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 Fall Economic Statement 2020 (FES 2020). A list of the PBO's cost estimates of components of the FES 2020 can be viewed on its website.

Publication Date:	2021-01-28
Short Title:	International corporate tax and digitalization
Description:	Implementation of a new corporate income tax for companies offering digital services. The tax will take effect January 1, 2022 and details will be revealed in the 2021 budget. It is assumed that it will be a 3% tax introduced as a value-added tax (VAT), targeting advertising and digital intermediation services, and will apply to businesses with worldwide revenues of at least $1 billion and Canadian revenues of more than $40 million. This assumption is consistent with the cost estimate of the tax on digital services carried out during the last election campaign and is based on article 1 of Law No. 2019-759 passed in France.

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:

The tax base was determined using data from the financial statements of the public companies meeting the criteria set out above. The tax base was then projected using the historical average growth rate in the T2 income tax return data for companies in the technology sectors in question.

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 for the behavioural response effect, set at 30%. This assumption is based on the work of the

[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.

	United Kingdom's Office for Budget Responsibility presented in its Economic and fiscal outlook – October 2018. The proposed measure acts as a value-added tax. As a result, 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. Finally, 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.
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Cost of proposed measure

$ millions	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Total cost	-	-180	-790	-890	-990	-1,110

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.

[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.