



Canadian indirect tax news

Global trade advisory update

December 4, 2019

In an era of increasing protectionism and a rise in the imposition of tariff measures globally, how are companies that engage in cross-border trade affected? Is the impact felt at the company's bottom line or at the level of compliance?

US Customs and Border Protection (US CBP) continues to focus on potential leakage of tariffs on shipments arriving from their closest trading partners, including Canadian exporters.

Now is the time to assess this new reality.

Contacts:

Doug Myrden

National Indirect Tax Leader
Tel: 416-601-6197

Quebec

Michel Lagrange

Tel: 514-393-7124

Eastern Region

Michael Matthews

Tel: 613-751-5310

Toronto

Danny Cisterna

Tel: 416-601-6362

Rising tariff measures

Since February 2018, there have been ongoing trade disputes between the United States and China that have resulted in the imposition of retaliatory tariffs on both sides. By December 15, 2019, almost all Chinese origin goods would have been, or will be, impacted by these trade tariffs that range from 10% to 30%, on top of normal rates of duty. The total value of US imports impacted by tariffs applied exclusively to Chinese goods will amount to approximately USD 550 billion.

Correspondingly, China has also imposed retaliatory tariffs on US-made goods, with tariffs ranging from 5% to 25%. The total value of Chinese imports impacted by tariffs applied exclusively to US goods will amount to approximately, USD 185 billion.

Further, as of October 18, 2019, in a World Trade Organization (WTO) case regarding illegal subsidies by the European Union in the aerospace industry, the WTO ruled that the United States is entitled to impose tariff countermeasures as the subsidies caused injury to the American aerospace industry. These retaliatory tariffs, which range from 10% to 25%, are applicable to specified European Union-origin goods in addition to the normal rate of duty.

Canadian companies should be aware that US CBP is targeting exports from Canada to the United States for potential applicability of tariffs on Chinese origin goods; this is particularly the case where some processing or assembly has been done in Canada but potentially not enough to create a change in origin of the inputs. There have been several US CBP-issued rulings addressing the appropriate test to be applied in assessing the "origin" of the finished goods that are imported into the United States for purposes of establishing whether the additional tariff measures should apply.

The same concern may apply to European Union-origin inputs that are imported into Canada for processing or assembly before exporting the finished good to the United States.

To mitigate risk and potentially avoid substantial unexpected costs in the future, it is important for Canadian companies to evaluate whether the particular inputs they have sourced from China or the European Union (or steel and aluminum inputs from other countries that continue to be impacted by US tariff measures on these goods) have met the applicable origin transformation rules.

Lisa Zajko

National Global Trade Advisory
Leader
Tel: 416-867-8534

Western Region

Andrew Azmudeh

Tel: 587-293-3258

Janice Roper

Tel: 604-640-3353

Related links:

[Canadian indirect tax news archive](#)

[Deloitte Tax Services](#)

Link between transfer price and customs value

In view of the increased tariff measures on goods imported into the United States, it is not surprising that companies are taking steps to mitigate the effects of the rising tariffs. One such strategy involves analyzing the customs value – the base on which the tariffs are calculated – for potential reduction opportunities (e.g., unbundling non-dutiable elements or implementing a “first-sale-for-export” strategy).

As many cross-border transactions involve flows between related parties, it should be remembered that the transfer price (and the relevant documentation) established for income tax purposes is not sufficient on its own to support that price as a base for customs valuation purposes. US CBP remains highly focused on examining related party transactions and the supporting documentation in place to ensure that the US importer exercised reasonable care in determining that the customs values reported meet the arm’s length standard under the customs requirements.

Contrary to the general position taken by the Canadian customs authorities, the US CBP does not accept transfer pricing documentation and analysis, by themselves, as a basis for customs value. Specific requirements, analysis and documentation should be conducted and maintained by an importer to support using the transfer price as a base for customs value (possibly with adjustments required). The most common way to support the transfer price as a basis for customs value is to examine the circumstances surrounding the sale, using particular factors and criteria enumerated by US CBP in various rulings, to conclude whether the pricing is acceptable as a base. The transfer pricing documentation provides helpful information, but additional testing or analysis and documentation would generally be required to support using a related party price as a base for customs valuation purposes.

Where US CBP rejects the customs value declared, the impact can be significant and may include the imposition of additional duties and penalties (which apply to both dutiable and non-dutiable goods). As well, significant administrative work to correct prior transactions and to plan for future transactions would be involved. Further, where a US importer undervalues imported goods for customs duties, there are special rules in the United States which may apply to decrease the cost basis of the inventory for income tax purposes (i.e., a partial disallowance of an income tax deduction may result, thereby causing increased taxable income and increased income tax in the United States).

Canadian companies engaged in trade with foreign related parties, and particularly those in the United States, should take the opportunity to review their current state of compliance relating to customs valuation, particularly where there are significant cross-border transactions potentially impacted by the increased tariff measures, and to consider opportunities for lowering the base upon which duties are applied.

CBSA trade compliance verification priorities

In addition to the increased enforcement by US CBP for US imports, the Canada Border Services Agency (CBSA) continues to be very active in conducting post-importation verifications of Canadian importers.

Twice a year, the CBSA publishes a listing of its trade verification priorities (i.e., audit priorities).¹ The CBSA identifies products as priorities through a risk-based assessment. While there are priorities that have remained on the list for a number of years (e.g., apparel and footwear), new ones are added as the CBSA identifies trends of non-compliance and areas where there may be a risk of revenue loss (e.g., tariff classification of parts of machines and mechanical appliances).

The CBSA has reported that trade compliance verifications have resulted in the identification of substantial non-compliance by Canadian importers. It is expected that the CBSA will continue this activity, and importers are advised to proactively review their state of compliance in anticipation of customs-initiated verifications.

Next steps

Deloitte's Global Trade Advisory team, residing under the umbrella of Indirect Tax, can help Canadian clients navigate their way through these tumultuous times. Our team can help clients assess the impact and mitigate the cost and risk, while ensuring that compliance obligations are maintained. We can also support clients in the duties recovery process if applicable.

If you have any questions on any of the above, please reach out to your Deloitte representative or any of the individuals noted on this newsletter.

Deloitte LLP
Bay Adelaide Centre, East Tower
8 Adelaide Street West, Suite 200
Toronto ON M5H 0A9
Canada

This publication is produced by Deloitte LLP as an information service to clients and friends of the firm, and is not intended to substitute for competent professional advice. No action should be initiated without consulting your professional advisors. Your use of this document is at your own risk.

Deloitte provides audit & assurance, consulting, financial advisory, risk advisory, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries and territories bringing world-class capabilities, insights and service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 264,000 professionals—9,400 of whom are based in Canada—make an impact that matters, please connect with us on LinkedIn, Twitter or Facebook.

¹ The CBSA's trade compliance verification priorities can be found at <https://www.cbsa-asfc.gc.ca/import/verification/menu-eng.html>.

Deloitte LLP, an Ontario limited liability partnership, is the Canadian member firm of Deloitte Touche Tohmatsu Limited. Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private companies limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Please note that Deloitte is prepared to provide accessible formats and communication supports upon request.

© Deloitte LLP and affiliated entities.

To no longer receive emails about this topic please send a return email to the sender with the word "Unsubscribe" in the subject line.