# K: INTERNATIONAL TRADE

**In recent years, Canada has aggressively negotiated and concluded numerous new trade agreements that were built upon, and have gone beyond, the North American Free Trade Agreement (NAFTA) model.**

With the gains of NAFTA firmly in place, Canada and the United States have endeavored to intensify North American economic co-operation through enhanced border co-operation and regulatory harmonization within the Beyond the Border initiative. In addition, Canada has been active in finalizing several investment treaties designed to protect Canadian investors abroad.

*RAINBOW BRIDGE*

*One of many bridges across the Niagara River, the Rainbow Bridge is a symbol of the long-standing friendship Canada has with its largest trading partner, the United States.*

While integration provides enhanced opportunities, it also emphasizes the need to comply with the legal framework governing trade and customs in each country (including export controls and sanctions regimes), and highlights the necessity of understanding the recourses available when investment and trade disputes arise.

## 1. IMPORTATION OF GOODS

### a. Duties and tax

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

While tariff classification is based on the harmonized system, goods may be classified differently in Canada than in other countries. In addition, not all countries have identical tariff codes, meaning an item listed under one tariff code in the U.S. may be listed under a completely different code in Canada. This often raises the question of whether the components within an imported product undergo the necessary tariff shift to claim preferential treatment under a trade agreement such as NAFTA.

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

### b. Valuation

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

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

Issues relating to transaction-value methodology often arise in related-party transactions due to the requirement that the value for duty reflect an arm's-length transaction. For instance, there is often tension between transfer-pricing objectives from tax and customs perspectives: a balance must be achieved to establish a transfer price that satisfies customs while maximizing tax-planning objectives.

### c. Rules of origin

Preferential rates of duty are accorded to products that originate in a country with which Canada has a free trade agreement, such as NAFTA, or agreements between Canada and Panama, Peru, Israel, Chile and other states. (Canada currently has free trade agreements with 11 countries or regions and is in the process of ratifying three additional agreements.)

Whether a product "originates," so as to benefit from a trade agreement, is determined by rules of origin, which may involve complex calculations and analysis of both the tariff classification and value of the components that make up an imported product.

### d. Appeals

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

### e. Import restrictions

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

## 2. ANTI-DUMPING AND COUNTERVAILING DUTIES

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

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

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

## 3. EXPORT CONTROLS AND SANCTIONS

### a. Export controls

Canada has a comprehensive regime for export controls and sanctions administered primarily by Global Affairs Canada (GAC), with enforcement assistance from the CBSA.

Three lists established under the authority of EIPA govern exports of goods and technology from Canada to various destinations: the Export Control List, the Area Control List and the Automatic Firearms Country Control List.

Under the EIPA, it is an offence to export or transfer goods or technology included on the Export Control List, or export or transfer goods to a destination on the Area Control List, except under the authority of a permit. Canada does not have a "licensing" system similar to the U.S., which makes it necessary for each exporter of a controlled good or technology to apply for a permit where one is required.

The minister of foreign affairs has issued several general export permits (GEPs) that allow exports of controlled goods or technology to specific destinations without the requirement to apply for an exporter-specific permit (assuming certain conditions are met). In an effort to streamline the process for the export of certain controlled goods and technology, GAC has recently introduced a GEP authorizing the export of controlled dual-use goods and technology (with some exceptions) to certain eligible destinations, provided the exporter complies with specific conditions.

In the absence of an applicable GEP, exporters must apply for an individual export permit (IEP) to export controlled goods or technology, or to export to a controlled destination. "Broad base" categories of permits are available to authorize multiple shipments to multiple destinations over a certain time period, particularly for cryptography exports, which have created significant compliance problems for Canadian exporters.

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

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

Export permits are not required for most controlled goods or technology destined to a final consignee in the U.S. Items that do require an export permit to the U.S. are identified on the Export Control List with a statement indicating that the control applies to "all destinations."

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

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

### b. Sanctions

Canada has two main statutes that authorize the imposition of trade and economic sanctions: the *United Nations Act* and the *Special Export Measures Act*. In addition to export controls under the EIPA, regulations passed pursuant to these acts impose various other measures, such as limitations on official and diplomatic contacts, and restrictions on

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economic activity between Canada and states that are the targets of sanctions, and the creation of "designated persons" lists – and the seizure or freezing of their property situated in Canada as well as a prohibition on doing business with them anywhere in the world. Export controls are normally limited to arms and related material and technical assistance, but may be broader for a particular state, such as Canada's very extensive sanctions on Syria and sector-specific sanctions on Russia.

## 4. CONTROLLED GOODS REGIME

Public Works and Government Services Canada manages the Controlled Goods Program (CGP), which requires mandatory registration and regulation of persons and entities who examine, possess or transfer defence goods as defined in Canada's *Defence Production Act*. The CGP was created in 2001 to strengthen the Canada-U.S. agreement on defence trade controls, and is essential for maintaining the Canadian exemption with respect to the U.S. International Traffic in Arms Regulation (ITAR) regime.

In October 2011, the CGP began implementing the Enhanced Security Strategy, which imposes heightened security requirements on registered persons and entities. These requirements were adopted to allow Canadian registrants to make use of the new ITAR dual-national rule, which amends the treatment of dual- and third-country nationals in a manner that resolves the conflict that existed between ITAR restrictions and Canadian human rights laws that prohibit discrimination based on nationality.

## 5. INVESTOR-STATE DISPUTES

Canada is party to a number of trade and investment agreements that allow foreign investors to bring claims against the Canadian government for a breach of an obligation owed to the investor (by either the federal or provincial governments) under one of Canada's investment treaties.

NAFTA's investor-state provisions have given rise to a number of claims brought against Canada. Obligations owed to investors under Canada's investment treaties include:

- The requirement to accord national treatment and a minimum standard of treatment
- The prohibition against the adoption of certain performance requirements (e.g., domestic content requirements)
- The commitment to pay compensation for expropriation

Canadian investors abroad can also bring similar claims against their host country's government under the numerous investment treaties between Canada and foreign countries.

## 6. CANADA'S BLOCKING LEGISLATION: THE *FOREIGN EXTRATERRITORIAL MEASURES ACT*

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

There is currently only one order in force under FEMA: the Foreign Extraterritorial Measures (United States) Order. This Order creates a dangerous "catch-22" for related Canadian and American companies by prohibiting a Canadian company from complying with American extraterritorial measures that restrict trade between Canada and Cuba.

If the company complies with U.S. law, it faces serious sanctions under FEMA. On the other hand, if it does not comply with U.S. law, it may face serious sanctions under U.S. laws that prohibit trade with Cuba. The FEMA order also imposes an obligation on Canadian companies to "report" communications received that relate to an extraterritorial measure of the U.S. pertaining to Cuba, and imposes strict penalties for non-compliance to this obligation.

FEMA applies to any company incorporated and carrying out work in Canada, meaning that a subsidiary of a U.S. company registered in Canada and carrying on activities in Canada, even if minor, would be captured under the FEMA order and subject to its reporting and compliance obligations. As a result, FEMA issues often arise in the context of mergers between Canadian and U.S. companies where the Canadian companies have existing Cuban businesses or when a U.S. company establishes a Canadian affiliate or subsidiary.

## 7. PROACTIVE TRADE COMPLIANCE

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

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