Coalition for culture and media
CONTINUITY - FAIRNESS - SUPPORT

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Brief submitted to the House of Commons Standing Committee on Finance

Pre-budget Consultations in preparation for the 2019 Budget

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List of recommendations

Recommendation 1

- That the government put in place measures to ensure that foreign businesses doing business in Canada through the Internet collect GST/HST on sales made in Canada, on both tangible and intangible products.

Recommendation 2

- That the government make legislative changes to ensure that foreign businesses offering goods and services online in Canada pay taxes in connection with their Canadian operations.

Recommendation 3

- That the government clarify the deductibility provisions of the *Income Tax Act* (sections 19.1 and 19.01), or amend the CRA's interpretation thereof, so that advertising expenditures made by Canadian businesses through foreign media, including media transmitted over the Internet, are not tax deductible.

Recommendation 4

- That the government update the definition of the word *broadcasting* in the *Income Tax Act,* to be in line with the *Broadcasting Act* and match the CRTC's statements on broadcasting transmitted over the Internet.

Recommendation 5

- That the government amend the *Interpretation Act* to replace its outdated definition of the word *broadcasting* with the technologically neutral definition found in the *Broadcasting Act* in order to standardize the definition in all federal statutes.

Introduction

Trade on the Internet is an increasingly important part of the Canadian economy and it is recognized that this trend will continue in the coming years. In fact, the entire global economy is changing, which is what led the Organisation for Economic Co-operation and Development (OECD) to stop using the term *"digital economy"* and adopt the term *"digitalising of the economy"*: "The rapid spread of digitalisation, coupled with the liberalisation of trade policy has increased the pace of globalisation and induced an ongoing structural transformation of the economy. As this transformative process is having an impact across the board, **it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy**."[1]

The Canadian government must therefore stop considering the digitalising of the economy as a marginal phenomenon. Rather, it is a basic trend that impacts the competitiveness of Canadian businesses and urgently needs to be addressed in the upcoming budgetary year.

Moreover, unlike Canada, Quebec and many countries have begun to modernize their tax systems to ensure the maintenance of their incomes and protect their domestic industries. The Canadian government's inaction benefits many foreign suppliers of goods and services online – including large multinationals like Google, Facebook and Netflix – to the detriment of Canadian businesses, their workers, and our public services. It is time for the federal government to take steps to improve the competitive position of its industries affected by the digitalising of the economy.

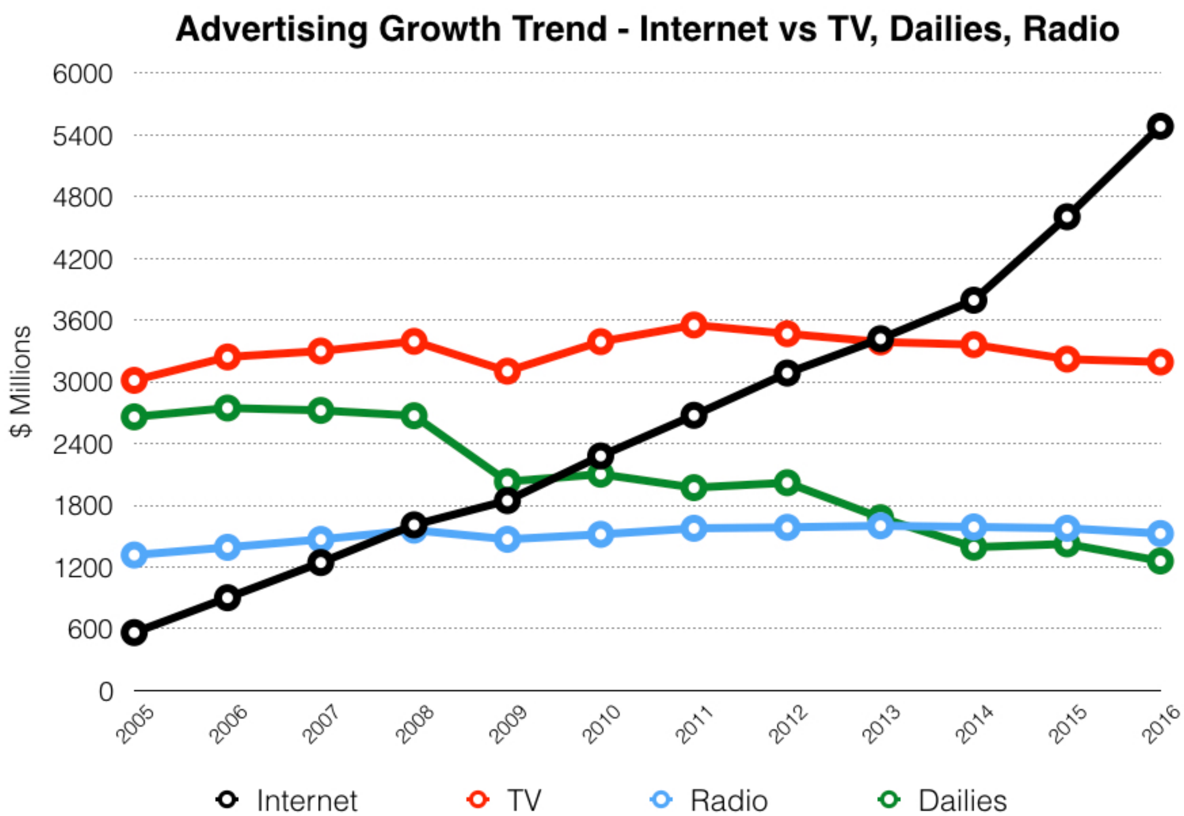
I – CULTURE AND MEDIA: AMONG THE FIRST AFFECTED

Canada's media and cultural sector – providing more than 650,000 jobs and accounting for almost 3% of the GDP – was one of the first to be affected by digitalisation and e-commerce. It is also one of the sectors most affected by the globalisation of the production and distribution of goods and services online.

In the music industry, for example, global revenues from Internet-based products (54% of total revenues) – music selections and streaming music subscriptions like Spotify – have dethroned revenues from the sale of albums on physical media (30% of total revenues) since 2015.

[1] OECD, "Tax Challenges Arising from Digitalisation – Interim report 2018: Inclusive Framework on BEPS," *OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, May 2018, p. 167.

In the media, the migration of advertising to the Internet has resulted in huge revenue losses for many years now. Print media has been the most affected, followed by television.



Source: Friends of Canadian Broadcasting

The closures of newspapers and television stations, unable to make ends meet, have increased in recent years. The most recent announcement targeted six newspapers in the Postmedia Network, which also reduced its remaining staff by ten percent. It must be said that Canadian media is disadvantaged by tax deductions for Canadian companies that advertise on foreign online media (see point III).

Add to this the fact that the American Netflix corporation dominates subscriptions to online services with offerings of television shows and movies, even in Quebec where its market penetration is not as strong. Again, current tax rules favour the foreign competition. Unlike Canadian companies, foreign digital services offering a taxable product are not required to collect the goods and services tax or the harmonized sales tax (GST/HST) when they sell a subscription to a customer located in Canada (see point II). Furthermore, those suppliers do not pay taxes in this country.

The competitiveness of our media must be improved to prevent the disappearance of local information and maintain our cultural sovereignty and the economic vitality of regions, as well as the democratic health of our country.

II – REINSTATE TAX EQUITY

All businesses should pay their fair share of sales taxes and income tax, whether for online services or traditional media. This symmetry is crucial in the current context where there is a proliferation of new digital services and platforms.

The OECD has since 2015 acknowledged that "... one of the broader tax challenges arising from digitalisation is the challenge associated with the collection of VAT on cross-border trade in goods, services and intangibles, particularly where they are acquired by private consumers from suppliers abroad."[2] To address this problem, the OECD recommends that governments apply the principle of destination whereby any value added tax must be collected not only by local businesses, but also by any foreign supplier, and returned to the country where the customer is situated.

So far, some 50 jurisdictions around the world – including a majority of OECD and G20 member countries – have adopted "... rules for the VAT treatment of B2C[3] supplies of services and intangibles by foreign suppliers in accordance with the OECD International VAT/GST Guidelines."[4] The Supreme Court of the United States has also just recognized that American states have the power to legislate to apply the destination principle.

The first data on the impact of the measures suggested by the OECD show that they are bearing fruit. Thus, in its first year of operation, in 2015, the European Union's simplified registration plan raised the equivalent of over C$4.3 billion in additional VAT revenues from online foreign businesses (3 billion euros). South Africa recovered the equivalent of nearly C$60 million in 2016-2017 ($585 million rands[5]).

Quebec has chosen to follow those countries and will ask all foreign businesses doing business online in Quebec to collect its sales tax (QST) on intangible property as of next January 1. Canadian suppliers located outside Quebec will have the same obligation for all goods and services sold as of September 1, 2019.

[2] OECD, p. 102.
[3] Business to consumer.
[4] OECD, p. 103.
[5] OECD, p. 104.

The province estimates that the QST collected on all goods and services offered through the Internet would generate $270 million per year.

The House of Commons Standing Committee on International Trade also recommended, in its April 2018 e-commerce trade report, that the government of Canada "... apply sales taxes on tangible and intangible products that are sold in Canada by domestic firms and by foreign sellers, including when such sales occur using an e-commerce platform." The tax expert Marwah Rizqy, from the University of Sherbrooke, estimates that for advertising sales for Facebook and Google alone, Canadian governments could fetch up to $700 million annually with such a measure.

Despite that, the government of Canada has been slow to act. Finance Minister Bill Morneau has said he intends to tax foreign companies transacting with Canadians over the Internet within a year, but he refuses to go it alone and is waiting for international consensus before acting.

While this cautious approach is fully justifiable in a tax context to prevent companies from moving their assets from one country to another, it seems at the very least unreasonable when it comes to collecting GST/HST on goods already considered taxable and for which the current system of self-assessment is ineffective because it is practically never used ($3.2 million collected in 2015).

III – THE DEDUCTIBILITY OF ADVERTISING ON THE INTERNET

Starting in the 1960s, successive governments amended the *Income Tax Act* (section 19) to eliminate or limit the deductibility of advertising expenses with foreign newspapers, periodicals or broadcasters in order to encourage advertisers to choose Canadian media. These provisions, still in place, are intended to protect Canadian media from unfair competition from foreign media, thereby preserving jobs, local voices and the Canadian nature of that media.

However, the Canada Revenue Agency (CRA) currently allows the full deduction of advertising expenditures dedicated to foreign digital media under a 1996 interpretation. This interpretation – based on case law prior to that date and on outdated definitions of *newspaper* and *broadcast*– does not reflect the technologically neutral approach of the *Broadcasting Act* or the evolution of media over the last 20 years.

While the value of Internet advertising was negligible in 1996, this market is now valued at more than $6.2 billion (2017).

More than 80 percent of that amount goes to foreign sites and platforms, including major U.S. corporations like Google and Facebook that grab over two-thirds of it.

According to a study conducted for the Friends of Canadian Broadcasting, if the current tax deduction was abolished – or the CRA's interpretation amended – and Canadian advertisers continued to buy advertising on foreign Internet media, the Canadian government would generate increased tax revenues. Based on 2017 data, up to $5 billion in advertising expenses would no longer be deductible, representing a potential gain in corporate taxes payable of $1.3 billion.

The study also estimates that 10 per cent of this newly non-deductible advertising spending would return to Canadian media, repatriating $275 to $440 million annually in additional advertising revenue for newspapers, radio and television.

Conclusion

Improving the competitiveness of Canadian businesses involves restoring fiscal equity in the 2019 budget. This is particularly true in the culture and communications sector already hard hit by the digitalising of the economy.

The Coalition for Culture and Media

The Coalition for Culture and Media is a group of cultural and media organisations representing hundreds of thousands of people in Canada. In its *Declaration for the sustainability and the vitality of national culture and media in the digital era*, the coalition is calling on governments to restore fiscal and regulatory fairness, to continue government interventions, and to take effective measures to support national culture and media.