



September 8, 2023

The Honourable Chrystia Freeland  
Deputy Prime Minister and Minister of Finance  
Department of Finance Canada  
90 Elgin Street  
Ottawa, Ontario K1A 0G5

Dear Minister Freeland,

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship. The startups in Engine's network provide novel, innovative solutions to global problems. While many of them are today's small businesses, with time, some will grow to be global companies. But discriminatory tax frameworks, like Canada's soon-to-be imposed digital services tax, will threaten startup success, causing a rise in costs that stands to harm global innovation. And while many of the U.S.' closest allies have agreed to continue postponing new DSTs, our closest ally has not.

Startups have limited resources, particularly in their initial stages. The average seed stage startup has just \$55,000 a month to cover all operating expenses, from payroll, to rent, to product development and more.<sup>1</sup> These funds are quickly depleted, leaving many startups dependent on free or low cost tools provided by large technology companies. The Canadian DST threatens a startup's bottom line, is a discriminatory tax directed largely at American companies, and may hamper the longstanding trading relationship between the U.S. and Canada and the important relationship Canada has with the U.S. startup ecosystem.

### **Canada's discriminatory digital services tax will impact the startup ecosystem**

A great deal has been said over the last several years about the proliferation of digital services taxes. These taxes, including that of Canada, are discriminatory, generally targeting large, American technology companies, who are leaders in global innovation. Moreover, the Canadian DST taxes revenue rather than profit, in contravention of international taxation norms, and can lead to double taxation for some companies.<sup>2</sup>

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<sup>1</sup> *The State of the Startup Ecosystem*, Engine (April 2021), <https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/60819983b7f8be1a2a99972d/1619106194054/The+State+of+the+Startup+Ecosystem.pdf>.

<sup>2</sup> *Understanding Digital Services Taxes and the OECD*, Bloomberg Tax (Jan. 4, 2023), <https://pro.bloombergtax.com/brief/understanding-digital-services-taxes-the-oecd/>.

Taxing revenue, in particular, poses a significant threat to the innovation ecosystem, because companies with slim profits, or those operating in the red, could be subject to the DST, but have little recourse to pay the levy. These companies will likely face little choice but to pass the cost of the tax onto the consumer. But the tax will likely be passed on by all companies that will be subject to the DST. It is naive to operate under the guise that this tax is a way to force large U.S. companies to pay their “fair share,” and will therefore only burden those select large companies. Not only is this largely false, with studies finding that “large digital companies often paid higher effective tax rates than their peers in more traditional industries,”<sup>3</sup> DSTs are already being passed down to customers. In the United Kingdom, Turkey, and Austria, Google announced that it would pass down the cost of the DST to advertisers.<sup>4</sup> Amazon similarly announced that it too would pass down the cost of the tax—to sellers on its platform.<sup>5</sup> And Apple implemented developer fees in Italy, France, the UK and Turkey.<sup>6</sup> It is perfectly reasonable to expect the same scenario following the implementation of Canada’s DST—large companies passing on the cost of the DST. Doing so could be hugely detrimental to Canada’s startup ecosystem, with small, new companies facing increased costs to do business. Given that the Canadian government has recently taken great efforts to bolster their startup ecosystem, implementing the DST and its likely resulting harms, runs counter to supporting domestic startup innovation.<sup>7</sup>

### **Startups rely on low cost digital tools to launch and grow**

The low or no cost tools affected by the Canadian DST—online marketplace services, online ad services, social media, and the collection of user data—are extremely important to startups operating across the globe. A report issued by Engine and the Computer & Communications Industry Association on the tools the U.S. startup ecosystem uses to compete with large companies, underscores this importance—“Startups rely on dozens of services and tools—many times for free or at low-cost—to perform those basic business functions. . . These tools help startups compete and have reduced the cost of launching a startup by at least three orders of magnitude in just the past

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<sup>3</sup> Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, Information Technology and Innovation Foundation (May 13, 2019),

<https://itif.org/publications/2019/05/13/digital-services-taxes-bad-idea-whose-time-should-never-come/>.

<sup>4</sup> Mark Sweney, *Google’s Advertisers will Take Hit from UK Digital Services Tax* (Sept. 1, 2020),

<https://www.theguardian.com/media/2020/sep/01/googles-advertisers-will-take-the-hit-from-uk-digital-service-tax>;

Isobel Asher Hamilton, *Apple, Amazon, and Google hike their developer and ad client fees to pass on the costs of paying new digital taxes in Europe* (Sept. 2, 2020),

<https://www.businessinsider.com/apple-amazon-google-pass-costs-digital-services-taxes-2020-9>.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> See, e.g., Elsa Allmendinger, *As startups struggle with talent, Canada is trying to attract U.S. bound high skilled immigrants*, Engine (July 28, 2023),

<https://engineadvocacyfoundation.medium.com/as-startups-struggle-with-talent-canada-is-trying-to-attract-u-s-bound-high-skilled-immigrants-99f2fe1e7dc8>; and, Valentin Petkantchin, *Canada’s Proposed Digital Services Tax: A Poor Solution in Search of a Problem* (June 13, 2023),

<https://www.iedm.org/canadas-proposed-digital-services-tax-a-poor-solution-in-search-of-a-problem/>.

two decades.”<sup>8</sup> While the study focused on U.S.-based startups, the conclusions it draws about the role the services provided by large technology companies play in the life cycle of a startup are likely parallel to the experience of Canadian startups. The study found that “100% of surveyed startups utilize three or more tools,” and 98% used 5 or more.<sup>9</sup> These tools covered many needs for startups, from web hosting, to marketing and digital advertising, to platforms and marketplaces, to cloud computing services.<sup>10</sup> Without these tools, cash-strapped startups struggle to grow. Launching a company used to take a significant investment, out of reach of most would-be founders.<sup>11</sup> But, “Innovations in the infrastructure to build companies has brought the cost of starting a company to below \$5,000, down from \$5 million in 2000,” with one Engine network member noting, “that the costs of launching a startup have come down from the tens of thousands when he started his first company to just a few thousand when he started his latest company.”<sup>12</sup>

These services, however, will likely cost more if the Canadian DST goes into effect and if other countries follow suit (or, if the global tax deal is not implemented). As noted earlier, in countries with DSTs already implemented, large technology companies responded with price increases—as Engine shared in its Tools to Compete report, “the ecosystem is connected through symbiotic relationships—startups are customers of the taxed firms, who have historically responded to such taxes by increasing prices for their services.” If, and as, these discriminatory taxes proliferate across the globe, large tech companies will continue to pass down the cost of the taxes—possibly through larger and larger price increases—that will hobble startups across the globe—including in the U.S. and in Canada. Even for platforms not directly affected by the DST, they could be tangentially impacted because they have a business relationship with or rely on infrastructure from an impacted company, and therefore cost increases could be distributed across broader business lines, covering even more services on which startups rely. And even if they aren't, as previously stated, 98 percent of startups are using five or more digital tools—it is unlikely that they'll be able to escape the impact of the tax by switching to an alternative. We know that even seed stage startups have very limited capital to operate, any increase in costs for needed services could hinder growth for an affected startup.

### **Canada is an important market for U.S. startups.**

Canada is the United States' top trading partner, including being a top partner for digital trade, accounting for tens of billions in two-way trade in Information and Communications Technology

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<sup>8</sup> *Tools to Compete*, Engine and the Computer & Communications Industry Association (Jan. 2023), [https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/63d2b8d5bec96f502264fd1f/1674754266044/FINAL\\_CCIA-Engine\\_Tools-To-Compete.pdf](https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/63d2b8d5bec96f502264fd1f/1674754266044/FINAL_CCIA-Engine_Tools-To-Compete.pdf); The Engine Team, *Engine and CCLA Release Tools to Compete Report*, Engine, (Jan. 26, 2023), <https://www.engine.is/news/category/engine-and-ccia-release-tools-to-competereport>.

<sup>9</sup> *Tools to Compete*, *supra* note 8.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*



taxes, that could leave less money available for supporting new companies. These factors, combined with the threat of a possible trade war between close allies because of a tax that will likely not generate “enough money to matter,”<sup>18</sup> should be of significant concern to the Canadian people.

### **Pursuing the proposed Digital Services Tax will lead to destructive trade conflict.**

The proposed tax is against the spirit of the U.S.-Canada trading relationship, and likely in violation of USMCA and our tax treaties.<sup>19</sup> The U.S. initiated investigations against other jurisdictions that pursued digital services taxes and found them to be “unreasonable or discriminatory” taxes that “burdens or restricts U.S. commerce,” meriting retaliatory duties.<sup>20</sup> (The U.S. suspended those duties to reach and then as part of the global tax framework.)<sup>21</sup> Should Canada proceed with this tax, it is likely that the U.S. will retaliate along similar lines, as the U.S. Trade Representative<sup>22</sup> and the U.S. Ambassador to Canada<sup>23</sup> have earlier warned.

Trade conflict will be destructive for both the U.S. and Canadian interests. U.S. and Canadian consumers will experience higher prices, while U.S. and Canadian businesses will encounter higher costs and diminished market access. U.S. startups will be increasingly burdened by heightened uncertainty, additional costs, and diminished competitiveness, as with past trade conflicts.<sup>24</sup> Finally, USMCA will need to be reviewed in 2026, and Canada should avoid compounding potential headwinds in the U.S. review process that could threaten the agreement. These negative outcomes can be avoided if Canada abandons its ill-conceived DST and recommits to working within the global tax negotiation framework.

### **Conclusion**

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<sup>18</sup> Rebecca Christie, *Taxing Tech*, *International Monetary Fund* (Spring 2021), <https://www.imf.org/external/pubs/ft/fandd/2021/03/taxing-big-tech-and-the-future-of-digital-services-tax-christie.htm>.

<sup>19</sup> See, e.g., *Wyden-Crapo Letter to USTR on USMCA Enforcement*, U.S. Sen. Cmte on Finance (Jan 26, 2023), <https://www.finance.senate.gov/imo/media/doc/2023.01.26%20Wyden-Crapo%20Letter%20to%20USTR%20on%20USMCA%20Enforcement.pdf>; Gary Hufbauer & Megan Hogan, *Canada's digital services tax threatens global effort to curb tax havens*, Peterson Institute for International Economics (Dec. 15, 2021), <https://www.piie.com/blogs/trade-and-investment-policy-watch/canadas-digital-services-tax-threatens-global-effort-curb-tax-havens>.

<sup>20</sup> *Notice of Action in Section 301 Investigation*, 86 Fed. Reg. 30350-67 (June 7, 2021),

[https://ustr.gov/sites/default/files/enforcement/301Investigations/Italy\\_DST\\_Action.pdf](https://ustr.gov/sites/default/files/enforcement/301Investigations/Italy_DST_Action.pdf).

<sup>21</sup> *Termination of Actions in the Section 301 Digital Services Tax Investigations*, 86 Fed. Reg. 64590-91 (Nov. 18, 2021),

<https://ustr.gov/sites/default/files/enforcement/301Investigations/86%20FR%2064590.pdf>.

<sup>22</sup> *Comments of the Office of the United States Trade Representative (USTR) on Canada's proposed Digital Services Tax Act*, Office of the United States Trade Representative (Feb. 22, 2022),

<https://ustr.gov/sites/default/files/USTR%20Cmts%20on%20Canadian%20DST%20Proposal.2022.02.22.pdf>.

<sup>23</sup> Anja Karadeglija, *'No choice' but to retaliate against Canadian digital tax, U.S. ambassador says*, *National Post* (July 21, 2023), <https://nationalpost.com/news/politics/no-choice-but-to-retaliate-against-canadian-digital-tax-u-s-ambassador-says>.

<sup>24</sup> See generally, *Trade*, *Engine* (Jan. 2023),

<https://static1.squarespace.com/static/571681753e44d835a440c8b5/t/63dd2ca839c9b87649890fdb/1675439784763/St+artup+Policy+Agenda+2023+Trade.pdf>.

It is clear that the Canadian DST will have a negative impact on the global startup ecosystem and global innovation. Because of this, Canada should continue to refrain from imposing the levy, instead pursuing engagement with international partners to implement a global tax framework.

Sincerely,

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