

**The Choice is Now: A North American Digital Hub or North American Digital
Border**

A Report on the Perspective of North American Technology Executives

by the Toronto-GTA Chapter of the American Chamber of Commerce in Canada

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Executive Summary

- The Canadian and American digital technology community welcomes the modernization of NAFTA because the tech sector has undergone revolutionary changes since the enactment of the NAFTA and its predecessor, the U.S.-Canada Free Trade Agreement.
- While much of the current NAFTA discussions regarding digital technology focuses upon issues provided in the proposed Trans-Pacific Partnership (TPP) such as prohibiting customs duties on data flows and data localization, the primary concern for technology leaders centers upon labor market mobility; specifically, professionals in the technology industry desire a more pliant administration of the B-1 business visitor program and improved flexibility to recruit talented university graduates in Canada and elsewhere to work in the United States.
- The tech sector would also like to see a clear and logical tax regime applied across the border and would like to make sure that any changes to NAFTA would not adversely affect its access to capital.

Background

How tech has grown during the lifespan of NAFTA

When the predecessor to the North American Free Trade Agreement (NAFTA), the Canada-U.S Free Trade Agreement, was executed on January 2, 1988, broadband internet access had not been invented; users had to dial into a node connected to ARPANET and tie up their landline phones while connecting. The best speed a user could hope for at the time was 56 kbts/second (today, consumers can enjoy download speeds that are over 13,000 times faster). CompuServe had been in business for about 8 years offering only e-mail and chat features to its users who needed to buy access at their local computer stores. Cell phones had been available for 4 years, but were only used for voice communications. Cisco Systems was 4 years old and only had 9 employees (at the end of 2016, Cisco employed nearly 74,000 worldwide). It would be 3 years until AOL became available on computers, 6.5 years until Amazon.com was founded, over 10 years until Google was incorporated, and over 16 years until the Facebook website was launched. In 1988, the Bureau of Economic Analysis of the U.S. Department of Commerce estimated that the technology sector (including the manufacturing of computer and connectivity devices, the publication of information over the internet and the provision of technology related services) contributed \$238 billion to the U.S. economy and accounted for 1.5% of total US GDP. In 2016, the BEA estimated that this figure rose to \$1.04 trillion and accounted for 7.1% of total US GDP. According to the Brookfield Institute, the 2016 GDP for tech sector in Canada was equal to CAD \$117 billion in 2016 and accounted for 7.1 % of total GDP in the country. According to TechRepublic, 6.7 million individuals were employed in the U.S. tech sector in 2015. According to the Brookfield Institute, 864,000 individuals were employed in the tech sector in Canada during 2016, accounting for 5.6% of total employment in the country.

The need to make changes to NAFTA and the concerns associated with such changes

The modernization of NAFTA requires the inclusion of provisions targeting the digital technology sector. The letter issued by United States Trade Representative (USTR) Robert Lighthizer launching

the 2017 NAFTA negotiation process expressly indicated that digital technology was a key focus area for the U.S. Administration. Similarly, the U.S. Federal Register notice calling for stakeholder consultations regarding the NAFTA negotiations expressly solicited comments regarding the digital technology sector. However, these positive developments must be weighed against the absence of any express indication of a need to address labor and digital workforce mobility in the NAFTA modernization efforts. Similarly, the U.S. Administration's persistent view to strengthen rules of origin and Buy American/Hire American provisions presents the potential to build digital borders between Canada and the U.S. A comprehensive approach to NAFTA "digital" modernization—not just a digital chapter—is what is needed in the NAFTA effort.

Cause for concern in the tech sector

The resulting confusion has placed business leaders who rely upon trade and investment across the longest undefended border in the world on edge. This sense of unease has been acutely felt in the technology industry where the need to collaborate, innovate and execute places great demands on companies to make sure that people, capital and solutions freely move anywhere in the world to respond to customer demand and marketplace dynamics.

The roundtable

On May 2, 2017, business and government leaders in the technology industry and in markets that rely heavily upon the solutions and services generated by this industry met in a roundtable discussion in Toronto to provide their perspective regarding proposed changes to NAFTA. While they understand the need to update a treaty that was adopted when "Walk Like an Egyptian" was the most popular song on the Billboard Hot 100, their concerns regarding any changes in NAFTA are centered among three primary issues, which are:

- 1) The movement of employees and other skilled individuals across the border to match the needs of technology businesses;
- 2) Tax policy with regards to the provision of services and solutions in an industry that does not manufacture in a traditional sense; and
- 3) Access to finance and investment.

Each of these issues will be described in greater detail below.

Free Movement of Human Capital

Background and history

Of all the issues that affect the cross-border technology community, the possible effect of any changes to NAFTA upon these companies' ability to deploy their talent into the United States was the overwhelmingly predominant concern. There was a general consensus regarding the need to update the portion of NAFTA that addresses the movement of professionals across the border, which is commonly referred to as the TN Visa program in the U.S. The categories of professionals who allowed to obtain work permits under the TN Visa program need to be updated to reflect the evolving nature of the work that is performed in the 21st century. This is especially true for the technology sector.

For example, most of the attendees at the technology roundtable would need to qualify as a computer systems analyst in order to be eligible under the TN Visa program. However, this category fails to account for the diversity of work performed by these professionals. Workers in the technology industry are not merely computer systems analysts, they are also graphic designers, coders, connectivity specialists, quality control testers and so forth. A renovation of NAFTA after 30 years may afford the possibility of providing more avenues to allow technology professionals to enter into the United States to work.

Concerns about how changes to NAFTA may affect cross-border labor market mobility

Despite the roundtable's understanding of the need to change the work permit provisions of NAFTA, the participants expressed concerns about the effect of any such changes on their businesses. This concern arises for three key reasons.

Reason 1 – Technological services or solutions may be produced anywhere

Physical location does not matter in the provision of technological services or solutions. Ideas that are generated in Canada may be sold and distributed throughout the world instantaneously.

Reason 2 – Intense competitive pressure for the tech professionals

There is an extraordinary amount of competition for talent in the industry, and this burden causes technology companies to search globally for the right people with the right skill sets.

Reason 3 – Technology depends on collaboration – walls between nations may hurt this arrangement

Collaboration among tech enterprises is not confined by national boundaries. The best team for a project may require assembling talented individuals located throughout North America and around the world.

Allowing for short term business visits to the U.S.

Beyond just changing the NAFTA professional "list", roundtable participants mentioned that current U.S. immigration rules make it difficult for a company to have any employee travel to the United States on business for a short period (say 72 hours) whether it is to visit a customer, attend meetings or collaborate with team members in the United States. This is because the program that allows for entry into the U.S., the B-1 business visitor program, requires that all income (whether it is the form of salary or revenue) come from a non-U.S. source. In technology, where production and delivery of the service or solution may come from nearly anywhere in the world, it is hard to demonstrate to a U.S. Customs and Border Protection ("CBP") Officer that the revenue resulting from a sales call will be generated in Canada or that an employee attending a conference or meeting in the U.S. will derive no salary or income from a U.S. based entity.

In fact, one of the problems created by the B-1 business visitor program stems from a benefit afforded to Canadian citizens. Generally, Canadian citizens may apply for B-1 visitor status at a U.S. port of entry without the need to file a formal application or to receive a formal visa. While this is practical and efficient, what this means is that each time a Canadian enters the U.S. for a short term visit on

business, he or she is effectively re-applying to obtain B-1 status in the country. The applicable rules and regulations to obtain B-1 status are broadly worded which allows CPB staff wide latitude in its interpretation of who is admissible under the B-1 program and who is not. This could lead to the same person being allowed to enter the U.S. under the B-1 program at one time while be denied entry at another time. This makes things difficult for technology concerns and other businesses that need reliability and predictability when making their decisions as to where to deploy their human capital.

Roundtable proposals addressing short-term business visits into the U.S.

One of the suggestions made by the roundtable participants to respond to the lack of uniformity in B-1 business visitor entry decisions is to grant automatic business visitor status to Canadian citizens and permanent residents who enter into the United States for a period of time not to exceed six months. This would be similar to the treatment afforded Canadians who enter into the U.S. as tourists. This would mean that Canadians would not need to meet the qualifications imposed upon business visitors from other countries such as:

- 1) Proof that all salary, income or other remuneration comes from a source outside the United States;
- 2) Proof that the Canadian business visitor has a residence in Canada and does not plan on abandoning this residence;
- 3) Proof of a return trip planned for a date certain in the future; and
- 4) Proof of funds sufficient to cover expenses for the duration of the Canadian's visit in the United States.

However, the participants concede that this benefit should not be granted to Canadians unless they bear a corresponding taxation burden. Under this scenario, Canadians would be responsible for the payment of U.S. income taxes for any salary or income earned in the United States.

The roundtable participants also expressed interest in the establishment of a NEXUS program dedicated for business visitors. It would allow trusted business travelers to receive expedited entry into the U.S. and obviate the need for such travelers to provide supporting documentation for each crossing of the U.S. frontier.

Concerns about the hiring of graduates with technology related degrees from Canadian universities

Technology companies, no matter how big or small, conduct an exhaustive search to find the brightest, most talented graduates at institutions of higher education throughout the world. These individuals graduate not only with engineering and science degrees, but also with degrees in a wide variety of disciplines. Once these people are hired, the companies want the flexibility to assign them wherever their clients and customers require, whether it is in the United States or elsewhere.

The roundtable participants reported that they are unable to find a sufficient number of capable graduates from U.S. universities to fill their staffing requirements in that country. Thus, they need to employ graduates from the University of Waterloo, the University of Toronto and other acclaimed Canadian institutions of higher education. The problem is that these companies are finding it increasingly difficult to hire graduates of Canadian universities and assign them to work in the United

States unless such graduates are U.S. citizens. This difficulty arises despite the fact that the NAFTA visa program has provisions that explicitly allow engineers and scientists with baccalaureate or advanced degrees to obtain status to work in the United States. The participants reported that the problem is twofold.

Problem 1 – It is not just engineers or scientists that tech companies need to employ

Companies in the technology sector may need to hire people in the U.S. for positions such as graphic designers, digital marketers or software architects, and these positions may not require an engineering or science degree.

Problem 2 – The perception that hiring Canadian graduates weakens the “Hire America” initiative

The belief among the American populace, which is sometimes reflected at the U.S. port of entry, is that bringing Canadian trained technology professionals into the U.S. inevitably takes away a job that would otherwise be offered to a U.S. citizen or resident.

This concern arises from the philosophy expressed by some leaders in Washington to place American interests first and foremost with respect to matters of trade and investment promotion from foreign countries. For example, in matters of trade, many leaders in the U.S. federal government favor a “Buy America” focus. This became evident when the construction of the Keystone XL Pipeline across the Canada-U.S. border was approved; such approval was conditional upon the use of U.S. sourced steel in the construction of the pipeline within the United States. The corollary to the “Buy American” doctrine is the “Hire American” doctrine. It is expected that any amendments to NAFTA will include provisions that are designed to protect the U.S. workforce, because those in power in Washington believe that such protections do not exist in the current version of NAFTA.

Moving from “Hire American” to “Hire North American”

The roundtable participants believe that the prospective provisions to protect U.S. labor should be altered slightly to create a workforce initiative for North America. This would allow Canadian workers to have greater access to the labor market in the U.S. compared to workers located in countries outside of North America. The connectivity of the U.S. and Canadian marketplaces, not just in the technology sector but in other key sectors such as automotive and resources, makes the economic argument for greater labor force integration between Canada and the United States compelling.

Tax Policy

Background

Cross-border tax policy is determined by a U.S.-Canada tax treaty that was originally executed on September 26, 1980 and has been subject to a series of amending protocols since then, the most recent of which went into effect on September 21, 2007. The current tax treaty provides the foundation for a preferred relationship between Canada and the U.S. For example, the withholding rate on U.S. sourced dividends received by foreign entities may be as high as 30%. The withholding rate for certain Canadian entities for U.S. sourced dividend income may be as low as 5%. Although, the U.S. Canada tax treaty does simplify some matters for cross-border businesses, many tech companies and

others find tax compliance across the border to be cumbersome and complex and they are concerned that any changes to NAFTA may further add to their tax burden.

Tax related issues raised at the roundtable

The roundtable participants were concerned about the tax implications of any amendments to NAFTA. There was near uniformity among the audience that the movement of data across borders should not be subject to taxation. There was an understanding that the sale and delivery of technology solutions and services for profit should be subject to tax, but the relevant government authorities should work to develop a way to automate the calculation of taxes and duties owing in a manner that is consistent with the speed with which management decisions are made and services are delivered in the technology industry. There also needs to be a consistency with the way that sales taxes are levied and source of supply issues are determined given the fact that technology services and solutions are often not manufactured in a particular location the way that traditional consumer or industrial products are manufactured.

Apprehension regarding possible border adjustment tax

In the area of potential tax policy changes, the focus of the roundtable's concern was the proposed implementation of a border adjustment tax. Even though the original plan to assess a 20% tax on all goods imported from outside the United States appears to no longer be viable, it is widely believed that leaders in Washington will advocate for some sort of tax on imports, even if its is through the backdoor method of providing U.S. businesses with tax relief for the goods they export to other countries. The amount of import tax levied (or export relief afforded) is intended to be harmonized around the globe. The policy justification for the border adjustment provision is to provide relief to U.S. exporters that have to assess value added charges when they sell goods or services in other countries but are not able to avail themselves of the relief offered to companies based in those other countries for the value added taxes assessed (for example, the HST rebate that Canada offers to Canadian businesses).

Canadian exemption to the border adjustment tax?

The possibility of an exemption to the U.S. border adjustment provisions that may be offered to Canadian companies was discussed at the roundtable. The participants at the roundtable were intrigued by this prospect and agreed that they would try to advocate for this exemption to government officials on both sides of the border.

Access to Capital and Financing

The problem with raising equity capital

Although this is not an issue that is directly related to NAFTA, the roundtable participants feel that Canadian technology companies are at a competitive disadvantage when it comes to the raising of capital compared to their American counterparts. The venture capital community in Canada is more cautious and risk adverse compared to VCs in the United States. This may be due to lack of national uniformity in securities regulation in Canada or the fact the regulations are stricter for venture capital and private equity concerns in Canada compared to the United States. No matter what is the cause, the United States has a more robust capital market environment for start-up and entrepreneurial companies compared to Canada.

The roundtable's response

The desire of the roundtable participants is that any amendments to NAFTA provide a subsidiary benefit of harmonizing the equity-raising environment between Canada and the United States, even if such a benefit is not intended.

Need to have more cloud-based services in Canada for Canadian based banks

The other concern raised at the roundtable addresses not the access to debt financing and the extension of credit, but the intellectual property issues associated with the institutions that provide such lending facilities. Roundtable participants noted that Canadian chartered banks subscribe to cloud-based services where the data is housed in the United States. Not only does this deprive Canadian technology businesses of the opportunity to provide such services for the leading financial institutions located in their country, but it could also provide U.S. borrowers in the technology industry with a competitive advantage compared to their peers in Canada.

Where the Technology Industry Goes from Here

Thirty years of fixed and predictable rules regarding the movement of people, goods and ideas across the U.S.-Canada border are most likely to become a relic of the past in the near future, and the period during which these rules are replaced is most likely to cause a period of anxiety and uncertainty. The most effective way to ensure that the transition between the NAFTA of the past and the NAFTA of the future is successful is to implement a two-pronged approach.

The first prong – more fulsome disclosure

The importance of the U.S. government setting a clear direction for the future incarnation NAFTA cannot be over-emphasized. Whatever the final rules are, they need to be communicated clearly and effectively, to aid technology companies in making the best decisions they can in real time for themselves and for those constituencies that rely upon them. However, disclosure is not merely the sole obligation of the U.S. government; those agents and specialists that technology companies rely upon should make sure that their clients are fully cognizant of the tools that are currently available to them. For example, most technology companies are not aware of the existence of the Regulatory Cooperation Council (RCC). The goal of the RCC is to harmonize the regulations between Canada and the U.S in all areas other health and safety. This council is very popular with the U.S. government because the work of the RCC prioritizes the removal of regulations. The RCC may also be a powerful ally for technology companies because, in general, the conflicting sets of regulations between Canada and the U.S. is a more burdensome obstacle to the free flow of trade, people and ideas across the border, compared to the rules that are enforced at the border.

The second prong – more engaged advocacy

There are two separate paths that Canada may take in response to the changes to NAFTA that are proposed by the United States. The first path is to propose free and open trading relationships with other countries. This is reflected in the Trudeau government's overtures to strengthen the trading relationships between Canada and China and between Canada and Europe. The second path is to emphasize greater North American trade and economic integration. A successful journey along the second path requires Canadian technology companies, together with their like minded cohort in the U.S. and in other industries, to show to Canadian and to U.S. policy makers that there are clear

benefits for the United States to allow Canadian technology companies to have greater access and participation in the U.S. market and for Canada to allow U.S. technology companies to have greater access and participation in the Canadian market. If this argument is effectively conveyed, Canadian technology businesses may look at 2017 not as the year when NAFTA ended, but as the year when it was enhanced.