



TaxNewsFlash

Canada

Canada Lays Out Digital Tax Proposals for Businesses

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Large digital businesses should consider how they may be affected by new draft legislative proposals to implement a 3% digital services tax (DST). Under these proposals, businesses that earn revenue from certain digital services may be liable for the DST, effective for certain revenues earned as of January 1, 2022. Although the DST will generally apply for businesses that have global group revenue from all sources of €750 million or more in their fiscal period ending in the previous calendar year, as well as more than \$20 million of “in-scope” revenue related to Canadian users for the particular calendar year, businesses with \$10 million of “in-scope” revenue for a particular calendar year will also be required to register under these proposals. Finance advises that, although the DST will apply to certain revenue earned from online marketplaces, social media, online advertising and user data as of January 1, 2022, this new tax will not be imposed earlier than January 1, 2024, and only if an international multilateral treaty to implement other tax measures has not yet come into force (i.e., Pillar One of the OECD’s two-pillar approach to tax reform).

The new draft legislative proposals, which were released alongside the 2021 Fall Economic Statement on December 14, 2021, include additional details on how taxpayers can calculate their in-scope revenue, and outline taxpayers’ related tax obligations. Finance indicates that it will accept comments on these draft legislative proposals until February 22, 2022.

Background

Finance announced the DST in the 2020 Fall Economic Statement, and provided further information on this proposed change in its 2021 federal budget. Under these proposals, the DST applies to qualifying large businesses that earn revenue from certain digital

services that rely on the engagement, data and content contributions of Canadian users, as well as on certain sales or licensing of Canadian user data. For details, see *TaxNewsFlash-Canada* 2021-21, "[2021 Federal Budget Highlights](#)".

Finance has said it would implement the DST as an interim measure that will apply until an acceptable multilateral approach comes into effect. Canada, along with 136 other members of the OECD/G20 Inclusive Framework agreed to a statement on a two-pillar plan for international tax reform on October 8, 2021 that would provide for this multilateral approach. In particular, Pillar One of this approach is intended to ensure that certain multinational enterprises pay tax in countries where they have consumer-facing activities but do not have a physical presence.

How the DST applies — Revenue thresholds

The legislative proposals provide that the new 3% DST generally applies to domestic and foreign large businesses that meet two separate revenue thresholds. Note that, where a taxpayer is a member of a consolidated group, these thresholds are calculated on a group basis.

Under the first threshold, a taxpayer (or its consolidated group) must earn a total revenue from all sources of €750 million or more in a fiscal year of the taxpayer or group that ends in the previous calendar year. In addition, a taxpayer (or the taxpayer's consolidated group) must meet an "in-scope revenue" threshold of more than \$20 million in the particular calendar year associated with users in Canada.

The new DST applies to in-scope revenue that exceeds the \$20 million threshold. Finance advises that the DST liability would not be eligible for a credit against Canadian income tax payable, but could be deductible in computing taxable income in certain circumstances, based on general principles.

Calculating in-scope revenue

The legislative proposals provide additional detail on how taxpayers can determine their in-scope revenue. Specifically, taxpayers must calculate their revenue under the following categories associated with users in Canada, each of which has distinct sourcing rules:

- Online marketplace services revenue
- Online advertising services revenue
- Social media services revenue
- User data revenue.

When calculating this revenue, taxpayers must also determine whether a user is located in Canada based on available data (e.g., billing, delivery or shipping address, phone number

area code, global satellite positioning data, Internet Protocol address data). In most cases, “user location” is where the user is normally located, although some users’ real-time location is determined at the particular time an advertisement is displayed or data is collected for purposes of the DST.

Online marketplace services revenue

Under these legislative proposals, online marketplace services revenue is earned from providing an online marketplace that helps match sellers of goods and services with potential buyers. This includes revenue earned from the provision of access to, or use of, the online marketplace, commissions from facilitating supplies between users of the online marketplace, and revenue from providing premium services relating to the online marketplace. However, certain financial service providers and revenue from providing storage or shipping services at a reasonable rate of compensation are excluded from this category.

This revenue is sourced depending on how it is earned. Where businesses earn revenue from facilitating the supply of a service delivered in physical form (i.e., the provision of transportation or accommodations), and the service is performed in Canada, the revenue is entirely sourced to Canada. Where revenue is associated with facilitating a particular transaction between users (other than a service delivered in physical form), sourcing to Canada depends on whether both users or just one user is located in Canada. If both users are located in Canada, all the revenue associated with facilitating that transaction is sourced to Canada, otherwise 50% of the revenue is sourced to Canada. Additionally, the legislative proposals provide that online marketplace services revenue that cannot be traced to a specific transaction is sourced to Canada based on the percentage of the marketplace’s transaction participants that are located in Canada.

Online advertising services revenue

Online advertising services revenue is earned from services aimed at the placing of online targeted advertisements, including facilitating the delivery of an online targeted advertisement and providing digital space for an online targeted advertisement.

The legislative proposals stipulate that revenue that can be traced to the display of an advertisement to a specific user located in Canada would be entirely sourced to Canada. However, revenue that cannot be traced to specific users is sourced to Canada based on the percentage of users to which the advertisement was displayed that are located in Canada.

Social media services revenue

Social media services revenue is earned from providing a social media platform that facilitates interactions between users, or between users and user-generated content. This includes the provision of access to, or use of, the social media platform, premium services, and facilitating specific interactions between users, or between users and user-generated content. However, the legislative proposals note that revenue from providing private

communication services (e.g., video calls, voice calls, emails and instant messaging), are excluded from this category where the platform's sole purpose is to provide such services.

Social media services revenue is sourced to Canada based on the percentage of the platform's users that are located in Canada.

User data revenue

User data revenue is earned from the sale or licensing of data gathered from users of an online marketplace, a social media platform, or an online search engine. User data revenue is included in this calculation to the extent that it is earned from user data that was collected by the taxpayer or, if applicable, by another member of the taxpayer's consolidated group.

The legislative proposals state that user data revenue that can be traced to the user data of a single user located in Canada, is entirely sourced to Canada. However, revenue that relates to a set of data that was collected from multiple users is sourced to Canada based on the percentage of those users that are located in Canada.

Special rules for consolidated groups

A taxpayer that is a member of a consolidated group must share a pro-rata portion of the \$20 million deduction amongst other entities of its consolidated group. Where the membership of the group changes during the year, that year would be split into intervals and a pro-rata allocation of the deduction would apply.

The legislative proposals also allow members of consolidated groups to designate an entity in the group to fulfill their filing obligations, pay the DST liability, and otherwise comply with the administrative requirements. In addition, each entity in a consolidated group is jointly and severally liable for DST payable by any other group member under these proposals.

Administrative obligations

Taxpayers that meet the two thresholds would be required to register under the DST rules and file annual DST returns and remit any DST payable on or before June 30 of the calendar year following the calendar year for which the return must be filed. In addition, taxpayers that earn a total revenue from all sources of €750 million or more in a fiscal year ending in the previous calendar year and have in-scope revenue of more than \$10 million must register under the new rules by January 31 of the following year. Penalties and interest may apply to taxpayers who do not comply with these requirements.

We can help

Your KPMG adviser can help you determine how you may be affected by the DST, if it is implemented in Canada. We can also help you manage your related compliance obligations. For details, contact your KPMG adviser.

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