



Canadian Market Entry: Key Customs Legal Considerations

Presented at: ICPA Conference
Las Vegas, Nevada
March 16, 2016

Presented by: Bennett Jones LLP, International Trade &
Investment Practice Group

Darrel Pearson, Partner and Co-Chair
pearsond@bennettjones.com
416-777-4811

Laura Murray, Associate
murrayl@bennettjones.com
417-777-5395



Entering the Canadian Market

Your company intends to enter the Canadian market and become either a resident or non-resident Canadian importer



What are the key legal issues to consider?

Agenda

A. Initial Steps to Becoming a Canadian Importer

- Services Providers
- Business Registrations
- Security Requirements

B. Customs Compliance

- Importer Obligations
- Tariff Classification, Customs Valuation, and Origin
- Legal Documentation
- Post-Importation Compliance
- Bri-Chem Trilogy (NAFTA & the Rule of Law)
- Internal Compliance Programs

Engaging Service Providers

- **Customs Brokers** – Provide customs clearance services
 - Letter of Undertaking should be signed by the parties
 - General Agency Agreement or POA is required by the CBSA

- **Freight Forwarders** - Arrange for the movement of goods from the producer to the final destination in Canada
 - Must have a CBSA issued carrier or identifier code
 - Use of freight forwarders can lower freight costs

- **Warehouse Providers** - Operate Canadian bonded and non-bonded warehouses
 - Customs bonded warehouses used to defer duties and tax
 - Operational limitations (e.g., minor operations only and goods can remain in the warehouse for a maximum of 4 years)



Engaging Service Providers

■ Canadian Legal Counsel

- Benefit of solicitor-client privilege
- Can assist with:
 - Strategies to minimize duty, GST, and interest
 - Contractual agreements with other service providers, leases, licenses, and distribution agreements
 - Tariff classification, tariff preference, and valuation
 - Trade verification audits and internal reviews
 - Appeals



Business Registrations

- Importers must have a Canadian Business Number (BN)
- Two key program accounts:
 - Import/Export (RM identifier)
 - GST/HST (RT identifier)
 - Mandatory vs. Voluntary Registration
 - Important for Input Tax Credits (ITCs)
- Payroll and corporate income tax accounts also available
 - Required for residents and companies with a permanent establishment in Canada
 - Careful about creating a permanent establishment in Canada - creates tax obligations
- Register for a business number and program accounts by calling 1-800-959-5525, registering online at <http://www.businessregistration.gc.ca/>, or by completing a Form RC1, Request for a Business Number



Security Requirements

- CBSA security required to obtain release prior to payment privileges
- Acceptable forms of security: cash, money order, certified cheque, transferable bond issued by the Government of Canada, or D120 Customs Bond
- Options:
 - Customs Broker Security
 - Importer Security
 - Direct Security Option
- NRI Security Amount - Importer's monthly average of duties and taxes owing (including the GST) based on the transactions that have occurred within a 12-month period
 - Maximum of \$10 million
 - Resident security amount excludes GST
- CRA Security deposit for importers that are registered for GST/HST
 - Initial amount - 50% of estimated net tax during the 12-month period after you register
 - Subsequent years - 50% of actual net tax for the previous 12-month period

Importer Responsibilities



- Reporting and accounting for imported goods to the CBSA
- Payment of all duties and taxes
 - Customs duties , GST, Anti-dumping and/or countervailing duties
- Payment of penalties resulting from missing or inaccurate information
- Compliance with record keeping requirements
 - Records must be kept in Canada, in either paper or electronic format, for six years
 - Agreement to Maintain Records Outside of Canada for NRIs
- Compliance with requirements of other government department (“OGD”) regulations

Responsibilities apply to all importers, regardless of residency or business vehicle

Tariff Classification

- Tariff classification number – Schedule of the Canadian *Customs Tariff*
- Tariff classification is important for:
 - Duty rate
 - Free trade tariff treatment entitlement
 - Availability of duty relief
 - Anti-dumping/countervailing measure applicability
 - Tariff rate quota applicability



Tariff Classification

- Importer's Responsibility
 - Liability for interest and penalties
 - Avoid overreliance on customs brokers
- Managing risk and exposure
 - Ensure you have detailed product information
 - Be aware that individual countries may classify goods differently
 - Maintain an import database that lists all imported goods and the applicable tariff classification numbers
 - Apply General Interpretive Rules (Rules) and Legal Notes (Notes) in the order mandated by the Rules and Canadian Rules
 - Obtain a legal opinion when correct classification is not clear (e.g., sets put up for retail sale, multi-function or composite goods)

Country of Origin Declarations and Marking

- Trade compliance managers must determine the country of origin of goods prior to importation into Canada because:
 - Country of origin must be declared on the B3, Canada Customs Coding Form
 - Certain products must be marked with country of origin, as per the *Marking of Imported Goods Regulations*, unless exempt
 - Country of origin determines the applicable tariff treatment, in part
- Tariff treatment should be considered concurrently with origin
 - Preferential tariff treatments applicable to certain countries may impact sourcing strategies



Tariff Preference

- There are numerous tariff treatments in Canada that reduce the rates of duties payable on imported goods
- Some examples are:
 - North American Free Trade Agreement (NAFTA): United States Tariff (UST), Mexico Tariff (MT), Mexico-United States Tariff (MUST)
 - Chile Tariff (CT)
 - Canada-Israel Agreement Tariff (CIAT)
 - Canada-Costa Rica Tariff (CRT)
 - Canada-European Free Trade Association Free Trade Agreement: Iceland Tariff (IT), Norway Tariff (NT), Switzerland-Liechtenstein Tariff (SLT)
 - Canada-Peru Free Trade Agreement: Peru Tariff (PT).
 - General Preferential Tariff (GPT)
 - Least Developed Country Tariff (LDCT)
 - Commonwealth Caribbean Countries Tariff (CCCT)
 - Australia Tariff (AUT)
 - New Zealand Tariff (NZT)
 - Korea Tariff (KRT)
- Important Upcoming
 - CETA (Canada-EU)
 - Trans-Pacific Partnership (Canada, Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam)

Tariff Preference

Conditions for goods to benefit from duty-free or reduced tariffs under preferential treatments:

- the goods must be eligible
- the importer must possess valid proof of origin
- the goods must be shipped directly from the beneficiary country with or without transshipment

Valuation

- Customs duty is calculated by applying a rate to a base known as the value for duty
- The methods used to determine the value for duty are known collectively as “customs valuation”
- Primary method of customs valuation – Transaction Value
 - Transaction Value is the price paid or payable for the goods in a sale for export to Canada, to a purchaser in Canada

Valuation

- Additions/Deductions to the price paid or payable
 - Transportation and associated expenses
 - Packing costs
 - Commissions vs. Buying agency fees
 - Assists
 - Royalties and license fees
 - Subsequent proceeds
 - Costs arising after importation
 - Rebates or other decreases in the price
 - Import duties and taxes

- Alternative Methods of Valuation - Identical or similar goods, deductive value, computed value, residual value



Valuation

- Related party transactions
 - Importance of being able to demonstrate lack of influence
 - Transfer pricing studies
 - Organization for Economic Co-Operation and Development (OECD) guidelines
- Importance of using the correct valuation methodology
 - Value for duty determined under one method may differ from that derived from another
 - Application of administrative monetary penalties for use of incorrect value for duty method and related declaration of value for duty code

Customs Valuation Issue: Purchaser in Canada Requirement

- Requirement that the sale for export to Canada be made to a “purchaser in Canada”
 - Unique to Canada
 - Does it negate the "First Sale Rule" in Canada? Yes and No

- A purchaser in Canada is:
 - Canadian resident "person"
 - Not a Canadian resident, but a permanent establishment
 - Neither of the above, but a person who imports the goods for:
 - Consumption; or
 - For sale, if prior to the purchase of the goods, person has not entered into an agreement to sell to a resident

- Important to structure business as a purchaser in Canada to base values for duty on first cost (versus resale price to Canadian customers)



Customs Valuation Issue: Downward Transfer Pricing Adjustments

- CBSA changed in its policy to allow duty refunds for qualifying downward transfer price adjustments by importers last year (January 19, 2015)
- Duty refunds not automatic – CBSA will test the importer’s documentation to verify eligibility for the refund
- Structuring intercompany pricing arrangements prior to importation into Canada is critical



Customs Valuation Issue: Downward Transfer Pricing Adjustments

Requirements to claim refunds for downward transfer pricing adjustments:

- Prior to importation, the adjusted PPP has been the subject of a written agreement
 - Predetermined amount or formulaic
- Related parties priced and adjusted the prices of goods in accordance with their agreement
- Amounts paid/adjusted conformed to the agreement relating to PPP
- Practices of the related parties were otherwise consistent with the terms of the agreement
- Transfer pricing study was undertaken to demonstrate that the PPP were not influenced by the relationship

Customs Valuation Issue: Treatment of R&D Payments *(Skechers USA Canada, Inc. v. President of CBSA)*

- Canadian importer/purchaser contributed to R&D cost sharing agreement (based on % of resale revenue)
- Entire R&D payment found to be dutiable by CITT and FCA – Payment treated as part of PPP rather than subsequent proceeds (payment "in respect of" the imported goods)
- Reasons
 - Found to be quantifiable and tangible segments of production process necessary for creation of footwear and therefore = COG
 - CITT described the design process as interactive or inter-related and not specific to a given line of product
 - Not for intangibles (brand marketing), which was deducted from dutiable amount, or an "assist"
 - Not a general payment or a Canadian operations expense

Customs Valuation Issue: Treatment of R&D Payments (*Skechers USA Canada, Inc. v. President of CBSA*)

- Skechers decision is not a departure from existing CBSA administrative policy - FCA confirmed the policy position of the CBSA regarding payments for R&D
- But, will same rationale will be used to develop policies respecting other type of payments made under cost sharing agreements?
 - Cost sharing arrangements for costs of production and/or selling, general and administrative expenses
 - Cost sharing arrangements dealing with intellectual properties (royalties/licences)
- CBSA re-issued Memorandum D 13-4-13 on March 31, 2015
 - Exclusion contemplated for payments where the Canadian importer contracts the foreign vendor to conduct the research development, bears all costs and risks of failure, and takes ownership of the research (Appendix "A")
- Importers should revisit cost-sharing arrangements

Customs Considerations for Contractual Agreements

■ **Distribution Agreements**

- Explicitly state that the sales are "for export to Canada"
- Consider Contractual warranties/certifications



■ **Licences/Royalty Agreements**

- Indicate that licence/royalty fees are not paid/payable as a condition of the sale of the goods for export to Canada

■ **Management Services Contracts**

- Should evidence the nature of payment, the basis on which it is paid, and that the actual services were provided and paid for

■ **Leases**

- Relevant to the determination as to whether there is a sale for export to Canada was made to a "purchaser in Canada"

Post-Importation Compliance

COMPLIANCE

- Required to correct erroneous declarations of origin, tariff classification, or value for duty within 90 days of date of "reason to believe"
 - Obligation to correct applies if result is payment of duty or revenue neutral
 - Must correct declarations back to the date of the specific information, up to a maximum of four years
- Errors not corrected within 90 days will result in penalties
 - Penalties are escalating based on contravention history
 - May be avoiding by making a valid voluntary disclosure to CBSA
- Important to establish internal compliance programs for early detection of origin, tariff classification, and value for duty errors (within 90 days)

Bri-Chem Trilogy - NAFTA and the Rule of Law

- An importer required to correct a tariff classification error that gives rise to dutiability can concurrently correct its tariff treatment declaration to claim duty-free treatment under a free trade agreement (*Frito-Lay* Rule)
- Revenue-neutral tariff treatment claims are permissible when correcting tariff classification under s. 32.2 – the 1 year limitation period only applies to refunds of duties paid
- CBSA's refusal to follow *Frito-Lay* led to the CITT's finding that the CBSA had engaged in an abuse of process
- CBSA is bound to apply past CITT decisions involving the same questions of law or mixed fact and law to resolve disputes
- Customs Notice 16-04 (January 29, 2016) - Requests made under section 32.2 where an importer is requesting a change in tariff treatment from MFN to NAFTA, beyond one year of accounting, will be held in abeyance pending appeal outcome

Elements of an Internal Customs Compliance Program

- Assignment of responsibility and oversight for Canadian customs compliance
- Employee training
- Canadian customs compliance policies and standard operating procedures, including protocol for ascertaining the value for duty
- Maintenance of customs/commercial documents at a central location
- Canadian database for tariff classification and tariff preference
- Establish clear lines of communication with brokers and suppliers regarding changes that may impact tariff classification, origin, and/or pricing
- Review sample of import transactions on a monthly basis to detect erroneous declarations of tariff classification, value, and origin

THANK YOU

Bennett Jones LLP
One First Canadian Place, 34th Floor
Toronto, Ontario M5X 1A4

Darrel Pearson, Partner and Co-Chair
pearsond@bennettjones.com

Laura Murray, Associate
murrayl@bennettjones.com

Toronto Office

3400-One First Canadian Place
Toronto, ON M5X 1A4

Vancouver

1055 West Hastings Street, Suite
2200
Vancouver, British Columbia
V6E 2E9 Canada

Calgary Office

4500 Bankers Hall East
855 – 2nd Street S.W.
Calgary, AB T2P 4K7

Doha

Qatar Financial Centre
37th Floor, Tornado Tower
Al Funduq Street, West Bay
PO Box 11972
Doha, Qatar

Edmonton Office

1000 ATCO Centre
10035 – 105 Street
Edmonton, AB T5J 3T2

Beijing Office

Room 09, Level 14
China World Office Tower 1
1 Jianguomenwai Avenue
Chaoyang District
Beijing, 100004 China

Ottawa Office

1900 World Exchange Plaza
45 O'Connor Street
Ottawa, ON K1P 1A4

Bermuda

Bennett Jones (Bermuda) Ltd.
Cumberland House
1 Victoria Street
Hamilton HM11
Bermuda

