IMPLICATIONS OF ELECTRONIC COMMERCE FOR TAX COLLECTION IN BRITISH COLUMBIA[1]

JASON R. LACHARITE

INTRODUCTION

For the better part of a decade, there has been a rather lively debate on the implications of electronic commerce (e-commerce) for tax collection in the developed world. The overwhelming consensus appears to be that business-to-consumer (B2C) and business-to-business (B2B) e-commerce pose a range of challenges for tax authorities in the Organisation for Economic Cooperation and Development (OECD).[2] Paris, Tanzi, Basu, and Davidson and Rees-Moog, in particular, have suggested that further developments in the adoption of electronic commerce platforms are likely to make it more difficult for taxing agencies to collect revenues from certain personal, corporate, and consumption tax sources.[3] Indeed, one of the principal concerns

[1] The author gratefully acknowledges the constructive feedback provided by the editor of *BC Studies* and the three anonymous reviewers assigned to this manuscript. Your dedication to professionalism and intellectual rigour has improved the overall quality of my analysis and is greatly appreciated.

[2] Robert Biscontri, Christina Ng, and Susan Yuen, "Electronic Commerce: Erosion of Tax Base and Challenge to the International Tax Authorities," *International Tax Journal* 27, 3 (2001): 51-63; Grady Means and David Schneider, *Meta-Capitalism: The E-business Revolution and the Design of 21st-Century Companies and Markets* (New York: John Wiley and Sons, 2000); Don Tapscott, David Ticoll, and Alex Lowy, *Digital Capital: Harnessing the Power of Business Webs* (Boston: Harvard Business School Press, 2000); Jeremy Rifkin, *The Age of Access: The New Culture of Hype-Capitalism, Where All of Life Is a Paid For Experience* (London: Penguin Books, 2000); OECD, *The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda* (Paris: OECD, 1999); and Uta Kohl, "The Horror Scope for the Taxation Office: The Internet and Its Impact on 'Residence,'" *University of New South Wales Law Journal* 21, 2 (1998): 436-51.

[3] Roland Paris, "The Globalization of Taxation: Electronic Commerce and the Transformation of the State," *International Studies Quarterly* 47, 2 (2003): 153-82; Vito Tanzi, "Globalization and the Work of Fiscal Termites," *Finance and Development: A Quarterly Magazine of the IMF* 38, 1 (2001): 34-37; Subhajit Basu, "Taxation of Electronic Commerce," *Journal of Information, Law and Technology* 2, July 2001, http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2001_2/basu1;

expressed by these authors is the extent to which cross-border internet shopping will undermine the tax collection powers of OECD governments and, thus, funding for various social programs.[4] In essence, it is argued that e-commerce – as just one element of globalization – has the potential to erode the tax base and tax yields of high-income countries.

While there have been some attempts to quantify the net effects of e-commerce on tax collection, it is difficult to estimate, with any certainty, how much tax revenue is lost, or will be lost, as a result of remote internet purchases.[5] Furthermore, much of the current literature has focused on sales tax-dependent jurisdictions in the United States and the European Union. This is not to suggest that there is a dearth of scholarly material on e-commerce and taxation in Canada, nor to imply that the relationship between economic globalization and welfare state sustainability has been overlooked by Canadian scholars. In both areas, there is an exceptionally rich, diverse, and instructive body of research dedicated to the impact of globalization on the Canadian state. Li, for example, has written extensively on a number of e-commerce-related issues, but they have been presented largely from a tax accountant's perspective and are thus highly technical in nature.[6] Ligthart and Bird[7] have also written on e-commerce in Canada but have failed to sufficiently analyze this element of globalization within the context of Canada's, or any of the provinces's, tax systems.[8]

---

and James Davidson and William Rees-Moog, *The Sovereign Individual: How to Survive and Thrive During the Collapse of the Welfare State* (New York: Simon and Schuster, 1997).

4 The OECD is an international organization, consisting of thirty market democracies, "where governments compare policy experiences, seek answers to common problems, identify good practice and coordinate domestic and international policies." See "About the OECD," at http://www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1,00.html (viewed 5 February 2008).

5 No such "tax loss" calculations have been made in Canada, but Bruce and Fox have estimated potential revenue losses in the United States. See, Donald Bruce and William Fox, "E-Commerce in the Context of Declining State Sales Tax Base," *National Tax Journal* 53, 4 (2000): 1373-90.

6 Jinyan Li, *International Taxation in the Age of Electronic Commerce: A Comparative Study* (Toronto: Canadian Tax Foundation, 2003); and Jinyan Li, "Consumption Taxation of Electronic Commerce: Problems, Policy Implementation and Proposals for Reform," *Canadian Business Law Journal* 38 (2003): 425-71.

7 Jenny Ligthart, "Consumption Tax in a Digital World: A Primer," *Canadian Tax Journal* 52, 4 (2004): 1076-101; and Richard Bird, "Taxing Electronic Commerce: A Revolution in the Making," C.D. Howe Institute Commentary No. 187 (2003), http://www.cdhowe.org/pdf/commentary_187.pdf (viewed 29 January 2008).

8 It should be noted that, while Ligthart and Bird recognize that e-commerce is not currently a problem, they also suggest that it could become problematic in the future. Bird's article in particular – "A Revolution in the Making?" – suggests that e-commerce is likely to pose a range of challenges for Canada's taxing authorities. Bird makes a number of legitimate points. However, from a tax policy standpoint, there is no reason to believe that e-commerce will

On the broader globalization side of the debate, McBride, Teeple, and Banting have suggested that Canada's ability to exercise policy autonomy (that is, to make key policy decisions independent of trade and investment considerations) has been challenged in a number of ways.[9] They have also indicated that the shift to a more liberalized international trading and investment system has had a somewhat constraining impact on Ottawa's and the provinces' ability to commit to equitable levels of social, family, and health care spending.[10] As well, Carroll has written about the impact of economic globalization on fiscal policy reform from a provincial (party) perspective.[11] In each case, these authors have consistently attempted to identify, measure, and account for the contextual and proximate factors that propel or facilitate globalization, and in each case, they have attempted to assess the overall impact of globalization on Canadian politics and policy. Yet, despite their efforts, they have also consistently overlooked the technological dimension to the debate. Moreover, with the exception of Carroll, the focus is almost always on Canada in general – especially when it comes to social and tax policy – and not the provinces.

This is problematic for at least two reasons. One is that internet technologies, such as e-commerce, have a direct and profound influence over consumer and corporate purchasing habits and trends. In other words, they drive globalization. The more pressing issue, however, is that Canada's provinces, and especially British Columbia, are important tax collection agents that exercise a relative degree of autonomy when it comes to vital tax policy initiatives and decisions. Indeed, Canada's more cooperatively oriented form of federalism does seem to allow for greater flexibility in the area of tax policy than what is normally experienced

necessarily have a "revolutionary" effect on tax collection or Canada's tax system in general. In addition, based on the existing evidence, and contrary to Bird's recommendations, there still does not appear to be any justifiable reason to alter any aspect of Canada's current tax system to address the issue of e-commerce.

9 See Stephen McBride, *Paradigm Shift: Globalization and the Canadian State* (Halifax: Fernwood Publishing, 2001); Gary Teeple, *Globalization and the Decline of Social Reform* (Toronto: Garamond Press, 2000); and Keith Banting, "The Social Policy Divide: The Welfare State in Canada and the United States," in *Degrees of Freedom: Canada and the US in a Changing World*, ed. Keith Banting, George Hoberg, and Richard Simeon (Montreal: McGill-Queen's University Press, 1997), 267-309.

10 Even so, McBride and Banting also suggest that governments still possess the ability to regulate – to some extent – the pace and impact of political, economic, and social reform and convergence.

11 See William K. Carroll and R.S. Ratner, "The NDP Regime in British Columbia, 1991-2001: A Post-Mortem," *Canadian Review of Sociology and Anthropology* 42, 2 (2005): 167-96.

in the United States and Europe.[12] Hence, substate level analyses, in a Canadian context, are relevant and warrant more careful consideration.

The existence of a diverse range of tax systems at the state and substate levels in the OECD suggests that the effects of e-commerce on tax collection are likely to be uneven and to vary from country to country, state to state, or province to province. What can be expected in British Columbia's case? And does e-commerce have the potential to undermine the province's tax collection requirements? This article attempts to answer these questions and argues that the challenges posed by e-commerce have been overstated for at least three reasons. First, British Columbia's tax system differs considerably from what is found at the state and substate levels in the United States and the European Union. The province draws the bulk of its revenue from relatively fixed tax sources, such as personal income taxes, property taxes, and income derived from the extraction of natural resources. This is not to assert that, as a source of revenue, the province's social services tax (SST) is unimportant. Clearly, it is important and there are certain retail items vulnerable to the effects of cross-border internet shopping. However, British Columbia can be described as an income tax-dependent system suitably equipped to deal with any of the potential tax problems that may arise as a result of e-commerce.[13] Second, Statistics Canada's survey results show that e-commerce has had only a modest impact on sales tax collection thus far and that most Canadian households and businesses continue to buy their online products and services from domestic websites.[14] Moreover, in British Columbia's case, the total amount of money spent on internet purchases remains noticeably low compared to overall retail purchases. This is not surprising when one considers that most of the "big ticket items" – such as vehicles, property, renovation materials, appliances, and so on – remain intimately tied to the physical act of shopping. Finally, the overall tax burden in Canada is relatively low by OECD standards. Therefore, it may be possible – although not politically expedient – to increase taxes in various areas to compensate for any potential loss in tax revenue resulting from e-commerce. This is not to say that any decision to increase provincial tax levels will be

---

12 See, for example, Robin Boadway and Harry Kitchen, *Canadian Tax Policy* 3rd ed. (Toronto: Canadian Tax Foundation, 1999), 7.

13 British Columbia has been more reliant on income taxes (personal and corporate) than it has on any other source of revenue for several decades now.

14 Statistics Canada, "Electronic Commerce: Shopping on the Internet," *The Daily*, 1 November 2006, http://www.statcan.ca/Daily/English/061101/d061101a.htm (viewed 29 January 2008).

easy; rather, it is merely to suggest that this option remains available to policy makers.

This analysis concludes that significant shortfalls in provincial tax revenue, on a year-to-year basis, are largely the result of tax policy decisions. In other words, e-commerce is not a problem, nor is it likely to be in the future; rather, declines in tax yields appear to be strongly connected to more provincially or domestically oriented factors such as annual economic growth rates, political ideology, and whether a party is preparing for a provincial election. Hence, one of the underlying goals of this article is to add more support to Drezner's, Watson's, and Gray's view that the various elements of globalization are not entirely beyond the control of the state and that British Columbia and Canada are well positioned to respond to the challenge of e-commence should the need arise.[15]

ELECTRONIC COMMERCE AND TAX COLLECTION: A LEGITIMATE SOURCE OF CONCERN?

E-commerce can span a range of activities,[16] but from a taxing standpoint, it primarily refers to the buying and selling of goods and services over the internet and the tax implications of purchasing items from non-jurisdictional or external sources; that is, from suppliers that lie outside the administrative control of the buyer's taxing regime. The two most well known forms of e-commerce are business-to-consumer (B2C) and business-to-business e-commerce (B2B). As its name suggests, B2C e-commerce involves businesses selling tangible and/or intangible items directly to consumers over some sort of digital or electronic medium. B2B e-commerce also involves the use of telecommunications platforms to sell goods and services to prospective clients or customers. The crucial difference is that B2B transactions are typically inter- and intra-organizational, whereas B2C is restricted to direct sales to private consumers. Of the two, B2B commercial transactions are widely con-

[15] Daniel Drezner, "The Governance of the Internet: Bringing the State Back In," *Political Science Quarterly* 119 (Fall 2004): 477-98; William Watson, *Globalization and the Meaning of Canadian Life* (Toronto: University of Toronto Press, 1998); and John Gray, *False Dawn: The Delusions of Global Capitalism* (London: Granta Books, 1998).

[16] See, for example, Jiyan Li, *International Taxation in the Age of Electronic Commerce: A Comparative Study* (Toronto: Canadian Tax Foundation, 2003); Subhajit Basu, "Taxation of Electronic Commerce," *Journal of Information, Law and Technology* 2, July 2001, http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2001_2/basu1; and Kenneth Laudon and Carol Traver, *E-commerce: Business, Technology and Society*, 3rd ed. (Upper Saddle River, NJ: Prentice Hall, 2007).

sidered to be more problematic because they dominate the total value of Canadian and global e-commerce activity.[17] In Canada's case alone, the "majority of gains in e-commerce … have been the result of increased sales from one business to another [and] not sales from businesses to households."[18]

When it comes to the issue of taxing e-commerce, OECD governments appear to be of two minds. On the one hand, they seem to recognize that e-commerce remains in an incipient stage of development, even though yearly increases in combined B2C and B2B revenues have slowed considerably since 1997.[19] The tendency in countries such as Canada, Australia, and the United States, therefore, has been to encourage e-commerce development by remaining non-interventionist in the area of internet taxation. At the same time, however, taxing authorities in the OECD and elsewhere have expressed a number of concerns in relation to the impact of e-commerce on tax collection.

One of the more common concerns articulated in the literature is the ability of consumers to buy goods and services from merchants located outside the reach of their own government's taxing authorities. More specifically, there are two aspects of cross-boarder e-commerce that have caught the attention of tax analysts and policy makers. The first, and perhaps most controversial, issue is the buying and selling of intangible "goods" from external (or non-domestic) sources. A number of consumer items have recently undergone a digital conversion of sorts. Books, software, video material, film, and music can now be stripped of their physical qualities and supplied from almost any location. And, as Teltscher has pointed out, this transition represents an important departure from how these items used to be delivered and taxed: "In the past, these products were shipped physically … [and] subject to import duties. Today … they are being sent via digital files through virtual networks, thereby crossing numerous (sometimes unknown) borders."[20]

Of course, a more deeply integrated consumer market system – characterized by multiple points of consumption – makes it more difficult for independently administered tax agencies to identify, monitor, and resolve international "tax" transactions. Furthermore, since "con-

---

17 Fay Hansen, "Global E-commerce Growth," *Business Credit Magazine* 109, 9 (2003): 58.

18 Mark Uhrbach, "How Business-to-Business Sales Dominate e-Commerce," *Analysis in Brief*, Statistics Canada (November 2005), http://www.statcan.ca/english/research/11-621-MIE/11-621-MIE2005033.htm (viewed 5 February 2008).

19 See Hansen, "Global E-Commerce Growth," 58; OECD, *Economic and Social Impact of Electronic Commerce*, 27; and Uhrbach, "How Business-to-Business Sales Dominate e-Commerce."

20 Susanne Teltscher, "Electronic Commerce and Development: Fiscal Implications of Digitized Goods Trading," *World Development* 30, 7 (2002): 1,139.

sumption taxes are levied on the principle of taxation at the place of consumption," several complications arise. For instance, "in the case of business to consumer transactions, the supplier who [would] normally [be] responsible for collecting consumption taxes may have limited means to prove the location of their customers."[21] Another potential problem concerns whether OECD governments possess the technical and human resources capacity to examine all of the various types of commercial transactions that originate from within their borders.

A second concern relates to the digitization of private services. In the United States' case, Tannenwald has shown that a gradual decline in the production of "goods" has been replaced by a simultaneous increase in the delivery of private "services" – in essence, a profound and permanent shift away from the production of tangible and taxable revenue sources.[22] According to Tannenwald, the increasing importance and value of professional and business services have direct "revenue consequences" for state and local governments. Similar to the convertible products highlighted above, the potential spread of service-oriented purchases from remote jurisdictions might make it more difficult for revenue officials to collect consumption taxes on certain internet transactions. Ultimately, it is asserted that, in jurisdictions where consumption taxes are a significant source of government income, an increase in purchases from external suppliers might result in a noticeable decline in tax yields. Yet, at this stage it remains unclear how the outright taxation of global e-commerce transactions will affect corporate profitability and growth, which might partially explain why the OECD collective has been rather tentative on the issue of supply- and destination-based taxation.

Finally, the issue of "permanent establishment" (PE), or determining whether a server or website constitutes a fixed place of business, has caused some concern in several higher-taxing countries. Under the OECD's Model Tax Convention, the assets, agency, and activities tests are used to determine whether PE exists in a particular country. In all three instances, a taxing agency must show some combination of the following: (1) that the company in question has significant tangible and intangible assets in use, (2) that the "non-resident employs a dependent agent having contracting ability in the taxing jurisdiction,"[23] and (3) that an evidentiary connection exists between core and peripheral activities.

---

[21] OECD, "E-Commerce: Impacts and Policy Challenges," *OECD Outlook 67* (Paris: OECD, 2000), 207.

[22] Robert Tannenwald, "Are State and Local Revenue Systems Becoming Obsolete?" *New England Economic Review* 4 (2001): 31-32.

[23] Basu, "Taxation of Electronic Commerce," 11.

Given the relatively non-physical nature of e-commerce transactions, it can be difficult to assess the extent to which PE actually exists. In Canada, for example, "[a] non-resident person who has [a] Web-site hosted on a server of an independent ISP … [is] not regarded as having an ISP at [his/her] disposal."[24] Even if a non-resident owns an ISP, its contribution must be one of the core functions of the enterprise. As one might expect, the uncertainty associated with PE provides some businesses with opportunities to avoid certain tax obligations.

The ability of e-commerce to expand the boundaries of consumption and to dematerialize business operations has implications for a range of critical tax sources and tax policy. However, each country's, state's, or province's experience with e-commerce will differ considerably, and the impact of e-commerce on tax collection will be determined, in most cases, by the existing tax system itself. Hence, the following section attempts to contextualize the implications of e-commerce in British Columbia by highlighting the province's tax system.

BRITISH COLUMBIA'S TAX STRUCTURE: IMPORTANCE OF TAX SYSTEMS

Overview

In Canada, taxing and spending powers are divided among three orders of government: the federal government, the provincial governments, and local or municipal governments. Similar to other federations in the OECD, however, Canada's federal government exercises a great deal of (de facto) control over personal and corporate income taxes – except in Quebec. This is not to suggest that Canada's provinces are completely subordinate to the federal government in the area of fiscal policy. For example, it is important to note that, while the provinces are "constitutionally restricted" to collecting only direct taxes, they also levy indirect taxes to ensure that a sufficient amount of tax revenue is on hand to support the various public services provided by the country's provincial governments.[25] Indeed, sales taxes, and in some cases a harmonized sales tax, remain the single most important source of indirect tax revenue for most of Canada's provinces. The fairly recent expansion of provincial taxing powers – due in large part to judicial interpretation – along with

[24] Canada Revenue Agency, "GST/HST Technical Information Bulletin: GST/HST and Electronic Commerce," (July 2002), http://www.cra-arc.gc.ca/E/pub/gm/b-090/b-090-e.pdf (viewed 18 March 2008).

[25] Alberta is the exception here. It is the only province that does not levy a provincial sales tax.

the federal government's capacity to levy any kind of tax, has provided Ottawa and the provinces with unlimited taxing powers.[26]

Canada has also experienced what can be described as a form of progressive fiscal decentralization over the past several years. As was suggested earlier, "Canadian provinces and their municipalities have considerably more fiscal responsibility than do lower-level jurisdictions in other federations."[27] This can be attributed, in part, to the provinces' being primarily responsible for important "welfare" services such as health care, education, and various forms of social assistance. Yet, greater fiscal decentralization has also occurred as a result of demands from the provinces for more fiscal autonomy and Ottawa's desire to maintain its commitment to balanced budgets and responsible program spending.[28]

Breakdown of Important Revenue Sources in British Columbia

British Columbia's tax system consists of a mix of direct and indirect revenue sources. However, the bulk of the province's tax revenue has traditionally come from four main sources: income taxes (personal and corporate), a social services tax (also known as the provincial sales tax), property taxes (residential, business, rural, and transfers), and royalties derived from the extraction, or use of, natural resources. In fiscal year 2005/06, these four revenue sources accounted for approximately 53 percent of the government's total income (the remaining relevant tax sources are highlighted below). Figure 1 illustrates the comparative importance of British Columbia's major revenue sources since 1992. It shows that personal income taxes (PITs) have remained the most important source of tax revenue for well over a decade.

Measured as a percentage of all taxes, however, PITs have actually declined quite significantly since 1992. In other words, past governments have had a tendency to rely more consistently on personal income tax

---

26 Niels Velhuis, Joel Emes, and Michael Walker, *Tax Facts 13*, (Vancouver: The Fraser Institute, 2004), 5. See also Geoffrey Hale, *The Politics of Taxation*, (Toronto: Broadview Press, 2002); and Robin Boadway, "The Vertical Fiscal Gap: Conceptions and Misconceptions," in *Canadian Fiscal Arrangements: What Works, What Might Work Better*, ed. Harvey Lazar (Montreal and Kingston: McGill-Queen's Press, 2005), 51-80.

27 Boadway and Kitchen, *Canadian Tax Policy*, 7.

28 Marc Lee, "Tax Cuts and the Fiscal Imbalance," Canadian Centre for Policy Alternatives (Ottawa: CCPA, 2006), 13-17. See also Robert Asselin, "The Canadian Social Union: Questions about the Division of Powers and Fiscal Federalism," Parliamentary Research Branch (PRB 00-31E) (Ottawa: Library of Parliament, 2001); and Christopher Heady, "The Truth about Tax Burdens," *OECD Observer* 230 (2002): 17-20.

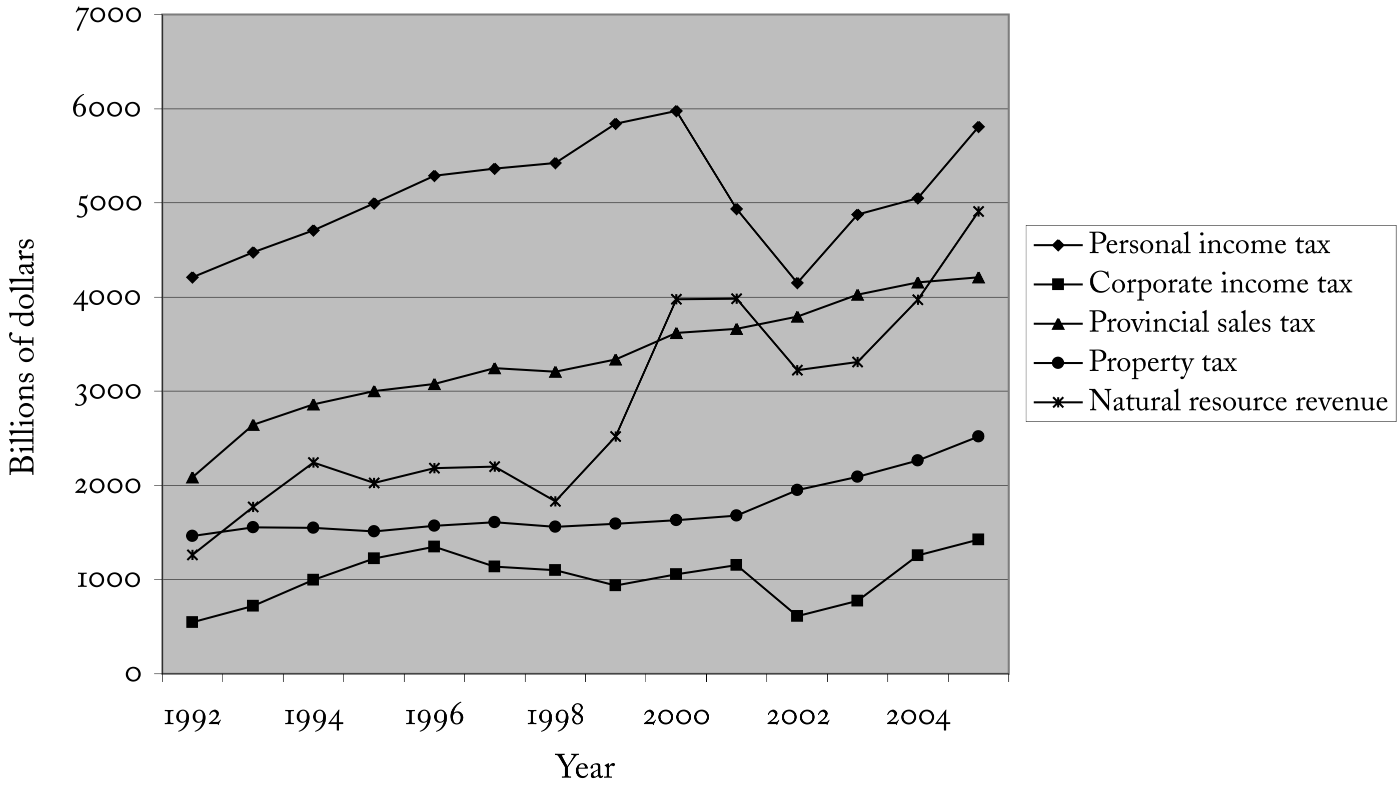

Figure 1: British Columbia's main sources of tax revenue. *Source*: BC Ministry of Finance, "British Columbia Budgets," http://www.bcbudget.gov.bc.ca/ (viewed 20 February 2008).

sources than has the current Liberal administration. For example, in the ten-year period leading up to 2002, PITs, on average, accounted for approximately 25 percent of all the tax dollars collected in British Columbia.[29] In fiscal year 2005/06, it was a mere 16 percent. As an election strategy, tax cuts are not unique to BC politics, but the post-2001 slide in personal income tax revenue did coincide with Liberal (election) promises to reduce the overall PIT rate – the largest personal income tax cut in BC history.[30] Hence, in this particular instance, the relative decline in PITs was the direct and immediate result of a well thought out political strategy rather than of the negative forces of globalization.[31]

In contrast to PIT sources, the province's reliance on corporate income tax revenues (CITs) has fluctuated slightly since 1992. A combination of economic growth (or lack thereof) and tax policy decisions (i.e., whether to increase or decrease corporate income tax rates) have largely determined the extent to which the province has benefited from this source of tax revenue on a year-to-year basis. Indeed, periods of economic growth have rewarded Victoria with a windfall of corporate income tax dollars despite attempts to lower the overall CIT rate and provide businesses with other forms of tax relief.[32] Between 1999 and 2002, for example, corporate income taxes increased by 38 percent, fell dramatically in the 2002/03 fiscal year – again, as a result of a Liberal tax cut initiative – but then recovered to their 1999/00 levels in 2005 – due to a better than expected surge in economic growth.[33] Therefore, while corporate income taxes remain an important source of revenue for the province, corporate income tax policy would also appear to be heavily influenced by domestically oriented contextual factors such as

29 Author's own calculations, based on BC Ministry of Finance budgetary data from 1992 to 2002.

30 British Columbia Ministry of Finance, "Tax Fact Sheet," Economic and Fiscal Update (July 2001), 1, http://www.fin.gov.bc.ca/archive/efu/update_factsheet.htm (viewed 21 February 2008).

31 It is also important to note that tax cuts of this nature have frequently been associated with regimes that are neoliberal in orientation.

32 British Columbia Ministry of Finance, "Tax Fact Sheet," Economic and Fiscal Update (July 2001), 1, http://www.fin.gov.bc.ca/archive/efu/update_factsheet.htm (viewed 21 February 2008).

33 On 1 January 2002, British Columbia's CIT rate fell by a full 3 percentage points to 13.5 percent. See, British Columbia Ministry of Finance, "Tax Fact Sheet." Also, the latest budgetary figures show that the CIT rate will be reduced to 10 percent by 2011 – representing an additional 3.5 percent from 2002. See BC Ministry of Finance, "Budget and Fiscal Plan 2008/09 - 2010," http://www.bcbudget.gov.bc.ca/2008/bfp/default.html#2 (viewed 6 March 2008).

prevailing economic conditions, political ideology, and whether or not a party is preparing for a provincial election.[34]

Since 1992, the second most important source of revenue for Victoria has been the Social Services or Provincial Sales Tax (PST). The PST is a "provincial retail sales tax imposed under the *Social Service Tax Act*. It applies to sales and leases of goods and to some services, such as services to repair and maintain taxable goods. The tax is payable by the person who purchases or leases the goods, unless the item is specifically exempt from tax under the Act."[35] In 2005/06, the PST accounted for 12.1 percent of total taxation revenue, or $4.3 billion. Given British Columbia's relative economic success over the past several years, it is not surprising that revenue collected from the PST has increased steadily since 1995. Between 1995 and 2005, PST revenues actually increased by over $1 billion, or 28 percent. The province's budgetary data and projections also suggest that the gap between PIT and PST revenue is closing rapidly. At this rate, it is possible that the PST will overtake personal income taxes as the most important source of revenue for all levels of government in British Columbia. Of course, this will depend on tax policy decisions and sustained economic growth, but it may be worth pointing out that the province's reliance on sales taxes, as a source of revenue, is consistent with the OECD's findings on the increasing importance of broad-based consumption taxes as an effective means for raising revenue.[36]

Natural resource revenues (including natural gas royalties, stumpage fees, and income from other energy and mineral sources) and property taxes are the third and fourth most important sources of income for the provincial government. In 2005/06, these two revenue sources accounted for 20 percent, or $7.1 billion, of total provincial revenue. Like CITs, royalties or fees derived from staples products are contingent on the state of the provincial economy from year to year and international demand for British Columbia's natural resources. In general, when international demand (mostly US demand) for British Columbia's raw materials is high, the province can generate a considerable amount of

---

[34] There can be very little question that the Liberal government's decision to lower the CIT rate was politically, ideologically, and economically motivated. Will McMartin has provided an excellent account of fiscal policy under the BC Liberal Party from 2001 to 2005. See McMartin's "Conjuring a $5 billion NDP deficit," and "Did Liberals Fix BC's Economy?' in *Liberalized: The Tyee Report On British Columbia Under Gordon Campbell's Liberals*, ed. David Beers (Vancouver: New Star Books, 2005), 119-71.

[35] British Columbia Ministry of Small Business and Revenue, "Provincial Sales Tax (2007)," http://www.sbr.gov.bc.ca/individuals/Consumer_Taxes/Provincial_Sales_Tax/pst.htm (viewed 18 March 2008).

[36] Ken Messere, Flip de Kam, and Christopher Heady, *Tax Policy: Theory and Practice in OECD Countries* (Oxford: Oxford University Press, 2003), 22 and 38.

revenue from the forestry, gas, mineral, and energy sectors. However, given the anticipated decline in US demand for BC products, it remains to be seen how much revenue will actually be collected from 2006/07 onwards.[37] Property taxes and transfers round out the four main sources of revenue used by the provincial government to finance its activities.

The remaining sources of revenue worthy of note are contributions made by the federal government (in the form of health and social transfer payments), income derived from Commercial Crown Corporations, and revenue derived from Medical Services Plan premiums. Together, these additional sources accounted for 26 percent of the total taxes collected in fiscal year 2005/06, or $9.4 billion.

Clearly, not all of these tax sources are going to be equally affected by e-commerce, and this is perhaps the real strength of British Columbia's tax system: its diversity. For instance, there is no compelling body of evidence (existing or emerging!) to support the claim that e-commerce will have a long-term negative impact on PIT sources or MSP contributions. To be sure, one of the more apparent and consistent features of PITs, MSP contributions, resource royalties, property taxes, and income derived from commercial Crown corporations is that they are all relatively fixed or immobile tax sources subject to the country's and the province's existing tax codes.

With regards to consumption and corporate income taxes, however, technological innovations such as electronic commerce are important insofar as they pose a challenge for taxing agencies in the areas of compliance and collection. Yet, even in the areas of consumption and corporate taxes, it is clear that the impact of e-commerce will be uncertain. Gas and alcohol taxes, for example, are unlikely to be affected by e-commerce in any meaningful way. Two other notable examples are hotel room taxes and insurance premiums. Furthermore, as has already been shown, there would appear to be a stronger empirical link between provincial CIT policy and declines in CIT revenue than any association that may exist between global e-commerce (globalization) and declines in CIT revenue. The next section attempts to clarify the relevance of British Columbia's tax system to its relative vulnerability to e-commerce by examining the province's key e-commerce and internet adoption trends. It is hoped that the evidence provided below will further

[37] The US Department of Housing and Urban Development's latest figures on "housing starts" can be reviewed at: http://www.census.gov/const/newresconst.pdf (viewed 18 March 2008).

demonstrate why the shape and form of British Columbia's tax system matters.

TRENDS AND IMPLICATIONS:

Have the Potential Effects of E-Commerce Been Exaggerated and Should British Columbia's Revenue Authorities Be Concerned?

The best available evidence does not lend a sufficient amount of support to the proposition that e-commerce will have a noticeably negative impact on tax collection and tax redistribution in British Columbia. However, Statistic Canada's data does indicate that electronic commerce is increasing in popularity across Canada and British Columbia. According to Industry Canada, this increase in popularity can be attributed to three main factors: (1) an accommodating regulatory environment, (2) improvements in internet security (as it relates specifically to e-commerce transactions), and (3) a recognition by small- and medium-sized enterprises (SMEs) of the benefits of utilizing e-commerce applications to improve services, reduce costs, and increase profitability. In some cases, businesses appear to adopt e-commerce out of a sense of competitive necessity as well.[38]

From a retail perspective, these are certainly encouraging signs and suggest that Canada will continue to remain at the forefront of e-commerce development. However, they tell us nothing of the implication of e-commerce for tax collection in British Columbia. The more relevant trends worthy of further analysis are the upward trajectory in internet subscribers in British Columbia; internet and e-commerce usage among small-, medium-, and large-sized enterprises; increases in online purchasing; and increases in the total value of combined B2C and B2B e-commerce sales in British Columbia and Canada.

Regarding the issue of online subscribers, British Columbia's internet penetration rate has increased by a rather impressive margin over the past five to ten years. In 1997, for example, roughly 3.3 out every ten households in the province were connected to the internet.[39] By 2005, internet usage in British Columbia had more than doubled and

---

38 Industry Canada, "Fast Forward 5.0: Making Connectivity Work for Canada," Canadian e-Business Initiative (September 2004), 13.

39 BC Ministry of Management Services, "Small Business Is Embracing the Internet," *Infoline Report* 4, 17 (30 April 2004), http://www.bcstats.gov.bc.ca/releases/info2004/in0417.pdf (viewed 5 February 2008).

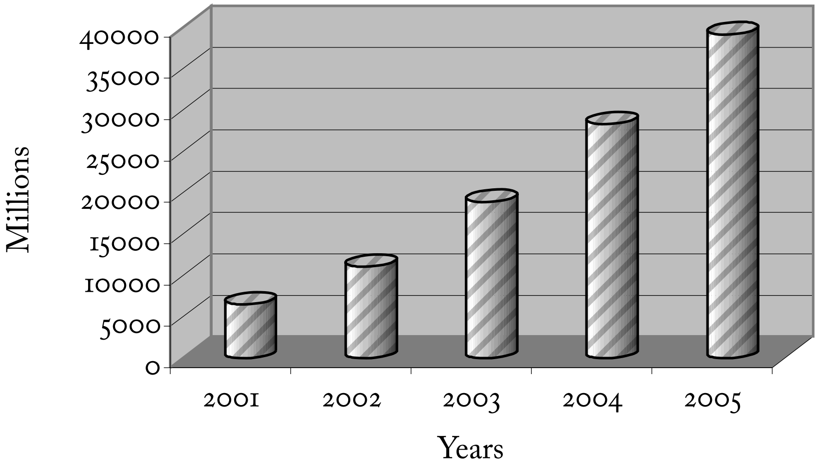

Figure 2: Value of internet sales in Canada, 2001-2005. Source: Statistics Canada, "Electronic Commerce and Technology," *The Daily*, 20 April 2006, http://www.statcan.ca/Daily/English/060420/d060420b.htm (viewed 21 February 2008).

represented the third highest internet penetration rate in the country.[40] British Columbia's increasing internet connectivity rate actually reflects a broader country-wide increase in internet usage. Between 1997 and 2003, for example, internet usage in Canada, as a whole, increased by 179 percent, or 4.4 million households.[41] Not surprisingly, this increase in internet subscribers has been accompanied by an increase in online shopping.

Statistics Canada's data show that BC households spent approximately $500 million on internet-related purchases in 2003 – second only to Ontario.[42] This represented 17 percent of all of the online purchases made in Canada in 2003. Statistics Canada's data also reveal that those who did make online purchases in British Columbia tended to spend, on average, $1,011 - up 10 percent from 2001.[43] In 2005, the most popular products purchased were travel services and arrangements, books, magazines, and online newspapers, along with various digital items such as software and music. In the area of e-commerce usage among SMEs

40 BC Ministry of Management Services, "Internet Use," *Infoline Report* 6, 33 (18 August 2006), http://www.bcstats.gov.bc.ca/releases/info2006/in0633.pdf (viewed 5 February 2008).

41 It should be noted here that Statistics Canada redesigned its Household Internet Use Survey in 2004/05. In 2005, the new Canadian Internet Use Survey shifted focus from "household use" to "adult Canadian use."

42 BC Ministry of Management Services, "E-commerce," *Infoline* 4, 38 (24 September 2004), http://www.bcstats.gov.bc.ca/releases/info2004/in0438.pdf, (viewed 31 May 2007).

43 Ibid.

in British Columbia, the data show that, while interest in internet use continues to grow, adoption rates – for business purposes – remains quite low. The figures for Canada, as a whole, are also remarkably low, but there are promising signs that business use of the internet, in general, is increasing. In all, combined B2C and B2B sales in Canada amounted to approximately $39 billion in 2005.[44] Figure 2 underscores the overall growth in e-commerce in Canada from 2001 to 2005.

Statistics Canada's survey results indicate, among other things, that British Columbia and Canada are on their way to becoming well established digital economies and consumer markets. However, the question that remains is: will embracing e-commerce have a noticeable impact on tax collection in British Columbia? The answer to this question (for several reasons) would appear to be no. First, while the appeal of online shopping is increasing, B2C transactions only represented 0.011 percent of the total value of retail sales ($44 billion) in British Columbia in 2003.[45] Furthermore, the 2005 data show that over half of all internet subscribers use the internet to window shop. However, the most relevant finding is that "6 out of 10 on-line window shoppers actually wound up making a purchase not on-line but directly from a retailer."[46] Hence, most of the items purchased would not have been vulnerable to e-commerce-related tax avoidance. For instance, consumer electronics, furniture, home appliances, motor vehicles, and clothing and jewellery were all listed as popular items likely to be purchased from domestic retailers. In contrast, digitally convertible items such as music, software, and entertainment products rated comparatively low in terms of popularity. In addition, most digital "supply/service" outlets were used to buy concert tickets or to make domestic or international travel arrangements – service transactions that remained within the jurisdictional control of Canada's and British Columbia's revenue authorities.

Second, the data on household shopping show that Canadians, and presumably British Columbians, prefer to shop on Canadian websites.[47] On average, roughly 60 percent to 70 percent of all B2C e-commerce

[44] Statistics Canada, "Electronic Commerce and Technology," *The Daily*, 20 April 2006, http://www.statcan.ca/Daily/English/060420/d060420b.htm (viewed 31 May 2007).

[45] BC Ministry of Management Services, "E-commerce," *Infoline* 4, 38 (24 September 2004), http://www.bcstats.gov.bc.ca/releases/info2004/in0438.pdf (viewed 7 February 2008).

[46] Statistics Canada, "E-commerce: Shopping on the Internet," *The Daily*, 1 November 2006, http://www.statcan.ca/Daily/English/061101/d061101a.htm (viewed 28 February 2008).

[47] Statistics Canada, "E-commerce: Household Shopping on the Internet," *The Daily*, 21 September 2004, http://www.statcan.ca/Daily/English/040923/d040923a.htm (viewed 28 February 2008).

transactions/purchases have taken place within Canada since 2001.[48] Even so, Statistics Canada's results have also consistently shown that up to a third of the dollars spent online have been spent on, or at, foreign websites.[49] At face value, this is certainly an unsettling figure and suggests that some provincial sales tax revenue might be vulnerable to cross-border internet shopping. In particular, digitally convertible items such as music and software can easily be delivered "tax-free." A closer look at the significance (and reality) of cross-border B2C purchases, however, casts some doubt over the claim that they represent a legitimate challenge to Canada's and British Columbia's revenue collection powers and ability to sustain social programs. For example, if one were to use Victoria's 7 percent PST to calculate the potential loss in sales tax revenues from e-purchases from non-Canadian websites, it might have cost the provincial government roughly $11.5 million in 2003.[50] This is a significant sum of money, but it is certainly not enough to cripple the province's tax collection requirements: $11.5 million in lost tax revenue would have only represented 0.0015 percent of the total sales/consumption taxes collected in British Columbia in 2004/05.[51]

Internet usage (i.e., what Canadians are actually using the Internet for) is another important factor to consider. As a platform for consumption purposes, the internet has clearly broadened the average adult Canadian's access to international goods and services, but most Canadians continue to use the internet for other reasons – for example, to communicate (e-mail), to collect information on weather and road conditions, to browse travel destinations, and/or to pay bills.[52] Only 43 percent of home users actually used the internet to purchase personal goods and services in 2005, and, of those 43 percent, only 37 percent and 32 percent, respectively, used a B2C option to buy music and software.[53] Moreover, the appeal of buying goods and services from remote e-vendors has remained fairly consistent, which would seem to contradict the belief that Canadians

48 Author's own calculation based on Statistics Canada's results from the House Internet Use Survey and the more recent Canadian Internet Use Survey.

49 For example, see Statistics Canada, "Electronic Commerce and Technology."

50 Author's own calculation(s).

51 Author's own calculation based on the $7.6 billion in sales/consumption taxes collected in the 2004/05 fiscal year. See Karin Treff and David Perry, *Finances of the Nation, 2005* (Toronto: Canadian Tax Foundation, 2006), 5:5.

52 Statistics Canada, "Canadian Internet Use Survey," *The Daily*, 15 August 2006, http://www.statcan.ca/Daily/English/060815/d060815b.htm (viewed 22 February 2008).

53 Ibid. In 2003, Canadian purchases of "digital products" from foreign venders amounted to approximately $60 million. The potential "tax revenue losses" from these purchases can be estimated at $4.2 million.

are constantly on the look out for cheaper consumer alternatives in the United States and elsewhere.

In addition, not all cross-border internet purchases are tax free. The Canada Revenue Agency, for example, requires all non-Canadian e-vendors conducting business in Canada to remit the appropriate level of sales taxes to the federal government.[54] British Columbia's revenue authorities also require "out-of-province sellers" to charge, collect, and remit PST on all electronic orders "regardless of whether or not [a] business has an agent in the province."[55] Furthermore, all B2C-initiated purchases that are either mailed or couriered to buyers located in British Columbia are subject to the PST.[56] In all, Victoria has made it clear that the deliberate targeting or solicitation of BC customers by "out-of-province sellers" makes them liable to collect PST on "out-of-province" purchases.[57]

A third area that warrants more consideration involves the fact that, while online sales by Canadian private companies grew for a fifth consecutive year in 2004, they still represented less than 1 percent of total operating revenue.[58] In addition, B2B e-commerce is mainly confined to large enterprises. Industry Canada has reported that, while B2C and B2B adoption rates and online purchasing have increased among SMEs, only 45 percent have a web presence, only 38 percent make online purchases, and only a mere 10 percent sell online.[59] SMEs, of course, are not only "central to the Canadian economy," they "account for over 99 percent of Canadian companies."[60]

Hence, in British Columbia's case the impact of electronic commerce on tax collection, at the moment, would appear to be minimal. But what about over the longer term? Again, there does not appear to be sufficient justification for concern over the impact of e-commerce on tax collection and redistribution. If anything, the trends highlighted

---

54 Canada Revenue Agency, "Doing Business in Canada: GST/HST Information for Non-Residents," 27 June 2006, http://www.cra-arc.gc.ca/E/pub/gp/rc4027/rc4027-06e.pdf (viewed 18 March 2008).

55 Ministry of Small Business and Revenue, "Out-of-Province Sellers: Social Service Tax Act," *Bulletin SST 074* (June 2001 [rev. March 2007]), 2.

56 Ministry of Small Business and Revenue, "Goods for Personal Use Imported by British Columbia Residents at International Borders," *Bulletin SST 013* (October 1981 [rev. July 2007]), 2. It is worth pointing out that purchases under twenty dollars in value are PST exempt.

57 Ministry of Small Business and Revenue, "Out-of-Province Sellers," 2. However, there are certain items that are exempt under the Social Service Tax Act.

58 Statistics Canada, "Electronic Commerce and Technology."

59 Industry Canada, "The Challenge of Change: Building the 21st-Century Economy," conference background paper presented at "E-commerce to E-economy Strategies for the 21st Century," Ottawa, September 2004, 8.

60 Ibid.

above are perhaps more an indication of a levelling off of e-commerce's appeal than they are an indication that it will necessarily contribute to a gradual, but altogether meaningful, decline in provincial tax revenue.

POLICY RESPONSE AND CONCLUSION

Since electronic commerce and internet taxation are the responsibilities of Industry Canada and the Canada Revenue Agency, respectively, Victoria has had, and will continue to have, a relatively minor role to play in this specific area of tax policy. Yet, it is important to recognize that the province has made an attempt to account for cross-border internet shopping. As was highlighted in the previous section, there are SST/PST-specific regulations designed to recover revenue on "taxable" items purchased from businesses located outside of the province. This is not to assert that all of British Columbia's enforcement/regulatory efforts have been successful or that they will necessary compel individuals or businesses to surrender to existing provincial tax codes: when has federal or provincial tax policy ever done this? Instead, it merely aims to draw attention to the existence of a regulatory framework and to credit the provincial government with identifying, and responding to, the issue of B2C and B2B e-commerce. Moreover, it seems that Ottawa has decided, at least temporarily, that the commercial benefits of e-commerce outweigh the potentially negative impacts of this technology on tax collection. Hence, it is entirely likely that Ottawa will continue to approach the e-commerce and taxation issue in an ad hoc fashion.[61]

This could very well be the most appropriate policy response to the e-commerce and taxation issue in British Columbia and Canada. Indeed, the evidence suggests that, while electronic commerce is certain to grow into the future, it is not likely to pose a significant challenge to the tax collection and redistribution powers of British Columbia's provincial government. Assuming that it did become more problematic, however, there is certainly enough "tax room" to compensate for any anticipated shortfalls in provincial revenue. For example, British Columbia now boasts – as of the February 2008 budget announcements – the lowest personal income tax rates in the country.[62] British Columbia also cur-

[61] Ligthart, "Consumption Tax in a Digital World," 1087-88.

[62] See British Columbia Ministry of Finance, "Turning to the Future, Meeting the Challenge: Balanced Budget 2008 Highlights," http://www.bcbudget.gov.bc.ca/2008/highlights/2008_Highlights.pdf (viewed 6 March 2008). See also Canada Revenue Agency, "What Are the Income Tax Rates in Canada for 2008?" http://www.cra-arc.gc.ca/tax/individuals/faq/taxrates-e.html (viewed 6 March 2008).

rently has one of the country's lowest combined corporate income tax rates, and there are plans to lower it even further.[63] Should the need arise there may be opportunities to readjust the PST as well.

Increasing tax rates is unpopular. At the same time, however, it is important to understand that raising taxes is not unprecedented. Taxes on income (as a percentage of GDP), for instance, increased considerably (coinciding, of course, with the expansion of Canada's welfare system) between 1965 and 1990.[64] Furthermore, for all of the tax-cutting rhetoric reminiscent of the 1980s and 1990s, Canada's overall tax burden actually increased under the leadership of Brian Mulroney and Jean Chrétien – without, it should be added, any dramatic impact on Canada's overall standard of living.[65] According to Garrett and Mitchell, this may be part of a deliberate strategy pursued by high-income countries to "compensate" for some of the more potentially corrosive features of globalization.[66] The "compensation hypothesis" suggests that "globalization may increase demands on governments to cushion market-generated inequality and insecurity by welfare-state expansion."[67] This might partially explain why, across Canada, spending on social assistance and health care have increased and why it has also coincided with federal Liberal and Conservative party efforts to expand trade and investment arrangements into Central America and South America.[68] Therefore, the idea of possibly raising taxes or expanding the tax base to "compensate" for the effects globalization would appear to have some merit.

---

63 BC Ministry of Finance, "Budget and Fiscal Plan 2008/09-2010," http://www.bcbudget.gov.bc.ca/2008/bfp/default.html#2 (viewed 6 March 2008). See also Canada Revenue Agency, "Corporation Tax Rates," http://www.cra-arc.gc.ca/tax/business/topics/corporations/rates-e.html (viewed 6 March 2008).

64 OECD, *Revenue Statistics, 1965–2005* (Paris: OECD, 2006), 75.

65 Ibid., 19.

66 Geoffrey Garrett and Deborah Mitchell, "Globalization, Government Spending and Taxation in the OECD," *European Journal of Political Research* 39, 2 (2001): 152. See also Geoffrey Garret, "Globalization and Government Spending," *Studies in Comparative International Development* 35, 4 (2001): 6-7; and Geoffrey Garrett, *Partisan Politics in the Global Economy* (New York: Cambridge University Press, 1998).

67 Garrett and Mitchell, "Globalization, Government Spending and Taxation in the OECD," 152.

68 For more information on increases on social and health care spending, see Statistics Canada, *Canada Year Book 2007*, "Government," http://www41.statcan.ca/2007/3055/ceb3055_000_e.htm (viewed 6 March 2008). With regard to trade and investment agreements, Canada has recently (since 1999) signed several "free trade agreements" and "foreign investment protection agreements" with Chile, Costa Rica, Peru, and Venezuela. See Foreign Affairs and International Trade Canada, "Negotiations and Agreements: By Country or Region," http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/neg_country-pays_region.aspx?lang=en&menu_id=17&menu (viewed 6 March 2008).

Yet, the other more significant observation to be made here may be that global electronic commerce and the various other elements of globalization are often used as a convenient scapegoat for rather dubious tax policy decisions. Issues such as global e-commerce are frequently presented as something that is beyond the power of the state to correct, and they seem to be used to deflect criticism away from retrograde – and politically oriented – tax policy manoeuvres. Although this is hardly a revelation, it could be argued that issues related to welfare state sustainability are more contingent on "good" tax policy (i.e., maintaining a progressive tax system, in combination with more reliable and effective forms of taxation in Canada and British Columbia) than on any of the potentially negative effects of globalization. In other words, the elements of globalization are not only unlikely to undermine British Columbia's and Canada's tax bases, but they can be addressed through the collective efforts of provincial and federal revenue authorities – provided there is the political will to do so. Ultimately, we can be certain that, where taxes are at stake or seriously threatened, Ottawa and the provinces will respond accordingly.