

## Finally! CBSA to Allow Duty Refund Claims on Downward Transfer or Sale Price Adjustments

### The CBSA's Policy Change Provides New Opportunity to Claim Duty Refunds

To ensure arm's length purchase prices are paid by an importer to a foreign affiliate for Canadian income tax purposes, post-importation transfer price adjustments are common. Where transfer prices for dutiable goods are adjusted downward after the importation of the goods, the CBSA will now allow importers to claim duty refunds in certain circumstances. To reverse its three-decade old policy, the CBSA on January 19, 2015 issued *Customs Notice 15-0001* (the "**Customs Notice**").<sup>1</sup> Beyond transfer pricing, this policy change may also affect post-import downward price adjustments between arm's length parties.

### Evolution of the Policy Change

The CBSA has been of the view that post-importation downward price adjustments should be ignored for the purpose of determining the value for duty ("**VFD**") under the Transaction Value Method (the "**TVM**") pursuant to paragraph 48(5)(c) of the *Customs Act* (the "**Act**"). While importers could not benefit from downward transfer or sale price adjustments under the old policy, the CBSA required importers to amend import filings to pay any additional duties arising from upward transfer or sale price adjustments after import. The change in policy announced in the Customs Notice corrects this inherently inequitable treatment.

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<sup>1</sup> Canada Border Services Agency, "*Customs Notice 15-001: Treatment of Downward Price Adjustments in Value for Duty Calculations*" (19 January 2015), online: .

In *Jockey Canada Co. v President of the CBSA*,<sup>2</sup> the CBSA informed the Canadian International Trade Tribunal (the "CITT") that its standard practice was to allow amendments to lower the VFD as the result of downward year-end transfer pricing adjustments. (For more information about this decision and its implications on VFD calculations, please refer to McMillan's January 2014 Bulletin: *Surprise! The Impact of Transfer Price Adjustments on Canadian Customs Valuation and Compliance*). This 2013 decision led importers to believe that they may pursue duty refund claims made on the basis of downward transfer price adjustments.

The final motivation for the policy change was the CITT's decision in *Hudson's Bay Company v. President of the Canada Border Services Agency*.<sup>3</sup> Relying on the precedents in *Quadra Chemicals Ltd. v. Deputy M.N.R.*<sup>4</sup> and *Nordic Laboratories v. Deputy M.N.R.*,<sup>5</sup> the CITT ruled that:

1. a price reduction made after importation, but
2. which arose from a sale agreement in effect at the time of importation and which did not depend on satisfying a condition after importation,
3. should be considered "effected" before importation and allowed as an adjustment for the purpose of calculating the "price paid or payable" (the "PPP") under the TVM.

In summary, paragraph 48(5)(c) of the Act was held to be inapplicable.

In explaining its finding, the CITT in *Hudson's Bay Company* referred to *Jockey Canada*, which specifically addressed year-end transfer

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<sup>2</sup> *Jockey Canada* (2013), AP-2011-008 (CITT).

<sup>3</sup> *Hudson's Bay Company* (2014), AP-2012-067 (CITT). For more about this case, you can refer to the article by Jamie Wilks of McMillan LLP entitled "Value for Duty – What Should Be Included in the 'Price Paid or Payable' under the Transaction Value Method?" published by Federated Press in *Sales and Use Tax*, Volume XII, No. 4, 2014.

<sup>4</sup> *Quadra Chemicals Ltd.* (2004), AP-93-260 (CITT).

<sup>5</sup> *Nordic Laboratories* [1996] F.C.J. No. 1067.

pricing adjustments. In the CITT's view, *Jockey Canada* stands broadly for the principle that corrections can (or should) be made to the PPP after importation, where there is an agreement in place between the parties prior to importation that establishes the adjusted price at the time of importation.

After the CBSA formalized its policy change in January 2015, it began to process duty refund claims arising from downward transfer pricing adjustments (including those held in abeyance pending the CBSA's policy announcement on point).

The Customs Notice advises that the CBSA will amend the D13 Valuation memoranda to reflect the policy change in the Customs Notice. Among those to be changed could be D13-3-6 "Income Transfer Pricing and Customs Valuation" published on October 18, 2006.

### When *may* an importer claim a duty refund?

Where prices are adjusted downward after the importation of dutiable goods, the importer *may* make corresponding downward adjustments to the PPP and claim refunds to recover duties previously paid on the adjusted amounts pursuant to section 74 of the Act, provided that the following conditions are satisfied:

1. the vendor and purchaser (whether or not related to each other) must have entered into an agreement prior to importation, providing for the post-import decrease to the PPP;
2. the downward adjustments should be in accordance with the agreement; and
3. the duty refund claim must be filed in accordance with the requirements of section 74 of the Act (among which, the claim must be filed within four years after accounting for the imported goods subject to the downward adjustments, although the Customs Notice refers to duty refund claims being available "for importations occurring within four years of the date of this notice").

Where duty refund claims would be available under section 74 of the Act for the overpayment of duties resulting from too high VFD declarations, there would be *no requirement* to correct pursuant to subsection 32.2(5) of the Act. The importer *may* claim the duty refunds within the 4-year claim period.

### When *must* an importer correct entries?

Where the imported goods were duty-free and there are subsequent downward price adjustments, the importer could have to correct the PPP within 90 days of the importer having acquired "reason to believe" that the VFD declarations were incorrect. Section 32.2 of the Act imposes a *positive obligation* on the importer to correct revenue neutral VFD errors. Failure to do so could result in the imposition of Administrative Monetary Penalties ("**AMPs**").

The obligation to correct *would depend* on the first two conditions listed above for duty refund claims being satisfied; otherwise, the downward adjustments would be considered to be *effected after* importation and should be ignored pursuant to paragraph 48(5)(c) of the Act (as discussed above in relation to duty refund claims). The obligation to correct generally expires four years after accounting for the imports pursuant to subsection 32.2(4) of the Act.

Where post-importation adjustments are made pursuant to a transfer price agreement in place at the time of import, the CBSA provides guidance as to what would constitute "reason to believe". At the specific moment "when the net total of upward and downward transfer pricing adjustments occurring in a fiscal period is identified", the CBSA is of the view "the importer has reason to believe that corrections to declarations of value for duty are necessary." Importers will need to know about adjustments made by related parties in order to meet these obligations.

### Other Considerations

In light of the retroactive application of the Customs Notice, consideration should be given to the accounting and income tax treatment of the duty refunds received by an importer. If the

importer is a Canadian taxpayer, then the duty refunds received could be required to be included in the importer's income in the year of receipt, or could have the effect of requiring adjustments to previous years' income tax returns filed. Beyond that, the accounting and income tax treatment of the downward pricing adjustments need to be considered from both the foreign vendor's and purchaser's perspectives.

### Going Forward

Importers should consider whether they have received downward price adjustments that could lead to duty refund opportunities. The Customs Notice applies retroactively to permit duty refund claims arising from importations within four years of the release of the Customs Notice on January 19, 2015. In addition, importers should monitor duty refund opportunities going forward. Where applicable, duty refund claims should be filed with the CBSA in a timely manner.

Importers should monitor in a timely manner whether they have obligations to make revenue neutral corrections to reduce the VFD. Where these obligations arise, the importers should make their corrections within 90 days of acquiring "reason to believe" that they have over-valued their duty-free imported goods. Failure to make downward transfer or sale price adjustments to duty-free imported goods may give rise to AMPs.

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#### [a cautionary note](#)

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