral negotiations, noting inflationary pressures the DST may have on consumers, the potential harm to Canadian innovation, and Canada's relationship with international trading partners.

In addition to the international response to the formal enactment of the DST, the DSTA may yet see legal challenges from within Canada given the significant administrative and enforcements powers under the DSTA. As discussed under the Department of Justice's Charter statement for Bill C-59, the DSTA includes broad powers that potentially engage with sections 7, 8, 11, and 12 of the *Charter of Rights and Freedoms*, and while there are some similarities with accepted powers under other Canadian tax statutes, we observe that the general erosion of the Taxpayer's Bill of Rights, discussed in our earlier article, has yet to be substantively tested by taxpayers. Further, specific measures under the DSTA to collect, disclose and use confidential information from Canadian residents and non-residents, including concepts such "foreign-based information record"[1] represent a high risk for administrative overstep and likely require significant restraint in application in order to avoid potential challenges.

Given the wider of context of the DST and the fact that significant elements of the DST are included in the underlying regulations of the DSTA, we may yet see changes to the DST in application without the need to return to Parliament to amend the legislation itself.

Conclusion

Large businesses should consider potential new DST obligations, as well as reporting and revenue related elections available under the DSTA.

For further information on the DST and its potential impact to your business, please contact the author or any member of BLG's Tax group.

Footnote

[1] "Any information or record that is available or located outside of Canada and that may be relevant to the administration or enforcement of the [DSTA]"

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