

Intelligence MEMOS



From: Jon Johnson
To: Global Affairs Canada
Date: September 25, 2024
Re: **CANADA'S DIGITAL SERVICES TAX IS IN US CROSSHAIRS**

On August 30, the US [requested](#) consultations respecting *Canada's Digital Services Tax Act* under the dispute settlement procedure set out in the Canada-US-Mexico Agreement (CUSMA). The US maintains that by imposing the tax, Canada has failed to provide US service providers and investors treatment no less favourable than it provides to Canadian service providers and investors. Given Canada's unique trade relationship with the US, this could have major implications.

The essence of the complaint is that Canada is violating a specific CUSMA obligation to grant US firms terms that are no less favourable than its own companies receive. This is called national treatment. The crux of the US argument is that the revenue and earnings thresholds are so high that no Canadian service provider would be subject to the tax, but at least some US providers would be. While the DST is not discriminatory on its face, its practical effect is discriminatory.

Canada's taxation of digital services has been an on-going contentious issue with the US. The new legislation entered into effect on June 20 and imposes a 3-percent levy – retroactive to January 1, 2022 – on revenue (not income) earned from digital services when certain thresholds are met. Annual gross revenues in a calendar year must exceed €750 million for the tax to apply. The taxpayer must also earn at least C\$20 million in Canadian digital services revenue in a calendar year. Affected companies are to start paying the tax next June 30.

On August 1, the Congressional Research Office released a [paper](#) outlining multiple concerns. It cites industry associations that maintain that Canada's DST could “cost US exporters and the US tax base up to \$2.3 billion annually and could directly result in the loss of thousands of full-time US jobs.” The paper also cites possible violations of CUSMA and WTO obligations.

The paper also notes that the United States Trade Representative (USTR) has applied sanctions under Section 301 of the 1974 Trade Act against digital services taxes enacted by other countries. Section 301 is much broader in its application than either CUSMA or the WTO.

The CUSMA panel could decide for the US if the facts establish that only US companies meet the €750 million threshold for overall earnings and whose Canadian digital earnings exceed C\$20,000,000.

Aside from the possibility of an adverse panel decision and action by the US under Section 301, there are other factors that Global Affairs Canada should consider before the Canadian government commences with the retroactive portion of the tax.

CUSMA is up for renegotiation on July 1, 2026. The process on the US side starts with a USTR report to Congress, due by the end of 2025, that will include an assessment of CUSMA's operation, as well as a recommendation on CUSMA extension. As Canadian initiatives to impose digital taxes have been a US concern for years now, the recommendation will doubtless address the question of Canada's DST regime. If that regime remains an open issue and US concerns are not satisfied, the stage could be set for the ultimate demise of CUSMA in 2036.

CUSMA Article 32.6 also provides that a party can withdraw from CUSMA upon giving six months' notice to the other parties.

Decision time for the Canadian government falls on June 30, 2025, and it has to decide whether to go ahead and start collecting its retroactive DST and face the inevitable hostile reaction of its largest trading partner. This has to be carefully managed, or this small issue could become a big one.

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