Written Submission for the Pre-Budget Consultations in Advance of the 2019 Budget

By: BCE Inc.

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- **Recommendation 1:** That the government increase the capital cost allowance (CCA) rate to 100% for the classes of assets most closely associated with broadband communications networks.

- **Recommendation 2:** That the government require all foreign-based vendors selling to Canadian residents to register with Canada Revenue Agency (CRA) and collect the GST/HST on all e-commerce sales to Canadian residents.

- **Recommendation 3:** That the government revise the Scientific Research and Experimental Development (SR&ED) program by expanding the scope of investments that are eligible for tax credits and returning the rate to its previous level.

Introduction

1. Communications networks drive productivity, innovation and growth in the Canadian economy. As consumers and businesses continue to shift their daily activities online, telecommunications providers must invest heavily in both fixed line and wireless networks to maintain Canada's digital economy leadership and accommodate rapid traffic growth. For example, BCE is playing a pivotal role in the evolution to 5G wireless networks and services, and has committed billions of dollars to the roll-out of all-fibre networks across our operating territory. The benefits of such initiatives to Canada are significant, and form part of a larger story of massive ongoing industry investment.

2. It is imperative to Canada's competitiveness, economic growth and innovation performance that the communications industry continues to invest in R&D and network upgrades. The following document outlines our recommendations for achieving this goal.

Accelerated CCA

3. We recommend an increase to the CCA rate for the classes of assets most closely associated with broadband communications networks. Currently, there is an accelerated CCA policy which provides a 50% straight-line depreciation rate rather than the usual 30% declining-balance rate for machinery and equipment used in manufacturing and processing. The rationale for this policy is to "provide businesses with planning certainty for larger projects where the investment may not be completed until several years after the investment decision is made and for longer term investments with multiple phases."[1] The same policy rationale that applies to the manufacturing sector should apply to Canada's communications services sector.

4. It is noteworthy that Canada's legislators recently recognized the importance of competitive CCA rates as an investment driver. Specifically, the Standing Committee on Finance's report on the 2017 budget included a recommendation to increase CCA rates for telecommunications companies.[2]

5. Recent changes in U.S. tax policies increase the need for CCA changes in Canada. U.S. tax reform increased the depreciation deduction to 100% for capital assets.[3] In commenting on Canada's potential response to U.S. tax reform, the International Monetary Fund (IMF) Executive Board indicated that Canada should strive to improve the efficiency and competitiveness of its tax system.[4] The Financial Post noted that: "[t]he IMF agrees with those who say that Canada risks losing investment to the U.S. because it has lost its corporate tax advantage. It called for a "careful rethink" of the way it taxes companies."[5]

6. In consideration of the above, we recommend changes to the CCA rate for the following classes: Class 42 – fibre optics, wire and cable, i.e. telephone and data communication equipment and Class 46 – data network infrastructure equipment. We believe that increasing the rate to 100% to match U.S. policy is now necessary to ensure Canada's competitiveness.

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1 *Economic Action Plan 2015*, page 77.

2 Standing Committee on Finance, *Creating the Conditions for Economic Growth: Tools for People, Businesses and Communities,* December 2016. See Recommendations 32 and 61.

3 Excludes long-lived assets such as buildings and other assets used in real estate.

4 International Monetary Fund, *IMF Executive Board Concludes 2018 Article IV Consultation with Canada*, July 16, 2018.

5 Kevin Carmichael, The Financial Post, *Weak competitiveness dragging down Canada's long term prospects, IMF warns*, June 4, 2018.

E-commerce Sales Tax

7. E-commerce is a large and growing source of sales tax revenue for Canada. Retail e-commerce sales in Canada were over $45 billion in 2017 and are expected to continue to grow at a double-digit pace for the foreseeable future.[6] However, companies that sell digital goods and services to Canadians but do not carry on business in Canada are not required to register for GST/HST and collect and remit these taxes to the CRA. [7] This longstanding oversight should be addressed by requiring all foreign-based digital vendors to collect the GST/HST on all e-commerce sales to Canadian residents.

8. Canada is quickly becoming an exception internationally by ignoring this tax problem. More than 50 countries have modernized their tax policies to require non-resident companies to charge sales tax on digital goods and services. For example, the 28 members of the European Union, as well as Australia, India, Norway, South Africa, Japan, and Russia have already updated their policies, while Singapore, Thailand, and Israel have signaled their intentions to do so in the near future.[8]

9. Domestically, there is an emerging consensus that changes to the federal e-commerce sales tax policy are needed quickly. The Standing Committee on International Trade recently recommended making this change.[9] Similarly, the Canadian Centre for Policy Alternatives (CCPA) and the C.D. Howe Institute recommended that Canada join the rest of the world and require foreign e-commerce vendors to remit taxes.[10] As members of the Standing Committee are no doubt aware, Quebec recently enacted legislation requiring foreign and out-of-province digital vendors to collect and remit provincial sales taxes.

10. The uneven application of sales tax requirements for digital services has three key public policy implications. First, it causes significant lost tax revenues for Canada. The CCPA estimated that Netflix alone was responsible for tax losses of more than $62 million in 2016.[11] Accounting for growth since then, it is likely that annual sales tax losses from Netflix will be more than $100 million in 2018.[12] More broadly, Revenu Quebec estimated that tax losses resulting from uncollected QST on goods and services purchased online from vendors outside of Canada totaled $227 million in 2017.[13] Extrapolating from these estimates, the annual federal sales tax lost would be approximately $500M.[14]

11. The second key implication of this policy is that it puts Canadian firms at a competitive disadvantage. All things being equal, digital goods from firms that do not charge the GST/HST are

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6 eMarketer, *Ecommerce in Canada 2018: eMarketer's Latest Forecast, with a Focus on Grocery*, January 2018.

7 CRA's GST/HST Policy Statement P-051R2, dated 29 April 2005, states that non-resident businesses (those with no offices, employees, bank accounts in Canada) supplying digitized content through websites over the internet to consumers in Canada, are not carrying on business in Canada, where the servers used are located outside Canada.

8 For example, see 2017 KPMG Study, *VAT/GST treatment of cross-border services*.

9 Standing Committee on International Trade, *E-Commerce: Certain Trade-Related Priorities Of Canada's Firms,* April 2018, page 21.

10 Canadian Centre for Policy Alternatives, *An Over-the-Top Exemption*, June 2016, and C.D. Howe Institute, *Bits, Bytes, and Taxes: VAT and the Digital Economy in Canada*, August 2017.

11 CCPA, page 13. Assumes a household price of $9.99 and uses the Ontario HST rate as a proxy.

12 Based on a growth in subscribers from 5.1 million to 6.2 million and a $1/month increase to the standard subscription price.

13 Gouvernement du Québec, *The Québec Economic Plan : Additional Information 2018-2019*, B-12.

14 Revenu Quebec estimated a loss of over $227 million in sales tax from vendors outside of Canada, or 1.33% of the sales tax actually collected by Quebec ($17 billion) in 2017. The 2018 Federal Budget expects $37.7 billion in GST during the 2018-19 fiscal period. Applying the Quebec lost tax factor of 1.33%, the annual lost GST is estimated to be around $501M.

13% less expensive than the same goods purchased from firms that do. Consider the case of over-the-top (OTT) streaming services in Canada. Canadian streaming services like Bell Media's CraveTV, as well as the CBC's Tou.tv and Quebecor's illico, must charge sales tax on their monthly subscriptions, unlike American OTT services like Netflix.[15]

12. In a rapidly changing media environment, strong domestic players are a key element of ensuring a vibrant Canadian content market remains. Canada's tax policy places services like CraveTV at an unfair disadvantage to foreign OTT providers, which harms both the Canadian economy and our cultural landscape.

13. The third implication of the current policy is that it serves as a disincentive for foreign companies to invest in Canadian operations. In fact, by having no operations or employees in Canada whatsoever foreign firms can gain a competitive advantage when selling to Canadians (i.e., a 13% price advantage from the exemption from charging GST/HST). Therefore, rather than incenting foreign direct investment in Canada, the current policy serves as a disincentive. As a result, Canadian jobs are not created by foreign firms selling to Canadians and the economic stimulus associated with foreign investment is foregone.

14. American companies already benefit from several tax advantages over Canadian companies, including lower corporate tax rates and more favourable CCA rates. With the U.S. imposing harsh tariffs on Canadian goods and services, there is simply no reason the Canadian government should add to the U.S. tax advantage by giving American suppliers a tax break when selling in Canada.

SR&ED Tax Credits

15. We recommend that the Government revise the SR&ED program by expanding the scope of investments that are eligible for tax credits, including those for R&D-related capital expenditures, and returning the rate to its previous level. We invest over $500 million in R&D each year, more than any other communications service provider in the country and fifth among Canadian corporations.[16] These investments assist in providing consumers with the latest products and services and making our operations more productive. They also help fuel a positive cycle of innovation and growth in our partners and suppliers. However, the current SR&ED program is not supportive of these efforts.

16. In recent years, the CRA has changed the eligibility rules for SR&ED spending by reducing the overall SR&ED tax credit rate from 20% to 15% and eliminating the deduction for capital expenditures, such as lab hardware and software. These changes disallow a significant amount of R&D spending from the SR&ED program. For BCE, this means that of the $500 million we invested in R&D in 2017, less than one-fifth qualified for SR&ED tax credits.

17. The Federal Government has placed great emphasis on fostering innovation and making Canada competitive internationally. However, Canada's R&D spending currently underperforms its peers, and total R&D expenditures as a percentage of gross domestic product has been falling since 2009.[17] Incentivizing R&D spending is imperative in the communications industry where rapidly evolving technologies and the advent of 5G wireless networks and services require constant investments to keep pace with global developments. To ensure Canada's

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[15] Canadians who subscribe to Netflix through Apple's iStore, and are invoiced monthly by Apple, are charged the GST/HST.

[16] Research Infosource, "Top 100 Corporate R&D Spenders," 2017.

[17] C. D. Howe Institute, *Getting Real: A Shadow Federal Budget for 2017,* February 2017, page 7.

communications networks remain world-class, we recommend that the SR&ED credit program be revised as noted above to encourage R&D investments which will facilitate the achievement of Canada's innovation goals.

Conclusion

18. We thank the Standing Committee on Finance for the opportunity to provide our comments in advance of the 2019 Budget.

Yours truly,

Glen LeBlanc
Chief Financial Officer and Executive Vice President