THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

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Dear Janine Harker:

Re: Valuation for Duty Regulations

The Commodity Tax, Customs and Trade Section of the Canadian Bar Association (CBA Section) is responding to proposed *Regulations Amending the Valuation for Duty Regulations* published in the Canada Gazette, Part I, Volume 157, Number 21 on May 27, 2023 (proposed Regulations).

The CBA is a national association of over 37,000 members, including lawyers, notaries, academics and students across Canada, with a mandate to seek improvements in the law and the administration of justice. The CBA Section deals with law and practice related to commodity tax, customs and trade remedy matters.

Stated rationale for changes

The Regulatory Impact Analysis Statement released with the proposed Regulations (RIAS) explains that the existing legislative and regulatory framework needs renewal to:

- align current law with Canada's international obligations
- protect Canadian importers' ability to compete with non-resident importers (NRIs)
- give greater certainty and predictability to the importing community, and
- give the CBSA the authority to enforce collection of the correct amount of revenue from import duties.

CBA Section comments

As discussed in detail below, the proposed Regulations do not achieve these objectives. Further, the 30-day consultation period is extremely short given the broad and significant implications of the proposed Regulations. The proposed Regulations would negatively affect resident and non-resident importers, including small businesses in Canada. In addition, the cost to the Canadian economy could far exceed the additional duty collected by the CBSA.

Accordingly, we would request that the proposed Regulations be revised and published again for review before implementation.

Proposed Regulations incompatible with WTO Customs Valuation Agreement

The RIAS cites alignment with international obligations as the basis for the proposed changes to the existing *Valuation for Duty Regulations*.

In fact, the proposed Regulations are incompatible with Canada's international obligations, particularly Article 1 of the Agreement on the implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (WTO Customs Valuation Agreement).

Article 1 of the WTO Customs Valuation Agreement states "the customs value of imported goods shall be the transaction value, that is the price actually paid or payable for the goods *when sold for export to the country of importation […].*"

World Customs Organization (WCO) Advisory Opinion 1.1 discusses the term "sale" for customs valuation purposes and states that "uniformity of interpretation and application can be achieved by taking the term 'sale' in its widest sense". WCO Advisory Opinion 14.1 opines on the expression "sold for export to the country of importation" and gives several examples of the types of transactions that would qualify under this expression. WCO Commentary 22.1 considers the expression "sold for export to the country of importation" in the context of an import transaction that involves a series of sales.

In WCO Commentary 22.1, the Technical Committee on Customs Valuation (Committee) specifically concludes that, in a series of sales situations, the price paid or payable for the imported goods when sold for export to the country of importation is the price paid in the last sale occurring *prior to the introduction of the goods into the country of importation*. The Committee adds that "this is consistent with the purpose and overall text of the [WTO Customs Valuation] Agreement."

There is no suggestion in the WCO materials that an "understanding" or an "arrangement" between two parties is sufficient to satisfy the legal definition of "sale" for export to the country of importation, or that the terms "understanding", "arrangement" and "sale" can or should be interpreted as interchangeable.

The proposed Regulations would drastically depart from the WCO's stated policy on what constitutes the appropriate "last sale" of imported goods for customs purposes by instead basing the transaction value on the last "understanding" or "arrangement" in respect of the goods. The effect would be to shift the basis for customs valuation from the last sale occurring prior to the introduction of the goods into Canada and to capture purely domestic transactions between Canadian entities that do not occur until after the goods have been imported. This is neither contemplated under the WTO Customs Valuation Agreement nor supported by the Committee's opinions and commentary.

It is therefore misleading for the CBSA to assert that the definition of "sold for export to Canada" in the proposed Regulations aligns with the WTO's Customs Valuation Agreement, when it goes much further by effectively extending the term "sale" far beyond its widest sense.

A definition of "sale" for customs valuation purposes that is contrary to its meaning under Canadian common law as well as its meaning under international law or conventions such as the UN Convention on Contracts for the International Sale of Goods would not be within the reasonable expectation of a trader. Accordingly, it is not consistent with the WTO Customs Valuation Agreement.

Proposed Regulations are inconsistent with the customs regulations of Canada's major trading partners

The RIAS cites alignment with Canada's largest trading partners as rationale for the proposed Regulations.

The CBSA states that, with the exception of the United States, Canada is not aware of any other WTO members that do not apply the last sale rule where a series of sales occurs before importation of the goods. The CBSA refers specifically to the European Union, noting that in 2016, EU legislation was amended to state that the "last sale" could be the only basis for customs valuation in a series of sales scenario.

Again, the CBSA's comments are misleading. The Guidance on Articles 128 and 136 UCC IA (EU Guidance) addresses the meaning of "sold for export" to the customs territory of the Union in the context of the EU legislation and clearly states that "the relevant sale to determine the value of goods is the sale for export that brings the goods into the Union. This is the sale *occurring immediately before* the introduction of the goods into the customs territory of the Union" (at page 53).

Moreover, the EU Guidance specifies that, to be sold for export, the imported goods must be the subject of a "sale." The Guidance references WCO Advisory Opinion 1.1 and the Committee's view that the term "sale" should be interpreted in the widest sense. However, unlike the proposed Regulations, the EU legislation and guidance does not purport to extend the legal meaning of the term "sale" to include "understandings" and "arrangements" or any other scenario that would not legally qualify as a sale. The EU Guidance instead reiterates that the transaction value of imported goods must be based on an actual legal sale (at page 54):

> 10. It is of course necessary to ensure that the transaction being used as the basis of customs value under Article 70 UCC takes the form of an actual sale, with an actual buyer and seller. In other words, in order to determine a customs value under Article 70 UCC, it must be established whether the parties to a transaction can be regarded as buyer and seller and thus whether the transaction constitutes a sale *in legal terms*, as well as in a commercial sense. [emphasis added]

The EU Guidance aligns with the WCO's "last sale" policy, which requires that the transaction value must be based on an actual, legal sale of the goods occurring immediately before the introduction of the goods into the country, and not on some sort of understanding or arrangement with respect to a future sale that does not yet exist, or is not legally binding, at the time of importation.

The attached Appendix highlights the difference in the application of the "last sale" rule in the EU with the application of subsection 2.01(2) of the proposed Regulations. Under the EU rules, the sale for export would be between the foreign manufacturer and the importer, whereas it would be between the dealer and the consumer under the proposed Regulations.

Proposed Regulations will eliminate the role of Canadian distributors of commercial and consumer goods

The proposed Regulations go well beyond levelling the playing field for Canadian importers relative to NRIs. They will have the effect of requiring Canadian distributors who are resident and/or have a

significant presence in Canada (i.e., existing "purchasers in Canada" or PICs) to pay higher duties on goods they import into Canada for domestic sale in any scenario where the distributor does not import and store the goods as inventory with the remote possibility of a sale.

The CBSA has never identified these scenarios as "loopholes" (as that term is referred to in the RIAS) or attempted to assess customs duty based on the price the Canadian distributor (PIC) charges to its resale customer in Canada, even in circumstances where the distributor has a prior agreement to sell the goods in Canada. The CBSA has generally accepted that the domestic resale in Canada is not the sale for export that brings the goods into Canada (consistent with the WCO's "last sale" policy).

The proposed Regulations would also capture Canadian retailers who sell goods via e-commerce to domestic consumers and import those goods into Canada, which will result in a value for duty based on the consumer price and will lead to elimination of the Canadian retailer, given that the sales could be made directly from the foreign (e.g., US) retailer utilizing the *de minimus* rules. In other words, there is no need to have the Canadian retailer involved in the e-commerce transaction with the Canadian consumer.

While the RIAS indicates that "sales that occur in Canada and do not cause the goods to be exported to Canada will not be used in the determination of the value for duty of imported goods," this statement is misleading. If the proposed Regulations are enacted, sales that have always been considered by both importers and the CBSA to be domestic sales would now qualify for customs valuation (contrary to WTO rules). This would result in an overvaluation of the imported goods, a corresponding detriment to Canadian importers and a higher cost for consumers. In addition, by raising the cost of imported goods relative to domestically produced like goods, the proposed Regulations would violate Canada's WTO national-treatment obligations.

Importing and storing goods in Canada is relatively expensive, given Canada's relatively high duty rates and limited warehousing in comparison to other countries, particularly the United States. It follows that prudent businesses do not import goods solely on a speculative basis, i.e., without having a sense on whether the goods can be sold at a profit in Canada. There is a benefit to being resident in Canada under the current law, where under the proposed changes, there would not be. It follows that businesses are likely to reconsider whether it makes sense to have any presence in Canada particularly as most Canadians live within one hundred miles of the United States border. As a result, the proposed Regulations would encourage more importers to be NRIs because they would have a cost advantage over resident distributors and retailers. This would be the direct result of the proposed Regulations increasing the costs to certain Canadian companies.

Accordingly, the proposed Regulations go well beyond the CBSA's stated objectives of levelling the playing field and enforcing the collection of the "correct" amount of revenue from import duties owed to the Government of Canada.

Lack of certainty and predictability for the importing community

One of the primary tenets of taxation law and trade agreements is certainty. This is particularly important for businesses conducting thousands of transactions daily through multiple sales channels. Moreover, this was a founding principle of the transaction value (TV) system, which was intended to apply uniformly across jurisdictions to increase predictability, stability and transparency for international trade.

The RIAS cites "greater certainty and predictability for the importing community" as another rationale for the proposed changes.

However, the consensus among CBA Section members who practice extensively in this area is that:

- the proposed Regulations are difficult to understand;
- their potential application to many scenarios and, in particular, those involving domestic sale transactions is uncertain; and
- the proposed Regulations are likely to result in an increase in appeals and litigation from a very broad group of importers, rather than a decrease.

The terms "understanding" and "arrangement" and the phrase "for the purpose of being imported into Canada" in proposed section 2.01 of the proposed Regulations are vague, at best. Their intended meaning is not clear and importers will have difficulty identifying the relevant sale for export under these provisions, particularly where complex supply chains with multiple sales and channels are involved.

The determination of which "agreement", "understanding" or "arrangement" in a series has been made for the purpose of exporting the goods to Canada for sale to a purchaser in Canada is fraught with uncertainty. As discussed above, it would also result in the transaction value being determined in a manner that is wholly out of line with WTO rules and the laws of Canada's largest trading partners. Canada's misalignment with its trading partners would undermine a fundamental tenet of the TV system.

The CBSA may believe that vague and ambiguous terminology will cast a wide net and increase certainty and predictability in the application of the rules (albeit primarily through unbounded discretion for the CBSA and its verification officers). However, the vague terminology and ungrammatical language is more likely to have the opposite effect on the larger importing community, resulting in confusion and, ultimately, more appeals and litigation.

The CBSA notes that the proposed changes have been endorsed by Finance Canada. However, we question whether Finance Canada has carefully reviewed and considered the efficacy of the proposed language, potential impact on Canada's international trade laws, or the degree to which Canada is departing from the WCO's interpretation of "last sale" by purporting to base customs valuation on purely domestic transactions. As noted above, these transactions are not considered by the WCO or Canada's trade partners to qualify as sales for export to the country of importation.

No analysis has been offered by the CBSA in support of its assertion that the current regulatory framework has resulted in an uneven playing field for Canadian importers. Similarly, there is no analysis addressing the disruption to commerce, or lost tax revenues associated with the departure of Canadian distributers, which are likely to occur if the proposed Regulations are enacted.

Importers' inability to comply with the proposed regulations

Under the proposed Regulations, the importer does not have to be party to the sale for export. As a result, it is not clear how the importer would have the information needed to comply with, or the CBSA would have the information needed to enforce, the legislation.

The importer is typically required to provide either a commercial invoice or a customs invoice to support the value for duty being declared. However, if the sale for export is the last transfer of the goods in the supply chain, the importer is unlikely to have a copy of the invoice for the sale for export and as such, would not be able to give supporting information to the CBSA.

Accordingly, the proposed Regulation would be more difficult to comply with and enforce than under the current regime.

Summary and conclusion

The proposed Regulations do not achieve the CBSA's stated objective of aligning Canada's current law with its international obligations. On the contrary, the proposed language purports to extend the meaning of the term "sale" far beyond established international consensus on the type of transaction that qualifies. Nothing in the WTO Customs Valuation Agreement or the WCO materials, including the WCO's Advisory Opinion 1.1 supports the CBSA's view that a sale should include circumstances where there is no *agreement* of the parties prior to the importation of the goods. The proposed Regulations would result in a radical departure from international customs laws and practice.

Likewise, the proposed Regulations do not meet the CBSA's stated objective of protecting Canadian importers' ability to compete with NRIs or giving the CBSA authority to enforce collection of the correct amount of revenue from import duties. The proposed Regulations go well beyond levelling the playing field for Canadian importers and enforcing collection of the "correct" amount of revenue from import duties owed to Canada. Instead, they would have the effect of requiring Canadian importers to pay higher duties based on domestic sales occurring after goods are imported into Canada, resulting in an overvaluation of the imported goods, a higher cost for Canadian importers and ultimately Canadian consumers, and an unwarranted windfall to the CBSA.

The proposed Regulations do not meet the CBSA's stated objective of giving greater certainty and predictability to the importing community. The intended meaning of the vague terminology in the proposed Regulations is not clear. Moreover, importers will undoubtedly have difficulty identifying and declaring the relevant sale(s) for export under these provisions, particularly where multiple sales through multiple sales channels are involved. The proposed language is likely to result in confusion for importers and, ultimately, more appeals and litigation. Further, under the proposed Regulations, the importer may not be a party to the domestic sale that purportedly qualifies as the relevant sale for export. As a result, it is not clear how the importer would have or obtain the information needed to comply with these new rules, or how the CBSA would have or compel the information required to enforce them.

Amendments to the *Valuation for Duty Regulations* to address the CBSA's concerns could be made without wholly repealing the current PIC rules and, in so doing, drastically changing Canada's trade laws in a manner that is incongruous with the laws and policies of Canada's trading partners and impracticable for the broader importing community.

However, it would be necessary for the changes to align with the WTO Customs Valuation Agreement and WCO opinions and commentary, respecting the internationally accepted principle that a sale for export must, by definition, involve an actual (legal) sale agreement between the parties. It must also do so in a manner that does not deem the relevant sale for export to include domestic transactions between Canadian residents occurring after the goods are imported into Canada.

We request that the proposed Regulations be revised and published again for review and comment prior to coming into force.

Yours truly,

(original letter signed by Marc-André O'Rourke for Maryse Janelle)

Maryse Janelle
Chair, CBA Commodity Tax, Customs and Trade Section

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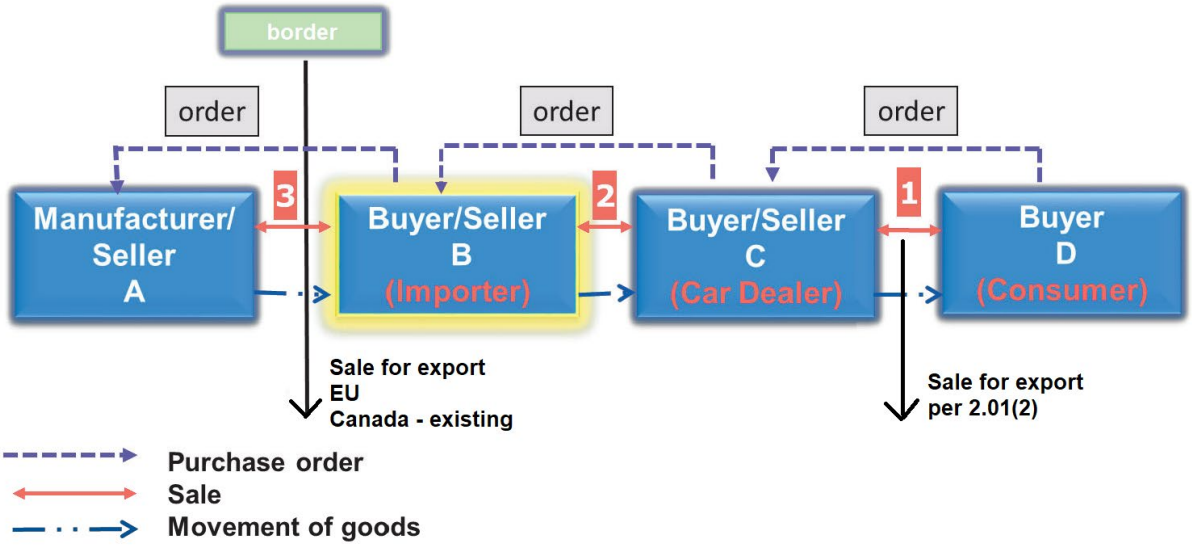
APPENDIX

COMPARISON BETWEEN EU AND CANADA (PROPSED REGULATIONS)



This is an example of a succession of orders followed by the corresponding acceptance of such orders leading to a succession of sales, starting with a consumer (Buyer D), through the Canadian car dealer (Buyer C), up to the importer (Buyer B).

Under Article 128(1) UCC IA, the sale concluded between the distributor (Buyer B) and the manufacturer (Seller A) is the sale occurring immediately before the goods were brought in the EU and accordingly, is the sale for export.

Under the proposed Regulations, however, the order placed by the consumer (Buyer D) could be interpreted to be an agreement, understanding or type of arrangement for the purpose of having the goods exported to Canada and accordingly would be an arrangement described in subsection 2.01(1).

Accordingly, based on subsection 2.01(2) of the proposed Regulations, the sale to the consumer (Buyer D) would be the arrangement respecting the last transfer of the goods in the supply chain among the transfers under those agreements. This would mean, contrary to the EU approach, that the sale to the consumer would be the sale for export upon which duty should be paid.

This example is from the European Commission Compendium of Customs Valuation Texts, Edition 2022 at page 65.