TAX EXECUTIVES INSTITUTE, INC.

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Re: *Effective Collection of Sales Tax on E-Commerce Sales to Residents of Canada by Foreign-Based Vendors*

To Whom It May Concern:

On February 11, 2014, the Government through the Federal Budget invited "input from stakeholders on what actions Canada should take to ensure the effective collection of sales tax on e-commerce sales to residents of Canada by foreign-based vendors. For example, should Canada adopt the approach taken in some other countries (such as in South Africa and the European Union) and require foreign-based vendors to register with the Canada Revenue Agency ("CRA") and charge the Goods and Services Tax/Harmonized Sales Tax ("GST/HST") if they make e-commerce sales to residents of Canada?" Tax Executives Institute, Inc. ("TEI" or "the Institute") commends the Government for recognizing the importance of the growing digital economy and the difficult issues that arise in the application of sales tax rules to cross-border e-commerce. TEI is pleased to participate in this effort by providing the comments contained in this letter. We would also be pleased to meet with you to discuss our comments.

Background on Tax Executives Institute

TEI is the preeminent international association of in-house tax professionals worldwide. The Institute's nearly 7,000 professionals manage the tax affairs of more than 3,000 of the leading companies across all industry sectors in North America, Europe, and Asia. Canadians constitute approximately fifteen-percent of TEI's membership, with our Canadian members belonging to chapters in Calgary, Montreal, Vancouver, and Toronto (which is TEI's largest chapter). TEI members must contend daily with the planning and compliance aspects of Canada's business tax laws.

Many TEI members (including those in Europe and Asia) work for companies involved in the sale, distribution, and purchase of digital products and services on a global basis. Those members, and those of other businesses, constantly monitor sales tax and value-added tax ("VAT") developments around the world. TEI espouses organizational values and goals that include integrity, effectiveness and efficiency, and dedication to improving the tax system for the benefit of taxpayers and tax administrators alike. The comments set forth in this letter reflect the views of TEI as a whole, but more particularly those of our Canadian constituency.

TEI Comments

The growth of "[t]he digital economy has increasingly allowed the delivery of services by businesses from a remote location to consumers around the world without any direct or indirect physical presence of the supplier in the consumer's jurisdiction."[1] Remote sales of digital services and intangibles place new pressures on national and sub-national VAT and sales tax systems that have traditionally relied on physically present sellers to act as tax collectors. For business-to-business ("B2B") transactions, purchasers buying from foreign, non-registered sellers self-assess the tax where required through the normal filing of their returns. In the equivalent business-to-final-consumer ("B2C") transaction, the final consumer must self-report and pay the tax. In practice, however, compliance by consumers in the B2C context rarely occurs.

One of the pillars of a properly functioning international VAT/GST system is the neutrality principle, which stands for the proposition that businesses should not bear the burden of the tax. Instead, businesses act as tax collectors in a multi-stage consumption tax system. TEI has long supported the neutrality principle. For example, the Institute submitted comments on the International VAT/GST Neutrality Guidelines published by the Organisation for Economic Co-operation and Development stating, "The fundamental principle of the VAT is that it is borne by the final consumer rather than any of the intermediaries in the supply chain. Thus, to the extent businesses act as the tax collector on behalf of governments (rather than as a consumer),

[1] OECD, *BEPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft)*, 24 March 2014-14 April 2014, at para. 194.

neutrality is critical."[2] For that system to work effectively, however, tax must ultimately be collected from the final consumer.

A system where only resident businesses collect GST/HST effectively results in price differences on goods and services purchased from resident and nonresident suppliers – a price difference based solely on the presence or absence of GST/HST on those transactions. While most jurisdictions require purchasers to self-report and remit GST/HST on purchases from vendors that do not charge the tax, "consumer self-assessment has proven to be largely ineffective."[3] The resulting price differences and corresponding lack of neutrality inherent in such a system conflict with OECD guidelines in this area that TEI has supported.[4] Specifically, Guideline 2.4 of the OECD's International VAT/GST Guidelines states, "With respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid."

Despite difficult jurisdictional issues, requiring foreign e-commerce suppliers to register with CRA and collect GST/HST on sales to final consumers would restore neutrality to the Canadian sales tax system and mitigate the pricing differences resulting from the ineffectiveness of self-assessment. To be effective and consistent with the neutrality principle, the administrative requirements of a mandatory registration system must be clear, simple, and user-friendly when applied to suppliers based outside Canada. The remainder of our letter notes several of the areas that TEI recommends should be considered and addressed by Canada if it adopts a mandatory GST/HST registration system for foreign e-commerce providers.

Experience with other Jurisdictions

Over the past 15 years, the European Union ("EU") has been developing systems and rules to govern the VAT treatment of electronically supplied services. The first changes took effect on July 1, 2003, and applied to non-EU based suppliers of electronic downloads and similar items. Changes effective January 1, 2015 will expand the application of those rules to EU-based suppliers. The scope of the rules will also broaden to include most broadcasting and telecom services. Over the past three years, TEI has worked extensively with the European Commission and Member State tax authorities to provide context and understanding about the nature of the businesses that the rules seek to tax to facilitate effective amendments to the law and guidance interpreting those rules. The result of this effort is a body of legislation and

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[2] Letter to OECD, *Draft Commentary on the International VAT/GST Guidelines* (September 16, 2012), *available at* http://www.tei.org/news/Documents/OECD%20VAT%20Neutrality%20Guidelines%20Commentary.pdf.

[3] OECD, *BEPS Action 1: Address the Tax Challenges of the Digital Economy (Public Discussion Draft)* at para. 200.

[4] Letter to OECD, *International VAT/GST Guidelines Draft Consolidated Version* (May 10, 2013), *available at* http://www.tei.org/news/Pages/TEI-Submits-VAT-Comments-to-the-OECD.aspx ("Treating domestic businesses differently from foreign businesses breaches the neutrality principle and distorts competition.").

guidance that will make it easier for businesses and EU Member States to comply and administer the new rules, respectively.[5]

Over the last few years, a number of other countries have also introduced rules to tax downloads and similar electronic services. In particular, Norway has been taxing sales of electronic services made by foreign (non-established) vendors to Norwegian customers and operating a simplified registration and collection system since July 1, 2011. The Norwegian system, which is loosely based on the original EU arrangements, has generally been viewed positively by both the Norwegian tax administration and businesses, and it was even recommended as a model for taxing digital sales to final consumers during a plenary session of the OECD Global Forum on VAT held in Tokyo this past April. Norway operates an online registration system with registered businesses reporting sales through an online portal and remitting tax electronically. Our understanding is that the Norwegian approach has resulted in a high level of compliance by non-Norwegian suppliers of affected services.

By contrast, new rules implemented by South Africa effective June 1, 2014, have generated much confusion among foreign suppliers of affected services. For example, it is unclear whether the new rules apply to B2B transactions and what products and services fall under the definition of "electronic services." Also, administrative requirements for businesses registering as part of the new program create an unnecessarily heavy compliance burden (*e.g.*, mandated use of a South African bank account and fiscal representative). This creates undue hurdles and uncertainty for suppliers making their best efforts to comply.

References to the EU and Norwegian rules should not be read as inferring Canada should simply adopt regulations that have been designed for other countries with different legal frameworks, customs, and backgrounds. Our comments focus on the practical implementation of these rules, as we expect all countries will have common objectives of fair taxation, maintaining (or achieving) a level playing field between domestic and foreign vendors, as well as efficient collection and enforcement of their tax systems. In the specific context of electronic commerce, it is in the best interest of all parties to ensure a consistent global approach in line with OECD principles and guidelines.

Issues to Consider in Evaluating a Sales Tax Registration System for Foreign E-Services

1. Defining Electronic Services and Digital Products

With the incredibly quick pace of change in the electronic commerce market, updated guidance for determining what services will be considered "e-commerce" for purposes of the *Excise Tax Act* (or what services will fall outside that definition) would be helpful. To the extent legislative changes are made, businesses would benefit from the issuance of a backgrounder and

[5] *See e.g.*, Letter to European Commission, *Explanatory Notes for Amendments to Implementing Regulation (EU) No 282/2011* (September 16, 2013), *available at* http://www.tei.org/news/Documents/TEI%20Comments%20-%202015%20Implementing%20Regulation%20Explanatory%20Comments%20-%20FINAL.pdf.

extensive technical notes explaining the changes. GST/HST Technical Information Bulletin B-090 ("TIB B-090") provides useful examples and analysis in this area, but should be updated to ensure it reflects the many changes in what can be delivered electronically since the publication was released (*e.g.*, various forms of cloud computing services). When making these changes, it will be important to define the affected electronic goods and services in a way that can adapt to this fast-changing marketplace.

2. Place of Supply Rules

The place of supply analysis in Canada has two levels. First, the supplier must determine whether the supply is made in Canada and then whether the supply is made in a participating province (*i.e.*, a province that has adopted the HST). Again, TIB B-090 provides helpful guidance on this subject, but would benefit from an update that addresses the ever-changing business models of the digital economy.

Guidance would also be helpful in addressing the proxies that would be acceptable as evidence to support the decision to charge (or not charge) GST/HST. This absence of authority would undoubtedly lead to varying approaches by businesses for determining place of supply and difficult audits where the interpretation of existing place of supply rules differ between businesses and CRA auditors. These administrative inefficiencies would be costly to businesses and the government. The supplies likely to be the subject of new rules in this area are heavily automated, high volume, low value transactions, generating slender margins for suppliers. It is important, therefore, that any legal requirements be proportionate in terms of cost of implementation and complexity. Tax logic (*e.g.*, for place of supply determinations, etc.) must be capable of being automated so that it does not interfere with customer experience. If the process of purchasing electronic goods and services is made too cumbersome, it could easily dissuade the customer from completing a purchase thus damaging revenues both for business and the government.

Without suggesting CRA follow any particular path in developing this needed guidance, it is worth mentioning that the European Commission has done significant work on this issue. On April 2, 2014, after much consultation with business groups (including TEI), the European Commission published its "Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015" (the "Explanatory Notes").[6] The Explanatory Notes are not prescriptive. Rather, they provide a framework within which all suppliers of e-services can find the compliance logic that best suits their business model, their systems, etc. to achieve a reasonable tax result. Large international

[6] The latest and final version of the Explanatory Notes can be found at: http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/telecom/index_en.htm#explanatory_notes

or directly at:

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/telecom/explanatory_notes_2015_en.pdf

suppliers of e-services are already designing their systems in line with these EU rules, including identifying the types of documentation and logic to best assess the location of their customers for determining the place of supply.

Adopting a similar approach in Canada would benefit CRA by providing a solid foundation for building its compliance and audit programs. Also, CRA and businesses could leverage the work already being done by businesses to adopt systems that comply with the EU rules. This would give all parties comfort that foreign vendors' systems would be tested and audited elsewhere, which would further increase compliance.

3. Create a Simple Registration, Recordkeeping, and Return Filing System

Any registration system for foreign e-commerce companies should efficiently promote compliance with the *Excise Tax Act*. In 1999, the OECD Forum on Tax Administration published Principles of Good Tax Administration and has encouraged governments to apply those principles in practice. Of special importance to a registration system for foreign e-commerce providers, Paragraph 4 of those Principles states, "Voluntary compliance is promoted not only by awareness of rights and expectations for a fair and efficient treatment but also by clear, simple and user-friendly systems and procedures."[7] Indeed, the OECD's VAT Neutrality Guidelines amplify that statement, providing in Guideline 6 that "[w]here specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses."

One area where efficiencies can be gained without affecting revenue collection is employing different compliance requirements for B2B and B2C supplies. The *Excise Tax Act* and associated guidance do not differentiate between B2B and B2C supplies in the context of e-commerce. Generally, however, non-compliance in this area occurs with B2C supplies where the GST/HST is a cost, rather than at the B2B level where GST/HST is rarely a cost (except for exempt or input-taxed businesses). Requiring collection of GST/HST on B2B supplies creates a new administrative burden for government and business alike without enhancing compliance with, or collection of, GST/HST. Excluding B2B sales from the new rules would make the GST/HST collection process more efficient for the government and businesses alike, while still achieving the goal of leveling the playing field between Canadian suppliers of e-services and foreign suppliers.

Differentiating between customers could be done via a simple test, such as the collection of a GST/HST number. TEI suggests excluding transactions with customers that provide a GST/HST number from the reporting and collection requirements of any registration system for foreign e-commerce businesses.

[7] GAP001 Principles of Good Tax Administration – Practice Note.

4. Establishment of a Registration Threshold

The compliance burden of registering with CRA and collecting and remitting GST/HST could be significant for small businesses. Also, the administrative costs of CRA to administer registered suppliers making small amounts of taxable supplies would exceed the revenue Canada would receive from such suppliers. Creating a minimum threshold for required registration would address these challenges.

5. Billing and Remittance Agents

Allowing foreign-based vendors to enter into GST/HST collection and remittance agreements with Canadian-based registrants could result in more efficient collection and remittance of the tax. For example, the government could explore permitting the operators of app stores and/or the carriers involved to collect and remit the tax. Many of the suppliers of apps, subscriptions, etc. that sell through this type of marketplace are small operations that would likely be exempt from the registration and compliance system under a small-seller registration threshold. Having larger, established businesses manage the compliance for those transactions would reduce the number of registrations CRA would need to administer and avoid placing heavy burdens on small business. This approach is being adopted in the EU under the rules that will take effect January 2015.

Conclusion

Any new GST/HST registration system adopted for foreign suppliers of digital services and intangibles to address the lack of neutrality in the current system should be guided by the *Ottawa Taxation Framework Conditions*. The approach should take into account the administrative and compliance burdens imposed and ensure that the neutrality of the GST/HST is restored. TEI would welcome the opportunity to meet with Finance and CRA representatives to discuss these comments and other issues relating to the administration of the GST/HST to ensure that the system operates in the most practical, effective, and efficient manner to the benefit of both the government and the business community.

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TEI appreciates the opportunity to provide input on what actions Canada should take to ensure the effective collection of sales tax on e-commerce sales to residents of Canada by foreign-based vendors. TEI's comments were prepared under the aegis of the Institute's Canadian Commodity Tax Committee, whose chair is Robert Smith. The incoming chair of the Committee is Richard Taylor. Should you have any questions, please do not hesitate to call Mr. Smith at 514.832.8198 (or Robert.Smith@mckesson.ca) or Mr. Taylor at 416.935.2568 (Richard.Taylor@rci.rogers.com). TEI consents to having this letter posted on the Department of Finance website.

Respectfully submitted,
Tax Executives Institute, Inc.

Terilea J. Wielenga
International President

Cc: The Honourable Kerry-Lynne D. Findlay, Minister of National Revenue
Mr. Brian McCauley, Assistant Commissioner, Legislative Policy and Regulatory Affairs Branch, Canada Revenue Agency