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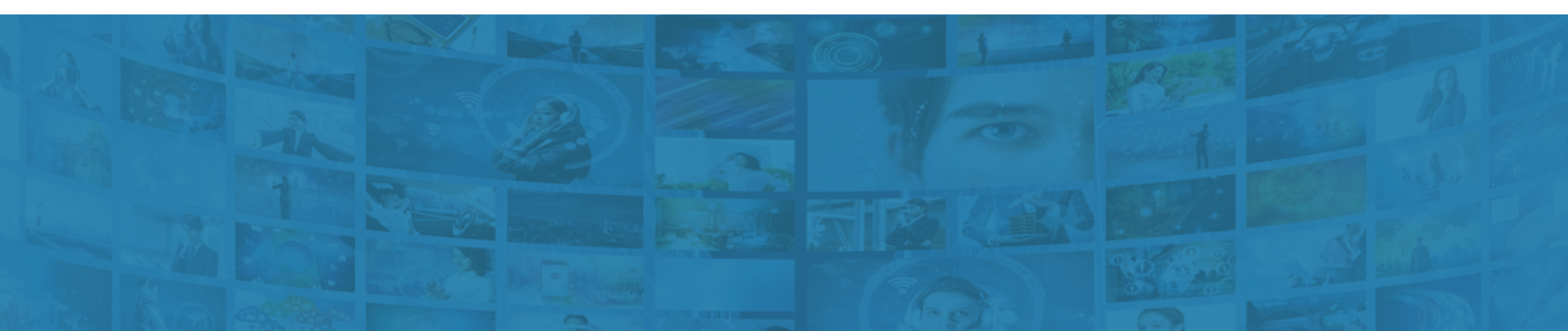
Report of the Standing Senate Committee
on Transport and Communications

The Honourable David Tkachuk, Chair
The Honourable Patricia Bovey, Deputy Chair
The Honourable Dennis Dawson, Deputy Chair

AUGUST 2018

THE TAX DEDUCTIBILITY OF FOREIGN INTERNET ADVERTISING IN CANADA



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THE COMMITTEE

MEMBERSHIP

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Deputy Chair

Dennis Dawson
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Denise Batters, Yvonne Boyer, Elaine McCoy, Victor Oh, Nancy Greene Raine and Josée Verner, P.C.

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Senate Committees Directorate:

Victor Senna, Clerk of the Committee
Lyne Héroux, Administrative Assistant

ORDER
OF REFERENCE

Extract from the *Journals of the Senate*, Tuesday, October 31, 2017:

The Honourable Senator Dawson moved, seconded by the Honourable Senator Joyal, P.C.:

That the Standing Senate Committee on Transport and Communications be authorized to examine and report on emerging issues related to its mandate under rule 12-7(6);

That it be further authorized to examine and report on the elements related to its mandate found in the ministerial mandate letters of the Minister of Transport, the Minister of Infrastructure and Communities and the Minister of Canadian Heritage;

That the papers and evidence received and taken and work already accomplished by the committee on this subject since the beginning of the First Session of the Forty-second Parliament, as authorized by the Senate on January 28, 2016, be referred back to the committee; and

That the committee submit its final report no later than June 30, 2018.

The question being put on the motion, it was adopted.

ATTEST

Nicole Proulx
Clerk of the Senate

Extract from the *Journals of the Senate*, Monday, June 11, 2018:

The Honourable Senator Tkachuk moved, seconded by the Honourable Senator MacDonald:

That, notwithstanding the order of the Senate adopted on Tuesday, October 31, 2017, the date for the final report of the Standing Senate Committee on Transport and Communications in relation to its study on emerging issues related to its mandate and ministerial mandate letters be extended from June 30, 2018 to June 28, 2019.

The question being put on the motion, it was adopted.

ATTEST

Richard Denis
Clerk of the Senate

INTRODUCTION

Under its general order of reference to study emerging issues related to its mandate, the Standing Senate Committee on Transport and Communications (the committee) decided to study the tax deductibility of foreign Internet advertising. The issue was brought to the committee's attention through a number of recent publications, including those from the FRIENDS of Canadian Broadcasting and the Public Policy Forum.[1] This report presents the committee's findings regarding whether or not advertising purchased on foreign websites that act as broadcast and newspaper services should continue to be deemed a deductible expense under the *Income Tax Act* (ITA).[2]

The committee held five meetings in May and June 2018, during which it heard from the FRIENDS of Canadian Broadcasting, as well as witnesses from the federal government, the news media sector and academia.

The first section of this report provides background information summarizing the arguments used by critics of this existing tax deduction, as well as situating the issue of a tax deduction for foreign Internet advertising within the broader challenges facing local news media in Canada. The second section provides the committee's analysis of these arguments, along with the committee's own recommendation regarding how the federal government should address the tax deductibility of foreign Internet advertising.

1 Peter Mill and David Keeble, [Close the Loophole! The Deductibility of Foreign Internet Advertising,] FRIENDS of Canadian Broadcasting, March 2018; and Public Policy Forum, [The Shattered Mirror: News, Democracy and Trust in the Digital Age], January 2017.

2 *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), ss 19-19.1.

BACKGROUND

The global media landscape has experienced dramatic change over the last 10 to 15 years with the rise of digital media offerings that have allowed newspapers, television, radio and video to exist on a myriad of personal devices. This shift in technology has also led to changes in how and where media is consumed.

Newspaper, television and radio media must now compete with social networks, search engines and streaming services for people's attention and, perhaps more importantly, the advertising dollars that come with this attention.

In the normal course of their operations, businesses can deduct certain expenses, which reduces the part of their income that would be subject to income tax. For advertising expenses, section 19 of the ITA includes a number of restrictions limiting the tax deductibility of certain expenses related to advertising to the Canadian market.[3] More specifically, there are two restrictions:

1. Only costs related to advertising on Canadian television and radio broadcast stations are deductible for broadcast advertising;

2. For print media, advertising costs are deductible at a rate of 50% for periodicals with less than 80% original editorial content, and at a rate of 100% for periodicals with more than 80% original editorial content. The ITA defines "original editorial content" as content created by a Canadian citizen or a permanent resident that is created for the Canadian market and that is not contained in other editions published in foreign markets.

3 A full excerpt of the provision related to advertisements directed at the Canadian market is included in an appendix to this report.

Since no such restrictions exist for advertising that Canadian businesses purchase from foreign websites, those advertising expenses are fully tax deductible. The different tax treatment of advertising purchased from foreign websites stems in part from a tax decision rendered in 1996, which continues to apply today. The decision centred upon the definition used for "periodical" and "newspaper" in the *Foreign Publishers Advertising Services Act*, which is also the definition used in the ITA. In both acts, the definitions of "periodical" and "newspaper" refer to print products, suggesting that a digital equivalent is not similarly restricted, and is therefore fully tax deductible.

It has been suggested by witnesses that this decision may have been accurate in 1996, when the Internet was still in its infancy, but does not reflect the dominant place Internet advertising plays in media today and the broad array of broadcast and news media available online. Witnesses told the committee that foreign Internet advertisers, including Facebook and Google,[4] account for approximately 70% to 80% of Canadian online advertising revenues, and that their service offerings play a decisive role in both competing against and providing ad services for traditional broadcast and print media outlets.[5]

4 The committee invited witnesses from these companies to appear. However they declined to participate either in person or through the submission of written briefs.

5 For example, see: Standing Senate Committee on Transport and Communications (TRCM), *Evidence*, 1st Session, 42nd Parliament, 30 May 2018 (Matthew Holmes, President and Chief Executive Officer, Magazines Canada); and TRCM *Evidence*, 1st Session 42nd Parliament, 22 May 2018 (Daniel Bernhard, Executive Director and Spokesperson, FRIENDS of Canadian Broadcasting) (Unless otherwise stated, all mention of TRCM, *Evidence* will have been taken from the 1st Session of the 42nd Parliament). Total Canadian Internet ad revenues were $5.5 billion in 2016 and estimated at $6.2 billion in 2017, as per Mill and Keeble (2018), p. 8.

In that context, witnesses, such as the FRIENDS of Canadian Broadcasting, have recommended that section 19 of the ITA be extended to Internet advertising. The FRIENDS of Canadian Broadcasting offered three different ways to implement this recommendation:

- Update the definition of broadcasting in the ITA to match that of the *Broadcasting Act* and pronouncements by the Canadian Radio-television and Telecommunications Commission on broadcasting delivered through the Internet;
- Amend the *Interpretation Act* to replace its definition of broadcasting with the *Broadcasting Act's* technology-neutral definition so that a single definition applies in Canadian legislation;
- Revise the advertising tax deductibility provisions of the ITA to apply equally to all foreign media, including Internet-delivered media.[6]

Witnesses told the committee that this proposal regarding the tax deductibility of foreign Internet advertising is part of a larger issue of how modern technology affects the local news media.[7] As annual Internet advertising revenues have risen from $901 million in 2006 to $5.5 billion in 2016, advertising revenues for daily newspapers have fallen by more than 50% during that same period, from $2.66 billion in 2006 to $1.25 billion in 2016.[8]

This decrease in advertising revenue for print media has also been paired with declining rates of newspaper subscriptions, putting the viability of the Canadian newspaper and news media industries into doubt. During its study, committee members heard witnesses discuss closures of local news outlets and the resulting job losses that arose from those closures. Specifically, April Lindgren, Professor, School of Journalism, Ryerson University (who appeared as an individual) told the committee that 248 news outlets in 176 different Canadian communities have closed since 2008.[9]

Notwithstanding the difficult period that the Canadian newspaper and news media industries are going through, John Hinds, President and Chief Executive Officer, News Media Canada told the committee that readership of news media has been growing, with reports stating that almost 9 in 10 Canadians read newspapers at least once per week.[10]

As part of this broader discussion, witnesses also highlighted the civic role that journalists play to hold governments to account and to keep the public informed of local, national and international news.[11] These witnesses suggested that this role may be compromised in the absence of a sustainable business model for journalism.[12] In that regard, a report published by the Public Policy Forum suggests that more work needs to be done to foster a healthy and diverse Canadian press corps.[13]

6 TRCM, *Evidence*, 22 May 2018 (Daniel Bernhard).

7 TRCM, *Evidence*, 5 June 2018 (John Hinds, President and Chief Executive Officer, News Media Canada); *Evidence*, 12 June 2018, (April Lindgren, Professor, School of Journalism, Ryerson University, as an individual).

8 Mill and Keeble (2018), p. 9.

9 TRCM, *Evidence*, 12 June 2018, (April Lindgren).

10 TRCM, *Evidence*, 5 June 2018 (John Hinds).

11 TRCM, *Evidence*, 30 May 2018 (Matthew Holmes).

12 Ibid, (Linda Lauzon, Executive Director, Association de la presse francophone).

13 Public Policy Forum (2017), pp. 81–94.

THE TAX DEDUCTIBILITY

OF FOREIGN INTERNET ADVERTISING

Witnesses from the media were generally supportive of the recommendation regarding the tax deductibility of certain advertising costs, namely, cancelling the deductibility of advertising with foreign organizations such as Facebook and Google.[14]

They also noted that eliminating the tax deductibility of foreign Internet advertising would increase the amount of tax dollars flowing to the federal government. Some witnesses went further by suggesting that those extra tax dollars could be reinvested back into the broadcasting sector.

Witnesses supporting this proposal also suggested that its implementation would help repatriate some of the Internet advertising revenues that currently go to foreign companies.[15] As noted above, a large majority of Internet advertising revenues currently go to two foreign companies: Facebook and Google.

However, other witnesses, such as Professor Lindgren from Ryerson University, noted that the recommendation is not a panacea in itself.[16]

An official from the Department of Finance added that the recommendation may also impose an additional tax on Canadian businesses:

> Estimates provided by the FRIENDS of Canadian Broadcasting indicate that roughly **10% of foreign Internet advertising expenditures would shift back to Canada and that their proposal would increase the tax burden on Canadian businesses by more than $1 billion**. This suggests the measure would likely not change firms' behaviour to a significant degree. As such, it seems it would mainly result in a tax increase on Canadian businesses.
>
> – Miodrag Jovanovic, Associate Assistant Deputy Minister, Finance Canada[17]

14 For example, see: TRCM, *Evidence*, 5 June 2018 (John Hinds; Matt Thompson, Director on the Board of Directors, Canadian Association of Broadcasters; and Barry Rooke, Executive Director, National Campus and Community Radio Association Inc.); and TRCM, *Evidence*, 30 May 2018 (François Côté, Executive Director, Alliance des radios communautaires du Canada; Linda Lauzon; and Thomas S. Saras, President and Chief Executive Officer, Media, National Ethnic Press and Media Council of Canada).

15 TRCM, *Evidence*, 22 May 2018 (Daniel Bernhard).

16 TRCM, *Evidence*, 12 June 2018 (April Lindgren).

17 TRCM, *Evidence*, 29 May 2018 (Miodrag Jovanovic, Associate Assistant Deputy Minister [Analysis], Tax Policy Branch, Department of Finance Canada).

Some witnesses, such as those from News Media Canada and the Canadian Association of Broadcasters, acknowledged that implementing the proposal would not be a complete solution to all the problems facing Canadian media, but suggested that it would represent a welcome first step.[18]

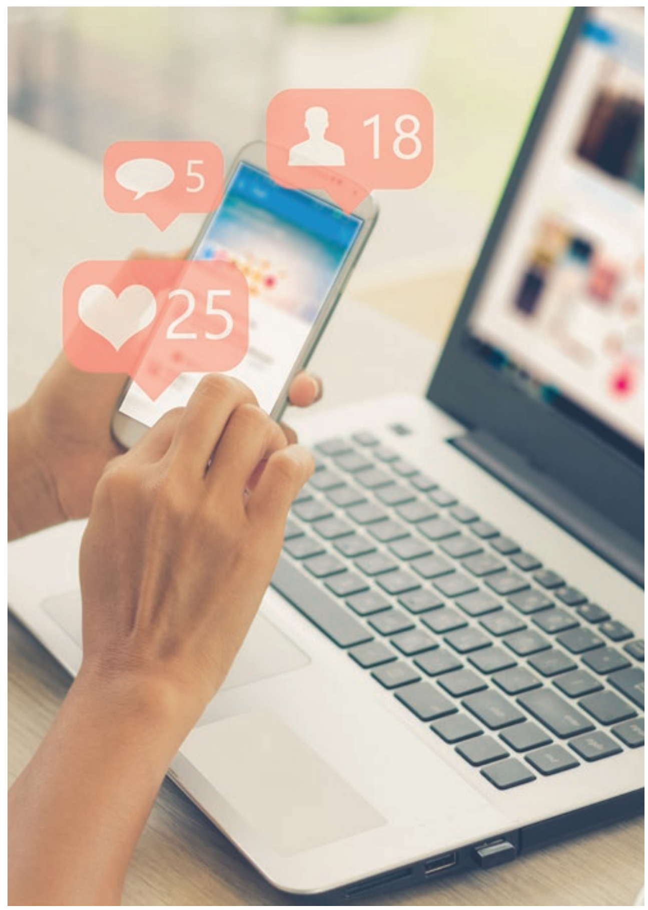
As noted above, there are three different ways to extend the application of section 19 of the ITA to Internet advertising. Given the fiscal and cultural implications that such measures could have, the committee believes that each of the three options should be carefully considered by the Government of Canada.

THE COMMITTEE RECOMMENDS

that the Government of Canada study the tax deductibility of foreign Internet advertising and publish a report providing its position on the matter. The report should indicate if the government intends to take actions to extend section 19 of the *Income Tax Act* to Internet advertising; if it does, the government should indicate the best way to do so.

The committee also heard a number of recommendations on how to address the broader challenges facing local news media and broadcasters in Canada. Some witnesses, such as Matthew Holmes, President and Chief Executive Officer, Magazines Canada, told the committee that the federal government spends most, if not all, of its advertising budget on digital platforms like Google and Facebook.[19] Therefore, it was suggested that the federal government develop a policy on how to spend its advertising budget more equitably and with a view to targeting the desired audience. Other witnesses suggested that Canadian sales taxes should be applied to foreign digital content providers.[20]

Although these recommendations are beyond the scope of its current study, the committee believes they require more thorough examination and will investigate them in more detail as part of their study on the modernization of Canadian communications legislation.



18 TRCM, [Evidence](), 5 June 2018 (John Hinds and Matt Thompson).

19 TRCM, [Evidence](), 30 May 2018 (Matthew Holmes).

20 TRCM, [Evidence](), 30 May 2018 (Matthew Holmes); [Evidence](), 5 June 2018 (John Hinds).

CONCLUSION

Over the course of its study on the tax deductibility of foreign Internet advertising, the committee heard testimony about the many challenges that the local news media industry is facing in Canada. Advertising revenues have declined, with many traditional media and local news organizations having closed or having been forced to significantly reduce the depth and scope of their reporting. As the industry seeks different business models to finance itself, the proposal to extend the application of section 19 of the ITA to Internet advertising represents one measure among many that could help alleviate some of those pressures in the short term. Whether this measure would place an undue tax burden on Canadian businesses remains a subject for further study.

As discussed by Professor Lindgren in her remarks to the committee:

> The work in this area for news organizations is an acknowledgement that advertising, which used to be the old source of how news organizations financed themselves, can no longer be counted on as the staple. […] You shouldn't be under any illusions the tax change you are discussing today is a silver bullet that will solve the problems of the news industry. It can be one of many tools.
>
> – April Lindgren, Professor, School of Journalism, Ryerson University[21]

21 TRCM, *Evidence*, 12 June 2018 (April Lindgren).

The committee recognizes that a single decision or recommendation will not solve the complex cultural and tax policy challenges faced by the local news media and broadcasters in Canada. Indeed, as explained by an official from Canadian Heritage:

> The general disruption across the cultural industries brought on by new technologies, evolving business models and changing user behaviours and expectations has raised a wide range of increasingly complex policy questions for policymakers, not least the nature and extent of government intervention that is necessary or appropriate.
>
> – Thomas Owen Ripley, Acting Director General, Department of Canadian Heritage[22]

22 TRCM, *Evidence*, 29 May 2018 (Thomas Owen Ripley, Acting Director General, Broadcasting and Digital Communications Branch, Cultural Affairs, Canadian Heritage).

In consideration of the compelling testimony provided by witnesses and in appreciation of the many issues they raised, the committee has decided that when it returns in the Fall it will undertake a more detailed study of Canada's broadcasting and telecommunications legislation. In that regard, the following order of reference was approved by the Senate on 20 June 2018:

> That the Standing Senate Committee on Transport and Communications be authorized to examine and report on how the three federal communications statutes (the *Telecommunications Act*, the *Broadcasting Act*, and the *Radiocommunication Act*) can be modernized to account for the evolution of the broadcasting and telecommunications sectors in the last decades. Some of the main issues the study would examine will include:
>
> (a) how the three statutes may promote the creation, production and distribution of competitive, quality Canadian content in both French and English;
>
> (b) the realities and challenges of Canadian consumers, businesses, broadcasters, artists and artisans;
>
> (c) blurring of the distinction between broadcasting and telecommunications;
>
> (d) fragmentation of services;
>
> (e) corporate consolidation and concentration;
>
> (f) Canadian content;
>
> (g) CBC/Radio-Canada;
>
> (h) foreign ownership constraints;
>
> (i) low participation and Information and Communications Technology Development Index score;
>
> (j) lack of a national broadband strategy;
>
> (k) net neutrality; and
>
> (l) statutory authority and the role of the CRTC; and
>
> That the committee report to the Senate no later than June 28, 2019, and that it retain all powers necessary to publicize its findings until 180 days after the tabling of the final report.[23]

23 Senate of Canada, *Order Papers and Notice Papers*, 1st Session 42nd Parliament, 19 June 2018; and Senate of Canada, *Debates*, 1st Session 42nd Parliament, 20 June 2018.

APPENDIX A: WITNESSES

Tuesday, June 12, 2018	
As an Individual	April Lindgren, Professor, School of Journalism, Ryerson University
Tuesday, June 5, 2018	
News Media Canada	John Hinds, President and Chief Executive Officer
Canadian Association of Broadcasters	Matt Thompson, Director on the Board of Directors Peter Miller, Consultant
Alliance des producteurs francophones du Canada	Carol Ann Pilon, Executive Director
National Campus and Community Radio Association Inc.	Barry Rooke, Executive Director
Wednesday, May 30, 2018	
Magazines Canada	Matthew Holmes, President and Chief Executive Officer
Association de la presse francophone	Francis Sonier, President Linda Lauzon, Executive Director
National Ethnic Press and Media Council of Canada	Thomas S. Saras, President and Chief Executive Officer, Media
Alliance des radios communautaires du Canada	François Côté, Executive Director

Tuesday, May 29, 2018	
Canada Revenue Agency	Roxane Brazeau-Leblond, Director, Income Tax Rulings Directorate, Legislative Policy and Regulatory Affairs Branch Costa Dimitrakopoulos, Director General, Income Tax Rulings Directorate, Legislative Policy and Regulatory Affairs Branch
Department of Finance Canada	Miodrag Jovanovic, Associate Assistant Deputy Minister (Analysis), Tax Policy Branch
Canadian Heritage	Marc Lemay, Director General, Cultural Industries, Cultural Affairs Thomas Owen Ripley, Acting Director General, Broadcasting and Digital Communications Branch, Cultural Affairs
Tuesday, May 22, 2018	
FRIENDS of Canadian Broadcasting	Daniel Bernhard, Executive Director and Spokesperson Peter Miller, Consultant and Author Ian Morrison, Spokesperson

APPENDIX B: RELATED PROVISIONS OF THE *INCOME TAX ACT*

Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.)

Definitions

19.01 (1) The definitions in this subsection apply in this section.

advertisement directed at the Canadian market has the same meaning as the expression ***directed at the Canadian market*** in section 2 of the *Foreign Publishers Advertising Services Act* and includes a reference to that expression made by or under that Act. (*annonce destinée au marché canadien*)

original editorial content in respect of an issue of a periodical means non-advertising content

> **(a)** the author of which is a Canadian citizen or a permanent resident of Canada within the meaning assigned by the *Immigration Act* and, for this purpose, "author" includes a writer, a journalist, an illustrator and a photographer; or
>
> **(b)** that is created for the Canadian market and has not been published in any other edition of that issue of the periodical published outside Canada. (*contenu rédactionnel original*)

periodical has the meaning assigned by section 2 of the *Foreign Publishers Advertising Services Act*. (*périodique*)

Limitation re advertising expenses – periodicals

(2) Subject to subsections (3) and (4), in computing income, no deduction shall be made by a taxpayer in respect of an otherwise deductible outlay or expense for advertising space in an issue of a periodical for an advertisement directed at the Canadian market.

100% deduction

(3) A taxpayer may deduct in computing income an outlay or expense of the taxpayer for advertising space in an issue of a periodical for an advertisement directed at the Canadian market if

> **(a)** the original editorial content in the issue is 80% or more of the total non-advertising content in the issue; and
>
> **(b)** the outlay or expense would, but for subsection (2), be deductible in computing the taxpayer's income.

50% deduction

(4) A taxpayer may deduct in computing income 50% of an outlay or expense of the taxpayer for advertising space in an issue of a periodical for an advertisement directed at the Canadian market if

(a) the original editorial content in the issue is less than 80% of the total non-advertising content in the issue; and

(b) the outlay or expense would, but for subsection (2), be deductible in computing the taxpayer's income.

Application

(5) For the purposes of subsections (3) and (4),

(a) the percentage that original editorial content is of total non-advertising content is the percentage that the total space occupied by original editorial content in the issue is of the total space occupied by non-advertising content in the issue; and

(b) the Minister may obtain the advice of the Department of Canadian Heritage for the purpose of

(i) determining the result obtained under paragraph (a), and

(ii) interpreting any expression defined in this section that is defined in the *Foreign Publishers Advertising Services Act*.

Editions of issues

(6) For the purposes of this section,

(a) where an issue of a periodical is published in several versions, each version is an edition of that issue; and

(b) where an issue of a periodical is published in only one version, that version is an edition of that issue.

NOTE: Application provisions are not included in the consolidated text; see relevant amending Acts. 2001, c. 17, s. 12.

Limitation re advertising expense on broadcasting undertaking

19.1 (1) Subject to subsection 19.1(2), in computing income, no deduction shall be made in respect of an otherwise deductible outlay or expense of a taxpayer made or incurred after September 21, 1976 for an advertisement directed primarily to a market in Canada and broadcast by a foreign broadcasting undertaking.

Exception

(2) In computing income, a deduction may be made in respect of an outlay or expense made or incurred before September 22, 1977 for an advertisement directed primarily to a market in Canada and broadcast by a foreign broadcasting undertaking pursuant to

(a) a written agreement entered into on or before January 23, 1975; or

(b) a written agreement entered into after January 23, 1975 and before September 22, 1976 if the agreement is for a term of one year or less and by its express terms is not capable of being extended or renewed.

Definitions

(4) In this section,

foreign broadcasting undertaking means a network operation or a broadcasting transmitting undertaking located outside Canada or on a ship or aircraft not registered in Canada; (*entreprise étrangère de radiodiffusion*)

network includes any operation involving two or more broadcasting undertakings whereby control over all or any part of the programs or program schedules of any of the broadcasting undertakings involved in the operation is delegated to a network operator. (*réseau*)

NOTE: Application provisions are not included in the consolidated text; see relevant amending Acts. 1974-75-76, c. 106, s. 3; 1977-78, c. 1, s. 13; 1985, c. 45, s. 126(F).

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