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June 5, 2014

The Honourable Joe Oliver
Minister of Finance
International Tax Consultation
Tax Policy Branch
Department of Finance
140 O'Connor Street
Ottawa, Ontario K1A 0G5
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Dear Minister Oliver,

Re: Submission on Effective Collection of Sales Tax on E-Commerce Sales by Foreign-Based Vendors

We are writing in response to the Government's invitation in the 2014 Federal Budget for input from stakeholders relating to what actions it should take to ensure the effective collection of sales tax on e-commerce sales to Canadian residents by foreign-based vendors. We appreciate the opportunity to provide our input and provide our consent for our submission to be publicly posted.

We recommend the Canadian government introduce a mandatory registration requirement for foreign-based suppliers of supplies in the digital economy ("digital supplies") to Canadian residents similar to the approaches taken in other Value-Added Tax (VAT) jurisdictions. In addition, we recommend the Canadian government should amend the rules around agency/billing agency for digital supplies into Canada as a complementary measure to mandatory registration.

About Rogers Communications

Rogers is a communications and media company. We are Canada's largest provider of wireless communication services and one of Canada's leading providers of cable television, high-speed internet and telephone services to consumers and businesses. Rogers currently employs more than 28,000 people and, in its most recent fiscal year, recorded $12.7 billion in sales. From a sales tax perspective, in 2013, Rogers collected approximately $1.4 billion in GST/HST revenue for the federal government and its HST provincial counterparts.

As a large portion of Rogers' business has a Business-to-Consumer (B2C) focus, the digital economy and the sales tax issues that surround it are of particular interest to Rogers.

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The Digital Economy

The rapid pace of innovation in the digital economy has added to the challenges of tax policy keeping pace. Mobility has been one of the key features of the digital economy that often makes the characterization of the supply difficult for sales tax. Whether a supply is a good, service, intellectual personal property or a telecommunication service is often a difficult characterization to determine. However, often that characterization is very important to the determination of the tax treatment.

Several examples of digital supplies currently include e-books and e-magazines; online streaming of music, movies and television shows; downloads of music, movies and televisions shows; applications for mobile devices, computers and tablets; online or downloaded video games; online advertising; services provided online; downloaded software; cloud computing, etc.

A definition of the digital economy is not necessary for our submission, but for an expanded discussion of the digital economy and its challenges for tax, we draw your attention to Chapters 2 and 3 of the Organisation for Economic Co-operation and Development's (OECD) draft paper *BEPS Action 1: Address the Tax Challenges of the Digital Economy*.[1]

As the digital economy continues to evolve, the move online for digital supplies presents similar sales tax policy challenges for governments as when the sales tax base changed from a goods-based economy to a services-based economy. The sales tax base rules must also change and adapt to the reality of today's economy.

The Organisation for Economic Co-operation and Development and the Digital Economy

Principles of a VAT

Recently, the governments of 86 countries endorsed the *International VAT/GST Guidelines* ("VAT Guidelines") released by the OECD on April 18, 2014.[2] These VAT Guidelines reiterated the generally accepted principles of tax policy for consumption taxes that have been broadly applicable since laid out in the *Ottawa Taxation Framework* in 1998.

The principles are as follows:

- **"Neutrality**: Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions, should be subject to similar levels of taxation.

[1] OECD, Draft on *BEPS Action 1: Addressing the Tax Challenges of the Digital Economy*, paragraph 189, Chapter 2-3, pp. 8 to 41, OECD, Paris, March 2014 (http://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf).
[2] *Governments endorse new OECD Guidelines on applying VAT across borders*, OECD Newsroom, April 18, 2014 - *http://www.oecd.org/newsroom/governments-endorse-new-oecd-guidelines-on-applying-vat-across-borders.htm*

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- **Efficiency**: Compliance costs for businesses and administrative costs for the tax authorities should be minimised as far as possible.

- **Certainty and simplicity**: The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where, and how the tax is to be accounted.

- **Effectiveness and fairness**: Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to risks involved.

- **Flexibility:** The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments."[3]

In our view, these tax policy principles are important for the Canadian government to keep in mind when developing measures to address GST/HST issues in the digital economy.

VAT Challenges in the Digital Economy

Action 1 of the OECD's *Action Plan on Base Erosion and Profit Shifting* on Addressing the tax challenges of the digital economy summarized the challenge for VAT/GST as "...the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services."[4]

The OECD's draft paper on *BEPS Action 1: Address the Tax Challenges of the Digital Economy* provides further detail on this challenge:

> "Cross-border trade in both goods and services (which include for VAT purposes digital downloads) creates challenges for VAT systems, particularly where such goods and services are acquired by private consumers from suppliers abroad. The digital economy magnifies these challenges, as the evolution of technology has dramatically increased the capability of private consumers to shop online and the capability of businesses to sell to consumers around the world without the need to be present physically or otherwise in the consumer's country. This often results in no VAT being levied at all on these flows, with adverse effects on countries' VAT revenues and on the level playing field between resident and non-resident vendors...." (emphasis added)[5]

[3] OECD (2014), *International VAT/GST Guidelines*, p. 9, OECD, Paris. (http://www.oecd.org/ctp/consumption/international-vat-gst-guidelines.pdf.)
[4] OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, p. 15, OECD, Paris. (http://www.oecd.org/ctp/BEPSActionPlan.pdf)
[5] OECD, Draft on *BEPS Action 1: Addressing the Tax Challenges of the Digital Economy*, paragraph 189, p. 59, OECD, Paris, March 2014.

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In many cases of Business-to-Consumer sales (B2C), consumers are often required to self-assess VAT/GST that was not charged by foreign suppliers. However, the OECD points out that consumer self-assessment has proven to be largely ineffective with the result that it is highly likely that no VAT is paid by the consumer in these situations.[6] The OECD concludes that the most viable option to address the issues of non-collection of VAT in cross-border B2C digital supplies is to require non-resident suppliers to register and account for VAT on these supplies in the jurisdiction of the consumer.[7]

GST/HST Challenges in the Digital Economy in Canada

In our opinion, the GST/HST challenges facing the Canadian government in the digital economy are no different than those discussed by the OECD as summarized above. The Canadian government has also been grappling with the issue of the GST and the digital economy going back to 1998, however the issue continues to magnify as the digital economy continues to grow and innovate.

At the outset, it is important to remember that the issue is not whether or not digital supplies should be taxable in the hands of the consumer. These digital supplies are already taxable, with the main issue being the effective collection of GST/HST on B2C digital supplies by foreign non-registrant businesses to Canadian consumers.

Currently, the combination of sections 240 and 143 (or 142.1) of the *Excise Tax Act* (ETA) provide that foreign-based suppliers are not required to register for and collect GST/HST on digital supplies to Canadian consumers when they are not "carrying on business in Canada". Further, the Canada Revenue Agency's (CRA) guidance on "carrying on business in Canada" as provided in GST/HST Policy Statement P-051R2 and GST/HST Technical Information Bulletin B-090 has concluded that foreign-based digital businesses with no physical presence in Canada supplying digital supplies to the Canadian marketplace are not "carrying on business in Canada".

However as these supplies are taxable in the hands of the Canadian consumers, the ETA shifts the burden to consumers to self-assess GST/HST when not collected by the foreign-based suppliers.

This is in contrast to Canadian resident suppliers which are obligated to register for and charge GST/HST to Canadian consumers on often very similar supplies that Canadian consumers can acquire without GST/HST from foreign-based suppliers. The difference in collection of GST/HST on digital supplies can often lead to consumer confusion about when tax is due and on what digital supplies. This confusion is magnified when foreign-based suppliers use Canadian domestic agents to supply their digital supplies as consumers may be faced with paying tax on one digital supply from the Canadian agent and no tax on another similar digital supply from the same Canadian agent. The Canadian government should strive for simplicity in collection to reduce the consumer confusion that exists in the GST/HST system, specifically in the digital economy.

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[6] OECD, Draft on *BEPS Action 1: Addressing the Tax Challenges of the Digital Economy*, paragraph 200, p.61, OECD, Paris, March 2014.
[7] OECD, Draft on *BEPS Action 1: Addressing the Tax Challenges of the Digital Economy*, paragraph 222, p.67, OECD, Paris, March 2014.

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As noted above, the OECD observed that self-assessment by consumers of VAT in digital transactions involving non-resident suppliers has proven to be largely ineffective. The reliance on consumer self-assessment in digital transactions causes revenue loss for the Canadian and provincial governments. This revenue loss will continue to grow as the digital economy continues to expand globally. Another by-product of the reliance on consumer self-assessment in digital transactions involving foreign-based suppliers is the competitive disadvantage in the digital economy for Canadian domestic suppliers which must charge GST/HST to Canadian consumers.

A prime example of this issue is illustrated by the OECD in its *BEPS Action 1: Address the Tax Challenges of the Digital Economy* at paragraphs 198, 200 and 201 (The OECD points out that this issue is not unique to streamed movies or TV, but also applies to most, if not all of remotely delivered services to consumers, such as cloud computing, gaming, software downloads, etc.):

> "198. Consider an example of an online supplier of streaming digital content such as movies and television shows. The supplies are made mainly to consumers who can access the digital content through their computers, mobile devices and televisions that are connected to the internet. If the supplier is resident in the same jurisdiction as its customers, it would be required to collect and remit that jurisdiction's VAT on the supplies. However, if the supplier is a non-resident in the consumer's jurisdiction, issues may arise.
>
> ...
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> 200. However, consumer self-assessment has proven to be largely ineffective and as result, it is highly likely that no VAT would be paid by the consumer in this scenario. Alternatively, using consumer residence to identify the taxing jurisdiction with vendor collection as the mechanisms for collecting the tax would require the non-resident supplier to register, collect and remit VAT according to the rules of the jurisdiction in which the consumer is resident. This would result in the correct amount of VAT being paid in the jurisdiction of consumption. This scenario, however, is dependent on the non-resident supplier complying with the requirement to register, collect and remit the VAT. In other words, if taxing rights are allocated to the jurisdiction of consumer residence without implementing a suitable mechanism to collect the tax in this jurisdiction, no VAT would be paid.
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> 201. The example illustrates how domestic suppliers of competing services could face potential competitive pressures from non-resident suppliers. Domestic suppliers are required to collect and remit VAT on their supplies of services to their domestic consumers while the non-resident supplier, depending on the scenario, could structure its affairs so that it collects and remits no or an inappropriately low amount of tax. The example also illustrates how an incentive could arise for domestic suppliers to restructure their affairs so that their supplies of services are made from an offshore location which could allow them to make the supplies with no or an inappropriately low amount of VAT. This incentive could arise as a response to competition from non-resident suppliers who are collecting no or an inappropriately low amount of VAT or as part of a strategy to gain a

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potential competitive advantage over domestic suppliers who are charging VAT. Such relocations by domestic businesses is likely to have a negative impact on domestic employment and direct tax revenues,"[8]

In our opinion, the continued reliance of an ineffective system of self-assessment, which allows foreign-based suppliers of digital supplies into the Canadian marketplace without the need to register for and collect GST/HST, violates the above-referenced VAT principles of neutrality, certainty and simplicity and effectiveness and fairness.

Approaches Taken by Other VAT Jurisdictions

The 2014 Federal Budget noted that several other jurisdictions (most notably the European Union and South Africa) have taken the approach of requiring foreign-based suppliers to register for and collect VAT.

European Union

The European Union (EU) has required non-EU suppliers of radio, television broadcasting and electronically supplied services to register for EU VAT and charge VAT in the jurisdiction of the recipient since 2003, regardless of whether the non-resident supplier has a permanent establishment in the EU.[9] The EU will also introduce new place of supply rules on January 1, 2015 for telecommunications, broadcasting and electronic services to private individuals within the EU to tax based on place of recipient.

The EU provides three examples of how the non-EU supplier registration works for EU VAT (which will continue under the new place of supply rules) that are illustrative of non-resident registration:

> "**Example**
> A person living in Barcelona pays a US company for access to American TV channels. The US company must charge the customer Spanish VAT.
> **Example**
> A French customer of a Swiss telecoms operator using their mobile phone in France will be charged French VAT. When using their phone while on holiday in Greece, the customer will be charged Greek VAT on the calls made from Greece.
> ...
> **Example**
> A private person living in Sweden uses a Japanese online library. The Japanese supplier must charge Swedish VAT." [10]

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[8] OECD, Draft on *BEPS Action 1: Addressing the Tax Challenges of the Digital Economy*, paragraph 198, 200 and 201, p.61, OECD, Paris, March 2014.
[9] Council Directive 2002/38/EC (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:128:0041:0044:en:PDF)
[10] *Telecommunications, broadcasting & electronic services*, European Commission website (http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/telecom/index_en.htm#one_stop)

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It should be noted that none of these example hinge on whether or not the non-EU supplier is "carrying on business" in the EU country where the EU recipient is located.

Lastly, while noting that the sustainability of this system needs to be monitored, specifically compliance by non-EU suppliers, the European Commission's Expert Group on Taxation of the Digital Economy recently pointed out that mandatory registration of non-EU suppliers has achieved a reasonably high level of compliance. [11]

Non-EU European Countries

Several non-EU European countries, including Norway (since 2011), Switzerland (since 2010) and Iceland (since 2011), have all implemented rules similar to the EU to require non-resident businesses that provide electronic supplies of services to their resident consumers to register for and collect VAT (subject to certain registration thresholds).

South Africa

South Africa is one of the latest VAT jurisdictions that is currently in the process of implementing non-resident registration for e-commerce services to South African customers, currently set to be implemented on July 1, 2014.

According to the National Treasury's *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2013*, the rationale provided by the South African government is as follows:

> "Placing reliance on the reverse charge mechanism for imported services as a means of enforcing VAT is impractical. Customer compliance with the reverse charge mechanism is low, especially in the case of e-commerce. This lack of compliance can be attributable to two causes: (i) some customers do not comply based on sheer ignorance, while (ii) other customers do not comply because they perceive the tax to be wholly voluntary as a practical matter (e.g. enforcement is impossible).
>
> This lack of compliance has left local e-commerce suppliers (especially e-book providers) in an uncompetitive position vis-à-vis foreign suppliers of e-books. Foreign suppliers benefit because these suppliers are not required to charge VAT on their sales to South African customers (due to their wholly foreign location), and customers simply don't pay the VAT. Meanwhile, local e-book suppliers are subject to VAT like any other vendor. The net result is a near 14 per cent competitive advantage for foreign suppliers."[12]

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[11] European Commission Expert Group on Taxation of the Digital Economy, *Working Paper: Digital Economy – Facts and Figures*, p. 18, European Commission, Brussels, March 4, 2014. (http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/2014-03-13_fact_figures.pdf)

[12] *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2013*, p. 91, National Treasury, Republic of South Africa, November 12, 2013 (http://www.treasury.gov.za/legislation/bills/2013/EM%20on%20the%20TLAB%202013.pdf)

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At the same time, South Africa will introduce new place of supply rules for e-commerce emphasizing that foreign suppliers are required to register as a VAT vendor since they are providing supplies to South African customers.[13]

Proposed Actions for the Canadian Government

As a result of non-compliance with self-assessment obligations, digital supplies by foreign-based suppliers to Canadians in the B2C context have largely not been subject to GST/HST. In order to ensure the effective collection of GST/HST on these supplies, we propose the Canadian government consider the following measures.

Non-Resident Mandatory Registration

We recommend that the Canadian government introduce a mandatory registration requirement for foreign-based suppliers of digital supplies to Canadian residents similar to the approaches taken in Europe and South Africa as detailed above. As pointed out above, the OECD BEPS project noted that "non-resident supplier registration remains the most viable option today"[14] and the European Commission's Expert Group on Taxation of the Digital Economy noted that mandatory registration of non-EU suppliers has achieved a reasonably high level of compliance.[15]

While we acknowledge that non-resident supplier registration is not without its enforcement challenges for the CRA, it should be noted that none of the other VAT jurisdictions that have implemented non-resident supplier registration have been deterred by enforcement challenges.

We note that the ETA already has a precedent for mandatory registration for non-resident suppliers in subsection 240(4) and the corresponding section 143.1. This subsection deems non-resident suppliers that solicit orders for books, newspapers, periodicals, magazines and any similar printed publications to be carrying on business in Canada and requires these suppliers to register. We would propose an amendment similar to subsection 240(4) and 143.1 in the case of non-resident suppliers of digital supplies to Canadian residents.

As some foreign-based suppliers may argue that their digital supplies are deemed outside of Canada and therefore not subject to GST/HST in spite of the mandatory registration for foreign-based suppliers, the place of supply rules under sections 142, 142.1 and 143 may also need to be amended to ensure the effective collection on digital supplies by foreign-based suppliers in a manner similar to how section 143.1 ties in with subsection 240(4) discussed above. For example, a foreign-based supplier could argue that their supplies of streamed content are telecommunication services

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[13] Ibid.

[14] OECD, Draft on *BEPS Action 1: Addressing the Tax Challenges of the Digital Economy*, paragraph 222, p.67, OECD, Paris, March 2014.

[15] European Commission Expert Group on Taxation of the Digital Economy, *Working Paper: Digital Economy – Facts and Figures*, p. 18, European Commission, Brussels, March 4, 2014.

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that are deemed outside Canada. In such cases, the mandatory non-resident registration would prove to be ineffective even when the Canadian consumer effectively consumes the streamed content in Canada.

The effect of non-resident registration is not to make a digital supply taxable that wasn't already taxable, but to remove the burden of self-assessment from consumers in the B2C context to ensure that GST/HST is properly collected on the transaction.

Agency Collection

While mandatory registration of non-resident suppliers of digital supplies to Canadian residents remains our primary proposal, the Canadian government should also consider amendments to the rules around agency/billing agency in section 177 as a complementary measure to mandatory registration.

Currently, agents/billing agents and principals may jointly elect under subsection 177(1.1) or (1.11) to allow the agent to collect and remit GST/HST on behalf of the principal when the principal is registered and required to collect tax. Subsection 177(1) further provides that an agent is deemed to make the supply for tangible personal property when a principal is not required to collect tax, however this is limited to tangible personal property. Under the current rules of the ETA, Canadian resident agents/billing agents are not required to collect GST/HST on sales to Canadian consumers when the principal is a non-resident, non-registrant supplier.

If mandatory registration for foreign-based suppliers of digital supplies is implemented, its effectiveness will depend on voluntary compliance by foreign suppliers and enforcement efforts of the CRA.

As many foreign-based suppliers of digital supplies currently use Canadian agents/billing agents for supplies to Canadian consumers, the Canadian government should amend the agency/billing agency rules to require Canadian agents/billing agents to collect GST/HST on behalf of non-resident suppliers of digital supplies when those suppliers are required to register under the proposed mandatory registration requirement. The effect would essentially be to deem the consequences of a subsection 177(1.1) or (1.11) election for Canadian agents/billing agents and non-resident supplier principals or in other words require the agent/billing agent to collect and remit GST/HST on digital supplies in Canada on behalf of the foreign-based principal.

The effect would be fourfold: first, it would alleviate some of the additional compliance burden for non-resident suppliers that would now be required to register and collect the GST/HST by only requiring registration if they use a Canadian agent/billing agent (i.e. lower compliance costs for non-residents as they would only need to file nil returns and now be eligible for input tax credits); secondly, it would assist in the effective collection of GST/HST by providing a mechanism to decrease any sales tax leakage when the non-resident registration mechanism fails; thirdly, it would remove pressure on Canadian agents/billing agents by requiring collection of tax even if the non-resident supplier principal did not comply with the non-resident registration requirement; and lastly, it would help level the playing field for Canadian developers

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of intellectual personal property in cases where agents/billing agents must charge GST/HST on their digital supplies, but not on very similar digital supplies from foreign-based developers.

In addition, consideration could be given to amending s. 177(1) to include digital supplies in addition to tangible personal property. The effect would be that supplies by a principal that is not required to charge tax would be deemed supplies of the agent in the case of digital supplies. While this would mean that tax would be charged when Canadian agents are acting on behalf of Canadian small suppliers, it would also ensure the Canadian government does not lose on sales tax revenue when foreign-based suppliers that mistakenly believe they are small suppliers due to the low amount of sales into Canada and refuse to register.

However, implementing this proposal without mandatory registration for foreign-based suppliers would have negative impacts on Canadian agents and billing agents.

Conclusion

We firmly believe that the above proposals would provide the Canadian government with measures that would help to ensure the effective collection of sales tax on e-commerce sales to Canadians while allowing the Government to meet its goal stated in the 2014 Budget to "better protect the Canadian tax base, while maintaining an internationally competitive tax system that is attractive for investment."

We would be pleased to meet with you to further discuss our comments set out above. Should you have any questions, please do not hesitate to contact Richard Taylor, Senior Director, Commodity Tax at (416) 935-2568 or richard.taylor@rci.rogers.com or Martin Behagg, Director, Commodity Tax – Legislative Interpretation & Tax Planning at (416) 935-7206 or martin.behagg@rci.rogers.com.

Thank you for your time and consideration.

Sincerely,

Nick Pantaleo, FCPA, FCA
Senior Vice President, Tax

cc: Sean Keenan, Director, Sales Tax Division, Tax Policy Branch, Department of Finance Canada
Carlos Achadinha, Chief, Sales Tax Division, Tax Policy Branch, Department of Finance Canada