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International Trade



Fifteen years after the North American Free Trade Agreement (NAFTA) came into effect, merchandise trade among the NAFTA partners has more than tripled. The high level of integration of the NAFTA economies has increased competitiveness and provided companies in the three countries with better access to materials, technologies and financial and human capital. Given the stalled pace of multilateral trade negotiations, the NAFTA governments have aggressively expanded bilateral trade relations with many other countries. Canada has negotiated NAFTA-like bilateral agreements with several countries and is currently pursuing even broader integration with the European Union.

While integration provides enhanced opportunities, it also gives rise to a need to comply with the legal framework governing trade and customs in each country, and a need to understand the recourse available when investment and trade disputes arise.

1. Importation of Goods

a. Duties and Tax

In Canada, customs duties are levied on imported goods that are classified under the Schedule to the Customs Tariff in accordance with the harmonized system of customs classification. Duties represent the principal tax levied on goods imported into Canada. In addition to customs duties, imported goods and some services are subject to the federal Goods and Services Tax (GST). For more information on the GST, see Section E, “Taxation.”

While tariff classification is based on the harmonized system, goods may be classified differently in Canada than in other countries, which often raises the question of whether a product should undergo the necessary tariff shift to claim preferential treatment under a trade agreement such as NAFTA.

There are many special tariff items under the Customs Tariff that allow for duty relief, such as goods destined for particular end uses. Canada also has duty-relief programs for temporary importations, as well as duty drawbacks and deferrals.

b. Valuation

Classification of a product under the Customs Tariff provides the rate of duty, which is then applied to the value for duty to calculate the duty payable. Canada’s system of customs valuation is based on the WTO’s *Customs Valuation Code*, which has been implemented into Canada’s *Customs Act*.

Transaction value is the primary valuation method in respect of imported goods. It is the price actually paid or payable for the goods sold for export to a purchaser in Canada, subject to certain upward and downward adjustments.

Issues relating to transaction-value methodology often arise in related-party transactions, due to the requirement that the value for duty reflect an “arm’s-length” transaction. There is often a tension between transfer-pricing objectives from a tax perspective and a customs perspective. A balance must be achieved to establish a transfer price that satisfies customs while maximizing tax-planning objectives.

c. Rules of Origin

Preferential rates of duty are accorded to products that originate in a country with which Canada has a free trade agreement such as NAFTA. Whether a product “originates” so as to benefit from a trade agreement is determined by rules of origin, which may involve complex calculations and analysis of both the tariff classification and value of the components that make up an imported product.

d. Appeals

Tariff classification, valuation and origin issues may all be appealed at the first level internally with the Canada Border Services Agency (CBSA), and then to an independent tribunal, the Canadian International Trade Tribunal (CITT).

e. Import Restrictions

Canada maintains quantitative restrictions (tariff rate quotas) primarily on sensitive agricultural products under the authority of the *Export and Import Permits Act*, which authorizes an import control list. A permit must be obtained to import these products unless a permit exemption applies.

2. Anti-dumping and Countervailing Duties

The *Special Import Measures Act* (Canada) deals with dumping by foreign manufacturers/exporters, as well as subsidies received by foreign manufacturers. Dumping occurs when goods are sold for export at a price lower than that at which they are domestically sold in the country of origin under comparable conditions and terms of sale. The difference between the “normal” value and the export price is the margin of dumping. A

subsidy is a financial or other benefit that is granted by the administration of the country of origin to a manufacturer of exported goods. Subsidies may be subject to countervailing duties.

While the CBSA determines the amount of dumping or subsidy, Canada does not impose duties on the dumped or subsidized goods unless the CITT finds that the dumping or subsidization has caused or threatens to cause material injury to a domestic producer. In recent years, dumping and subsidy actions before the CITT have often resulted in success for foreign manufacturers.

3. Export Controls and Sanctions

a. Export Controls

Canada has a comprehensive regime for export controls and sanctions that is administered primarily by the Department of Foreign Affairs and International Trade (DFAIT), with enforcement assistance from the CBSA.

Three lists established under the authority of the *Export and Import Permits Act* govern exports of goods and technology from Canada to various destinations: the Export Control List, the Area Control List and the Automatic Firearms Country Control List. Under the Act, it is an offence to export or transfer goods or technology included on the Export Control List or to a destination on the Area Control List, except under the authority of a permit. Canada does not have a “licensing” system similar to the U.S., which makes it necessary for each exporter of a controlled good or technology to apply for a permit where one is required.

The Minister of Foreign Affairs has issued several general export permits (GEPs) that allow exports of controlled goods or technology to specific destinations without the requirement to apply for an exporter-specific permit.

In the absence of an applicable GEP, exporters must apply for an individual export permit (IEP) to export con-

trolled goods or technology, or to export to a controlled destination. DFAIT has recently added more categories of “broad base” permits that authorize multiple shipments to multiple destinations over a certain time period, particularly for cryptography exports, which has created significant compliance problems for Canadian exporters.

Detailed schedules to the Export Control List, which set out the specific goods and technology that are controlled, are included in the Government of Canada’s *A Guide to Canada’s Export Controls*, which is available online at www.international.gc.ca.

While Canada’s export control regime focuses on “export or transfer” versus “origin,” item 5400 of the Export Control List respects the United States’ controls on the re-export of U.S.-origin goods by requiring a permit to export U.S.-origin goods and technology from Canada. DFAIT usually considers a good to be of U.S. origin if it contains greater than 50 per cent U.S. content. General Export Permit No. 12 allows the export or transfer of U.S.-origin goods/technology without an individual export permit, except to Cuba, North Korea, Iran, Syria or any destination on Canada’s Area Control List.

Export permits are not required for most controlled goods or technology destined to a final consignee in the U.S. Those items that do require an export permit to the U.S. are identified on the Export Control List by virtue of a statement indicating that the control applies to “all destinations.”

No goods or technology may be exported or transferred from Canada to a country on the Area Control List without an individual export permit. The countries currently listed include Belarus, North Korea and Myanmar.

A number of specific export controls are imposed by legislation administered by government departments other than DFAIT. These controlled products include wheat and barley, certain cultural property, rough diamonds, endangered species, ozone-depleting substances, hazardous waste and certain wild plants and animals.

b. Sanctions

Canada has two main statutes that authorize the imposition of trade and economic sanctions: the *United Nations Act* and the *Special Export Measures Act*. In addition to export controls, regulations passed pursuant to these Acts impose various other measures such as limitations on official and diplomatic contacts, restrictions on economic activity between Canada and states that are the targets of sanctions, and the seizure or freezing of property situated in Canada. Export controls are normally limited to arms and related material and technical assistance, but may be broader for a particular state.

4. Investor-State Disputes

Canada is party to a number of trade and investment agreements that permit an investor of a foreign country to bring a claim against the Canadian government for a breach of an obligation owed to the investor under the treaty, by either the federal government or a province.

The investor-state provisions of NAFTA have given rise to a number of claims brought against Canada. Obligations owed to investors under Canada's investment treaties include the requirement to accord national treatment and a minimum standard of treatment; the prohibition against the adoption of certain performance requirements (e.g., domestic content requirements); and the commitment to pay compensation for expropriation.

5. Canada's Blocking Legislation: *The Foreign Extraterritorial Measures Act*

The *Foreign Extraterritorial Measures Act* (FEMA) provides for the enactment of orders to prevent compliance by Canadian companies with extraterritorial measures of other countries.

There is currently only one order in force under the Act: the Foreign Extraterritorial Measures (United States) Order. This order creates a dangerous "catch-22" for related Canadian and American companies by prohibiting a Canadian company from complying with American extraterritorial measures restricting trade between Canada and Cuba. If the company complies with U.S. law, it faces serious sanctions under FEMA. On the other hand, if it does not comply with U.S. law, it may face serious sanctions under the U.S. laws that prohibit trade with Cuba. The FEMA order also imposes an obligation on Canadian companies to "report" communications received that relate to an extraterritorial measure of the U.S. pertaining to Cuba, and imposes strict penalties for non-compliance to this obligation.

FEMA issues often arise in the context of mergers between Canadian and American companies where the Canadian companies have existing Cuban businesses.

6. Proactive Trade Compliance

Failure to comply with the numerous laws and regulations that govern trade with Canada can result in serious penalties and prosecution, as well as disruptions in business operations. It is important for companies intending to do business in Canada to retain experienced trade counsel, both to ensure compliance and to identify strategies that enhance the ability to operate competitively in the Canadian market.

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