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March 29, 2024

The Honourable Katrine Conroy
Minister of Finance
Parliament Buildings
Victoria, BC V8V 1X4
FIN.Minister@gov.bc.ca

Via email and mail

Re: 2024 Budget Changes to Provincial Sales Tax definition of "Software"

Dear Minister Conroy:

The 2024 BC provincial Budget and accompanying *Bill 3 – Budget Measures Implementation Act, 2024* ("**Bill 3**") introduce changes to the Provincial Sales Tax ("**PST**") definition of "software" and its treatment as signaled in *BC PST Notice 2023-005 - Notice to Providers and Purchasers of Cloud Software and Services*. Tax Executives Institute, Inc. ("**TEI**") has significant concerns with these changes and wanted to highlight its concerns and recommendations to you.

About Tax Executives Institute, Inc.

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 56 chapters in Europe, North and South America, and Asia, including four chapters in Canada. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 6,000 individual members represent over 2,800 of the leading companies in the world. Approximately 15 percent of TEI's members are resident in Canada and many of our non-Canadian members' companies do business in Canada and BC.

TEI has ongoing annual liaison meetings with representatives from the BC Ministry of Finance ("Ministry") Taxation Programs and Tax Policy branches. At these meetings, TEI and Ministry representatives discuss administrative and technical issues relating to British Columbia's *Provincial Sales Tax Act*, *Motor Fuel Tax Act*, and *Carbon Tax Act*. TEI appreciates the opportunity to now share its views with BC on the proposed changes to the *Provincial Sales Tax Act*, SBC 2012, c. 35, as amended ("**PSTA**") and welcomes the opportunity to meet with the Ministry to discuss further.

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Summary of TEI's Recommendations

TEI respectfully urges the Minister to reconsider the retroactive effect of Bill 3 on the PSTA definition of software. Further, given the complex nature of defining an ever-evolving technology as computer software, TEI reiterates the need for the Ministry to launch consultations prior to legislating changes to the definition of software in the PSTA. TEI's concerns with the proposed legislative changes to the definition of software, and related terms, are outlined in the remainder of this Letter as follows:

1. Consequences of Retroactive Legislation and the disregard for BC's Judicial Branch of Government

2. Capturing of services and experiences not previously taxed as "Software" which go beyond the Ministry's stated intention.

3. Misalignment between the Ministry's and Subject Matter Experts' understanding of the definition of "Software".

4. Competitive disadvantage and cost impact to British Columbians

1. Consequences of Retroactive Legislation and the disregard for BC's Judicial Branch of Government

TEI is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of administration and compliance costs to the mutual benefit of government and taxpayers. TEI is committed to fostering a tax system that works—one that is administrable and with which taxpayers can comply with in a cost-efficient manner.

Retroactive legislation hampers these goals. While retroactive legislation may be within the power of the Legislature, the use of such power should only be used in rare circumstances. As a result, TEI rarely supports retroactive tax legislation. The following excerpt from a 2016 TEI policy statement on retroactive legislation provides further context to TEI's position that tax changes should not be retroactive:

"TEI maintains taxpayers must be able to rely upon the legislation and regulations in existence when business transactions and other taxable events occur for a tax system to be fair and perceived as fair. Governments may change their tax policies and laws, but fairness demands that these changes be enforced prospectively, especially if they will have significant financial effects on taxpayers. Moreover, even when governments possess the authority to change tax laws retroactively, legislatures should exercise that power sparingly and within narrow limits.

Retroactive tax legislation is particularly suspect when it overrules a judicial decision. Under a system of divided government, the legislature is charged with writing the laws, the executive branch is charged with administering them, and courts are charged with interpreting them as written. It is always within a legislature's province to change tax laws prospectively in response to a judicial decision. However, doing so retroactively after a court has interpreted the law cannot be reconciled

with basic tenets of sound tax policy and administration because it disrupts taxpayer expectations."[1]

As the Legislature of British Columbia itself makes clear, "[t]he role of the judicial branch is to interpret laws, settle questions about specific legal issues, and hear cases to determine questions of […] liability […] in the course of settling disputes"[2] Despite the importance and recognition by the Legislature of the role of the judicial branch as a fundamental pillar to the governance of BC and the interpretation of laws, the Ministry has twice recently used retroactive legislation to override judicial decisions that did not rule in its favour. In 2022, *Budget Measures Implementation Act, 2022* implemented retroactive PST changes for real property contractors to override a BC Court of Appeal decision (as detailed in *BC PST Notice 2022-01*). Now in 2024, though Bill 3's changes to the PSTA, the Ministry is again seeking to implement retroactive changes to the PST treatment of software to override a BC Supreme Court decision (as detailed in *BC PST Notice 2023-005*). TEI is very concerned with the disturbing trend of using legislation to retroactively override judicial interpretations of the PSTA. When ambiguous legislative drafting and lack of clear administrative guidance leave taxpayers uncertain as to how to interpret laws, the role of the courts is to provide that certainty. The use of retroactive legislation to effectively override a court's decision means taxpayers have little recourse to ensure the law is looked at objectively and fairly in these instances and are beholden to the Ministry to continue to revise legislation retroactively to suit the Ministry's own needs.

While *BC PST Notice 2023-005* purports that these amendments will enhance certainty for service providers by supporting how the PST was administered prior to the BC Supreme Court decision, Bill 3 does precisely the opposite. Bill 3 provides retroactive regulation making powers in respect of the changes to the definition of software which may be exercised as late as March 31, 2025. This adds another layer of uncertainty for taxpayers as they await regulations which may not be released until another full year that could result in even further retroactive changes. This is far from sound and equitable tax policy.

Retroactive tax legislation leads to uncertainty for taxpayers in respect of past transactions. These vendors and purchasers interpret the law as it exists on the date of the transaction to determine the tax treatment. Retroactive legislation seeks to impose new rules and interpretation on transactions that already occurred. The effect of the retroactive nature of these amendments will grant the Ministry the power to assess both vendors and purchasers for tax in spite of bona fide decisions on the application of tax to these transactions based on the interpretation made by the BC Supreme Court.

Some of the additional practical implications of retroactive tax legislation on industry include:

- **Uncertain financial burden:** Companies could face an unexpected tax liability for past periods. This impact is particularly harsh on vendors which would have to incur the burden of the tax themselves without the ability to go back and charge the tax to the ultimate consumer of the software.

- **Uncertain financial positions:** Retroactive legislation requires taxpayers to revisit past financial periods and potentially require them to adjust past financial statements.

[1] https://www.tei.org/sites/default/files/advocacy_pdfs/TEI-Policy-Statement-on-Retroactivity-9-20-2016.pdf.
[2] Legislative Assembly of British Columbia, Judicial Branch: https://www.leg.bc.ca/dyl/Pages/Judicial-Branch.aspx

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- **Risk of Unintended Consequences:** While the BC Ministry of Finance's stated intention in *BC PST Notice 2023-005* is for the retroactive amendments to the definition of software to support how PST was administered prior to the BC Supreme Court decision, the wording in Bill 3 changes the definition from an inclusion definition (i.e. "software means…") to an open-ended definition (i.e. "software includes") with additional expansive new concepts. This creates a high likelihood that concepts that taxpayers and the Ministry would not generally consider to be software to now be defined to be software, including potentially eliminating certain exemptions that the Legislature did not intend to eliminate with such retroactive changes. This topic is discussed further in section 2 below.

- **Complication of Audits and Potential for Increased Disputes:** As mentioned above, this retroactive legislation will allow the Ministry auditors to challenge bona fide interpretation decisions. The retroactive nature combined with the open-ended definition will increase the complication of PST audits for both auditors and taxpayers alike. Further, such lack of clarity could lead to increased tax appeals.

- **Increased Cost of Compliance**: As many tax departments of vendors have limited resources with a focus to compliance, audits and new business products and services, many will be required to incur additional costs to hire outside advisors to assist with determining any retroactive exposure and sorting through the lack of clarity in the expansive new definition.

  While TEI understands the need to update the definition of "software" to cover technological advances in software for a definition that has largely remained unchanged since the 2013 reintroduction of PST (save for the additional of the paragraph on a contractual right to receive modifications in 2018), updating the definition of an ever-changing technology such as software on a retroactive basis is unfair to taxpayers and is bad tax policy. The BC Ministry of Finance should have, and could have, followed a similar approach as Ontario did in 2002 when it undertook broad consultations to get a better understanding of the technologies with the goal to update the definition of software and related services for Retail Sales Tax on a prospective basis.

  TEI respectfully urges the Minister to reconsider the retroactive effect of the legislation and retroactive regulation making power. Further, given the complex nature of defining an ever-evolving technology as computer software, TEI encourages the Ministry to launch consultations with taxpayers and industry groups to develop a workable, clear definition for both the Ministry and taxpayers on a prospective basis. TEI outlines some of the fundamental challenges with the proposed definition of services, and related changes in Bill 3, below.

2. <u>Capturing of services and experiences not previously taxed as "Software" go beyond the Ministry's stated intention</u>

In response to the BC Supreme Court decision on the application of BC PST to software, in June 2023, the BC Ministry of Finance released BC PST Notice 2023-005, which stated:

"In response to the [BC Supreme Court] decision, Government intends to introduce legislation as part

of Budget 2024. If the legislation is enacted, it will retroactively support **how the PST was administered prior to the court decision**, thereby enhancing certainty for service providers and their customers by clarifying how PST applies to remote access to software, cloud computing services, online support services and other associated services.

The Ministry recommends that cloud computing service providers and their customers continue to follow the guidance outlined in our public information. For more information, see Bulletin PST 105, Software, and Bulletin PST 107, Telecommunication Services."[3] [emphasis added]

Despite this stated intention, the Budget 2024 amendments introduced in Bill 3 to the definition of "software" in the PSTA significantly update and expand the definition of software and do not merely support how PST was administered prior to the court decision. For convenience, we offer the below comparisons of the definitions, and have underlined the text which expands the definition of software:

The current definition of Software under Section 1 of the PSTA:

"software" means the following:

(a) a software program that is delivered or accessed by any means;

(b) the right, whether exercised or not, to use a software program that is delivered or accessed by any means;

(c) a contractual right
(i) to receive modifications to or new versions of software programs described in paragraph (a) or (b) if modifications or new versions become available, whether or not that right is exercised, and

(ii) to which section 15 (2) (h) does not apply;

The proposed definition of Software in Section 204 of Bill 3:

"software" includes the following:

(a) software that is delivered or accessed by any means;

(b) the right, whether exercised or not, to use software that is delivered or accessed by any means;

(c) coded instructions or a right to use coded instructions, whether exercised or not, designed to cause an electronic device to perform a task;

(d) infrastructure as a service;

(e) software as a service;

[3] https://www2.gov.bc.ca/assets/gov/taxes/sales-taxes/publications/notice-2023-005-notice-to-providers-purchasers-cloud-software-services.pdf

(f) an application programming interface;

(g) the right to receive modifications to or new versions of software if modifications or new versions become available, whether exercised or not, and to which modifications or versions section 15 (2) (h) does not apply;

"infrastructure as a service" includes access to computational services or the right to access computational services, including computing or processing capacity and electronic storage;

"software as a service" includes software or the right to use software when possession of the software is maintained by the provider of the software or another person other than the person to whom the software is being provided;

The proposed definition is problematic in a number of ways.

Firstly, changing the definition from a comprehensive definition (i.e. "software" *means*) to an open-ended definition (i.e. "software" *includes*) broadens the definition of software for the purposes of the PSTA. This change in and of itself arguably expands the definition beyond "how the PST was administered prior to the court decision". It allows for an open-ended view to what the Ministry decides to treat as software for PST purposes and could include both present and future technologies that are commonly not viewed as software by the industry. This change further introduces a significant amount of uncertainty for taxpayers and fails to achieve the stated intent of "enhancing certainty for service providers and their customers by clarifying how PST applies to remote access to software, cloud computing services, online support services and other associated services" referenced in *BC PST Notice 2023-005*.

Next, the introduction of concepts such as "coded instructions…designed to cause an electronic device to perform a task", "application programming interface" and "computational services" significantly broaden the definition of software and cause confusion on how to interpret these new concepts given these terms are undefined in Bill 3. In TEI's view, the addition of these new concepts expands the definition of software for PST purposes beyond "how the PST was administered prior to the court decision."

One overt example of how this new definition is an expansion on the administrative practice prior to the BC Supreme Court decision is data backup services. The January 2024 version of *BC PST Bulletin 107 – Telecommunication Services* specifically provided "Data backup services are exempt from PST if provided to a customer for the purpose of backing up the customer's data that is installed on an electronic device"[4] whereas the February 2024 version released with Bill 3 now provides "Data backup services are a type of electronic storage and therefore are considered Infrastructure as a Service. As a result, data backup services are taxable as software. For more information on software and Infrastructure as a Service, see Bulletin PST 105, Software." [5] This is a clear example of how the Bill 3 definition of software is changing the PST treatment of data backup services despite that the stated intent of BC PST Notice 2023-005. Two other examples from *BC PST Bulletin 107 – Telecommunication Services* include data hosting services, which were considered non-taxable web design services, and

[4] BC PST Bulletin 107 – Telecommunication Services, Revised January 2024.

[5] https://www2.gov.bc.ca/assets/gov/taxes/sales-taxes/publications/pst-107-telecommunication-services.pdf

electronic storage (web hosting) becoming taxable when the prior version of *BC PST Bulletin 107 – Telecommunication Services* indicated these services were non-taxable.

If the Ministry's intent was to only align with the BC Finance's administrative policy in existence before the BC Supreme Court decision, there would have been no need to update the administrative policy in *BC PST Bulletin 105 – Software* and *BC PST Bulletin 107 – Telecommunication Services* given these bulletins were not updated after the BC Supreme Court decision at issue. As these bulletins have been significantly updated with new concepts, it is clear that the amendments to the PSTA definition of software in Bill 3 are an expansion of the existing administrative practice and not just a clarification. As stated, it is inappropriate to make such expansions retroactively.

In addition to expanding the definition of Software, Bill 3 also retroactively expands the definition of "use" in relation to software. Currently, in section 1 of the PSTA defines "use" in relation to software to "the sending, receiving, downloading, viewing or accessing of software by any means, including if possession of the software is maintained by the provider of the software or another person".

The new proposed definition of use has been expanded to also include "the sending, receiving, downloading, viewing or accessing of software by any means, <u>if the software is accessed directly or indirectly, including on, through or with other software or electronic devices</u>" [emphasis added].

The potential expansion of "use" in relation to software to include situations where software is indirectly accessed through or with other software or electronic devices is so broad it becomes difficult to contemplate a situation in today's electronic world where this definition would not apply. While "incidental" rules do exist, their application in the context of software is not routinely applied and TEI's experience is that BC Ministry of Finance tends not to follow generally accepted principles of when software may be considered incidental to the purchase of a non-taxable good or service, even when such principles are clearly laid out by a court.

Given the Bill 3 amendments are an expansion on the definition of software and not merely aligning to how the Ministry administered the definition prior to the BC Supreme Court decision, TEI calls on the Minister to reconsider the retroactive effect of the legislation and launch consultations with taxpayers and industry groups on a workable, clear definition of software on a prospective basis.

TEI provides additional context below on how the definitions proposed by the BC Ministry of Finance fail to follow expert testimony provided to the BC Ministry of Finance by subject matter experts on software and how the expanded definitions are unworkable for industry

3. <u>Misalignment between the Ministry's and Subject Matter Experts' understanding of definition of "Software"</u>

The administration of the new PSTA definition of "software" for both taxpayers and the Ministry will be incredibly difficult in many respects of the expanded definition. This is an unnecessary and preventable scenario since the Ministry of Finance heard from an expert witness on Software during the aforenoted BC Supreme Court case and was advised by TEI and other groups throughout 2023 to hold industry consultations prior to the introduction of any changes to the software definition.

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Instead, Bill 3 widens of the definitions of software and use to include concepts that are not generally considered to be software by industry (such as Infrastructure as a Service and an application programming interface ("APIs") and introduces language that is entirely contrary to the how "software" works in practice. Consider the following example of an API to illustrate this point.

An API is effectively a contract that outlines the set of permissions for software to interact with another type of software, and not software in and of itself. One example of the difficulties of administering the new definition in respect of APIs is the potential to overstep the reseller exemption (which TEI believes would be an unintended consequence of such amendment) for purchasers that integrate an ecosystem of software to resell to end customers. Companies do not sell APIs directly unlike the sale of software. This could lead to double taxation under the new definition with PST applying on the software when integrated into its product to resell and also PST applicable on the sale to the end users.

The following analogy highlights why attempting to tax APIs as software under the PSTA is completely not aligned with how APIs are used in practice:

An API is like a restaurant menu. When you go to a restaurant, the menu presents you with a list of dishes you can order, along with a description of each dish. When you specify which dish you want, the kitchen (the system) prepares the meal and serves it. In this analogy:

- **The Menu**: This represents the API itself. It tells you what requests you can make (what dishes you can order), how you should make those requests (the format or ingredients you should specify), and what you can expect in response (the dish that will be served).

- **The Waiter**: This role is akin to the API's interface between the client and the server. The waiter takes your order (the request), communicates it to the kitchen (the server/system), and then brings back your meal (the response or data).

- **The Kitchen**: This is like the server-side system that performs the requested operations. It receives the order from the waiter (the call from the API), processes it according to the recipe (the code and logic defined in the API implementation), and prepares the meal (the data or service).

- **Placing Your Order**: This is like making an API call. You provide specific details about what you want (such as the dish and any customizations), which the kitchen uses to prepare your order.

This is an illustration of how an API works, by defining a set of available operations (the menu), the way requests should be made (ordering through the waiter), and how responses are returned (the meal served). Taxing APIs is like taxing a virtual restaurant menu. Perhaps unintentionally, given the broadness of the wording of the proposed definition of software and use, combined with the unclear application of incidental rules, a person in BC ordering food through some electronic means, such as via an actual virtual restaurant menu, would be required to pay tax on that otherwise exempt food as they have accessed "software" through an electronic device (e.g. an ordering kiosk) to be able to order and pay for their meal.

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TEI therefore respectfully submits prior to the expansion of the definition of software to include new concepts that will be unworkable for both the Ministry and taxpayers, the Ministry should have a broad consultation with taxpayers and industry groups to ensure any new definition of software under the PSTA is both prospective and workable.

4. <u>Competitive disadvantage and cost impact to British Columbians</u>

At a time when British Columbians are struggling with the high cost of living and BC businesses are struggling with the high cost of doing business in the Province, the retroactive expansion of the definition of software and the definition of use will further increase costs to individuals, families, and businesses throughout the province.

The British Columbians who will be most directly impacted by BC's broad and far-reaching retroactive definition of software is the technology sector. BC has a thriving and world-renowned tech industry that is made up of approximately 11,000 companies and employs over 220,000 British Columbians.[6] The tech sector is a critical pillar of the BC economy. Even further, the majority of businesses in BC's tech industry are small-to-medium sized business that employ fewer than 50 people.[7] Having to pay an additional 7% on many purchases that now fall within these expanded definitions of software and use will have a drastic impact on operating margins for companies in the tech sector and beyond. The new broadened definitions also increase the gap between BC's application of PST to software in comparison to other provinces and will put tech businesses who operate in BC at a competitive disadvantage to businesses who operate outside the Province. The combination of increased costs and operating in a climate of uncertainty in which the Province will simply introduce retroactive legislation when they dislike how their laws are interpreted within the bounds of the judicial system, has the potential to cause businesses to more carefully consider (1) expanding their operations to BC, (2) expanding their operations within BC, or (3) relocating their operations to a more business and rule-of-law-friendly jurisdiction outside BC.

While the tech industry is likely to see the biggest ramifications of BC's retroactive changes to software given the nature of their purchases as well as their sales, it certainly is not the sole sector of the BC population to be impacted. Given the nature in which the 'Internet of Things' is woven into the fabric of everyday life, it is rare that a good, service or experience does not come with the ability of a user to interact with that product through an electronic device, and at the end of the day, it is ultimately consumers who bear the consequences of increased costs.

The expanded definitions of "software" and "use" in Bill 3 and difficulty in applying any incidental rules may mean that using self-checkout counters at the grocery store, accessing a bank account or health services through a laptop or app may be just a few of the examples of how BC's expansion of the taxation of "software" will permeate into the everyday lives of British Columbians, raising costs when many businesses, individuals and families are struggling to make ends meet. Having such language as is proposed in section 204 of Bill 3 is irresponsible and includes elements which BC-based experts have previously explained to the Province to not be software. Further, it casts an extremely wide net and will

[6] BC Tech Association, https://wearebctech.com/research/why-bc/

[7] Vancouver Public Library, https://www.vpl.ca/siic/guide/industry-profiles/fastest-growing-industries-tech/overview-tech-industry

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result in businesses and British Columbians paying more to use the same services and have the same experiences as they did prior to Bill 3 unless changes are made.

Concluding Remarks

Given several negative implications of these changes on British Columbians and the competitiveness of the BC economy, TEI respectfully urges the Minister to reconsider the retroactive effect of Bill 3 on the PSTA definition of software and to reject the broadening of software for PST purposes against the Ministry's stated intention without thorough consultations with taxpayers and industry experts to ensure a new PSTA definition of software is workable for both the Ministry and taxpayers alike.

TEI would welcome the opportunity to further discuss with the Ministry. We thank you for the opportunity to provide these comments. TEI's comments were prepared under the aegis of TEI's Canadian Commodity Tax Committee, whose chair is Jun Ping and whose legal staff liaison is Kelly Madigan. Should you have questions about our recommendations, please call Ms. Ping at Jun.Ping@Enbridge.com or (416) 753-4684.

Respectfully submitted,

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