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Tax Implications for Non-Residents Conducting E-Commerce in Canada

*Mike Nienhuis**

This paper considers potential liability in respect to both income tax and tax on goods and services that can arise for non-residents conducting e-commerce targeting the Canadian market. Although the tax implications of e-commerce have been discussed for over a dozen years now, a number of factors make fresh consideration of the topic timely.

First, Canada is becoming an increasingly attractive market for internationally based e-commerce businesses. The United States remains not only the largest source of e-commerce start-ups, but also the primary target for such businesses because of its relative homogeneity, size, and propensity for new product adoption. But as web based companies reach stability and start to think about geographic expansion, Canada is often a natural first target for international growth. Usually, a portion of existing revenue will already be generated from Canadian-based consumers and businesses, in spite of not being specially targeted. But with a population nearly as large as California's, more than ten percent that of the United States as a whole, Canada often becomes the subject of specific growth strategies of American e-commerce firms. Cultural similarities make the decision even easier, since they minimize or even eliminate the need for product modifications and other aspects of localization.

Second, establishing e-commerce businesses in no- or low-tax jurisdictions is becoming a more viable practical alternative for entrepreneurs, including Canadians, looking for a combination of warm weather and tax relief, and for corporations seeking to optimize their international business structures from a tax perspective. In some countries, such as Bermuda, telecommunications infrastructure and connectivity to primary international telecommunications hubs now rivals or even exceeds that of much larger developed nations. Domestic credit card processors are available to handle high volume transactions in multiple currencies. And access to sophisticated professional services, international air travel, and a stable legal system exists.

A final factor making consideration of our topic timely is the relatively recent — some might say belated — clarification by the Canada Revenue Agency (“CRA”) of its positions on when an e-commerce provider will be considered to have established a permanent establishment in Canada through a computer server,¹

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¹ By “computer server” we mean a computer, connected to the internet that is used to store and serve up web page files (or other digital information) or to execute programs

thus creating nexus for tax purposes, as well as the rules it will adopt in determining the characterization of e-commerce income in a treaty context.

This paper focuses on taxation issues faced by non-resident e-commerce companies with no sustained presence in Canada apart from a web site. The tax liability of foreign corporations with a Canadian subsidiary, a physical Canadian office, or Canadian-based employees or agents will not be considered, even though there is substantial overlap in some of the relevant issues. By e-commerce companies we refer broadly to any firms conducting their primary business — whether business-to-business (B2B) or business-to-consumer (B2C) — by means of the internet.

In the first section we outline the framework for Canada's taxation of non-residents conducting business in Canada and introduce the value-added taxation of goods and services supplied within the country. Second, we consider one of the most difficult issues that has arisen in connection with the taxation of e-commerce businesses, namely, the characterization of income from e-commerce transactions for tax purposes. The third section looks at Canada's taxation of a non-resident e-commerce firm's business profits under Part I of the *Income Tax Act*² and relevant treaty provisions. Fourth, we examine tax liability under Part XIII of the ITA, which concerns withholding tax on certain categories of payments made to non-residents. Finally, in section five we discuss administrative requirements with respect to the taxation of goods and services imposed on non-resident firms conducting e-commerce in Canada.

I. FRAMEWORK FOR THE TAXATION OF INCOME AND GOODS AND SERVICES IN CANADA

Like most nations, Canada imposes income tax on the business profits of non-residents earned within the country. This liability is grounded primarily in Part I of the ITA³ which covers taxation of "active" income, including income from business and employment. In addition, Canada imposes withholding tax on the "passive" income of non-residents under Part XIII of the ITA. "Passive" income refers primarily to income earned from investments such as dividends, interest, and the like, but also includes one category of income potentially relevant to the conduct of e-commerce: royalties and rental payments.⁴ While active income is taxed on a net basis, passive income is taxed on a gross basis by means of a withholding tax, at the default rate of twenty-five per cent, imposed on all qualifying payments made to non-residents. The distinction between active and passive income under Parts I and XIII of the ITA respectively makes the characterization of income critically important. As we will see in the following section, such characterization in the context of e-commerce transactions has been particularly problematic.

The provisions of the ITA affecting non-residents are sometimes supple-

and services that are accessed by other computers or devices, typically by means of a web browser.

² R.S.C. 1985, c. 1 (5th Supp) [ITA].

³ Specifically, in ss. 2(3)(b), 115(1).

⁴ ITA, s. 212(1)(d).

mented, modified, or even overridden⁵ when the non-residents are considered resident, for tax purposes, in one of about ninety countries with which Canada has signed a bilateral tax treaty. Canada's tax treaties, like those of most developed nations, in large measure follow the OECD Model Tax Convention⁶ in terms of both structure and content.⁷ The purpose of such tax treaties is to avoid double taxation, prevent tax avoidance and allocate tax revenues equitably between nations.⁸ This is achieved primarily by delineating the scope of each nation's right to tax non-residents earning income originating in the country of non-residence. The Canada-US Convention, not surprisingly, is the most significant of Canada's bilateral tax treaties.

In order to illustrate the differing tax liabilities of non-residents, depending on whether or not they are resident in a country with which Canada has a tax treaty in force, we will make periodic reference in the course of this paper to two fictive companies conducting e-commerce in the Canadian market: first, BermudaCo.com as an example of a corporation resident in a non-treaty tax haven country and therefore subject only to the provisions of the ITA; and second, USCo.com as an example of a company able to avail itself of treaty provisions that mitigate terms of the ITA which would otherwise prevail.

Canada also imposes a value-added tax ("GST") of five per cent on most goods and services supplied within, or imported into, the country under section IX of the *Excise Tax Act*.⁹ Through a system of input credits available to suppliers who collect the tax from purchasers and pay it on their own purchases,¹⁰ GST is ultimately borne only by the final consumer of such goods and services. The concern from the standpoint of a non-resident e-commerce provider, then, is not the imposition of an additional tax on income, but rather the need for administrative compliance. In section five we will discuss the conditions under which nexus can be cre-

⁵ In Canada, each treaty's implementation act, by which the treaty takes effect as domestic law, specifies that treaty provisions prevail to the extent of inconsistency with other domestic legislation, including the ITA. See, for example, the *Canada-United States Tax Convention Act, 1984*, R.S.C. 1984, c. 20, s. 3(2).

⁶ Organization for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, 2010) [OECD Model Convention]. Canada is among the 34 current member states of the OECD, mostly representing Western developed nations. But participation by non-member states in the area of international tax policy has also been very significant.

⁷ In some cases — for example, the services permanent establishment discussed later in this paper — Canada has adopted provisions of the United Nations Model Taxation Convention between Developed and Developing Countries, UN publication No ST/ESA/102, 1980, which is generally favoured by developing nations over the OECD Model Convention.

⁸ See for example the prologue of the *Canada-United States Tax Convention (1980)*, 26 September 1980 [Canada-US Convention]: "Canada and the United States of America, desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, have agreed as follows. . ."

⁹ R.S.C. 1985, c. E-15, s. 165 [ETA].

¹⁰ *Ibid.*, ss. 221, 225.

ated with respect to GST by non-resident companies conducting e-commerce in Canada, as well as the characterization of e-commerce transactions for the purpose of value-added taxation.

II. CHARACTERIZATION OF E-COMMERCE TRANSACTIONS

As we have already noted, income characterization — like residence — is a threshold issue in taxation. At the most fundamental level, whether income is characterized as active or passive will determine if it is taxed on a net or gross basis, the applicable tax rates, and the rules for withholding and remitting such tax. In short, nearly *everything* depends on how income is characterized. This is true not only with respect to the ITA, but also tax treaties. Since tax treaties are designed in part to modify the rules found in the domestic tax legislation of treaty partners, they generally follow the broad categories of income characterization found in such legislation.

The development of e-commerce compounded existing difficulties associated with income characterization both by creating new categories of transactions and by blurring the lines between existing categories. For example, subscription revenue for the use of software applications accessed by means of a browser is a type of income that simply did not exist prior to development of the internet. Should such revenue be characterized as a rental payment under Part XIII of the Act, taxed on a gross basis, or as business income under Part I, taxed on a net basis? Or, as an example of a transaction that blurs the lines of existing income categories, consider the sale of a licence to use a software product that is downloaded for use on the purchaser's computer. Should the resulting revenue be characterized as income from business under Part I or as a royalty for the use of copyright under Part XIII? And in a cross-border context — in a situation where neither personnel nor physical assets are required to conduct even very significant amounts of business — which state should retain the right to tax such income: the provider's state of residence or the state in which the income originates (the "source state")? The answer may depend in part on how certain transactions are characterized.

The OECD has served as perhaps the most significant international platform for discussion of these and other questions related to the emergence of e-commerce in the nineties.¹¹ At meetings of the OECD's Committee on Fiscal Affairs¹² held at Ottawa in 1998, consensus emerged that e-commerce transactions should be dealt with according to longstanding taxation principles whenever possible.¹³ Subsequently, a number of working committees were struck to consider particular aspects of the taxation of e-commerce. Of special importance for present purposes was the work of the Treaty Characterization Technical Advisory Group, whose report (the

¹¹ Arthur J. Cockfield, "The Rise of the OECD as Informal 'world tax organization' through the Shaping of National Responses to E-commerce Tax Challenges" (2006) 8 *Yale Journal of Law and Technology* 136.

¹² The Committee on Fiscal Affairs is the OECD's primary body responsible for the development of taxation policy.

¹³ Cockfield, *supra* note 11 at 140.

“Characterization Report”) was published in February 2001.¹⁴ In its report, the committee made recommendations for changes to the commentary on the OECD Model Tax Convention (the “Commentary”), a source frequently relied on by both the CRA¹⁵ and Canadian courts¹⁶ in interpreting Canada’s tax treaties based upon the OECD model.

In addition to its recommended changes to the Commentary, many of which were adopted in subsequent editions of the Model Tax Convention, the committee also scrutinized twenty-eight categories of e-commerce transactions in order to illustrate application of the characterization principles it developed to particular types of transactions. A summary of the categories and their resulting characterization may be found in Appendix I. In a technical interpretation concerning the taxation of e-commerce in Canada first made public in May 2010 (the “E-commerce TI”),¹⁷ the CRA indicated that for treaty purposes the principles outlined in the Characterization Report should be applied in characterizing income from e-commerce transactions. By explicitly aligning its position on this issue with that of the OECD, the CRA has not only co-opted useful and detailed background material developed by a broad spectrum of state and industry representatives,¹⁸ but has increased the likelihood that any decisions of Canadian courts on such matters will be in line with the CRA’s position, thus increasing stability in this area of taxation law. However, the Characterization Report is only applicable in a treaty context. For non-treaty purposes income is characterized by applying relevant provisions of the ITA as they are interpreted by relevant court decisions and guidance offered by the CRA.

E-commerce also poses challenges to the characterization of transactions for the purposes of value-added taxation, where a fundamental distinction must be made between transactions involving the provision of property and services. Although the Characterization Report is applicable only with respect to the ITA, as we will see the CRA and even Canadian courts have adopted some of the report’s

¹⁴ OECD, *Tax Treaty Characterisation Issues Arising from E-Commerce: Report to Working Party No. 1 of the OECD Committee on Fiscal Affairs*, (Paris: OECD, 2001) [Characterization Report].

¹⁵ See for example “Sub 9(b) of Article V of the Canada-U.S. Treaty” in *Window on Canadian Tax Commentary*, Document number: 2008-0030941C6 (North York, ON: CCH Canadian, 2008), where the CRA indicated that it views the Commentary as a useful tool in interpreting the new services PE provision in the Canada-US Convention.

¹⁶ See *Crown Forest Industries Ltd. v. Minister of National Revenue*, [1995] 2 S.C.R. 802 at para. 55, where the Supreme Court held that the OECD Model Convention and Commentary were of “high persuasive value” in determining that only those liable to tax on their world-wide income can be considered residents for tax treaty purposes.

¹⁷ “Electronic Commerce” in *Window on Canadian Tax Commentary*, Document number: 2008-0279141E5 (North York, ON: CCH Canadian, 2008). The source CRA document first became available publicly 26 May 2010: Paul Hickey, “CRA Guidance on E-Commerce” (2010) 18:7 Tax News.

¹⁸ The committee consisted of twenty-seven individuals representing ten countries, including four non-OECD members (two of whom, Chile and Israel, have subsequently become OECD members), and eight corporations. Canada was not among them, but was generally heavily involved in the e-commerce discussions.

underlying principles in order to determine characterization in a GST context.

III. TAX ON BUSINESS PROFITS

This section addresses the taxation of business profits under Parts I and XIV of the ITA as well as related treaty provisions. First, we consider the taxation of net income from business carried on in Canada by non-residents under Part I. Second, we provide an overview of Canada's additional tax, under Part XIV of the ITA, on such companies' income when it is not reinvested in Canada.

(a) Tax on Business Income (ITA, Part I)

(i) *Non-treaty Contexts*

According to subparagraph 115(1)(a)(ii) of the ITA, a non-resident is taxed on "incomes from business carried on by the non-resident person in Canada." The word "business" is defined very broadly to include "a profession, calling, trade, manufacture or undertaking of any kind whatever and . . . an adventure in the nature of trade."¹⁹ The ITA extends the common law definition of "carrying on business" with respect to a non-resident in section 253:

For the purposes of this Act, where in a taxation year a person who is a non-resident person . . .

(a) . . .

(b) solicits orders or offers anything for sale in Canada through an agent or servant, whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada . . .

the person shall be deemed, in respect of the activity or disposition, to have been carrying on business in Canada in the year.

In order to clarify the meaning of "anything" in paragraph 253(b), in *Maya Forestales*²⁰ the Tax Court of Canada quoted with approval from Jinyan Li's article "Rethinking Canada's Source Rules in the Age of Electronic Commerce: Part I" in which the writer stated: "The word 'anything' is very broad and includes both tangible and intangible property, as well as services."²¹ The court went on to say that "the choice . . . of terms as broad and vague as 'anything' . . . certainly does not indicate that Parliament intended to limit the object of the activities in question — quite the contrary."²²

It seems clear that the phrase "carrying on business," since it includes "both tangible and intangible property, as well as services," is sufficiently broad to encompass a wide spectrum of typical e-commerce transactions. The question then becomes, in a non-treaty context, whether such transactions — or more precisely, the solicitation of orders or offers for sale in connection with such transactions —

¹⁹ ITA, s. 248(1), "business."

²⁰ *Maya Forestales S.A. v. R.*, 2005 TCC 66 at para. 34, 2005 D.T.C. 514 [*Maya Forestales*].

²¹ (1999), 47:6 Can. Tax. J. 1077 at 1096.

²² *Maya Forestales*, *supra* note 20 at para. 36.

can be considered as having been conducted “in Canada through an agent or servant.” The E-commerce TI addresses this question as follows:

It is our view that a business can be carried on in Canada without the presence of personnel in Canada because the functions of a service business can be performed electronically (the service business can be performed by using the internet to remotely provide a service or a website on a server can perform the essential functions of a service business without the presence of personnel). In evaluating the factors connecting a business to Canada, there are two factors that must be taken into account with respect to web businesses specifically: (1) the presence of digital inventory in Canada; and (2) the use of a “.ca” domain name.

The CRA thus takes the position that the automated functions of a web site can be viewed as the legal equivalents of the activities (“services”) of servants (i.e. employees) or agents in a traditional business, at least in determining for tax purposes whether business has been carried on in Canada by a non-resident e-commerce provider. This view appears to have led the writer to characterize a web-based business generally as a “service business,” which in our view is somewhat unfortunate. The sale of tangible goods by means of a web site, for example, would not normally be characterized as a service business, and it is unlikely that the CRA intended to exclude such transactions from being considered as “carrying on business in Canada.”

The E-commerce TI identifies two factors that it will consider when determining whether a commercial web site run by a non-resident will be viewed as doing business “in Canada”: the presence of digital inventory in Canada and the use of a .ca domain name. Presumably, then, so long as BermudaCo.com were to avoid using a .ca domain name and ensure that its digital inventory, if applicable, were stored on servers located outside Canada, the CRA will not consider it as having established tax nexus in Canada, in spite of its conduct of e-commerce in the Canadian market. The restriction on choice of a .ca domain name would of course present little difficulty to most non-resident e-commerce companies — even many Canadian businesses select a .ca domain extension only because a .com domain is unavailable. The need to avoid storage of digital inventory on servers located in Canada might, in some circumstances, present an unwelcome restriction, particularly where the files to be downloaded by Canadian customers are large or the non-resident is located in a country with insufficient bandwidth between it and primary international telecommunication hubs. But as noted earlier, this is becoming less of an issue today and, regardless, many options exist to design an e-commerce web site such that its various components, including digital inventory, are distributed in a way that best accounts for a variety of constraints, whether technical or non-technical.

(ii) Treaty Contexts

(A) The Permanent Establishment Threshold

As we have seen, Canada is not unique in asserting its right to tax the business profits of non-residents, provided such income originates from business conducted within the country. Tax treaties usually modify this general rule by limiting the

income subject to such taxation to that earned by the non-resident through a “permanent establishment” (“PE”) in the source country.²³ The *Canada-US Convention* defines a PE as “a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on,” including “a place of management; branch; office; factory; workshop,” but excluding “a fixed place of business used solely for . . . activities which have a preparatory or auxiliary character.”²⁴ The Commentary on article 5 of the OECD Model Convention also emphasizes that it is necessary that the premises be “at the disposal” of the non-resident in order for them to constitute a PE,²⁵ a phrase which Canadian courts have interpreted to include a legal right of disposal over the premises, not mere actual use of the premises without such right.²⁶

(B) Server Permanent Establishments

Earlier we observed the consensus view that new challenges presented by the emergence of e-commerce should be treated wherever possible according to traditional taxation principles. It is not surprising, then, that as OECD members confronted the issue of when tax nexus is created in an e-commerce context, they began by applying the concept of the PE. This in turn raised further questions. For instance, can a web site *per se* constitute a PE? And if not, what about a computer server on which the web site pages (files) are stored? The answer to the first question is no, since a web site, being “a combination of software and electronic data, does not constitute tangible property” and “therefore does not have a location that can constitute a ‘place of business’.” But the answer to the second is yes, since a computer server is a “piece of equipment having a physical location and such location may thus constitute a ‘fixed place of business’ of the enterprise that operates the server.”²⁷ Also, when will a server be considered to be “at the disposal” of the e-commerce firm? Here the Commentary takes the view that a computer server will generally only be at the disposal of a non-resident who owns or leases the server. Use of an internet service provider (“ISP”) to host the web site on a server in the source country will not create a server PE.²⁸ Finally, the Commentary suggests that activities on a web site that are merely preparatory or auxiliary, such as advertising, relaying information through a mirror server for security or efficiency purposes, or supplying information, will not be sufficient to establish a PE *unless* such functions

²³ See article 7(1) of both the OECD Model Convention and the Canada-US Convention.

²⁴ Article 5, paragraphs 1, 2, 6. The definition in the OECD Model Convention is similar.

²⁵ At paras. 4-4.6.

²⁶ See for example *Knights of Columbus v. R.*, 2008 TCC 307 at paras. 78-79. It should be noted that this is contrary to the Commentary on article 5 at para. 4.1. For a full discussion of the meaning of “right of disposal” see Joel Nitikman, “The Painter and the PE” (2009) 57:2 Can. Tax J. 213.

²⁷ Commentary on Article 5 of OECD Model Convention at para. 42.2.

²⁸ Neither will use of an ISP create an “agency PE” according to article 5(5) of the OECD Model Convention: see the Commentary on Article 5 at para. 42.10.

are “an essential and significant part” of the provider’s core business.²⁹

The position that a server can constitute a PE has been rejected by a number of states,³⁰ both OECD members and non-members. But Canada is not among them. On the contrary, in the E-commerce TI³¹ the CRA explicitly adopted the OECD position:

As in the OECD Reports, it is our view that because a web site is intangible (no location), it cannot be a PE. However, a computer server on which a website is stored can be a PE if the taxpayer owns or leases the server as long as the server is fixed in place and time and business is carried on through [the] server. In summary, a non-resident who presents a web site to its Canadian customers may be considered to carry on business in Canada through a PE where all of the following conditions are met:

- (1) the host server is located in Canada,
- (2) the business is being carried on, wholly or in part, through the operation of the web site on that server,
- (3) the host server is at the non-resident’s disposal,
- (4) the host server is more or less permanently linked to a geographic location in Canada, and
- (5) the web site is hosted by the particular computer server on a more than merely temporary or tentative basis.

The interpretation thus adopts the section of the OECD Commentary on article 5 concerning Electronic Commerce³² and casts it in the form of a five-part test, each condition of which must be met for a server to constitute a PE. Condition (1) simply reflects the requirement that a PE must exist within the source country. Condition (2) is intended to exclude functions that are merely preparatory or auxiliary, as noted above, from establishing a PE in and of themselves. At least some core functions of the business must be conducted through the web site. Condition (3) captures the usual requirement of the right of disposal over the premises of a PE, which, as already seen, in the case of a server PE the CRA generally confines to situations where the non-resident owns or leases the server, rather than utilizes

²⁹ *Ibid* at para. 42.8. For example, operating computer servers is part of the core business of an ISP but may be incidental to the business of a company whose main business involves the sale of digital music via its web site.

³⁰ Countries such as Portugal and Chile, who are net importers of goods and services provided through e-commerce and thus concerned about inequitable access to taxation of economic activity occurring within their borders, appear more apt to take the view that a web site targeting their residents, though hosted on foreign servers, can still establish a PE. See Commentary on Article 5 at paras. 45.6, 45.11 and Jinyan Li, *International Taxation in the Age of Electronic Commerce* (Toronto: Canadian Tax Foundation, 2003) at 468.

³¹ The CRA had previously considered the issue of a server PE in connection with GST/HST (*GST/HST Policy Statement P-208R*, “Meaning of ‘Permanent Establishment’ in subsection 123(1) of the *Excise Tax Act* (the Act)” (23 March 2005)), but the E-commerce TI appears to have been the first time it addressed the issue explicitly in connection with income tax.

³² At paras. 42.1–42.10.

an ISP. It should be noted that right of disposal over the *premises at which the server is located* is not required for a server PE, the server itself constituting the “fixed place” of business.³³ Conditions (4) and (5) reflect the OECD Commentary’s elaboration on the word “fixed” as including both geographical and temporal elements, i.e. the PE “must be established at a *distinct place* with a certain *degree of permanence*.”³⁴ “Permanence” itself relates to whether the server remains in place for an extended period, not whether it *may* be moved.³⁵

In light of this test, how can USCo.com avoid establishing a server PE in Canada as it conducts e-commerce targeted at the Canadian market? The obvious answer is by simply hosting its web site on servers outside of Canada. For most e-commerce firms this will be not present a problem. But for some it will and not only for the technical reasons we noted earlier. In some cases, for example, privacy legislation may force non-resident companies to store Canadian information on servers within the country. In these and similar situations, based on CRA commentary a server PE may still be avoided by using an ISP or other co-hosting or cloud-computing based solutions. Given the practicality of these approaches in the vast majority of scenarios, it is unnecessary to discuss other options for avoiding application of the server PE test.³⁶

In concluding this discussion of server PEs, it will be worthwhile to briefly contrast the “server PE test” just outlined, which is applicable only to e-commerce providers resident in countries with which Canada has a tax treaty, to the test previously described based solely on the ITA (and its interpretation by courts), which is applicable to providers resident in non-treaty countries (the “non-treaty test”). As expected, the server PE test establishes a higher threshold for establishing tax nexus; that is, it will be easier for a treaty-based company to avoid tax liability. This is for two reasons primarily. First, while the server PE requires that the server itself be located in Canada to establish tax nexus, the non-treaty test requires only use of a .ca domain extension or the presence of digital inventory on a server located in Canada. More significant, however, is the requirement for a server PE that core business functions be conducted through the server itself. In contrast, the non-treaty test requires only that goods or services are offered for sale by means of the web, based on the definition of “carrying on business” in Canada in section 253 of the ITA. As the court in *Maya Forestales* emphasized, the words “in Canada” in that section apply to the activity of soliciting, ordering or offering anything for sale, not the object of that activity,” i.e. not the actual provision of such goods or services.³⁷ The distinction may not be of consequence in the case of some e-com-

³³ In much the same way as other automated equipment can constitute a PE even without the presence of personnel: Commentary on Article 5 at para. 10. *Contra* Nitikman, *supra* note 26 at 237.

³⁴ Commentary on Article 5 at para. 2 [emphasis added].

³⁵ *Ibid* at para. 42.4.

³⁶ For a discussion of further avoidance strategies, see George Seitz, “International Income Taxation of Cross-Border Electronic Commerce Transactions — A United States-German-New Zealand Case Study” (2005) No. 0022 Center for Business and Corporate Law at 45 (Heinrich Heine Universität Dusseldorf).

³⁷ *Maya Forestales*, *supra* note 20.

merce transactions, such as the sale of digital goods (e.g. music or information), in which all aspects of the transaction (advertising, offer and acceptance of the contract, payment, and delivery/receipt of the product) take place online. But in other cases the distinction could be significant; for example, in situations where services are offered and perhaps even paid for online, but are delivered offline. If the services themselves are considered core business functions, the online transactions may still be captured by the non-treaty test since they are offered for sale in Canada, but would be excluded by the server PE test, which requires that the core business functions be conducted by means of the server PE itself.

(C) Services

E-commerce companies commonly provide services as a component of their offering. Such services may be performed automatically by the functionality of a web site or remotely by staff in the provider's country of residence. But sometimes non-resident e-commerce companies provide services at customer locations in Canada itself. For example, a software-as-a-service company may deliver substantial implementation and training services at the customer's place of business if the application is particularly complex. Non-resident companies that do so should be aware that tax implications may arise in two ways in these sorts of circumstances. We will only consider them briefly since they will not be relevant to most non-resident e-commerce companies.

First, regulation 105 of the ITA obligates anyone making a payment to a non-resident for services³⁸ *performed in Canada* to withhold and remit fifteen per cent of the gross value of the payment.³⁹ This obligation applies even when the non-resident is resident in a country with which Canada has a tax treaty, although waivers may be obtained in these and other circumstances. The amount withheld constitutes an instalment on the non-resident's final tax liability under Part I of the Act, not a final remittance, and is designed to secure payment of tax by non-residents where enforcement could otherwise prove difficult.⁴⁰

Second, some of Canada's treaties contain a provision based on the UN model, usually in either article 14 (Independent Personal Services) or article 5 (Permanent Establishments),⁴¹ which deems a permanent establishment to have been created when a non-resident provides services in Canada aggregating more than 183 days in a twelve month period. When the provision is found in article 14 it is usually restricted to "professional services," which are generally defined as includ-

³⁸ "Service" and "services" are not defined terms in the ITA.

³⁹ *Income Tax Regulations*, CRC, c. 945, s. 105 [Regulations].

⁴⁰ See *Information Circular 75-6R2*, "Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada" (23 February 2005) for additional details.

⁴¹ For example, *Convention Between Canada and The Hellenic Republic [Greece] for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and on Capital*, 29 June 2009, article 5(4), and *Convention Between the Government of Canada and the Government of the United Mexican States For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income*, 12 September 2006, article 5(3)(b), (c).

ing “independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.”⁴² When the provision occurs in article 5 it usually speaks of services much more broadly, or without any restriction at all. The *Canada-US Convention* has a similar provision that is considerably more complex and has additional conditions. It also applies to services generally, not just professional services.⁴³ We should also note that if a PE is established, personnel of the non-resident entity delivering services in Canada may also be subject to income tax.⁴⁴

(D) Attribution of Profit to a Permanent Establishment

The E-commerce TI indicates that the CRA will generally follow the OECD approach regarding attribution of profits to a PE in assessing the taxable profits of a non-resident e-commerce provider, meaning that only profits generated through the business activity of the PE itself are taxable.⁴⁵ In essence this requires the creation of a pro forma income statement that treats the PE as if it were a separate business, applying arm’s length transfer pricing principles to the hypothetical entity in order to identify its revenues and expenses.⁴⁶ Because of the matching of revenues and expenses implicit in this exercise, it could have the practical effect of transferring the taxation of a non-resident e-commerce provider’s profits from the marginal rates of its state of residence to those applicable in Canada. For USCo.com, this may not be objectionable in that Canadian corporate tax rates are generally lower and the United States may allow credits for taxes paid in Canada.⁴⁷ For corporations resident in other treaty countries, the situation may be different. In any case, it will be evident that if a PE is established, compliance costs associated with tracking such revenue and expenses could be significant, quite apart from any tax liability incurred.

(b) Branch Tax (ITA, Part XIV)

In addition to taxing the net income earned by a non-resident from business carried on within the country, Canada also imposes a tax under Part XIV of the

⁴² See for example the *Convention between the Government of Canada and the Government of the Republic of Korea*, 5 September 2006, article 14(1).

⁴³ Article 5(9). For a complete discussion of the services PE in the Canada-US Convention, see Marsha Reid, “The New Services PE Provision of the Canada — US Tax Treaty” (2010) 58:4 Can. Tax J. 845.

⁴⁴ This is generally addressed in article 15 (Income from Employment) of Canada’s tax treaties.

⁴⁵ See for example article 7(1) of the Canada-US Tax Convention.

⁴⁶ In its “2010 Report on the Attribution of Profits to Permanent Establishments” (2010), the OECD elaborates significantly on the general principles contained in article 7. For a summary, see Reid, *supra* note 43 at 889ff.

⁴⁷ Article 7 of the OECD Model Convention was amended in 2010 to incorporate the requirement of such adjustments: OECD, “The 2010 Update to the Model Tax Convention” (2010) at 3.

ITA⁴⁸ (usually called the “branch tax”) of twenty-five per cent on *after-tax*⁴⁹ earnings when those earnings are not re-invested in the business. Here the concept of “branch” includes non-residents operating in Canada through a PE as defined by treaty (one of the definitions of which is a “branch”)⁵⁰ or through “carrying on business in Canada” by way of the definition in section 253 of the ITA. The tax therefore will generally apply to all non-resident e-commerce providers who have established tax nexus in Canada in the manner described in Part A, Tax on Net Income above.⁵¹ Tax treaties generally reduce the rate of branch tax and sometimes create other exemptions; for example, the *Canada-US Convention* reduces the rate for qualifying U.S. residents to five per cent and exempts the first \$500,000 of Canadian income.⁵²

IV. TAX ON “INVESTMENT” INCOME (ITA, PART XIII)

(a) Withholding Tax

Under Part XIII of the ITA Canada imposes a withholding tax of twenty-five per cent, subject to modification by treaty, on the gross amount of payments (or credits) made by Canadian residents to non-residents in respect of “passive” (investment) income derived from Canadian sources.⁵³ The tax represents a liability of the non-resident but responsibility for withholding and remitting it is placed upon the resident payer as typically the only practical means of enforcing compliance. Of course, e-commerce plays havoc with this premise since payments are most often made by means of the web site itself, under conditions imposed by the non-resident. Although argument in the Characterization Report proceeds almost exclusively on a principled basis, one suspects that practical concerns regarding compliance may well underlie some of the recommendations reflected in the report.⁵⁴ Withholding tax is *not* applicable if such income is earned by the non-resident through a PE in Canada; in that case it is treated as income from business and taxed on a net, rather than gross, basis under the rules we have previously consid-

⁴⁸ Beginning in section 219.

⁴⁹ *I.e.*, after Part I tax discussed in the previous section.

⁵⁰ See for example article 5(2) of the Canada-US Convention.

⁵¹ Subsection 219(2) of the Act exempts corporations whose principal business is “communications” from branch tax. The exemption is unlikely to apply to e-commerce companies as generally understood. For the CRA’s views on the definition of “communications,” see Financial Industries Division, Technical Interpretation, (30 October 1995) and Reorganizations and Foreign Division, Technical Interpretation, (28 February 1995).

⁵² Article X(6).

⁵³ ITA, ss. 212–218.

⁵⁴ The only overt acknowledgement of compliance as a factor in the characterization recommendations concerned so-called “mixed payments” in a B2C context involving relatively small sums of money, in which the payments cover elements that would normally be characterized separately but compliance considerations caused the committee to recommend that the principal element characterize the entire payment: see paras. 46–48 of the Characterization Report, *supra* note 14.

ered in section III, Tax on Business Profits.⁵⁵ Therefore, the following remarks are limited to e-commerce providers deriving Part XIII income from Canadian residents that has not been earned through a PE.

While tax on “investment” income may not appear to be relevant in the case of a non-resident conducting e-commerce in the Canadian market, one category of such payments⁵⁶ — rents and royalties — is potentially applicable, depending on how e-commerce revenues are characterized for tax purposes. Because characterization presents particular difficulties in connection with rent and royalty payments, before attempting any generalizations we will set out the relevant provision and summarize approaches to its interpretation. Following this we will consider its application in a non-treaty scenario before turning to ways the provision may be modified by treaty in a context where the Characterization Report is directly applicable.

(b) Rent, Royalties and Know-how

The basic rules governing withholding tax on rents, royalties and “know-how” are set out in paragraph 212(1)(d) of the ITA. Here we set out only the elements most relevant to e-commerce providers.

212. (1) Every non-resident person shall pay an income tax of 25% on every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit, to the non-resident person as, on account or in lieu of payment of, or in satisfaction of,

...

(d) Rents, royalties, etc. — rent, royalty or similar payment, *including*, but not so as to restrict the generality of the foregoing, any payment

(i) for the use of or for the right to use in Canada any property, invention, trade-name, patent, trade-mark, design or model, plan, secret formula, process or other thing whatever,

(ii) for information concerning industrial, commercial or scientific experience where the total amount payable as consideration for that information is dependent in whole or in part on

(A) the use to be made of, or the benefit to be derived from, that information,

(B) production or sales of goods or services, or

⁵⁵ Regulations, *supra* note 39, ss. 805, 805.1. Note that the definition of PE applicable is that contained in section 8201, which is similar if not identical to the way the term is defined in most treaties as discussed above.

⁵⁶ Another category that may be applicable to some businesses conducting e-commerce is “management” fees in subsection 212(1)(a). But since the definition (ITA, s. 212(4)) excludes services “performed in the ordinary course of a business carried on by the non-resident person that included the performance of such a service for a fee,” it would not normally be applicable.

(C) profits,
 (iii) for services of an industrial, commercial or scientific character performed by a non-resident person where the total amount payable as consideration for those services is dependent in whole or in part on
 (A) the use to be made of, or the benefit to be derived from, those services,
 (B) production or sales of goods or services, or
 (C) profits
 but not including a payment made for services performed in connection with the sale of property or the negotiation of a contract

...

but *not including*

(vi) a royalty or similar payment on or in respect of a copyright in respect of the production or reproduction of any literary, dramatic, musical or artistic work . . . [emphasis added]

It should be observed at the outset that the phrase “including, but not so as to restrict the generality of the foregoing” suggests that all payments that can be characterized as having the qualities of rent or a royalty are subject to the withholding tax, unless they fall under the exclusions beginning in subparagraph (vi). The provision is therefore potentially extremely broad in its application.⁵⁷ Although “rent” and “royalty” are not defined in the ITA, the terms have been judicially interpreted in a consistent manner. In *Saint John Shipbuilding* Chief Justice Turlow of the Federal Court of Appeal defined “rent” in the following manner:

A rental can, of course, be paid in a lump sum but in my opinion the word is inseparable from the connotation of a payment for a term, whether fixed in time or determinable on the happening of an event or in a manner provided for, after which the right of the grantee to the property and to its use reverts to the grantor.⁵⁸

Thus, the notions of right of use of property and reversion of that right upon expiry of a term are central to the concept of “rent.” The word “royalty” similarly involves use of property, but contains an element of contingency based on variation of use or effect that is absent from the idea of “rent”:

A royalty or similar payment is therefore one made for the use of property, rights or information whereby the payments for such use are contingent upon the extent or duration of use, profits or sales by the user.⁵⁹

⁵⁷ The prefatory words “on account or in lieu of payment of, or in satisfaction of” in subsection 212(1) can also have the effect of widening the scope of the terms “rent” and “royalty” in some circumstances: see for example *Transocean Offshore Ltd. v. R.*, 2005 FCA 104 at para. 47, 2005 D.T.C. 5201 (Eng.).

⁵⁸ *R. v. Saint John Shipbuilding & Dry Dock Co.*, 80 D.T.C. 6272 (Fed. C.A.).

⁵⁹ *Hasbro Canada Inc. v. R.*, 98 D.T.C. 2129 (T.C.C.) [*Hasbro*] at para. 22.

As a result of these definitions, anything considered an outright sale, in which all legal rights in a property are transferred, will not be considered either “rent” or a “royalty.”⁶⁰

Like the phrase “rent, royalty or similar payment,” subparagraph (i) is potentially of very broad application, since it includes any payment “for the use of or for the right to use in Canada *any property*, invention, trade-name, patent, trade-mark, design or model, plan, secret formula, process *or other thing whatever*” (emphasis added). Even if the scope of “other thing whatever” is constrained (under normal legislation interpretative principles) to property with similar characteristics to those listed,⁶¹ the definition of “property” in the ITA is itself very broad, meaning “property of any kind whatever whether real or personal or corporeal or incorporeal.”⁶² As we have seen, the definitions of “rent” and “royalty” also included the notion of use of, or right to use, property. In effect, then, there is substantial overlap in the practical scope of subparagraph (i) and the phrase “rent, royalty or similar payment” in paragraph (d).

Similarly, the contingency we noted earlier that is inherent in the idea of “royalty” is also found in subparagraphs (ii) and (iii), which both require that the total amount of applicable payments be “*dependent* in whole or in part” (emphasis added) on the use or effects of the specified information or services. The subject matter of subparagraphs (ii) and (iii), taken together, is commonly referred to as payments for “know-how,” which the CRA has described as including:

payments for special knowledge, skills or techniques which are considered beneficial in the conduct of a business. Such payments may be for expertise flowing from experience, ability or research which may be reflected in blueprints, drawings, specifications, plant layouts, designs, secret processes and formulae.⁶³

While know-how will not likely be applicable to most e-commerce businesses, as we shall see it may arise in some situations that are perhaps not evident from this description alone.

(i) Non-treaty Contexts

In a non-treaty context the CRA has provided only limited clarification regarding when it will consider e-commerce transactions as having the character of rent or royalty payments for purposes of withholding tax. The E-commerce TI merely refers to the judicial definitions of “rent” and “royalty” we have considered above, but offers no further guidance. The agency has, however, clarified its views on when payments for software will be considered as rents or royalties. Since those views and related judicial interpretation appear to be mostly applicable in an e-commerce context, and because software is clearly an important category of goods

⁶⁰ Jinyan Li, *International Taxation*, *supra* note 30 at 145.

⁶¹ CCH, Editorial Comment on s. 212(1)(d), “Rents, royalties, and similar payments — Definitional issues and lump-sum payments” (North York, ON: CCH Canadian) at para. 26,075b.

⁶² S. 248, “property.”

⁶³ CRA, Interpretation Bulletin IT-303, “Know-how and similar payments to non-residents” (8 April 1976) [IT-303] at para. 3.

provided by e-commerce firms, we consider it first before turning to other categories of e-commerce goods and services.

As a type of intangible property protected by copyright of “literary” works,⁶⁴ software is rarely sold outright; rather, rights to its use are nearly always sold by way of licence. Payments for software licences therefore fall under subparagraph 212(1)(d)(i) as payments for use of property.⁶⁵ But subparagraph 212(1)(d)(vi) exempts royalty or similar payments “on or in respect of a copyright in respect of the *production or reproduction* of any literary . . . work” (emphasis added). What types of software licensing arrangements will qualify for the exemption? To date, case law suggests that only licences for the right to produce or reproduce software, and ancillary rights such as the right to distribute — rights that are often found in reseller agreements, for example — are included in this exemption, whereas licences for internal use of software are not,⁶⁶ whether the term of use is unspecified, perpetual, or unlimited.⁶⁷ However, the CRA also exempts the outright purchase of “shrink-wrap” software applications from withholding tax, treating them as proceeds of sale rather than licence fees.⁶⁸ Shrink-wrap software is understood as “software that is pre-packaged, has a general licence agreement and is commercially available through mail order or at a retail store,” whereas “custom computer software” refers to software whose use is acquired under a “specific licence agreement.”⁶⁹ If a web site is viewed as analogous to mail order or a retail store and a “click-wrap” licence is considered a form of “general licence agreement” — which the CRA has further defined as one that does not contain the name of the purchaser or the amount of the purchase fee⁷⁰ — presumably the exemption applies to most software purchased and subsequently downloaded or accessed via the internet. Other software applications also accessed or downloaded via the internet, but involving a separately negotiated licence agreement, would not be subject to the exemption, though in all other material respects the transaction may be identical.

What about other forms of intangible property such as digital music, images or information, or an interactive web site, which are also obtained or accessed by means of a licence agreement that confers only limited rights on the user? Such “goods” clearly fit the ITA’s definition of “property,” so payments for rights to use them would appear to constitute rent or royalties under paragraph 212(1)(d), or payments for the use of, or right to use, property under subparagraph (i). Although there is no case law exactly on point and the CRA has failed to provide specific

⁶⁴ *Angoss International Ltd. v. R.*, 99 D.T.C. 567 at para. 21 (T.C.C.).

⁶⁵ John Stavropoulos, “Withholding Taxes — Purchase of Software from a Non-Resident” (17 February 2005) No. 1719 CCH Tax Topics.

⁶⁶ *Syspro Software Ltd. v. R.*, 2003 TCC 498 at para. 28, 2003 D.T.C. 931.

⁶⁷ Stavropoulos, *supra* note 65.

⁶⁸ *Ibid.* Again, this exemption appears to be based on practical issues relating to enforcement and materiality rather than distinctions implicit in the text of subsection 212(1)(d) or as recognized in judicial interpretation of the provision.

⁶⁹ *Ibid.*

⁷⁰ Paul Hickey, “Control: All Rights Exercised?” (2004) 12:4 Canadian Tax Highlights 7.

guidance in a non-treaty context, the recent case of *Blais v Canada*⁷¹ may be indicative of one approach courts could take to at least some categories of payments for intangible goods in an e-commerce environment. The case involved a Canadian partnership that sold Ontario residents subscriptions permitting them to access television programming provided directly by a U.S. corporation. The court held that the subscription fees, which were remitted by the partnership, less commissions, to the American company, “had none of the characteristics of “rent or similar payment” since “property rights were not acquired.” Instead, “customers acquired only the right to view their chosen channels” and at the end of the subscription period “merely lost that right.”⁷² In the court’s view the payments also lacked an element of contingency required to characterize them as royalties. They were simply payments “for the performance of services” and therefore income from business.⁷³ Although the decision may be criticized,⁷⁴ it is possible that other courts would similarly view payments for the right to view or interact with online materials as payments for the mere provision of services rather than for use of “property.”

It is also possible that courts could be influenced by the CRA’s characterization, for GST/HST purposes, of payments for licenses to use digital goods in some circumstances as outright purchases of goods or services, rather than use of copyright, as we shall see later. Interestingly, the Federal Court of Appeal has followed the same line of reasoning in *Dawn’s Place*,⁷⁵ a case in which the court considered whether subscription fees for access to a Canadian company’s web site by non-residents were exempt from GST as the “supply of . . . copyright . . . or any right, licence or privilege to use such property.” The court held that the making of a copy of the copyrighted material on the subscriber’s own computer (intrinsic to the functionality of a web browser) was merely incidental to the supply, which it characterized as being a supply of access to the web site, thus a service. Interestingly, in doing so the court adopted the principle from the OECD Commentary that the essential consideration for the payment should govern its characterization.⁷⁶ Thus, based on analogy, the court was willing to adopt reasoning applicable under a dif-

⁷¹ *Blais v. R.*, 2010 D.T.C. 1271 (Eng.) (T.C.C. [Informal Procedure]) [*Blais*]. The case only considered whether the payments constituted rent or royalties since the Minister only relied on subsection 212(1)(d) and not subsection (i).

⁷² *Ibid* at para. 20.

⁷³ *Ibid* at para. 22. “Services” here referred to activation of the descrambler units rather than provision of actual television programming.

⁷⁴ The decision does not recognize the right to view the channels as a chose in action (legally enforceable right to intangible property), which is a form of “property” according to the definition of that term in s. 248 of the ITA.

⁷⁵ *Dawn’s Place Ltd. v. R.*, 2006 FCA 349 [*Dawn’s Place*], leave to appeal refused (10 May 2007), 2007 CarswellNat 1099 (S.C.C.).

⁷⁶ The case has been criticized for running counter, in effect, to the purpose of the zero-rating provisions in Part V of the ETA, which are designed to ensure that exports of Canadian goods and services are not made less competitive through imposition of GST/HST: Robert Kreklewetz & Vern Vipul, “GST on Internet Subscription Fees” (2006) 14:12 CCH Tax 7. While characterizing the transaction as the provision of access to a web site, it did not further characterize such access as either provision of intangible property or a service.

ferent legislative tax regime. It would not be surprising, then, that courts may be willing to take the lesser step of applying characterization principles developed in a treaty context to that governed solely by the ITA. Still, in the absence of more directly relevant case law, certainty may only be ascertainable by means of an advance ruling from the CRA.⁷⁷

Determining in an e-commerce environment whether payments for information or services — like payments for rent and royalties — should be characterized as know-how also poses some difficult questions. A broad spectrum of e-commerce transactions, however, will be excluded altogether from being considered payments for know-how simply because of the requirement for contingency in both subparagraphs 212(1)(d)(ii) and (iii). Contingency here does not refer to situations where the amount paid varies with the quantity of information or services purchased, but rather to circumstances in which the fee varies depending on the *subsequent* use to which such information or services is put, or their effect on *subsequent* productivity, sales, or profitability.⁷⁸ Therefore, any “once-and-for-all payment in a predetermined amount”⁷⁹ will escape being captured by these provisions, as will recurring payments, such as subscriptions, so long as the fees are determined beforehand.⁸⁰ In addition, subparagraph (ii) (regarding information know-how) has been interpreted as referring only to knowledge or experience that has *not been publicly divulged* since the provision’s wording originated in the OECD Model Convention’s definition of “royalties” and thus could be interpreted in connection with the Commentary. In contrast, the court was unwilling to read down subparagraph (iii) because the Model Convention contained no reference to know-how in respect of services.⁸¹ However, the postamble of subparagraph (iii) explicitly excludes services “in connection with the sale of property or the negotiation of a contract.”

Apart from these exclusions, the scope of the provisions is quite broad. Neither “information” nor “services” are defined in the ITA, nor are they restricted to technical matters given occurrence of the word “commercial” in both subparagraphs. For example, according to the CRA payments to view the styles and designs of a fashion designer could be captured by subparagraph (ii) provided they are in some way contingent on use.⁸² Similarly, payments for marketing research could fall under subparagraph (iii) if they vary with production or use.⁸³ Moreover,

⁷⁷ It should also be noted that while courts will look to the wording of the contract to determine characterization of a disputed payment, they will look to the substance of the transaction rather than its characterization by the parties, for purposes of determining tax liability: see for example *Entré Computer Centers Inc. v. R.*, 97 D.T.C. 846 (T.C.C.).

⁷⁸ Such use, production or sales could be those of the payer or a third party: “Know-how and similar payments,” IT-303, *supra* note 63 and *Hasbro*, *supra* note 59 at para. 43.

⁷⁹ “Know-how and similar payments,” IT-303, *supra* note 63 at para. 18.

⁸⁰ *Blais*, *supra* note 71 at para. 22.

⁸¹ *Hasbro*, *supra* note 59 at paras. 24–42. Another attribute of know-how in a treaty context, but not discussed by the court, is the requirement that such information be pre-existing: see Characterization Report, *supra* note 14 at para. 21.

⁸² “Know-how and similar payments,” IT-303, *supra* note 63 at paras. 19 and 23.

⁸³ *Ibid.*

it is not necessary that such information be obtained or used in Canada, or that the services be provided within the country.⁸⁴

But more fundamentally, it is not obvious that market research should be considered provision of a service at all, rather than information, which would invoke the requirement of being previously undivulged, or even bring subparagraph (i) into play as we saw earlier. Does payment for a web site banner ad, the amount of which was determined after the fact, based on the number of “click-throughs,” constitute payment for a service under subparagraph (iii)?⁸⁵ Can in fact the automated functions of a web site constitute services, or only those provided through the agency of individuals? Again, the term “service” is undefined in the ITA and no case law addresses the question precisely. But courts have taken a very broad view of how “services” should be understood in connection with other provisions of the ITA, including benefits provided by a “thing” or “equipment,”⁸⁶ so it is possible that services provided by means of a web site could be caught by subparagraph (iii) provided they are of an industrial, commercial or scientific character and payments have the required element of contingency.

(ii) *Treaty Contexts*

Fortunately, in a treaty context, matters are significantly clearer. Article 12 of Canada’s tax treaties, including the *Canada-US Tax Convention*, generally reserves Canada’s right to impose withholding tax on royalty payments to non-residents who for tax purposes are resident in the treaty partner state, but often reduces the rate to a maximum of ten per cent⁸⁷ and, like the ITA, exempts royalties earned by the non-resident through a PE in Canada. The definition of “royalty” varies from treaty to treaty, but generally includes any payment for the use of, or right to use, the same forms of intellectual property as those identified in paragraph 212(1)(d) of the ITA. The term also includes know-how, again defined similarly to the ITA, but only in terms of information or experience, not usually services, as noted previously. Importantly, in a number of Canada’s treaties, including that with the United States, payments for the use of software are exempt from withholding tax altogether, as are payments for know-how.⁸⁸

As we saw earlier, the CRA has indicated that it will follow the Characterization Report for purposes of classifying e-commerce transactions that are not excluded from taxation by the terms of a particular treaty. Of the twenty-eight categories of transactions considered in the report, the great majority result in the creation of business profits under article 7, rather than royalties. One of the most perplexing issues in a non-treaty context — whether payments for licenses for use of copy-

⁸⁴ Unlike those covered by Regulation 105 as discussed earlier.

⁸⁵ In a GST/HST context, the CRA views the provision of banner ads as a service. See Appendix II “Advertising.”

⁸⁶ See *Ogden Palladium Services (Canada) Inc. v. R.*, 2001 D.T.C. 345 (T.C.C. [General Procedure]) at paras. 25–31.

⁸⁷ Treaties often specify that the ten per cent maximum only applies to the “beneficial owner” of the property in question. The term is undefined. For interpretation in Canadian courts, see *Prévost Car Inc. v. R.*, 2008 TCC 231.

⁸⁸ See for example Canada-US Tax Convention, article 12(3)(b).

right, including software and other digital goods and information, should be considered as income from business or royalties — is dealt with by way of the following principle:

Where the essential consideration is for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, data or services), and the use of copyright is limited to such rights as are required to enable downloading, storage and operation on the customer's computer, network or other storage, performance or display device, such use of copyright should be disregarded in the analysis of the character of the payment for purposes of applying the definition of "royalties."

This is the case for transactions that permit the customer . . . to electronically download digital products (such as software, images, sounds or text) for that customer's own use or enjoyment. In these transactions, the payment is made to acquire data transmitted in the form of a digital signal for the acquirer's own use or enjoyment. This constitutes the *essential consideration* for the payment, which therefore does not constitute royalties but falls within Article 7.⁸⁹ [emphasis added]

The result is that royalties involving copyright will only arise in situations where purchases occur in order to exploit the copyright itself, such as payments to acquire digital photos for display in a book or content to be incorporated in a web site.

V. VALUE-ADDED TAX: GST/HST (PART IX, ETA)

To date, six provinces⁹⁰ (known as "participating provinces") have opted to harmonize their provincial sales taxes with GST, the resulting single tax being known as the Harmonized Sales Tax ("HST"), ranging from twelve to fifteen per cent inclusive of the federal component of five per cent. The remaining provinces, except Alberta, continue to impose an independent sales tax which, although not discussed further in this paper, may impose requirements on non-resident suppliers additional to those related to GST.⁹¹ In the remaining sections we will discuss registration of non-resident suppliers for GST/HST purposes, characterization of transactions, and how place of supply is determined in an e-commerce context.

(a) Registration of Non-Resident Suppliers

Anyone making a "supply" in the course of carrying on business in Canada is required to register for purposes of collecting and remitting GST/HST.⁹² A "sup-

⁸⁹ Characterization Report, *supra* note 14 at para. 16.

⁹⁰ Nova Scotia, New Brunswick, Newfoundland and Labrador, British Columbia, and Ontario: ETA, Schedule VIII.

⁹¹ None of the territories impose sales tax or participates in HST.

⁹² ETA, s. 240(1). The registration requirement is literally for anyone making a "supply in Canada in the course of commercial activity." "Commercial activity" is defined in s. 123(1) as including carrying on "business," which in turn is defined in s. 123(1) as including "a profession, calling, trade, manufacture or undertaking of any kind

ply” means “the provision of property or a service in any manner.”⁹³ We will consider the meaning of “property” and “service” below in our discussion of characterization. As under the ITA, non-residents are considered as carrying on business in Canada if they have a “permanent establishment” in Canada, which the ETA defines⁹⁴ by way of reference to various sections of the Income Tax Regulations where the term has a meaning very similar to that in the OECD Model Convention which we discussed previously. For GST/HST purposes, non-residents can also be considered as carrying on business in Canada even though they do not have a permanent establishment in the country. Subsection 240(4) of the ETA indicates that non-residents who, even by means of advertising directed at the Canadian market, solicit orders or offer to supply *tangible* property that is subsequently sent to a recipient at a Canadian address are deemed to carry on business in Canada for the purpose of the registration requirement. The test is markedly similar to that already considered under the ITA, again establishing a low threshold for creating nexus. However, the CRA’s administrative position is that isolated transactions, either in a conventional or e-commerce business context, may be insufficient to be considered as carrying on business in Canada. The agency instead considers multiple factors whose relevance and weight depend on the circumstances of each case.⁹⁵ In general, a non-resident e-commerce provider must have a “significant presence in Canada” in order to be considered as carrying on business in the country and thus subject to the registration requirement.⁹⁶ This is perhaps best illustrated by way of the following example of an e-commerce provider the CRA considers as *not* carrying on business in Canada:

A non-resident corporation supplies downloadable audio files by way of sale. The non-resident has a Web site hosted on its own server located at its main office in the United States, and advertises its Web site on the Internet. The advertisements are directed to the Canadian market. The Web site and server are fully interactive: the Canadian customer may view product listings of music and other advertising, place orders (including payment for audio files selected), and download a copy of the purchased audio files without any contact with the non-resident’s personnel. The place of contract is in Canada. The customer pays by credit card and an independent ISP located in Canada processes payments for the non-resident. Once the audio files are received by the customer, they may be used in Canada. All customer service and after-sales support is provided by means of telephone or e-mail communication by the non-resident’s personnel located in its main office in the United States.⁹⁷

It will be evident that the CRA’s interpretation of “carrying on business in

whatever.” There are exceptions to the registration requirement, including small suppliers with annual revenues under \$30,000: s. 240(1), 148(1).

⁹³ *Ibid* s. 123(1) “Supply.”

⁹⁴ *Ibid* s. 132.1(2).

⁹⁵ Interpretation Bulletin B-090, “GST/HST and Electronic Commerce” (July 2002) at 29-30.

⁹⁶ *Ibid* at 30.

⁹⁷ *Ibid*.

Canada” for GST/HST purposes is quite similar to its guidance in the E-commerce TI for income tax purposes in a treaty context.⁹⁸

(b) Characterization of Transactions for GST/HST Purposes

As noted earlier, a supply consists of the provision of either property or a service. Determining whether a particular transaction involves provision of property or a service is critical for purposes of GST/HST, since it “affects the place where a supply is considered to be made, the tax rate that applies to a supply, the manner in which tax is collected, and the timing of liability for tax in respect of a supply.”⁹⁹ It can also affect whether a particular good or service is considered exempt from GST/HST altogether. “Property” in the ETA means “any property, whether real or personal, movable or immovable, tangible or intangible.”¹⁰⁰ “Service” is defined as “anything other than” property or money.¹⁰¹

In an e-commerce context, then, the key distinction is typically whether a transaction involves the supply of *intangible* property or a service. Not surprisingly, e-commerce again blurs the lines between categories, so interpretation is required. In the technical information bulletin “GST/HST and Electronic Commerce” the CRA has set out its approach to characterization in a manner clearly heavily dependent on the OECD Characterization Report already discussed, even though the latter Report discusses only income — not value-added-tax. The following table summarizes factors viewed as indicative of the supply of intangible property or a service in respect to transactions conducted over the internet:¹⁰²

Factors Indicating Supply of Intangible Property	Factors Indicating Supply of a Service
<ul style="list-style-type: none"> • Right in or to use product for personal or commercial purposes is provided: <ul style="list-style-type: none"> — intellectual property or right to its use (e.g., a copyright) — rights of a temporary nature (e.g., a right to view, access or use a product while on-line) • Product already created/developed or in existence 	<ul style="list-style-type: none"> • No provision of rights, or rights, if provided, are incidental to the supply • Involves specific work performed for a specific customer • Human involvement in making the supply

⁹⁸ The distinction between treaty and non-treaty contexts, vital in respect to income tax, is not relevant for purposes of GST/HST; value-added taxes are not typically within the scope of bi-lateral tax conventions.

⁹⁹ “GST/HST and Electronic Commerce,” *supra* note 95 at 2.

¹⁰⁰ ETA, s. 123(1), “property.”

¹⁰¹ *Ibid.*, “service.”

¹⁰² “GST/HST and Electronic Commerce,” *supra* note 95 at 4.

Factors Indicating Supply of Intangible Property	Factors Indicating Supply of a Service
<ul style="list-style-type: none"> • Product created or developed for specific customer, with supplier retaining ownership • Right to make copy of digitized product 	

Using these principles, the CRA goes on to characterize nineteen categories of transactions, using scenarios virtually identical to those in the Characterization Report; for a summary see Appendix II. A key element of the approach again lies in emphasizing the fundamental purpose of a transaction for characterization purposes, ignoring elements that are only incidental. Thus provision of access to a trouble-shooting database, for example, though it may involve some interaction with support technicians, is classified as provision of intangible property.

The approach also emphasizes the provision of rights in characterizing transactions. Hence access to an interactive web site, though it might be viewed as provision of an automated service, is considered instead as the supply of intangible property, the property in question being the *right* of access, which is a chose in action and included in the ETA's definition of property. We note that this approach, which in our view is sound, is contrary to that taken by the court in *Blais*, noted earlier, where the provision of access to television programming was considered provision of a service, albeit in an income tax context. It also appears to be contrary to the Federal Court of Appeal's ruling in *Dawn's Place*, also noted above, which characterized the provision of a licence to view web site content as "the supply of access to the . . . website," by which the Court presumably meant provision of a service. The cases demonstrate the difficulty of obtaining certainty in characterization of e-commerce transactions in the absence of CRA guidance backed by judicial decisions.¹⁰³

(c) Place of Supply

Place of supply determines the type and therefore rate of value-added tax applicable in Canada for a given transaction. If a supply is considered as having been made outside Canada, it will generally not be subject to GST or HST.¹⁰⁴ If it is

¹⁰³ In our view the cases also illustrate the dangers of courts providing characterizations of e-commerce transactions as mere alternatives to those actually in dispute, without a full consideration of the ramifications. In *Blais*, *supra* note 71, it was sufficient for the court to have found that the payment did not qualify as a royalty since it lacked the element of contingency. It was unnecessary to further characterize the transaction for purposes of the decision. Similarly, in *Dawn's Place*, *supra* note 75, the court only needed to decide that the element of copyright was incidental to the purpose of the transaction to determine that the supply was not captured by the provision in question. In choosing to characterize the transaction alternatively as provision of a service, the court failed to consider other possibilities, including that the supply was one of intangible personal property, i.e. a right to view the web site's content.

¹⁰⁴ ETA, s. 165(1).

made in Canada and within a participating province, HST will be applicable, whereas if it is made in a province that is not a participating province, only GST will apply.¹⁰⁵ The process of determining place of supply therefore involves two steps: first, determining whether supply has been made in Canada, and if so, second, whether it has been made in a participating province.¹⁰⁶ The actual rules are quite detailed so a full discussion is impossible within the scope of this paper. What follows, then, is only a summary of the principles involved.

(i) Supply in Canada

It should be noted first that supplies made by non-residents are considered to take place outside Canada unless the non-resident is viewed as “carrying on business” in Canada.¹⁰⁷ Therefore, unless a non-resident supplier meets the “substantial business” threshold of the test for “carrying on business in Canada” discussed above, any supplies it makes in Canada will be deemed as having been made outside the country even though it meets the following requirements. For intangible property, supply is generally considered as having taken place in Canada where the intangible property may (i.e., is allowed to) be used in whole or in part within the country.¹⁰⁸ Whether the property is allowed to be used in Canada is determined by way of reference to explicit restrictions within any conditions of use contained in the sales agreement governing the transaction or those mentioned on the web site through which the transaction is conducted.¹⁰⁹ For services, supply is considered to be made in Canada when the service is “performed” within the country.¹¹⁰ However, the CRA’s administrative position is that services can be provided in Canada even when the work is performed remotely, provided it involves working on equipment located in Canada.¹¹¹

(ii) Supply in a Participating Province

The rules for determining whether a supply of intangible property has been made in a participating province were recently modified.¹¹² Three scenarios are

¹⁰⁵ ETA, s. 165(2). As noted earlier, in some non-participating provinces sales tax may still be applicable.

¹⁰⁶ Interpretation Bulletin B-103, “Harmonized Sales Tax — Place of supply rules for determining whether a supply is made in a province” (June 2010). The bulletin reflects changes anticipated by Ontario and British Columbia becoming participating provinces effective July 1, 2010.

¹⁰⁷ ETA, s. 143(1)(a).

¹⁰⁸ ETA, s. 142(1)(c)(i).

¹⁰⁹ “GST/HST and Electronic Commerce,” *supra* note 95 at 17. For example, a contractual provision limiting use of software to corporate headquarters of the purchaser, which are located in a Canadian city.

¹¹⁰ ETA, s. 142(1)(g).

¹¹¹ “GST/HST and Electronic Commerce,” *supra* note 95 at 18.

¹¹² Many of the rules governing place of supply in a province contained in Schedule IX of the ETA have been superseded by Part I Place of Supply in the *New Value-added Tax System Regulations* (SOR/2010-117) (in force since 31 May 2010, under the ETA).

generally applicable in the case of non-resident e-commerce providers. First, if the majority of rights associated with the supply of intangible property are restricted to use in non-participating provinces, only GST will be applicable. Second, if the majority of those rights are restricted to use in a participating province, HST will be applicable at that province's rate. Third, if use of the majority of rights is unspecified, the address of the recipient will determine the province of supply.¹¹³ For services, the province of supply is also generally governed by the recipient's address. Again, computer-related services delivered remotely by means of telecommunications are considered as supplied in the province in which the person acquiring the service is located.¹¹⁴

CONCLUSION

It is trite at this point to recognize that the internet has been among the most disruptive technologies ever introduced, revolutionizing the way business is conducted globally and creating opportunities scarcely imaginable in its absence. It is perhaps somewhat less obvious to observe that it has also created significant challenges in the area of international taxation, some of which we have noted in this paper. The wisdom of the international community's decision to "pour new wine into old wineskins" in applying existing principles of taxation to entirely new categories of commerce remains to be seen. Still, by facilitating important discussion within the international tax community in respect to the taxation of e-commerce, the OECD has enabled consensus to be reached in many areas. For non-residents conducting e-commerce targeting the Canadian market, clarity has significantly increased because of the willingness of the CRA and Canadian courts to adopt much of the OECD's policy groundwork in interpreting Canada's domestic tax legislation and tax treaties. Nevertheless, this paper has demonstrated that in some situations it will still be prudent for the non-resident e-commerce provider to advert not only to tax advice, but advance rulings from the CRA in order to achieve greater certainty.

¹¹³ *Ibid.* See also "Harmonized Sales Tax — Place of supply rules," *supra* note 105.

¹¹⁴ CCH Commentary on ETA s. 144.1, "Supply Made in a Participating Province" at para. 3577.

**Appendix I — Summary, OECD Characterization of
E-Commerce Transactions for Income Tax Purposes¹¹⁵**

Category		Definition	Characterization
1	Electronic order processing of tangible products	The customer selects an item from an online catalogue of tangible goods and orders the item electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalogue. The product is physically delivered to the customer by a common carrier.	Business Profits
2	Electronic ordering and downloading of digital products	The customer selects an item from an online catalogue of software or other digital products and orders the product electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalogue. The digital product is downloaded onto the customer's hard disk or other non-temporary media.	Business Profits
3	Electronic ordering and downloading of digital products for purposes of commercial exploitation of the copyright	The customer selects an item from an online catalogue of software or other digital products and orders the product electronically directly from a commercial provider. There is no separate charge to the customer for using the online catalogue. The digital product is downloaded into the customer's hard disk or other non-temporary media. The customer acquires the right to commercially exploit the copyright in the digital product (e.g. a book publisher acquires a copyrighted picture to be included on the cover of a book that it is producing).	Royalty

¹¹⁵ Source: Characterization Report, *supra* note 14.

Category		Definition	Characterization
4	Updates and add-ons	The provider of software or other digital product agrees to provide the customer with updates and add-ons to the digital product. There is no agreement to produce updates or add-ons specifically for a given customer.	Business Profits
5	Limited duration software and other digital information licenses	The customer receives the right to use software or other digital products for a period of time that is less than the useful life of the product. The product is either downloaded electronically or delivered on a tangible medium such as a CD. All copies of the digital product are deleted or become unusable upon termination of the license.	Business Profits
6	Single-use software or other digital product	The customer receives the right to use software or other digital products one time. The product may be either downloaded or used remotely (e.g. use of software stored on a remote server). The customer does not receive the right to make copies of the digital product other than as required to use the digital product for its intended use.	Business Profits
7	Application Hosting — Separate License	A user has a perpetual license to use a software product. The user enters into a contract with a host entity whereby the host entity loads the software copy on servers owned and operated by the host. The host provides technical support to protect against failures of the system. The user can access, execute and operate the software application remotely. The application is executed either at a customer's computer after it is downloaded into RAM or remotely on the host's server. This type of arrangement could apply, for example, for financial management, inventory control, human resource management or other enterprise resource management software applications.	Business Profits

Category	Definition	Characterization	
8	Application Hosting — Bundled Contract	For a single, bundled fee, the user enters into a contract whereby the provider, who is also the copyright owner, allows access to one or more software applications, hosts the software applications on a server owned and operated by the host, and provides technical support for the hardware and software. The user can access, execute and operate the software application remotely. The application is executed either at a customer’s computer after it is downloaded into RAM or remotely on the host’s server. The contract is renewable annually for an additional fee.	Business Profits
9	Application Service Provider (“ASP”)	The provider obtains a license to use a software application in the provider’s business of being an application service provider. The provider makes available to the customer access to a software application hosted on computer servers owned and operated by the provider. The software automates a particular back-office business function for the customer. For example, the software might automate sourcing, ordering, payment, and delivery of goods or services used in the customer’s business, such as office supplies or travel arrangements. The provider does not provide the goods or services. It merely provides the customer with the means to automate and manage its interaction with third-party providers of these goods and services. The customer has no right to copy the software or to use the software other than on the provider’s server, and does not have possession or control of a software copy.	Business Profits

Category		Definition	Characterization
10	ASP License Fees	In the example above, the ASP pays the provider of the software application a fee which is a percentage of the revenue collected from customers. The contract is for a one year term.	Business Profits
11	Web site hosting	The provider offers space on its server to host web sites. The provider obtains no rights in the copyrights created by the developer of the web site content. The owner of the copyrighted material on the site may remotely manipulate the site, including modifying the content on the site. The provider is compensated by a fee based on the passage of time.	Business Profits, with some exceptions depending on treaty wording
12	Software maintenance	Software maintenance contracts typically bundle software updates together with technical support. A single annual fee is charged for both updates and technical support. In most cases, the principal object of the contract is the software updates.	Business Profits (if software updates are the principal object of contract), with some exceptions depending on treaty wording
13	Data warehousing	The customer stores its computer data on computer servers owned and operated by the provider. The customer can access, upload, retrieve and manipulate data remotely. No software is licensed to the customer under this transaction. An example would be a retailer who stores its inventory records on the provider's hardware and persons on the customer's order desk remotely access this information to allow them to determine whether orders could be filled from current stock.	Business Profits

Category		Definition	Characterization
14	Customer support over a computer network	The provider provides the customer with online technical support, including installation advice and troubleshooting information. This support can take the form of online technical documentation, a trouble-shooting database, and communications (e.g. by e-mail) with human technicians.	Business Profits, with some exceptions depending on treaty wording
15	Data retrieval	The provider makes a repository of information available for customers to search and retrieve. The principal value to customers is the ability to search and extract a specific item of data from amongst a vast collection of widely available data.	Business Profits
16	Delivery of exclusive or other high-value data	As in the previous example, the provider makes a repository of information available to customers. In this case, however, the data is of greater value to the customer than the means of finding and retrieving it. The provider adds significant value in terms of content (e.g. by adding analysis of raw data) but the resulting product is not prepared for a specific customer and no obligation to keep its contents confidential is imposed on customers. Examples of such products might include special industry or investment reports. Such reports are either sent electronically to subscribers or are made available for purchase and download from an online catalogue or index.	Business Profits

Category		Definition	Characterization
17	Advertising	Advertisers pay to have their advertisements disseminated to users of a given web site. So-called “banner ads” are small graphic images embedded in a web page, which when clicked by the user will load the web page specified by the advertiser. Advertising rates are most commonly specified in terms of a cost per thousand “impressions” (number of times the ad is displayed to a user), though rates might also be based on the number of “click-throughs” (number of times the ad is clicked by a user).	Business Profits
18	Electronic access to professional advice (e.g. consultancy)	A consultant, lawyer, doctor or other professional service provider advises customers through email, video conferencing, or other remote means of communication.	Business Profits
19	Technical information	The customer is provided with undivulged technical information concerning a product or process (e.g. narrative description and diagrams of a secret manufacturing process).	Royalty
20	Information delivery	The provider electronically delivers data to subscribers periodically in accordance with their personal preferences. The principal value to customers is the convenience of receiving widely available information in a custom-packaged format tailored to their specific needs.	Business Profits
21	Access to an interactive web site	The provider makes available to subscribers a web site featuring digital content, including information, music, video, games, and activities (whether or not developed or owned by the provider). Subscribers pay a fixed periodic fee for access to the site. The principal value of the site to subscribers is interacting with the site while online as opposed to getting a product or services from the site.	Business Profits

Category		Definition	Characterization
22	Online shopping portals	A web site operator hosts electronic catalogues of multiple merchants on its computer servers. Users of the web site can select products from these catalogues and place orders online. The web site operator has no contractual relationship with shoppers. It merely transmits orders to the merchants, who are responsible for accepting and fulfilling orders. The merchants pay the web site operator a commission equal to a percentage of the orders placed through the site.	Business Profits
23	Online auctions	The provider displays many items for purchase by auction. The user purchases the items directly from the owner of the items, rather than from the enterprise operating the site. The vendor compensates the provider with a percentage of the sales price or a flat fee.	Business Profits
24	Sales referral programs	An online provider pays a sales commission to the operator of a web site that refers sales leads to the provider. The web site operator will list one or more of the provider's products on the operator's web site. If a user clicks on one of these products, the user will retrieve a web page from the provider's site from which the product can be purchased. When the link on the operator's web page is used, the provider can identify the source of the sales lead and will pay the operator a percentage commission if the user buys the product.	Business Profits
25	Content acquisition transactions	A web site operator pays various content providers for news stories, information, and other online content in order to attract users to the site. Alternatively, the web site operator might hire a content provider to create new content specifically for the web site.	Business profits if payment for creation of new content, royalties if payment for right to display copyrighted material

Category		Definition	Character- ization
26	Streamed (real time) web based broadcasting	The user accesses a content database of copyrighted audio and/or visual material. The broadcaster receives subscription or advertising revenues.	Business Profits
27	Carriage fees	A content provider pays a particular web site or network operator in order to have its content displayed by the web site or network operator.	Business Profits
28	Subscription to a web site allowing the downloading of digital products	The provider makes available to subscribers a web site featuring copyrighted digital content (e.g. music). Subscribers pay a fixed periodic fee for access to the site. Unlike category 21, the principal value of the site to subscribers is the possibility to download these digital products.	Article 7: Business Profits

Appendix II — Summary, CRA Characterization of E-Commerce Transactions for GST/HST Purposes¹¹⁶

Category		Definition	Characterization
1	Electronic ordering and downloading of digitized products	A customer selects an item from an on-line catalogue of software or other digitized products and orders it electronically directly from a commercial supplier. There is no separate charge to the customer for using the catalogue. The product is downloaded onto the customer's computer. For a separate fee, the customer will receive updates and add-ons to the product, which are also downloaded directly to the customer's computer.	Supply of intangible personal property
2	Limited duration software and other digitized information licences	A customer receives the right to use software or another digitized product for a period of time that is less than the useful life of the product. The product is downloaded to the customer's computer. Upon termination of the licence, all copies of the digitized product are deleted or become unusable.	Supply of intangible personal property
3	Subscription to a Web site that allows the downloading of digitized products	A supplier makes a Web site available to subscribers that features copyrighted digitized products (e.g., music). Subscribers pay a fixed periodic fee to access the site and to select and download digitized products.	Supply of intangible personal property
4	Software maintenance	A supplier and customer enter into a software maintenance contract, which typically bundles software updates with technical support. The customer is given the right to copy and use the product for personal or commercial purposes and is charged a single annual fee for the software updates and the technical support. The principal object of the contract is the software updates.	Supply of intangible personal property

¹¹⁶ Source: "GST/HST and Electronic Commerce," *supra* note 95.

Category		Definition	Characterization
5	Customer support over a computer network	A software supplier provides a customer with on-line technical support, including installation advice and trouble-shooting information. This support is in the form of on-line technical documentation, a trouble-shooting database, and, as a last resort, communication with a technician by e-mail.	Depends on dominant purpose of transaction
6	Application hosting — separate licence	A customer with a perpetual licence to use a software product enters into a contract with a host entity, whereby the host entity loads a copy of the software on servers owned and operated by the host and provides technical support to protect against system failures. The customer can access, execute and operate the software application remotely. The application is executed either at the customer's computer after it is downloaded, or remotely on the host's server. This type of arrangement could apply, for example, to financial management, inventory control, human resource management or other enterprise resource management software applications. The customer has no control over the equipment used by the host entity.	Supply of service
7	Application hosting — bundled contract	For a single fee, a user enters into a contract whereby a host entity, which is also the copyright holder, allows access to one or more software applications, hosts the applications on a server owned and operated by the host, and provides technical support for the hardware and software. The user can access, execute and operate the software application remotely. The contract is renewable annually for an additional fee. The principal object of the contract is the provision of software applications.	Supply of intangible personal property

Category		Definition	Characterization
8	Service provider	A supplier has a licence to use a software application in the course of its business. It hosts the software on a server that it owns, operates and maintains. The supplier enters into an agreement with a customer to manage a particular back-office function (e.g., the customer's payment processing), and provides the customer with access to the software application, enabling the customer to perform specific tasks when required (e.g., data entry, addition of tombstone data for new suppliers and clients). However, the supplier is responsible for the major aspects of the payment processing, such as cheque issuance and bank verification, and uses the software application to automate these tasks. The customer has no right to copy the software or use it other than for the specific functions assigned by the supplier, and at no time does the customer have possession or control of the software (since it resides on the supplier's server).	Supply of service
9	Web site hosting	An Internet Service Provider (ISP) hosts its customers' commercial Web sites on its servers. The ISP does not obtain any rights in the copyrighted material on the site. Customers can remotely manipulate the site, including modifying its content, but do not possess or have direct control of the server(s) used to host the site. The customer pays a fee based on the passage of time.	Supply of service

Category		Definition	Characterization
10	Data warehousing	A customer stores its computer data on servers owned and operated by a supplier. The customer can access, upload, retrieve and manipulate data remotely. No software is licensed, or rights transferred, to the customer in this transaction. The customer does not have control over or possession of any specific equipment used by the supplier in the data storage. For example, a retailer may store its inventory records on the supplier's hardware, and the retailer's employees may remotely access this information to allow them to determine whether orders can be filled from current stock.	Supply of service
11	Advertising	Companies pay a fee to Web site operators to place advertisements on their Web sites. Advertising rates may be determined in a number of ways, including the cost per thousand "impressions" (i.e., the number of times the advertisement is displayed to a user), or the number of "click-throughs" (i.e., the number of times the advertisement is clicked by a user). For example, "banner ads," which are small graphic images embedded in a Web page, allow a company's Web page to be loaded to a user's computer when clicked by the user.	Supply of service

Category		Definition	Characterization
12	On-line shopping portals	A Web site operator hosts electronic catalogues of various merchants on its servers. Shoppers can select products from these catalogues and place orders on-line. The Web site operator has no contractual relationship with the shoppers, and merely transmits orders to the merchants, who are responsible for accepting and filling them. The merchants pay the Web site operator a commission based on a percentage of the value of orders placed through the site.	Supply of service
13	On-line auctions	A Web site operator displays a vendor's items for purchase by auction. On-line shoppers purchase items directly from the owner of the items, rather than from the operator. The vendor compensates the Web site operator with a percentage of the sale price or a flat fee. The vendor and on-line shoppers have only the incidental use of the software to perform certain tasks in respect of the transactions (e.g., payment processing), but are not provided any rights to use the software.	Supply of service

Category		Definition	Characterization
14	Data retrieval	A supplier makes a vast repository of information available to customers for search and retrieval purposes. Customers pay a fee which enables them to access the data and to search and extract specific information from the repository. In some instances, the supplier adds significant value in terms of content (e.g., analysis of raw data), but the resulting product is not prepared for a specific customer and there is no obligation to keep the contents confidential. Such products might include special industry or investment reports, which are either sent electronically to subscribers, or are made available for purchase and download from an on-line catalogue or index.	Supply of intangible personal property
15	Access to an interactive Web site	A supplier makes a Web site featuring digitized content available to subscribers, including information, music, video, games, and activities, whether or not developed or owned by the supplier. The subscribers pay a fixed periodic fee for access to the site. The principal value of the site to subscribers is interacting with the site while on-line, as opposed to getting a product or services from the site.	Right to access content: supply of intangible personal property
		The supplier also charges companies a fee for placing their banner or pop-up ads on the site.	Banner ads: supply of service
16	Electronic access to professional advice (e.g., consulting)	A consultant, lawyer, doctor or other professional service provider advises clients through e-mail, video conferencing, or other remote means of communication.	Supply of service
17	Undisclosed technical information	A customer is provided with undisclosed technical information concerning a product or process (e.g., narrative description and diagrams of a secret manufacturing process).	If provided by way of licence: supply of intangible personal property

Category		Definition	Characterization
			If customer owns information, supply of service
18	Information delivery	A supplier delivers data electronically on a periodic basis to subscribers (e.g., news clippings or stock market quotations), in accordance with their personal preferences. The principal value to the customers is the convenience of receiving information in a customized format tailored to their specific needs.	Supply of intangible personal property
19	Content acquisition transactions	A Web site operator pays various content providers for news stories, information, and other on-line content to attract users to a site. Alternatively, the Web site operator might hire a content provider to create new content specifically for the Web site.	Determined by owner of content