KPMG

Trade Matters

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Canada

TAX

NAFTA Verification

If your company prepares a North American Free Trade Agreement (NAFTA) Certificate of Origin for goods being exported to the US or Mexico, as an exporter, you should be aware of several issues.

Article 506 of the NAFTA grants customs authorities of all three countries—Canada, Mexico, and the US—with authority to conduct verifications of the books and records of exporters and/or producers of NAFTA certified goods. The verifications are intended to ensure that goods certified as originating under the NAFTA do, in fact, qualify in accordance with the specific rule of origin for that product, as set out in Annex 401 of the NAFTA.

Any one or all of the following methods may be used by the customs authorities when conducting a NAFTA verification:

- Written NAFTA verification questionnaire sent to the exporter or producer for completion
- Verification letter sent to the exporter or producer requesting more detailed information on the goods
- A visit to the exporter's or producer's premises

Some of the objectives of a NAFTA verification review are to ensure that:

- The tariff shift requirement of the specific rule of origin for the finished good is being met
- All non-originating parts used in the production of the finished good are being classified correctly
- The regional value content requirement has been met
- The production process required for a good is not considered a non-qualifying operation in accordance with Chapter 4 of the NAFTA
- Records relating to the origin of goods are being kept for the required time period

The verification may take place at any one, or all, of the following locations:

- Where the goods or materials are produced
- The place where the records are stored
- The site from which the goods or materials are distributed

When completing and signing a NAFTA certificate of origin, it is the exporter's responsibility to ensure the goods being certified qualify as originating in accordance with the Specific Rules of Origin in Annex 401 of the NAFTA.

Exporters should have documented procedures in place to help ensure all parts and/or materials going into the exported product have been verified. Statements of origin or certificates of origin from all domestic and foreign vendors should be kept on file.

Failure to provide any or all of the required information may result in the goods being denied preferential status under the NAFTA.

To help ensure your product does qualify as originating under the NAFTA, we recommend a NAFTA verification review. Please contact a KPMG Trade and Customs professional for more information.

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AUDIT ▪ TAX ▪ ADVISORY

Samples of Negligible Value

The Canada Border Services Agency (CBSA) has revised the regulations pertaining to samples of negligible value.

Goods that qualify as samples of negligible value may be classified under tariff item Nos. 9990.00.00 or 9991.00.00 of the *Customs Tariff*. These goods may also qualify for remission of the Goods and Services Tax (GST) or the Harmonized Sales Tax (HST), and any other taxes owing under the *Excise Tax Act*.

Remission

Remission of taxes paid or payable under Division III of Part IX of the *Excise Tax Act* is granted, under Order-in-Council P.C. 1976-2984, provided the following conditions have been met

a) The samples are of negligible value
b) The samples will be used only in soliciting orders for goods of the kind represented by the sample
c) There is not more than one sample of each kind or quality in a consignment
d) The goods referred to in paragraph *(b)* will be supplied direct from abroad

A sample is deemed to be of negligible value when the duty and taxes payable does not exceed two dollars.

Tariff Item 9990.00.00

The provisions of tariff item No. 9990.00.00 allow commercial samples imported from the US, Mexico, Chile, or Costa Rica, regardless of the country of origin or tariff treatment, to be imported free of duty. Samples must meet the following conditions

a) Be used solely for the solicitation of order for goods or services provided from a country other than Canada
b) Have a value individually or in the aggregate as shipped, of not more than one Unites States dollar or the equivalent in Canadian, Chilean, Mexican, or Costa Rican currency
c) Samples are so marked, torn, perforated, or otherwise treated that they are unsuitable for sale or for use, except as commercial samples.

Along with the customs documentation indicating the value of the samples, the importer of record must also submit any documentation verifying the importer is a representative of the foreign supplier or is acting on behalf of such a representative.

Tariff Item 9991.00.00

Tariff item No. 9991.00.00 can be used to import samples from any country, including a free trade partner country, that are representative of a particular category of goods that have been produced, or an article for which production is contemplated. Samples must meet the following conditions

a) The aggregate of duty and all taxes otherwise payable does not exceed two dollars
b) The samples will be used only in soliciting orders for goods of the kind represented by the sample
c) The goods will be supplied directly from abroad
d) There is not more than one sample of each kind or quality in a shipment. This condition does not apply to foodstuffs, non-alcoholic beverages, perfumes, and chemical products that will be consumed or destroyed during demonstration

Samples under tariff item 9991.00.00 may include any package, case, binder, or other articles attached to or imported as an integral part of the sample. Also, a shipment may consist of more than one sample of each kind or quality when the quantity and manner in which they are packaged clearly prevents them from being sold.

However, samples imported that will be given away as "sales gifts," or goods provided as incentives to salespeople, are not entitled to be imported under this tariff item.

If your company imports samples and you would like more information on this rather complex issue, please contact a KPMG professional.

Updates from the Canada Border Services Agency

Partners in Protection

As reported in our Fall 2007 Newsletter, the Canada Border Services Agency (CBSA) has been conducting public consultations on proposed changes to the Partners in Protection (PIP) security program. The CBSA has now provided a draft transition strategy for current PIP members. A current PIP member is defined as "any approved member of the program as of June 30, 2008."

The new PIP program, containing new minimum security requirements and new policies and procedures, is scheduled to be implemented on June 30, 2008. Highlights of the proposed transition strategy are

- Current PIP members will *not* be grandfathered into the new program
- Current PIP members will have to reapply for the new program by submitting a new Security Profile to the CBSA
- The deadline, for current PIP members, for submitting a new Security Profile will be December 31, 2008
- Applications under the old program will be accepted only until March 31, 2008
- All transitions should be completed by December 31, 2009

The CBSA is also simplifying the application process by creating a single Security Profile for all segments of the trade community. The new Security Profile will contain generic sections that all applicants must complete, as well as sector-specific sections that should be completed only if they apply to the applicant's business sector.

A seal requirement is being added to the PIP program to align it with the US Customs-Trade Partnership Against Terrorism security program. This means seals that meet or exceed the current ISO/PAS 17712 standard will be required to be affixed to all loaded trailers destined for Canada.

The CBSA's PIP Web site should be updated with the finalized Security Profile and draft Memorandum of Understanding by March 31, 2008. The results of its consultations and the changes to current policies and procedures should be posted on the same Web site in June 2008.

Any current PIP member that does not submit a new Security Profile by December 31, 2008, will have their membership in the program cancelled. Renewal applications will be given priority over new applications.

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Administrative Monetary Penalty System

The Canada Border Services Agency has recently announced changes to the Administrative Monetary Penalty System (AMPS). These changes are based on the Agency's review of the system, which began in 2005, and to concerns raised by importers, exporters, and service providers.

Recommendations aimed at enhancing the system include

- The number of contraventions be decreased by 50 percent or more by combining several contraventions into one where they present the same level of risk and are of a similar type
- Increase the clarity regarding what contraventions apply under certain circumstances
- Draft new backgrounders pertaining to the modified contraventions, in plain language
- Contraventions be assessed on the risk associated with the potential harm of non-compliance (e.g., health, safety, security, and prosperity)
- Streamline the appeals process
- Publish quarterly reports that analyze and report the penalties assessed under AMPS

One of the most significant recommendations is the CBSA's intention to seek legislative changes authorizing the application of penalties to third parties (e.g., customs brokers and other service providers). Under the current system, broker errors have resulted in penalty assessments against the importer that remain on the importer's compliance history, regardless of which party actually committed the error or paid the penalty.

Also, penalties for Advance Commercial Information (ACI) contraventions have been suspended until further notice.

The CBSA has recommended the establishment of a National Framework to review AMPS penalties. The intent is to achieve consistency and accuracy when reviewing AMPS penalties, regardless in which region the penalty was issued.

While it will take some time for these recommendations to be implemented, it is expected by the CBSA that some of these recommendations will become effective in 2008 and extending into 2009.

For more information on these issues, please contact a KPMG Trade and Customs professional.

Transfer Pricing: A Customs Perspective

From a tax perspective, customs valuation and transfer pricing (TP) have much in common but, more often than not, are in opposition. For many importers this may result in severe consequences.

When determining the transfer price for imported goods between related parties, the majority of importers in Canada determine their TP in accordance with Part XVI.1, Section 247 of the *Income Tax Act*.

Because the Canada Revenue Agency (CRA) and the Canada Border Services Agency (CBSA) enforce their respective statutes from different perspectives, this practice leaves importers exposed to CBSA valuation investigations and customs audits, often resulting in monetary penalties being assessed.

Both customs valuation and TP attempt to reach arm's-length values but, due to differing methodologies and standards, TP for tax purposes may not be suitable for customs purposes and vice versa. For instance, the CRA looks to assert adjustment when prices are too high and the CBSA looks to assert adjustment when prices are too low.

To help ensure compliance, it is imperative that importers make sure that their method for determining their transfer price for imported goods is in accordance with the CBSA regulations. Nevertheless, with proactive planning, it is possible to develop values that are acceptable to both the CRA and the CBSA.

As the CBSA and the CRA are both becoming increasingly aggressive in their valuation audits, importers should also be aware that the reassessment periods for the two agencies are not the same. The CBSA's reassessment period is four years, while the CRA's is seven years from the date of mailing of the original Notice of Assessment.

If you are uncertain your current valuation method meets the CBSA's standards, please contact one of KPMG's trade and customs professionals.

Importing Vehicles

People considering the purchase of a new vehicle outside Canada to be imported for use in Canada, should be aware of some valuation issues concerning this type of transaction.

A new or used vehicle or boat imported within 30 days of the date of delivery to the purchaser will, for customs purposes, be valued at the purchase price when determining the correct transaction value.

However, new vehicles imported after 30 days from the date of delivery to the purchaser, but before one year from the date of purchase, can be valued by deducting the depreciation allowance from the purchase price, in accordance with the customs regulations.

New vehicles that are not imported within one year from the date of purchase cannot deduct the depreciation allowance when determining the correct transaction value for customs purposes. Purchasers should consult a "neutral source," such as the *Canadian Automobile Red Book* to determine the correct transaction value.

The depreciation allowance is applicable to the purchase of new vehicles only and cannot be deducted from the purchase price of a used vehicle.

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US Customs and Border Protection Proposes Change in Valuation Rule

On January 24, 2008, US Customs and Border Protection (USCBP) posted a notice in the Federal Register that it is proposing to eliminate the First Sale Rule under the import valuation methodology. If adopted, this change will cause US importers to pay higher duties on dutiable goods, thereby making goods more expensive to US consumers and industries.

Revoking the First Sale Rule will eliminate the ability of importers to use the first sale price in a multi-sale transaction as the value for duty. Under current US customs law, transaction value is the primary method of appraising imported goods, and is defined as "the price actually paid or payable for merchandise when sold for exportation to the United States." The First Sale Rule provides that in a transaction involving a series of sales, the price actually paid or payable is the price paid in the first sale. Based on a non-binding commentary by the World Custom Organization's Technical Committee on Customs Valuation, USCBP is proposing a vertical shift upward from the "first sale" to the "last sale" as the basis for the valuing of imported goods. If adopted, this change will result in significantly higher duties on US imports. The proposed wording of transaction value is defined as, "the price paid in the last sale occurring prior to the introduction of the goods into the United States."

Thus, rather than valuing imported goods based on the price paid by an intermediary to the foreign manufacturer, importers would be required to value their goods based on the price paid by the US buyer to the intermediary. This "last sale" interpretation would more likely than not result in a higher valuation and therefore higher import duties for dutiable goods.

The reasons cited for the new interpretation are broad and far-reaching. The USCBP contends that its proposal would bring US law into conformity with the recent conclusion of the World Customs Organization's Technical Committee. In April 2007, the Technical Committee concluded that in a series-of-sales situation, transaction value is determined by the last sale rather than by the first sale.

The USCBP proposal would also no longer require the importer to confirm that the first sale was a *bona fide* arm's-length transaction, and that the merchandise was destined for the US. Finally, the new interpretation would also establish a transparent standard for determining transaction value that is easily applied and based on information available in the US.

The USCBP is soliciting public comments on the proposed new interpretation by April 23, 2008. It is expected that many US importers, trade associations, and customers will participate in the public comment process.

In the event that the proposal is adopted, US importers and buyers should revisit their sourcing options and consider restructuring import transactions to mitigate the involvement of intermediaries. The restructuring should close the gap between "last sale" and "first sale" prices. However, there may be restrictions on arm's-length transactions between related companies where a transfer-pricing arrangement exists. In these cases, an importer may consider alternative suppliers to identify more cost-effective global sourcing strategies through free trade agreements and other tariff preference programs.

For more information on this important issue or any other issue relating to trade and customs, please contact one of KPMG's trade professionals.

More Information?

For more information on the articles in this newsletter or any of the services mentioned, contact a KPMG Trade & Customs professional.

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