Customs "Purchaser in Canada" Requirement: Judicially Watered Down

In yet another staggering blow to CBSA's Valuation Divisions view of the world, the Federal Court of Appeal has significantly watered down the so-called "purchaser in Canada" requirement.

The "purchaser in Canada" requirement is a legislated rule in section 48 of the Customs Act, which now requires that in order for "transaction value" to be used to value goods imported to Canada, the "sale" transaction be with what Canada Customs would regard as an appropriate "purchaser in Canada". The requirement has traditionally been used by CBSA to ensure that appropriate Canadian purchases amount to more than simple "shell companies", incorporated in Canada in order to take advantage of lower value for duty, and other tax consequences. In effect, CBSA has used a *de facto* control test, which demanded that the Canadian purchase exercise the de facto control over its own operations, and not be controlled, in fact, by another entity (e.g., a foreign parent): see Customs Memorandum D 13-1-3.

After the CITT upheld CBSA's view of the world – which would have required that clear mind and management and control exist in such "purchasers in Canada", and which would have excepted from qualification most shell structures – the Federal Court of Appeal ("FCA") has recently overturned the CITT, and put into question the legitimacy of CBSA's current policies.

The balance of this article provides the relevant background, reviews the high-points of the FCA decision, and provides commentary on the implications of the decision for Canadian importers.

Context of the Foster Grant Case

FosterGrant dealt with the "purchaser in Canada" requirements in section 48 of the *Customs Act,* and focused on just what it takes for a Canadian subsidiary to be able to use its "intercompany price" from a related parent, as its "value for duty" of imported goods under transaction value.

This issue has been around since the early 1990's, with Canada Customs generally demanding that a subsidiary have a "substantive presence" in Canada before being able to use the transaction value price – and backing that policy up with the 1997 "purchaser in Canada" amendment, as well as detailed regulations, and a fixed policy in Memorandum D13-1-3.

In *FosterGrant,* the CITT seems to have supported Customs attempts, and placed a high standard on what a "purchaser in Canada" means. The FCA can be seen to have rejected that approach, with important implications to Canadian importers.

The Facts

The purchaser and importer was AAi.FosterGrant of Canada Co. ("AAi Canada"). AAi Canada took title to the goods upon their delivery in a warehouse facility in Rhode Island owned by its U.S. parent, AAi.FosterGrant, Inc. ("AAi U.S."). AAi Canada bore the risk of loss from damaged goods, and took discounts on slow-moving goods or end-of-season price reductions. However, the goods were packaged at that warehouse for delivery directly to AAi Canada's Canadian customers, as AAi Canada did not maintain an inventory of goods in Canada.

AAi Canada did lease office premises and a showroom in Toronto, Ontario, and the FCA accepted that it also employed approximately 100 full-time and part-time employees across Canada, with seven full-time employees, including the president and vice-president, working at the Toronto location.

These full-time employees negotiated the selling terms of the goods to the Canadian purchasers, accepted and approved purchase orders and developed Canadian marketing programs and strategies for those goods, within the guidelines set by AAi U.S. They also managed the activities of AAi Canada, including the supervision of part-time employees, whose responsibility was to regularly visit the stores of the customers of AAi Canada to ensure that the products were replenished as required.

The FCA also concluded that the management of AAi Canada had the authority to enter into the lease for its Toronto premises, to enter into binding agreements of purchase and sale with its Canadian suppliers and customers, to approve invoices for the payment of its expenses, and to hire and fire employees.

Many day-to-day operations and functions were performed by AAi U.S., however, under a service agreement between AAi Canada and AAi U.S.. These included financial and banking services, financial support and invoicing services, and most of AAi Canada's administrative and accounting functions, including the invoicing of customers and the taking of action to collect unpaid accounts.

The banking arrangements for AAi Canada were a bit more problematic such that, for much of the relevant period, AAi Canada's money was held in bank accounts located in the United States, for which no employees of AAi Canada had signing authority.

AAi Canada did recognized profits from the sale of the goods it purchased from AAi U.S., reporting the same for Canadian income tax purposes, and paying the resulting income tax.

FCA Decision

Meaning of "Carrying on Business"

While the FCA fully understood the CITT's approach in the hearing of the matter in the case below (where it is fair to say that the CITT accepted CBSA's policy position and its interpretation in D-Memo 11-*-*), the FCA applied a more conventional approach to the question: it drew on established legal precedence, as follows:

> ¶ 17 There is a significant body of jurisprudence on the meaning of the phrase "carrying on business". I do not propose to attempt a summary. It is sufficient to refer to the helpful comments of Justice Iacobucci and Justice Bastarache, writing for the Supreme Court of Canada in *Backman v. Canada,* [2001] 1 S.C.R. 367 at paragraph 19:
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> > [19] In law, the meaning of "carrying on a business" may differ depending on the context in which it is used. Provincial partnership acts typically define "business" as including "every trade, occupation and profession". The kinds of factors that may be relevant to determining whether there is a business are contained in the existing legal definitions. One simple definition of "carrying on trade or business" is given in Black's Law Dictionary (6th ed. 1990), at p. 214: "To hold one's self out to others as engaged in the selling of goods or services." Another definition requires at least three elements to be present: (1) the occupation of time, attention and labour; (2) the incurring of liabilities to other persons; and (3) the purpose of a livelihood or profit: see Gordon v. The Queen, [1961] S.C.R. 592, per Cartwright J., dissenting but not on this point, at p. 603.

That permitted the FCA to conclude, quite easily, that AAi Canada was in fact "carrying on business" in Canada:

> ¶ 18 There is nothing in the *Customs Act* or the Valuation for Duty Regulations that would suggest that the meaning of the phrase "carries on business" should be interpreted in a manner that is not consistent with these established legal definitions. From those definitions, it would seem to be axiomatic that a corporation that buys and sells goods on its own account for a profit is carrying on business.
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> (emphasis added)

In dealing with the effect of CBSA's *de facto control* point, the FCA clearly rejected this approach as being "wrong at law":

> As I understand the reasons for the CITT's decision, the conclusion that AAi Canada was not carrying on business was based solely on the significant degree of de facto control exercised by AAi U.S. over the affairs of AAi Canada. In essence, the CITT adopted the principle that a corporation is not carrying on business if its affairs are subject to significant de facto control by the parent corporation. There is no authority for that proposition, and in my view it is wrong in law. There is nothing in the Customs Act that requires or permits that approach.
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> (emphasis added)

Standard of Review

In a subsidiary part of the case, the FCA also confirmed, per the *Mattel* decision,[i] that where

decisions of the CITT involve only the interpretation of language, and not any specialized knowledge, that the appropriate standard of review is correctness.

Commentary

The FCA appears to have based its decision, heavily, on the judicial policy established in the *Shell Canada* case,[ii] which holds that absent a sham transaction, the legal relationship that the parties establish between themselves is the relationship that will govern for tax purposes.[iii]

Searching for the "economic realities" of the situation, as one might suggest is the aim of CBSA's current policies (and most particularly, D 13-1-3), it not to be permitted.

And that is probably the most important part of the decision – particularly given the FCA's confirmation that this sort of analysis is as appropriate for customs cases as it is for income tax (or GST) cases.

For CBSA, this means that it is back to the drawing board' in terms of enforcing its longstanding policy regarding appropriate purchasers in Canada. Likely what is required is clear regulatory amendment that puts into clear words the tests that CBSA would like to enforce. The current framework, which establishes a rule using familiar concepts like "carrying on business" and "permanent establishment" – and then attempts to back-door a special meaning of those words through Departmental Memoranda – will not work in the current judicial environment.

Time will tell what CBSA decides to do; it is unlikely in my view that the case will be appealed to the Supreme Court of Canada, in that CBSA's case is very very weak – at least in light of the prevailing Supreme Court jurisprudence on statutory interpretation.

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i Canada v. Mattel Canada Inc., [2001] 2 S.C.R. 100.

ii Shell Canada Ltd. v. Canada, [1999] 3 S.C.R. 622.

iii For example, at one point the FCA observed that "[i]t was not alleged by the Commissioner, or found by the CITT, that the documents comprising evidence of the transactions to which AAi Canada was a party did not correctly state the legal rights and obligations of the various parties[;] [t]here is no allegation or finding of sham."