

# THE DEDUCTIBILITY OF FOREIGN INTERNET ADVERTISING

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## PRÉCIS

The thesis of this paper<sup>1</sup> is that advertising purchased on foreign **internet-delivered** media that act as broadcast and newspaper services<sup>2</sup> **should not continue to be deemed a deductible expense** under the Canadian *Income Tax Act (ITA)*.

Starting in the 1960s, the federal government introduced a number of amendments to the *Income Tax Act* (section 19) to eliminate or limit the deductibility of advertising expenses on foreign newspapers, periodicals and broadcasters, hence providing a material incentive for advertisers to choose Canadian alternatives. The purpose of these provisions of the *ITA* is socioeconomic - to protect Canadian media from unfair competition from foreign media, preserve Canadian jobs and voices, and keep Canadian media Canadian.

As it stands, the Canada Revenue Agency (CRA) allows full tax deductibility of advertising expenses on foreign internet-delivered media. CRA's interpretation of the *ITA* in this respect has not been updated since 1996, and it is based on (a) case law prior to that date (some of it from as early as 1935) and (b) definitions of "newspaper" and "broadcasting" that do not reflect developments in these on-line media since 1996.

This paper takes the position that it is time to consider new developments and definitions, and work from a new interpretation reflecting current internet realities. Such realities include, first, the legal inference that much if not most internet advertising by Canadians is on media that are, by reasonable current definition, foreign broadcast and newspaper services and, second, the policy consequence of the direct and demonstrable negative impact this diversion of advertising revenue is having on Canadian owned-and-controlled broadcasters and print media.

A new interpretation need not require amendment to the *Income Tax Act*.

The basic legal reasoning of the paper is:

1. The *Income Tax Act* states that "*no deduction shall be made for ... an advertisement directed primarily to a market in Canada and broadcast by a foreign broadcasting undertaking*", defined therein as "*a network operation or broadcasting transmitting undertaking located outside Canada*".
2. The CRTC's original *New Media Exemption Order (1999)* (now called the *Exemption Order for Digital Media Broadcasting Undertakings*) established that most internet-delivered media are broadcasting undertakings, specifically, "digital media broadcasting undertakings" (DMBU), based on the definition of "broadcasting" in the *Broadcasting Act*.
  - a. Some services are excluded – e.g. those whose content is "*still images consisting predominantly of alphanumeric text*" – but most of the significant advertising carriers are DMBUs.
  - b. The 1999 CRTC decision also ruled that delivering content over the internet is "transmission" within the meaning of the *Broadcasting Act*, and therefore it follows that "*broadcasting transmitting undertaking*", the term used in the *ITA*, is included in the term DMBU.
3. Therefore, foreign DMBUs are "foreign broadcasting undertakings" for the purposes of the *Income Tax Act*, and advertisements placed with foreign DMBUs directed primarily to a market in Canada are not deductible expenses.

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<sup>2</sup> Specific examples are discussed below.

4. The *Income Tax Act (ITA)* also establishes that advertising in foreign newspapers is not deductible. The CRA's reference definition of "newspaper" (it is not defined in the *ITA*) does not deal explicitly with the question of internet delivery.
5. Accordingly, the need for a new interpretation of the definition of newspaper and periodical is proposed here, reflecting the current reality that these media are delivered over the internet as well as through physical means. A new interpretation is justified and necessary because:
  - a. CRA's current interpretation of "newspaper" under the *ITA* is also not based on definitions derived from legislation, but rather on Webster's Dictionary as it was in 1996.
  - b. CRA's interpretation also applies only to "web sites" as they existed in 1996, not to the current reality of media delivery.
  - c. Most advertisers have already substituted placement on internet media for the physical forms, showing that they are functionally the same.

The basic policy reasoning of the paper is:

1. The original policy rationale behind the advertising tax deductibility provisions of the *ITA* remains equally as relevant, if not more relevant, with regard to internet media.
2. As was the case with border TV and radio stations and foreign newspapers targeting Canadians, foreign internet media operate in Canada with minimal investment in Canadian jobs, infrastructure, and Canadian content. While foreign services may provide access to Canadian creators, allowing tax deductibility for spending on such entities results in unfair competition with Canadian equivalents and lost revenues and jobs, as well as losses of Canadian programming and news.
3. In the two decades since CRA's current interpretation of the *ITA*, internet advertising has risen from an inconsequential volume and percentage of overall Canadian advertising to more than \$4.6 billion in 2015 – or well over a third of all Canadian advertising revenues. Almost 90% of Canadian internet advertising accrues to foreign-owned internet sites and platforms, with a significant majority of revenues going to top US-owned internet platforms such as Google, YouTube and Facebook.
4. When broadcast advertising deductibility rules were introduced in 1976 through Bill-C-58 (section 19.1 of the *ITA*), US Border TV stations were estimated to be drawing \$10 million annually from total Canadian television advertising spending of \$100 million at the time.
5. If this 10% loss was considered a serious problem in 1976, today's one-third loss should be considered a national media crisis.
6. The economic challenges currently facing Canadian broadcasters and newspapers, and the consequential cuts to local news coverage, in particular, suggest that Canadian local media is indeed in crisis.
7. There is a direct correlation between losses in Canadian media advertising revenue and gains in foreign-based internet media advertising revenue. Enforcing current advertising tax deductibility provisions of the *ITA* with respect to foreign-based internet media would help reverse this trend.
8. In addition, at a time of limited growth in the Canadian economy, there would be a net fiscal benefit in terms of increased tax revenues, to the extent that Canadian advertisers continued to advertise on foreign-based internet media, despite the lack of a tax deduction.

The suggested re-interpretation of the advertising tax deductibility provisions of the *ITA* would result in on the order of 50% - 80% of current internet advertising expenditures being deemed non-deductible.

Conservatively estimating that 10% of these now non-deductible foreign internet advertising expenditures shift back to Canadian media, this would represent an influx of \$250 to \$450 million annually in incremental advertising revenue for a Canadian media sector that is under serious threat.

For the Canadian government, re-interpreting S.19 of the *ITA* as suggested would also bring demonstrable fiscal benefits.

As at 2016, as much as \$4.4 billion in advertising expenditures would no longer be tax deductible – representing a potential gain in corporate tax payable of \$1.15 billion. A massive policy problem (the loss of local media & news) could be solved in a way that actually saved government money.

A policy decision to *amend* the advertising tax deductibility provisions of the *ITA* to apply to all foreign internet media, whether deemed broadcast, print or not, may also be worthy of consideration. Were such a decision to be made by government, the incremental benefit to Canadian media could represent on the order of \$500 million annually, and the fiscal benefit as much as \$1.3 billion.

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## THE POLICY RATIONALE

The purpose of the advertising deductibility provisions of the *ITA* is to protect Canadian media from unfair competition from foreign media, and thereby preserve Canadian jobs and voices.

They do this by limiting or eliminating the deductibility of advertising expenses on foreign newspapers, periodicals and broadcasters, hence providing a material incentive for advertisers to choose Canadian alternatives.

In the 1960s and 70s, US border TV & and radio stations, as well as American newspapers and magazines, came to realize that they could lucratively target the Canadian market with zero to minimal incremental investment in content and infrastructure.

TV and radio stations in markets like Buffalo and Rochester, New York, Bellingham, Washington and Burlington, Vermont started to sell advertising in neighbouring major Canadian markets such as Toronto, Vancouver, and Montreal, undercutting Canadian stations, with no incremental investment other than the cost of sales. By the time broadcast advertising deductibility rules were introduced in 1976 through Bill-C-58 (section 19.1 of the *ITA*), US Border TV stations were estimated to be drawing \$10 million annually from a then total Canadian TV advertising spend of \$100 million.<sup>3</sup>

Similar effects were suffered by print media, resulting in, among other things, Ottawa's efforts to shut down Time Magazine's "split run" – wherein the US version of the magazine was reprinted and redistributed in Canada with Canadian advertisements.<sup>4</sup>

Note that none of these policy efforts were aimed at denying foreign media access to the Canadian market; they were merely aimed at addressing the unfair competition that arose from foreign media competing directly with Canadian media for advertising revenue, without the same investment in Canadian jobs and infrastructure, or its cultural and democratic value.

Essentially, the concept of 'dumping', historically applied in the case of goods sold in Canada for less than their true cost, found parallels in advertising on television and print intellectual property, where the incremental costs of providing content in Canada, and selling advertising on it directed to Canadians, was almost nil.

The advertising deductibility provisions were introduced as a focused measure to protect and advance Canada's economic, cultural and democratic interests.

While not explicitly stated, in the absence of provisions to the contrary, it must be assumed that this legislation was intended to be technology-neutral.<sup>5</sup>

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<sup>3</sup> Value of Public Support for Broadcasters – Simultaneous Substitution and Tax-based Advertising Incentive, Nordicity, November 4, 2011. <http://www.cbc.radio-canada.ca/files/cbcrc/documents/latest-studies/nordicity-value-public-support-en.pdf>

<sup>4</sup> See, for example, McCarthy Tétrault Analysis, at Appendix E: 'The purpose of section 19 was socioeconomic rather than fiscal in nature. Its original objectives were twofold: to place a curb on advertising by Canadian taxpayers in non-Canadian newspapers and periodicals aimed at Canadian markets via "split runs" (a practice which places Canadian publications at a competitive disadvantage) and to remove the likelihood of the control over newspapers and periodicals published in Canada falling into foreign hands (a situation considered prejudicial to Canada's national interests).'

<sup>5</sup> The so-called Supreme Court "copyright pentology" – five copyright judgments released concurrently by the Court in July 2012 – confirmed the importance accorded by the Court to the principle of technological neutrality. See for example, *Entertainment Software Association v. Society of Composers, Authors and Music Publishers of Canada*, 2012 SCC 34, [2012] 2 SCR 231, where the court states at para 9:

"SOCAN has never been able to charge royalties for copies of video games stored on cartridges or discs, and bought in a store or shipped by mail. Yet it argues that identical copies of the games sold and delivered over the Internet are subject to *both* a fee for reproducing the

In 1996, given the state of the internet at that time, the CRA determined that foreign web sites could not be considered foreign newspapers or broadcasters, and therefore allowed full tax deductibility of advertising expenses on such sites.

In the two decades since CRA's interpretation, the internet has emerged as a direct and material competitor to traditional print and broadcasting media, as well as an aggregator and distributor of them.

Internet advertising has risen from an inconsequential volume and percentage of overall Canadian advertising to more than \$4.6 billion in 2015, or well over a third of all Canadian advertising revenues. In 2016, Canadian internet advertising revenue is projected to increase 21% to \$5.55 billion. Double-digit percentage increases have been the norm for two decades, with little indication they are about to end.<sup>6</sup>

Meanwhile, as overall Canadian advertising spending tracks the economy at a relatively fixed ratio,<sup>7</sup> the growth of traditional media has stalled and collapsed. Print was the first traditional media segment to suffer, given that the first wave of the internet consisted primarily of alphanumeric and static images, with advertising (search and classifieds) competing directly with newspapers. Newspaper advertising peaked in Canada at \$2.66 billion in 2005 and has declined to under \$1.3 billion today.<sup>8</sup>

Television was the second traditional media segment to suffer, with private over-the-air television revenue declining from a peak of \$2.14 billion in 2011 to \$1.76 billion in 2015, and specialty television starting to show advertising revenue declines as of 2014.<sup>9</sup> In aggregate, Canadian TV advertising revenue peaked at \$3.55 billion in 2011 and declined to \$3.22 billion in 2015.<sup>10</sup> These advertising revenue declines are now accompanied by declines in subscription revenue as Over-the-Top (OTT) television services like Netflix increase their penetration. These trends reduce the capacity of the broadcasting system to support Canadian content.<sup>11</sup>

Radio is the most recent traditional media segment to see evidence of this impact. The CRTC reports a small advertising revenue decline, from a peak of \$1.62 billion in 2013 to \$1.60 billion in 2015.<sup>12</sup> Going forward, the growth of streaming audio, growth of mobile advertising, smart phone usage and the connected car are expected to increase downward pressure on radio advertising.

Until 2016, the Canadian Internet Advertising Bureau (IAB) published a compelling graph that tracked the year-over-year trend among major media.

Until 2016, the Canadian Internet Advertising Bureau (IAB) published a compelling graph that tracked the year-over-year trend among major media. Starting in 2016, data for only Internet and TV advertising were published. The following is from the 2015 and September 2016 IAB Reports:

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work and a fee for communicating the work. The principle of technological neutrality requires that, absent evidence of Parliamentary intent to the contrary, we interpret the *Copyright Act* in a way that avoids imposing an additional layer of protections and fees based solely on the *method of delivery* of the work to the end user. To do otherwise would effectively impose a gratuitous cost for the use of more efficient, Internet-based technologies."

<sup>6</sup> Data from the Internet Advertising Bureau (Canada) (IAB) *Annual Internet Advertising Revenue Report*, 2016. September 8, 2016 (IAB Report). Current growth is largely driven by mobile, which grew 70% in 2015, as opposed to 3% for online. Mobile has grown from a 3% share of Internet revenues in 2011 to a 35% share in 2015.

<sup>7</sup> A ratio that has nevertheless declined over the last three decades. See, for example, *Progress Amid Digital Transformation*, Scotiabank Equity Research, November, 2013. p.18.

<sup>8</sup> IAB 2015 Report & industry figures.

<sup>9</sup> CRTC statistical summaries. Specialty service national advertising revenue declined from \$1.27 billion in 2013 to \$1.2 in 2015.

<sup>10</sup> IAB 2012 & 2106 Reports.

<sup>11</sup> See for example, *Canadian Television 2020: Technological and Regulatory Impacts*, Peter Miller & Nordicity, January 2016.

<sup>12</sup> CRTC statistical summaries.

The decline of traditional media advertising in favour of the internet might not be of tax policy concern, but for a troubling economic reality.<sup>13</sup>

**Almost 90% of Canadian internet advertising accrues to foreign internet sites and platforms, with two thirds of expenditures going to top US-owned internet platforms Google and Facebook.<sup>14</sup>**

The reason is not a failure on the part of Canadian media to transition to the internet age, or to meet Canadians' needs. The reason, adapting the well known trade term, is the 'dumping' of advertising inventory into the

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<sup>13</sup> The decline of Canadian news media has been called a crisis. Such a crisis merits a policy response. While the CRTC has made some moves to support private local TV, this is seen as an interim fix at best, and in any event, does not address print media. For further background on the state of Canada's news media, see *Media Math: Democracy, News and Public Policy in Canada*, June 19, 2016, Canada's Public Policy Forum and *Near Term Prospects For Local TV in Canada*, Peter Miller & Nordicity, November 5, 2015.

<sup>14</sup> IAB reports that the Top 10 Internet Advertising Earners bringing in 86% of all Canadian internet Ad Revenues in 2015, and the top 20, 90%. This is an increase from the equivalent 2009 numbers of 77% and 87%. The 2016 IAB Report does not identify these companies, but they are understood to be mostly US-owned and controlled, a presumption reflected in viewing stats. The Canadian Media Concentration Project, *Growth of the Network Media Economy in Canada, 1984-2015*, identifies Google and Facebook alone as representing 66.5% of internet advertising revenues in 2015; with identified Canadian media representing 8.2%. This represents a material shift away from Canadian media in a single year, as 2014 #s had 64.1% and 9.9% respectively (with the latter missing in 2014 a major French Canadian Media Group, Group Capitales Média). Internet revenues of Canadian radio and television are generally not publicly reported, but are believed to represent under 5% of traditional advertising revenue. Assuming a 5% level, Canadian media would represent approximately 11% of total internet advertising revenue in Canada.



Canadian marketplace by foreign-based internet conglomerates, which do not contribute the same level of investment, jobs and Canadian content as Canadian media.<sup>15</sup>

This is exactly what the advertising deductibility provisions of the *ITA* were designed to address.

Failure to update these provisions to reflect current reality, while understandable, has already caused significant losses to the Canadian economy, in Canadian economic value, reduced support for Canadian content, and most alarmingly, has reduced the capacity of Canada's private news media to cover and report news to Canadians, particularly local news.

Continued failure to update the application of these provisions is more than a lost economic opportunity. Should current trends continue, the lack of a modernized advertising tax deductibility regime will call into question the ability of Canadian owned-and-controlled media to provide even modest levels of local news coverage. The result would be that Canadians would increasingly have to obtain their news from foreign sources. For an independent democracy to rely on foreign news sources for domestic news coverage should be unthinkable. And while the CBC can and does play an increasing role in providing news to Canadians, loss of diversity of Canadian news services and the notion that the public broadcaster could become the primary, and in some markets, only Canadian news source, is not one most Canadians (or Parliamentarians) are likely to find acceptable.

## THE *INCOME TAX ACT*

Appendix A of this paper contains the full text of Section 19.1 and 19.01 of the Income Tax Act. There are many detailed provisions, but the essential meaning of these sections is:

For newspapers, advertising expenses are deductible only if the advertisement is placed in:

- an issue that is edited and published in Canada,
- and typeset and printed in Canada or the United States,
- of a newspaper whose publication rights are owned by a Canadian citizen, or corporation that is effectively controlled by Canadians,

or it is placed in

- an issue that is published less than twice a year, with editorial content devoted to Canada.

For broadcasting, advertising expenses are not deductible if:

- the advertising is placed in a "broadcasting transmitting undertaking" or network (two or more undertakings whose content is controlled by a network operator) located outside Canada, and
- the advertisement is directed primarily to a market in Canada.

The questions raised by these provisions are, within the meaning of the *Income Tax Act*, (a) is broadcasting still broadcasting when it is transmitted over the internet, and (b) is a newspaper or a periodical still a newspaper or periodical when it is delivered over the internet?

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<sup>15</sup> While some foreign Internet companies make investments in Canada, the *level* of such investment pales in comparison to Canadian companies. For example, Google, which has R&D and YouTube facilities in Canada, reportedly employs on the order of 800 Canadians. Google's Canadian Internet advertising revenues are estimated at over \$2 billion in 2015 – more than either Canadian conventional TV advertising, radio advertising and more than print advertising. By contrast, Canadian conventional TV alone employs close to 6,000 people, almost eight times Google's estimated Canadian employment. (Source: CRTC Statistical Summaries.)

Several subsidiary questions need to be raised to determine the deductibility of an expense, for example, what constitutes “located outside Canada”, but the primary question is one of definition of these changing media.

## INTERPRETATION OF THE INCOME TAX ACT

Sections 19.1 and 19.01 of the Income Tax Act, governing broadcasting and newspapers respectively, date back to the 1960s and 70s. As recently as 2001, when the *ITA* was amended to include Section 19.01(1) (on periodicals), internet advertising was not significant, and the issue of adapting definitions to reflect the internet was not discussed – only traditional media were part of the discussion at that time. It is therefore understandable that the *ITA* does not contain clarifying definitions explicitly including or excluding internet activities.

The only significant document that bears on the question of a definition was a letter issued by the Income Tax Rulings and Interpretation Directorate on October 24, 1996 (full text in Appendix B). This was not an official advance ruling but provided “*general comments*” in response to a taxpayer request for clarification. It also stated that the comments represented a current position only and might not reflect future views.

The issue was: “*Whether section 19 or 19.1 of the Income Tax Act applies to deny a deduction for expenses incurred by a Canadian taxpayer to advertise on a foreign owned World Wide Web site on the internet.*” The letter stated that Sections 19 and 19.1 did not apply, because “*A web site is not a newspaper, a periodical or broadcasting undertaking.*”

Within the context of the time – twenty years ago – this interpretation made sense. A typical “web site” in 1996 did not perform the functions of print media or broadcasting. In 1996, web sites generally contained content made up only of text and still images formatted with the HTML presentation language. Consumer internet speeds did not permit the reliable transmission of video and audio to most users; the widespread use of high-speed broadband internet connections came some years later. Moreover, the only effective means for using internet content was the personal computer; mobile smartphones and tablets, which accelerated the popularity of online periodicals and newspapers, did not yet exist.

Therefore, while the interpretation was appropriate for 1996 technology, it does not apply to media in 2017. Even the term “web site” is outmoded. It does not reflect current practice, in which content is distributed over the internet using a variety of technologies and program languages that permit extensive use of video and audio, and to a wide variety of devices. While a 1996 web site could not provide broadcasting, newspapers and periodicals, internet media in 2017 can, and do. A new interpretation of the *ITA* is required, one that acknowledges this reality.

The 1996 interpretation acknowledges that “newspaper” was not defined in the *ITA*. It therefore draws a definition from a then-current edition of Webster’s Dictionary and from a court case decision written in 1935. These definitions were appropriate in their time but clearly could not reflect the reality of, for example, the online delivery of the Wall Street Journal, the New York Times, or Toronto Star Touch eight decades later. These current delivery mechanisms are unquestionably newspapers, and are branded as such – they are digital ‘electronic editions’, with the same name as their physical equivalents. They contain the same content as the physical editions, adapted to delivery over the internet and enhanced with audio, video, and applications, such as puzzles, that provide user assistance and the opportunity to comment. An interpretation that encompasses these changes is required.

The 1996 interpretation comments noted that their definition of broadcasting was based on “*diverse definitions of words used in paragraphs 19.1(1) and (4) of the Act.*” This was appropriate, since no other source was readily

available in 1996. In 1999, however, the CRTC provided a definition of broadcasting transmitted over the internet in its New Media Exemption Order<sup>16</sup>. Since the CRTC is the body charged with interpreting the meaning of ‘broadcasting’ in Canadian law, its definitions should be used to interpret the *Income Tax Act*.<sup>17</sup>

## DEFINITION OF “BROADCASTING”

The limited definition of ‘broadcasting’ in the *ITA* is appropriate, given that the *Broadcasting Act* (1991) provides a detailed definition, and creates a body – the Canadian Radio-Television and Telecommunications Commission (CRTC) – whose role includes interpretation of that Act.

Three years after the 1996 comments cited above, the CRTC dealt with the question of broadcasting over the internet, and issued a decision in Broadcasting Public Notice CRTC 1999-84 (or DMEO – text of the relevant section in Appendix C) in which the Commission determined that broadcasting over the internet was indeed broadcasting, since the internet represented simply another form of telecommunication:

‘The Commission notes that the definition of “broadcasting” includes the transmission of programs, whether or not encrypted, by other means of telecommunication. This definition is, and was intended to be, technologically neutral. Accordingly, the mere fact that a program is delivered by means of the internet, rather than by means of the airwaves or by a cable company does not exclude it from the definition of “broadcasting”.’

The CRTC’s ‘technology neutral’ approach was based directly on the *Broadcasting Act* and is both a principle of sound regulation and a basic principle of statutory interpretation. There is no legal basis for CRA to read the *Income Tax Act* differently.<sup>18</sup>

The DMEO has been re-examined several times since 1996, and the original determination has stood the test of time. It has occasionally been challenged, but nearly two decades later, and given the judicial deference given it by the Courts, that position must be regarded as the position of the Government of Canada, and therefore appropriate for the interpretation of the *Income Tax Act*. Indeed, there is no contradiction between the two instruments: the DMEO amplifies the definitions in the *ITA*.

## BROADCASTING PUBLIC NOTICE CRTC 1999-84 (DMEO)

The Commission’s determination follows a simple logic:

*The Broadcasting Act* defines “broadcasting” as the “transmission of programs, whether or not encrypted, by radio waves or other means of telecommunication for reception by the public by means of broadcasting receiving apparatus, but does not include any such transmission of programs that is made solely for performance or display in a public place.”

This definition contains several elements, which are treated separately in the decision:

1. Has “transmission” taken place when the program is delivered over the internet?

<sup>16</sup> Called, at the time, the New Media Exemption Order but now known as the Exemption Order for digital media broadcasting undertakings or DMEO. See Broadcasting Order CRTC 2012-409.

<sup>17</sup> A limited number of other Canadian statutes (e.g. the federal *Copyright Act* or the Ontario *Libel and Slander Act*) contain definitions of broadcasting that parallel the *Broadcasting Act* or expand on it to suit their purposes, but it is reasonable to conclude that the legislation that governs broadcasting should provide the ruling definition.

<sup>18</sup> See note 5, supra.

2. What media activities constitute “programs”, whose transmission is therefore broadcasting?
3. Does the use of programs delivered over the internet constitute “reception by the public”?
4. Are the devices used in internet reception, “broadcasting receiving apparatus”?
5. What is excluded from the definition by the provision about “display in a public place”?

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## TRANSMISSION

The Commission rejected the proposal that no transmission could take place on the internet, noting that the *Broadcasting Act* is meant to be technologically neutral. “Other means of telecommunication” would certainly include the internet. Nor is the “on-demand” nature of the communication a barrier.

*39. ... The fact that an end-user activates the delivery of a program is not, in the Commission's view, determinative. As discussed below, on-demand delivery is included in the definition of "broadcasting". ... Based on a plain meaning of the word, and recognizing the intent that the definition be technologically neutral, the Commission considers that the delivery of data signals from an origination point (e.g. a host server) to a reception point (e.g. an end-user's apparatus) by means of the internet involves the "transmission" of the content.*

This is particularly significant because the *ITA* states:

***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*)

The use of the term “transmitting undertaking” is thus covered by the Commission’s definition. A digital media broadcasting undertaking is a broadcasting transmitting undertaking as described in the *ITA*.

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## PROGRAM

The definition of “program” is key, and results in the one significant exclusion of internet media from the definition of “broadcasting”. If what the internet service transmits does not include “programs” then it is not broadcasting. In the original DMEQ, the CRTC said:

*34. The term "program" is in turn defined in section 2 of the Act as:*

*sounds or visual images, or a combination of sounds and visual images, that are intended to inform, enlighten or entertain, but does not include visual images, whether or not combined with sounds, that consist predominantly of alphanumeric text.*

*Explicit statutory exclusions from the definition of broadcasting*

*35. The Commission notes that, as stated above, much of the content available by way of the internet, Canadian or otherwise, currently consists predominantly of alphanumeric text and is therefore excluded from the definition of "program". This type of content, therefore, falls outside the scope of the Broadcasting Act.*

This definition is exclusionary – “program” includes every kind of content that is not excluded: all sounds and visual images – except those that “consist predominantly of alphanumeric text.”<sup>19</sup> As the Commission noted, in 1999 a great deal of internet content consisted predominantly of text. That is far less true today. Certainly on the services that attract the most viewers and therefore attract the most advertising, there is a great deal of audio, video, and images that are not text.

Even a cursory examination of different kinds of advertising-carrying internet services available today reveals a wide spectrum – from, at the extremes, sites that are predominantly video, such as YouTube, to some informational sites that rely exclusively on text. In between these are services like Google search, Facebook, Instagram, and Twitter, consisting of posts containing video, audio, non-alphanumeric images as well as text. Whether such in-between services transmit “programs” and constitute “broadcasting” requires a more detailed examination. Key cases are discussed below under “Deductibility of Specific Sites and Services”.

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## RECEPTION BY THE PUBLIC

The CRTC also dealt with the argument that much internet-transmitted content was not “for reception by the public” because it was delivered on-demand, and was, to some extent, customizable. Since the Commission had been licensing on-demand services for some time in 1999, it did not consider that aspect of the internet to provide a relevant exclusion.

*44. ... The Commission notes that the legislator could have, but did not, expressly exclude on-demand programs from the Act. As noted by one party, the mere ability of an end-user to select content on-demand does not by itself remove such content from the definition of broadcasting. The Commission considers that programs that are transmitted to members of the public on-demand are transmitted "for reception by the public".*

*45. The Commission considers, however, that some internet services involve a high degree of "customizable" content. This allows end-users to have an individual one-on-one experience through the **creation of their own uniquely tailored content.** (emphasis added) In the Commission's view, this content, created by the end-user, would not be transmitted for reception by the public. The Commission therefore considers that content that is "customizable" to a significant degree does not properly fall within the definition of "broadcasting" set out in the Broadcasting Act.*

*46. By contrast, the ability to select, for example, camera angles or background lighting would not by itself remove programs transmitted by means of the internet from the definition of "broadcasting". The Commission notes that digital television can be expected to allow this more limited degree of customization. In these circumstances, where the experience of end-users with the program in question would be similar, if not the same, there is nonetheless a transmission of the program for reception by the public, and, therefore, such content would be "broadcasting".*

Facebook and other social media provide an interesting example. While users do create or, more usually, retransmit content, the individual user has not significantly customized what they themselves see – they have simply provided “profiles” that are then used by the application to select and blend a stream of items for each user. It would therefore seem likely that the most popular social media would be included in “broadcasting”, at

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<sup>19</sup> This also means that the transmission of still images, whether or not accompanied by audio and including graphic images, constitutes a broadcasting undertaking. While the Commission has chosen to exempt such undertakings from licensing, this does not change their legal status as broadcasting undertakings. See <http://www.crtc.gc.ca/eng/archive/1993/PB93-51.htm>

least in some of their modes of communication. The Facebook “news feed” and “live streaming” should be considered broadcasting, while “messaging”, a form of one-to-one communication, would not usually be for reception by the public, and therefore would not be broadcasting.

While there might therefore be argument as to the deductibility of advertising placed on the private communication aspect of foreign social media services, the issue is largely academic. Advertising is not generally placed in “messaging” applications. If provided, it is placed alongside content that is clearly part of a broadcasting offering, and is therefore non-deductible.

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## BROADCAST RECEIVING APPARATUS

This part of the *Act’s* definition of broadcasting is not very useful since it is clearly a circular definition, i.e. the *Broadcasting Act* says the content is broadcasting if it’s received on “broadcast receiving apparatus”, and “broadcast receiving apparatus” is defined by its use to receive “broadcasting”.

The Commission therefore determined that the various devices used to receive content from the internet were “broadcast receiving apparatus” when they were used to receive broadcasting.

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## “PUBLIC PLACE” AND OTHER EXCLUSIONS FROM THE DEFINITION

The Commission rejected the argument that the internet was “a public place”

*36. ... in the sense intended by the Act. Programs are not transmitted to cyberspace, but through it, and are received in a physical place, e.g. in an office or home.*

It confined the use of this exception to narrow circumstances:

- *37 ... to a particular service delivered via the internet that is accessible by end-users only in a terminal or kiosk located in a public place, such as a public library.*

## DETERMINATION OF “FOREIGN”

The *ITA* defines “foreign broadcasting undertaking” as a network operation or a broadcasting transmitting undertaking located outside Canada. The term “located outside Canada” is not defined and therefore must be defined based on broader current and historic context.

One quick way to determine the location of a company and its services is to look at the Wikipedia entry – which the company itself could edit if it deemed it inaccurate. For the major providers of internet-delivered advertising, sample results include:

*Google is an American multinational technology company specializing in Internet-related services and products that include online advertising technologies, search, cloud computing, software, and hardware. (<https://en.wikipedia.org/wiki/Google>)*

*Facebook is an American for-profit corporation and online social media and social networking service based in Menlo Park, California, United States. (<https://en.wikipedia.org/wiki/Facebook>)*

*Twitter is an online news and social networking service where users post and read messages restricted to 140-characters, which are called "tweets". ... Twitter Inc. is based in San Francisco and has more than 25 offices around the world. (<https://en.wikipedia.org/wiki/Twitter>)*

Shares for these companies trade on NASDAQ, the NYSE, and the Hamburg stock exchange. It is evident that the common understanding of the public, tacitly supported by the firms themselves, is that these are not Canadian entities. The CRA could therefore justifiably use its discretion to deem such global internet conglomerates as "located outside Canada".

A more legalistic approach, consistent with historic interpretations, is, however, also available and informative.

When broadcasting solely involved over the air transmission, the location of the transmitter along with the majority of originating broadcasting operations easily defined the location of the undertaking. The fact that a foreign broadcasting undertaking might have had some physical presence in Canada, such as a sales team or even journalists, did not change this determination. The absence of an actual transmitter does not change this determination either, given the Commission's conclusion that that "the delivery of data signals from an origination point (e.g. a host server) to a reception point (e.g. an end-user's apparatus) by means of the internet involves the "transmission" of the content" and thus constitutes broadcasting.<sup>20</sup>

The DMEQ itself, when issued, did not deal with how to determine what DMBUs were foreign. First, since it exempted all digital media broadcasting undertakings from licensing or regulation, whether domestic or foreign, no definition of foreign was required. Second, the *Broadcasting Act* already deals with the question of nationality.<sup>21</sup>

Thus the interpretation of "located outside Canada", under the *ITA*, should rely on a common sense view of its ordinary meaning, within the context of how broadcasting is now defined.

It could be argued that if a DMBU receiving the advertising does not meet the requirements of a Canadian licensee under the *Broadcasting Act*, in terms of its ownership, then that alone could determine the matter – that is, under the *ITA*, advertising expenses could be deemed non-deductible since the broadcasting undertaking is "located outside Canada", in the more general sense of the term.

Given, however, the Commission's definition of internet "transmission", another interpretation of "located outside of Canada" as it is used in the *ITA* could be where the originating point of the content, the host or main servers are located outside of Canada.

A further interpretation could focus on the location of physical infrastructure, including where the majority of equipment and employees are located.

Key here is to address situations where a Canadian internet corporation is essentially a shell for a service whose content is assembled and transmitted from abroad – the case with much of the Internet media available in Canada.

Thus we believe the test for "located outside of Canada" might appropriately start with the second determining factor noted above, namely the location of the originating servers. In 2009, the Federal Court of Appeal dealt with

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<sup>20</sup> DMEQ, cited above.

<sup>21</sup> Section 3(1)(a) of the *Broadcasting Act* states that "the Canadian broadcasting system shall be effectively owned and controlled by Canadians". Specific rules on Canadian ownership are set out in the *Direction to the CRTC (Ineligibility of Non-Canadians) P.C. 1997-486, 1997-04-08*.

a reference from the CRTC on whether ISPs were engaged in broadcasting. In its decision, the Court quoted Paragraph 95 of the Supreme Court’s CAIP decision, which contained a conclusion on location:

*95. Having properly instructed itself on the law, the [Copyright] Board found as a fact that the “conduit” begins with the host server. No reason has been shown in this application for judicial review to set aside that conclusion.<sup>22</sup>*

In other words, while a transmission on the internet can take many routes from origination to user, including temporary storage in a Content Delivery Network, the transmission begins with the first server in the content chain – if that is outside Canada, then so is the broadcasting transmitting undertaking. When the origination point of the transmission is outside Canada, though it may be cached on facilities and have advertisements inserted inside Canada, it does not originate here. As before with over the air broadcasting, the mere presence of some physical facilities or infrastructure in Canada so does not make an internet broadcaster Canadian. However, in cases of some doubt, a multi-layered test, that also factors in ownership and control, where a corporate headquarters are located, and where the majority of employees work, could help ensure “located in Canada” is given an ordinary and appropriate meaning.

As a side note, it appears that many internet services that serve Canada do not collect GST/HST for their sales here. It is due, but they are not obliged to collect it because they have “no facilities in Canada.” Therefore by definition such services are serving Canadians from abroad and their transmissions are foreign.

## TARGETED TO A CANADIAN MARKET

This is a subject on which there is already case law, which need not be different because the transmission takes place over the internet.

As a practical matter, the way advertising on the internet is now sold – the micro-targeting of specific geographies, and (not demographics, but) specific interest profiles – allows Canadian advertisers on both foreign and domestic media to target Canadians with immense precision. By definition, Canadian advertisers advertising on such foreign media are targeting Canadians.

Of course, there are many forms of advertising on the internet that target specific groups of consumers based on their internet activity, with or without the consumers’ knowledge. One can imagine that the argument will be made that these are not directed to a Canadian market, because people may receive them anywhere in the world. And as a matter of fact, it would be possible – though probably impractical – without the co-operation of all parties to the transmission, to determine the location of those who received the advertisements.

However, the situation is no different from that of a business buying an ad in one television market, knowing that the ad will ‘spill’ into another market via on the station’s cable and DTH carriage. In such cases, it is fair to say that the ad is also directed at the second market if people in that market can avail themselves of the service being advertised, because of the Canadian advertiser’s ability to serve that market, whether through physical or e-commerce means.

Appendix D contains text of an analysis by McCarthy-Tétrault of a court decision on this general question. It is useful in that it establishes that “directed to the Canadian market” is not dependent on the use of technology that ensures the ad can only be seen by Canadians, or even content in the ad identifying the product or the service as

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<sup>22</sup> *Society of Composers, Authors and Music Publishers of Canada v. Canadian Assn. of Internet Providers*, 2004 SCC 45 (“SOCAN v. CAIP”).



Canadian. Instead, it can be based on some part of the content of the ad or the service itself that makes it more useful to Canadian customers – in this case a Canadian telephone number.

## DEFINITION OF NEWSPAPER AND PERIODICAL

The issue here is whether the applicable definitions restrict the terms “newspaper” and “periodical” to physical media, and exclude internet-delivered media.

“Newspaper” is not defined in the *Income Tax Act*. The *ITA* refers to the *Foreign Publishers Services Act* for the definition of “periodical”. It is defined there in Section 2:

*periodical means a printed publication that appears in consecutively numbered or dated issues, published under a common title, usually at regular intervals, not more than once every week, excluding special issues, and at least twice every year. It does not include a catalogue, a directory, a newsletter or a newspaper. (périodique)*<sup>23</sup>

The only restrictive element of this definition is the word “printed”, which is not itself defined. We might make the argument that the term does not necessarily imply the use of paper or other physical media, since many dictionary definitions do not include that element. For example, Merriam-Webster provides this (somewhat circular) definition of “printing”:

*the process of producing books, magazines, etc. by using machinery*

but the Cambridge Dictionary, like some other apparently older definitions, makes reference to physical product:

*the activity or business of producing writing or images on paper or other material with a machine:*

On one level, the distinction between physical and digital media is beside the point. The New York Times is clearly a newspaper. It has a physical edition and an electronic edition. Both are branded the same, both are produced from the same content created by the same journalists, though formatted differently and in some cases enhanced by video – which cannot be placed in the physical edition using current technology.<sup>24</sup> Its online edition is simply called “The New York Times”. The periodical, the “New Yorker” also has identical names for online and physical editions.

At minimum, therefore, technological neutrality should require that a periodical or newspaper that is in both physical and digital form should be deemed a “printed publication” in either or both formats.

Beyond this, however, some aspects of the existing definitions become more difficult in the absence of a physical product. Under s. 19(1) and (5) of the *ITA*, the determination of what is “foreign” activity depends to some degree on the location of the activities that produce the physical editions, e.g. typesetting activity and printing on paper. Digital electronic equivalents of these functions exist: physical typesetting is replaced by digital typesetting (or formatting), which requires human design decisions which take place in a physical location.<sup>25</sup>

<sup>23</sup> <http://laws-lois.justice.gc.ca/eng/acts/f-29.6/FullText.html>

<sup>24</sup> Although this too is changing. The physical edition may in future be a flexible, refreshable display device that resembles paper but functions like an electronic screen.

<sup>25</sup> One could also reasonably argue that these latter digital activities are not even “typesetting” within the analogous meaning to that of analogue typesetting.

While some of these latter algorithm-based “digital typesetting” activities might arguably occur in Canada on content delivered to Canadians, if the initial or primary human design decisions for aggregating content within a publication occurred in a foreign jurisdiction, then the publication might reasonably be considered foreign.

What is clearly needed is an interpretive practice that, as in the past, relies on contemporary common-sense definitions derived from sources outside the *ITA*. It should not be necessary to rewrite the definitions, since those parts that are relevant to digital media should be deemed technologically neutral. The existing definitions of Canadian newspapers and periodicals can be interpreted for digital media by reframing those elements that to date have been deemed applicable only to physical media and considering:

- The requirements for 80% original (i.e. Canadian) content
- Canadian ownership as detailed in the *ITA* (see Appendix A)
- Editorial control by Canadians.

## APPLICATION & IMPLEMENTATION

Enforcement of the advertising tax deductibility provisions of the *ITA* in respect of foreign internet-based media would be a non-trivial exercise.

With billions of dollars at stake, and the possibility of litigation and threats of trade retaliation, the temptation to side with the “certainty” of the *status quo* would be high.

As Canada enters into a potentially more fractious trade relationship with the United States, however, advancing the Canadian public interest in a strong Canadian media sector should become an even greater imperative.

Determinations on the applicability and/or extent of applicability of the advertising deductibility provisions to different types of internet media would likely be required. We do not, however, believe that the latter would be unduly onerous or difficult. Specific examples of determining deductibility for some of the major internet media are provided further below.

## TRADE ISSUES

It is reasonable to assume that a new interpretation of the advertising tax deductibility provisions of the *ITA* could raise trade issues.

The US advances its economic interests aggressively, and the potential that billions of dollars accruing to US internet conglomerates may be at risk could attract immediate attention and reaction at the highest levels. The possibility that Canada’s moves could set a precedent for other nations would not be lost in this equation.

We have gone down this road before.

The inclusion of the ‘cultural exemption’ in the FTA, and subsequently NAFTA, was hard fought and yet does not offer full protection to Canada.<sup>26</sup>

The ultimate negotiated compromise on split-run magazines may be a more direct analogy to the current situation; in that trade dispute, Canada held firm and achieved a compromise that stands today<sup>27</sup>.

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<sup>26</sup> This is because, if invoked, it permits retaliation of equivalent commercial effect.

The authors acknowledge that some kind of compromise might ultimately be sought in this situation.<sup>28</sup> Such a compromise may be driven by Canadian interests as well as U.S. – for example, Canadian advertisers<sup>29</sup> may argue that there is no real Canadian equivalent to the reach and rating points achievable on U.S. internet media.

However, our view is that while such considerations may ultimately temper, they should not preclude serious consideration of the need for new or re-interpreted advertising tax deductibility provisions, and their adoption.

This is based both on the economic, cultural and democratic importance of the issue to Canada, and because we believe that the advertising tax deductibility provisions of the *ITA* have always been, and would remain under a new interpretation, consistent with Canada’s obligations under NAFTA and other international trade agreements.

As taxation is generally carved out of both NAFTA and GATS, and this is clearly a tax matter, NAFTA should not apply and the cultural industries exemption should not come into play.<sup>30</sup>

Moreover, to re-interpret the *Income Tax Act* would be no more discriminatory than the existing enforced rule, that has stood up, and moreover been sanctioned in an explicit U.S.-Canada agreement. After all, the rule does not specifically apply to U.S. media interests; it applies only to the tax treatment of expenses incurred by Canadian companies in acquiring advertising inventory from such U.S. interests.

This does not mean that if CRA were to move to enforce the advertising tax deductibility provisions of the *ITA* as suggested in this paper, there would not be trade concerns. It does, however, mean that Canada would be able to respond from a firm legal position.

## DEDUCTIBILITY OF SPECIFIC SITES AND SERVICES

This paper does not argue that all foreign internet-delivered advertising expenses are non-deductible under current law. The benefits of a single blanket rule of non-deductibility on foreign internet-delivered advertising are evident, and the government could consider amendments to legislation to bring this about. Under the current rules, however, it appears that deductibility must be decided on a case-by-case basis, depending on the content of the site or service that presents the advertising.

This section of the paper looks at how these cases might play out with advertising on the most popular sites.

It is significant that the form of advertising is not important; the only consideration is whether it is provided alongside content that constitutes broadcasting, a newspaper or a periodical. Of course, in current practice, much internet advertising is a mix of media, and those ads that appear as simple text often link to other media.

- Section 19.1 of the *ITA* uses the language, “for advertising space in an issue of a newspaper”, and does not limit non-deductibility based on what goes into that space. The wording in Section 19.1(1) is, “for an

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<sup>27</sup> Bill C-55, which was amended to allow foreign publishers limited access to the Canadian market, provided they establish a majority of Canadian content and new periodicals businesses in Canada. See <http://www.lop.parl.gc.ca/content/lop/researchpublications/prb9925-e.htm>

<sup>28</sup> We are reminded of the federal government’s decision to limit tax deductibility of entertainment expenses to 50% from 80% effective February 22, 1994. (Section 67.1 of the *ITA*.) Evidently, the government looked to contain such expenses, but felt it could not reasonably rule them ineligible in their entirety.

<sup>29</sup> The federal government is among those advertisers that have reportedly increased advertising on U.S. Internet sites, to the detriment of Canadian media. See <http://www.cbc.ca/news/politics/newspapers-canadian-heritage-public-policy-forum-digital-news-gathering-Internet-1.3743580>

<sup>30</sup> See, for example <http://www.ucalgary.ca/biztechlaw/node/285>. The fact that the enactment of the advertising tax deductibility provisions of the *ITA* preceded the coming into force of NAFTA (January 1, 1994) also comes into play. While detailed analysis of Trade Law implications is beyond the scope of this paper, it is also worth noting that tax measures favouring Canadian cultural industries, such as tax credits for film and television production, have withstood trade scrutiny.

advertisement ... broadcast by a foreign broadcasting undertaking". All that matters is that it is an advertisement, and that it is transmitted by a service that is a foreign broadcasting undertaking. The form of the advertisement itself is not a consideration.

- Another general question is whether the ads are targeted to a Canadian market. With all of these services, algorithms that track users' internet behaviour can ensure that ads by local retailers in Canada are targeted to their domestic market.

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## YOUTUBE

The content provided on YouTube clearly lies within the CRTC's definition of broadcasting: video is what internet consumers go to YouTube to see. There is a section of text comments attached to each video, but the comments are clearly supplementary to the video – without the video the comments are meaningless, whereas the video itself is meaningful content even if there are no text comments. YouTube is clearly a New Media Broadcasting Undertaking and the cost of advertising placed on YouTube is clearly non-deductible<sup>31</sup>.

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## FACEBOOK

Facebook is the second-largest internet ad revenue generator in the United States, after Google, and is the venue for many advertisements directed to Canadians.

Ads appear throughout the site's various pages and are a mix of static images placed to one side of the screen and dynamic ads that are inserted into the user's NewsFeed, where most users spend the largest proportion of their Facebook time.

On balance, Facebook is a DMBU. The Newsfeed is a mix of text and images, and the images are a mix of video and static, non-alphanumeric pictures, with an occasional alphanumeric image. Typically, users 'share' items to their feed drawn from somewhere else – online newspapers and periodicals, YouTube, broadcast sources, bloggers and a variety of user comments.

From a pure screen space perspective, it could be argued that a large proportion of what Facebook presents is text – but the prevalence and attractiveness of images makes that argument unconvincing. Text can stand on its own more often than it does on YouTube, but typically the video/audio or image (of cats, dogs, music, etc.) is key to the user experience. It is very rare to see a text posting without an image, and the great majority of images are not alphanumeric text. Thus, using the Commission's terminology, videos and images are clearly the "the focus of attention", meaning Facebook cannot be considered to "consist predominantly of alphanumeric text."

Some parties might also revive the argument cited in the CRTC's New Media Exemption Order of 1998 that because each user's experience is different, this is not broadcasting. The Commission dealt with that in its decision, however, and made it clear that unless the users themselves customized their own content and altered it in a truly interactive way – as in a game – that customization made no difference.

Therefore, since Facebook transmits content that falls within the definition of programming, it is a DMBU.

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<sup>31</sup> This legal conclusion does not suggest that, in providing access and distribution for Canadians, YouTube does not make a distinct contribution to the Canadian cultural and social landscape.

## GOOGLE SEARCH

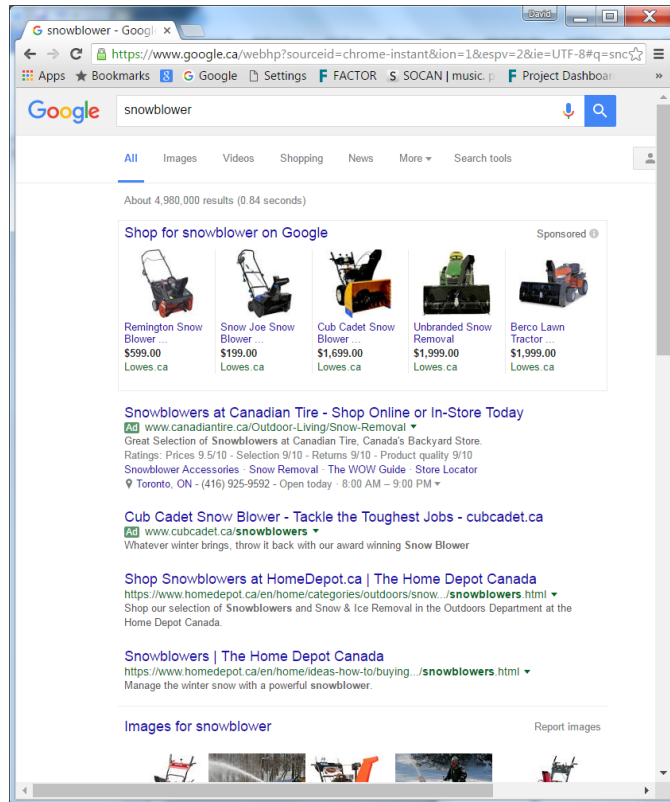
Google Search is also a major generator of ad revenue. It is a somewhat more difficult case to analyze, as can be seen by the sample screenshot to the right.

In this example, a search for “snowblower” on the “All” setting, has resulted in a returned screen that contains:

1. Five images with accompanying text, all of them from a “.ca” address.
2. Four paragraphs of text, two from advertisements tagged as ‘paid’, two from retailers (all Canadian)
3. Five more images of snowblowers, these without text.

When the same search is done under the setting, “Images”, the entire screen is Images but the advertising is less apparent – though there are branded retailers across the top of the screen.

Using the settings for “Videos” or “Shopping” the screen gives roughly equal prominence to images and text, though one might argue that the user’s interest, in this case, is primarily in the information contained in the text.



Given CRA’s definitional approach, Google Search is not a periodical, since it does not produce regular issues. Some informational aspects are akin to a newspaper.

Is it broadcasting?

According to the *Broadcasting Act*, it is broadcasting if the content transmitted fits the definition of “program”, i.e. “sounds or visual images, or a combination of sounds and visual images, that are intended to inform, enlighten or entertain, but does not include visual images, whether or not combined with sounds, that consist predominantly of alphanumeric text.”

The page shown above apparently contains both program and non-program content. The non-alphanumeric images are programs, and those images that are predominantly alphanumeric text are not. The *Income Tax Act* establishes that ads are non-deductible when carried by a foreign broadcaster – but what is Google Search? According to the *Broadcasting Act*, it is a broadcaster when it transmits programs, and some part – but not all – of each page it transmits is programming. So, can Google Search be both – a broadcaster and a non-broadcaster – simultaneously with the same page of content?

We note that a typical licensed broadcasting undertaking such as a television station may spend some part of its time transmitting images that are alphanumeric – e.g. a weather prediction, or a ‘Jeopardy’ question slide – but

the undertaking does not cease to be a broadcaster for that time and purpose. Only services that are exclusively alphanumeric, like the service “Text-TV” (now defunct) have been permitted to operate without a broadcast licence or authorization.

In addition, the Commission determined over the course of a number of decisions in the late 1990s and early 2000s (as to whether certain services should be deemed alpha-numeric) that the term ‘predominantly’, “has no special legal definition and is used in its ordinary sense, i.e. that which is more influential or more powerful.” In examining program guide channels, which combined video and text in a fixed format, it decided that even where an image occupies only one-quarter of the screen, if it is “the focus of attention,” it is a “program”<sup>32</sup>.

In that case, of course, the “image” the Commission was examining was a TV screen in a fixed format. Services on the Internet, however, provide a stream of content in an ever-changing format. Images are often combined with text or alternated with text. It is therefore worth noting that the predominance test for “program” in the *Broadcasting Act* does not apply to a service as a whole but rather, in the case of screen based content, to the visual images that the service provides. A literal interpretation of the *Broadcasting Act* would therefore determine that a service is broadcasting if it transmits any “programs” within the stream; a less demanding interpretation would use the Commission’s test that a service is broadcasting if the images are the “focus of attention”.

Thus, it would appear that CRA has the discretion to deem Google Search a DMBU in its entirety because at least some of its search pages are legally “programs”. Therefore, the ads on those pages are broadcast by a foreign broadcasting undertaking, and their costs are non-deductible.

Alternatively, in the absence of detailed analysis of Google Search usage patterns, we are left with at least two indices that suggest CRA should exercise its discretion to deem Google Search to be predominantly broadcasting:

1. By the CRTC’s measure of “the focus of attention”, even relatively little on-screen use of video or images renders the service non-alphanumeric; and
2. As Canadians’ internet use gravitates more and more to audio and video content, use of search is gravitating in the same direction.

Under such an interpretive approach, CRA might deem Google a DMBU only in respect of those searches that can be deemed “programs”, and a “newspaper” in respect of many if not most of those searches that are not.

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## MUSIC STREAMING SERVICES

Online services such as Spotify, Google Play, and Apple Music provide streaming music. The content of such services is clearly comprised of ‘programs’ within the meaning of the *Broadcasting Act*, and any advertising on them that is in some way directed to a Canadian market should be non-deductible.

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## MAGAZINES

Online magazines are the functional and literal equivalents of paper magazines and should be considered periodicals for the purposes of the *Income Tax Act*. Subject to the current definitions of “foreign” as applied to paper magazines, their advertising, if directed to a market in Canada, should be considered non-deductible. Examples abound, from Harpers to Yachting Monthly.

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<sup>32</sup> Broadcasting Decision CRTC 2005-120.

Texture is a Canadian aggregating service that offers a packaged subscription to many magazines through portable devices like tablets and smartphones. The various packages of content in this service are described as “magazines” without modification of that term. They carry the same names, the same issues and even the same front covers as their printed equivalents. Texture provides a mix of Canadian and foreign magazines.

As in the case of Google Search, it would appear that CRA would have some discretion in the application of the periodical advertising deductibility rules, depending on whether advertising was deemed to be placed on in a foreign magazine or on the aggregating service itself.

## CONCLUSION

The conclusion of this paper is that CRA’s 1996 interpretation of “web sites” needs revisiting, and that under current circumstances, advertising purchased on foreign **internet-delivered** media acting as broadcast and newspaper services **should not be a deductible expense** under the *Income Tax Act (ITA)*.

The upholding of this conclusion would be of major benefit to Canadian media, and Canadians generally.<sup>33</sup>

For Canadian media, it could be the single greatest factor in reversing revenue declines and ensuring viability for Canadian local print, TV and radio operations – and their contributions to Canadian culture, news and democracy. Hundreds of millions of dollars could move back from foreign to Canadian owned-and-controlled media companies – stabilizing and growing their revenues, and allowing these companies to reverse job cuts and re-invest in Canadian content, including journalism.

Specifically, the suggested re-interpretation of the advertising tax deductibility provisions of the *ITA* would, we estimate, result in on the order of 50% - 80% of current internet advertising expenditures being deemed non-deductible.<sup>34</sup>

Conservatively estimating that 10% of these now non-deductible foreign internet advertising expenditures shift back to Canadian media, this would represent an influx of \$250 to \$450 million annually in incremental advertising revenue.<sup>35</sup>

For the Canadian government, re-interpreting S.19 of the *ITA* as suggested would bring demonstrable fiscal benefits.

As at 2016, as much as \$4.4 billion in advertising expenditures would no longer be tax deductible – representing a potential gain in corporate tax payable of \$1.15 billion.<sup>36</sup> Monies would shift to Canadian local media without

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<sup>33</sup> Trade threats, potential threats by foreign internet media to pull out of the Canadian marketplace, and complaints from Canadian advertisers would need to be anticipated and addressed. We nevertheless submit that, for foreign internet-delivered broadcast and newspaper services, it would be a relatively small financial impact, given that many Canadian advertisers would likely remain on foreign internet media, despite a lack of tax deductibility and the relatively low proportionate importance of Canadian marketplace to such global players, generally.

<sup>34</sup> As noted, advertising deductibility on foreign internet sites would need to be interpreted on a case-by-case basis. We would envisage CRA issuing interpretive bulletins that would provide specific guidance on the extent of deduction permitted on different classes of internet media or potentially companies. Foreign video and newspaper sites like YouTube, Crackle and NewYorkTimes.com would be 100% non deductible, while alphanumeric learning or information sites would be 100% deductible. Sites like Facebook and Google Search might be deemed partially deductible, accounting for the lower end of this range.

<sup>35</sup> Based on IAB’s estimate of \$5.55 billion in 2016 Canadian internet advertising revenue.

<sup>36</sup> This assumes an average corporate tax rate of 26%, and that only 20% of internet advertising would retain advertising deductibility (roughly half of this would be Canadian, the other half foreign). While it is impossible to predict the behaviour of internet media or advertisers, it is reasonable to assume that a material portion of newly ineligible advertising on foreign internet media would shift back to Canadian media while

additional government grants or tax credits. A massive policy problem (the loss of local media & news) could be resolved in a way that actually saved government money.

A policy decision to revise the advertising tax deductibility provisions of the ITA to apply to all foreign internet media, whether deemed broadcast, print or not, is also worthy of consideration, but would require amendments to the *ITA*.<sup>37</sup> Should such a decision be made by government, the incremental benefit to Canadian media could represent on the order of \$500 million annually, and the fiscal benefit as much as \$1.3 billion.

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a larger portion would remain. Even if only 50% of current internet advertising expenditures were deemed to be non deductible, that would still leave a fiscal benefit to the Treasury of over \$700 million. Moreover, if foreign internet media dropped their advertising rates to account for any lack of tax deductibility, the majority of the fiscal benefit would still accrue to the government.

<sup>37</sup> Department of Finance Officials acknowledged this in an appearance before the House of Commons Standing Committee of Canadian Heritage Review of Media and Local Communities, December 1, 2016. They noted that measures for print and broadcast outlets are considered "cultural" support through the tax system put in place a long time ago and that extending it to online platforms would be a policy direction the government would have to take. The lesser option of reinterpreting current provisions was not discussed on that occasion.



## APPENDIX A – SECTION 19 OF THE INCOME TAX ACT (CURRENT)

### Limitation re advertising expense — newspapers

**19 (1)** In computing income, no deduction shall be made in respect of an otherwise deductible outlay or expense of a taxpayer for advertising space in an issue of a newspaper for an advertisement directed primarily to a market in Canada unless

- (a) the issue is a Canadian issue of a Canadian newspaper; or
- (b) the issue is an issue of a newspaper that would be a Canadian issue of a Canadian newspaper except that
  - (i) its type has been wholly set in the United States or has been partly set in the United States with the remainder having been set in Canada, or
  - (ii) it has been wholly printed in the United States or has been partly printed in the United States with the remainder having been printed in Canada.

### Marginal note: Where s. (1) does not apply

**(3)** Subsection 19(1) does not apply with respect to an advertisement in a special issue or edition of a newspaper that is edited in whole or in part and printed and published outside Canada if that special issue or edition is devoted to features or news related primarily to Canada and the publishers thereof publish such an issue or edition not more frequently than twice a year.

### Marginal note: Definitions

**(5)** In this section,

**Canadian issue** of a newspaper means an issue, including a special issue,

- (a) the type of which, other than the type for advertisements or features, is set in Canada,
- (b) all of which, exclusive of any comics supplement, is printed in Canada,
- (c) that is edited in Canada by individuals resident in Canada, and
- (d) that is published in Canada; (*édition canadienne*)

**Canadian newspaper** means a newspaper the exclusive right to produce and publish issues of which is held by one or more of the following:

- (a) a Canadian citizen,
- (b) a partnership
  - (i) in which interests representing in value at least 3/4 of the total value of the partnership property are beneficially owned by, and

(ii) at least 3/4 of each income or loss of which from any source is included in the determination of the income of,

corporations described in paragraph (e) or Canadian citizens or any combination thereof,

(c) an association or society of which at least 3/4 of the members are Canadian citizens,

(d) Her Majesty in right of Canada or a province, or a municipality in Canada, or

(e) a corporation

(i) that is incorporated under the laws of Canada or a province,

(ii) of which the chairperson or other presiding officer and at least 3/4 of the directors or other similar officers are Canadian citizens, and

(iii) that, if it is a corporation having share capital, is

(A) a public corporation a class or classes of shares of the capital stock of which are listed on a designated stock exchange in Canada, other than a corporation controlled by citizens or subjects of a country other than Canada, or

(B) a corporation of which at least 3/4 of the shares having full voting rights under all circumstances, and shares having a fair market value in total of at least 3/4 of the fair market value of all of the issued shares of the corporation, are beneficially owned by Canadian citizens or by public corporations a class or classes of shares of the capital stock of which are listed on a designated stock exchange in Canada, other than a public corporation controlled by citizens or subjects of a country other than Canada,

and, for the purposes of clause (B), where shares of a class of the capital stock of a corporation are owned, or deemed by this definition to be owned, at any time by another corporation (in this definition referred to as the "holding corporation"), other than a public corporation a class or classes of shares of the capital stock of which are listed on a designated stock exchange in Canada, each shareholder of the holding corporation shall be deemed to own at that time that proportion of the number of such shares of that class that

(C) the fair market value of the shares of the capital stock of the holding corporation owned at that time by the shareholder

is of

(D) the fair market value of all the issued shares of the capital stock of the holding corporation outstanding at that time,

and where at any time shares of a class of the capital stock of a corporation are owned, or are deemed by this definition to be owned, by a partnership, each member of the partnership shall be deemed to own at that time the least proportion of the number of such shares of that class that

(E) the member's share of the income or loss of the partnership from any source for its fiscal period that includes that time

is of

**(F)** the income or loss of the partnership from that source for its fiscal period that includes that time,

and for this purpose, where the income and loss of a partnership from any source for a fiscal period are nil, the partnership shall be deemed to have had income from that source for that period in the amount of \$1,000,000;  
(*journal canadien*)

**substantially the same** [Repealed, 2001, c. 17, s. 11(2)]

**United States** means

**(a)** the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other United States possession or territory, and

**(b)** any areas beyond the territorial sea of the United States within which, in accordance with international law and its domestic laws, the United States may exercise rights with respect to the seabed and subsoil and the natural resources of those areas. (*États-Unis*)

**Marginal note: Interpretation**

**(5.1)** In this section, each of the following is deemed to be a Canadian citizen:

**(a)** a trust or corporation described in paragraph 149(1)(o) or (o.1) formed in connection with a pension plan that exists for the benefit of individuals a majority of whom are Canadian citizens;

**(b)** a trust described in paragraph 149(1)(r) or (x), the annuitant in respect of which is a Canadian citizen;

**(c)** a mutual fund trust, within the meaning assigned by subsection 132(6), other than a mutual fund trust the majority of the units of which are held by citizens or subjects of a country other than Canada;

**(d)** a trust, each beneficiary of which is a person, partnership, association or society described in any of paragraphs (a) to (e) of the definition *Canadian newspaper* in subsection (5); and

**(e)** a person, association or society described in paragraph (c) or (d) of the definition *Canadian newspaper* in subsection (5).

**Marginal note: Trust property**

**(6)** Where the right that is held by any person, partnership, association or society described in the definition *Canadian newspaper* in subsection (5) to produce and publish issues of a newspaper is held as property of a trust or estate, the newspaper is not a Canadian newspaper unless each beneficiary under the trust or estate is a person, partnership, association or society described in that definition.

**Marginal note: Grace period**

**(7)** A Canadian newspaper that would, but for this subsection, cease to be a Canadian newspaper, is deemed to continue to be a Canadian newspaper until the end of the 12th month that follows the month in which it would, but for this subsection, have ceased to be a Canadian newspaper.

**Marginal note: Non-Canadian newspaper**

**(8)** Where at any time one or more persons or partnerships that are not described in any of paragraphs (a) to (e) of the definition *Canadian newspaper* in subsection (5) have any direct or indirect influence that, if exercised, would result in control in fact of a person or partnership that holds a right to produce or publish issues of a newspaper, the newspaper is deemed not to be a Canadian newspaper at that time.

NOTE: Application provisions are not included in the consolidated text;

see relevant amending Acts. R.S., 1985, c. 1 (5th Supp.), s. 19;

1994, c. 7, Sch. II, s. 14;

1995, c. 46, s. 5;

2001, c. 17, s. 11;

2007, c. 35, s. 13.

[Previous Version](#)

**Marginal note: 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*)

**Marginal note: 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.

**Marginal note: 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.

**Marginal note: 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.

**Marginal note: 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](#).

**Marginal note: 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.

**Marginal note: 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.

**Marginal note: 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.

**Marginal note: 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).

## APPENDIX B – THE 1996 INTERPRETATION DOCUMENT

Source: Taxnet Pro TM © 2016 Thomson Reuters Canada Limited.

Legislation

9618735 -- Deductibility of advertising expenses — internet

Date: October 24, 1996

Reference: 19, 19.1

**SUMMARY:** Whether section 19 or 19.1 of the Income Tax Act applies to deny a deduction for expenses incurred by a Canadian taxpayer to advertise on a foreign owned World Wide Web site on the internet.

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the Department.

**PRINCIPAL ISSUES:**

Whether section 19 or 19.1 of the Act applies to deny a deduction for expenses to be incurred by a Canadian taxpayer to advertise on a foreign owned web site.

**POSITION:**

No

**REASONS:**

A web site is not a newspaper, a periodical or broadcasting undertaking.

5-961873 XXXXXXXXXXX L. Roy Attention: XXXXXXXXXXX

October 24, 1996

Dear Sir\Madam:

Re: Deductibility of advertising expenses

This is in reply to your facsimile of May 24, 1996 in which you requested a ruling on whether expenses by a Canadian taxpayer to advertise on a foreign owned web site would be deductible under the Income Tax Act (the "Act").

Advance income tax rulings, in addition to there being a charge for the service, are given only in respect of proposed transactions involving specific taxpayers and will only be provided in response to a request for an advance income tax ruling submitted in accordance with the Information Circular 70-6R2 dated September 28, 1990, and the Special Release thereto issued on September 30, 1992, issued by Revenue Canada, Customs, Excise and Taxation. Nevertheless, we can provide you with the following general comments.

Advertising expenses related to the income earning process are generally deductible. However, pursuant to section 19 of Act, no deduction shall be made in respect of an otherwise deductible expense of a taxpayer for advertising space in an issue of a non-Canadian newspaper or periodical for an advertisement directed primarily to a market in Canada.

Also, subsection 19.1(1) of the Act provides that in computing income, no deduction shall be made in respect of an otherwise deductible expense of a taxpayer for an advertisement directed primarily to a Canadian market and broadcast by a foreign broadcasting outlet.

**The words "newspaper" and "periodical" are not defined in the Act. The Webster's Ninth New Collegiate Dictionary has the following meaning for the word "newspaper":**

**"a paper that is printed and distributed usu. daily or weekly and that contains news, articles of opinion, features, and advertising".**

**The Supreme Court, in the King v. Montreal Stock Exchange, (1935) 4 D.L.R. 630 (S.C.C.), gave the meaning of newspaper for the purposes of the Excise Tax Act as follows:**

**"a paper printed and distributed at stated intervals... to convey news... and other matters of public interest".**

**The Department has taken the position that a periodical is a publication, other than a newspaper, the issues of which appear at regular intervals of less than a year.**

**Consequently, based on those definitions, it is our view that generally section 19 of the Act would not apply to expenses incurred by a Canadian taxpayer to advertise on a foreign owned web site, since the web site would not be a newspaper or a periodical.**

Concerning the issue of broadcasting, subsection 19.1(4) of the Act defines "foreign broadcasting undertaking" to mean a network (as defined under subsection 19.1(4) of the Act), operation or a broadcasting transmitting undertaking located outside Canada or on a ship or aircraft not registered in Canada. Based on diverse definitions of words used in paragraphs 19.1(1) and (4) of the Act, it is our view that section 19.1 of the Act would not apply to expenses incurred by a Canadian taxpayer to advertise on a foreign web site since a web site is not a broadcast by a "foreign broadcasting undertaking".

As explained in paragraph 21 of Information Circular 70-6R2 dated September 28, 1990, the above comments do not constitute an advance income tax ruling and are not binding on the Department. We trust that our comments are of assistance to you.

Yours truly,

for Director Financial Industries Division Income Tax Rulings and Interpretations Directorate Policy and Legislation Branch



**APPENDIX C – EXCERPTS FROM BROADCASTING PUBLIC NOTICE CRTC 1999-84 / TELECOM PUBLIC NOTICE CRTC 99-14 OTTAWA, 17 MAY 1999**

**Is new media "broadcasting"?**

*Statutory Definitions*

33. "Broadcasting" is defined in section 2 of the Broadcasting Act as follows:

[a]ny transmission of programs, whether or not encrypted, by radio waves or other means of telecommunication for reception by the public by means of broadcasting receiving apparatus, but does not include any such transmission of programs that is made solely for performance or display in a public place.

34. The term "program" is in turn defined in section 2 of the Act as:

[s]ounds or visual images, or a combination of sounds and visual images, that are intended to inform, enlighten or entertain, but does not include visual images, whether or not combined with sounds, that consist predominantly of alphanumeric text.

*Explicit statutory exclusions from the definition of broadcasting*

35. The Commission notes that, as stated above, much of the content available by way of the internet, Canadian or otherwise, currently consists predominantly of alphanumeric text and is therefore excluded from the definition of "program". This type of content, therefore, falls outside the scope of the Broadcasting Act. Accordingly, the remainder of this section contemplates internet content that consists only of audio, video, a combination of audio and video, or other visual images including still images that do not consist predominantly of alphanumeric text.

36. It was submitted, among other things, that information displayed on the internet can be considered to be solely for display in a public place and therefore excluded from the definition of "broadcasting". Certainly, the Canadian public expressed its view that the internet has a unique ability to foster citizen engagement and public discourse. While the Commission agrees, it considers that the internet is not in and of itself a "public place" in the sense intended by the Act. Programs are not transmitted to cyberspace, but through it, and are received in a physical place, e.g. in an office or home.

37. The Commission considers, however, that the exception to the definition of "broadcasting" for programs transmitted for display in a public place would apply, as suggested by one participant, to a particular service

delivered via the internet that is accessible by end-users only in a terminal or kiosk located in a public place, such as a public library.

*Technological neutrality of "broadcasting"*

38. The Commission notes that the definition of "broadcasting" includes the transmission of programs, whether or not encrypted, by other means of telecommunication. This definition is, and was intended to be, technologically neutral. Accordingly, the mere fact that a program is delivered by means of the internet, rather than by means of the airwaves or by a cable company, does not exclude it from the definition of "broadcasting".

39. Some parties argued that there is no "transmission" of content over the internet, and therefore, there is no "broadcasting". The fact that an end-user activates the delivery of a program is not, in the Commission's view, determinative. As discussed below, on-demand delivery is included in the definition of "broadcasting". Further, the Commission considers that the particular technology used for the delivery of signals over the internet cannot be determinative. Based on a plain meaning of the word, and recognizing the intent that the definition be technologically neutral, the Commission considers that the delivery of data signals from an origination point (e.g. a host server) to a reception point (e.g. an end-user's apparatus) by means of the internet involves the "transmission" of the content.

40. Some parties submitted that the definition of "broadcasting receiving apparatus" was not intended to capture devices such as personal computers or Web TV boxes when used to access the internet. The Commission notes that the definition of "broadcasting receiving apparatus" includes a "device, or combination of devices, intended for or capable of being used for the reception of broadcasting". The Commission considers that an interpretation of this definition that includes only conventional televisions and radios is not supported by the plain meaning of the definition and would undermine the technological neutrality of the definition of "broadcasting". In the Commission's view, devices such as personal computers, or televisions equipped with Web TV boxes, fall within the definition of "broadcasting receiving apparatus" to the extent that they are or are capable of being used to receive broadcasting.

*Transmission of programs for reception by the public*

41. It is therefore necessary to consider whether the transmission of sounds or visual images (or a combination of sounds and visual images) that do not consist predominantly of alphanumeric text by means of the internet can be said to involve the transmission of programs for reception by the public.

42. A number of parties submitted that content that is "customizable" does not constitute "broadcasting". The Commission notes that parties have used the term "customizable" to mean different things. For example, some parties cited the non-simultaneous characteristic of internet services as a basis for which such services cannot be considered to be "broadcasting".

43. The Commission considers it important to distinguish between the ability to obtain internet content "on-demand" - the non-simultaneous characteristic of internet services - and the ability of the end-user to "customize", or interact with, the content itself to suit his or her own needs and interests.

44. In the Commission's view, there is no explicit or implicit statutory requirement that broadcasting involve scheduled or simultaneous transmissions of programs. The Commission notes that the legislator could have, but did not, expressly exclude on-demand programs from the Act. As noted by one party, the mere ability of an end-user to select content on-demand does not by itself remove such content from the definition of broadcasting. The Commission considers that programs that are transmitted to members of the public on-demand are transmitted "for reception by the public".

45. The Commission considers, however, that some internet services involve a high degree of "customizable" content. This allows end-users to have an individual one-on-one experience through the creation of their own uniquely tailored content. In the Commission's view, this content, created by the end-user, would not be transmitted for reception by the public. The Commission therefore considers that content that is "customizable" to a significant degree does not properly fall within the definition of "broadcasting" set out in the Broadcasting Act.

46. By contrast, the ability to select, for example, camera angles or background lighting would not by itself remove programs transmitted by means of the internet from the definition of "broadcasting". The Commission notes that digital television can be expected to allow this more limited degree of customization. In these circumstances, where the experience of end-users with the program in question would be similar, if not the same, there is nonetheless a transmission of the program for reception by the public, and, therefore, such content would be "broadcasting". These types of programs would include, for example, those that consist of digital audio and video services.

## APPENDIX D - MCCARTHY TÉTRAULT ANALYSIS, 19.1

Analysis/Commentary — Canada Tax Service — McCarthy Tétrault Analysis, 19.1 -- Limitations re Advertising Expense, published by Thomson Reuter Canada (Taxnet Pro (c))

Advertising on Foreign Broadcasts

Last Updated: 2016-01-12

### Overview

Section 19.1, proclaimed in force from September 22, 1976, prohibits the deduction of expenses for advertising directed primarily to the Canadian market by foreign radio and television broadcasters. This provision applies only to advertising expense incurred on or after September 22, 1976, subject to certain transitional relief relevant to advertising contracts already entered into on that date.

### Application

In terms similar to those in section 19, section 19.1 extends the ban on foreign advertising directed primarily at Canadian consumers by Canadian taxpayers to advertisements appearing on foreign radio and television broadcasts. The cost of any such commercials on or after September 22, 1976 will not be deductible as advertising expense by Canadian taxpayers (subsection 19.1(1)). Excepted, however, are outlays or expenses made or incurred before September 22, 1977 in respect of commercials aired pursuant to a written contract dated prior to January 24, 1975, or to certain short-term written agreements entered into after January 23, 1975 and before September 22, 1976 (subsection 19.1(2)).

In *Ontario Craftmatic Ltd v MNR*, [1989] 2 C.T.C. 2342, Canadian dealers of Craftmatic products attempted to deduct payments made as their share of costs in connection with the broadcasting of certain advertisements by US television stations, contending that such expenses were not for “advertising” but for purchase of customer “leads” resulting from responses to the toll-free number displayed in the ads for Canadian residents. Alternatively, the taxpayers maintained that the expenses were not directed primarily to a market in Canada. Even though neither the name of the Canadian dealer nor its telephone number appeared in the ads, the Tax Court of Canada ruled that the costs incurred constituted expenses for advertisement which, because of the Canadian telephone number, were directed specifically at the Canadian market. Accordingly, the expenses were held to be non-deductible by virtue of subsection 19.1(1).

## APPENDIX E - MCCARTHY TÉTRAULT ANALYSIS, 19

Analysis/Commentary — Canada Tax Service — McCarthy Tétrault Analysis, 19 -- Limitations re Advertising Expense, published by Thomson Reuter Canada (Taxnet Pro)

Limitations re Advertising Expense

Last Updated: 2015-10-13

### Overview

The purpose of section 19 was socioeconomic rather than fiscal in nature. Its original objectives were twofold: to place a curb on advertising by Canadian taxpayers in non-Canadian newspapers and periodicals aimed at Canadian markets via “split runs” (a practice which places Canadian publications at a competitive disadvantage) and to remove the likelihood of the control over newspapers and periodicals published in Canada falling into foreign hands (a situation considered prejudicial to Canada's national interests). Both of these initial objectives were sought by means of the single expedient of disallowing as an expense of Canadian taxpayers the cost of advertising in foreign publications aimed at the Canadian market or in Canadian publications not effectively owned by Canadian citizens. The measure was expected to render both practices so unprofitable as to be prohibitive.

As a result of the Canada-United States Free Trade Agreement, which came into effect on January 1, 1989, however, section 19 was amended so that it became inapplicable with respect to newspapers and periodicals dated after December 31, 1988 which would meet the qualifications of a Canadian issue of a Canadian newspaper or periodical except that they were printed, or their type was wholly set, in the United States, or partly printed or set in that country and the remainder in Canada. The anti-avoidance rule in subsection 19(8) was enacted by SC 1995, c 46 (Bill C-103) which also amended the Excise Tax Act to impose an excise tax on split-run editions of periodicals. See Finance Canada News Release 95-050 reproduced below.

Section 19 partially implemented the recommendations of the O’Leary Royal Commission while at the same time enlarging the scope thereof to embrace newspapers as well as periodicals.

Following the May 26, 1999 announcement of an agreement-in-principle between the government of Canada and the government of the United States concerning the access of foreign periodicals to the Canadian advertising services market, it was announced in a Canadian Heritage News Release dated June 4, 1999 that the governments had signed a formal Agreement on Periodicals. As part of this Agreement, Canada agreed to amend Bill C-55 (the Foreign Publishers Advertising Services Act) as well as the Income Tax Act. Accordingly, section 19 was amended in 2001, applicable in respect of advertisements placed in an issue dated after May 2000, so that advertisements in periodicals are excluded from the ambit of section 19. Rules concerning the deductibility of expenses for certain advertisements in periodicals containing specified levels of original editorial content are now set out in section 19.01. **Section 19.01 permits full deductibility of expenses for advertisements published in issues of periodicals that contain at least 80 per cent original editorial content, and 50 per cent deductibility for advertising expenses in other periodicals, regardless of the ownership of the periodical.** Section 19 will not preclude the deduction of an otherwise deductible advertising expense for an advertisement in a non-Canadian newspaper or periodical that is directed at a market located outside Canada (see for example CRA Views Doc No 2004-0071381E5).

Application

As already explained, section 19 is intended to preclude objectionable practices with social or economic consequences. **If its objectives are attained, it follows that it will have no income tax consequences whatever and will be without application in practice, being prohibitive in nature rather than operational.** However, the principal features of this provision—which applies to any issue of a “non-Canadian” newspaper—are briefly reviewed below.

#### Statutory Exceptions

A “Canadian issue” of a “Canadian newspaper” (discussed below) is excepted from the operation of section 19 by paragraph 19(1)(a). A most significant exception to the section is found in paragraph 19(1)(b) applying to an issue of a newspaper which would qualify as a Canadian issue of a Canadian newspaper except for the fact that: (i) its type was wholly set in the United States, or was partly set in the United States and the remainder in Canada, or (ii) it was wholly printed in the United States, or partly printed in that country and the remainder in Canada. For the purposes of section 19, “United States” does not include Puerto Rico, the Virgin Islands, Guam or any other United States possession or territory but includes areas beyond the territorial seas of the United States within which it may exercise rights with respect to the seabed and subsoil and the natural resources thereof according to international and United States law.

Prior to the amendments made applicable in respect of advertisements placed in an issue dated after May 2000, the introductory words to subsection 19(1) referred to an issue of a newspaper or periodical, paragraph 19(1)(a) referred to a Canadian issue of a Canadian newspaper or periodical dated after 1975, and paragraph 19(1)(b) referred to an issue of a newspaper or periodical dated after December 31, 1988 that would be a Canadian issue of a Canadian newspaper or periodical except for the circumstances described in subparagraphs 19(1)(b)(i) and (ii) discussed above.

Excepted from the effect of section 19 prior to January 1, 1976 was any newspaper or periodical which, though foreign-owned, was regularly publishing special Canadian editions throughout the 12 months preceding April 26, 1965 (the Budget date) and continued to do so thereafter without interruption, provided that the Canadian editions were at least partly edited in Canada and were printed and published in Canada (former subsec 19(2)).

Also excepted from the application of section 19 are special twice-yearly (or less frequent) issues of foreign publications (subsec 19(3)).

#### “Canadian Issue”

**Applicable in respect of advertisements placed in an issue dated after May 2000, a “Canadian issue” of a newspaper is defined in subsection 19(5) to mean an issue (including a special issue) meeting the following four conditions:**

- (iv) its type (except the type for advertisements or features) must be set in Canada;**
- (ii) all of the issue (exclusive of any comics supplement) must be printed in Canada;**
- (iii) it must be edited in Canada by individuals resident in Canada; and**
- (iv) it must be published in Canada.**

As formerly defined in subsection 19(5), a “Canadian issue” of a newspaper or periodical was one of which the type (except for advertisements or features) was set in Canada and which was printed in Canada (except for comics),

edited in Canada by Canadian residents, and published in Canada (former para (a) of the definition). Two exclusions applicable to periodicals were provided for in former subparagraphs (b)(v) and (vi) of the definition, notably in the case of an issue of a periodical the contents of which, excluding advertisements, were more than 20 per cent the same as the contents of one or more issues of one or more periodicals printed, edited or published outside Canada.

#### “Canadian Newspaper”

For a newspaper to qualify as Canadian, the exclusive right of publication must belong to Canadian citizens, Her Majesty in right of Canada or a province, a municipality in Canada, or other entities meeting specified requirements. If the publication right is held by an association or society, at least three-fourths of its members must be Canadian citizens. In general terms, if such right is held by a partnership or corporation, at least three-fourths of the real ownership must belong to Canadian citizens or qualifying corporations. (Further discussion is provided below under separate headings.) If such right is the property of a trust or estate, it does not qualify unless each beneficiary thereof falls into one of the foregoing categories (subsec 19(6)).

Prior to amendments made applicable in respect of advertisements placed in an issue dated after May 2000, subsection 19(5) defined the term “Canadian newspaper or periodical” in the same manner.

#### Deemed Canadian Citizens

A special deeming rule was added in subsection 19(5.1), applicable generally in respect of advertisements placed in an issue dated after June 1996. However, in its application to advertisements placed in an issue dated after June 1996 and before June 2000, references in the subsection to “Canadian newspaper” are to be read as references to “Canadian newspaper or periodical”.

According to the March 16, 2001 Explanatory Notes, subsection 19(5.1) extends the meaning of Canadian citizen for section 19 purposes to ensure that Canadian pension funds and certain other entities (as described in paragraphs (a) to €) that may own Canadian newspapers are considered to be Canadian citizens for the purpose of the ownership requirements. In the case of periodicals, the amendment applies from July 1996 to May 2000, as nationality of ownership ceases to be relevant in the context of periodicals after May 2000.

The following entities are deemed to be Canadian citizens for purposes of section 19:

- pension trusts or pension corporations described in paragraph 149(1)(o) or (o.1) formed in connection with a pension plan existing mainly for the benefit of Canadian citizens;
- an RRSP or RRIF trust having a Canadian citizen as its annuitant;
- a mutual fund trust, except where the majority of its units are held by citizens or subjects of a foreign country;
- a trust of which each beneficiary is a person, partnership, association or society described in any of paragraphs (a) to € of the definition “Canadian newspaper”; and
- a person, association or society described in paragraph € or (d) of the definition “Canadian newspaper” (ie, the federal or provincial government or a municipality in Canada and associations or societies of which at least  $\frac{3}{4}$  of the members are Canadian citizens).

#### Exclusive Right to Publish Held by a Partnership

Where a partnership holds an exclusive right of publication, paragraph (b) of the definition “Canadian newspaper” requires that interests in the partnership representing in value at least three-fourths of the total value of the partnership property be beneficially owned by Canadian citizens, corporations described in paragraph € of the definition, or a combination of Canadian citizens and such corporations, and that at least three-fourths of the income or loss of the partnership from any source must be included in determining the income of such persons or combinations of such persons. Prior to the 2001 amendments made applicable as described above, paragraph (b) of the definition “Canadian newspaper or periodical” set out these requirements in respect of a partnership holding an exclusive right of publication that was acquired after July 13, 1990. These requirements could have applied with respect to rights referred to in paragraph (b) that were acquired after 1988 where the acquirer of the right so elected by notifying the Minister of National Revenue in writing before 1992 (by section 159 of SC 1993, c 24, if such an election was made before December 11, 1993, it was deemed to have been made before 1992).

Prior to the 1991 amendments, it was required that at least three-fourths of the members of a partnership owning an exclusive right to publish be Canadian citizens and that interests in the partnership representing at least three-fourths of the total value of the partnership property be beneficially owned by Canadian citizens.

Exclusive Right to Publish Held by a Corporation

**Where the exclusive right to publish is held by a corporation, paragraph € of the definition “Canadian newspaper” requires that the corporation be incorporated under Canadian or provincial laws and that its chairperson or other presiding officer and at least three-fourths of its directors (or similar officers) be Canadian citizens.** In addition, subparagraph €(iii) sets out requirements concerning ownership of the corporation’s share capital. These requirements were formerly set out in the definition “Canadian newspaper or periodical”. With respect to rights that are acquired after July 13, 1990 (or acquired after 1988 where the acquirer makes a timely election in writing) a public corporation must have a class or classes of its shares listed on a designated stock exchange in Canada (formerly a prescribed share exchange in Canada; see the commentary to section 262) and may not be controlled by citizens or subjects of a country other than Canada. See the special application rule discussed below concerning the acquisition of rights by citizens or subjects of a country other than Canada or corporations controlled by such individuals.

If the corporation is not a public corporation, at least three-fourths of its shares with full voting rights and shares having a total fair market value of at least three-fourths of the fair market value of all the corporation’s issued shares must be beneficially owned by Canadian citizens or by public corporations described above. A special “see-through” rule is provided for these purposes where shares of a class of a corporation’s capital stock are owned or deemed to be owned by a holding corporation other than a public corporation with shares listed on a designated stock exchange (formerly a prescribed stock exchange; see the commentary to section 262). The rule treats each shareholder of the holding corporation as owning that proportion of the corporation’s shares of that class that the fair market value of the holding company shares the shareholder then owns is of the fair market value of all the issued and outstanding shares of the holding company. Similarly, where shares of a class of a corporation’s capital stock are owned or deemed to be owned by a partnership, each member thereof is deemed to own the least proportion of shares of that class that the member’s share of the partnership’s income or loss from a particular source for the relevant fiscal period is of the partnership’s income or loss from that source for that fiscal period. Furthermore, for purposes of determining this proportion, where the partnership’s income and loss from any source for a fiscal period are nil (so that the member’s income interest would not be determinable), the partnership is deemed to have had income from that source for that period equal to \$1,000,000.



Prior to these amendments, it was merely required that at least three-fourths of the shares having full voting rights and shares representing at least three-fourths of the corporation's paid-up capital be beneficially owned by Canadian citizens or by corporations other than corporations controlled by citizens or subjects of a country other than Canada.

#### Special Application Rule

Where after July 13, 1990 an individual who is a citizen or subject of a country other than Canada (or a corporation controlled by such an individual or individuals) acquires in an arm's length transaction more than one-fourth of a corporation's shares having full voting rights or shares having a total fair market value of more than one-fourth of the fair market value of all the corporation's issued shares, the corporation of which such shares are acquired and any corporation controlled by it are deemed to have acquired at that time any publication/production right referred to the definition that it then owns.

#### Saving Provision

Because the status of "Canadian newspaper" (previously, of "Canadian newspaper or periodical" might be unavoidably, if temporarily, lost (for example through the death of the owner or one of the part owners of the publication right), a 12-month grace period is allowed throughout which the preferred status is regarded as continuing, thus affording an opportunity for the publication to regain its Canadian status without interruption, if possible (subsec 19(7)). See for example CRA Views Doc No 2003-0048425.

#### Anti-avoidance Rule (subsection 19(8))

Subsection 19(8) deems a newspaper not to be a Canadian newspaper at any time that a person or partnership not described in para (a), (b), (c), (d) or € of the definition "Canadian newspaper" has any influence (direct or indirect) that would result in control in fact of a person or partnership holding a publication right. Prior to the amendments made applicable in respect of advertisements placed in an issue dated after May 2000, subsection 19(8) deemed a newspaper or periodical not to be a Canadian newspaper or periodical where such a person or partnership had any such influence. This rule applied generally after December 15, 1995. However it did not apply where the influence that would result in control in fact arose as a consequence of a transaction or series of transactions completed before April 1993.

The following Finance Canada News Release (No 95-050, dated June 15, 1995) explains the context in which former subsection 19(8) was enacted.

#### NOTICE OF WAYS AND MEANS MOTION TO AMEND THE EXCISE TAX ACT AND THE INCOME TAX ACT TABLED IN THE HOUSE OF COMMONS

Minister of National Revenue, David Anderson, on behalf of Finance Minister Paul Martin, today tabled in the House of Commons a Notice of Ways and Means Motion to amend the Excise Tax Act and the Income Tax Act.

The amendments proposed in the motion will implement two measures that were announced by Canadian Heritage Minister Michel Dupuy in December 1994 in the government's response to the Report of the Task Force on the Canadian Magazine Industry. These measures maintain the government's long-standing policy respecting Canadian magazines and underscore the federal commitment to support the continued existence of a viable and original Canadian magazine industry. They include an excise tax on split-run editions of periodicals and an anti-avoidance rule relating to the deductibility of advertising expense in non-Canadian newspapers and periodicals.

The proposed amendments to the Excise Tax Act will impose an excise tax at the rate of 80% of the value of all the advertisements contained in a Canadian split-run edition. A split-run edition is an edition that is distributed in Canada, that contains more than 20% editorial material that is not original to the Canadian market and that contains one or more advertisements directed at Canadians.

The tax will be payable by the responsible person in respect of the split-run edition. Depending on the circumstances, the responsible person will be the publisher, a person connected with the publisher, the distributor, the printer or the wholesaler of the edition. Persons connected with the responsible person will be jointly and severally liable for payment of the tax.

Certain existing split-run periodicals will be given limited grandfathering treatment. They will be exempted from the tax based on the number of split-run editions that were distributed in Canada during the twelve-month period ending on March 26, 1993.

The new excise tax will apply to split-run editions that are published after the legislation implementing the tax receives Royal Assent [December 15, 1995]

**The proposed amendment to the Income Tax Act will add an anti-avoidance rule to section 19 of the Act. That section provides rules restricting the deductibility of expenses of taxpayers in respect of advertising in non-Canadian newspapers or periodicals where the advertising is directed primarily to a market in Canada. The purpose of the new anti-avoidance provision is to ensure that Canadian newspapers and periodicals are controlled in fact by Canadians.**

## APPENDIX F - ABOUT THE AUTHORS

### DAVID KEEBLE, B.A. (POLI SCI); B.MUS. (COMPOSITION)

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David Keeble has been an independent consultant since 1998. Prior to that he was Senior Director of Strategic Planning and Regulatory Affairs for the CBC, and before that, an Executive Producer at CBC Radio. He also served as Senior Vice-President of Policy and Regulatory Affairs at the Canadian Association of Broadcasters (CAB) from 2004 to 2006.

His consulting practice has included major studies for government departments and agencies, as well as broadcasters and digital media companies, public and private. For the Ontario Ministry of Tourism and Culture ("MTC"), he wrote a major study of digital media, co-wrote with Peter Miller a recent (2010) study on the future of broadcasting, assisted with strategy and presentation materials for CRTC appearances, analyzed broadcasting business plans and, with Peter Miller, developed a five year strategic plan for the Ontario Media Development Corporation ("OMDC").

For the CRTC, he has undertaken many studies, which in recent years included a paper on the potential extension of the simultaneous substitution regime, genre definition, and two studies on community television. From 1999-2006, he provided the *Executive Technology Impact Analysis* to the Commission and also to the Department of Canadian Heritage and Bell Canada. This regular series of studies and presentations, which synthesized interview material and hard data and provided independent analysis, projected future business and policy implications in both traditional and interactive digital media, among other topics.

For the Department of Canadian Heritage, he co-researched and co-wrote a major study of the transformation of the value networks of cultural products as a result of digital technology, as described above.

He also provided several papers to the Lincoln Committee (the Parliamentary Standing Committee on Canadian Heritage) during their two year study of the broadcasting system, and contributed to their final report.

In the area of new media, in addition to the CRTC and Ministry of Culture studies noted above, Keeble developed the first new media strategy for the CBC, several papers on online and interactive strategy for the CAB, and worked with Astral Media on their submissions to the CRTC's 2011-12 review of the New Media Exemption Order and their response to the Digital Economy consultation.

## **PETER MILLER, P. ENG., LL.B.**

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Peter Miller is a communications lawyer and engineer with over 25 years of creative and telecommunications industry experience, in both private practice and senior executive positions. Since 2006, he has acted as an advisor to select clients in the public and private sectors, specializing on the impact of digital technology.

Peter's legal practice is largely focussed on media, but is wide ranging in terms of the types of clients and nature of assignments. Clients have included numerous private entities, such as Bell, CHCH-TV, CMPA, Corus, Shaw, Astral, Acadia, Newcap, Rogers Media and smaller independent and ethnic broadcasters, as well as numerous public entities, including the CRTC, Canadian Heritage, CMF, Competition Bureau, City of Mississauga, OMDC and the Ontario Ministry of Tourism, Culture and Sport. Assignments themselves have included legal and regulatory advocacy through public policy, strategic planning and economic impact exercises.

Over the past decade, Peter has researched and authored a number of public and private reports relating to creative industries, digital media trends, convergence and the future production and media landscape. These include four studies on the Canadian Program Rights Market (2007, 2011, 2012 & 2014), three broadcasting environmental scans (2014 & 2016 on TV; 2014 on radio), two studies of over-the-air OTA Television (2009 & 2015), one on genre protection (2013), one on over the top (OTT) television (2015), and two on New Media and Convergence (2007), in addition to studies undertaken with David Keeble.

### **Additional Background**

Peter's professional background includes private practice in communications law, and senior broadcast executive positions.

From June 2008 to May 2009, Peter was Chief Operating Officer for S-VOX, the Vision TV group of companies. In this capacity he oversaw the organization's operations and broadcast infrastructure as well as its marketing, communications, advertising sales, business development, legal, regulatory and affiliate relations functions.

From 2002 to 2005, Peter held the position of Vice President, Planning and Regulatory Affairs for CHUM Limited, where he was the key strategic advisor on industry developments and growth opportunities for CHUM Limited, as well as being responsible for all facets of CRTC regulatory affairs and government relations. Prior to joining CHUM in 1998, Peter was Senior Vice-President and General Counsel to the Canadian Association of Broadcasters (CAB), responsible for all policy and legal issues for radio, specialty and television.

Peter Miller began his career in telephone network design at Bell Northern Research in Ottawa. His experience also includes serving as a Parliamentary Assistant in the House of Commons.

Peter is a frequent industry commentator who has been actively involved in numerous industry boards and committees. Peter is the past Chair of Interactive Ontario, past chair of the CAB Specialty & Pay Services Board, past treasurer of Canadian Digital Television and a current member of the Centre for Addiction and Mental Health Constituency Council and Toronto Film Board.

For more information on Peter, please contact him at [info@petermiller.ca](mailto:info@petermiller.ca).