Digital Services Tax

Legislative Costing Note

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The Budget 2023 confirms the government's intention to implement a Digital Services Tax (DST) as of 1 January 2024, with retroactive effect to 1 January 2022 if Canada does not reach a multilateral agreement on the taxation of digital services.[1]

The DST would apply to businesses (on a consolidated group basis) with annual worldwide revenues from all sources of €750 million and more, as well as annual Canadian digital services revenue greater than CA$20 million.

Taxable Canadian Digital Services Revenue Categories:

- Canadian online marketplace services
- Canadian online advertising services
- Canadian social media services; and,
- Canadian user data services

The DST would be equivalent to 3% of Canadian digital services revenues in excess of CA$20 million in a calendar year.

The PBO estimates the DST will increase federal government revenues by CA$7.2 billion over five years.

5-Year Cost

$ millions

Fiscal year	2023-2024	2024-2025	2025-2026	2026-2027	2027-2028	Total
Total cost	-2,468	-1,230	-1,207	-1,169	-1,158	-7,231

Notes

· Estimates are presented on an accrual basis as would appear in the budget and public accounts.
· A positive number implies a deterioration in the budgetary balance (lower revenues or higher spending). A negative number implies an improvement in the budgetary balance (higher revenues or lower spending).
· Totals may not add up due to rounding.

[1] To this effect, on August 4, 2023, the Department of Finance released a revised draft of the *Digital Services Tax Act*.

Estimation and Projection Method

The tax base was determined using data from the financial statements of public companies meeting the criteria set out above for 2022. The tax base was then projected using the average growth rate of 9.3% forecasted by various sources for the relevant sectors.

The data were adjusted to account for revenues in scope that relate to Canada. Whenever those were not explicitly disclosed in companies' annual reports, the proportion of relevant global revenues was estimated using the relative size of the Canadian economy or web traffic data. The tax base was further adjusted to account for a potential behavioural response from affected businesses, which would gradually reduce revenues by 30% by 2027-28.[2] An effective tax rate of 2.59% was then applied to the adjusted tax base to reflect the expected reduction in corporate income tax, as businesses paying the DST can deduct the expense from their taxable income.

Sources of Uncertainty

The limited information in financial statements means the estimation of in-scope revenues subject to DST involves a high degree of uncertainty. 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 consider 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 streaming TVs were not included in the analysis given the difficulty of isolating this data.

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[2] Potential behavioural responses from businesses, on a consolidated group basis, may involve reclassifying revenue currently considered in scope to be out of scope, especially for entities with mixed business models; modifying business models to generate new revenue streams that are out of scope; and engaging in profit shifting.

Data Sources

Revenues
Annual reports, Capital IQ

Revenues growth
Various (PricewaterhouseCoopers, Shopify, Business Research Insight)

Nominal Gross Domestic Product
Organization for Economic Co-operation and Development (OECD)

Traffic data
Similarweb

Attrition rate (behavioural response)
United Kingdom Office for Budget Responsibility

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