



November 25, 2016

## **Internet Society Canadian Chapter**

### **Submission to the Department of Canadian Heritage Consultation on Canadian Content in a Digital World**

#### **A. Introduction**

1. The Internet Society Canadian Chapter (ISCC), submits the following comments in response to the Department of Canadian Heritage consultation on Canadian content in a digital world.
2. The Internet Society, of which ISCC is a Chapter, is an international not for profit organization. Its vision, shared by ISCC, is that the Internet is for everyone and that everyone should have barrier-free access to an open Internet with global reach in which no online service is privileged by state action or favour over others.
3. The ISCC strongly supports the presence of Canadian content in all media and platforms of expression, and recognizes the benefit of appropriate measures to strengthen the presence and availability of Canadian content for the Canadian and international public.
4. The ISCC notes that most of the discussion around the production and availability of Canadian content revolves around analogies with and comparisons to the broadcasting industry and the funding models that evolved to ensure the availability and distribution of Canadian content in that environment.
5. In addition, the ISCC notes that there are a number of funding proposals that have been put forward by interested parties that involve taxes or levies to ensure streams of revenue that could be devoted to the production and distribution of Canadian content.
6. In this submission, the ISCC will review and comment on:
  - a. the application of broadcasting regulatory concepts to online services; and

- b. proposed mechanisms for funding Canadian content by way of special levies or taxes.
7. To be clear from the outset, the ISCC has grave doubts that the *Broadcasting Act* can, as a matter of law, be extended to the regulation of either content or online content providers on the Internet. ISCC is concerned that any attempt to extend the *Broadcasting Act* to online content and online providers would be unconstitutional on both Charter of Rights and division of powers grounds.
  8. Apart from any legal concerns, ISCC is, as a matter of policy, unqualifiedly opposed to the application of broadcasting regulatory principles to the Internet, and is resolutely opposed to the imposition of any levy or tax on either access to the Internet or on online services to support Canadian content. Whatever the intended purpose of any levy or tax may be, the practical impact would be to lessen Canadians' access to premium content on the Internet and raise the costs to Canadians of participating in the online marketplace created by the Internet. Those outcomes outweigh any good that could possibly come from any tax or levy that has been publicly discussed.
  9. ISCC notes that the regulatory framework put in place to support Canadian content in broadcasting is in marked contrast to how the Government of Canada has traditionally supported Canadian culture.
  10. In broadcasting, the panoply of interrelated measures serve both to control Canadians' access to foreign content, and give preference, priority and support to Canadian content. These measures and policies are more prescriptive and costly than measures relied upon to support Canadian cultural expression in other media and platforms.
  11. By contrast, support for Canadian content in publishing, the fine and performing arts, sound recording and film making include, primarily, direct subsidies, tax benefits, and public institutions and agencies financed out of general tax revenues. We believe that the dominant approach to support artistic creation in Canada should remain the keystone of support to Canadian content creation. We believe that the hands' off model is appropriate to safeguard artistic expression in a free and democratic society.
  12. ISCC believes that the prescriptive regulatory approach taken to support Canadian content in broadcasting cannot and should not be applied to the Internet. Such regulation imposes heavy costs and inefficient use of resources, which results in:
    - a. higher prices for Canadians;
    - b. disincentives to innovation; and
    - c. incentives to produce content for which there are no audiences in Canada or abroad

## **B. Broadcasting regulation is not appropriate to the Internet**

13. The regulation of broadcasting to support Canadian content was premised on, and justified by the scarcity of distribution channels either by way of available radio spectrum or the limited channel capacity of early cable television and satellite technologies of the

mid-20th century. These media shared common characteristics that made content regulation defensible:

- a. the owner's or operator's ability to control one-way public communications on a fixed number of channels (expressive power), and
  - b. the oligarchic or monopolistic nature of the distribution systems (economic power).
- 14.** The concentration of potential power in those in possession of a broadcasting licence justified the imposition of strict terms of licence. As the emphasis of regulation shifted from averting a misuse of communications power to ensuring that Canadian content reached Canadian audiences, this foundation in channel scarcity has grown to a vast, complex, and burdensome regulatory regime with distinct obligations, conditions, expectations and spending requirements imposed upon various and distinct categories of 'broadcasters'.
- 15.** The Internet is radically different from the regulated 'broadcasting system'. The Internet is, by design, a robust world of abundance. Each participant can choose the role they will play (consumer, citizen, creator, supplier, intermediary, etc) and when they will play it. No one operates by the grace of the state, and no one has either expressive or economic monopolies.
- 16.** Despite the claims of some, the Internet is not *primarily* a 'cultural medium'. The Internet is an open, transactional, platform and marketplace for private person-to-person or one-to-many communications, enabling access to information, content, commerce and services of all kinds — from a virtually limitless number of suppliers.
- 17.** Audio and audiovisual content is increasingly put to any and every purpose on the Internet. Everyone online has direct and open access to all available and legal content and services, which stand or fall, whether artistically or commercially, on their own merits.
- 18.** There is no single owner or operator that controls what is available, and at what time, or at what price. The Internet is a platform vital to innovation and economic growth. 'Permissionless innovation' is a technical principle that has guided the open Internet's development and evolution from its inception. This arises from grass-roots innovation, start-ups, and research labs. No permit had to be applied for, no new network had to be built, and no commercial negotiation with other parties was needed. This concept, is a key driver of economic growth. *It ought to be an underlying principle of any policy to promote online content.*
- 19.** The ISCC therefore opposes the imposition of any form of broadcasting regulation on the Internet, including extraction of broadcasting-like fees, charges or regulatory burdens on Internet access or content services.

### **C. Regulating the Internet as ‘broadcasting’ is not conducive to promoting Canadian Content in the Digital World**

20. While ISCC believes strongly in the continued presence of Canadian content in all media and platforms, we equally believe that the extension of broadcasting regulatory burdens and costs to actors on the Internet is not only inappropriate — but would prove ineffective and counterproductive. Imposing new transaction costs in an economic space that is marked by fierce price competition, open market entry and an absence of economic rents for content providers will hamper the efforts of Canadians to establish their place in the global competition for eyes and ears on the Internet.
21. Broadcasting regulation is grounded in cross-subsidies from distribution to support production of CanCon — by way of both quotas and mandated financial ‘contributions’. Such measures are not sustainable in the Internet environment. These cross-subsidies can only succeed in a closed system with controlled access and controlled market entry. Open access and unfettered competition undermine these tools by enabling users to choose the content they will consume, and to bypass the ‘regulated system’.
22. Even in the controlled broadcasting environment, the regulatory and economic measures that mark the broadcast environment have had uneven outcomes. For example, two recent reports that examined the matter from very different perspectives suggest that the regulatory framework has failed to incentivize broadcasters and producers to place the audience — Canadians — at the centre of their work. (See end notes — LYA: The Evolution of TV and New Media in Canada; and Richard Stursberg: Cultural Policy for the Digital Age.) ISCC does not claim expertise in the intricacies of broadcasting policy, nor do we endorse either of these reports. However, evidence that these measures have not achieved their objectives, even in the closed broadcasting system, reinforces concerns about attempting to apply such measures to the Internet.

### **D. The Internet Ecosystem Spurs Creativity**

23. As the consultation paper points out, Canadians make ‘binge-worthy’ content and Canadians are finding success on the global Internet. Media reports suggest that market forces — notably the demand for premium online content — are generating a great deal of commercial production in Canada, for both Canadian and other content. For example, Netflix has partnered with Canadian producers, the CBC and major private broadcasters, on a string of high profile CanCon originals, where the Canadian broadcaster has first rights for Canada and Netflix gets international rights outside Canada. Other OTT services and major American studios are also producing content in Canada. If there is truth to the criticism that the current regulatory framework fails to incentivize Canadian broadcasters and producers to focus on their audience, then there is value in bringing this market-based, global audience focus to CanCon production.

- 24.** Beyond film and television content, Canada has become an online powerhouse in content for children and interactive games that target the global market. Aside from a favourable economic climate, the choice of Canada as a destination for premium productions is dictated by the high quality and talent of Canadian creators and innovators.
- 25.** Such activity should be encouraged and incentivized — rather than saddling the source of new demand with regulation designed for an era of channel scarcity. It may be understandable for an industry that has come to depend on a steady stream of regulated cross-subsidies to respond to the opportunities and threats of the Internet’s dynamic environment by trying to extend the old regime to online media, as a way to ‘stay whole’. But this is no basis for effective policy in the public interest — especially when the Internet is lowering costs of distribution and creating new streams of revenues. Ensnaring online services in the regulated “system” would introduce incentives for them, too, to make decisions on investments in CanCon that are driven by regulatory criteria, access to subsidy, and quotas. That outcome is not consistent with the consultation paper’s forward-looking policy orientation.
- 26.** To the extent that cultural content is on offer, the Internet ecosystem makes online media much more akin to the free and open markets in which other media of culture and communications operate, than to the controlled ‘broadcasting system’. It also makes the incentive based tools used to support CanCon in all other media more appropriate to the Internet and online media than would be broadcasting regulation.
- 27.** Canadian content policy for the digital world ought to be focused on incentivizing entrepreneurial risk-taking among Canadian producers and broadcasters. It would be folly to extend to the Internet and online media an outdated regulatory framework. Protection and regulation are no substitute for market forces that are demanding an abundance of content, including more and better Canadian productions.
- 28.** In short, ISCC believes that the digital marketplace appears to be delivering on many of the consultation paper’s objectives. More Canadian content, and content made in Canada, is being produced for domestic and export markets. Canadian creators are gaining global visibility and are exposed to productions focused on global audiences. Canada appears to have a competitive advantage. At the same time, Canadians have open access to more content than at any time in history, and they have taken full advantage of the Internet as a platform for innovation, commerce and access to global markets. Regulation of the Internet along broadcasting lines is unnecessary and risks undermining these outcomes.

## E. Proposals for Internet Taxes and Levies

29. ISCC has learned of three proposals respecting taxes or levies to contribute to the current regime of funds and subsidies for the creation of Canadian content that would have special relevance to the Internet:
- a. The first, and by far the most market-distorting, is what is popularly called the “Netflix Tax”, sometimes suggested as a levy, and other times as a tax;
  - b. The second would be a tax or surcharge on Internet Access Providers (sometimes called an ISP Tax), that ISPs would collect from subscribers and remit to the government; and,
  - c. The third would be the collection and remittance of GST/HST for online services that currently provide services from outside Canada to persons inside Canada in circumstances where a provider inside Canada would have to collect and remit GST/HST on a similar transaction.

As each proposal raises unique issues of policy and equity, we will deal with them separately in the following paragraphs.

### a. “Netflix Tax”

30. ISCC is concerned by suggestions that Internet content services (in particular so-called ‘over-the-top’ audiovisual content services) should be subject to contribution requirements similar to those imposed today on broadcasters and cable distributors. The proposals vary somewhat but, at heart, all the proposals that have come to our attention assume that online content service providers are actually broadcasters and as such should be contributing to the subsidy funds created by the CRTC for the purposes of Canadian content production. Such a levy would amount to collecting uneconomic rents from Canadians who are simply choosing content services that they prefer, to finance content that they may not want. This creates an incentive for Internet users to find services not captured by the levy, or worse, to participate in content piracy. ISCC opposes any special levy on Internet content providers to support CanCon production.
31. To the extent that this proposal has been examined, the purported benefits are far from evident. For example, the Richard Stursberg paper (see end notes) estimates that a regulatory levy on Netflix would generate between \$22M and \$134M, depending on which regulatory category of ‘broadcaster’ an online content service was considered to best fit). To put this in context, the same paper reported that in 2015, over \$1.2 billion in public funds were spent on private-sector television and film production combined (tables 8&9), while private broadcasters and BDUs spent \$2.7 billion on Canadian programs (table 13). This excludes the CBC, which would add almost another \$600 million. In context, it is hard to see how the amount generated by this proposed “Netflix tax” would have any significant impact on Canadian content production — especially in light of media reports about that company's ongoing production activity in Canada. Moreover, results of a recent survey done by Lemay Yates Associates (see end notes) suggest that in response to a 15% to 20% “Netflix tax” to support CanCon: 37% of Canadians would cancel their Netflix subscription; about 26% would reduce (13%) or cancel altogether

(13%) their cable or satellite TV subscription; and a third would keep everything as is. In the outcome, net financial contributions to support CanCon would be substantially reduced. LYA concludes that everyone loses.

32. A levy, or regulatory charge, is not a tax. The suggestion would seem to depend on the CRTC repealing, at least in part, the Exemption Order for Internet services, and treating foreign Internet content services as Canadian broadcasters. How Canada could treat foreign entities as Canadian broadcasters and impose concomitant regulatory obligations, when the entities providing such services are not owned by Canadians, have no presence in Canada, and own neither radio based or hard wire facilities in Canada, remains a puzzle.
33. The justification for regulatory levies is that, as a result of the privilege of holding a licence, the licensee will realize profits based not on competitive factors, but from its ability to extract from advertisers or subscribers revenue that it would not, in the absence of the privileges attached to the licence, be able to raise through ordinary market forces. These excess revenues are referred to in the economic literature as “rents”. Rents have been a feature of broadcast regulation in Canada, as witnessed by the variety of levies imposed on various players in the licensed broadcasting industry, and their ability to pay those levies without losing audiences or advertisers.
34. There is no evidence at all to support the notion that Internet content services are recipients of economic rents. They do not exist by grace of the state, and receive no protection from competition – whether domestic or foreign. In such circumstances, regulatory charges are simply a drag on market forces, and a cost that would go to the bottom line of any online content service.
35. ISCC is concerned that foreign online content services would simply withdraw from the Canadian market altogether, leaving Canadian subscribers deprived of content for which they are willing to pay. This would considerably disadvantage Canadian Internet users, and may also result in foreign entities withdrawing support for content creation in Canada.
36. The ISCC is wholly opposed to any “Netflix Tax”, whether by way of a regulatory levy or by way of a tax imposed by Parliament. Either would be detrimental to interests of Canadian Internet users, and could prove negative to the interests of Canadian content creators.

#### **b. An ISP (Internet Access) Tax**

37. The idea of an ISP tax is essentially that a separate tax or surcharge would be added to the bill paid by Canadian Internet subscribers. Canadian Internet subscribers already pay GST/HST/PST on their monthly Internet bills. As we understand it, the hope of its advocates would be that this additional tax would be dedicated to a fund for the creation of Canadian content.

- 38.** The idea is highly problematic from several perspectives. First, a tax will be passed on directly to subscribers, making Internet access less affordable for all Canadians; and thereby deterring access to and enjoyment of the Canadian content it is intended to support. This would be especially true for low income households and for Canadians living in rural and remote areas where the price of Internet access is already higher than in urban Canada. That outcome would conflict directly with the government of Canada's goal of extending the reach of Internet access across Canada. ISCC believes that the Internet is for everyone: taxation that specifically targets ISPs to artificially support CanCon, with the collateral damage of increasing the price of Internet access, undermines that vision.
- 39.** Second, the Internet is not merely a platform for 'content distribution'; it is a general purpose communications medium and an infrastructure for 21st century commerce. Accordingly, taxing *all* Internet use for the purpose of funding Canadian cultural producers cannot be construed as a narrowly tailored, efficient, or even effective means to its intended purpose. It is an inefficient and unfair cross-subsidy.
- 40.** Third, from a policy perspective, such a tax is grounded in the notion that telecommunications service providers should make a contribution to CanCon in a manner comparable to broadcasting distributors. The CRTC itself determined long ago that Internet access is a telecommunications service — not a broadcasting service — and that ISPs are therefore a form of common carrier under the *Telecommunications Act*. Subsequently, the Supreme Court confirmed that the CRTC cannot impose, through the *Broadcasting Act*, a CanCon levy on ISPs acting solely in their capacity as common carriers. This could only be changed by legislation. But such legislation would conflict directly with the Supreme Court's decision, and with longstanding concepts of "common carriage" that are fundamental to the *Telecommunications Act*.
- 41.** This is no small matter. An open Internet has enabled an unprecedented level of innovation, creativity, economic development and citizen engagement. Central to the open Internet has been the concept of 'net neutrality' and the underlying principles of common carriage: no undue preference or discrimination. Legislative change to enable a tax or regulatory levy on ISPs to support CanCon would conflict directly with those common carriage principles. Support for CanCon ought not to come at the expense of, or in a manner that undermines, an open Internet, net neutrality and common carriage responsibilities and obligations.
- 42.** Finally, past Canadian experience has shown that notionally "dedicated purpose taxes" are quickly subverted. Such a special purpose tax was levied in Canada as an excise tax imposed on cable subscriptions in the 1980s. While some modest amount of the tax did fund Canadian production, most of the sums raised were diverted to general government revenue and expended for purposes that had no relationship with Canadian content production. The cable tax fell by the wayside when the Goods and Services tax was introduced in 1990.

43. The ISCC opposes any special tax on Internet access. Consumers already pay Provincial and Federal sales taxes on Internet access, so any further charges will have a disproportionate impact on the poor, raise issues respecting equality of access to publicly available information, and by taking money from consumers and placing it into special production subsidies, further immunize content producers from the impact of consumer demand. In ISCC's view, to put it briefly, the downsides far outweigh any potential benefits of such an idea.

### **c. Application of GST/HST/PST**

44. It is a concern that foreign entities that sell goods or services (such as online content services) to Canadians do not collect and remit to the government sales taxes in situations where domestic providers of goods or services would be required to.

45. ISCC is aware that countries around the world, and several U.S. states and municipalities have begun to apply sales and other taxes to transactions that take place on online media. At the international level, the Organization for Economic Cooperation and Development (OECD) has also examined the matter of taxing online services from the dual perspective of the impact of lost tax revenues on national finances and deficits and the impact of tax havens on competition and global economic growth and development. Suffice it to say that this issue is moving on its own track, driven by considerations that have little, if anything, to do with cultural policy.

46. Requiring foreign streaming and other online services to collect and remit sales tax, where the services are provided by an entity outside of Canada to subscribers in Canada, would essentially put them on the same footing as domestic service providers. This would 'level the playing field' as well as raise general tax revenues that could provide a source of funding to enhance existing measures to support Canadian content in all media, including online.

47. However, as a generally applicable tax, the GST/HST/PST cannot be expected to generate amounts for CanCon commensurate with the needs of the Canadian content production sector. These taxes are a source of general revenue for the relevant taxing authorities, and will continue to go to the general revenues of government for such purposes as that government will decide is most important to it. This cannot be seen as an issue respecting Canadian content, but rather as a question of broader tax policy and tax equity.

### **F. Income Tax Act, Section 19.1**

48. Section 19.1 of the Income Tax Act provides that a business in Canada cannot deduct as a business expense money that is expended on advertising on a foreign broadcaster where the advertising is aimed at the Canadian market. The effect of this measure is to ensure that Canadian broadcast advertising dollars remain within the closed Canadian broadcasting system. It has been proposed that a similar non-deductability provision

should be extended to advertising by Canadian businesses on non-Canadian websites (see Richard Stursberg paper, end notes).

49. ISCC believes this proposal is based on a fundamental misunderstanding of how advertising works in the online environment. Its effect would be to deny Canadian advertisers access to Canadian Internet users who visit non-Canadian websites, and would deny Canadian Internet users information that would assist them in making their choices respecting online and traditional commercial transactions.
50. Advertising in mass media is typified by a single advertisement reaching a large and largely undifferentiated mass audience. Advertisers largely seek to differentiate their audiences by program genre, so advertisements aimed at women will tend to support programs that attract a significant number of women (cooking, daytime talk shows, etc.). Advertisements aimed at men will tend to be grouped around professional sports or action programming.
51. By contrast, advertising on the Internet is based on the profile of an individual Internet user as evidenced by the websites visited, online searches undertaken, and history of online purchases and transactions. Online advertising sellers use this information to put before individual online users advertising that is relevant to their interests. The placement of the advertisement is agnostic as to the website on which it appears – it follows the user and not the website. Thus, for instance, a Canadian who has recently searched for used cars in his area of residence may, while viewing a French website that explores political developments in France, see an advertisement relating to the availability of used cars in his locality. This type of advertising would effectively be outlawed if section 19.1 were extended to the Internet.
52. An extension of s.19.1 to Internet advertising will add to the inefficiencies in the Canadian advertising market. It would deny Canadian businesses the ability to reach Canadians where Canadians are present online. It would deny Canadian online users access to commercial information that may be critical to their ability to participate in online and traditional commerce. ISCC would see an extension of s. 19.1 as deleterious to the creation of efficient markets and would do nothing to support Canadian content production.

## **G. Conclusion**

53. The ISCC believes that the consultation on Canadian content in a digital world is a timely initiative, in some respects long overdue. We take no issue with government objectives to support Canadian content. Indeed, we applaud the direction taken by the consultation paper to refocus policy on:
  - 1 promotion rather than protection;
  - 2 global rather than just domestic markets;
  - 3 investing rather than subsidizing;

- 4 platform agnosticism, rather than platform specific support; and
- 5 realizing the potential of Canadian culture as a driver of economic growth in addition to its social and cultural benefits.
54. ISCC believes that the open Internet is already contributing to these objectives in significant ways, and that these objectives can best be further pursued in a manner that respects the great benefits that an open Internet has brought to all Canadians as creators, innovators, entrepreneurs, citizens and consumers. We believe that the government should fully explore the longstanding measures of subsidies, tax benefits, institutions and agencies to identify ways and means to pursue these objectives in online media.
55. If it is determined that new infusions of funding from tax revenues are required, extending the HST to online media would likely generate more than sufficient funds to allocate to this purpose, and this would be a more efficient, effective, economic and sustainable approach than attempting to impose broadcasting regulation, levies or dedicated taxes on the Internet.
56. In conclusion, the ISCC believes strongly in the necessity of Canadian content being made available to Canadians, whether as broadcasting viewers, or as Internet users. However, the ISCC believes:
- a. it would be folly to regulate audio-visual content on the Internet as broadcasting, and
  - b. it would be counterproductive and regressive to impose of any special levy or tax on online content providers or on Internet access.

Respectfully submitted by the Internet Society Canadian Chapter, November 25, 2016.

## End Notes

### **Lemay Yates Associates: The Evolution of TV and New Media in Canada**

<http://alphabeatic.com/wp-content/uploads/2014/09/lemay-report.pdf>

### **Would Anyone Win from Imposing a CanCon Tax on Netflix?**

<http://www.lya.com/index.php/2016/11/15/would-anyone-win-from-imposing-a-cancon-tax-on-netflix/>

### **Richard Stursberg: Cultural Policy for the Digital Age:**

<https://techlaw.uottawa.ca/sites/techlaw.uottawa.ca/files/culturalpolicyforthedigitalage.pdf>