



BJ Cross-Border Retailing :
A Guide to Canadian Market Entry

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**BJ Bennett
Jones**

Cross-Border Retailing: A Guide to Canadian Market Entry

Given our healthy economy, a robust retail market and proximity to the United States, Canada is an increasingly attractive destination for U.S. retail investment. Entering the Canadian retail market can be smooth and profitable if market entrants successfully address the Canadian business and regulatory environment. Key considerations for cross-border retailers are highlighted in this guide to Canadian market entry.

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Location and Leasing

Major Canadian retail landlords are interested in fresh, new retail concepts. With the greater concentration of Class A malls in the hands of pension funds and large commercial landlords the retail malls have been well maintained and remain vibrant. In some cases, bundled retail leases offer opportunities for streamlined market entry in established locations.

U.S. retailers should note that Canadian leases are typically completed in a two-step process: a binding offer to lease (non-binding letters of intent are not commonly used) followed by a formal lease. Aside from typical business terms included in a lease agreement (area of the premises, base rent, percentage rent, estimate of additional rent, term, option to renew, early termination options, slack periods, operating covenants, co-tenancy, etc.), the offer to lease should include direct references to anything the retailer may consider *off market*. Additionally, leasing transactions are generally exempt from land transfer tax if the lease term is fewer than 50 years.

The customs treatment of store build-outs in advance of establishing a Canadian corporate presence or a permanent establishment may offer opportunities but the approach must also guard against detrimental tax and customs consequences. Negotiation and documentation of contractual agreements are important.

Supply Chain Logistics

Logistics/warehousing

When your supply chain crosses the border into Canada, you must consider Canadian customs (and tax) issues, including border and supply chain security, bonded facilities, and other laws impacting duty and GST liability. Selection of freight forwarders and negotiation of competitive rates is an important aspect of establishing the supply chain.

Selection of customs brokerage services

Numerous customs service providers will work with retailers by brokering their importations with the Canada Border Services Agency (CBSA), but for many new retailer entrants, the choices in Canada and their relative strengths/weaknesses are unknown – they may or may not be similar to experiences in other countries. As virtually every customs broker is known to us, we are positioned to facilitate choices for our clients. Importantly, standard contractual terms should be negotiated and responsibilities allocated between the broker and importer.

Recommended trade associations

Consider joining key trade associations to ensure a voice on common trade issues of concern. This is increasingly important as the number of U.S. retailers entering the Canadian market increases and your presence grows.

CSA and other customs compliance best practices

If the scope and amount of importations warrant, you should consider establishing qualifications to facilitate and reduce costs involved in compliant importation under the customs self-assessment program and other special programs offered by the CBSA. Commitments should be carefully negotiated and documented.

Partners in Protection and supply chain security issues

Partners in Protection (PIP) is the Canadian equivalent of C-TPAT. It is a Canadian government compliance certification that, although voluntary, is critical for expedited border clearance. Benefits include enhanced overall supply chain security and corporate compliance. PIP certification is obtained on application and by

meeting defined compliance/supply chain security standards. It normally requires an assessment, generally by an outside service provider, followed by preparation and documentation of the PIP application. PIP certification follows government verification of the application and is renewable periodically, subject to government verification.

Valuation, classification and tariff preferences

Amongst the key costs of goods sold are customs duties and costs of financing GST on supplies, including imports. Proper analysis will result in opportunities for savings derived from tariff classification and preference exercises in which the rate of duty is determined. The base for these costs depends on the correct valuation of goods (and potentially services and intellectual property if dutiable), and there exists opportunity for planning to minimize the base and therefore costs through corporate and commercial transaction structuring.

Business Organization and Key Contracts

Choosing a Business Vehicle

Typically, a wholly-owned Canadian subsidiary is used although other business structures may be employed to achieve specific corporate and tax objectives. Canadian corporate and commercial law is similar in substance to U.S. state law subject to some minor differences, including a 25-percent Canadian resident director requirement in certain jurisdictions.

Corporate tax

Canada has an increasingly competitive tax regime, including a corporate tax rate of roughly 27 percent and preferential withholding tax rates on dividends and interest payments to qualifying U.S. parent companies of five percent and zero percent respectively.

Sales and consumption taxes: GST/HST

Canada has a national value added tax called the GST (Goods and Services Tax), which most provinces have harmonized with their provincial sales tax for a single blended HST (Harmonized Sales Tax). GST is imposed on most goods and services, including imports. As a value-added tax, GST/HST is borne by the ultimate customer. A credit mechanism ensures that intermediate participants in the commercial supply chain do not ultimately pay the tax, although there may be cash flow impacts, which can be mitigated in some cases. Registration is mandatory and audit activity is significant.

Vendor agreements and policies

Vendor agreements and policies should be implemented to optimize customs and tax planning and to ensure that trade policies and practices are consistent with legal commercial and responsible trade obligations. Care must also be taken to ensure that vendor agreements are consistent with, and place the retailer in the best legal and practical position in the context of, Canadian laws and regulations. Similarly, third-party service agreements should be formally documented and structured to avoid hidden withholding taxes and negative customs consequences. Canadian regulation of services should also be reviewed.

Human resources including employment services

Minimum employment standards legislation (*e.g.*, minimum wage, hours of work, overtime, etc.) varies by province. As a result, to the extent that a Canadian subsidiary is operating in multiple provinces consideration must be given to whether the enterprise will attempt to apply a single standard to all locations (*i.e.*, meet the highest applicable provincial requirement) or vary its practices by province. Though

not required, it is strongly recommended that written employment agreements be implemented for all employees to confirm terms and conditions of employment and limit potential liability, especially upon termination of employment.

Transfer Pricing

A unified approach to tax and customs transfer pricing on all cross-border related party transfers of goods, services and licences is strongly recommended to minimize duties and withholding taxes and mitigate compliance risk. Ensuring consistency and adequacy of legal agreements and transfer pricing studies is critical, especially within the current enforcement environment.

Management services and licenses from U.S. parent to the Canadian subsidiary should be carefully documented and charged to avoid tax or customs transfer pricing challenges. The amounts are subject to transfer pricing rules for both tax and customs purposes.

Product Regulation and Consumer Safety

Canada and its provinces have a robust regulatory environment for product regulation and consumer safety. Regulations extend to standards, certifications, licences and often require significant advance planning and approval of importers/vendors who are engaged in a direct import program, and substantial due diligence of external suppliers. Products that are regulated in Canada include food, health and beauty products, apparel, housewares, hardware, electronics and appliances, toys, and most other manufactured products. Canadian product regulation is not harmonized with U.S. product regulation. Independent, Canadian-specific regulatory planning and approvals must be considered prior to importing or selling products in Canada.

Like many countries, Canada has undertaken an overhaul of its consumer product safety legislation to better reflect modern practices and needs, and to better adhere to international practices reflecting global commerce. Canadian consumer product safety legislation enables the Canadian government to recall consumer products and prohibit the importation or sale of dangerous products, and imposes a range of record keeping requirements on importers and vendors, enforced by fines and penalties for non-compliance.

Canada also has unique consumer protection laws that apply to specific types of retail operations, such as motor vehicle dealerships and repair, fitness clubs, home renovations, collection agencies, payday loan outlets as well as general rights and obligations applying to all consumers, such as extending credit, leases and warranties to customers.

Competition, including marketing and advertising law

The *Competition Act* of Canada includes criminal and civil regimes applicable to false or misleading representations in advertising or other materials and practices, such as bait and switch selling, price maintenance and refusal to deal. Adherence to the *Code of Advertising Standards* established by Advertising Standards Canada, the advertising industry's self-regulatory body, is recommended.

Packaging and Labelling, including French language requirements

Often retailers mistakenly conclude that their French language obligations stop at the Quebec border, and initially choose to set up operations in other provinces to, in their expectation, avoid the language

requirements of the province of Quebec. However, there are dual language requirements that extend to certain goods sold in all provinces. There are also packaging, standards, and other non-tariff barriers that must be considered prior to accessing the Canadian market. Your product line should be carefully scrutinized to avoid costly and disruptive repackaging, relabelling or removal from shelves.

Licensing and marks

Ownership and licensing of trademarks and copyright are important and should be carefully documented. As we have significant experience in the acquisition and enforcement of trademark rights, .ca and .com domain name disputes and parallel imports (also known as grey goods), we are well-positioned to offer comprehensive intellectual property advice.

Insurance

Insurance concerns for a new business in Canada are similar to those in the U.S – the need for property insurance, business interruption insurance, vehicle insurance, liability insurance and the like. Similar considerations as in the U.S. will dictate the extent of deductibles, how much coverage to put in place, etc., but liability insurance in Canada is typically less expensive than in the U.S. in large part because of the Canadian litigation experience (far less litigious than in the U.S. and with typically smaller damage awards).

e-Commerce and m-Commerce

e-Commerce and mobile commerce (m-commerce) in Canada for retail product purchases is growing, with Canadian broadband penetration and web usage being amongst the highest in the world. Challenges in e-commerce and m-commerce generally relate to establishing a seamless, legally compliant and cost-competitive cross-border program to deliver goods or services to the customer's door or electronic device. The issues, which include consumer protection dealing with Internet-based and remote transactions, Internet sales contract requirements, Canada's new anti-spam law, privacy laws protecting customer information collected over the Internet or through mobile activity, Privacy Commissioner of Canada's policy for online behavioural advertising, security laws dealing with spyware and malware, supply-chain management, customs duties, freight forwarding and brokerage, distribution, and sales taxes, have improved but require careful planning and implementation, as doing e-commerce and m-commerce in Canada differs significantly from the U.S. and elsewhere.

Payments

Credit Cards and Debit Cards

Unlike the U.S., Canadian debit cards are widely used on a low-cost domestic private network (Interac). Visa and MasterCard are not currently significant players in the debit card industry. In order to access the common Canadian payment networks to process customer transactions, retailers will need to contract with the various payment processors and banks. As is the case in the U.S., merchants have been lobbying for government regulation of credit card fees and other aspects of the payments industry. As a result, issuers and acquirers are subject to a recent voluntary Code of Conduct. The Canadian federal government has not yet determined the necessity of additional changes following the release of a task force report and policy and discussion papers in early 2012.

Retailers in Canada are following a trend of issuing co-branded or white-labeled credit cards, and with the recent Bank Act amendments, are now able to successfully apply for bank licenses in order to issue their own financial products, such as credit cards, and take deposits from customers. Such arrangements require careful planning of card programs, compliance with Canadian financial services laws and regulations, as well as various commercial agreements with terms unique to the Canadian marketplace for the adoption of account opening and processing technologies and services.

Prepaid Cards

In Canada, most provinces and territories have enacted legislation which applies to prepaid cards (such as gift cards) and impose disclosure requirements as well as restrictions on fees and expiration dates.

Mobile Payments

The proposed use of e-wallets and mobile payments via wireless handheld devices is on the rise in Canada. Money Services businesses are subject to regulation, and the regulation of other players in this emerging area is currently under review in Canada, with a proposal to have legislation fall under the same Code of Conduct that applies to the Canadian credit and debit card industry. Retailers need to be aware of the available technology and new regulations that will affect them in this area.

Bennett Jones provides turn-key advice to U.S. retailers entering the Canadian market. We combine local knowledge with international experience to streamline your entry into Canada and help you establish a robust platform for growth in a new market. We have advised leading U.S. department stores, junior department stores and retail chains, covering a full range of consumer products, with respect to Canadian market entry.

Bennett Jones is an internationally recognized Canadian law firm founded and focused on principles of professional excellence, integrity, respect and independent thought. Our firm's leadership position is reflected in the law we practise, the groundbreaking work we do, the client relationships we have, and the quality of our people.

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