OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET

Legislative Costing Note

This is an independent cost estimate of a budgetary measure contained in the federal government's Budget 2021. A list of the PBO's cost estimates of components of the Budget can be viewed on its website.

Publication Date:	2021-05-27
Short Title:	Digital services tax
Description:	Implementation of a new tax on revenues for companies offering digital services. The tax will take effect January 1, 2022. This measure is temporary and will only apply in the event that Canada does not reach a multilateral agreement on the taxation of digital services. It will be a 3% tax on revenues collected by online marketplaces, social media, online advertising services, and user data sales and licensing services. This tax will apply to businesses with worldwide revenues of at least €750 million and Canadian revenues of more than $20 million.

Data Sources:

Variable	Source
Public company revenues by geographic segment	Capital IQ[1]
Total revenue (code 8299 of the General Index of Financial Information)	Canada Revenue Agency (CRA) administrative data obtained through Statistics Canada
Nominal GDP	World Bank
Behavioural response adjustment factor	United Kingdom Office for Budget Responsibility – Economic and fiscal outlook – October 2018

Estimation and Projection Method:

This is an update of the note *International corporate tax and digitization* published on January 28, 2021, which was adjusted to reflect the new parameters outlined in the 2021 budget and 2020 corporate financial statements.

The tax base was determined using data from the financial statements of the public companies meeting the criteria set out above for reference years 2019 and 2020. The tax base was then projected forward using the historical average growth rate of 12% observed in the T2 income tax return data for companies in the relevant technology sectors.

The data were adjusted where the breakdown did not specify revenues generated in Canada. An estimate of Canadian revenues was made based on the relative size of the Canadian economy in the available segment. For some companies, the revenue share subject to the tax was estimated from publicly available information. The tax base was also adjusted to account

[1] The statements, findings, results, conclusions, views and opinions contained and expressed in this analysis are based in part on data obtained under license from S&P Global Market Intelligence (all rights reserved) and are not those of S&P Global Market Intelligence or any of its affiliated or subsidiary entities.

for the behavioural response effect, set at 30%. This assumption is based on the work of the United Kingdom's Office for Budget Responsibility presented in its Economic and fiscal outlook – October 2018.

The effective tax rate of 2.59% was estimated by taking into account variations in the revenues of the businesses subject to the new tax. The decrease in tax revenue owing to variations in business revenues was estimated using the marginal corporate income tax rate and the type of business. The estimate of total revenues was made by multiplying the resulting effective tax rate by the tax base corrected for behavioural response.

Sources of Uncertainty: Estimating the tax base involves a high degree of uncertainty because of the limited information in the corporate financial statements. As a result, the estimate of the share of revenues generated in Canada that is subject to this tax is based on strong assumptions. In addition, the volatility observed in revenue growth in the major technology sectors also creates uncertainty in the tax base projection. Furthermore, the proposal's scope depends on companies' worldwide revenues, information that Canada Revenue Agency did not collect before 2016.[2] It is also expected that businesses in the targeted sectors will adjust their services and prices in response to the new law. In addition, this analysis does not take into account the fact that the government will have to deploy additional resources to track transactions in Canada since this data is not currently collected. Finally, advertising services targeting connected TVs were not included in the analysis given the difficulty of isolating this data. However, PBO estimates that this sector would have a marginal impact on the tax base.

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[2] For fiscal years beginning on or after January 1, 2016, multinational enterprise groups with more than €750 million in consolidated worldwide revenue have to file a Country-by-Country (CbC) report pursuant to section 233.8 of the *Income Tax Act*. The CbC report presents the worldwide breakdown, by jurisdiction, of revenue, income, tax paid and other key variables for each entity in the multinational enterprise group. However, the PBO does not have access to these data.

Cost of proposed measure

$ millions	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Total cost	-190	-840	-950	-1,060	-1,190

Notes

· Estimates are presented on an accruals basis as would appear in the budget and public accounts.

· Positive numbers subtract from the budgetary balance, negative numbers contribute to the budget balance.

· "-" = PBO does not expect a financial cost.