

API 2010 International Trade & Customs Conference

Canadian Duty and Border Tax Issues: Selected Topics

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The logo for the law firm Blakes, featuring the name "Blakes" in a stylized, cursive script font.

Order of Presentation

1. Customs

- Valuation
 - “Purchaser in Canada” – Unique to Canada
 - New Policy on “Subsequent Proceeds” Addition
- Administrative Monetary Penalties
 - System overhaul commencing in 2010

2. GST

- GST Overview
- Division III of the ETA (i.e., on imports)
- Paying and Recovering GST at the Border

3. Harmonized Sales Tax

- Sales Tax Harmonization in Ontario and British Columbia

Valuation - Legislative Framework

- Canada's valuation rules are set out in the *Customs Act* (primarily sections 44-55) and *Valuation for Duty Regulations*
- valuation provisions are based on international rules, specifically
 - Article VII of the GATT 1947
 - Agreement on Implementation of Article VII of the GATT (“Customs Valuation Code”)
 - now included in “GATT 1994” and part of World Trade Organization agreements

Customs Act - Valuation Provisions

Section 44

If duties ... are imposed on goods at a percentage rate, such duties shall be calculated by applying the rate to a value determined in accordance with sections 45 to 55.

Section 46

The value for duty of imported goods shall be determined in accordance with sections 47 to 55.

Section 47(1)

The value for duty shall be appraised on the basis of the transaction value of the goods in accordance with the conditions set out in section 48.

Transaction Value Method

- s. 48(1) of the *Customs Act*
 - “the value for duty of goods is the transaction value of the goods if the goods are sold for export to Canada to a purchaser in Canada and the price paid or payable for the goods can be determined...”

Price Paid or Payable

- ss. 45(1) of the *Customs Act*
 - “the aggregate of all payments made or to be made, directly or indirectly, in respect of the goods by the purchaser for the benefit of the vendor”

Sale Requirement

- Transaction value method applies only if the imported goods were the subject of a “sale”
- Meaning of “sale”
 - Customs Memorandum D13-4-2
 - widest possible meaning
 - includes agreements to sell

“Purchaser in Canada”

- relevant sale for export is to a “purchaser in Canada”
- “purchaser in Canada” defined by *Valuation for Duty Regulations* as
 - a) resident
 - b) non-resident with a permanent establishment in Canada
 - c) a person who neither is a resident nor has a permanent establishment in Canada, and who imports the goods ...
 - i. [for own use], 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

Resident

- Resident
 - “...a corporation that carries on business in Canada and of which management and control is in Canada ...”

Permanent Establishment

- Permanent Establishment
 - “...a fixed place of business of the person and includes a ... branch ... through which the person carries on business”

Non-Resident Importer

- **“Non-Resident Importer”**
 - a person who is neither a resident nor has a permanent establishment in Canada, and who imports the goods ...
 - i. [for own use], 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

Statutory Additions

- Required pursuant to ss. 48(5)(a) of the *Customs Act*
 - commissions and brokerage
 - packing and other costs prior to shipment and transportation costs
 - assists
 - royalties
 - subsequent proceeds

Subsequent Proceeds

- Must be added to price paid or payable
- Required pursuant to ss. 48(5)(a)(v) of the *Customs Act*
 - “the value of any part of the proceeds of any subsequent resale, disposal or use of the goods by the purchaser thereof that accrues or is to accrue, directly or indirectly, to the vendor”

Subsequent Proceeds

- A payment will be considered a “subsequent proceed” where:
 - payment accrues directly or indirectly to the vendor of the goods
 - payment based on, or a result of, the resale, disposal or use of the goods in Canada
- Often occurs between related parties

Subsequent Proceeds

- Examples from Customs Memorandum D13-4-13, *Post Importation Payments or Fees “Subsequent Proceeds”*:
 - payments based on resale of goods not related to services received
 - management or administration fees
 - contributions to research and development
 - contributions to marketing and promotion
 - overhead expenses not captured in the selling price
 - interest on deferred payments

Other Post-Importation Considerations

- To take advantage of exclusions, importers must provide “sufficient information” pursuant to s. 45(1) of the *Customs Act*
- Documentation must describe:
 - the nature of the service
 - the basis on which it is paid
 - proof that the actual services are being provided and paid for

Other Post-Importation Considerations (cont'd)

- Year-end adjustments to price paid to vendor must be added to the price paid or payable
- Dividends, transactions involving share capital, debt and other financing activities *not* “subsequent proceeds”
- Timing of payment is irrelevant
- Importers should estimate payment amounts at the time of importation and self-correct if necessary

Administrative Monetary Penalty System (AMPS)

- Comprehensive sanctions regime designed to ensure compliance with trade and border legislation and to level the playing field among traders
- Enforced through a series of graduated civil penalties that match the severity and frequency of contravention
- Intended to be corrective rather than punitive
- Seizures and forfeitures are reserved for only the most serious contraventions, such as drug or weapons smuggling

Legal and Regulatory Framework

- AMPS regime enacted through section 109.1 of the *Customs Act*

109.1 (1) Every person who fails to comply with any provision of an Act or a regulation designated by the regulations made under subsection (3) is liable to a penalty of not more than twenty-five thousand dollars, as the Minister may direct.

(2) Every person who fails to comply with any term of condition of a licence issued under this Act or the *Customs Tariff* or any obligation undertaken under section 4.1 is liable to a penalty of not more than twenty-five thousand dollars, as the Minister may direct

Legal and Regulatory Framework

109.1(3) The Governor in Council may make regulations

- (a) designating any provisions of this Act, the *Customs Tariff* or the *Special Import Measures Act* or of any regulation made under any of those Acts; and
- (b) establishing short-form descriptions of the provisions designated under paragraph (a) and providing for the use of those descriptions

Legal and Regulatory Framework

- The *Designated Provisions (Customs) Regulations* bring into effect the AMPS by setting out the sections that are subject to penalty
- Master Penalty Document contains details of each contravention, including “Backgrounders”, a source of confusion for traders

Changes to AMPS

- Since implementation, numerous issues/concern raised by both clients and employees:
 - too many penalties
 - penalty structure too complex
 - inconsistent application of penalties
 - some penalties/backgrounders not clear

Changes to AMPS

- Fundamental review of penalty regime
 - review of existing penalties to ensure fairness and consistency
 - identify and correct inconsistencies with future direction
 - extensive consultations (internal and external) throughout process

Changes to AMPS

Reduce Contraventions

- Currently too many penalties (246)
- lack of clarity, too complex, duplication
- Under new system current contraventions will be reduced to 79
- New guidelines to be prepared

Changes to AMPS

Risk-based contraventions and penalty amounts

- Penalty grid introduced to measure level of harm associated with non-compliance (5 levels ranging from very low to very high)
- Based on 4 criteria - national security, health & safety, economy, and international reputation
- Three escalating penalty amounts within each level
- Severe infractions and infractions by higher risk groups subject to steeper penalties

Changes to AMPS

Volumetric Fairness

- Recognition that large clients and transporters may be more vulnerable to AMPS due to high volumes
- Volumetrics accommodation based on high compliance (may apply only to CSA and PIP approved clients)
- Changes include revised penalty reduction agreements, non-escalating penalty levels within 30 days, and improved access to corrections process

Changes to AMPS

National Review Framework

- Reinstatement of regional review committees
- All penalties to be reviewed by superintendants prior to issue
- Periodic review by regional review committees to ensure consistency and accuracy

Changes to AMPS

Enhance Appeals Process

- Client concerns that time frames for decisions are too long
- Financial impact for client if penalty is upheld a significant amount of time after issuance
- Proposals to include time frames for decisions, increase consistency, improve transparency and issue more substantive decisions

Implementation

- Phase I of changes to be implemented as of April 14, 2010
 - risk-based penalty structure
 - new penalty amounts
 - 30-day delay in escalation of penalties
- Phase II to be implemented in October 2010
 - enhancements to automated system
 - elimination of some penalties
- Full programming of collapsed contraventions into logical groupings expected by 2011-2012

GST Overview

GST

- Goods and Services Tax is a 5% value-added tax imposed under the *Excise Tax Act*
- Applies to supplies of “property” and “services” that are “made in Canada” or imported into Canada
- There are “taxable supplies”, “exempt supplies” and “zero-rated supplies”
- GST registered suppliers are required to charge and collect the GST on “taxable supplies”; GST on “zero-rated” supplies is 0% (tax free)
- GST registered suppliers may as a general rule claim a full refund of GST incurred on inputs acquired to make “taxable” or “zero-rated” supplies

GST Overview

HST

- Nova Scotia, New Brunswick and Newfoundland have a Harmonized Sales Tax (“HST”) of 13%
- the HST was formed from the harmonization of these provinces’ sales taxes and the federal GST
- the HST is a value added tax that applies in the same manner as the GST on most goods and services supplied in these three provinces
- GST registrants are automatically registered for HST purposes

GST Overview

GST Registration

- registration is mandatory for companies that “carry on business” in Canada
- a non-resident may voluntarily register for GST if it:
 - is engaged in a commercial activity in Canada;
 - in the ordinary course of carrying on business outside Canada, regularly solicits orders for goods (except prescribed goods) to be exported or delivered to Canada; or
 - in the ordinary course of carrying on business outside Canada, enters into an agreement to supply services to be performed in Canada, or intangible personal property such as intellectual property to be used in Canada or that relates to real property situated in Canada, to goods that are ordinarily situated in Canada, or to services to be performed in Canada.

GST Overview

Advantages of Registering for GST

- as a GST registrant, the company is entitled to recover as an Input Tax Credit (ITC) any GST incurred on any goods and services acquired in Canada in relation to its commercial activities (e.g., purchases of inventory, office supplies, computers, office rent, warehouse costs, customs broker's fees)
- GST registrants are entitled to recover GST paid on imports (under Division III of the *ETA*) by way of an ITC

Division III of the *ETA*

- GST/HST is levied under Division III of the ETA when goods are imported into Canada
- S. 212 – Every person who is liable to pay duty under the *Customs Act* or who would be liable if the goods were subject to duty, is required to pay GST on imported goods (the importer of record)
- GST/HST is collected at the time of importation into Canada

Division III of the *ETA*

- S. 212.1 – Every resident in a participating province who is liable to pay duty under the *Customs Act*, is also liable to pay provincial taxes on imported commercial goods (goods that are imported for sale or for any commercial, industrial, occupational or other like use)
- S. 215 – The value of imported goods for the purpose of Division III is the value for duty calculated in accordance with the *Customs Act* plus the amount of all duties and taxes, if any, imposed under the *Customs Tariff*, the *Excise Act*, the *Special Import Measures Act*, and any other law relating to customs.

Division III of the *ETA*

Schedule VII – Non-taxable importations

- goods listed in Schedule VII are not taxable when imported into Canada – s. 213
- examples:
 - tariff exemptions (Chapter 98, Customs Tariff)
 - warranty replacements/parts
 - mailed goods up to \$20 VFD
 - prescribed goods (*Non-Taxable Imported Goods (GST/HST) Regulations*)

Division III of the *ETA*

Schedule VI – Zero-Rated Goods

- zero-rated goods are subject to GST at a rate of 0%
- applies to goods listed in 10 Parts of Schedule VI, such as:
 - prescription drugs
 - medical and assistive devices
 - basic groceries
 - agricultural and fishing
 - certain transportation services

Division III of the *ETA*

Schedule V - Exempt Supplies

- goods listed in Schedule V are not considered taxable supplies
- examples:
 - health care services
 - educational services
 - supplies by charities (e.g., meals on wheels)
 - financial services

Division III of the *ETA*

- **Canadian Goods Returned**

- tax free importation of goods under tariff items 98.13 and 98.14 where the owner or importer previously acquired the goods in Canada or imported them for consumption, use or supply in Canada
- **HOWEVER**, tax-free importation will not be allowed for goods that are being imported for the first time after having been:
 - supplied outside Canada;
 - supplied in Canada for export under conditions resulting in zero-rating of the supply; or
 - supplied to a non-resident recipient who was entitled to claim a rebate of the GST under s.252(1).

Paying/Recovering GST

1. SS. 169(1) – General Rule
2. SS. 169(2) – Services on Imported Goods
3. S. 180 – Non-resident supplier/importer
4. S.178.8 – Registered non-resident supplier who imports

Paying/Recovering GST

169(1) – General Rule

- the GST/HST and QST are recoverable taxes for persons who are:
 - registered for such taxes; and
 - purchasing goods and services for consumption, use or supply in a “commercial activity”
- registrants net out GST/HST and QST paid on input costs against GST/HST and QST collected for any reporting period
- if GST/HST and QST paid is greater than GST/HST and QST collected, registrants claim a “net tax refund” from relevant governmental authority

Paying/Recovering GST

169(2) – Services on Imported Goods

- section 169(2) of ETA provides ITCs for goods imported to provide commercial services
- applies where a registrant service provider imports goods of a non-resident person who is not registered for GST purposes
- goods must be imported for the purpose of making a taxable supply to the non-resident person of a commercial service in respect of the goods
- the section allows the registrant service provider to claim ITCs for GST paid on the importation of the goods

Paying/Recovering GST

180 – Non-resident Supplier/Importer

- section 180 of ETA/“Flow through” of ITCs to a recipient
- the section applies where a non-resident person, who is not registered for GST purposes
 - makes a supply of tangible personal property to a recipient
 - delivers the property or makes it available in Canada to the recipient
 - has paid GST on the importation of the property; and
 - provides to the recipient evidence that such GST was paid
 - the recipient is deemed to have paid the GST and (if entitled) can then claim an ITC for such GST pursuant to subsection 169(1) of the ETA

Paying/Recovering GST

S. 178.8 Registered Non-Resident Supplier Who Imports (introduced in 2007)

- addresses circumstances where a registered supplier delivers goods outside of Canada to a recipient and then supplier imports goods into Canada
- supplier cannot technically claim ITCs for GST paid on importation, as the recipient is considered by the CRA to be the "de facto" importer

CRA De Facto Importer Policy

Section 178.8 of the ETA deals with the issue of *de facto* importers in a two-fold manner:

(i) Parties can rely on default rule:

- recipient of the imported goods can claim the ITC
- provided the recipient obtains the necessary information from the supplier to substantiate the claim
- supplier should obtain reimbursement of GST it paid at the border

CRA De Facto Importer Policy

(ii) Parties can elect to have supplier claim the ITC:

- election must be made on prescribed form
- avoids the need for the exchange of import documentation
- under the election, the two parties agree to have the supplier claim the ITC and treat the supply as if it had been made in Canada
- supplier must then charge and collect GST from the recipient on supply deemed to have been made in Canada

GST Concluding Remarks

- The application of GST at the border can be complicated.
- There are a number of ways to strategically structure transactions to save on the costs of importation.
- It is prudent to seek the advice of an experienced commodity tax practitioner.

Harmonized Sales Tax

- currently, 3 provinces have “harmonized” their sales tax with the GST at a combined rate of 13% (Quebec has its own version called QST at 7.5%)
- this benefits businesses which make “taxable supplies” because the entire tax amount is treated like GST meaning it is fully refundable to such registrants
- in 2009, Ontario and B.C. announced plans to harmonize their respective taxes with GST effective July 1, 2010 (13% and 12% respectively)

Harmonized Sales Tax

Harmonization Issues

- on July 1, 2010, HST applies in 5 provinces of Canada (only PEI, Manitoba, Saskatchewan charge their own PST)
- consider transitional rules now as key dates are coming up (i.e., May 1, 2010)
- place of supply rules should be considered
- restricted ITCs for large suppliers (energy, telecom, road vehicles, food (beverages and entertainment))

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