

E-commerce tax policy penalizes Canadian business

By MICHAEL GEIST

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While my previous column highlighted encouraging new Canadian policy on the consumer e-commerce front, recent e-commerce tax policy developments are troubling. After several years of deliberations, the Canada Customs and Revenue Agency has released its interpretation on the application of the goods and service tax to e-commerce. The result should set off alarm bells among Canadian businesses engaged in e-commerce, since it places them at a competitive disadvantage relative to their U.S. and European rivals.

The policy addresses several key issues, the most important of which are: how electronic transactions are characterized for tax purposes; and which businesses are required to collect GST.

The characterization of electronic transactions boils down to whether an electronic product is treated as a good or a service. This is important since it can determine the jurisdiction where the supply occurs, the applicable tax rate, and the manner in which the tax is collected.

Unfortunately, the guidelines distinguishing a good from a service are artificial. Canadian tax authorities have concluded that electronic goods are those that include a right to use a product (such as software), or goods that have already been created or developed (such as a database). Conversely, electronic services are those where there is no provision of rights or where humans are involved in their supply.

In providing several case studies for how these guidelines might be applied, Canada Revenue reveals how much it relies on human involvement as the benchmark for distinguishing between electronic goods and services. For example, computer technical support supplied through on-line documentation is characterized as a good, while real-time interaction with a technician is considered a service. A Web site featuring digitized content is treated as a good rather than a service since there is no human involvement when the subscriber visits the site.

The flaw in this approach is apparent when characterizing information delivery services, such as customized electronic news clipping or stock market

quotation services. These are not treated as services for GST purposes since there is no human involvement in the supply. Not only are these distinctions artificial, they are likely to become quickly outdated as smart computing achieves many human-like capabilities.

Even more troubling for Canadian businesses is whether GST must be collected. Canadian businesses are typically required to collect GST when they supply a service performed in Canada. Since e-commerce enables businesses to supply their services electronically without regard for their location, requiring Canadian businesses to collect GST may leave them at a competitive disadvantage relative to international rivals.

The policy concludes that a service is performed in Canada when the supplier's or recipient's equipment is located in Canada. In an e-commerce context, this suggests that Canadian businesses using Canadian Internet service providers are more likely to supply their services in Canada and, thus, may be required to collect GST.

While Canadian businesses face the prospect of GST collection, non-resident companies face no such burden. The policy provides a scenario in which a U.S. company supplies music on-line from a U.S.-based server. The company advertises on the Internet with a campaign that targets the Canadian market, allows Canadians to download music using a Canadian credit card with the help of a Canadian ISP, and uses an agreement that specifies Canada as the place of the contract. According to Canadian tax authorities, this company is not carrying on business in Canada and thus does not need to register for GST collection.

For Canadian businesses competing on the global e-commerce stage, this policy approach represents a significant competitive disadvantage.

While foreign rivals can target the Canadian market without the burden of federal and provincial sales tax collection, their Canadian counterparts will frequently be required to collect sales tax from both Canadian residents and non-residents.

Coming on the heels of the recent sensible proposal on consumer e-commerce jurisdictional rules, it appears that Canadian e-commerce policy has taken one step forward and two steps back.

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