LEGAL BUSINESS

Growth in customs and trade law after *AAi. Foster Grant*

By Oliver Bertin
Toronto

The right to minimize taxes has been a long-standing principle of Canadian law. But in 2004, the Federal Court of Appeal held, *in AAi FosterGrant of Canada Co. v. The Commissioner of the Canada Customs and Revenue Agency*, that this right applied to customs duties as well. That ruling broadened the horizons of practising customs and trade lawyers.

"It is a small, specialized bar, but it is growing," Daniel Kiselbach recently told the 74th annual conference of the Canadian Association of Importers and Exporters Inc. in Toronto.

A partner with Miller Thomson LLP in Vancouver, he noted that only a few hundred lawyers practise customs and trade law in Canada.

Practitioners in the area deal with some of the more vexing issues in Canada's relationship with its trading partners.

The importance of that trade is not in doubt. Canada's imports totalled $355.6 billion in 2004 or nearly $1 billion a day, according to Jacqueline Couture of the Canada Revenue Agency. Exports were even higher that year, reaching $410.9 billion.

This trade produces a large amount of revenue for the federal government, mainly in the form of customs duties and revenue from the federal Goods and Services Tax.

That is the area that concerns Kiselbach and his clients. The duties and GST may seem trivial to a consumer who crosses the border for a weekend of shopping. But they can become a substantial cost for commercial importers.

Canada's importers paid $2.9 billion in customs duties in 2004. But Couture said the GST on imports reached $19.6 billion that year or 69 per cent of total GST revenue.

That sum would be even higher but for the efforts of Kiselbach and the few hundred lawyers in Canada who work with importers to minimize their import tax load. These lawyers handle the many disputes that arise every day over import duties, GST levies and the retail sales taxes.

The work of a trade lawyer is vital to an importer, he said, because Canada's import rules are "a horrible quagmire." There are many pitfalls, the rules change constantly and they are often applied retroactively, giving Canadian businessmen a very expensive surprise months after they have imported their goods.

"Regulations change overnight," he said. "Every day, we have a new arrangement on something ...It is a very tricky technical area that many people get stuck in," Kiselbach said. "It is important to keep informed because there are lots of traps for the unwary. There is no way out once a decision has been made."

Kiselbach, like others, concentrates on Canada's import trade, usually on goods from the United States, but also from Hong Kong, Japan and Europe.

Other lawyers handle Canada's exports to these countries, each with unique rules of its own.

As with softwood lumber and beef, many of the most contentious issues are between Canada and the United States.

The North America Free Trade Agreement "didn't solve all the problems," Kiselbach said, describing NAFTA as "a good start ... (But) there have been many problems with implementation."

Those problems along with the

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Consequences of an adverse NAFTA verification can be devastating

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U.S.'s post 9/11 security concerns have caused serious challenges for Canadian exporters.

Kiselbach offered several suggestions that would help Canadian importers minimize the sting of import duties and GST.

He advises his clients to verify the customs valuation in advance of importation. "The consequences of an adverse NAFTA verification can be devastating," he warned. "Under the *Customs Act*, a customs officer may re-determine the tariff classification of imported goods at any time within four years."

And they will do so regularly. "It is our experience that valuation verifications occur on a regular basis," Kiselbach warned. Importers who undervalue their goods may be liable for penalties, additional duty, taxes and interest. The customs officer may also have the power to seize the goods, an expensive proposition for the importer concerned.

The easiest way to avoid that problem is to devise a properly constructed contract that includes the value of the goods and sometimes an appraisal.

The same warning applies to Certificates of Origin. "The duty and tax consequences of an adverse determination can be devastating where an invalid blanket certificate ... has been used to cover imports over a lengthy period, or in the case of high-value goods," Kiselbach said.

This problem arises when a

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Canadian imports goods where the original country of origin is not immediately obvious. One customs officer may rule that goods originated in the United States and are subject to preferential treatment. Another official, four years later, may say they really came from France or China and are subject to retroactive duties and interest.

In a simplistic case, an auto manufacturer may import a car engine from the United States that has Swedish ball bearings, Japanese spark plugs and a German alternator. Sorting out the duties on that fictional engine can be both difficult and controversial.

The problem is compounded because many suppliers are reluctant to disclose the nationality of their own subcontractors, claiming the information is a trade secret. If that happens, the importer may be liable for thousands of dollars in retroactive duties.

One way for importers to manage their risk is to insist on an indemnity clause, Kiselbach said. Simply put, the Canadian importer asks his supplier to provide a Certificate of Origin with his products. And then the importer asks the supplier to pay the cost of any additional duties or interest that may arise if the goods are re-evaluated.

Further difficulties can arise when a Canadian operation imports a product from a related company. The importer must demonstrate that the declared price is real, untainted by the relationship.

With many of these goods, Kiselbach said the importer should check with a lawyer who knows the latest version of the rules. Often, a subtlety can make a significant difference to the duty that is payable.

Kiselbach noted that the cost of freight, packing and insurance can sometimes be deducted from the value of the goods that are being shipped. Assembly and erection can also be deducted, as can the cost of operating and maintenance manuals.

Royalties and licence fees have been a particularly hot topic recently. The Supreme Court of Canada ruled that these fees may be deducted from the selling price of a good. But that ruling did not answer all the questions. Kiselbach said certain fees may still be taxable or even subject to a withholding tax.

Another area of contention concerns imports of software. Kiselbach said software has been the subject of litigation for 35 years, yet many questions still remain.

In some cases, software is not subject to import duties because it is intangible. However, software that is loaded onto a CD disk becomes a tangible good that is reportable and perhaps dutiable.

This question is particularly important for GST. Software that is transported electronically is probably not liable for GST. But software on a tangible carrier medium can be subject to GST.

Those rules are just the start. The subtleties can be obscure, frustrating and expensive. Kiselbach noted that in British Columbia a social services tax applies on packaged software, whether shipped electronically or on a CD disk. However, that rule does not apply to custom software designed for a specific person.

Given the complexity of these rules, Kiselbach advised importers to use a lawyer who knows the ins and outs, who can file a formal appeal or can simply chat with the right official.

"It is good to have somebody on the ground who can deal with a local official," Kiselbach said. "They have to know the right people and understand the latest rules."