Submission for Pre-Budget Consultations in Preparation for the 2021 Federal Budget

7 August 2020

About the Conseil québécois du commerce de détail

The Conseil québécois du commerce de détail (CQCD) was founded in 1978. Its mission is to represent, promote and enhance the image of the sector in Quebec and to develop ways to foster the advancement of its members. The CQCD is the largest network of retailers in Quebec, representing an economic sector that includes more than 45,000 commercial establishments throughout all regions of Quebec. Retail creates more than 480,000 jobs in the province, making it Quebec's second-largest employer.

List of recommendations

- **Recommendation 1: Force credit card issuers to lower interchange fees to an average maximum of 0.5%.**

- **Recommendation 2: Eliminate fees charged to merchants on the GST/HST paid on credit card transactions.**

- **Recommendation 3: Adopt the OECD's unified approach to address the tax inequity associated with cross-border e-commerce transactions.**

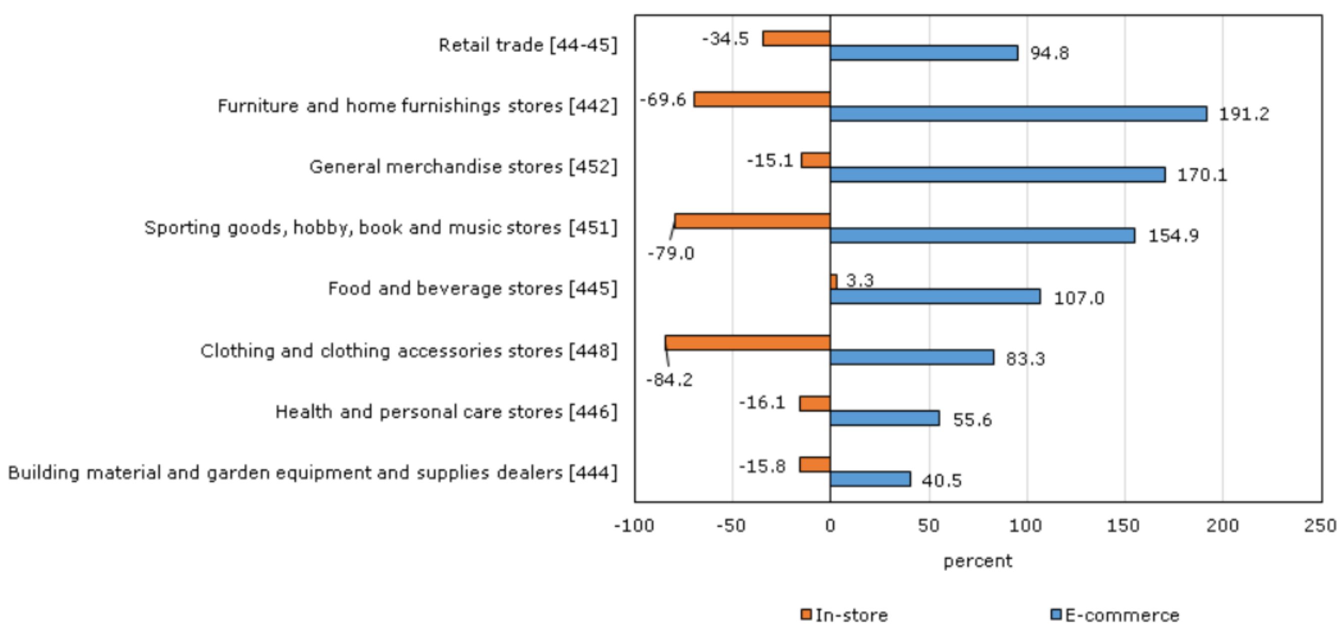
The ever-changing retail sector is a vital part of the Canadian economy. The recent pandemic has hit our merchants especially hard. The first section of this submission addresses the impacts of COVID-19, highlighting the issues that were already known but have since become urgent if we are to achieve a recovery that benefits all Canadians. The second and third sections propose immediate measures related to transaction fees and the tax inequity associated with cross-border e-commerce.

1. Impacts of COVID-19 on the retail sector

a. Impact on sales and GDP

The COVID-19 pandemic has fundamentally altered the annual growth of retail sales. From February to May 2020, total retail sales fell 17.9%, although e-commerce sales nearly doubled (+99.3%).[1] According to Statistics Canada, retail sales plummeted to $33.9 billion in April, a 29.1% decline from February and a 26.4% decline from April 2019. While e-commerce sales rose from 2.4% in 2016 to 4.0% in 2019, the proportion of retail e-commerce sales jumped to a record high of 11.4% in April 2020.[2]

Changes in in-store and e-commerce sales during COVID-19 for selected subsectors, February to April 2020



Source: Statistics Canada, Monthly Retail Trade Survey.

COVID-19 also caused a 40% drop in Quebec's retail GDP in March and April.[3]

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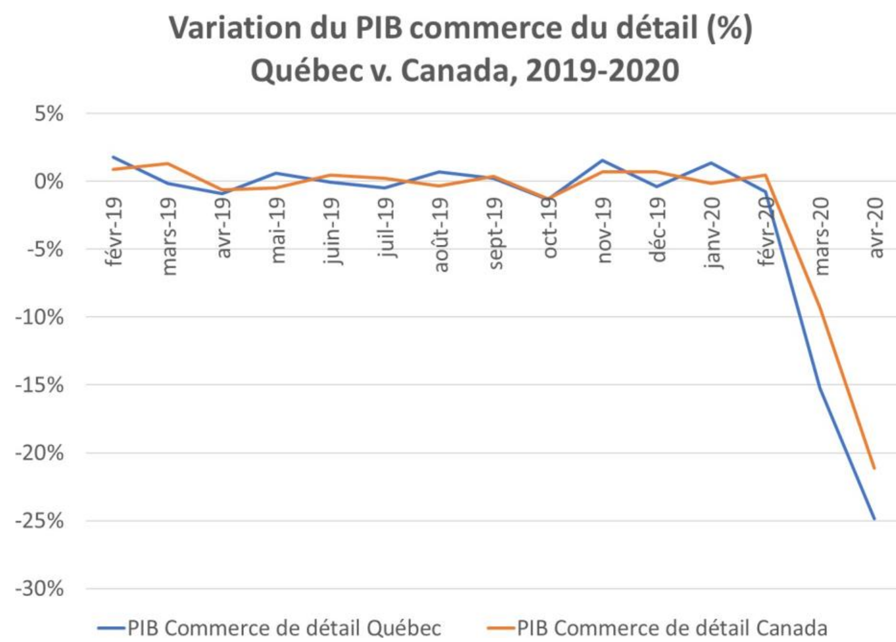
[1] https://www150.statcan.gc.ca/n1/pub/45-28-0001/2020001/article/00064-eng.htm

[2] See also https://cefrio.qc.ca/fr/realisations-et-publications/netendances-2019/ [French only] and https://www.adviso.ca/en/blog/business/covid19-ecommerce-quebec/

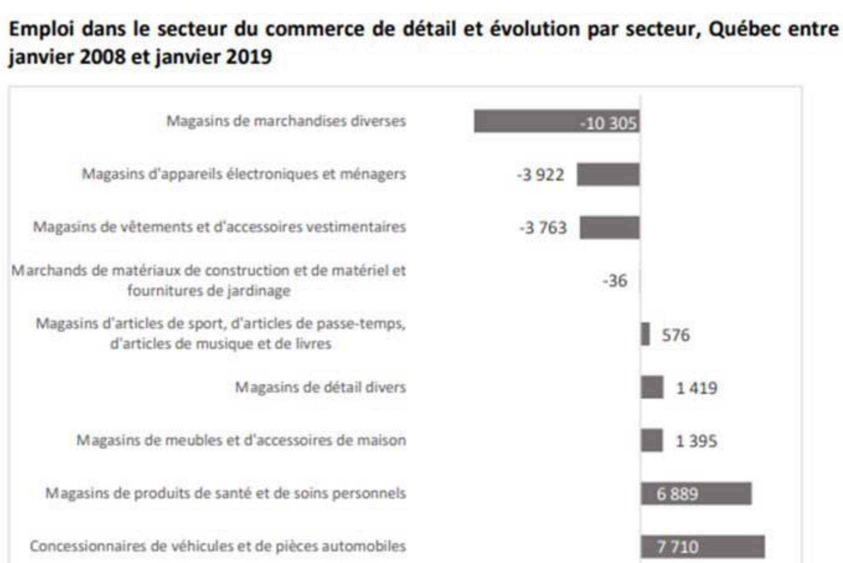
[3] https://www.stat.gouv.qc.ca/statistiques/economie/comptes-economiques/comptes-production/pib-reel-industrie.htm [French only]



[Translation: **Changes in GDP in the Retail Sector (%) – Quebec and Canada, 2019-2020**
Jan/19; Feb/19; Mar/19; Apr/19; May/19; Jun/19; Jul/19; Aug/19; Sep/19; Oct/19; Nov/19; Dec/19; Jan/20; Feb/20; Mar/20; Apr/20; May/20; Jun/20]
---Quebec Retail GDP ---Canada Retail GDP]

b. Impact on employment

Since 2008, employment in the retail sector has been essentially stable.[4]



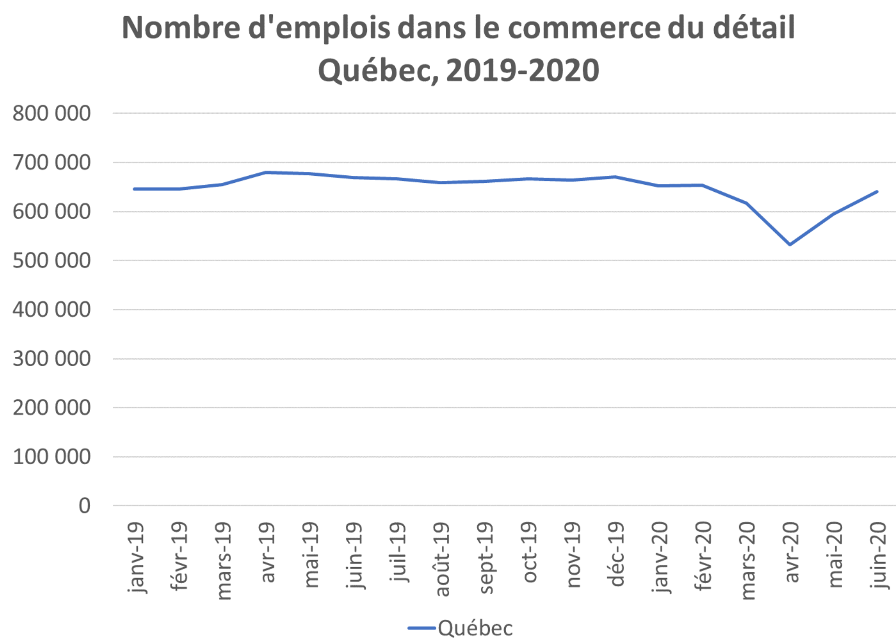
[Translation: **Retail jobs and Change by Sector, Quebec Between January 2008 and January 2019**

General merchandise stores
Electronics and appliance stores

[4] https://cffp.recherche.usherbrooke.ca/wp-content/uploads/2020/05/cr_2020-07_e-commerce_et_fiscalite.pdf [French only]

Clothing and accessories stores
Building material and garden equipment and supplies dealers
Sporting goods, hobby, book and music stores
Retail trade
Furniture and home décor stores
Health and personal care stores
Auto dealerships and car parts stores]

Since the lockdown, the retail employment level in Quebec contracted by 5.5% from February to March and by 13.9% from March to April.[5] Today the sector accounts for 82,000 fewer jobs compared to last year.



[Translation: **Number of Retail Jobs – Quebec 2019-2020**
Jan/19; Feb/19; Mar/19; Apr/19; May/19; Jun/19; Jul/19; Aug/19; Sep/19; Oct/19; Nov/19; Dec/19; Jan/20; Feb/20; Mar/20; Apr/20; May/20; Jun/20]

c. Impact related to health protection measures

The recovery is still triggering a mixed response. On the one hand, the recovery allows entrepreneurs to get back to business. On the other hand, employees and customers still have health-related concerns; without a vaccine, the risk of contracting the virus remains. The in-store experience is no longer necessarily straightforward; customers often have to deal with long line-ups and health restrictions. They are increasingly turning to digital shopping, which has made a 10-year leap forward.

Merchants need to adapt their operations.[6] It is too early to estimate the impact of supplementary health expenditures, such as additional staff, security personnel, the installation of plexiglass and sinks,

[5] https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1410035501&request_locale=en
[6] https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3310026301&request_locale=en

the purchase of masks, etc. Nevertheless, some reports[7] point to significant challenges for our merchants as their meagre profit margins shrink.

d. Impact related to changing payment methods

At the same time, the use of contactless payments has increased significantly. Initially, there was some uncertainty as to the transmissibility of the disease through currency.[8] In fact, the CQCD encouraged its members to prioritize contactless payments. The Bank of Canada is asking merchants to continue accepting cash,[9] although the use of debit cards and credit cards represent 52% and 62% of transactions respectively.

As a final point, Payments Canada recently announced that 62% of Canadians are using less cash, and 53% reported using credit card or mobile tap payments more often for purchases.

The CEO stated, "While we have seen a continued shift towards digital payments over a number of years in Canada, there's no doubt that the prevailing pandemic has accelerated this shift and will likely act as a catalyst in transforming the Canadian payment landscape forever."[10]

2. The government must cap credit card transaction fees at 0.5%

As previously stated, online commerce is exploding, and payment methods are changing. This leaves merchants burdened with additional costs related to the exorbitant transaction fees charged by credit card issuers. With the pandemic, credit card transaction ratios are skyrocketing and so are the transaction fees paid by merchants to accept those payments.

The CQCD believes it is urgent that the federal government cap credit card transaction fees in order to help retailers get through this crisis. The average rate, which is expected to rise to 1.4% in Canada in May 2020, should immediately be capped at 0.5%, the European rate. Such a measure would really help retailers by giving them the liquidity they need and enough financial leeway to protect jobs and avoid imminent bankruptcies.[11]

a. Interchange fees in Canada are among the highest in the world

Canadian merchants are at a disadvantage compared to their foreign competitors. The Federal Reserve Bank of Kansas City has shown that **Canada has one of the highest rates of interchange fees in the**

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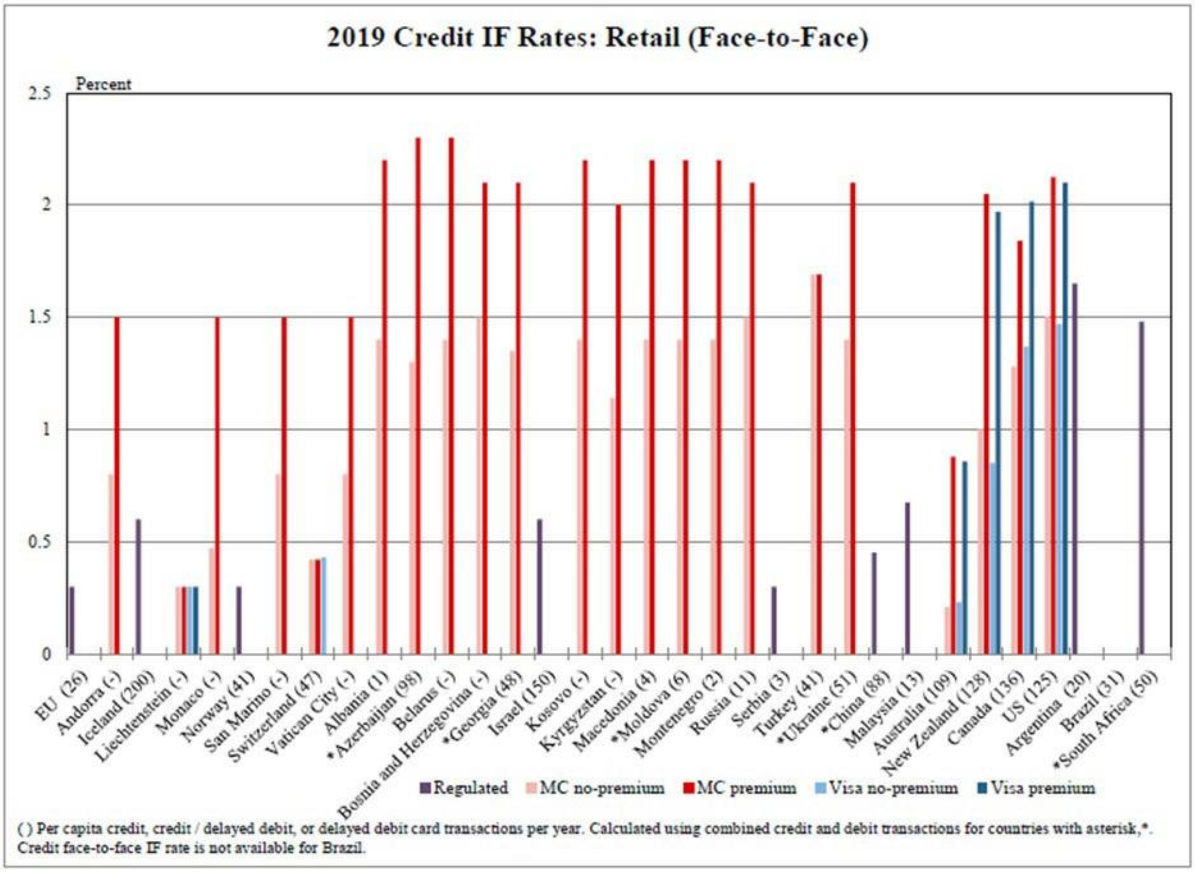
[7] https://ici.radio-canada.ca/nouvelle/1708620/epicerie-frais-covid-prix-panier-comptabilite-hausse [French only]
[8] https://www.inspq.qc.ca/en/publications/2932-handling-cash-stores-covid19
[9] https://www.bankofcanada.ca/2020/05/bank-canada-asks-retailers-continue-accepting-cash/?_ga=2.2438512.1532466430.1598366008-1356712616.1598366008
[10] https://www.payments.ca/about-us/news/covid-19-pandemic-dramatically-shifts-canadians'-spending-habits?_ga=2.229861276.146126556.1598366828-345701822.1598366828
[11] https://www.lesaffaires.com/blogues/l-economie-en-version-corsee/attention-la-covid-19-dissimule-une-bombe-a-retar-dement/619046 [French only]

developed world for both basic and "elite" or "privilege" credit cards.[12] It is worth noting that all jurisdictions that have regulated interchange fees have significantly lower rates.



b. A social problem that must be addressed

Credit card issuers lack no imagination when it comes to offering new "elite" or "privilege" credit cards that often double the average rate charged to merchants. Major banks and credit card issuers charge retailers for loyalty programs offered to their customers.[13]

However, we must not delude ourselves: those transaction fees are inevitably built into the prices paid by all consumers, even the ones who do not reap the benefits of those privileges, including low-income consumers. This raises questions about the level of social justice in Canada.[14] For the sake of fairness and solidarity, the CQCD believes the government should instead promote the user-pay principle and encourage transparency regarding the fees associated with those programs.

The European Community has just published a report on the implementation of regulations on interchange fees for card payments. The conclusions are unequivocal:

[12] https://www.kansascityfed.org/~/media/files/publicat/psr/dataset/intl_if_august2019.pdf

[13] https://bit.ly/33skTML; https://bit.ly/39WaJ8p [French only]

Interchange fees declined following the implementation of the IFR, in line with its expected impact. This resulted in lower merchant service charges for consumer cards. More reductions are likely over an extended period of time, due to the gradual adjustment of acquirers' contractual terms, notably as regards blended fees schedules. The reduction in interchange fees resulted in a redistribution of revenues from issuers to acquirers and merchants, while consumers in the longer run benefit either directly via lower final prices or indirectly through improved retail services. […] Overall, the capping of interchange fees will over time entail significant benefits for consumers, by means of lower merchant service charges passed through into lower consumer prices, with estimated annual consumer cost savings of between EUR 864 million and EUR 1,930 million.

As a final point, in 2019, the Liberal Party of Canada promised to put an end to the GST/HST transaction fee on credit card payments. This "double taxation" of credit card transactions must stop!

Recommendation 1: Force credit card issuers to lower interchange fees to an average maximum of 0.5%.

Recommendation 2: Eliminate fees charged to merchants on the GST/HST paid on credit card transactions.

3. The government must combat tax erosion due to cross-border e-commerce

a. Tax inequity experienced by merchants

Canadians love to shop online. According to the Canadian Internet Use Survey, 86% of Canadian consumers reported purchasing goods online from Canadian retailers, 55% had purchased goods from American merchants and 31% from merchants in other countries.[14] According to eMarketer estimates, 25% to 50% of online purchases by Canadians are made from foreign companies.[15]

Canadian store-front retailers, which must charge all the taxes, are at a serious disadvantage compared to foreign companies with no business locations in Canada, which are exempt from those tax obligations. When transactions are not all taxed the same, this leads to undue competition and deprives the government of the tax revenue needed to fund our public services.

[14] https://www150.statcan.gc.ca/n1/pub/89-28-0001/2018001/article/00016-fra.htm#mi-rs. See also: https://www.bdc.ca/en/documents/analysis_research/report_bdc_mapping_your_future_growth.pdf.
[15] https://www.emarketer.com/content/in-canada-cross-border-shopping-has-always-been-popular-even-before-the-internet

b. Unjustifiable tax losses

Tax losses associated with cross-border e-commerce are estimated at $518 millions in Quebec.[16] In Canada, the tax gap in 2014 was between $21.8 billion and $26 billion.[17] By transposing the same proportions from the Godbout study (2020),[18] indexed federal tax losses associated with cross-border e-commerce totaled $1.1 billion in 2018.

In fact, the inequity associated with cross-border transactions and tax losses drew the attention of the Auditor General of Canada who, in 2019, recommended that the government take the following corrective action:

> *Overall, we found that the Canadian sales tax system did not keep pace with the rapidly evolving digital marketplace. […] In addition, the federal government could not assess and collect all sales taxes on e-commerce transactions.*
>
> *We found that existing legislation, combined with the Canada Border Services Agency's poor data management of low-value shipments imported into Canada by courier companies, placed Canadian businesses at an unfair disadvantage in relation to foreign vendors. […]*
>
> *The Canada Border Services Agency was aware that some courier companies were likely not remitting all sales taxes on low-value shipments into Canada. However, we found that the Agency did not step in, despite a significant increase in the volume of shipments declared as low value coming into the country.*[19]

c. The international community is taking action… When will Canada do the same?

Canada must take action to tax cross-border e-commerce, just as the following jurisdictions have done:

- The United States has introduced the *Marketplace Fairness Act*, which allows states to collect sales taxes from retailers with no local business locations;
- In the European Union, since 2015, the VAT is collected at the applicable rate of the country of residence where the purchase is made;
- In the United Kingdom, since 2015, the "Google Tax" requires companies doing business in that country in excess of £10 million to collect a 25% withholding tax on profits.
- Since 2103, Brazil has been collecting sales taxes by imposing a 6% withholding tax on credit cards.

[16] Op. cit. note 4, p. 21.

[17] https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/corporate-reports-information/tax-gap-overview.html The analysis does not establish the proportion of tax losses associated with cross-border trade, but those losses are certainly a factor.

[18] Op. cit. note 4

[19] https://www.oag-bvg.gc.ca/internet/English/parl_oag_201905_03_e_43340.html

The OECD is leading the harmonization of taxation of cross-border e-commerce transactions. Under its "unified approach," foreign suppliers would be required to register for, collect and remit local sales tax to the jurisdiction where the product or service is consumed.[20]

In October 2019, the G20 supported the OECD's proposal and planned to adopt it in June 2020. Unfortunately, negotiations have been blocked by the United States since 15 June 2020. The deadline for an agreement has been extended to October 2020.[21] The European Union is threatening to break ranks and create its own GAFA tax if no agreement can be reached.[22]

The Canadian position favours multilateral discussions within the OECD. At this time, only the United States opposes the change. The government therefore must:

- Join with the international community, the G20 and other OECD members by permanently adopting the unified approach;
- Address the tax inequity experienced by Canadians;
- Include enabling provisions in the Budget Implementation Bill for the Canada Revenue Agency and the Canada Border Services Agency to collect corporate income and sales taxes associated with e-commerce transactions by foreign suppliers for the delivery of goods and services in Canada.

Recommendation 3: Adopt the OECD's unified approach to address the tax inequity associated with cross-border e-commerce transactions.

[20] www.oecd.org/tax/consumption/the-role-of-digital-platforms-in-the-collection-of-vat-gst-on-online-sales.pdf

[21] http://www.oecd.org/tax/OECD-Secretary-General-Angel-Gurria-has-reacted-to-recent-statements-and-ex-changes-regarding-the-ongoing-negotiations-to-address-the-tax-challenges-of-the-digitalisation-of-the-economy.htm

[22] https://www.lesechos.fr/monde/europe/taxe-gafa-leurope-au-pied-du-mur-apres-le-camouflet-americain-1216491 [French only]