‘Significant risk’ of economic pain could outweigh the reward of Canada’s unilateral digital services tax: Geist

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Tax on digital services, despite protests from international allies, could lead the feds to counting its chickens before they’ve hatched, says law expert Michael Geist.

According to a revised Parliamentary Budget Officer (PBO) report released on Oct. 17, the proposed digital services tax—set to come into force on Jan. 1, 2024, and apply retroactively to the beginning of 2022—would raise $7.2-billion over five years. Previously, the PBO estimated the tax could raise $4.32-billion, while the government’s own estimate had predicted $3.4-billion in tax revenue.

The proposed tax will apply to businesses with a combined total revenue of $1.1-billion, and levy a three per cent tax on all Canadian revenue from digital services—including online marketplaces, social media platforms, and online advertising—exceeding $20-million.

Canada and several other countries initially agreed to pause any plans to enact such a tax while the Organisation for Economic Co-Operation and Development (OECD) negotiated a multilateral deal to overhaul outdated rules on how governments tax multinational digital tech giants like Amazon and Google.

The proposed deal would consist of two “pillars,” the first of which would aim to reallocate rights on an estimated US$200-billion in tax revenue to the countries where the sales occur. The second pillar would call on governments to end competition by setting a global minimum tax rate of 15 per cent.

While that deal was meant to be in place by the beginning of 2024, Canada said it is unwilling to agree to terms negotiated by the United States that would have delayed the enactment of unilateral taxes for at least another year. Of the 143 countries party to the agreement, the only other countries to disagree with the delay were Russia, Sri Lanka, Pakistan, and Belarus.

However, despite threats of retaliation if Canada does go forward on its own, U.S. Treasury Secretary Janet Yellen said on Oct. 16 her country wouldn’t be ready to sign the OECD deal, which some have speculated could lead others to move forward with their own digital services taxes.

Finance Minister Chrystia Freeland has said that delaying the implementation of the digital services tax by another year would run counter to Canada’s national interests. The Hill Times photograph by Andrew Meade.

Geist, a law professor and Canada Research Chair in Internet and E-commerce Law at the University of Ottawa, told The Hill Times that he believes taxes like this are a much better mechanism to ensure tech giants pay their “so-called fair share,” unlike the government’s approach with things like the Online News Act and the Online Streaming Act, which he called “mistakes.”

However, Geist also said he believes the government’s plan to unilaterally move forward with the implementation of the digital services tax next year comes with “significant risk,” and, similar to the government’s approach to the Online News Act, he said the Liberals are downplaying those potential risks.

Following the release of the PBO’s revised estimate, when asked by reporters...
whether that revenue was worth the potential anger and retaliation from her American counterparts, International Trade Minister Mary Ng (Markham–Thornhill, Ont.) told reporters that the digital services tax is part of an obligation the government made to Canadians to make sure that “big tech companies pay their fair share of taxes.”

“I’m not going to guess where things are going to go, but I will continue to work with my U.S. colleagues,” Ng said.

Geist said he “questions the wisdom of pushing ahead against an international consensus while discounting the risk of retaliation,” adding that he gets the sense that the Liberals simply don’t think the Americans would want to retaliate.

“I don’t know why they would think that,” Geist continued. “Because that sentiment is why we now find ourselves with blocked news links on Facebook and the prospect of the same on Google.”

Both Katherine Tai, the United States’ trade representative, and U.S. Ambassador to Canada David Cohen have warned against Canada implementing the tax unilaterally, with Cohen telling The National Post that doing so would leave the U.S. with “no choice” but to take retaliatory measures.

While Geist recognizes that the PBO’s projected $7.3-billion in revenue from the implementation of the tax represents a sizeable reward for going it alone, he also said it would be an incredibly high-risk strategy, especially on the eve of the 2024 U.S. presidential election.

“If we’re talking about billions of dollars, I think the Biden administration wouldn’t hesitate to levy tariffs against the dairy industry to shore up support in Wisconsin or the steel industry to shore up support in Pennsylvania,” Geist said. “I don’t think you’ve got to be a political genius to figure out that tying this into a hotly contested presidential election might be viewed as an attractive possibility.”

Additionally, Geist cautioned that any potential pushback would likely be designed to nullify any financial benefits while targeting those sectors that would cause the most amount of “economic pain,” pointing to the Americans’ response to France’s implementation of its own digital services tax by applying tariffs to French handbags, cosmetics, and other luxury goods.

“The government would be best off really putting most of its eggs in a global solution basket,” Geist explained. “I think the best scenario for us is to have an international mechanism to ensure that tech companies pay their fair share.”

Alex Gray, a senior director of fiscal and financial services policy at the Canadian Chamber of Commerce, also cautioned against counting those eggs before the actual tax revenue can be collected, noting that France collects roughly 30 per cent less than it had originally projected. Those increased tax costs will also inevitably be passed along to the consumer, Gray said, noting that services in that country also saw a two to three per cent increase in prices since implementation.

While he doesn’t have much insight into what those sanctions or tariffs may look like, Gray said the U.S. would most likely target Canada’s steel and lumber sectors, and undoubtedly be designing them “to make a point.”

Gray said that given the precarious state of both economies, with both countries only narrowly avoiding a recession, Canadian businesses are feeling increasingly worried by the federal government’s seeming willingness to provoke such a close trade ally.

“Our economy is much more tightly tied to the U.S. than France or the U.K., not just through the volume of trade, but through our trade agreements and the USMCA, so they have far more venues to be able to hurt us,” Gray explained.

U.S. businesses more concerned about avoiding a trade war, says tax law expert Wei Cui Wei Cui, a professor of tax law and policy at the Peter A. Allard School of Law at the University of British Columbia, has written numerous research papers in defence of Canada’s proposed digital services tax, following the similar proposed taxes by the EU and the U.K. in 2018.

In the course of his research over the past five years, Cui found that while the prevailing sentiment of the Canadian business community stands against the implementation of such a tax, it has been rather difficult to get them to talk about why.

Normally, Cui said, the tax advisers and policy analysts he speaks to would seize on any opportunity to criticize any measure they believe will negatively affect their clients, but in this instance, the lack of understanding of how the tax would work has muted those voices that have simply assumed it will be bad.

“They’re relying on a few soundbites,
like claiming the [digital services tax] is discriminatory, but that’s completely false,” Cui explained, highlighting the complaint that so many of the affected firms were U.S.-based.

In September, 41 members of the U.S. House of Representatives Ways and Means Committee signed a letter calling Canada’s approach to the tax “unusually aggressive and discriminatory” by unfairly targeting “U.S. companies and workers who would disproportionately bear the burden of this new tax.”

Cui explained that the financial thresholds for multinational firms making more than $1.1-billion would affect roughly 7,000 corporations around the world, and while roughly 25 per cent of those will be American, those companies are already paying similar taxes, including employee income tax.

While Cui said those companies had not raised concerns of discrimination in those other instances, he believes much of the confusion comes from businesses believing that Canada’s tax will follow the thresholds suggested by the U.K. and France, which only taxed corporations that made more than $1.1-billion in digital services alone rather than total revenue.

Additionally, Cui said Canada has a much broader base of business that will meet the digital services tax thresholds, which could possibly include Canadian businesses like Shopify and Canadian Tire.

While many U.S. tech companies are the loudest critics of Canada’s proposed tax, much of the remainder of the country’s business community is far less animated against it, he said.

Cui said that many companies without digital services don’t seem to care whether or not Canada implements the tax, but are much more likely to care if their import and export business are subjected to tariffs in response.

“Those businesses care more about avoiding a trade war than the [digital services tax],” Cui explained, adding that Yellen does have a good relationship with Finance Minister Chrystia Freeland (University–Rosedale, Ont.), and that the rest of the cabinet would most likely want to avoid a trade war as well.

That desire to keep the trade relationship amicable between Canada and the U.S. is why Yellen has been working to negotiate the OECD deal, Cui said, but with the implementation of even the first pillar looking less and less likely, the U.S. no longer had a good reason to retaliate.

“The only reason we’re talking about retaliation is because of some of the crazier people in the U.S. Congress, and look at what kind of mess they’re in; they’re not in a good position to retaliate,” Cui said.