Customs Valuation Update

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I. General Legal and Administrative Framework

1. Domestic Law – Part III of the *Customs Act*, ss. 44 to 56 and *Valuation for Duty Regulations* (the "**VFD Regs**")

2. CBSA's Administrative interpretations and policies, notably Group D13 Valuation Guidelines

I. General Legal and Administrative Framework (cont'd)

3. Derived from WTO's *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994* (the "**GATT Valuation Code**"). Section 2, Article II of the *Agreement Establishing the WTO* makes the GATT Valuation Code, among other international trade agreements, an "integral part of the *Agreement Establishing the WTO*".

I. General Legal and Administrative Framework (cont'd)

4. World Customs Organization's Technical Committee on Customs Valuation ("**WCO Committee**") publications

II. The Six Methods for Determining VFD

- In accordance with the GATT Valuation Code, the *Customs Act* sets out six methods for determining the Value for Duty ("**VFD**") of imported goods.

- An importer must choose among the valuation methods by selecting the first listed method which is available to the importer, with one exception. The *Customs Act* allows the importer the flexibility to reverse the order of (4) and (5) and choose (5), the Computed Valuation Method ("**CVM**"), over (4), the Deductive Valuation Method ("**DVM**"), even though the DVM is available.

II. The Six Methods for Determining VFD (cont'd)

– The six methods of customs valuation are as follows:

1. **The transaction value method** ("**TVM**") – the price paid or payable for goods in a sale for export to Canada to a purchaser in Canada, subject to certain adjustments (s. 48 of the *Customs Act*);

II. The Six Methods for Determining VFD (cont'd)

2. **The transaction value of identical goods** – sold for export to Canada to a different purchaser than the purchaser of the goods being appraised when sold and exported in substantially the same conditions as the goods being appraised, or with appropriate adjustments made to compensate for any difference(s) in those conditions (s. 49 of the *Customs Act*);

3. **The transaction value of similar goods** – parallels the definition above in 2 (s. 50 of the *Customs Act*);

II. The Six Methods for Determining VFD (cont'd)

4. **The DVM** – is based on the sale price in Canada of the imported goods, identical goods or similar goods at the first trade level after importation to an unrelated person, with "reasonable" deductions allowed for commissions or profits earned in Canada and general expenses incurred in Canada (s. 51 of the *Customs Act*);

II. The Six Methods for Determining VFD (cont'd)

5. **The CVM** – the cost of producing the imported goods, plus amounts to account for profits earned by, and general expenses incurred by, the supplier or producer in the country of export "that is generally reflected in sales for export to Canada of goods of the same class or kind as the goods being appraised made by producers in the country of export" (s. 52 of the *Customs Act*); and

II. The Six Methods for Determining VFD (cont'd)

6. **Residual value** – a flexible method of valuation derived from among the methods and principles of valuation set out in 1 to 5 above, so as to most appropriately determine the customs valuation in accordance with these principles (s. 53 of the *Customs Act*).

III. TVM

- The primary basis for determining the VFD is the TVM. (s. 47 of the *Customs Act* and s.1, General Introductory Commentary of GATT Valuation Code)

- The TVM can apply "if the goods are sold for export to Canada to a purchaser in Canada". The "purchaser in Canada" requirement was added effective September 17, 1997. (*Customs Act*, s. 48(1))

- The GATT Valuation Code says nothing about the "sale for export" having to be made to a particular person. (GATT Valuation Code, Article 1)

IV. Purchaser in Canada

- "Purchaser in Canada" has the meaning assigned by the VFD Regs. (*Customs Act*, s. 45(1))

- "Purchaser in Canada" means:
  - (a) "a resident"; or
  - (b) a non-resident with a "permanent establishment" ("**PE**") in Canada; or

IV. Purchaser in Canada (cont'd)

c) a non-resident without a PE in Canada, who imports goods into Canada either:

i. for its own consumption, use or enjoyment in Canada, but not for sale, or

ii. for sale by the person in Canada, if, before the purchase of the goods, the person has not entered into an agreement to sell the goods to a "resident".

(VFD Regs, s. 2.1)

IV. Purchaser in Canada (cont'd)

- A "resident" corporation "carries on business in Canada" and is managed and controlled within Canada.

- A person's PE means its fixed place of business, such as an office or warehouse, "through which the person carries on business."

(VFD Regs, s.2)

V. Certain Jurisprudence

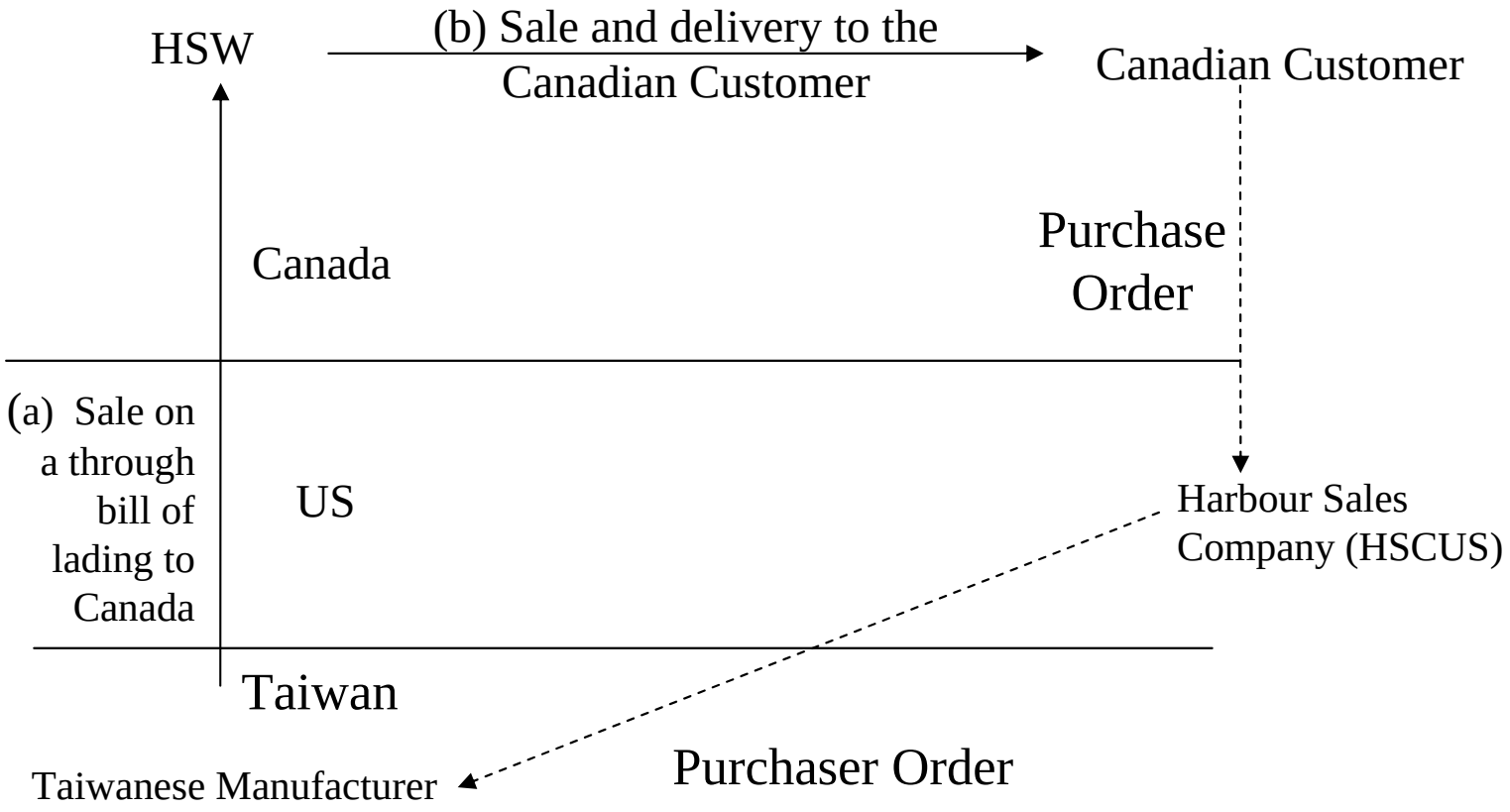
1. Harbour Sales *(Windsor) v. The Deputy Minister of National Revenue*

(CITT, Appeal No. 93-322, November 4, 1994, with leave to appeal by the Deputy Minister subsequently denied by the Federal Court, [1995] 2824 ETC, February 2, 1995)

– Effective September 17, 1997, the federal government added the "purchaser in Canada" requirement to respond to the decision in *Harbour Sales.*

V. Certain Jurisprudence (cont'd)

1. Harbour Sales (cont'd)



The lower price sale (a) held to be the "sale for export to Canada". Canada Customs believed that the higher price sale (b) was the "sale for export to Canada".

V. Certain Jurisprudence (cont'd)

1. Harbour Sales (cont'd)

– In accordance with CBSA's long-standing administrative policy, as set out in its Memorandum D13-4-2, "Customs Valuation: Sold for Export to Canada" (August 21, 1989), CBSA argued that each sale to a Canadian customer was a sale for export to Canada, as it was the initial sale, the one that sets off the chain of events leading to the export of the products to Canada.

V. Certain Jurisprudence (cont'd)

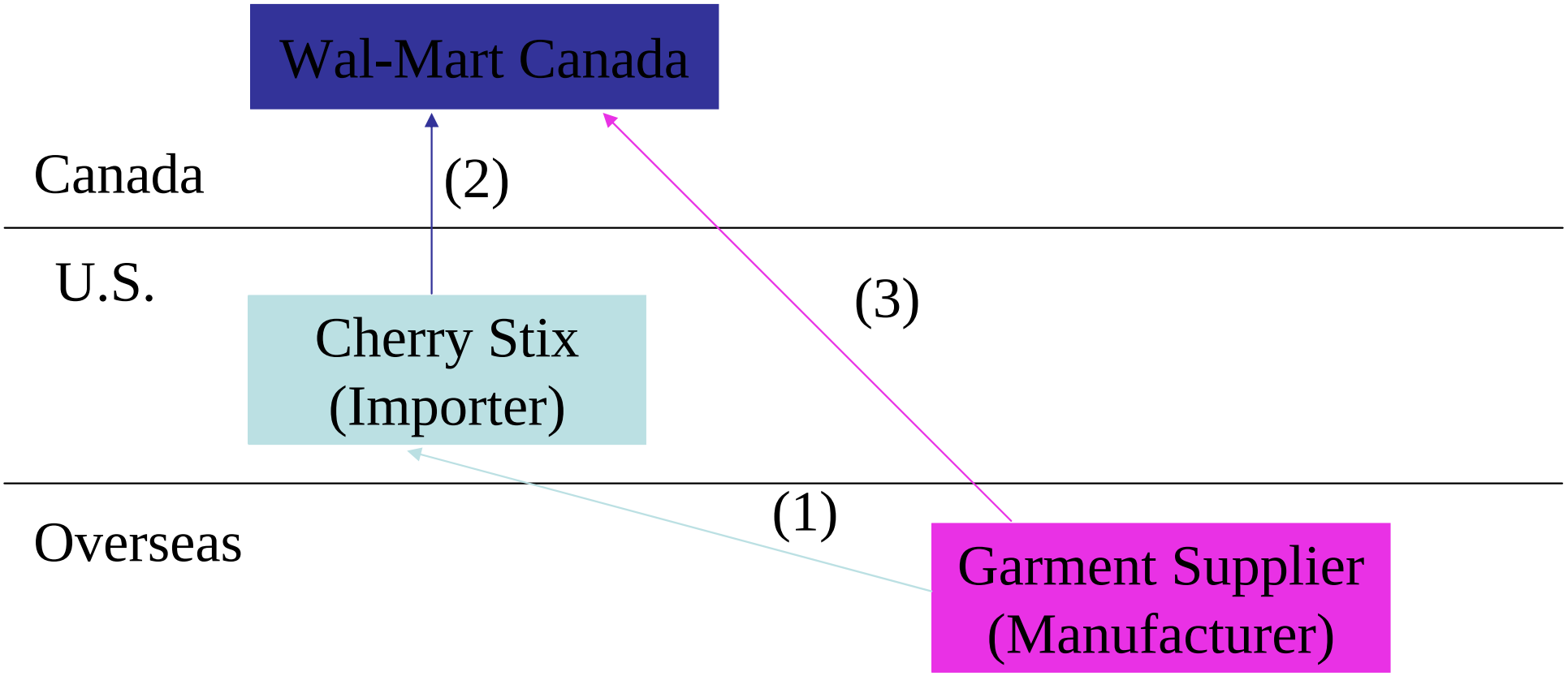
1. Harbour Sales (cont'd)

- Both the CITT and the Federal Court rejected this assertion, finding nothing in the law to support the view that a "sale for export to Canada" must be "to a purchaser in Canada".

- The relevant documentation confirmed the direct shipment and export of the goods from Taiwan to Canada. HSW acquired title to, and assumed risk of loss for, the goods in Taiwan. HSW imported the goods into Canada and then transferred title to its customers in Canada.

V. Certain Jurisprudence (cont'd)

2. *Cherry Stix Ltd. v. CBSA* (CITT, Appeal No. 2004-09, October 6, 2005)



V. Certain Jurisprudence (cont'd)

2. *Cherry Stix* (cont'd)

1) Cherry Stix Non-Resident Importer declares VFD under the TVM using a "sale for export" of garments from the Overseas Supplier to Cherry Stix.

2) CBSA alleges that the VFD should be determined under the TVM based on a "sale for export" from Cherry Stix to Wal-Mart Canada. CBSA re-determines VFD and assesses GST and duties on the increased VFD. CITT agrees.

3) Direct "export" of the goods from the Overseas Supplier to Wal-Mart Canada with Cherry Stix acting as Importer.

V. Certain Jurisprudence (cont'd)

2. *Cherry Stix* (cont'd)

- A non-resident of Canada not carrying on business in Canada and without a permanent establishment in Canada, such as Cherry Stix, can be a "purchaser in Canada" in a "sale for export" of goods to Canada for the purpose of the TVM if:
  - Cherry Stix enters into its agreement to sell goods to a resident in Canada (Wal-Mart Canada) after purchasing the goods from the Overseas Supplier.

S. 2.1(c)(ii) of the VFD Regs

V. Certain Jurisprudence (cont'd)

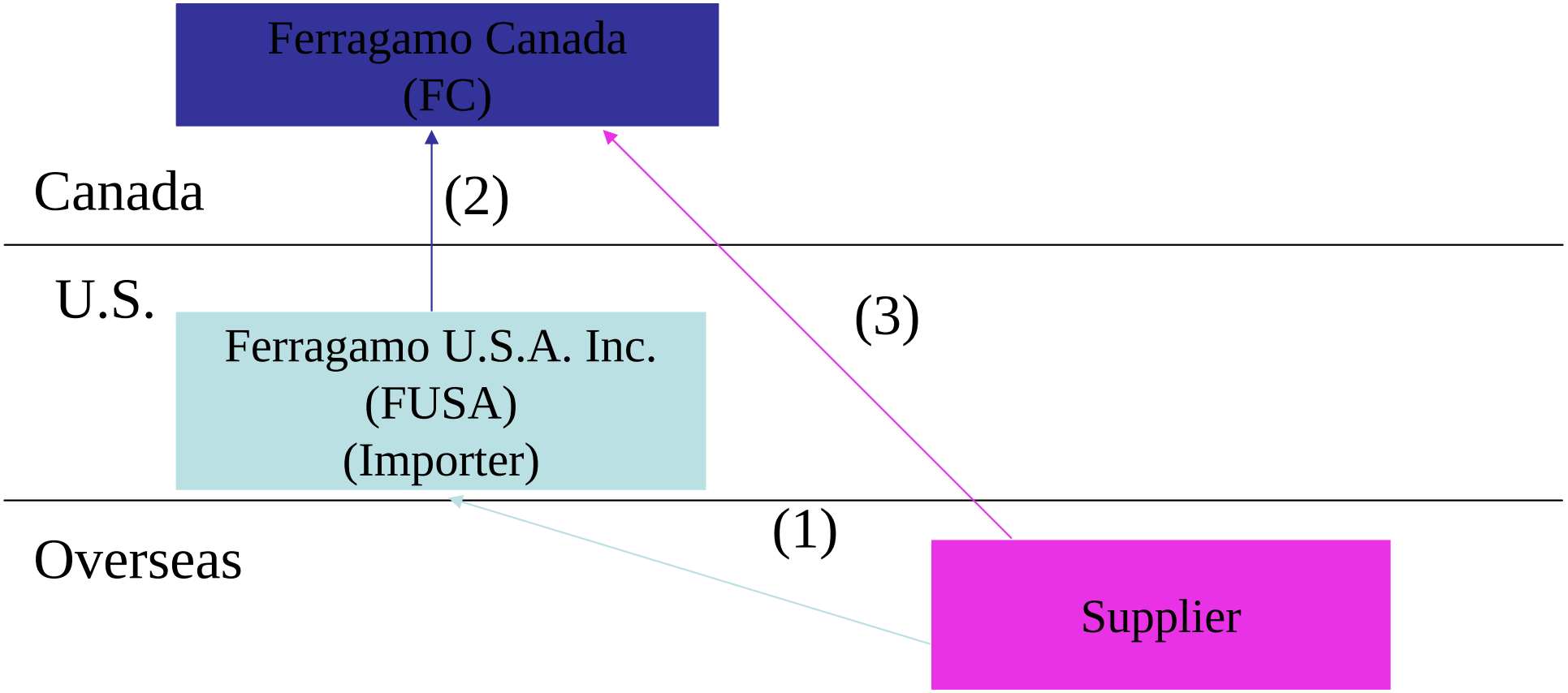
2. *Cherry Stix* (cont'd)

- CITT found that Cherry Stix entered into a verbal agreement to sell the apparel to Wal-Mart Canada, a resident in Canada, before purchasing the apparel from its Overseas Suppliers based on discussions between Cherry Stix's sales associates and Wal-Mart buyers.

- Therefore, Cherry Stix cannot be a "purchaser in Canada".

V. Certain Jurisprudence (cont'd)

3. *Ferragamo* U.S.A. Inc. *v. CBSA* (CITT, Appeal No. AP-2005-053, March 2, 2007)



V. Certain Jurisprudence (cont'd)

3. *Ferragamo* (cont'd)

1) FUSA Non-Resident Importer declares VFD under the TVM using a "sale for export" of goods from the Overseas Supplier to FUSA.

2) CBSA alleges that the VFD should be determined under the TVM based on a "sale for export" from FUSA to FC. CBSA re-determines VFD and assesses GST and duties on the increased VFD. CITT disagrees.

3) Direct "export" of the goods from the Overseas Supplier to FC with FUSA acting as Importer.

V. Certain Jurisprudence (cont'd)

3. *Ferragamo* (cont'd)

- FUSA enters into an agreement to sell goods to FC ***before*** purchasing the goods from the Overseas Supplier. However, FUSA does not fail to satisfy s. 2.1(c)(ii) of the VFD Regs because FC is not a "resident" in Canada within the meaning of that term in s. 2 of the VFD Regs. FUSA manages and controls FC from outside Canada.

V. Certain Jurisprudence (cont'd)

4. *Deputy Minister of National Revenue v. Mattel Canada*, [2001] 2 S.C.R. 100 and 2001 SCC 36

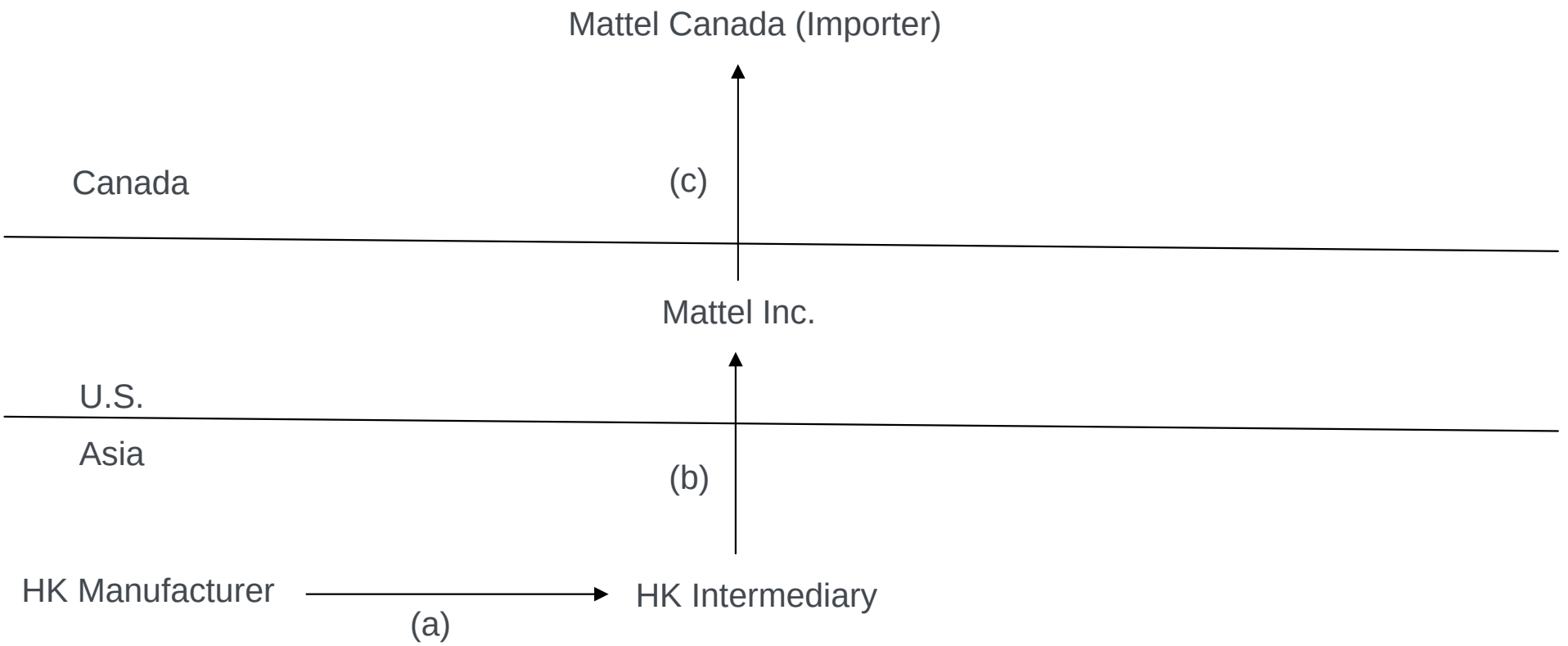
– The Supreme Court of Canada considered the meaning of "goods sold for export to Canada" in a multi-tiered sales arrangement ***prior to*** the "purchaser in Canada" amendments taking effect.

a) Hong Kong manufacturer sells to intermediary Mattel company in Hong Kong.
b) Intermediary re-sells to Mattel Inc. in U.S.
c) Mattel Inc. re-sells to Mattel Canada in Canada.

Which of the above sales is the "sale for export" to Canada?

V. Certain Jurisprudence (cont'd)

4. *Mattel Canada* (cont'd)



Mattel Canada argued in favour of (a). Canada Customs argued in favour of (c). Canada Customs won. "The relevant sale for export is the sale by which title to the goods passes to the importer. The importer is the party who has title to the goods at the time the goods are transported into Canada."

V. Certain Jurisprudence (cont'd)

4. *Mattel Canada* (cont'd)

- The Supreme Court expressed concern that importers would establish multi-tiered sales arrangements to artificially lower the sale price in calculating the transaction value by using the first trade level in the distribution chain as the "sale for export to Canada".

- To what extent have the legal principles established by the Supreme Court been supplanted by the "purchaser in Canada" amendments?

V. Certain Jurisprudence (cont'd)

5. *AAi.FosterGrant of Canada v. CCRA*, (CITT, Appeal No. AP-2001-94, June 13, 2003; rev'd by FCA at 2004 FCA 259, July 14, 2004)

- Whether AAi.FosterGrant of Canada purchased for resale from a related U.S. company or acted as selling agent on behalf of the U.S. company?

- CITT found AAi.FosterGrant of Canada could not be a "purchaser in Canada" under either s. 2.1(a) or (b) of the VFD Regs because it "did not carry on business in Canada". Therefore, the higher sale price charged to arm's length customers in Canada determined the transaction value, as opposed to the intercompany transfer price paid by AAi.FosterGrant of Canada.

- Surprising finding! 100 full-time employees across Canada with leased office premises and showroom in Toronto, Ontario.

V. Certain Jurisprudence (cont'd)

5. *AAi.FosterGrant of Canada (cont'd)*

- The FCA allowed the appeal. The CITT misapplied "residence" criteria in evaluating whether AAi.FosterGrant of Canada "carried on business" in Canada. Since the related U.S. company controlled and managed AAi.FosterGrant of Canada's business operations from outside Canada, the CITT found that AAi.FosterGrant of Canada did not carry on business in Canada.

- The FCA refers to two alternative legal definitions for "carries on business" from the Supreme Court of Canada case in *Backman v. Canada,* [2001] 1 S.C.R. 367.

V. Certain Jurisprudence (cont'd)

5. *AAi.FosterGrant of Canada (cont'd)*

1) Holding "oneself out to others as engaged in the selling of goods or services."

2) At least three of the following elements must exist:

   a) the occupation of one's time, attention and labour;
   b) the incurring of liabilities to other persons; and
   c) the purpose of a livelihood or profit.

VI. CBSA's Administrative Policies

- CBSA's administrative policies in D13-4-2 continue to be out of date. In paragraph 13, a person incorporated in Canada should be considered a selling agent of a foreign corporation "if minimal operations are conducted in Canada and management and control reside outside Canada" with the foreign corporation.

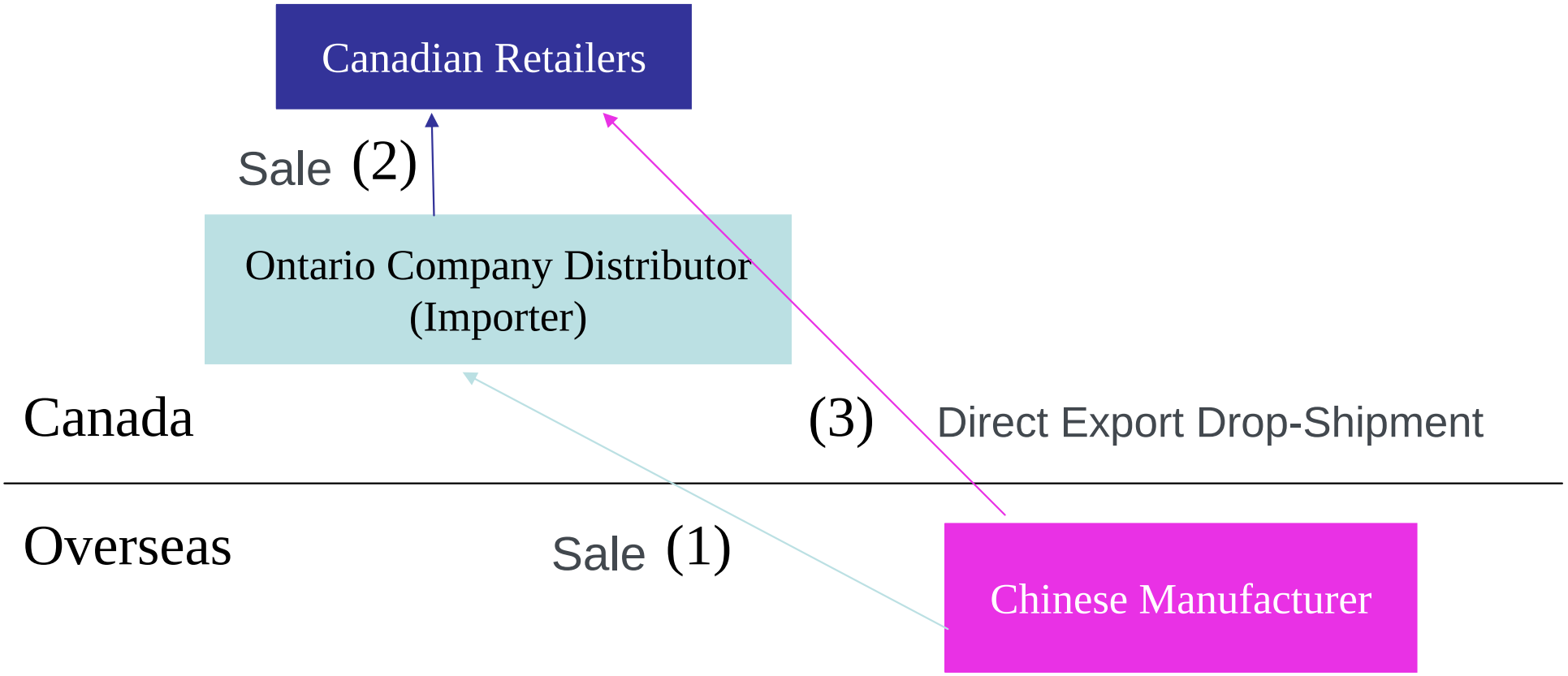
- CBSA ignoring agency law concepts and the legal nature of the relationship and transactions between the parties. Runs contrary to SCC jurisprudence, including *Mattel* Canada, as the FCA in *AAi.FosterGrant of Canada* indicates.

VI. CBSA's Administrative Policies (cont'd)

- CBSA's Memorandum D13-1-3, "Customs Valuation: Purchaser in Canada Regulations" (April 9, 2001) pre-dates the aforementioned "purchaser in Canada" decisions in *Cherry Stix, Ferragamo,* and *AAi.FosterGrant of Canada.* As a result, D13-1-3 needs a significant overhaul to reflect "carrying on business" legal tests and set out criteria to determine where business is carried on, among other things.

- After the *Ferragamo* CITT decision, CBSA suspended its policy review process to re-assess how it wishes to move forward.

VII. Case Study



VII. Case Study (cont'd)

- Which sale is for export to Canada to a purchaser in Canada?
- Can the Distributor be a "purchaser in Canada"? May not be under s. 2.1(a) or (b) of the VFD Regs even though incorporated in Ontario.
- If not, are the requirements in s. 2.1(c)(ii) of the VFD Regs satisfied?

VII. Case Study (cont'd)

- Does the Distributor enter into an agreement to sell goods to a Canadian retailer before purchasing (acquiring title to) goods from the Chinese Manufacturer (as in *Cherry Stix* and in *Ferragamo*)?

- Even if the Distributor does so, is the Canadian retailer a "resident", disqualifying the Distributor as a "purchaser in Canada" (as in *Cherry Stix)*, or is the retailer not a "resident", entitling the Distributor to be a "purchaser in Canada" (as in *Ferragamo*)?

VII. Case Study (cont'd)

- The answers may not necessarily be straight-forward.
- In *Cherry Stix*, the importer and CBSA disagreed as to when it entered into an "agreement to sell goods".
- As far as the question of whether a customer in Canada is "resident" under s. 2 of the VFD Regs, it requires a detailed understanding of the inner workings of the customer's operations. For business reasons, the customer may not be readily forthcoming with these details. If multiple customers, multiply the difficulty.

VII. Case Study (cont'd)

- The Distributor cannot be a "selling agent" to be a "purchaser in Canada" in a "sale for export to Canada" (*AAi.FosterGrant of Canada)*.

- CBSA might maintain the "sale for export" is the sale from the Distributor to the Canadian retailer, the one with the person in Canada or importer, that sets off the chain of events leading to the direct export of the goods to Canada, as in D13-4-2, which remains unamended since the *Mattel Canada* Supreme Court decision in June 2001.

VII. Case Study (cont'd)

- Difficult to reconcile CBSA's administrative policies with Supreme Court decision in *Mattel Canada*.

- If the Distributor were to acquire title to the goods outside Canada and import them into Canada, then the sale from the Chinese manufacturer to the Distributor should be the "sale for export" (as supported by *Mattel Canada*). For the TVM to apply to this sale at the initial trade level, the Distributor must be a "purchaser in Canada".

VIII. Planning Idea

- Distributor sets up a PE in Canada under s. 2 of the VFD Regs. Distributor is already a Canadian income taxpayer because incorporated in Ontario.

- If a U.S. corporation, could be possible to set up a PE under the VFD Regs but not under the *Canada-U.S. Income Tax Convention*, so that the U.S. corporation's profits are not subject to Canadian income taxes. See paragraph 6 in Article V of the *Convention*.

IX. WCO's Committee's Views

- In July 2007, the WCO Committee published its Commentary 22.1, "Meaning of the Expression 'Sold for Export to Country of Importation' in a Series of Sales".

- For various reasons, it supports the interpretation that the sale at the higher trade level is the "sale for export".

- One rationale is that the importing country's customs administration may find it more difficult to audit a foreign intermediary or seller as importer.

IX. WCO's Committee's Views (cont'd)

- In our view, as a practical matter, the situation is no different than when a foreign vendor and exporter of goods acts as an importer of record in entering the goods into the destination country, to deliver and sell the goods to the domestic purchaser within the destination country. A foreign importer, whether the vendor or the purchaser in a sale for export, is subject to the same requirements to maintain customs records as a domestic importer and to the same array of enforcement tools.

IX. WCO's Committee's Views (cont'd)

– U.S. Customs and Border Protection ("**CBP**") was initially persuaded by WCO Committee's views, despite U.S. jurisprudence to the contrary and no equivalent of "purchaser in Canada" requirement in U.S. customs statute. On January 24, 2008, CBP published its notice of proposed new interpretation of the expression "sold for export to the US" based on WCO Committee's Commentary 22.1.

IX. WCO's Committee's Views (cont'd)

– In the U.S. "2008 Farm Bill" passed into law, the Congress expressed its desire that CBP postpone administering U.S. law on the basis of Commentary in 22.1 until at least January 1, 2011, and only after extensive information gathering and consultation process with the U.S. Congress. Subsequently, later in 2008, CBP withdrew its notice of proposed new interpretation.

IX. WCO's Committee's Views (cont'd)

- For a one-year period effective August 20, 2008, importers declaring the transaction value with a "sale for export" other than the last sale in the distribution chain, must indicate "F" next to the declared value on the appropriate line item of the CBP Form 7501. CBP is gathering this data as part of the consultative process on the application, if any, of WCO Committee's Commentary 22.1 under U.S. law.