

Blakes Bulletin

International Trade & Investment

Cherry Stix II Signals Opportunity to Reduce Duties on Imports

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On May 10, 2010, the Canadian International Trade Tribunal (CITT or Tribunal) issued its decision in *Cherry Stix Ltd. v. President of the Canada Border Services Agency* (Cherry Stix II). The CITT decided that where title to imported goods transfers in Canada to the “purchaser in Canada”, the transaction value method is not applicable in the determination of the customs value of the goods on which duties must be paid. This article will review the decision and the implications for importers.

It is important to note that the transaction value method (TVM) would have been clearly applicable to the acquisition cost to Cherry Stix Ltd. if the company had ordered the goods from the foreign manufacturer prior to having entered into an agreement to sell those goods to Wal-Mart Canada. This conclusion follows from the decision in *Cherry Stix Ltd. v. President of the Canada Border Services Agency* (Cherry Stix I). However, it was accepted that Cherry Stix Ltd. had entered into its agreement to sell to Wal-Mart Canada prior to ordering the goods from the foreign supplier and, as a result, the valuation method was put in issue.

THE FACTS

Cherry Stix Ltd. imported various styles and colours of women’s T-shirts from China, that were sold to Wal-Mart Canada. Cherry Stix Ltd. initially valued the goods using the TVM based on the sale price to Wal-Mart Canada. Cherry Stix Ltd. subsequently applied for a refund of duties on the basis that the goods are properly valued based on the acquisition cost to Cherry Stix Ltd. Following denial of the refund claim by the Canada Border Services Agency (CBSA), Cherry Stix Ltd. appealed to the CITT, arguing initially that the deductive value method was properly applicable and then, during the hearing, agreed the issue was simply whether or not the TVM was the correct method to use.

The Tribunal summarized the evidence concerning the five main steps leading to the import transactions

at issue. The Tribunal provided details concerning the initial step involving preparation of a sketch and sample, the process of marketing, sales negotiation, manufacturing and, finally, delivery. The Tribunal also considered the documentation which evidenced the transactions at issue, including a vendor agreement, vendor information manual, and the purchase order. Pursuant to these documents, Wal-Mart Canada would initially issue a “Blanket Order/Estimated Quantities (Not Firm Commitment)” to Cherry Stix Ltd. Once the goods are manufactured and have been imported into Canada, Cherry Stix Ltd. issues an “Allocation Request Form” to Wal-Mart Canada and, in response, Wal-Mart Canada issues individual “Purchase Orders” to Cherry Stix Ltd. which allocates the quantities in the Blanket Order to distribution centres designated by Wal-Mart Canada, and Cherry Stix Ltd. then issues individual invoices for each such Purchase Order.

CITT’S ANALYSIS

The CITT focused its analysis on the three conditions that must be met before the transaction value can be used to appraise the value for duty, namely: there must be a sale for export; there must be a purchaser in Canada; and the price paid or payable must be ascertainable. The CITT also focused on the Supreme Court of Canada’s test in *Mattel Canada (Canada - Deputy Minister of National Revenue v. Mattel Canada Inc.)* for the determination of the relevant sale for export, namely, “the sale by which title to the goods passes to the importer” and for the definition of “importer”, namely “the party who has title to the goods at the time the goods are imported into Canada”.

Framing the issue as to whether there was a “transfer of title of the goods in issue by Cherry Stix Ltd. to Wal-Mart Canada prior to their importation into Canada”, the Tribunal then made reference to the Ontario *Sale of Goods Act* (SGA) and, in particular, the rules applicable to a contract for the sale of specific or ascertained goods. Subsection 18(1) of the SGA provides that “property” in specific or ascertained goods “is transferred to the buyer at such time as the parties to the contract intend it to be transferred”.

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The Tribunal concluded, after a review of all of the facts, that the completion of the sale and, therefore, the transfer of title to the goods in issue did not occur until Wal-Mart places its purchase order with Cherry Stix Ltd., which in all cases occurred after the goods had been imported into Canada. As a result, the CITT determined that there was no "sale for export" as between Cherry Stix Ltd. and Wal-Mart Canada, so that the TVM was not applicable in this case.

TRANSACTION VALUE METHOD TO APPLY LESS OFTEN

The TVM is intended to be the primary method of appraisal of imported goods. This is clear from subsections 47(1) and (2) of the *Customs Act*. However, should the Tribunal's decision in Cherry Stix II not be appealed or if it withstands an appeal, it is likely that the TVM will be applicable in fewer import transaction scenarios. This is especially the case in respect of (but not limited to) imports of clothing and footwear, as the facts in Cherry Stix II are not uncommon in such industries.

The decision is bound to complicate the determination of the proper customs valuation of imported goods. This is due to the relatively more complex methodology applicable in the case of the alternative methods of valuation that are prescribed by the *Customs Act*, namely: the transaction value of identical goods; the transaction value of similar goods; the deductive value; and the computed value.

POTENTIAL REFUND OPPORTUNITY FOR IMPORTERS

The decision in Cherry Stix II presents a potential refund opportunity for importers who have valued their import transactions applying the TVM to the sale price charged to the customer in Canada. However, it is not entirely clear whether the application of any of the alternate valuation methods will result in a lower value for duty than the application of TVM. This must be considered on a case-by-case basis. For example, both the TVM of "identical goods" followed by the TVM of "similar goods" must be applied before consideration of the deductive value or compute value methods can occur.

For this reason, the determination of the proper customs valuation of import transactions is likely to become a more complex exercise than was the case before Cherry Stix II.

Notwithstanding the foregoing, importers should be aware that there is a potential for any refund opportunity to be short-lived or eliminated should the CBSA push for amendments to the *Customs Act* and/or regulations to correct the perceived abuse of the *Customs Act*. It is not yet clear whether the CBSA will choose to appeal the Cherry Stix II decision and/or take steps to amend the *Customs Act* to effectively reverse the decision in Cherry Stix II.

CONCLUDING COMMENTS

The decision in Cherry Stix II is a significant departure from the CBSA's current administrative practice and interpretation of the TVM provisions of the *Customs Act*. To the extent the decision is not appealed or if it withstands an appeal, customs valuation cases will likely become far more complex, involving more and varied legal considerations given the critical importance of the determination of when a "sale" is considered to have occurred and the relevance to this issue of the application or potential application of non-customs laws such as the Ontario *Sale of Goods Act* and/or the international *Convention on the International Sale of Goods*.

At the time of writing, it is not clear whether the CBSA intends to appeal the decision. Pursuant to subsection 68(1) of the *Customs Act*, there is a right of appeal to the Federal Court of Appeal on a question of law, within 90 days of the decision. The period for an appeal will expire on or about August 8, 2010.

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