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DIRECT SALES TO CANADA, BUSINESS RISK, AND GETTING PAID IN CANADA

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INDEX

PART I

DIRECT SALES TO CANADA: ADVISING CLIENTS ON THE ISSUES COMING ACROSS THEIR DESKS

1. Doing Business in Canada – Taxation Matters

In Canada, taxes are levied by three levels of government: federal, provincial and municipal. The federal government relies on income taxes, the goods and services tax, excise tax and customs duty to generate most of its revenue, while the provincial governments rely for the most part upon income and sales taxes.

(a) Income Tax

Generally speaking, persons (both individual and corporate) who are resident in Canada are liable for tax on their worldwide income. Non-residents are taxed if they are employed in Canada, carry on business in Canada or dispose of certain types of Canadian property ("taxable Canadian property"). Non-residents are also subject to Canadian withholding tax on various types of property income earned in Canada (discussed in greater detail below).

(i) Taxation of Corporate Entities

Under the Canadian *Income Tax Act* (the "ITA")[1], the taxation of a corporation varies depending on the type of corporation, its residence, the activities carried on by the corporation in Canada and the nature of the income earned by the corporation.

(ii) Corporations Resident in Canada

Generally, a corporation will be considered to be a resident of Canada, and therefore liable for tax in Canada on its worldwide income, if it is incorporated in Canada, or if its "central management and control" resides in Canada. Usually, management and control exists where the members of the board of directors hold their meetings.[2] If, however, the board of directors does not exercise its powers, and management and control of the corporation is actually exercised by

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1 *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1.

2 See *Debeers Consolidated Mines Ltd. v. Howe*, [1906] A.C. 455.

some other party (such as the directors of a parent company, who are resident in another country), the company will, at common law, be considered a resident of that other country.[3]

(iii) Non-Resident Corporations "Carrying on Business" in Canada

Unless exempted by a tax treaty, a non-resident corporation will generally be subject to Canadian income tax on income from a business "carried on" (either in whole or in part) in Canada, through a branch in Canada, or otherwise.

A corporation that is not resident in Canada will be considered to be "carrying on business" in Canada if it solicits orders or offers anything for sale in Canada through an agent or servant, irrespective of whether the contract or transaction is to be completed inside or outside Canada or partly inside and partly outside Canada.

A non-resident corporation will also be considered to be "carrying on business" in Canada if the corporation (or its agent) produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada, whether or not it is exported from Canada prior to its sale.[4]

(iv) Relief under Canada's Bi-lateral Tax Treaties

Where a non-resident corporation is a tax resident of a jurisdiction with which Canada has a bilateral tax treaty (e.g., the United States), the business income of the non-resident corporation is subject to Canadian income tax only to the extent that such income is attributable to a Canadian "permanent establishment", as that term is defined in the relevant tax treaty.[5]

Under Canada's tax treaties, a permanent establishment is generally a fixed place of business through which the non-resident carries on business, and includes a branch, office, factory or

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[3] See *Unit Construction Co. Ltd. v. Bullock*, [1060] A.C. 351.

[4] See *Supra* note 1, s. 253, which significantly extends the meaning of the phrase "carrying on business" beyond its common law definition.

[5] For example, *Canada-United States Income Tax Convention*, 26 September 1980, Can. T.S. 1984 No. 15 (entered into force 16 August 1984), Art. VII(1) provides as follows:

> The business profits of a resident of a Contracting State shall be taxable only in that State unless the resident carries on business in the other Contracting State through a permanent establishment situated therein. If the resident carries on, or has carried on, business as aforesaid, the business profits of the resident may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

workshop. It also includes a person (other than an independent agent acting in the ordinary course of its business) acting in Canada on behalf of the non-resident person who has an habitually exercises the authority to conclude contracts on behalf of the non-resident. Thus a representative in Canada who does not have authority to contract on behalf of the non-resident corporation would not constitute a permanent establishment.

Additionally, Canada's tax treaties generally provide that a fixed place of business, in and of itself, will not be considered a permanent establishment if it is used solely for one or more of the following activities:

(a) the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the non-resident;

(b) the maintenance of a stock of goods or merchandise belonging to the non-resident for the purposes of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the non-resident for the purpose of processing by another person;

(d) the purchase of goods or merchandise, or the collection of information, for the non-resident; or

(e) advertising, the supply of information, scientific research or similar activities which have a preparatory or auxiliary character for the non-resident.[6]

(v) U.S. Limited Liability Companies

It is important to note that tax treaty exemptions are generally available only to persons who are residents of another country with which Canada has a bilateral tax treaty. In this regard, Canadian courts and the Canada Revenue Agency ("CRA") generally require the foreign entity to be subject to income tax in its home country on the same basis as other residents of that country in order to qualify for treaty relief. Accordingly, the CRA has indicated that U.S. Limited Liability Companies ("LLC") do not qualify for treaty relief since, under the *U.S.*

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[6] *Ibid.*, Arts. V(6) - (7), which exclude certain types of activities from the definition of "permanent establishment" for the purposes of the treaty.

Internal Revenue Code, it is the members of the LLC who pay US tax, as opposed to the LLC itself. Accordingly, an LLC will be taxable in Canada if it carries on business in Canada, even if it does not have a permanent establishment in Canada.

(vi) Canadian Corporate Tax Rates

For corporations subject to Canadian income tax (e.g., corporations resident in Canada, and non-resident corporations carrying on business in Canada through a permanent establishment in Canada), the rate of Canadian income tax payable by the corporation is a function of the applicable federal and provincial income tax rates.

The basic federal rate of tax for non-manufacturing corporations is 21%, which is applied to the taxable income (i.e., profit) of the corporation.[7] In addition to basic federal tax, a 4% surcharge is applied, resulting in an additional tax of 1.12% for a combined federal tax rate of 22.12%.

A corporation will be liable for provincial tax in any province in which it has a permanent establishment. In this regard, consideration should also be given to the permanent establishment rules of the provinces in which the non-resident intends to carry on business, as provincial rules are not always consistent with Canada's tax treaties. If a corporation has a permanent establishment in more than one province, its income is allocated among the relevant provinces for the purposes of provincial taxation. Special rules exist in each province's legislation that allocate tax liability amongst the provinces based on gross revenue and salaries and wages attributable to each of the permanent establishments.

The combined 2005 federal and provincial corporate income tax rates for non-manufacturing income of a corporation which is not a Canadian-controlled private corporation are as follows:

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[7] Under section 123 of the ITA, a federal tax rate of 38% is applicable, *supra* note 1, s. 123; however, a 10% provincial abatement is provided for in section 124 of the ITA for corporations earning taxable income in a province, *supra* note 1, s. 124.

Province/Territory	%	
Alberta		33.6
British Columbia		35.6
Manitoba		37.1
New Brunswick		35.1
Newfoundland and Labrador		36.1
Northwest Territories		36.1
Nova Scotia		38.1
Nunavut		34.1
Ontario		36.1
Prince Edward Island		38.1
Quebec	Active Business: Investment	31.0 38.4
Saskatchewan		39.1
Yukon		37.1

Income from Canadian-based manufacturing is generally taxed at somewhat lower rates.

(vii) Capitalizing a Canadian Business

Once a decision is made to establish a business in Canada, the capitalization of the business and associated tax costs must be considered. Generally, interest expense is deductible by a business if the borrowed funds are reasonable and are used for the purpose of earning income from the business or property. However, where a non-resident lender does not deal at arm's length with the Canadian corporate debtor or owns more than 25% of the shares of the Canadian corporate debtor, the "thin capitalization" rules in section 18(4) of the ITA will apply.[8] In general terms, these rules restrict the amount of interest which is deductible by a Canadian corporation on debt

[8] *Supra* note 1, s. 18(4).

owed to a non-resident lender who is either a 25% shareholder of the corporation or a person related to such a shareholder. The maximum debt to equity ratio for this purpose is 2:1.[9]

Where a Canadian business borrows money from a non-resident lender, the interest that is paid to the non-resident will be subject to a withholding tax of 25% under the ITA.[10] In most cases, the applicable tax treaty will reduce this withholding rate to 10%. However, where a Canadian resident corporation borrows money from an arm's length non-resident lender and not more than 25% of the principal is repayable within 5 years (except in the event of a default which is commercially reasonable and beyond the control of the lender), the ITA exempts the interest from withholding tax.

(viii) Withholding Taxes on Payments to Non-Residents

The ITA imposes a 25% withholding tax on certain payments (including, for example, dividends, management fees, interest and royalties) made to non-residents by persons resident in Canada.[11] Under Canada's various tax treaties, the rate of withholding tax is often reduced, provided that the non-resident recipient of the payment qualifies for treaty relief.

Dividends paid by the Canadian subsidiary to a non-resident shareholder will be subject to non-resident withholding tax. If the shareholder is resident in a country with which Canada does not have a tax treaty, the withholding tax rate is 25%. Under most of Canada's tax treaties, the withholding rate is reduced to 15%. Under the *Canada-United States Income Tax Convention*, where the non-resident shareholder is a US resident corporation that owns at least 10% of the voting stock of the Canadian subsidiary, the withholding tax rate is reduced to 5%.

It is common for non-resident corporations to charge management and administration fees to their Canadian subsidiaries. The non-resident corporation's head office will often provide services to the Canadian subsidiary in areas such as accounting, data processing, tax, legal, treasury, human resources, marketing, management, technical systems, etc. It is often more cost

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[9] For the purposes of determining the debt-to-equity ratio, equity will include the paid-up capital of the Canadian corporation as well as retained earnings and other surplus accounts. Only interest-bearing debt held by non-resident shareholders holding 25% or more of the shares of any class of the capital stock of the Canadian corporation, or their affiliates, is included in calculating debt.

[10] *Supra* note 1, s. 212.

[11] *Supra* note 1, s. 212.

effective for the head office to provide these types of services than for each subsidiary to have separate staff and resources in these areas.

Subject to two exceptions, management fees paid or credited to a non-resident will be subject to non-resident withholding tax.[12] The first exception applies with respect to management services provided to an arm's length non-resident. The second exception applies for payments that reimburse a non-resident for specific expenses incurred on behalf of the resident payor. Specific expenses are considered to include rent, power, hear, salaries, fringe benefits and other such business expenses, but do not include depreciation, capital costs, reserves or unvouchered amounts.[13]

Additionally, the CRA takes the position that management fees paid by a resident of Canada to a resident of a country with which Canada has a tax treaty will not be subject to withholding tax, provided that the treaty in question either: (a) does not contain a specific article on management or administration fees; or (b) does contain such an article but the fees are effectively connected with a permanent establishment in Canada of the non-resident.[14] Accordingly, under Article VII of the *Canada-United States Income Tax Convention*, management fees paid by a resident of Canada to a U.S. resident will only be subject to withholding tax in Canada if the U.S. resident earns the fees through a permanent establishment in Canada.

Under section 212(1)(d) of the ITA, payments made by residents of Canada to non-residents in respect of rents, royalties, and similar payments, including payments for the right to use in Canada any "property, invention, trademark, design or model, plan, secret formula, process, trade name, patent or other thing whatever" are subject to the 25% withholding tax. Payments made to non-residents for "information concerning industrial, commercial or scientific experience" (commonly referred to as "know-how") will also be subject to withholding tax where the total amount payable as consideration for such information is dependent in whole or in

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[12] *Supra* note 1, s. 212(4).

[13] Canada Revenue Agency, Interpretation Bulletin IT-468R, "Management or Administration Fees Paid to Non-Residents" (29 December 1989) at paras. 7, 8.

[14] *Ibid*. at para. 3.

part upon: (a) the use to be made thereof or the benefit to be derived therefrom; (b) production or sales of goods or services; or (c) profits.[15]

Under Article XII of the *Canada-United States Income Tax Convention*, the withholding rate in respect of rents, royalties and similar payments is reduced to 10%.[16] Additionally, the following types of payments are excluded from withholding requirements: (a) copyright royalties in respect of artistic work; (b) payments for the right to use computer software; and (c) payments for the right to use any patent or any information concerning industrial, commercial or scientific experience (i.e., payments for the right to use "know-how").

Under paragraph 212(1)(b), interest payments from a Canadian resident payor to a non-arm's length non-resident payee are also subject to withholding tax at a rate of 25%.[17] Under the *Canada-United States Income Tax Convention*, the rate of withholding on interest payments is reduced to 10%.

(ix) Transfer Pricing Considerations

The ITA contains detailed rules about transfer pricing. Transfer prices are prices at which services, tangible property, and intangible property are traded across international borders between related parties. If a transfer price paid by a U.S. parent to its Canadian subsidiary is greater than the amount that would have been reasonable in the circumstances if the parties had been dealing at arm's length, the CRA has the authority to adjust the price accordingly. Additionally, a 10% penalty may be issued in situations where the transfer price is overstated by more than 10% (or $5,000,000 per year) and reasonable efforts were not made to arrive at an arm's length price.[18]

To satisfy the "reasonable efforts" requirement, section 247(4)[19] of the ITA requires certain documentary requirements to be met:

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15 *Supra* note 1, ss. 212(1)(d)(i) - (ii).

16 *Supra* note 5, Art. XII.

17 *Supra* note 1, s. 212(1)(b).

18 Canada Revenue Agency, Information Circular IC 87-2R, "International Transfer Pricing" (27 September 1999), which sets out Canada's transfer pricing policy.

19 *Supra* note 1, s. 247(4).

> 247(4) For the purposes of subsection (3) and the definition "qualifying cost contribution arrangement", in subsection (1), a taxpayer or a partnership is deemed not to have made reasonable efforts to determine and use arm's length transfer prices or arm's length allocations in respect of a transaction or not to have participated in a transaction that is a qualifying cost contribution arrangement, unless the taxpayer or the partnership, as the case may be,
>
> (a) makes or obtains, on or before the taxpayer's or partnership's documentation-due date for the taxation year or fiscal period, as the case may be, in which the transaction is entered into, records or documents that provide a description that is complete and accurate in all material respects of
>
> (i) the property or services to which the transaction relates,
>
> (ii) the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction,
>
> (iii) the identity of the participants in the transaction and their relationship to each other at the time of the transaction was entered into,
>
> (iv) the functions performed, the property used or contributed and the risks assumed, in respect of the transaction, by the participants in the transaction,
>
> (v) the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contribution to costs, as the case may be, in respect of the transaction, and
>
> (vi) the assumptions, strategies and policies, if any, that influenced the determination of the transfer prices or the allocation of profits or losses or contributions to costs, as the case may be, in respect of the transaction;
>
> …

No additional penalties will apply to the extent that these requirements are satisfied, however, the transfer price may still be adjusted.

(b) Customs Duty and Importation of Goods into Canada

Importers of goods into Canada must account for the value, classification and origin of such goods at the time of importation. The amount of duties payable on the importation of goods will vary depending on these factors.

(i) Tariff Classification

Every good imported into Canada must be classified under one of the tariff classification numbers set out in Chapters 1 to 97 of the Canadian *Customs Tariff*. Some goods may also fall within certain special classification provisions in Chapters 98 and 99 of the *Customs Tariff*.

These provisions reduce or eliminate duty otherwise payable for qualifying goods under specific conditions.[20]

(ii) Value for Duty

The value for duty of goods (in Canadian dollars) must be declared upon entry of the goods into Canada. Value for duty is determined in accordance with the World Trade Organization Valuation Agreement, the provisions of which are codified in sections 47 to 53 the Canadian *Customs Act*.[21]

The primary basis for the appraisal of goods under the *Customs Act* is the transaction value of the goods, which is the price paid or payable for goods sold for export to Canada to a purchaser in Canada. In arriving at the transaction value, the price paid or payable for the goods is adjusted by adding in and subtracting out certain amounts, as set out in section 48(5) of the *Customs Act*.

There are several legislative requirements that must be met in order to apply the transaction value method:

(a) the imported goods must "sold for export to Canada";

(b) the purchaser must be a "purchaser in Canada"; and

(c) the price paid or payable for the goods can be determined.

Generally speaking, the Canada Border Services Agency ("CBSA") considers the term "sale" to mean the transfer of the property in the goods (i.e., title) from one independent entity to another independent entity for a money consideration. Additionally, it must be a condition of the sale agreement between the vendor and the purchaser that the goods be sold "for export to Canada". [22]

"Purchaser in Canada" is defined in the *Valuation for Duty Regulations* to include a resident of Canada or a person who is not a resident but who has a permanent establishment in Canada. A "purchaser in Canada" also includes a person who is neither a resident nor has a permanent

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[20] *Customs Tariff* S.C., 1997, c. 36.

[21] *Customs Act*, R.S.C. 1985 (2nd Supp.), c. 1, ss. 47 – 53.

[22] Canada Border Services Agency, Memorandum D13-4-1, ""Transaction Value" Method of Valuation (Customs Act, Section 48)" (17 April 2001).

establishment in Canada and who imports goods: (a) for consumption, use or enjoyment by the person in Canada, but not for sale; or (b) for sale by the person in Canada, provided that, before the purchase of the goods, the person has not entered into an agreement to sell the goods to a resident (i.e., where an inventory of goods is maintained in Canada).[23]

In order to qualify as "resident" in Canada under the *Valuation for Duty Regulations*, a corporation must be carrying on business in Canada *and* the management and control of the business entity must be maintained in Canada. The mere fact that a business entity is incorporated in Canada is not sufficient to meet the residency definition. In this regard, the CBSA takes the view that "carrying on business" in Canada requires, among other things, that the Canadian employees of the business to have the general authority to contract on behalf of the business without the approval of anyone outside Canada.

"Permanent establishment" is defined to mean a fixed place of business, including a place of management, an office or a factory through which the person carries on business.[24]

Where the transaction value method of valuation cannot be used, the *Customs Act* provides for five alternative methods of valuation (transaction value of identical goods, transaction value of similar goods, deductive value, computed value and residual value), which must be considered sequentially until an applicable method of valuation is determined.[25]

Generally speaking, the value for duty must reflect, as accurately as possible, the price at which the goods would be sold in an arm's length, cross-border transaction to a third party in Canada. Accordingly, the value for duty is usually different from the book value of the goods.

(iii) Origin and Tariff Treatment

The origin of the goods must also be declared by the importer at the time of importation. Depending on the country of origin, some goods may be eligible for preferential tariff treatment, which may reduce or eliminate the duty otherwise payable. For example, if goods are wholly

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[23] *Value for Duty Regulations*, S.O.R./86-792, s. 2.1.

[24] *Ibid.*, s. 2.

[25] *Supra* note 22, ss. 49 - 51.

produced in the United States, they will likely qualify for preferential tariff treatment under the North American Free Trade Agreement ("NAFTA").[26]

Once the classification number and tariff treatment are determined, the applicable duty rate can also be determined under the *Customs Tariff*. The amount of duty payable upon importation of the goods into Canada may then be calculated by multiplying the applicable duty rate by the value for duty.

(iv) Temporary Importations – Tariff Classification Number 9993.00.00

Goods that are otherwise dutieable may qualify for duty-free entry under the special classification provisions of Chapter 99 of the *Customs Tariff*, which exempts temporary importations. Generally, all goods imported into Canada on a temporary basis, so long as they are not being imported for sale, lease, further manufacturing or processing, will qualify for duty-free entry under tariff classification number 9993.00.00.

With the exception of goods that are controlled, restricted or prohibited from importation into Canada, there are no restrictions on the types or kinds of goods that may be imported temporarily into Canada or the use to which they may be put. However, at the time of importation the importer must specify how the goods will be used while in Canada.

Goods eligible for temporary importation are typically documented on a *Temporary Admission Permit* in Form E29B, which must be presented to the CBSA, along with the goods, at the time the goods are imported into Canada and, again, when they are exported out of Canada.

To ensure that the goods being imported temporarily will subsequently be exported from Canada, the CBSA may require the importer to provide a security deposit. The amount of security required will not exceed the duties (including Goods and Services Tax ("GST")) that would otherwise be payable on permanent importation.

Goods imported temporarily under tariff classification number 9993.00.00 may remain in Canada for up to 18 months, or for any other period prescribed by regulation for those goods.

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[26] *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can. T.S. 1994 No. 2, 32 I.L.M. 289 (entered into force 1 January 1994) [*NAFTA*].

The importer must identify the period of time the goods are expected to remain in Canada and enter an expiry date on the Form E29B. If the goods cannot be exported before the date identified on the Form E29B, the importer may apply to the CBSA for an extension.

(v) Importing by Post – Postal Importations Valued At Less Than $20

Where the value for duty of goods imported into Canada by mail is less than $20 (CAD) per item, the goods are generally exempt from GST and granted remission of any customs duties otherwise payable.

(vi) Importing by Post – Postal Importations Valued At Less Than $1,600

Where the value for duty of goods imported into Canada by mail is more than $20 (CAD) but less than $1,600 (CAD) per item, Canada Post will generally deliver the goods to their Canadian destination.

The exporter of the goods is responsible for accurately reporting the value for duty and providing a description of mailed goods. Where duties and/or taxes are payable, Canada Post will complete a Form E14, *Customs Postal Import Form*, which they will then affix to the package for delivery to the addressee.

The Form E14 sets out the tariff classification, the duty rate, the value for duty, and the total duties and taxes owing on the imported goods. Canada Post also charges a $5 processing fee ($8 for priority post) on postal importations where duties and taxes are payable. In general, the goods are not released to the addressee until the duties, taxes and the processing fee (if any) are paid. Customarily, Canada Post will look to the addressee, and not the importer of record, for payment prior to release.

(vii) Postal Importations Valued at $1,600 or More

In the case of commercial importations valued at $1,600 (CAD) or more, the addressee will be advised that a mail shipment has arrived. The addressee will then be required to submit accounting and release documentation, together with payment of any duties, taxes due and processing fees due, before the goods will be released by the CBSA.

(viii) Importing by Courier – Courier Importations Valued at Less than $20

Where the value for duty of goods imported into Canada by courier is less than $20 (CAD) per item, the goods are generally exempt from GST and granted remission of any customs duties otherwise payable.

(ix) Importing by Courier – Courier Importations Valued at Less Than $1,600

Many international couriers who transport large volumes of low-value goods (i.e., goods with a value for duty of less than $1,600 (CAD) participate in the CBSA Courier/Low-Value Shipment ("LVS") program.

Couriered goods that have not been selected by the CBSA for examination are instantly released upon arrival into Canada if the following conditions are satisfied:

- the goods have an estimated value for duty of less than $1,600 and are not prohibited, controlled or otherwise regulated;
- the courier has a written undertaking from the importer that authorizes delivery after release of the goods under the LVS program; and
- security is posted.

Where the goods are eligible for temporary importation under tariff classification number 9993.00.00 (discussed above), a Form E29B *Temporary Admission Permit* should also be presented with the goods upon arrival into Canada.

Low value commercial goods released under the LVS program must be accounted for by the importer on a monthly consolidated Form B3, *Canada Customs Coding Form.* Accounting documentation is due by the 24th day of the month following the month in which the goods are released, with the payment of any duties and taxes due by the end of that month.

If low value shipments imported for temporary use are released under the LVS program without the presentation of Form E29B and are subsequently exported, proof that the goods were imported for temporary use, as well as proof of export must be kept at the importer's (or broker's) premises for future compliance verification. In such a case, the export documentation replaces the requirement for Form E29B accounting.

(x) Importing by Courier – Courier Importations Valued at More Than $1,600

Shipments of goods valued at more than $1,600 (CAD) by courier must be fully accounted for at the time of entry into Canada, and any duties and/or taxes owing must be paid before the goods will be released by the CBSA.

Alternatively, at the importer's request, the CBSA may fast-track the release of goods valued at more than $1,600 on minimum documentation if security is posted. Where goods are released on minimum documentation, the importer is required to submit a full and final accounting package to the CBSA no later than 5 business days after release of the goods. The CBSA will then issue an invoice to the importer for any duties and taxes owing.

Where the goods are eligible for temporary importation under tariff classification number 9993.00.00 (discussed above), a Form E29B *Temporary Admission Permit* must be presented with the goods upon arrival into Canada.

(c) Goods and Services Tax and Provincial Sales Tax

(i) GST

The GST is a federal value-added tax levied at the rate of 7% on "taxable supplies" of most goods and services in Canada. The general concept is that GST is only a net tax liability for the ultimate consumer of a good or service. In other words, most businesses in Canada that sell goods or services subject to GST are eligible to claim "input tax credits" for the GST paid to their suppliers. Accordingly, for a business that is fully eligible for input tax credits, the GST does not result in a net tax liability, but is only an issue of cash flow and reporting. A business must be registered for GST to claim input tax credits.

Under the GST, registered suppliers of taxable goods and services are generally required to collect the tax from their purchasers at the time of sale. Purchasers are legally required to pay the tax, and suppliers are required collect the tax as agents of the federal government, to whom the tax is remitted.

Generally, a business with in excess of $30,000 in annual taxable sales is required to register and collect GST. A non-resident carrying on business through a Canadian branch will be required to register and collect GST on its taxable supplies. Although a non-resident carrying on business

without a Canadian permanent establishment is generally exempted by tax treaty from Canadian income tax, the non-resident may still have to register for and collect GST. It is important to note that the meaning of "carrying on business in Canada" for GST purposes is significantly broader than it is for income tax purposes.

In addition to taxable supplies of goods and services made in Canada, the CBSA also collects GST on "taxable supplies" of goods imported into Canada. Such goods are taxed at a rate of 7% of the value of the goods as determined under the *Customs Act* (and on duty actually paid) from the importer of record. As a generally rule, the importer of record will recover the GST paid on importation of the goods by claiming an input tax credit, provided that the importer is registered.

(ii) PST

Provincial sales tax ("PST") is also payable in most provinces in respect of goods and, in some cases, services. PST differs from GST in that, generally speaking, PST is payable only by the final consumer of the goods. Goods purchased for resale are not generally subject to PST.

Newfoundland, New Brunswick and Nova Scotia have entered into an agreement with the Canadian federal government so that their PST operates in the same manner and under the same regime as GST. In these provinces, the combined GST and PST is known as the Harmonized Sales Tax ("HST"). HST applies at a rate of 15%.

The Province of Quebec also has a separate sales tax called the QST. The QST essentially operates in the same manner as GST, and applies at a rate of 7.5%. The combined GST and QST rate in Quebec is 15.025%.

Ontario, British Columbia, Prince Edward Island, Manitoba and Saskatchewan impose PST on the end users of most tangible personal property and software. A person making regular sales subject to PST in these provinces will typically be required to register under the relevant provincial legislation and collect PST from purchasers. Rates vary across the provinces from approximately 7% to 10%.

(d) Carrying on Business in Canada: Representative, Branch or Subsidiary?

If a non-resident does not wish to restrict its business activity in Canada so as not to have a permanent establishment in Canada as discussed above, the non-resident must decide whether to carry on business in Canada through a branch operation or incorporate a Canadian subsidiary.

(i) Canadian Branch Operations

A non-resident that operates a Canadian branch business will be carrying on business in Canada for the purposes of the ITA and will have a permanent establishment for the purposes of any relevant tax treaty. Accordingly, the non-resident corporation operating the branch will be subject to Canadian tax on its income from business carried on in Canada attributable to the branch.

The main advantage of using a branch operation to carry on business in Canada is that the losses of a Canadian branch may often be deducted by the foreign corporation in its home jurisdiction against its income from other sources. Of course, this will depend on the tax laws of the jurisdiction of the foreign corporation. Where losses of a Canadian subsidiary would not be deductible by the foreign and losses are anticipated, the use of a branch can be advantageous.

In addition to corporate tax at the rates shown above, a branch will also be subject to branch tax under the ITA. Branch tax is levied on the after-tax income of the corporation, reduced by an investment allowance reflecting the retention of business assets and retained earnings in Canada. Generally, the branch tax rate is the same as the withholding tax rate for dividends paid by a wholly-owned Canadian subsidiary under the relevant tax treaty (typically, 5% - 15%). If Canada does not have a tax treaty with the foreign corporation's home jurisdiction, then the branch tax rate will be 25%. The ITA provides an exemption from branch tax for certain limited types of business, such as certain transportation, mining and communications companies. Additionally, the *Canada – United States Income Tax Convention* provides for a lifetime exemption for the first $500,000 (CAD) of income otherwise subject to branch tax.

One potential drawback of branch tax is that it is applied on a yearly basis, whereas withholding tax on profits repatriated to a foreign corporation from a Canadian subsidiary via dividends is payable only when such dividends are actually paid.

If a non-resident uses a branch in Canada, its customers will be dealing with an entity that is a non-resident of Canada. As a result, section 105 of the *Income Tax Regulations* require Canadian customers to withhold and remit to the CRA 15% from payments for services rendered by the non-resident in Canada, whether through the branch or otherwise.[27] The withholding requirement also theoretically extends to non-Canadian customers. This withholding is on account of, and will be applied by the CRA against, the non-resident's Canadian income tax and branch tax liability.

Where a Canadian branch operation receives passive income, such as rents, royalties or interest, the payor will be required to withhold and remit to CRA non-resident withholding tax, unless the income is reasonably attributable to the business of the branch, in which case it will be exempted from withholding tax under the *Income Tax Regulations*. To preclude withholding, the non-resident must first obtain a waiver from the CRA. The waiver is available where the CRA is satisfied that income potentially subject to non-resident withholding tax is reasonably attributable to the business of the Canadian branch.

(ii) Canadian Subsidiary Corporations

As with any other Canadian corporation, a Canadian subsidiary will be resident in Canada for tax purposes and will therefore be subject to tax on its worldwide income. The corporate tax rates described above will apply to the subsidiary.

Establishing a Canadian subsidiary as an Alberta or Nova Scotia unlimited liability company ("ULC") is often considered by U.S. corporations. A Canadian subsidiary that is a ULC can be attractive from a U.S. tax perspective because the ULC may be treated as a partnership or disregarded entity rather than a corporation for U.S. tax purposes. As a result, the ULC allows for a flow through of income, deductions, gains and losses to the U.S. parent for U.S. tax purposes. For Canadian tax purposes, an NSUCL is not a flow through entity. Rather, it is considered to be a corporation resident in Canada and is liable for tax in Canada on its worldwide income. The ULC therefore has the US tax advantages of a branch without the Canadian tax disadvantages of a branch.

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[27] *Income Tax Regulations*, C.R.C., c.945, s. 105.

A disadvantage of the ULC is the lack of limited liability protection for its shareholders. This can be addressed by establishing a limited partnership under the ULC to carry on the business or as the shareholder of the ULC. Another approach is for the shareholder of the ULC to be a sole purpose U.S. corporation.

2. North America Free Trade Agreement Issues

The implementation of NAFTA[28] is linked to strong economic growth and dynamic trade within Canada, the United States and Mexico. This has contributed to, for example, strong retail trade figures. In 2004 Canadian store retailers reported operating revenues of $370.7 billion; a raise of 4.2% from 2003.[29] Most of Canada's merchandise trade is with the United States.[30] Canada imported over $409.1 billion in goods and services in 2003. Almost $2 billion in goods and services cross the Canada - U.S. border every day.[31] Since NAFTA was implemented, trade within North America has increased over 97%.[32]

An understanding of how NAFTA works requires an understanding of tariff treatments under Canadian customs law. Canada is bound to two major inter-related trade agreements, namely the WTO Agreement[33] and NAFTA. The WTO agreement on rules of origin ("Rules of Origin Agreement") sets out the basic rules with respect to the application of preferential rules of origin.

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28 *North American Free Trade Agreement Implementation Act*, S.C. 1993, c.44.

29 Statistics Canada "Annual Retail Trade 2004" *IE Today* (27 March 2006), online: I.E. Canada <http://www.iecanada.com>.

30 I.E. Canada, *Importing into Canada*, (Toronto: I.E., Canada, Canadian Association of Importers and Exporters Inc., 2005) at 7.

31 *Ibid*.

32 International Trade Canada, "NAFTA Works Brochure," online: International Trade Canada <www.dfait-maeci.gc.ca\nafta-alena\broch-main-en.asp>.

33 Marrakesh Agreement Establishing the World Trade Organization, 15 April 1994, 1867 U.N.T.S. 154, 33 I.L.M. 1144. Agreement Creating The World Trade Organization, 15 April, 1994 (Dobbs Ferry, NY: Oceana Publications, 1997.

NAFTA has strengthened trade by reducing tariff barriers. Goods may be eligible for preferential tariff treatment (sometimes referred to as NAFTA-eligible goods). Canada's *NAFTA Rule of Origin Regulations*[34] set out rules for determining when goods qualify for preferential treatment under NAFTA.[35] NAFTA-eligible goods originating from the United States are eligible for the United States tariff, which is identified with the letters "UST".[36]

NAFTA-eligible goods originating from Mexico are eligible for the Mexico tariff, which is identified with the letters "MT" in the preferential tariff column of the Schedule to the customs tariff.

Goods are eligible for NAFTA preferential treatment if they fit the NAFTA "preference criteria".[37] The most commonly used preference criteria are the following:

(a) preference criterion A – goods that are wholly obtained or produced within the NAFTA territories. The definition for "goods wholly obtained or produced" is found in article 415 of NAFTA;

(b) preference criteria B – goods including non-NAFTA originating materials which are used to produce a good entirely in a NAFTA country and undergoes a tariff classification changes which satisfies the specific Rule of Origin for the product, as provided for in NAFTA Annex 401;

(c) preference criteria C – goods containing materials that are not wholly obtained or produced within the NAFTA territories as defined in article 415 of NAFTA. The goods may contain materials that are non-originating but undergo sufficient

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34 *NAFTA Rules of Origin Regulations*, S.O.R./94-14.

35 Canada, the United States and Mexico have agreed to uniform regulations negotiated under NAFTA Article 511, which are based on the Rules of Origin set out in NAFTA, c 4. John R. Johnson, *International Trade Law*, (Concord: Irwin Law, 1998) at 126.

36 See preferential tariff column of the Schedule to the *Customs Tariff*, R.S.C. 1985, (3rd Supp.), s. 41. The Customs Tariff contains the customs charging provision, namely section 20. This section imposes customs duties on all goods imported into Canada at the rate set out in Schedule I. Good and Services Tax under Part IX of the *Excise Tax Act*, R.S.C. 1985, c. E -15 is collected on imported goods under the Customs Tariff.

37 The six criteria are based on the Rules of Origin found in chapter 4, Annex 401, Annex 301.1, and Annex 703.2 of NAFTA (see Canada Border Services Agency, Customs Memoranda D11-5-1, "*NAFTA Rules of Origin Regulations*" (16 April 2003); and Canada Border Services Agency, Customs Memoranda D11-4-14, "*Certification of Origin*" (16 March 2006) at para. 34 onwards).

> processing in the territory so that material qualifies as originating in its own right.[38]

Preference criteria B is the most frequently used. It is commonly referred to as a "tariff shift".[39] Tariff shift refers to the shift in the tariff classification of the non-originating materials through the tariff classification of the finished good.

(a) Compliance Issues

Under the *Proof of Origin of Imported Goods Regulations*, commercial importers (such as non-resident importers in the United States) seeking UST preference tariff treatment under NAFTA must have a valid Certificate of Origin pertaining to the goods in question which was signed by the exporter.[40] A valid Certificate of Origin must be presented to the Canada Border Services Agency ("CBSA") if and when requested. Failure to provide a valid Certificate of Origin upon request may result in the imposition of additional duties, the denial of NAFTA preferential treatment and penalties.[41]

(b) Goods Valued at Less than $1,600(CAD)

A formal Certificate of Origin is not necessary where the subject goods are valued at less than $1,600(CAD). Instead, an exporter or producer may provide a Statement of Origin.[42]

(c) Blanket Certificates of Origin

An exporter or producer may issue a blanket Certificate of Origin for multiple shipments of identical goods. A blanket Certificate of Origin can be used for up to one year. For NAFTA purposes, Certificates of Origin covering either a single importation of goods on a given date or multiple shipments over a 12-month period are valid for four years from the date of the signature

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38 Canada Border Services Agency, Customs Memoranda D11-4-14, "*Certification of Origin*" (16 March 2006).

39 John W. Boscariol "Key Canadian Trade and Customs Issues: A Practical Perspective" in Pennsylvania Bar Institute, *Doing Business with Canada* (Mechanicsburg, Pennsylvania: Pennsylvania Bar Institute, 2005) at Unique - 167 at 185.

40 Canada Border Services Agency, Customs D Memoranda D11-4-2, "*Proof of Origin*" (16 March 2006); *Proof of Origin of Imported Goods Regulations*, S.O.R./98-52.

41 *Supra* note 40 at para. 17.

42 *Supra* note 40 at Appendix B.

on the Certificate of Origin.[43] Certificates of Origin and other relevant documents must be retained for six years.[44]

(d) Verification of Origin

CBSA has the right to verify claims for preferential treatment.[45] If an exporter or producer of goods subject to verification fails to comply with the verification requests or activities, or does not consent to the verification of origin in the prescribed manner and in the prescribed time, preferential NAFTA tariff treatment may be denied.[46] On the completion of the verification, CBSA shall provide a statement as to whether or not the goods are eligible for preferential tariff treatment under NAFTA.[47]

The manner of conducting a verification of origin is set out in the *NAFTA and CCFTA Verification of Origin Regulations* and the *NAFTA Rules of Origin Regulation*. Officers may conduct a verification of origin by reviewing a verification questionnaire completed by the exporter or producer; by reviewing a written response received from an exporter or producer or supplier; or by conducting a verification visit of the exporter, producer or supplier of the goods or of material used in production.[48]

(e) Tips and Traps

Responsiveness on the part of an exporter of goods who is the subject of a NAFTA verification is critical. If an exporter fails to respond to a verification questionnaire, does not consent to a verification visit, or denies access to books and records, then preferential NAFTA tariff treatment may be denied. If CBSA determines that there is a pattern of non-compliant conduct by an exporter, it may withhold preferential tariff treatment until the exporter or producer

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43 *Supra* note 40 at para. 14.

44 See Canada Border Services Agency, Customs Memoranda D17-1-21, "*Maintenance of Records and Books in Canada by Importers*" (28 June 2000); and see Canada Border Services Agency, Customs Memoranda D20-1-5, "*Maintenance of Records and Books in Canada by Exporters and Producers*" (1 January 1994).

45 *Supra* note 22, s. 42.

46 *Supra* note 22, s. 42.1(2).

47 *Supra* note 22, s. 42.2(1).

48 *NAFTA and CCFTA Verification of Origin Regulations*, S.O.R./97-333, ss. 2-3.

establishes compliance.[49] Evidence of fraud or misrepresentation will be turned over to the U.S. Customs and Border Protection Officials together with a request to continue an investigation and take appropriate measures.[50]

Exporters who are uncertain as to whether or not goods are NAFTA-eligible should take steps to have a due diligence review conducted by a qualified person. A third-party review is sometimes useful, particularly having regard to the fact that an adverse NAFTA determination can cover the importation of goods going back four years. It is also useful to remember that, under CBSA's advance rulings procedure, an exporter can seek an advance ruling with respect to the issue of NAFTA eligibility.[51] An opinion respecting NAFTA eligibility is useful if the importer seeks a NAFTA indemnity from the exporter.[52]

3. Import Matters

(a) Marking Requirements

U.S. companies importing goods into Canada must be aware of Canada's origin marking requirements.[53] The *Customs Act* prohibits the importation of goods that are required to be marked unless they are marked for origin in accordance with the regulations.[54]

The *Determination Of Country Of Origin For The Purposes Of Marking Goods* (*NAFTA Countries) Regulations*[55] sets out, at Schedule I, the categories of goods originating from the U.S. that must be marked for customs purposes. The categories include: goods for personal or

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[49] See Canada Border Services Agency, Customs Memoranda D11-4-20, "Procedures for Verifications of Origin Under a Free Trade Agreement" (29 June 2005) at para. 32.

[50] *Ibid.*

[51] Canada Border Services Agency, Customs Memoranda D11-11-3, "Advance Rulings for Tariff Classification" (1 April 2003).

[52] Daniel L. Kiselbach, Douglas Han and Angelos Xilinas, "Strategies for Minimizing Duties and Import Taxes" (2006) 41(2) Tax Notes International 241.

[53] Canada Border Services Agency, Customs Memoranda D11-3-1, "Marking of Imported Goods" (18 February 1998); Canada Border Services Agency, Customs Memoranda D11-3-2, "Marketing Determination/Redetermination of Goods Imported from a NAFTA Country" (26 October 1996); Canada Border Services Agency, Customs Memoranda D11-3-3, "NAFTA Country of Origin "Marking Rules"" (31 January, 1996); Customs Document C-132, *Country/of Origin Marking*; Memorandum D11-3-3 *NAFTA Country of Origin "Marking Rules"*.

[54] *Supra* note 22, s. 35.01; *Customs Tariff*, s.19 of the Customs Tariff provides that regulations may be made in respect of marketing requirements.

[55] *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations*, S.O.R./94-23.

household use; hardware; novelties and sporting goods; paper products; apparel; and horticultural products. A list of goods that are exempt from marketing are set out at Appendix B to the Regulations and include: (1) gifts; (2) antiques; (3) items not intended for resale; and (4) goods that are incapable of being marked.

Again, as a matter of due diligence, it is sometimes worthwhile to obtain an opinion from a third party in order to clarify the question of whether or not imported goods should be marked for customs purposes. If CBSA determines that goods should be marked and have not been marked for country of origin purposes, they may be seized and prohibited entry into Canada.

(b) Labelling, Marking, Packaging and Standards

Some of the pieces of legislation affecting labelling, marking, packaging and standards are set out below.

(i) Consumer Packaging

The *Consumers Packaging and Labelling Act*[56] deals with the packaging, labelling, sale, importation and advertising of pre-packaged and other goods. "Pre-packaged product" means any product that is packaged in a container and is sold to or used or purchased by a consumer without being repackaged. Labelling requirements cover numerical counts or units of measurements set out in Schedule I to the *Weights and Measures Act.*[57] The *Consumers Packaging and Labelling Act* prohibits the importation into Canada of pre-packed products unless it has been labelled in the prescribed manner. False or misleading representations are prohibited.[58] Goods that have not been labelled in accordance with the *Consumers Packaging and Labelling Act* may be seized and forfeited.

(ii) Nutrition Labelling, Nutrient Content Claims

The *Food and Drugs Act*[59] prohibits the labelling, packaging, treating, processing, selling or advertising of any food in a manner that is false or misleading.[60] The *Food and Drugs Act*

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56 *Consumer Packaging and Labelling Act,* R.S.C. 1985, c. C-38.

57 *Ibid.*, s. 4.

58 *Ibid.*, s. 7(2). This section prohibits the application of a label containing a false or misleading representation.

59 *Food and Drugs Act*, R.S.C. 1985, c. F-27.

60 *Ibid.*, s. 5.

prohibits health claims that might suggest that a food is a treatment, preventative or cure for specified diseases or health conditions unless provided for in the regulations.[61] Food not labelled or packaged as required by, or contrary to, the regulations will be deemed to be labelled or packaged contrary to the *Food and Drugs Act*.[62] The *Food and Drugs Act* prohibits the importation into Canada of goods for sale unless it complies with any prescribed standard. Health Canada establishes standards and policies for the food safety.

New regulations on nutrition labelling, nutrient content claims and diet-related health claims took effect for most pre-packaged foods sold in Canada after a three-year transition period of voluntary compliance. Most food products must carry a Nutrition Facts Table and comply with prescribed composition and presentation criteria when making nutrition content claims and permitted diet-related health claims.[63] For most manufacturers, the implementation date is December 12, 2005. For small manufacturers, the implementation date is December 12, 2007. Manufacturers and exporters need to carefully assess whether or not they qualify for the December 12, 2007 extension.

Some pre-packaged foods that have specific nutrition labelling requirements of the Food and Drug Regulations are prohibited from carrying a nutrition facts table and from using the phrase "Nutrition Facts". These goods include formulated liquid diets, human milk substitutes, food representatives containing a human milk substitute, milk replacements, nutritional supplements and foods represented for use in very low-energy diets.[64]

There are differences between the Canadian and the U.S. Nutrition Facts Table. Some elements of the Nutrition Facts Table which are mandatory in the U.S. are optional in Canada (e.g., servings per container, calories from fat, daily values for vitamins and minerals, and labelling of trans fat).[65]

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61 *Ibid.*, s. 3.

62 *Ibid.*, s. 5(2).

63 See: Regulations Amending The *Food and Drug Regulations* (Nutrition Labelling, Nutrient Content Claims and Health Claims SOR/2003-11).

64 Health Canada, "Nutrition Labelling and Claims Regulations – Frequently Asked Questions", online: Health Canada <www.hc-sc.cg.ca/fn-an/label-etiquet/nutrition/reg/regulations-reglements-faqs_e.html>.

65 See *Ibid.* at 20 for "Differences between Canada and the US".

The Public Health Agency of Canada and, in particular, the Bureau of Food Safety and Consumer Protection, is responsible for the administration of a Fair Labelling Practices Program. The Fair Labelling Practices Program deals with the non-health and safety food components of the *Food and Drugs Act* and *Consumer Packaging and Labelling Act*. In 2006, the consumer protection priority areas for the Fair Labelling Practices Program include the following:

1. food safety related: allergen claims such as berry-free or sulphite-free;

2. nutrition: nutrition facts table, nutrient content claims and diet-related health claims;

3. misrepresentation: evaluation of ingredient and flavour claims;

4. verification of the accuracy of mandatory label information, e.g., ingredient lists, common name, standards of identity, net quantity and fortification;

5. evaluation of claims, as found on labels, such as "organic", method of production, method of manufacturing including "natural" and "no preservatives";

6. evaluation of advertising claims.

From April 1, 2004 to March 31, 2005 129 imported foods were recalled under the Food and Safety Investigation Program relating to food labelling and advertising, nutrition labelling compliance tests and nutrition labelling tool kit.[66]

(iii) Textile Labelling

Industry Canada administers the *Textile Labelling Act*,[67] which deals with the labelling, sale, importation and advertising of consumer textile articles. The *Textile Labelling Act* prohibits the importation of textile articles unless the article has applied to it a label containing a

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[66] Greg Orriss, "CFIA Overview and Recent Initiatives" (Presentation at the I.E. Canada Conference, February, 2006). See also Canadian Food Inspection Agency reference material at www.inspection.gc.ca.

[67] *Textile Labelling Act*, R.S.C. 1985, c. T-10.

representation with respect to the textile fibre content.[68] The *Textile Labelling Act* also prohibits misleading advertising.[69]

(iv) Natural Health Products

The *Natural Health Products Regulations*[70] regulate the sale, manufacturer, packaging, labelling and importation for sale of natural health products. Importers of natural health products must have a product licence.[71] Licence applications must list the medicinal ingredients, quantity per dosage unit, potency, the source material and provide a statement indicating whether or not it is synthetically manufactured.[72] The Minister assigns a product number to each natural health product in respect of which a product licence is issued.[73] The Minister has the authority to direct an importer or distributor to stop their sale of a natural health product in certain circumstances.[74]

(v) Process Products

Process Products Regulations[75] are made pursuant to the *Canada Agricultural Products Act*,[76] and deal with the grading, packing and marketing of processed products. The *Process Products Regulations* prohibit the marketing of a food product in import unless the food product is not adulterated or contaminated, and is sound, wholesome and edible and meets the requirements of the *Food and Drugs Act* and the *Food and Drug Regulations*. Part I.1 sets out grades and standards for processed food. Part III deals with standard containers for products.[77] Part IV deals with the marketing of food products. Part VIII deals specifically with requirements relating to imports into Canada, marketings with grade names such as "fancy grade", "choice grade", "standard grade" and the inspection of food products.

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68 *Ibid.*, s. 3.
69 *Ibid.*, s. 5.
70 *Natural Health Products Regulations*, S.O.R./2003-196.
71 *Ibid.*, s. 4.
72 *Ibid.*, s. 5.
73 *Ibid.*, s. 8.
74 *Ibid.*, s. 17.
75 *Processed Products Regulations*, C.R.C., c. 291.
76 *Canada Agricultural Products Act*, R.S.C. 1985, (4th Supp.), c. 20.
77 See, for example, the tables in Schedule 3

The *Process Products Regulations* contain 133 standards and 92 standards for which grades are established. Proposed *Process Products Regulations* set out 132 new/or rewritten standards, 54 standards for which grades are established.[78] The proposed *Process Products Regulations* will be circulated in the *Canada Gazette*, Part I, in the summer or fall of 2006.[79]

(vi) Marking of Precious Metals

Industry Canada also administers the *Precious Metals Marking Act*.[80] This Act deals with the marking of articles containing precious metals. It prohibits the importation of an article which has a quality mark unless the mark is authorized by the *Precious Metals Marking Act*.[81] The *Precious Metals Marking Act* provides that a quality mark may be applied if the precious metal content of the article meets standards provided for in regulations with respect to that precious metal.[82] Consequences for non-compliance include seizure, forfeiture and other penalties.

(vii) Hazardous Products

Health Canada administers the *Hazardous Products Act*.[83] The import of some goods may be prohibited[84] or restricted.[85] The *Hazardous Products Act* indicates that a person may sell or import into Canada a product included in items listed in Schedule I to the *Act* only if the product meets requirements of these regulations.[86] There are a variety of consumer products regulations too numerous to describe in detail here.[87] The following is a brief outline of some of the regulations affecting consumer goods.

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78 Jim Trenholm, "Proposed Amendments to the *Processed Products Regulations*" (Presentation to the I.E. Canada Conference, February, 2006).

79 A complete draft of the amendments are on the Canadian Food Inspection Agency website at http://www.inspection.gc.ca/english/reg/protra_pro/protra_pro_defie.shtml.

80 *Precious Metals Marking Act*, R.S.C. 1985, c. P-19.

81 *Ibid.*, s. 3.

82 *Ibid.*, s. 4.

83 *Hazardous Products Act*, R.S.C. 1985, c. H-3.

84 *Ibid.*, s. 4.

85 *Ibid.*, s. 4(2).

86 *Ibid.*, s. 3.

87 *Carriage and Strollers Regulations*, S.O.R./85-379; *Consumer Chemicals and Containers Regulations*, S.O.R./2001-269; *Cribs and Cradles Regulations*, S.O.R./86-962; *Hazardous Products (Booster Cushions) Regulations*, S.O.R./89-446; *Hazardous Products (Carpet) Regulations*, C.R.C., 923; *Hazardous Products (Cellulose Insulation) Regulations*, S.O.R./79-732; *Hazardous Products (Charcoal) Regulations*, C.R.C., c.924; *Hazardous Products (Child Restraint Systems) Regulations*, S.O.R./88-151; *Hazardous Products (Crocidolit*

Regulations made under the *Hazardous Products Act* such as *Hazardous Products (Toys) Regulations* include various types of consumer goods.[88] *The Hazardous Products (Toys) Regulations* indicate, for example, that film bags used as packaging shall meet certain requirements.[89] The *Hazardous Products (Toys) Regulations* deal with electrical hazards and indicate, for example, that every applicable product shall meet the requirements set out in the Canadian Standards Association standard.[90] The *Hazardous Products (Toys) Regulations* also deal with mechanical hazards ("CSA"), thermal hazards, toxicological hazards and product specific hazards for dolls, soft toys, plush toys, toy steam engines, finger paints, rattles, elastic and batteries.

Other regulations include *Carbonated Beverage Glass, Containers Regulation,*[91] *Controlled Products Regulations,*[92] The Hazardous Products (Children's Sleepwear) Regulations[93] (which, for example, sets out labelling requirements pertaining to products treated with a flame retardant[94] and fire performance requirements[95]) and the Hazardous *Products (Glazed Ceramics and Glassware) Regulations*[96] (which deal with leachability limits for lead and cadmium[97] and

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Asbestos) Regulations, S.O.R./89-440; *Hazardous Products (Expansion Gates and Expandable Enclosures) Regulations*, S.O.R./90-39; *Hazardous Products (Ice Hockey Helmets) Regulations*, S.O.R./89-257; *Hazardous Products (Infant Feeding Bottle Nipples) Regulations*, S.O.R./84-271; *Hazardous Products (Kettles) Regulations*, C.R.C., c.927; *Hazardous Products (Lighters) Regulations*, S.O.R./89-514; *Hazardous Products (Liquid Coating Materials) Regulations*, C.R.C. 928; *Hazardous Products (Matches) Regulations*, C.R.C., c.929; *Hazardous Products (Mattresses) Regulations*, S.O.R./80-810; *Hazardous Products (Pacifiers) Regulations*, C.R.C., c. 930; *Hazardous Products (Tents) Regulations* S.O.R./90-245; *Playpens Regulations*, C.R.C., c.932; *Safety Glass Regulations*, C.R.C., c.933; *Science Education Sets Regulations*, C.R.C., c.934; *Surface Coatings Materials Regulations*, S.O.R./2005-109; *Children's Jewellery Regulations*, S.O.R./2005-132; *Regulations Repealing the Hazardous Products (Ice Hockey Helmets) Regulations (Miscellaneous Program)*, S.O.R./2005-344.

88 *Hazardous Products (Toys) Regulations*, C.R.C., c. 931.

89 *Ibid.*, s. 4.

90 *Ibid.*, s. 5. This section states "Every product described in paragraph 13(b) of Part II of Schedule I to the Act shall meet the requirements applicable to it that are set out in the Canadian Standards Association Standard C22.2 No. 149-1972, entitled *Electrically Operated Toys* SOR/78-393, s.1; SOR/91-267, s.3".

91 *Carbonated Beverage Glass Containers Regulations*, S.O.R./80-831.

92 *Controlled Products Regulations*, S.O.R./88-66. (Sets out, for example, information to be disclosed on a material safety data sheet, the labeling of inner containers and outer containers of a controlled product and the information to be disclosed on labels).

93 *Hazardous Products (Children's Sleepwear) Regulations*, S.O.R./87-443.

94 *Ibid.*, s. 4.

95 *Ibid.*, s. 5.

96 *Hazardous Products (Glazed Ceramics and Glassware) Regulations*, S.O.R./98-176.

97 *Ibid.*, s. 4.

the steps that should be taken to render a good unsuitable for storing, preparing or serving food).[98]

(viii) Cosmetics

The *Cosmetic Regulations*[99] regulate the importation to Canada for sale of any cosmetics.[100] Regulations set out requirements with respect to labelling, and restrict the types of claims that may be made on any label or any advertisement for a cosmetic. Provisions also set out requirements concerning security packaging and evidence of safety of cosmetics.

(ix) Medical Devices

The *Medical Devices Regulations*[101] deals with such matters as manufacturer's obligations, licensing, safety and effectiveness and labelling.

(c) Competition and Trade Practices

Customs duties are regulated by several pieces of legislation other than the *Customs Act*, including the *Competition Act*.[102] For example, federal Cabinet may by order remove or reduce customs duties if it appears that necessary competition will be facilitated in respect of an article.[103] The *Competition Act* also deals with foreign suppliers who refuse to supply goods.[104] The Federal Court can impose a remedial order (such as an injunction) where rights (e.g., patents, trade-marks or copyrights) have been used to restrain trade.[105]

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98 *Ibid.*, s. 6.

99 *Cosmetic Regulations*, C.R.C., c. 869.

100 *Ibid.*, s. 5. This section states "Subject to section 9, no person shall import into Canada for sale cosmetic the sale of which in Canada would constitute a violation of the Act or these regulations."

101 *Medical Devices Regulations*, S.O.R./98-282.

102 *Competition Act*, R.S.C. 1985, c. C-34, Part IV of the *Competition Act* sets out special remedies.

103 *Ibid.*, s. 31.

104 *Ibid.*, s. 84. This section states "Where, on application by the Commissioner, the Tribunal finds that a supplier outside of Canada has refused to supply a product or otherwise discriminated in the supply of a product to a person in Canada (the "first" person) at the instance of and by reason of the exertion of buying power outside Canada by another person, the Tribunal may order any person in Canada (the "second" person) by whom or on whose behalf or for whose benefit the buying power was exerted (a) to sell any such product of the supplier that the second person has obtained or obtains to the first person at the laid-down cost in Canada to the second person of the product and on the same terms and conditions as the second person obtained or obtains from the supplier, or (b) not to deal or to cease to deal, in Canada, in that product of the supplier.

105 *Ibid.*, ss. 32, 33.

The *Competition Act* also sets out trade-related offences, such as the making of false or misleading representations for promotional purposes. The *Competition Act* also deals with deceptive telemarketing, and the offering of products in consideration of the supply or use of another product,[106] multi-level marketing plans[107] and pyramid selling.[108]

Part BII.1 of the *Competition Act* deals with deceptive marketing practices, including misrepresentations to the public respecting such matters as the ordinary price of a product, the publication of testimonials or representations concerning tests as to the performance, efficacy or length of life of a product.[109]

(d) Intellectual Property

(i) Registration and Protection

Intellectual property protection is governed by the *Patent Act*,[110] the *Trade-marks Act*,[111] the *Industrial Design Act*,[112] the *Integrated Circuit Topography Act*,[113] and the *Plant Breeders' Rights Act*.[114] A Canadian patent provides a grant of exclusive rights to make, use and sell an invention for 20 years from the date of filing, subject to payment of maintenance fees. The Canadian patent rules define a "first to file" system, unlike the U.S. "first to invent" system.

Canada's rules for registration of trade-marks are similar to those in the United States. Importers should be aware of potential liability for patent infringement, which includes damages suffered by the patentee by reason of the infringement of a patent.[115] Trade-mark registrations in Canada have a 15-year term and can be renewed, subject to payment of renewal fees and continued use.

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106 *Ibid.*, s. 52.1.

107 *Ibid.*, s. 55. This section defines "multi-level marketing plan" as a plan for the supply of a product whereby a participant in the plan receives compensation for the supply of the product to another participant in the plan who, in turn, receives compensation for the supply of the same or another product to other participants in the plan.

108 *Ibid.*, s. 55.1.

109 *Ibid.*, ss. 74.01, 74.02.

110 *Patent Act*, R.S.C. 1985, c. P-4.

111 *Trade-marks Act*, R.S.C. 1985, c.T-13.

112 *Industry Design Act*, R.S.C. 1985, c.I-9.

113 *Integrated Circuit Topography Act*, S.C. 1990, c. 37.

114 *Plant Breeders' Rights Act*, S.C., 1990, c. 20.

115 *Supra* note 112, s. 54.

Copyright is protected in Canada without registration for original literary, dramatic, musical and artistic work.[116] Copyright in most works has a term of the life of the author, plus 50 years.

(ii) Intellectual Property Enforcement at Ports of Entry

Under the *Copyright Act* and the *Trade-marks Act*, the owner of a registered trade-mark, the owner or exclusive licensees of a copyright, or the owner of a performer's performance may apply to the Court on an *ex parte* basis to seek an order directing the CBSA to take reasonable measures to detect and detain alleged infringing goods. Such applications must be made on notice to the CBSA, and the application must be supported by affidavits that provide detailed information, including a description of the goods; the classification of the goods under the Harmonized System; the quantity and value of the goods, the identity of the imported, exporter or vendor; the country of export or origin; the method of importation or release; the estimated date of arrival in Canada; and the mode of transport on which the counterfeited goods will arrive.[117]

Prior to issuing an order, the court may require an applicant to furnish security to cover items such as duties, storage and handling charges, or any damages that may be sustained by the owner, importer or consignee. If an order is issued, CBSA will notify the applicant and the importer when the goods have been detained, and provide the applicant and the importer the opportunity to inspect the detained goods for the purpose of substantiating or refuting the applicant's claim. Within two weeks of the applicant receiving notice from the CBSA of the detained goods, the applicant must notify CBSA that an action has been commenced for the final determination of an issue by the court. Otherwise, CBSA may release the goods without further notice to the applicant. If a court makes an order in favour of the applicant, the court will issue an order considered appropriate in the circumstances, including that the goods be destroyed, exported or delivered to the applicant. The current border enforcement system in Canada places the burden on IP rights holders to initiate enforcement procedures and IP rights holders are

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[116] *Copyright Act*, R.S.C. 1985, c. C-42.

[117] Vivian Ho, "Canadian Border Enforcement Measures Dealing with the Infringement of Intellectual Property Rights", in *Miller Thomson Customs & Trade Bulletin*," (February 2006), online: Miller Thomson LLP < http:\\www.millerthomson.com\mtweb.nsf\wnd?readform&PageID=kchn6m3vh5#3>.

responsible for obtaining shipment information with respect to IP crimes which may sometimes be difficult to obtain.[118]

(iii) Import Levy on Blank Recordable Media Under the Copyright Act

The *Copyright Act* allows the Canadian Private Copying Collective ("CPCC") to sue importers to collect any unpaid levy together with a penalty amount of up to five times the amount of the unpaid levy. The levy on blank audio recording media is set by the Copyright Board and is subject to change. Recent cases indicate that the CPCC has been enforcing its collection rights against importers in the Federal Court of Canada.[119]

Canada has established a system which is designed to facilitate the making of payments to authors, performers and makers of sound recordings for private copies of musical works and performances. Payments are made by way of a levy imposed on Canadian manufactures and importers of blank audio recording media. The liability of importers to pay the levy is established pursuant to section 82 of *Copyright Act*.[120]

The Copyright Board sets levy amounts. Examples of levy amounts under the *Private Copying Tariff*, 2003-2004, are as follows:

> $0.29 for each audiocassette of 40 minutes or more in length;
>
> $0.21 for each CDR or CDWR;
>
> $0.77 for each CDR audio, CDR audio or minidisk;
>
> $2.00 for each recorder that can record no more than one gigabyte (Gb) of data;
>
> $15.00 for each recorder that can record more than one Gb and no more than 10 Gb of data; and
>
> $25.00 for each recorder that can record more than 10 Gb of data.

Pursuant to section 8 of the *Private Copying Tariff*, every manufacturer or importer must provide information such as the names or relevant corporations, principal officers, and the number of

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[118] *Ibid.*

[119] Daniel L. Kiselbach, "Import Levy on Blank Recordable Media under the *Copyright Act*" (February 2005), online: Miller Thomson LLP <http://www.millerthomson.com/mtweb.nsf/wnd?readform&PageID=mtte6a9bsa#1>.

[120] *Supra* note 118, s. 82.

goods on account of which a levy payment is made. Section 9 requires manufacturers and importers to keep records for six years. Manufacturers and importers must submit reports along with levy payments. The CPCC has issued a reporting form for this purpose. The CPCC may conduct an on-site audit of records on reasonable notice. Subsection 9(3) indicates that, if an audit shows that levy payments have been understated by more than 10%, the manufacturer or importer shall pay the cost of the audit within 30 days of the demand for such payment.

(e) Language Requirements

The federal *Consumer Packaging and Labelling Act*[121] and the *Consumer Packaging and Labelling Act Regulations*[122] require some product information to be in French and English. The identity and the principal place of business of the person for whom the good was purchased for resale may be in either English or French.

The *Charter of the French Language*[123] provides that Quebec's official language is French. Labels on products, containers or wrappings must be in French.[124] The *Charter of the French Language Regulations* provides for an exception for labels: (a) for a firm name, if it has been established exclusively outside of Quebec; (b) a name of origin, a name of an exotic product or foreign speciality, a heraldic motto or non-commercial motto; (c) a place name designating a place outside of Quebec; and (d) a trade-mark within the meaning of the *Trade-marks Act* (unless a French version has been registered).[125]

Quebec's *Charter of the French Language* requires that information on a product or on its container or wrapping or on documents or objects supplied with the product, such as warranties or directions, be in French. A language other than French may be used if the French version is equally prominent or available. Generally, promotional materials distributed in Quebec must be in French. English may be used if a French version is also available. Exceptions relate to:

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121 *Consumer Packaging and Labelling Act,* R.S.C. 1985, c. C-38.

122 *Consumer Packaging and Labelling Regulations,* C.R.C., c. 417, s. 6.

123 *Charter of the French Language*, R.S.Q. c. C-11.

124 *Ibid.*, s. 51.

125 *Ibid.*; See *Commerce and Business Regulation,* RRQ, c. C-11, Regulation 9.01 and Section 13.

(a) products for use exclusively outside of Quebec; (b) trade-mark; (c) educational and cultural materials; (d) greeting cards and (e) calendars and agendas not used for advertising.[126]

The *Consumer Protection Act*[127] indicates that standard form contracts, consumer contracts and related documents must be in French unless one party requests that the contract be in another language.[128]

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[126] Kenneth G. Ottenbreit "Doing Business in Canada: A Legal Overview" in Pennsylvania Bar Institute, *Doing Business with Canada* (Mechanicsburg, Pennsylvania: Pennsylvania Bar Institute, 2005) at Intro- 31 at 81.

[127] *Consumer Protection Act*, R.S.Q. c. P-40.1.

[128] *Ibid.*, s. 55. It is common for parties to provide that "the parties acknowledge having requested that this document be drafted in English only". See Didier M. Culat, "Official Languages in Canada" in Pennsylvania Bar Institute, *Doing Business with Canada* (Mechanicsburg, Pennsylvania: Pennsylvania Bar Institute, 2005) at Intro - 11 at 28.

PART II

BUSINESS RISK: ASSESSMENT, MITIGATION OPTIONS AND DEAL BREAKERS

1. Factors for Making Accurate Risk Assessments

(a) Supply Risk:

The term "supply risk" is used here to refer to the possibility that licensing regulations, standards or similar regulations may prohibit or restrict the export from the U.S., import into Canada or the sale of goods in Canada.

(i) Export Controls

For example, many products are subject to export controls in this era of heightened scrutiny. Export controls commonly apply to so called "dual use" goods (i.e., those that have a civilian and a military application).[129] The *U.S. Export Administration Regulations*[130] set out "Commerce Control List" and "Product Group Categories". The Commerce Control List Categories[131] include the following: 0 – nuclear materials, facilities and equipment (add miscellaneous items); 1 – materials, chemicals, micro-organisms and toxins; 2 – materials processing; 3- electronics; 4- computers; 5- telecommunications and information security; 6- sensors and lasers; 7- navigation and avionics; 8- marine; and 9 – propulsion systems, space vehicles and related equipment. Product Group Categories include:

(a) systems, equipment;

(b) tests, inspection and production equipment;

(c) material;

(d) software; and

(e) technology.

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[129] Daniel L. Kiselbach "Export Controls to Watch For" (January 2006), online: Miller Thomson LLP <http://www.millerthomson.com/mtweb.nsf/wnd?readform&PageID=kchn6lduu6#3>.

[130] *U.S. Export Administration Regulations*, 15 C.F.R., Parts 730-774.

[131] See Supplement No. 1 to the *Export Administration Regulations*, Part 774.

One may determine whether an item may be classified under an Export Control Classification Number (ECCN). In order to determine whether an item can be classified under and ECCN, one must determine whether the item is listed in the Commerce Control List and Product Group Categories. An ECCN is an alpha-numeric code that: (a) describes the items or type of item; and (b) shows the controls placed on that item. Dealing with the issue of documentation requires careful planning sometimes with a third party service provider including a customs broker and customs counsel.

Other export concerns relate to extraordinary circumstances such as security alerts which may serve to tighten access across international boundaries. Dealing with issues concerning border security issues can be managed by participation in the so called "trusted trader programs". These programs include the Partners-In-Protection Program ("PIP") in Canada and the U.S. Customs-Trade Partners In Protection Program ("C-TPAT").[132]

(ii) Import Controls

The Export/Import Controls Bureau at International Trade Canada administers the Canadian *Export and Import Permits Act*.[133] The *Export and Import Permits Act* establishes a permit system for the control of imports into and exports from Canada. The *Export and Import Permits Act* establishes an "Import Control List" which sets out a list of goods which require an import permit. Goods on the Import Control List may be imported under a general import permit or in other cases pursuant to an individual import permit. Failure to comply with the provisions of the *Export and Import Permits Act* including failure to obtain permit can lead to the imposition of significant penalties.[134]

(iii) Cultural Property, Rough Diamonds, Hazardous Products, Food and Drugs

Various pieces of legislation prohibit or restrict the import of specific types of goods. These provisions have been described in detail in Part I. Further, the *Cultural Property Export and Import Act*[135] controls the importation of any foreign cultural property foreign cultural property

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[132] Requirements for participation in these so-called trusted trader programs are largely a matter of policy which is frequently evolving.

[133] *Export and Import Permits Act*, R.S.C. 1985, c. E-19.

[134] *Supra* note 41 at Unique - 167.

[135] *Cultural Property Export and Import Act*, R.S.C. 1985, c. C-51.

as being defined as any object specifically designated by a country as being of importance for archaeology, prehistory, history, literature, art or science. The *Export and Import of Rough Diamonds Act*[136] establishes controls preventing the export of conflict or so called "blood" diamonds used to fund rebel African activities. A rough diamond is defined as "a diamond that is unsorted, unworked or simply sawn, cleaved or bruited".

(b) Risk of Delivery, Insurance and Loss

Supply contracts must include provisions which identify the responsibilities of the parties. Supply contracts should cover the responsibility of the importer and exporter, including the following:

1. responsibility for delivery;

2. responsibility for freight and packing costs;

3. responsibility for insurance;

4. responsibility for inspecting the goods for fitness and specification before final payment;

5. specifying when title to the goods transfers to the purchaser;

6. responsibility for clearing the goods; (i.e., paying any duties and taxes, such as Goods and Sales Tax or Provincial Sales Tax);

7. responsibility for paying any service provider's fees (such as customs broker fees).

In this regard it is useful to refer to the International Chamber of Commerce ("ICC") and, in particular, the ICC Model International Sales Contract relating to manufactured goods intended for resale. The ICC Model International Sales Contract sets out standard conditions which balance the interests of exporter and importer.[137] ICC Incoterms may be used in connection with ICC Model International Sales Contract terms.

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[136] *Export and Import of Rough Diamonds Act*, S.C. 2002, c.25.

[137] International Chamber of Commerce, *The ICC Model International Sale Contract*, (Paris: ICC Publishing S.A., 1997).

Failing contrary agreement the ICC Model International Sales Contract applies the *United Nations Convention on Contracts for the International Sale of Goods*. The *United Nations Convention on Contracts for the International Sale of Goods* was expressly made for international transactions, was adopted as a part of Canadian law on May 1, 1992[138] and is also part of U.S. law.[139] The *United Nations Convention on Contracts for the International Sale of Goods* deals with issues such as when title passes, time of acceptance, oral agreements, formation of the contract, examination and threshold of breach of contract.

(c) Risk of Loss

Various international sales terms have been created which use abbreviations for inclusion in sales agreements. They may set out terms of sale relating to the passage of title, risk of loss, payment and price. As noted, the International Chamber of Commerce has developed Incoterms. These are different from the U.S. *Uniform Commercial Code* or the *Revised American Foreign Trade Definitions*. It is important to specify which terms are being used if an abbreviation is utilized. The question of who does what should also be stated in order to avoid misunderstanding.[140] In general, an exporter will have the least responsibility and risk if it exports goods "ex works". This term requires the buyer to pay for such things as transportation costs and customs duties.

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[138] See: *International Sale of Goods Contracts Convention Act*, S.C. 1991, c. 13. See also provincial legislation for the various provinces: Alberta – *International Conventions Implementation Act*, S.A. 1990, c. I-6.8; British Columbia – *International Sales of Goods Act*, R.S.B.C. 1996, c. 236; Manitoba – *International Sale of Goods Act*, S.M. 1989-90, c. 18, C.C.S.M., c. s11; New Brunswick - *International Sale of Goods Act*, S.N.B. 1989, c. I-12.21; Newfoundland - *International Sale of Goods Act*, R.S.N. 1990, c. I-16; Northwest Territories - *International Sale of Goods Act*, R.S.N.W.T. 1988, c. I-7; Nova Scotia - *International Sale of Goods Act*, S.N.S. 1988, c. 13; Nunavut - *International Sale of Goods Act*, R.S.N.W.T. 1988, c. I-7 [pursuant to section 29 of the *Nunavut Act*, S.C. 1993, c. 28]; Ontario - *International Sale of Goods Act*, R.S.O. 1990, c. I.10; Prince Edward Island - *International Sale of Goods Act*, S.P.E.I. 1988, c. 33; Quebec – *An Act Respecting the United Nations Convention on Contracts for the International Sale of Goods*, R.S.Q. c. C-67.01; Saskatchewan – *The International Sale of Goods Act*, S.S. 1990-91, c. I-10.3; Yukon - *International Sale of Goods Act*, S.Y. 1992, c. 7.

[139] See: 52 Federal Register 6262, 6264-6280 (March 2, 1987); *United States Code Annotated*, Title 15, Appendix (Supp. 1987).

[140] Thomas E. Johnson, *Export/Import Procedures and Documentation*, (Toronto: American Management Association, 1997) at 39.

(d) Risk Respecting Standards, Fitness and Infringements

When selling goods into Canada, an exporter must be aware of the unique regulations that exist with respect to standards for goods, fitness for purpose and potential infringements for intellectual property. The importer will often require satisfaction that the goods are fit for the purposes for which they are being sold. For example, in the case of aircraft, an appropriate Certificate of Airworthiness must be issued by Transport Canada for a new aircraft arriving in Canada before the aircraft may be used in Canada, and the Canadian purchaser will pay the foreign buyer. This is usually carried out by an inspection by Transport Canada personnel.

The same principles apply with respect to consumer goods. For example, in the supply of electrical components and products, the importer will require CSA approval on products in order to sell them in Canada. In some cases, CSA may accept USA standards, but this is not necessarily so.

In respect of intellectual property rights, it is important to research of the question of what type of protections have been made available in Canada. This may include trademark registration, copyright protection or any other patent protection.

(e) Business Risk

The term "business risk" refers to the risks associated with dealing with a foreign client whose identity and status requires verification. If the Canadian buyer is a corporation, it may be necessary to verify its existence. Legal entities, such as properly registered corporations like a British Columbia corporation, may have the powers of a natural person.[141] Further, it may be necessary to ensure the appropriate persons in the corporation have authority to make or enter into contracts that are proposed. In certain instances it may be necessary to seek the authority of the directors of the corporations to complete a deal.

(f) Foreign Exchange Risks

Imports must be converted from U.S. to Canadian dollars. The rate of exchange sets the amount that one currency may be bought or exchanged for another. Volatility in exchange rates may

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[141] *Business Corporations Act*, S.B.C. 2002, c. 57.

directly impact the supplier if the U.S. dollar depreciates (which may consequently reduce profit margins).[142]

Hedging is sometimes used by parties to an international supply contract when form of hedging is the use of "forward exchange contracts". These are contracts to buy or purchase foreign currencies at a fixed rate for payment sometime in the future. If, for example, an exporter seeks to ensure that the value of the payment currency will not depreciate to the extent where all the profit disappears the exporter may enter into a foreign exchange contract which will provide a guaranteed rate on the account due date.[143] A forward contract to purchase foreign currency entered into with a financial institution is usually for a period of between 30 days and one year.[144]

(g) Payment Risk

(i) Credit Management

"Payment risk" refers to the possibility that the buyer will be unwilling or unable to pay the price of the goods. Ways of managing this risk is partly a matter of common sense including conducting background research to minimize exposure to late payment and bad debts.[145] Credit management advice or tips include:

1. Telling the customer when payment is required.

2. Requiring the payment of a deposit.

3. Requiring payment of instalments at specified stages (e.g., when a third party verifies that the goods meet a requisite standard).

4. Acknowledging in writing the payment terms.

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[142] *Supra* note 31 at 19.

[143] *Supra* note 31 at 120.

[144] Canadian Counsel for International Business, "Managing Foreign Exchange Risks", publication no.549.

[145] See The Better Payment Practice Campaign, Owner/Manager Section "Credit Management Advice," online: The Better Payment Practice Campaign, Owner/Managers Section <http://www.payontime.co.uk/collect/collect_exporting.html > which sets out a number of factors that can be dealt with as a matter of determining a customer's creditworthiness.

5. Requiring a credit application form.

6. Checking the creditor's solvency and payment reliability with others.

7. Obtaining proof of delivery or written acceptance.

8. Invoicing which shows the customer's order reference.

9. Invoicing within 24 hours of delivery supply.

10. Sending a monthly statement of account.

11. Having a daily account.

12. Stopping supplies to slow payers.

13. Establishing a timetable for collecting until payment or insolvency.[146]

(ii) Personal Property Security

To protect itself, a U.S. seller might take a security interest in the goods that are supplied on credit to its customers, registering that security interest in Canada. In Canada the personal property securities Acts in each of the provinces offer means to secure a transaction which are similar to those in the U.S. *Uniform Commercial Code*.[147] Quebec secured transactions are different than in the common law provinces.[148]

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[146]. See The Better Payment Practice Campaign, Owner/Manager Section "Credit Management Advice," online: The Better Payment Practice Campaign, Owner/Managers Section <http://www.payontime.co.uk/collect/collect_checklist.html>.

[147] See for example the B.C. *Personal Property Security Act*, R.S.B.C., 1996, c.359 and the Ontario *Personal Property Securities Act*, R.S.O., 1990, c. P.10.

[148] Didier M. Culat and Audrey Mulholland: "Conditional Sales Contracts in Quebec" in Pennsylvania Bar Institute, *Doing Business with Canada* (Mechanicsburg, Pennsylvania: Pennsylvania Bar Institute, 2005) at Sales - 45 at 49.

(iii) Sales of Goods Legislation – Conditional Sales Contracts

All provinces except Quebec have specific sale of goods legislation which define the terms of contractual relations when there is a sale of personal property in a consumer transaction or otherwise where the agreement between the parties is silent.[149]

The *Quebec Civil Code*[150] governs conditional sales contracts. In this type of sale, the vendor holds ownership of the property until full payment is made.[151]

If a buyer fails to pay an instalment of the sale price or to pay the sale price in accordance with the terms and conditions of the contract the vendor may either: (1) obtain an immediate payment of unpaid instalments, or (2) take back the property. If there is an acceleration clause, the seller may elect to obtain payment of the balance of the sale price. A merchant who opts to exercise his rights under the *Consumer Protection Act* must provide the consumer with a 30 day notice in a prescribed form.[152] Notably, under the *Quebec Consumer Protection Act*,[153] a contract which provides that it is governed by a law other than an Act of Canadian Parliament, or of the National Assembly of Quebec is prohibited.[154]

(iv) Open Account

An "open account" means that the buyer must adhere to a payment schedule on receipt of an invoice. An advantage includes the simplicity of the process. Exporters may factor in an additional premium to account for the risk of non-payment, and the fact that the exporter may be required to rely upon legal provisions to enforce monetary judgments.

(v) Letter of Credit

Letters of credit are similar to a certified cheque that is given to a bank and cannot be released, cashed or returned until conditions are met or not met.[155] Letters of credit are arranged through a

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149 *Supra* note 128 at Intro - 79.
150 *Civil Code of Québec*, Art. 1745 - 1749 C.C.Q.
151 *Supra* note 150 at Sales - 50 - 51.
152 *Supra* note 129, ss . 105, 139.
153 *Supra* note 129, s. 19.
154 *Supra* note 150.
155 *Supra* note 31 at 115.

line of credit. A letter of credit is an undertaking by the importer's bank for the importer's client to guarantee payment to an exporter on sight of documents (such as a bill of lading, commercial invoice and a Canada Customs invoice).[156] A revolving letter of credit may be used for monthly purchases. Banks are not responsible for releasing the funds where goods are defective, or do not meet the terms and conditions of the supply contract. An importer is left to make a claim against the exporter.[157]

(vi) Advanced Payment - Documentary Collections

Here, the exporter entrusts the bank to handle commercial and financial documents. It gives instructions to the bank regarding the release of these documents to the importer and sent to the importer's bank. The banks act as intermediaries. Under the document against payment method, documents are released to the importer only if payment for the goods is made. In the case of "documents against acceptance", documents are released only against the acceptance of the obligation to pay for the goods at a future date.

(h) Risk of Cancellation

The *United Nations Convention on Contracts for the International Sale of Goods* deals with conduct and statements which constitute acceptance.[158] Practices or usage may be considered in evaluating whether an acceptance should be effective.[159] The *United Nations Convention on Contracts for the International Sale of Goods* does not generally influence the validity of consumer or specially regulated sales. These matters are subject to local law.[160]

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156 *Supra* note 31 at 118.

157 *Supra* note 31 at 116.

158 *United Nations Convention on Contracts for the International Sale of Goods*, 11 April 1980, 1489 U.N.T.S. 3 at Article 18.

159 Stephen M. Richman, "Formation of Contract under the United Nations Convention on Contracts for International Sale of Goods" in Pennsylvania Bar Institute, *Doing Business with Canada* (Mechanicsburg, Pennsylvania: Pennsylvania Bar Institute, 2005) at Sales - 1 at 8.

160 *Supra* note 160, Arts. 4 - 5.

Local law is set out in Canadian consumer protection legislation. Under provincial legislation, purchasers may have the right to cancel a direct sale within 10 days, and to be notified of that right.[161]

Similarly, under the *Competition Act*,[162] direct sellers must allow products to be returned in a saleable condition, and must inform sales contractors of this right. The *Competition Act* requires that any buyback be exercisable on "commercially reasonable" terms. The Fair Practices Branch may evaluate what is "commercially reasonable", having regard to factors including the nature of the product; the time given to return the product; the percentage of money returned; the procedures to be followed product; and product return policies of other companies.[163]

(i) Canadian Regulatory Risks

(i) Licensing and Bonding

Some provinces require the licensing and bonding of direct sellers. Some provinces also require the licensing of independent sales contractors.[164]

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[161] W. Jack Millar and Wendy A. Brousseau, "Establishing a Canadian Identity: Incorporation, Taxation & Customs Considerations" (Paper presentation to the Canadian Direct Sellers Association Seminar: "Doing Business in Canada", September 2005) at 27.

[162] *Supra* note 104, s. 55.1(1)(d).

[163] *Supra* note 163 at 31.

[164] *Supra* note 163 at 28.

(ii) Selling Practices

The *Competition Act* regulates direct sales practices, including earnings representations.[165] Direct sellers may manage this risk by ensuring that representations are fair and reasonable and include information such as the following: (1) levels of compensation received by all independent sales contractors; (2) compensation received by a typical independent sales contractor; (3) time and effort necessary to attain various levels of compensation; (4) recent figures respecting the levels of compensation; and (5) changes to the levels of compensation received.[166]

(iii) Recruitment Bonuses

The *Competition Act* prohibits independent sales contractors from making payments for the right to receive payments for the recruitment of other contractors, who in turn make payments to participate.[167]

(iv) Required Purchases

The *Competition Act* prohibits the requirement, as a condition of becoming an independent sales contractor, of product purchases. It also prohibits a seller from requiring independent sales contractors to purchase products to maintain a higher commission level.

(v) Inventory Loading

The *Competition Act* also prohibits direct sellers from supplying goods to independent sales contractors under commercially unreasonable terms.[168]

(h) Legal Risk

U.S. exporters may eliminate legal risk by providing for the legal jurisdiction that will apply.[169] The *United Nations Convention on Contracts for the International Sale of Goods* allows the

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[165] *Supra* note 104, s. 55(2).

[166] *Supra* note 163.

[167] *Supra* note 104, s. 55.1(1)(a).

[168] *Supra* note 104 at s. 55.1(c).

[169] Stephen M. Richman, "Selected Issues in International Litigation from the American Perspective: Choice of Law, Personal Jurisdiction, Form Selection, Enforcement of Judgments and Anti-Trust Injunctions" in Pennsylvania Bar Institute, *Doing Business with Canada* (Mechanicsburg, Pennsylvania: Pennsylvania Bar Institute, 2005) at Dispute – 33 at 51.

selection of applicable law. The choice of law may depend on the bargaining strength of the parties. If the exporter does not want the *United Nations Convention on Contracts for the International Sale of Goods* to apply, this should be stated in the supply contract. A clause that says, for example, state law applies could still lead to applicability, since a U.S. state could apply the Convention as the law of the state.[170]

United Nations Convention on Contracts for the International Sale of Goods has been the law of the United States effective January 1, 1988.[171] The *United Nations Convention on Contracts for the International Sale of Goods* only deals with the formation of contracts and remedies available to buyers and sellers. The Convention applies to parties who are located in countries which are "contracting states".[172] One must exclude the *United Nations Convention on Contracts for the International Sales of Goods* under Article 6 of the Convention.[173]

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[170] *Ibid. at* 52.

[171] *Supra* at note 161 at Sales – 5.

[172] *Supra* note 160, Art. 1(1)(a). An example of a case involving the interpretation of a supply contract involving a Canadian company and an American company is *Chi. Prime Packers, Inc. v. Northum Food Trading Co.* 408F. 3d 894, 898 (7th Cir. 2005) which indicated that a buyer must prove nonconformity of goods, and where *Uniform Commercial Code* principles were used to aid in the interpretation of the *United Nations Convention on Contracts for the International Sale of Goods*.

[173] *Supra* note 171 at Dispute - 52; *Volvo Constr. Equip. N. AM., Inc. v. CLM Equip. Co.*, 386 F.3d 581, 605 (4th Cir. 2004).

PART III

SHOW US THE MONEY: GETTING PAID IN CANADA

1. Deal Structures that Help Ensure Payment

Contractual provisions that are designed to ensure payment include the following:

1. Obtaining a deposit or advanced payment for the goods prior to the shipment of the goods. An importer may ask the exporter to have its bank issue an "advanced payment guarantee". An advanced payment guarantee protects the importer if the exporter does not ship the goods.[174]

2. Ensuring that title to the goods remains with the exporter until the importer accepts delivery of the goods and pays for the goods.

3. Stipulating that, on the non-acceptance of delivery, the exporter shall have the right to terminate the agreement, and retain deposits paid by the importer/purchaser as liquidated damages.

4. Providing for registration of security in Canada and obtaining appropriate security agreements.

5. Obtaining a letter of credit from the importer's bank to guarantee payment within a time limit and against stipulated documents.

2. Documentary Collections

As noted above in Part II, in "documents against payment" method, documents are released to the importer only against payment of the goods. In respect of the "documents against acceptance" method, documents are released only against the acceptance of the obligation to pay for goods at a specified future date.[175]

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[174] *Supra* at note 31 at 116.

[175] *Supra* at note 31 at 116.

3. Factoring

Exporters may sell invoices to a factor where they do not wish to wait or cannot afford to wait for importers to pay. The exporter then has funds available, and the factor assumes responsibility for obtaining payment of receivables. For this service, the exporter receives a discounted invoice price.[176]

4. Securitization of Receivables

Securitizing of receivables is similar to factoring. Unlike factoring, the receivables are serviced by the company selling the receivables. Companies that sell receivables for 30 days or less get a chance to put some cash in hand at the most opportune times and strategic intervals. Receivables can then be repurchased at a later date. Investment banks can take receivables and turn them into a security.[177]

In a "true sale" securitization, a true seller sells a pool of its assets (e.g., receivables) to a special purchase vehicle ("SPV"). The SPV issues bonds in order to finance the purchase of the assets such as receivables. The bonds are referred to as asset backed securities ("ABS"). The purchased assets provide a source of cash to service the bonds. The transfer of assets through a true sale helps to achieve a main benefit of securitization, namely, to cheaper funding. That is, a seller may obtain funding on better terms than would be the case on a loan. Securitization may also limit the seller's credit/payment risk.

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[176] See Marco Jostes & Martin Nelke, "Using Business Intelligence for Factoring Credit Analysis," online: European Network for Fuzzy Logic and Uncertainty Modeling in Information Technology <http://www.erudit.de/erudit/events/esit99/12545_p.pdf>.

[177] 1995 Chief Executive Publishing 2004; and William Whipple and David Kucera Harris Nesbitt Financial Forum "Boosting Liquidity for Growth" at http://www.harrisnesbitt.com/securitization/usa/publications/articles/images/finform12-05.pdf.; and Baker & MacKenzie Finamatics, Freshfields Bruckhaus Deringer, PriceWaterhouseCoopers, Standard & Poors, White & Case "Securitization Key Legal and Regulatory Issues" International Finance Corporation Global Financial Markets Department 2004, website: http://www.ifc.org/ifcext/eca.nsf/AttachmentsByTiltle/Securitization1A%B9-04/#FILE/Securitization1A%2B9-04.pdf.

5. Secured Debt: Personal Property Security Registration

As noted in Part II, Canada's several provinces have incorporated a personal property securities registration scheme whereby creditors can have their interests registered and interests on goods that have been provided.[178]

6. What to do when you find Yourself in a Payment Dispute

(a) Arbitration and Mediation

The *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*[179] (often referred to as the "New York Convention") requires courts within signatory nations to recognize and enforce arbitration clauses maintained in contracts. Canada and the U.S. have agreed to be bound (with declarations and reservations) by ratification accession or succession.[180] The New York Convention has been implemented in the U.S.[181]

While mediation focuses on a conciliatory process whereby a mediator settles on critical issues in the interests of the parties to achieve a consensus-based settlement,[182] arbitration is more like litigation in that it involves an adversarial process and the imposition of a binding order or award by an arbitrator. Several issues that could be dealt with in an arbitration clause are as follows:

(i) Arbitration Rules

The parties should identify the rules that will apply to the arbitration.

(ii) Place of Arbitration

The arbitration should be set down and dealt with at a mutually convenient location, having regard to the location of potential witnesses.

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178 See, for example, the Ontario *Personal Property Securities Act*, R.S.O. 1990, c.P-10.

179 *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 U.N.T.S. 38.

180 United Nations Commission on International Trade Law "Status 1958 – Convention on the Recognition and Enforcement of Foreign Arbital Awards at website: http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_Status.html.

181 *Supra* note 171 at Dispute – 64; *Federal Arbitration Act*, 9 U.S.C. §§ 1 – 14.

182 U.S. Department of Commerce, "Alternative Dispute Resolution in International Contracts" (NAFTA Advisory Committee on Private Commercial Disputes: October 1994) at 2.

(iii) Applicable Law

The parties should agree as to the jurisdiction which will apply to the arbitration and how an arbitration award might be enforced in that legal jurisdiction.

(iv) The Arbitration Panel

Arbitrators may need to have special qualifications to deal with issues concerning particular types of goods or rights (such as intellectual property rights).

(v) Language

If the parties are conversant in different languages, it is important to settle the language of the arbitration, or provide for simultaneous interpretation.

(vi) Discovery and Document Production

The parties should provide for adequate oral and/or documentary discovery.

(vii) Interim Relief

The parties may wish to have the right to resort to the court processes for interim relief, (e.g., injunctive relief).

(viii) Consolidation of Claims

The parties may wish to have the right to consolidate related matters into a single proceeding.

(ix) Type of Relief Granted

The parties should identify the scope of the arbitration powers. There are certain questions as to whether or not orders beyond a monetary order can be enforced, at least in Canada.

(x) Time Limitations

Parties should put their minds to whether or not a specific time limit should be imposed with respect to the institution of claims and the conduct of the arbitration.

(xi) Costs and Expenses

In Canada, the usual rule in litigation is that costs follow the event (that is, the loser pays the costs), and this may be different than the expectation.[183] The parties may wish to consider whether costs and expenses should be borne by the loser of an arbitration award.

The advantages of arbitration over litigation have been said to include the following: (1) faster completion time; (2) cost savings; (3) flexibility in procedures; (3) party autonomy in choosing relevant rules; and (4) use of specialist decision-makers.[184] Litigators sometimes dispute the supposed benefits of arbitration.

Parties may seek *ad hoc* or institutional arbitration. *Ad hoc* arbitration involves process which are adopted by the parties themselves. *Ad hoc* arbitration may involve the drafting of *ad hoc* procedures or referring to a generally accepted set of arbitration rules.[185]Institutional arbitration involves proceedings which are administered and supervised by professional arbitration organizations. Advantages of institutional arbitration have be listed as follows: (1) no suspensions or delays in the arbitration proceedings; (2) technical experience in using formats and procedures that have been time-tested; (3) set fees; and (4) a roster of professional arbitrators. [186] Professional arbitration organizations include the American Arbitration Association, the British Columbia International Commercial Arbitration Centre, the Commercial Arbitration and Mediation Centre for the Americas, or the International Chamber of Commerce, International Court of Arbitration, under their own rules.[187]

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183 *Supra* note 184 at 8, 9.

184 Ramon Mullerat, "Why To Choose Institutional Arbitration For International Commercial Disputes" (2006) 35(1) International Law News 1.

185 United Nations Commission on International Trade Law ("UNCITRAL") Arbitration Rules may be selected as part of a contract, or after a dispute has emerged. See United Nations Commission on International Trade Law, "FAQ - UNCITRAL and Private Disputes/Litigation", online: UNICITRAL <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration_faq.html>.

186 *Supra* note 185 at 6.

187 *Supra* note 184 at 4.

(b) Litigation

(i) Jurisdiction

Canadian courts will respect a selection as to legal jurisdiction if it was not made to avoid the laws of a more appropriate jurisdiction. The court will determine whether there is a contract and how it is to be interpreted by applying foreign laws.

(ii) Litigation in Canada

Litigation in Canada is very similar to U.S. litigation. There are, however, subtle differences. First, Canadian litigation usually involves trial by judges and not juries. Second, discovery does not involve wide-ranging depositions. An oral discovery is usually confined to a discovery of a single corporate deponent. Third, costs of the proceeding are usually borne by the loser of litigation; although costs are in the discretion of the court. Fourth, the nature of the remedies that will be imposed by Canadian courts may significantly differ from those that might be imposed in the United States. In particular, Canadian courts are usually very conservative with respect to the imposition of punitive damages. This might be particularly relevant in assessment of potential exposure to damages in, for example, product liability litigation.

(iii) Enforceability of Foreign Judgments

Canadian courts will enforce a U.S. court judgment where: (1) the U.S. court had jurisdiction over the party (e.g., where a defendant appeared and defended the matter on the merits); and (2) the U.S. judgment was for a sum of money (not for specific performance or an injunction).

In the case of *Beals v Saldanha*,[188] the Supreme Court of Canada discussed the enforcement and recognition in Canada of foreign judgments. The Supreme Court of Canada indicated that where a party enters into a contract in a foreign country, it has taken positive steps to bring itself within the jurisdiction of the foreign country's laws, and it can reasonably be expected to defend itself if an action in that foreign jurisdiction. There must be a real and substantial connection between the cause and the foreign court. Relevant factors include:

(a) the defendant's presence in the jurisdiction;

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[188] [2003] S.C.J. 77 (S.C.C.) at para.19.

(b) the formation of the contract in the jurisdiction;

(c) the breach of contract in the jurisdiction;

(d) the damages incurred in the jurisdiction;

(e) the events in dispute in the jurisdiction;

(f) a choice of law contract clause naming the jurisdiction; and

(g) the property in dispute located in the jurisdiction.

The U.S. court's judgment may be enforced in Canada if the foreign judgment is final.[189]

(iv) Non-monetary Foreign Judgments

The Supreme Court of Canada has granted leave in the case of *Pro Swing Inc. v. Elta Golf Inc.*[190] which will deal with the issue of whether or not Canadian courts may enforce a U.S. court's order enjoining a defendant from purchasing, marketing, selling or using golf clubs bearing the plaintiff's trademark. The Supreme Court of Canada is expected to re-examine the rules governing recognition and enforcement of foreign non-monetary judgments.[191]

(v) Non-enforcement of Foreign Judgments

A U.S. court's judgment might not be enforced if a defendant establishes that the proceedings were not fair, contrary to natural justice, or that enforcement is against public policy, public order or based upon a fraud.[192]

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189 *First American Bank & Trust (Receiver of) v. Garay et al*, [1994] O.J. 2942 (Gen. Div.), at paras. 5 to 7.

190 (2003), 68 O.R. (3d) 443, 30 C.P.R. (4TH) 165 (Ont. S.C.J.).

191 Jon-David Giacomelli "Key Changes in Canadian Law: Jurisdictional Issues and Enforcement of U.S. Judgments and Arbitral Awards In Canada" in Pennsylvania Bar Institute, *Doing Business with Canada* (Mechanicsburg, Pennsylvania: Pennsylvania Bar Institute, 2005) at Dispute - 1 at 27- 32.

192 *Supra* note 128 at Intro - 46.