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Technology Perspectives Outlook

2025

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This publication reviews key developments in Canada during 2024, and their potential impact in 2025 and beyond. For further information, please speak to one of our authors.

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Tech Outlook 2025: Introduction

The start to 2025 has continued with all the uncertainty and opportunities we saw coming out of 2024. With the highs of 2021 and the lows of 2022-23 firmly in the rearview mirror (or so we hope), a new equilibrium seems to be setting in. On the Canadian side of things, the regulatory climate has both limited and enabled opportunity.

Our first piece gives an update on the current state of early to middle stage venture financings in Canada. It is perhaps here where the effects of the receding tide of 2022-23 are still felt most. But as described in the piece, there are (always) reasons for optimism.

On the public side of things, while the magnificent seven lead the 2024 stock market rally in the US, public tech companies listed in Canada have been more likely the target of take private transactions. Our second piece for a discussion of this trend as well what to expect going forward.

The AI boom that had everyone looking for the top in 2024 instead continues with threats of disruption overtaking threats of a bubble. With that continued boom, our third piece outlines the corporate finance and M&A market practices that are evolving to deal with risks associated with companies' use of AI in developing products, in improving productivity or as a product offering itself (or an integration into a product offering). As well, with generative AI being entrenched in the marketplace, the impending conflict with copyright law is coming to a head. Our fourth piece delves into this issue and what to expect.

On the crypto side of things, while the rest of the world has gone from rebound to outright rally, our fourth piece describes why Canadian crypto has not kept pace and what can happen in 2025 to move out of those doldrums.

On different note, our final three pieces set out shifting Canadian regulatory environments in several tech verticals. Our sixth piece describes the legislative changes and a developing regulatory framework to enable open banking. Our seventh piece describes the new digital services tax facing larger players in the Canadian market. And our eighth and final piece described the Retail Payment Activities Act (Canada) and a new regime facing payment service providers in Canada.

Robert Anton, Editor

2025 Venture Market Update

VENTURE MARKET CORRECTION AND SHIFT IN INVESTOR FOCUS

Venture capital ("VC") investors emphasized quality over quantity during the first half of 2024, in response to the continued valuation correction in the venture market. This trend is reflected in data from H1 2024, which revealed that investment dollars rose to nearly C$3.6 billion across 279 deals. Investors focused on companies with strong, proven fundamentals while moving away from higher-risk companies. This shift is further reflected in the decline of both seed investments and later-stage deals during H1 2024. Higher median valuations in the U.S. venture capital market reflect similar investor selectivity.

The higher valuations, together with lowering interest rates, are a positive indicator for the tech market. However, the concentration of capital in top-performing growth companies means, in general, that access to VC remains relatively low.

VENTURE DEBT, DOWN ROUNDS, BRIDGE ROUNDS AND LAYOFFS

Debt has become a crucial source of capital for startups as venture capital equity investments have become more challenging to secure compared to the peak levels during the COVID-19 pandemic. In H1 2024, C$219 million was raised through venture debt across 20 transactions, reflecting a 7% increase in dollars compared to the first half of 2023.

Convertible debt bridge rounds, which help companies extend runway between priced financing rounds, have also continued to rise in 2024. Carta reported that 43% of Series A investments completed using its platform were bridge rounds, the second-highest rate of the 2020s, while the frequency of bridge rounds at Series B, Series C and Series D also surpassed their three-year averages in Q1 2024. In a challenging economic environment, bridge rounds may be a preferred alternative to priced rounds which may involve the challenge of renegotiating valuations.

Nearly 30% of all U.S. venture capital deals in H1 2024 were flat or down rounds, the highest levels in nearly a decade. Existing investors without anti-dilution protections and employees were generally the most negatively impacted by such rounds as their investments and ownership percentages may have plummeted with lower valuations. While down rounds and flat rounds are not ideal for founders, they remain a necessary step to help companies to recalibrate for growth in the future and stay afloat in times where capital is not as easy to secure.

Similar to 2023, 2024 saw layoffs and job cuts in the technology sector amongst startups and established companies. Although financial and economic factors are often cited as the primary drivers of layoffs, the growing impact of artificial intelligence ("AI") and automation, and their continuous integration into businesses, are also contributing factors.

DEAL TERMS AND EXITS

The challenging economic environment has led to an increase of investor-friendly deal terms, as investors seek to protect their investments and startups face fewer avenues to secure capital. The prevalence of cumulative dividends in U.S. term sheets has reached its highest levels in the past decade – a stark contrast to the decade lows observed during 2021 at the height of the pandemic. Such provisions provide investors with additional protections, as cumulative dividends attached to preferred shares ensure that any missed or unpaid dividends are paid out before the common shareholders receive any payments. Investor-friendly terms are not uncommon in VC financings. Typically, preferred shareholders are paid out before

common shareholders in a liquidation waterfall, regardless of market conditions. The payout for preferred investors is very tall in today's climate, as companies have remained private for longer periods of time and have raised capital at high valuations to drive growth. The combination of these payout structures and downward valuations from the highs of the pandemic create disincentives for founders and boards to pursue discounted exits.

Notwithstanding these challenges, there were 25 exits amounting to a total of C$3.6 billion in Canada during H1 2024. The majority of these exits resulted from mergers and acquisitions.

Additionally, a KPMG survey has revealed that nine out of 10 CEOs of major Canadian organizations are considering acquisitions within the next three years to drive growth, with four out of 10 targeting major deals. Furthermore, nearly three-quarters of small and medium-sized businesses are also considering acquisitions. This is a signal of optimism for future growth and stability within the Canadian business landscape.

TRENDS HEADING INTO 2025

In 2024, Canadian startups continued to garner interest from international investors. The U.S. has continued to play a key role in the Canadian venture ecosystem with U.S. investors participating in 34% of all VC deals during H1 2024. Additionally, European and Asian investor engagement in Canadian startups has remained stable. Sustained interest and investment by international investors are expected in 2025 as inflation continues to show signs of decreasing and the market stabilizes [coupled with a weaker Canadian dollar].

AI and machine learning startups are poised for another strong year in 2025, after capturing nearly half of the deal value in Q2 of 2024 in the U.S. Despite a decrease in investments across several industries due to high interest rates, inflation and post-pandemic valuation corrections, interest in AI has remained steady. Major tech giants have continued to demonstrate interest in AI in an attempt to outpace one another and to stay ahead of the curve. In H1 2024, Canada's largest disclosed deal involved an AI startup, which raised C$616 million in a Series D financing from Canadian and U.S. investors. AI's continuous growth and investor enthusiasm in AI demonstrate that the competition that was present in the entire venture market a few years ago is now concentrated in AI. With market conditions improving, interest rate cuts and a low and steady rate of inflation, AI will likely continue to have another strong year in 2025.

Non-traditional corporate venture capital continued the 2023 trend of significantly scaling back their investments compared to years prior and have narrowed in on companies that are able to provide non-monetary returns, while steering clear of riskier investments. This investment thesis on the part of non-traditional investors is likely to continue in 2025, resulting in a smaller pool of capital which further lowers valuations.

At the same time, alternative financing models such as venture debt, revenue-based financing and secondary market sales will become more prominent as startups seek non-dilutive capital. With traditional equity financing becoming harder to secure for some startups due to investor conservatism and selective investment practices, companies will turn to these alternatives to extend their runway or delay raising equity at unfavourable terms. This may lead to growth in venture debt and potentially hybrid models where equity is combined with flexible debt or revenue-share agreements, giving founders more options to manage dilution while maintaining control over their companies.

As of July 2024, global private equity and venture capital funds held a record C$2.62 trillion in dry powder. This accumulation is the result of decreased valuations, the market slowdown and investor selectivity in startups as they emphasized higher revenues and clearer paths to profitability, among other factors. As the economy stabilizes and inflation steadies, VC investors will need to invest this dry powder. In 2025, VC investors are likely to continue shifting their focus towards startups with sustainable growth models and proven paths to profitability. The economic pressures of 2023 and 2024, including higher interest rates, inflation and market corrections, have pushed investors away from the high-burn, growth-at-all-costs mentality that dominated during the pandemic. Instead, investors will prioritize companies with strong fundamentals and positive unit economics. This means more due diligence on business models and cash flow sustainability, longer fundraising cycles as companies take more time to meet these requirements and fewer moonshots as investors balance risk with clearer returns. Given the investor preference for top-performing companies, we may see bidding wars.

List of Sources: PitchBook, CVCA, Carta, EY, KPMG , PYMNTS, Yahoo Finance and S&P Global

Canadian Take-Privates in 2024 and Looking Forward[1]

The tech sector continued to contribute significantly to activity levels in the Canadian take-private market throughout 2024. We expect this trend to continue in 2025.

OVERVIEW

There were nearly 100 Canadian take-privates announced or closed during the period from September 1, 2023 to August 31, 2024, representing a total deal value of approximately C$50 billion. Overall, the most active sectors for targets were: metals and mining (approximately 40% of deal count and 30% of deal value), technology (approximately 20% of both deal count and deal value) and energy and power (approximately 11% of deal count and 20% of deal value).

Of the Canadian take-privates announced or closed, roughly 20 involved tech sector targets, with a total deal value of approximately C$10 billion. A majority of the tech-target take-privates were sponsored by private equity ("PE") firms, with PE-backed acquisitions accounting for approximately 60% of tech-target deal count and approximately 90% of tech-target deal value.

PE-SPONSORED TECHNOLOGY ACQUISITIONS ON THE RISE

As the data shows, Canadian tech companies continue to attract attention from PE investors.

Of the Canadian take-privates announced or closed, PE-backed deals represented approximately 40% of both overall deal count and deal value. For these PE-backed deals, the most active target sector was tech, representing approximately 40% of PE-backed deals, by both deal count and deal value.

From a valuation perspective, the deal price for Canadian tech take-privates announced or closed represented an average premium of approximately 40% compared to the pre-announcement trading price, with premiums for all Canadian tech take-privates ranging from as low as 0% (or less) and as high as approximately 120%, in each case, compared to the pre-announcement trading price. The average premium for the subset of Canadian tech take-privates that were PE-backed was approximately 40% as well compared to the pre-announcement trading price.

GETTING DEALS DONE

The success rate of Canadian take-privates continues to be very high following announcement. Fewer than 8% of the deals announced were withdrawn or otherwise unsuccessful, with only one instance of the board terminating the original deal to take a superior proposal and the rest of the withdrawn or failed deals tied to a failure to meet the minimum tender or shareholder approval requirement or other reasons particular to those deals.

The vast majority of Canadian take-privates continue to be friendly transactions carried out using the court-approved plan of arrangement structure (approximately 98% of deals), as compared to being structured as a takeover bid (approximately 2% of deals).

1 The data points described in this section are based on our review of relevant transactions disclosed on **https://www.refinitive.com** and the related information on **https://money.tmx.com**, during the period from September 1, 2023 to August 31, 2024.

AI Representations and Warranties in M&A Transactions

INTRODUCTION

With the emergence of generative artificial intelligence ("AI"), mergers and acquisitions ("M&A") practitioners are more and more likely to encounter AI issues during transactions. While those may involve well-known legal risks (corporate, employment, contractual, etc.), they can also entail novel ones depending notably on whether the transaction involves a company that develops or uses AI systems in its activities (or both), or the type of AI systems in question – be they generative or decision-making AI systems. Those novel issues stem notably from the way those AI systems are developed (i.e., using massive datasets) and the risks associated with their output, which can be unpredictable, biased and otherwise harmful.

In an M&A context, mitigating the risks associated with AI requires a comprehensive strategy that should start with a thorough due diligence of the target's AI profile. For detailed insights on this critical step, we refer the reader to a previous article published in our Technology Perspective Outlook 2024. Following such review, drafting robust representations and warranties ("R&W") is also essential to allocate AI risks between buyers and sellers, as we will discuss in this article.

REPRESENTATIONS AND WARRANTIES

Shares or assets purchase agreements usually include "technology" R&W, which are often sub-divided into "information technology," "privacy" and "intellectual property" R&W. Many AI risks can be addressed through such standard clauses. For instance, a target's ownership of intellectual property ("IP") rights in its AI solutions will generally be captured by a standard IP ownership R&W. After all, AI systems are software code that are subject to IP protections, including copyrights. However, in many cases additional bespoke AI R&W will be required to cover all relevant AI risks.

Updating Defined Terms

As software,[1] AI systems are likely captured in the "software" or "computer systems" definitions found in most purchase agreements. Yet, AI systems use advanced algorithms (such as machine learning) and are usually trained on data, which make them distinct from old-fashioned software. To avoid ambiguities and to allow for AI-specific R&W that need not apply to non-AI software, parties should include definitions of terms related to AI such as "AI Systems," "AI Output," "AI Standards," "AI Laws" and "Training Data." To draft theses definitions, parties should use as guidelines (and tailor them to their specific case) definitions from AI-specific laws in the jurisdictions relevant to the transaction. Such include, in the European Union ("EU"), the *Artificial Intelligence Act* ("EU AI Act") and, in the United States, the *AI Transparency Act* (California), the *Colorado AI Act* and the *Utah AI Policy Act* (among others).[2] In jurisdictions

1 Although AI systems may be used in embodied systems (i.e., robotics), we focus in this article on the software aspects of AI systems.

2 https://iapp.org/resources/article/us-state-ai-governance-legislation-tracker/#enacted-laws. As of October 2024, those laws have been adopted, but will enter into force in the coming months or years.

without such laws (including Canada),[3] parties can also take inspiration from the Organization for Economic Co-operation and Development ("OECD") definition of "AI System," which has influenced legislators in the U.S., the EU and Canada.

To ensure coverage by standard technology R&W, these defined AI terms should then be included within broader definitions such as "Software," "Technology" or "Computer System." This will clarify, for instance, that when a target represents that its computer systems are sufficient for the operation of its business, this includes AI systems. Results from the due diligence will also help determine if the definitions of "Owned IP" or "Licensed IP" should include "AI Output" (i.e., content generated by an AI system). This will be fact specific. For instance, an AI developer that licenses a generative AI system may assign IP rights in the system's output to its customers, but not in the system itself. In such cases, sellers will need to carefully review the definition of AI Output and ensure that R&W regarding their owned IP are accurate.

Intellectual Property Issues

Owned and licensed AI systems should be listed as part of standard IP representations. For sellers, meeting this representation will be facilitated if they have put in place an AI systems inventory, but they can also limit such R&W based on a materiality threshold. For instance, sellers could propose to limit disclosure to only "high risk" or "high impact" AI systems, as those are the types of AI systems that are subject to the most extensive obligations under emerging AI laws.[4] In addition, acquirers of AI developers may request the disclosure of the training datasets used to train their AI Systems (either directly or indirectly through third-party service providers), but also that this training data has been obtained and used lawfully. This is important in particular in the context of multiple actions brought by rights holders, principally in the U.S., against developers of AI systems for having allegedly used data to train their AI systems without proper permissions or licences. More broadly, R&W specific to training datasets may also consider the appropriateness and fitness of the datasets used for the AI systems' specific purposes.

Given the remaining uncertainties regarding the possibility of owning AI-generated output under copyright laws,[5] standard IP R&W should also generally now include a R&W to the effect that the target has not used any AI system to generate output embedded in the target's IP (like its software code). Depending on the context, sellers may be able to limit such R&W using a reasonable effort standard or by representing they have put in place reasonable AI use policies and provided proper training to their employees.

3 In Canada, the *Artificial Intelligence and Data Act*, which was set to be Canada's general AI law, died on the *Order Paper* with the prorogation of the federal parliament on January 6, 2025. **https://www.parl.ca/legisinfo/en/bill/44-1/c-27**.

4 "High-risk AI system" is the notion used in the EU AI Act, while the Canadian AI bill uses "high-impact systems." Certain jurisdictions also impose certain obligations on generative AI systems specifically and outright prohibit certain types of AI systems (like the EU AI Act).

5 The U.S. Copyright Office, for instance, has released a policy statement stating that generative AI output may not be copyrightable if it does not involve the required level of human authorship. **<https://www.copyright.gov/ai/ai_policy_guidance.pdf>**.

Compliance with AI Standards and Laws

Most purchase agreements include a general compliance with applicable laws R&W, which would include the AI laws of the jurisdictions where a target operates. Technology R&W often, however, also include a R&W to the effect that the target complies with specific privacy laws, and such an approach should be taken as regard to AI laws, especially given the rapidly evolving legal landscape. For acquirers, a definition that lists applicable laws in a non-limitative manner will be most favourable, while sellers will prefer a closed list.

The development and use of AI systems, even in the absence of dedicated legislations, is also increasingly subject to a series of voluntary standards developed by reputable institutions. Chief among those are the comprehensive AI governance frameworks ISO/IEC 42001 and NIST AI RMF 100-1. Acquirers may request targets to represent and warrant they have developed or used AI systems in accordance with those standards and include a broad definition of "AI Standards" in the purchase agreement. It is to be noted, however, that this remains an emerging area and that few organizations are currently compliant with those new standards. As such, sellers may have an easier time pushing back against strong "compliance with AI standards" R&W in the near future, but acquirers should insist minimally on a R&W that the target has put in place appropriate controls and policies, even if a reference to specific standards is not included. We expect, however, that, as AI adoption increases, certain standards will establish themselves as industry standards, similarly to the now well-known ISO and NIST cybersecurity frameworks.[6]

Computing Infrastructures

The development of AI systems requires access to key infrastructures, including servers, data centres, foundational models or compute capacities for training or processing purposes, which may be provided by third parties. For instance, AI developers may contract with cloud-based graphics processing unit ("GPU") providers to access computing capabilities they do not possess internally. Cost for theses cloud-based services have risen with the global shortage of GPUs. Additionally, the reliability of the infrastructure raises concerns about latency and network outages, which is essential for maintaining seamless operation of AI systems provided on a software-as-services basis.

These issues require technical due diligence, but also legal due diligence, especially regarding the review of a target's agreement with its AI infrastructure providers. On a R&W level, parties should consider listing the key AI infrastructure agreements as part of the material contracts R&W. Acquirers may also request AI developers to confirm they have access to all the AI infrastructures they need to develop and operate their AI systems. A pro-acquirer approach would be to also request sellers to represent and warrant such capabilities are sufficient for the target's current and expected needs, but sellers may insist on a R&W limited to its current operations.

CONCLUSION

The legal landscape governing AI is rapidly evolving in an attempt to keep pace with technological changes. In response, there is an increasing focus on AI governance practices by acquirers who recognize the need to understand and manage the risks associated with AI technologies. Ultimately, staying up to date with these legislative changes and market practices will be imperative for both acquirers and sellers of companies developing or using AI systems. Among the areas to monitor is the evolution of R&W insurance to account for AI risks and issues. R&W insurers are keenly aware of technology risks, especially as regard the high costs associated with privacy breaches and cybersecurity incidents. Although AI issues do not appear to have specifically impacted R&W insurance products to date, we expect R&W insurers to increasingly pay attention to AI-specific R&W in the near future.

6 Notably as those standards are adopted and recognized by legislators. For instance, the *Colorado AI Act* requires deployers of high-risk AI systems to implement a risk management policy and specifically refers to the NIST and ISO/IEC AI standards as setting forth appropriate guidance to implement such policy. *Colorado AI Act*, s. 6-1-1703(2)(a)(I)(A).

Is Copyright Law Catching Up to Generative AI?

Since the overnight sensation of ChatGPT's launch in 2022, businesses have rushed to develop and use generative artificial intelligence ("AI") in day-to-day business operations. OpenAI's success fuelled interest in investing and acquiring generative AI technologies. However, copyright infringement risks – and actual legal claims – against these new tools are rising in parallel.

As generative AI continues to evolve and integrate into various industries, the legal landscape concerning copyright infringement is growing increasingly intricate yet remains largely unsettled. Businesses acquiring generative AI tools should be mindful of this new category of legal risks, while those acquiring content and datasets should factor in their new potential value.

The current generative AI copyright landscape is reviewed below, focusing on emerging challenges and practical considerations for managing day-to-day AI-related issues.

COPYRIGHT INFRINGEMENT LAW

The situation in Canada created by the intersection of copyright and AI is under study. This year, the Canadian government completed its most recent consultation on "Copyright in the Age of Generative Artificial Intelligence." Two key themes of the consultation were:

1. The complexity of obtaining a vast number of authorizations for text and data mining copyright-protected works to train AI systems.

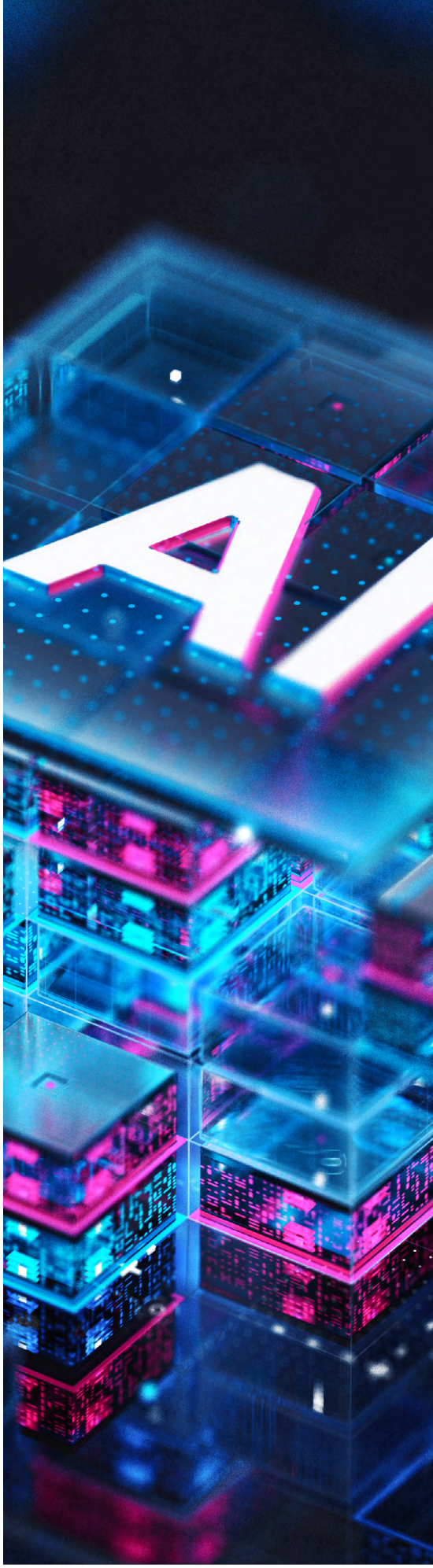
2. Infringement and liability for copying becomes less clear as human involvement decreases.[1]

In Canada, industry will continue to monitor how the government responds to the stakeholder feedback collected during its consultation, including if and how the *Copyright Act* is amended to deal directly with this challenge.

In the U.S., companies from UMG Recordings to The New York Times have already filed lawsuits against AI companies for copyright infringement. There are now over 30 cases alleging developers infringed copyright in different ways working their way through the U.S. courts. There is also litigation in the U.K., Germany, India, and even in Canada. Some preliminary decisions in the U.S. have started to identify the key issues and how they might be resolved.

1. The plaintiffs claim that unauthorized copies of works are made in training generative AI systems. There seems to be agreement that at least some copying is taking place preliminary to training activities.

2. There are major disputes as to whether further copies are made during AI system training. At least one court has expressed the view that alleging copies are made during AI system training presents a tenable pleading. However, there are factual disputes as to whether training involves making copies or merely extracting unprotectable information and mathematical relationships to create the tokens and model algorithms.



1 www.ic.gc.ca/eic/site/693.nsf/eng/00316.html.

3. The courts also accept as a tenable pleading that if copies are being made in training systems, the models themselves may be infringing and output generated from the models may also be infringing.

4. It is understood that the key issue in the AI copyright litigation is whether the training and output activities will be covered by fair use. This issue may be resolved sooner than some people think with pending summary judgement motions on fair use in the *Thomson Reuters v. Ross Intelligence* case.[2]

COPYRIGHT OWNERSHIP LAW

Authorship of AI-generated works is also a quickly evolving topic. In the U.S., the Copyright Office initially refused to register copyright in a graphical work because authors must be human. This year, the office's Review Board confirmed its position: a human using a generative AI tool that "predict[s] stylizations for paintings and textures never previously observed" will not receive copyright protection given the current state of generative AI systems.[3] The image they considered was called "SURYAST."

Canadian copyright law has not yet kept pace with U.S. development.[4] However, one Canadian public interest clinic is trying to change that. The Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic filed an application in July 2024 seeking a declaration that there is either no copyright in SURYAST or, if there is, the generative AI is not a co-author.

For now, Canadian copyright law mirrors the initial basic U.S. stance, namely the default is that the author of a work must be a human being.[5] Usually, the author only needs to contribute a minimal amount of skill and judgement to benefit from copyright protection. Whether a person controlling a generative AI program can be seen as directing or fashioning the work and contributing sufficient independent intellectual effort to satisfy the originality criteria is, for now, a case-by-case question.

Copyright ownership and authorship was explored in the consultation and changes to the *Copyright Act* may be forthcoming this year.

2 Barry Sookman, **AI models and copyright infringement, Andersen v. Stability AI**; Barry Sookman, **Resolving GenAI copyright infringement questions: 4 court decisions**.

3 Second Request for Reconsideration for Refusal to Register SURYAST (SR #1-11016599571; Correspondence ID: 1-5PR2XKJ

4 Although the Canadian Intellectual Property Office has registered AI-generated works for copyright, it does not conduct substantive assessments.

5 The *Copyright Act* connects the term of protection to the human author's lifespan and includes the concept of "moral rights" presupposing a human author with certain inalienable interests connected to their honour or reputation.

Canadian Crypto Outlook: Progress or Standstill?

2024 was a lacklustre year for Canadian crypto. While the price of bitcoin and other crypto assets soared against a backdrop of emerging regulatory clarity in the United States and Europe, Canada's regulatory regime – which had led the world in 2021 – imposed additional product restrictions, raised barriers to entry and did not approve any new crypto products. That being said, we are optimistic that Canada's strong regulatory foundation can support an innovative 2025, in which collaboration between industry and regulators allows Canada to reclaim its crypto leadership position.

GLOBAL CRYPTO PROGRESS

To contextualize our Canadian analysis, some of crypto's key global milestones achieved in 2024 are summarized below:

— **Jan. 10, 2024:** U.S. Securities and Exchange Commission ("SEC") approves Bitcoin ETFs, which end the year with aggregate assets under management ("AUM") of over USC$120 billion.[1]

— **May 22, 2024:** U.S. House of Representatives approves the *Financial Innovations and Technology for the 21st Century Act* ("FIT21") with broad bipartisan support, providing "robust, time-tested consumer protections and regulatory certainty necessary to allow digital asset innovation to flourish."[2]

— **June 30, 2024:** Titles III and IV of the European Union's ("EU") *Markets in Crypto Assets Regulation* ("MiCA") comes into force, with comprehensive regulation for asset-referenced tokens and e-money tokens, including disclosure and reserve requirements.[3]

— **Dec. 5, 2024:** Trading price of bitcoin ("BTC") hits USC$100,000 for the first time.

— **Dec. 31, 2024:** Rest of MiCA comes into force, providing uniform registration requirements for crypto asset service providers ("CASPs") which can be "passported" across the EU.[4]

— **Jan. 21, 2025:** SEC forms new crypto policy reform task force to "draw clear regulatory lines, provide realistic paths to registration, craft sensible disclosure frameworks, and deploy enforcement resources judiciously."[5]

— **Jan. 23, 2025:** U.S. Senate forms Senate Banking Subcommittee on Digital Assets to pass "bipartisan digital asset legislation that promotes

1 James Van Straten, Parikshit Mishra (Coindesk), "U.S. Listed Spot Bitcoin ETFs on the Verge of Surpassing Gold ETFs" (19 December 2024).
2 House Committee on Financial Services, "House Passes Financial Innovation and Technology for the 21st Century Act with Overwhelming Bipartisan Support (22 May 2024). FIT21 would require U.S. Senate approval prior to becoming legally effective.
3 Tanner J. Wonnacott and Dr. Jan Boeing (K&L Gates LLP), "The Regulation on Markets in Crypto-Assets Becomes Fully Applicable in All Member States of the European Union" (24 January 2025).
4 *Ibid*.
5 U.S. Securities and Exchange Commission, "SEC Crypto 2.0: Acting Chairman Uyeda Announces Formation of New Crypto Task Force" (21 January 2025).

responsible innovation and protects consumers" and supervise "Federal financial regulators to ensure those agencies are following the law."[6]

Another major development was the proliferation of payment use cases for fiat-backed stablecoins, which reached a global market capitalization of over USC$200 billion.[7] Similarly, 2024 saw concrete progress in real world asset ("RWA") tokenization, exemplified by the BlackRock USD Institutional Digital Liquidity Fund in March, offering Ethereum-based tokenized exposure to U.S. treasuries.

CANADA CRYPTO STANDSTILL

One Size Fits All: Mandatory CIRO Membership for Custodial CTPs

After approving only one crypto asset trading platform ("CTP") for registration in 2024,[8] the Canadian Securities Administrators ("CSA") announced in August that its flexible, "restricted dealer" framework is no longer available for CTPs seeking to enter the Canadian market.[9] Rather, the only option for a CTP that offers custodial services is to register with the CSA as an investment dealer and become a member of the Canadian Investment Regulatory Organization ("CIRO").

CIRO's stringent capital, insurance, financial reporting and proficiency requirements ensure that the crypto assets of Canadian users will be adequately protected. However, CIRO's prescriptive regime was built for securities dealers and does not contemplate crypto's 24-7 global markets, transparent on-chain settlement, and user-directed movement of assets between centralized CTP accounts and self-custody wallets. As a self-regulatory organization, CIRO does not have discretion to deviate too far from its familiar business models, which do not accommodate assets that can be used for purposes other than investment, such as payments, gaming and other Web3 functions.

Renewed flexibility from the CSA and CIRO will be necessary for Canadians to participate in crypto's new use cases while continuing to buy and store their assets with a regulated intermediary.

Only in Canada: Regulation of Fiat-Backed Stablecoins as Securities

The CSA finally implemented its interim regime for fiat-backed stablecoins (which the CSA calls "**value-referenced crypto assets**" or "**VRCAs**") when Circle Internet Financial Inc. accepted its jurisdiction over USD Coin ("USDC"), as discussed in our **December 10 blog post**. As a result, registered CTPs can continue to offer USDC in compliance with the "VRCA Terms & Conditions" imposed by the CSA.

However, CSA guidance[10] suggests any new stablecoin issuer that seeks to do business in Canada must file a prospectus and submit to a disclosure-based regime. In contrast, MiCA and all other emerging global regimes will regulate stablecoins as payment instruments pursuant to prudential standards. The Canadian Web3 Council articulated industry's concerns with the CSA's approach in its **December 20 comment letter**[11] on the Ontario Securities Commission's ("OSC") 2025-26 Statement of Priorities:

- "**Businesses** using stablecoins to pay employees or vendors face uncertainty over whether their transactions involve securities and the implications from both a tax and regulatory perspective.
- **Consumers** must worry about tax implications when using stablecoins for everyday payments.
- **Payment service providers** accepting stablecoins must consider whether they are effectively dealing in securities and need to register as securities dealers.
- **New VRCA issuers** face hurdles to list their stablecoins … The restriction discourages new product innovation particularly for a CAD denominated stablecoin, and undermines the development and adoption of new payment networks, applications and products in Canada."[12]

Fiat-backed stablecoins are an essential part of global crypto asset markets and are of increasing importance in global payments and finance. If Canada's regulatory approach does not reflect the predominant global use case

6 Cynthia Lummis, "Lummis to Chair Historic Senate Panel on Digital Assets" (23 January 2025).
7 Lawrence Wintermeyer (Forbes), "2024 The Year Of Crypto: From Bitcoin ETFs To Memecoins" (31 December 2024).
8 Coinbase Canada, Inc. was registered as a restricted dealer on April 3, 2024: OSC, *In the Matter of Coinbase Canada Inc. and Coinbase, Inc.* (3 April 2024).
9 OSC, "CSA and CIRO expect crypto trading platforms to prioritize applications for investment dealer registration and CIRO membership" (6 August 2024).
10 CSA Staff Notice 21-333 *Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients* (5 October 2023).
11 Canadian Web3 Council, "RE: Request for Comments Regarding Statement of Priorities for Fiscal Year 2025-2026" (20 December 2024).
12 *Ibid*, page 2.

for stablecoins as digital money, we risk isolating both our crypto asset markets and our fintech payment rails from the rest of the world.

Canadian Public Crypto Fund Outflows

Canada was the first country in the world to approve public crypto asset funds, with closed-end funds for Bitcoin and Ether launching on the Toronto Stock Exchange in 2020, followed by ETFs for both assets in 2021, and the first Ether staking fund and ETF approvals in 2023. Canada's innovative crypto asset funds attracted significant global investment, with over C$3 billion in aggregate AUM as of June 30, 2023.[13]

Not surprisingly, following the SEC's approval of Bitcoin ETFs in January 2024 and Ether ETFs in May, Canadian crypto ETFs experienced outflows of approximately C$1.4 billion as U.S. and other international investors shifted their exposure.[14] Only one new Canadian crypto ETF was launched in 2024 when small-cap issuer Ether Capital Corp. converted into Purpose Ether Staking Corp. ETF in June 2024 (CBOE:ETHC.B).

DeFi on the Horizon: Focus on Automated Market Makers (AMMs)

In July 2024, staff of the OSC and Bank of Canada published **The Ecology of Automated Market Makers** (the "AMM Paper")[15], a discussion paper about AMMs as a potential source of investor harm, risk to market integrity and channel for systemic risk. The AMM Paper was produced by authors from both the OSC and the Bank of Canada as a staff research study relevant to policy. The OSC and Bank of Canada explicitly disclaim responsibility for the views expressed in the paper.[16]

The AMM Paper describes potential investor harms arising from information asymmetries amongst users of AMMs and other Decentralized Finance ("DeFi") protocols that could give rise to losses due to misconduct or market failures, and identifies "a limited set of AMM activities that may already be captured within existing regulatory frameworks." The paper notes how AMMs appear to: (i) "issue and engage with a variety of crypto assets that may be considered securities or derivatives"; (ii) "perform some key functions comparable with centralized market structures"; and (iii) "encourage participation by retail and institutional users in trading activities and liquidity pool."[17]

Overall, the AMM Paper conveys that the OSC and Bank of Canada are still in the initial stages of considering when and how to regulate DeFi activities, and recognize that the decentralized, autonomous nature of AMMs raises regulatory challenges. However, it also demonstrates that the OSC, following the lead of the International Organization of Securities Commission, is deepening its understanding of DeFi, and has identified investor protection and market integrity concerns associated with DeFi.

The tone suggests that the OSC is examining the issue closely and is likely to issue guidance prior to exerting jurisdiction over AMMs or other DeFi projects. However, taking into account the widespread use of stablecoins in DeFi, which the CSA is already proposing to regulate as securities, regulatory risk is heightened in Canada and may deter crypto innovators from allowing Canadian users to access decentralized markets and services.

13 CSA Notice and Request for Comment – *Proposed Amendments to National Instrument 81-102 Investment Funds Pertaining to Crypto Assets* (18 January 2024).
14 Andres Rincon (TD Securities), "Canada's 2024 ETP Recap: A Year for the Record Books" (16 January 2025).
15 Annetta Ho (Bank of Canada), Cosmin Cazan (OSC), and Andrew Schrumm (OSC), "The Ecology of Automated Market Makers" (11 July 2024) ["AMM Paper"].
16 AMM Paper, page 32.
17 AMM Paper, page 38.

REASONS FOR OPTIMISM

Restraint in Enforcement

Although Canada's regulatory framework for CTPs is strict, the CSA have not used its enforcement powers to establish new rules for the crypto asset industry. To the contrary, to date, all enforcement actions commenced by CSA members against crypto market participants have been preceded by public staff notices[18] that seek to articulate CSA staff's views of how existing securities legislation applies to crypto asset activities.

The first wave of OSC enforcement actions came in 2022, a year after the publication of **CSA Staff Notice 21-329**, which clarified the CSA's view that the custodial accounts offered by centralized CTPs are securities or derivatives and, therefore, engage securities dealer and marketplace regulation. The OSC brought proceedings against four foreign CTPs that served Canadian users, all of which offered derivatives and highly leveraged products in addition to spot crypto contracts, as discussed in our **2023 article**. In response, many foreign CTPs withdrew their services from Canada.

In 2023 and 2024, the OSC and other CSA members prosecuted a total of 14 CTPs and issuers (many of which were discussed in our **2024 article**) for distributing and/or trading in crypto assets that are securities or derivatives without complying with the prospectus and/or dealer registration requirements. Generally, the respondents in these actions made false or misleading statements in promotional materials, were reckless or negligent when providing crypto asset services, or at a minimum, provided custodial services that are widely recognized to engage securities laws. To date, no CSA member has brought a public enforcement proceeding against a crypto asset developer in connection with non-custodial services.

In addition, the Ontario Capital Markets Tribunal ("OCMT") seems to be taking a measured approach toward the application of securities legislation to crypto assets. In the 2024 case ***Re Hogg***,[19] the OCMT rejected the OSC's position that the crypto assets promoted and sold by the respondents were, in and of themselves, securities, and endorsed the investment contract analysis in the U.S. decision in ***SEC v. Ripple Labs***[20]:

> We were not convinced by the Commission's assertion that the Tokens here are a "smart contract," "contract," "equivalent of a written document," or that they have "terms" embedded within them. The Commission relied on a single line in the Cryptobontix White Paper indicating that the Tokens are "based on the Ethereum Smart Contract technology, otherwise known as ERC20 tokens". The Commission did not satisfactorily explain why this was significant. There was no evidence supporting these assertions of the Commission…We were also not satisfied that the Tokens here are an investment instrument like a share certificate. It was not established that there is anything inherent in them that gives investors any interest in Cryptobontix or a business.
>
> Although the Tokens are the subject of the transaction or scheme in this case, we find that the Tokens (like the bags of silver coins in Pacific Coast Coin and the citrus groves in Howey, involving contracts in which investors bought citrus groves and essentially leased them back to a service provider to harvest, pool and market the produce), in and of themselves, do not embody the elements of an investment contract.[21]

18 The CSA Financial Innovation Hub maintains an up-to-date list of all CSA publications relating to crypto assets here: **CSA Publications**.
19 **2024 ONCMT 15** (*Hogg*).
20 **20 Civ. 10832 (AT)**.
21 *Hogg*, paras 104–105.

Silver Lining: Maturation of Canadian Crypto Asset Industry

A benefit of the CSA's heavy regulatory approach is that Canada now has five CTPs that are full investment dealers and CIRO members, six CTPs that are restricted dealers and a handful of others expected to complete registration in the first half of 2025. All of these CTPs are required to maintain robust financial, operational, compliance, and risk management programs in order to meet regulatory standards. As a result, Canadian CTPs are supervised by qualified professionals, many with traditional capital markets experience.

In addition, CSA and CIRO staff have developed expertise in crypto asset trading and markets. For example, each of the CSA and CIRO have developed terms and conditions under which CTPs are permitted to offer staking services to their users, as well as minimum standards for hot wallet controls, security audits and insurance.

The combination of professionalized CTPs and sophisticated regulators should facilitate collaboration that will allow regulated platforms to offer new products to Canadian users. The CSA and CIRO should be receptive to proposals by CTPs to offer margin, derivatives and advice related to crypto assets built upon existing capital markets regulatory principles, while recognizing that many crypto assets are not securities. As a result, clients may seek to trade and hold crypto assets for purposes other than investment, and therefore flexible approaches to product due diligence, suitability and custody may be appropriate.

Similarly, Canadian crypto asset ETFs have operated since 2021, and three Canadian public Ether funds engage in staking activities to enhance returns for their holders, while managing liquidity.[22] The CSA has proposed regulatory amendments which will expressly include crypto asset funds within Canada's public investment fund regime.[23] Late January 2025 saw prospectus filings by two Canadian fund managers for Solana (SOL) ETFs that will engage in staking strategies,[24] as well as one Ripple (XRP) ETF.[25] The CSA now has the opportunity to apply its established framework and regulatory expertise to these new products.

22 **Purpose Ether Staking Corp. ETF** (SEDAR+ Profile number 000104893); **3iQ Ether Staking ETF** (SEDAR+ Profile number 000051756); **The Ether Fund** (SEDAR+ Profile number 000060045).
23 **CSA Notice and Request for Comment - *Proposed Amendments to National Instrument 81-102 Investment Funds Pertaining to Crypto Assets* (18 January 2024)**.
24 Purpose Solana ETF (SEDAR+ Profile number 000107576) and 3iQ Solana Staking ETF (SEDAR+ Profile number 000107593); documents filed at **www.sedarplus.ca**.
25 3iQ XRP ETF (SEDAR+ Profile number 000107597).

Public Consultation and Regulatory Collaboration

The CSA introduced a capital markets regulatory framework for crypto assets in 2021,[26] bringing high standards of proficiency, solvency, and integrity to the Canadian crypto industry. Rather than proposing new rules specifically designed for crypto assets (which would likely have required legislative amendments), the CSA applied existing legislation to custodial CTPs, tailored through exemptive relief to provide flexibility.

The CSA implemented its framework by publishing nine staff notices, as well as bespoke terms and conditions of registration for each CTP that achieved dealer registration. Four years later, close to 20 CTPs are registered as dealers, or operate under pre-registration undertakings, under Canadian securities legislation. The CSA's initiative has provided regulatory clarity and strong consumer protection, which has benefited many Canadian crypto investors and users.

However, because the CSA's approach applies existing securities laws to crypto, rather than creating new rules based on capital markets principles, it is inherently limited and increasingly rigid. By and large, all Canadian CTPs offer only one product: self-directed spot crypto asset trading and custody, in some cases with staking. Similarly, the CSA's initiative to regulate fiat-backed stablecoins as securities has left USDC as the only fiat-backed stablecoin listed on Canadian CTPs, with significant regulatory burden impeding the offering of a CAD token or any other stablecoins in Canada.

Meanwhile, MiCA, FIT21, and other fit-for-purpose crypto asset regulatory regimes reflect the novelty of crypto assets, many of which have both investment and utility characteristics. Importantly, most global regimes also distinguish between fiat-backed stablecoins (generally regulated prudentially as digital money) and other types of crypto assets. In order for Canada to be able to continue to regulate crypto without stifling innovation, public consultation with industry and other stakeholders is imperative.

In addition, now that a critical mass of CTPs are registered, the CSA and CIRO should be open to hearing industry proposals for expanding crypto asset products and services for the benefit of Canadian clients and users. Together, industry and regulators can build upon their successful history of collaboration and forge an innovative path forward for crypto in Canada.

26 Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada Staff Notice 21-329 *Guidance of Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements* (29 March 2021).

Introducing Open Banking to the Canadian Market

WHAT IS OPEN BANKING?

Financial institutions hold large amounts of information about their customers and their customers' financial transactions, and traditionally there has been no mechanism to broadly share financial data with other companies or organizations in a secure manner. Open banking, also known as consumer-driven banking, is a system which seeks to change this and provide for the secure transfer of financial data between service providers of all types, including banks, credit unions and fintech companies, as authorized by the consumer. This provides consumers with the ability to view and manage their financial data, coordinate among their financial providers and plan for their financial futures with increased control and security.

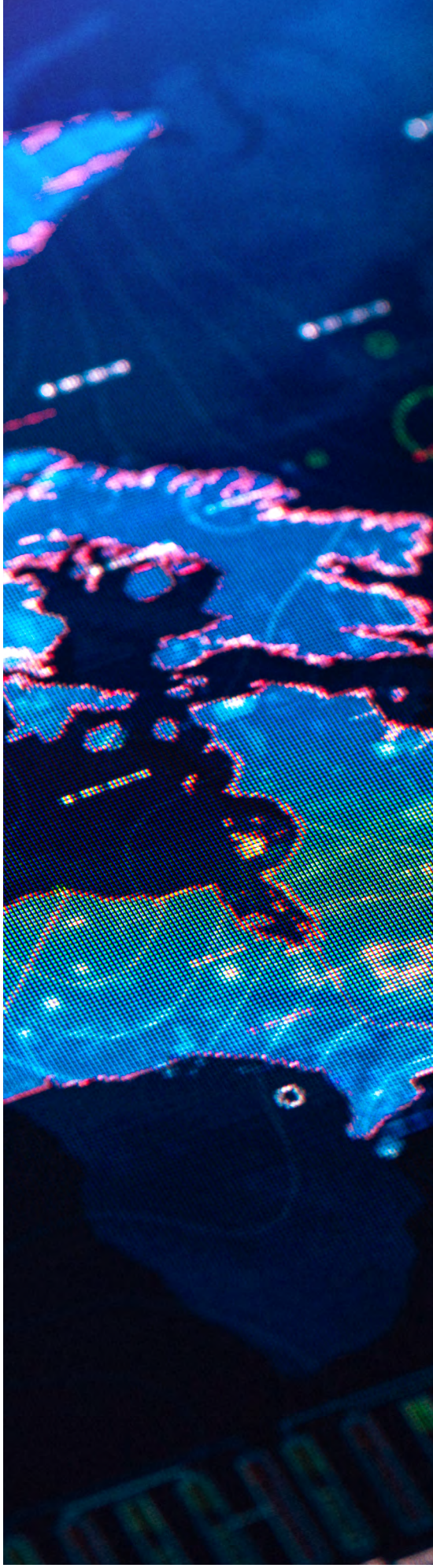
There is currently no standardized way in Canada for a consumer to share their financial data held by one financial institution with a fintech or other financial service provider; instead, consumers who wish to share their financial data with fintechs or other service providers must generally leverage a third-party aggregator service whereby the consumer shares their account login credentials, including their password, so that their financial data can be "screen scraped" from their online account. Sharing banking credentials poses serious security challenges and removes the protections provided by the financial institution to prevent unauthorized transactions and changing account information. Under the open banking model, a standardized set of application programming interfaces ("APIs") are leveraged across an ecosystem of providers to ensure financial data is securely shared based on clear and express consumer consents.

THE POTENTIAL OF OPEN BANKING

The ability to securely share financial data, instantaneously, means consumers have faster and more efficient access to a variety of useful services. It opens the door to freedom of selection and a more open market for fintechs and non-traditional providers of financial services. These providers can market their services to anyone and consumers can select the products and services they desire and that work for them, with full access to their financial data from other providers. Possible use case and benefits include the following:

— Loaning Funds: Open banking would enable a simplified process in applying for and granting loans. A consumer can instantaneously share all their financial data without the effort of compiling records and sharing them manually. They can also get a clearer picture of what kind and how much debt they can take on. Lenders can readily get a more accurate view of a consumer's financial information to better assess the risk of providing a loan.

— Financial Planning: Consumers are able to collect all their financial data from all accounts in one place and allow for a better picture of their financial health. The ability to aggregate financial data from all accounts means that services can provide actionable insights into the way consumers use their money. Open banking enables consumers to have customized budgeting tools, facilitate paying back debt and have all-in-one financial planning tools.



— Payment Reconciliation: By allowing access to transaction data from a variety of sources, services can be offered to allow for faster and more accurate payment reconciliation and bookkeeping.

CURRENT STATE OF OPEN BANKING IN CANADA

The Canadian federal government has been conducting consultations and studies on open banking for a number of years. These efforts have not yielded much progress until recently when, alongside the release of the 2024 federal budget, the federal government released a paper setting out Canada's plan to implement and legislate an open banking framework (the "Framework").[1] The Framework originally contemplated legislation regarding open banking, called the *Consumer-Driven Banking Act* (the "CDBA"), being introduced in two parts. The first part of the CDBA was introduced and received royal assent in the spring of 2024, and the second part of the CDBA was expected to be introduced in the latter part of 2024 but it is now unknown when it will be introduced given the prorogation of Parliament as of January 2025.

Notwithstanding that the first part of the CDBA has already passed into law, most of the details of the planned open banking regime are not yet known because: (a) the first part of the statute was rather light on substantive details; (b) it is unknown when the second part of the statute will be introduced; and (c) it is anticipated that most of the substance of the regime (e.g., technical details, accreditation requirements, API standards, etc.) will be addressed in future regulations under the CDBA. With that said, there are some notable points about the CDBA that are known and provide insight as to how open banking in Canada is likely to take form:

— Data Sharing: The CDBA is intended to establish a framework whereby consumers are able to choose which participating entities to share their data with. The CDBA applies to data that relates to a variety of products and services including deposit accounts, registered and non-registered investment accounts, payment products such as credit cards, lines of credit and other loans, and other such products or services. However, data which is "derived" (i.e., "that has been enhanced by a participating entity to significantly increase its usefulness or commercial value") falls outside the purview of the CDBA.[2]

— Participation and Accreditation: The Framework is on an opt-in basis and banks, credit unions and fintechs will have to opt into supervision. However, banks that meet a specified threshold for retail volume, which captures Canada's largest retail banks, will be mandated to participate. The federal government indicated that there will be an accreditation process for entities and a variety of criteria, including

1 https://www.canada.ca/en/department-finance/programs/financial-sector-policy/open-banking-implementation/budget-2024-canadas-framework-for-consumer-driven-banking.html.

2 https://lois.justice.gc.ca/eng/acts/C-36.75/page-1.html.

an application process and ongoing reporting requirements.

— Common Rules: The Framework also states that the CDBA will set out common rules in a number of areas, including setting out a liability regime, a single technical standard with principles and processes, privacy and consent management, and security requirements and certifications.

— Technical Standard: Under the CDBA, the Minister of Finance will designate a body to establish the technical standards for participating entities sharing data, and requires such a body to submit an annual report to the Senior Deputy Commissioner. Such a technical standards body is designated based on the Minister's assessment of, amongst other things, (i) the safety, security and efficiency of data sharing; and (ii) fairness, accessibility, transparency and good governance.

— FCCA: Under the Framework, the federal government expanded the mandate of the Financial Consumer Agency of Canada to include oversight of open banking. It also intends to create a new position, the Senior Deputy Commissioner of Consumer-Driven Banking, who will be responsible for overseeing open banking.

— Penalties and Prohibitions: An individual or entity not participating in the open banking system is prohibited from calling themselves a "participating entity" in any way that leads to the reasonable belief that the individual or entity is or is representing themselves as a participating entity. They are also prohibited from knowingly providing false or misleading information in relation to their participation under the CDBA. Penalties for contravening the CDBA include:

  — For individuals, a fine (up to C$1,000,000 on indictment, up to C$100,000 on summary conviction) and/or imprisonment (up to five years on indictment, up to one year on summary conviction);

  — For entities, a fine (up to C$5,000,000 on indictment, up to C$500,000 on summary conviction).

WHAT'S NEXT

Open banking is currently a rapidly evolving space in Canada. In particular, under the CDBA there are many unknowns, including how the legislation will progress, timing, rollout and the substantive requirements and standards that will apply. Further, at the time of writing of this article there is a high likelihood that a federal election will be called before the full set of CDBA legislation is passed into law. Because of the high level of uncertainty and pace of change in this space in Canada, please follow McCarthy Tétrault's **TechLex** for the most recent updates regarding the CDBA and open banking in Canada.

Canadian Digital Services Tax

The Canadian *Digital Services Tax Act* (the "DSTA") came into force on June 28, 2024, with the 2024 calendar year being the first year of application of the Digital Services Tax (the "DST") on Canadian digital services revenue. However, the DST will apply retroactively to January 1, 2022. The DST was enacted despite concerns raised by impacted business, both in and outside Canada, and opposition from the United States.[1]

LIABILITY FOR THE DST

The DST applies at a rate of 3% on "Canadian digital services revenue"[2] earned by a taxpayer (or members of a consolidated group (i.e., an ultimate parent entity and one or more other entities that are generally required to prepare consolidated financial statements)) in a particular calendar year, retroactive to January 1, 2022.

In general, the DST will only apply to a taxpayer (or members of a consolidated group) that meets the following two thresholds:

1. Total global revenue of the taxpayer, or if applicable the consolidated group, from all sources exceeded €750 million in a fiscal year ending in the previous calendar year; *and*

2. Canadian in-scope digital services revenue of the taxpayer, or if applicable the consolidated group, exceeds C$20 million in the calendar year. Digital services revenue earned from another member of the consolidated group is generally excluded from the computation of the in-scope digital service revenue.

Accordingly, the DST liability threshold for taxpayers or consolidated groups is C$20 million of Canadian digital services revenue earned annually, and any amounts above the threshold are subject to DST. Therefore, only Canadian digital services revenue above the C$20-miilion threshold will be subject to the DST by virtue of the C$20-million exemption that can be shared by all of the members of a corporate group.

REGISTRATION AND COMPLIANCE OBLIGATIONS

If a taxpayer (or, if applicable the consolidated group) meets the €750-million threshold, it will be required to register for the DST if its Canadian digital services revenue exceeds a threshold of C$10 million of Canadian in-scope digital services revenue. As the registration threshold is lower than the DST liability threshold, taxpayers and members of a consolidated group may have registration and filing obligations but will not have DST liability until they reach the C$20-million Canadian digital services revenue threshold (shared amongst members of the consolidated group).

1 On August 30, 2024, the United States requested dispute settlement consultation with Canada under the United States-Mexico-Canada Agreement (the "USMCA") regarding the digital services tax. **https://ustr.gov/about-us/policy-offices/press-office/press-releases/2024/august/united-states-requests-usmca-dispute-settlement-consultations-canadas-digital-services-tax**.

2 The DST applies to Canadian digital services revenue that is in-scope, which is determined in accordance with Part 3 of the DSTA. References to Canadian digital services revenue herein is to Canadian digital services revenue that is in-scope.

Taxpayers subject to the DST who meet both thresholds in one or more of the calendar years from 2022 up to and including the 2024 calendar year will be required to:

— register under the DSTA by January 31, 2025, and

— file a DST return and pay the DST annually (including DST payments for 2022 to 2024) by June 30, 2025 for each year that they exceed the threshold. There is an election available to simplify the calculation of revenues subject to DST for 2022 and 2023.

There is no tax credit against Canadian corporate income taxes for a DST liability. However, a DST liability may be deductible from taxable income for Canadian income tax purposes under general principles.

TYPES OF REVENUE SUBJECT TO DST: CANADIAN DIGITAL SERVICES REVENUE

In-scope revenue will generally include the following four categories to the extent the revenues can be sourced to users in Canada:

i. **Online marketplace services revenue**: An "online marketplace" is a digital interface, including a website or application, that allows users to interact with each other and facilitates the supply of property or services, including digital content between users. However, digital interfaces operated by a single supplier are excluded from the definition of "online marketplace" and therefore outside the scope of the DST. This category of revenue includes fees earned from providing access to or use of the online marketplace (e.g., subscription fees), commissions or other fees earned from facilitating supplies between users of the online marketplace and from premium services ancillary to the supply.

ii. **Online advertising services revenue**: This category of revenue includes (i) revenue from enabling the delivery of online targeted advertisements through a digital interface and (ii) providing digital space for online targeted advertisements with the in-scope revenues based on the number or proportion of users (i.e., persons accessing the advertisement) in Canada. The term "online targeted advertisement" is defined in the DSTA to mean an advertisement consisting of digital content that is "prominently" placed on or transmitted through a digital interface that is targeted at users based on the data attributes of the users (e.g., age, gender, location, browser history or purchase history).

iii. **Social media services revenue**: Social media services are provided via social media platforms, which are digital interfaces whose main purpose is to allow their users to interact with each other or with digital content created by users. A platform whose main purpose is the provision of property or another service, for example the provision of online games, will not be considered a social media platform where the user interaction component is incidental to that main purpose. This category of revenue includes subscription or pay-per-use fees earned from providing access to or use of the social media platform, premium services and revenues derived from facilitating interaction between users or between users and digital content.

and

iv. **User data revenue**: This category of revenue includes revenue from data (e.g., a user's name, address or a user's behaviour such as web pages visited and services used) that is collected by a taxpayer in respect of users of an online marketplace, social media platform or online search engine. The expression "user data" is defined in the DSTA to mean "representations, in any form, of information or concepts generated by, or collected from, a user's interaction (directly or indirectly in any manner whatever) with a digital interface" and the term "user" is also defined to include any individual or entity that interacts directly or indirectly with a digital interface. Revenues from the sale of or provision of access to the data (e.g., licensing the use of the data) will generally be considered user data revenue.

The DSTA imposes penalties for non-compliance. For example, the penalty for failing to register is C$20,000 per year for each entity that fails to register.

Regulation of Fintechs – Payment Service Providers

The year 2024 brought into focus the impact of the *Retail Payment Activities Act* (Canada) ("RPAA")[1] on payment service providers ("PSPs") doing or planning to do business in Canada. Over the past year, the Bank of Canada (the "Bank") released over 20 supervisory policies and guidelines (the "Supervisory Guidelines") and even more case scenarios relating to its categorization and expectations of PSPs and the Bank's approach to exercising the supervisory powers granted to it under the RPAA.[2]

BACKGROUND

The RPAA establishes a prudential regulatory regime that applies to PSPs that provide retail payment activities in Canada or that direct and provide such activities to Canadians from outside of Canada.[3] Organizations that are already subject to prudential oversight by a Canadian regulator (e.g., financial institutions, credit unions, securities dealers (with respect to such activities) are excluded from the application of the RPAA).[4] Also excluded from the scope of the RPAA are those organizations where the performance of a retail payment activity is "incidental" to such organization's non-payment services or activities.[5]

Despite the availability of certain exclusions from the new regulatory framework, the Supervisory Guidelines make clear that the Bank intends to take a broad approach when determining who is subject to the RPAA; however, the extent to which and how the Bank will exercise its new supervisory powers will only become apparent over the next few years.

REGISTRATION

At the time of writing, the initial two-week registration period for those PSPs that currently or intend to perform retail payment activities has concluded on November 15, 2024 (the "Initial Registration Period"). The Bank has communicated to industry that it has a list of entities that it views should register during the Initial Registration Period, and if they have not done so, the Bank will start seeking out those entities in early 2025 to complete the registration process.[6] Anecdotally, various stakeholders have speculated that the number of organizations that will register as PSPs during the Initial Registration Period will far exceed the Bank's estimate, largely due to the wide net cast by the RPAA and Supervisory Guidelines. Following the Initial Registration Period until September 7, 2025, PSPs that did not register with the Bank during such time may still do so, but they will be subject to a 60-day

1 *Retail Payment Activities Act* (Canada), S.C. 2021, c. 23, s. 177 [RPAA].
2 See Bank of Canada, "Retail Payments Supervision: Supervisory Policies and Guidelines", **https://www.bankofcanada.ca/core-functions/retail-payments-supervision/information-for-payment-service-providers/retail-payments-supervision-supervisory-policies-and-guidelines/**. We also published a number of blog posts on the RPAA, which can be found at: **https://www.mccarthy.ca/en/insights**.
3 RPAA, s. 5. Under the RPAA a "retail payment activity" is a "payment function" (i.e., the provision or maintenance of an account, the holding of funds of behalf of an end user, the initiation of an electronic funds transfer ("EFT"), the authorization of an EFT or the transmission, reception or facilitation of an EFT, or the provision of clearing and settlement services) performed in relation to an EFT that is made in the currency of Canada of another country.
4 RPAA, s. 6 - 9.
5 Regulations to the RPAA, SOR/2023-229, s. 3 [RPAA Regulations].
6 Mark Rendell, "Bank of Canada Exhorts Fintechs to Get on Board with New Rules, Warns of Repercussions," *The Globe and Mail* **https://www.theglobeandmail.com/business/article-bank-of-canada-exhorts-fintechs-to-get-on-board-with-new-rules-warns/**.

waiting period after submission of their application where they will not be permitted to perform retail payment activities. As of September 8, 2025, PSPs will not be permitted to perform any retail payment activities until the Bank has approved their registration application.[7]

All PSPs should mark September 8, 2025 in their calendars, as the date that: (i) the Bank will commence advising PSPs as to whether the Bank has approved their registration application and publishing the list of registered PSPs publicly (as well as those that had their registration rejected and the reason therefor); and (ii) the ongoing compliance provisions under the RPAA will come into effect.

Although not yet in force, the RPAA requires the Bank to maintain a registry of PSPs, which the Bank has recently made available on its **website**. A review of the registry reveals that private sector's approach and view of which businesses are PSPs is not yet consistent. It will be incumbent on the Bank in 2025 to set the record straight, so to speak.

COMPLIANCE OBLIGATIONS

As of September 8, 2025, PSPs will be required to have the following in place:

— **Operational Risk Management and Incident Response Framework:** PSPs must establish an operational risk management and incident response framework (the "Risk Framework") that includes objectives for its retail payment activities and systems related to integrity, confidentiality and availability. The Risk Framework must be proportionate to the PSP's activities and impact on end users, and include, among other things, reliability targets, identification of the human and financial resources required to implement the Risk Framework, allocation of roles and responsibilities, identification of operational risks (including risks associated with third-party service providers) and mitigants, and processes for monitoring, mitigating and recovery from incidents.[8]

— **Safeguarding of End User Funds:** PSPs that hold end user funds must hold such funds in a trust account, or another account that is not used for any other purpose where the PSP holds insurance or a guarantee in respect of such funds. In addition, such PSPs must establish a safeguarding of funds framework (the "Safeguarding Framework," and collectively with the Risk Framework, the "Frameworks") that includes, among other things, objectives relating to end users having reliable access to their funds and in the event of the PSP's insolvency, that such funds must be paid to the end user as soon as feasible, as well as identification of the risks that could prevent the PSP from meeting such objectives.[9]

— **Ongoing Approvals and Monitoring:** PSPs must incorporate into their board and executive approval processes annual approvals of each Framework by the senior officer responsible for the PSP's compliance with each Framework, as well as the board of directors of the PSP.[10] PSPs must also establish and implement procedures to evaluate the PSPs' compliance with each Framework, including an independent review every three years.[11]

— **Other Compliance Obligations:** In addition, PSPs must submit an annual report to the Bank no later than March 31 of each year, retain records demonstrating compliance with the RPAA for five years, and provide advance notice to the Bank of any significant changes to the PSP or if it undertakes a new retail payment activity.[12]

NEXT STEPS FOR PSPs IN 2025

The above is a very high-level summary of the compliance requirements that PSPs will be subject to as of September 2025. The regulations to the RPAA and the Supervisory Guidelines contain detailed requirements that PSPs must understand and which will take time to implement – a failure to do so could result in enforcement action taken against the PSP by the Bank, including significant fines or revocation of its registration, as well as disruptions to transactions that involve PSPs. Accordingly, PSPs should start preparing now and ensure that their 2025 plans account for the time and resources to be ready to comply with these obligations when they come into effect.

7 See RPAA, s. 23. See also Bank of Canada, "Supervisory Framework: Registration", https://www.bankofcanada.ca/core-functions/retail-payments-supervision/supervisory-framework-registration/.
8 See RPAA Regulations, s. 5.
9 See RPAA Regulations, ss. 13 - 15.
10 See RPAA Regulations, s. 5(6) & s. 15(5).
11 See RPAA Regulations, s. 10(1) & s. 17(1).
12 See RPAA Regulations, s. 18(1), s. 20(1) & s. 40; RPAA, ss. 21 - 22.

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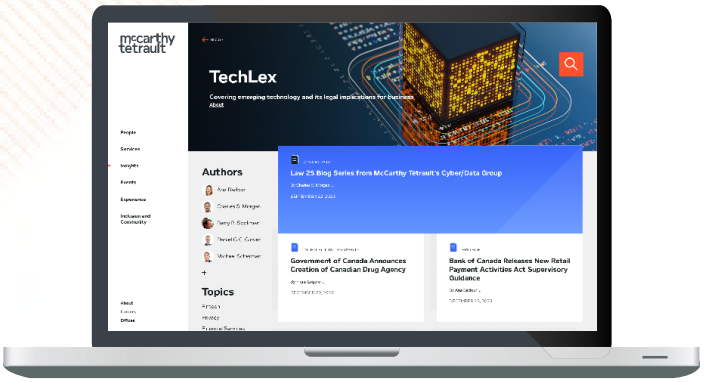

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