

THE UNITED STATES CHALLENGES CANADA'S DIGITAL SERVICES TAX

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On August 30, 2024, the United States announced that it was formally challenging Canada's Digital Services Tax ("DST") under the Canada-United States-Mexico Agreement ("CUSMA"). Below we provide background on the dispute and discuss the implications for digital trade and broader economic relations between the North American allies.

I. Background on the DST

The DST is a 3% tax on revenue generated from digital services provided to Canadian users by large multinational companies, namely firms with global revenues of €750 million or more and at least CAD 20 million in Canadian digital services revenue. The tax applies to revenue from online advertising, online marketplaces, social media platforms, and the sale and licensing of user data of an online interface.^[1] The DST is retroactive to January 1, 2022, and companies will start paying the tax on June 30, 2025.

Canada states that the DST's objective is to ensure that large digital firms, many of which have little physical presence in Canada, contribute fairly to the Canadian tax system. These firms generate substantial revenues from their activities in Canada and the monetization of Canadian users' data.

The USTR expressed strong opposition to the DST at the time of its [proposal](#) in 2022, arguing that it unfairly targets American companies and violates international trade agreements. Canada initially delayed implementing the tax to allow for ongoing global negotiations on digital taxation. However, that delay ended when the DST became law in June 2024.^[2] Having failed to halt Canada's imposition of the DST, the United States Trade Representative ("USTR") has now escalated the issue by [invoking the dispute settlement provisions of the CUSMA](#).

II. The Legal Claims and Next Steps in CUSMA Dispute Settlement

The US request for consultations follows the state-to-state dispute settlement procedure established under Chapter 31 of the CUSMA. The USTR contends that Canada's proposed DST may violate several provisions of the CUSMA, including the requirement to provide equal treatment to both US and Canadian services and service

suppliers (Article 15.3) and the requirement to provide equal treatment to both US and Canadian investors and investments (Article 14.4).

Both claims are grounded in the allegation that the DST targets US companies and discriminates against US companies in favour of Canadian companies providing those services. The implication is that the DST thresholds are designed to apply, or have the effect of applying, to US companies and not Canadian companies.

The first step taken by the United States was to request consultations, which triggers a formal process under CUSMA's dispute settlement mechanism. The key steps in the dispute are as follows:

1. **Consultations:** Within 30 days of the request, the U.S. and Canada must engage in consultations to attempt to arrive at a mutually satisfactory resolution of the matter.
2. **Panel Request:** If consultations fail to resolve the issue within 75 days, the US or Canada may request the establishment of a dispute resolution panel under CUSMA. The panel would hear arguments from both sides and issue a report on whether the DST is consistent with Canada's CUSMA obligations. In past cases, the panel process has taken on average approximately 270 days from the date of panel request to the issuance of a report.
3. **Panel Decision and Compliance:** Should the panel find in favour of the US, Canada would be expected to comply with the ruling, potentially by modifying or repealing the DST. If Canada does not comply, the US could be authorized to impose retaliatory trade measures.

For further information on the dispute settlement process under CUSMA, as well as an updated tally by McMillan's international trade team of wins and losses in dispute settlement under CUSMA, see our [CUSMA Dispute Settlement Scoreboard](#).

III. Implications for Canada and the United States

The USTR's request emphasizes that the DST could affect a significant volume of trade, as digital services are a rapidly growing segment of the US economy. In 2023, US exports of digitally delivered services to Canada were valued at over \$25 billion, highlighting the importance of this sector to both countries' economies. USTR notes that Canada expects to collect about \$875 million per year from the DST.

The CUSMA does not provide for monetary damages under the state-to-state dispute settlement mechanism. Instead, if a panel finds the DST to be inconsistent with a CUSMA obligation, Canada and the United States must endeavor to agree to a resolution, which could result in Canada agreeing to changes to the DST. However, if no agreement were reached, the United States may "retaliate" to equivalent effect. Given the significant volume of trade implicated in this dispute, the potential for retaliatory measures is a meaningful risk

that could impact various sectors of the Canadian economy.

More broadly, the USTR's consultation request highlights an isolated area of trade irritation between Canada and the United States in a period of otherwise substantial alignment on key aspects of trade policy.

As McMillan has recently discussed, Canada has recently taken steps to align itself with the United States by imposing trade measures against Chinese [steel, aluminum, and electric vehicles](#). However, digital trade has developed into a contentious issue, as the regulatory approaches of Canada and the United States appear to have diverged. This divergence extends beyond the DST and includes, for example, Canada's measures requiring dominant platforms to compensate news organizations under the *Online News Act* [\[3\]](#) and requiring broadcasters to showcase Canadian content under the *Online Streaming Act*, [\[4\]](#) both of which have generated push-back from US entities [\[5\]](#) although no formal actions have been taken under CUSMA to-date.

IV. Conclusion

The US challenge to the DST under CUSMA signals a commitment by the United States to protecting US digital giants from what it views as discriminatory taxation measures. Moreover, it highlights an area of recent trade friction between Canada and the United States, who now face the challenge of resolving these issues within the CUSMA framework. McMillan will continue to monitor this dispute and provide additional updates through our [CUSMA Dispute Settlement Scoreboard](#).

McMillan LLP's International Trade Group regularly assists leading Canadian and global companies in articulating their perspectives on tariffs and international trade disputes and on issues of economic security and national security.

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[1] See Government of Canada, [Digital Services Tax Act](#).

[2] See Bill C-59, [An Act to implement certain provisions of the fall economic statement tabled in Parliament on November 21, 2023 and certain provisions of the budget tabled in Parliament on March 28, 2023, passed on May 28, 2024 and received royal assent on June 20, 2024](#), Part 2: *Digital Services Tax Act*.

[3] See Government of Canada, [The Online News Act](#).

[4] See Government of Canada, [Online Streaming Act](#).

[5] See, for example, US Department of State, [2024 Investment Climate Statements: Canada](#).

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

The logo for mcmillan, featuring the word in a lowercase, sans-serif font. The 'm' and 'c' are in a dark red color, while the 'm', 'i', 'l', 'l', 'a', and 'n' are in a light blue color. The background of the logo area is a photograph of a modern glass skyscraper, likely the Burj Khalifa, viewed from a low angle looking up, with the sky visible in the background.

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