Prepared by EY Canada’s Tax Policy and Controversy Practice, News from the North is a periodic publication that summarizes recent tax administrative, legislative and case developments of interest to multinational corporations investing in Canada.

For more information, please contact your EY advisor.

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Our last “View from the bridge” in the April 2017 edition of *News from the North* noted that Canada’s federal government was still awaiting the outcome of the tax reform debate in the US Congress before deciding whether to chart any new tax policy course in Canada. It ended by commenting, “we are indeed living in interesting times.”

If anything, the times have only become a whole lot more interesting since then, especially for the Canadian Government. US tax reform became a reality and the resulting reduction in both corporate and personal tax rates put Canada at a competitive tax disadvantage vis-à-vis the United States, both in terms of attracting capital investment and in hiring and retaining the best and brightest talent in the international workforce.

Prior to passage of the *Tax Cuts and Jobs Act* (TCJA) in the US, Canada had enjoyed a significant business tax advantage as measured by both statutory rates and marginal effective tax rates on new investment. US tax reform completely eliminated that advantage. The TCJA’s provisions mean that multinational enterprises that have significant Canada-US cross-border operations and transactions now have an incentive to organize their businesses in a way that results in relatively more taxable revenue in the US and less in Canada.

As a result of this erosion in Canada’s business tax competitiveness among other things, a number of industry and professional associations, including the Canadian Chamber of Commerce and the Chartered Professional Accountants (CPA) Canada, have publicly recommended that the Canadian Government undertake a comprehensive tax policy review. The Canadian business community has not been alone in expressing this view. In two independent international external reviews, the OECD and the IMF both also concluded that Canada should review its tax system. In October, the Standing Committee on Banking, Trade and Commerce of the Senate of Canada added its voice to this growing chorus with a recommendation for a Royal Commission to review Canada’s taxation system to restore Canada’s competitiveness in a report ominously titled, *Canada: Still Open For Business*?

The Canadian Government has not expressed a willingness to undertake a comprehensive review at this point in time, nor acknowledged that Canada has a competitiveness problem. The only policy response so far from federal Finance Minister Bill Morneau has been a series of three accelerated depreciation changes announced in his annual Fall Economic Statement on 21 November 2018. Even these are temporary measures that will be phased out starting in 2024 and ending after 2027.
As if news on the tax policy front has not been bad enough, developments on the trade policy front have been equally troubling. In our last issue we noted, “Early signs from the Trump administration are that Mexico is the main target in renegotiating NAFTA and that the existing terms and balance of trade with Canada are less of a concern.” That was then – fast forward to now. The US and Mexico reached agreement in principle on a new deal earlier than the US and Canada, who remained deadlocked in bilateral negotiations on key issues that included Canada’s insistence on retention of an independent dispute resolution mechanism, similar to that contained in Chapter 19 of the existing NAFTA agreement, and US demands for greater access to Canada’s supply-managed dairy industry.

In the end, a new trilateral rebranded United States Mexico Canada Agreement (USMCA) was finally reached, but it now must be ratified by each country’s legislature. The politics of this process could be especially interesting in the US with the Democrats having won a majority in the House of Representatives following the 2018 mid-term Congressional elections.

With his Liberal Party enjoying a majority in Canada’s House of Commons, Prime Minister Trudeau has an easier row to hoe in that regard than does President Trump. However, he is heading into a federal general election in 2019 and so must also sell the deal politically to Canadians, just as it will be sold to Americans and Mexicans by their respective presidents.

This could be a challenging task for the prime minister, considering that while he is doing so, President Trump will no doubt be vocally reminding US voters that NAFTA was “the worst deal ever,” whereas his new “USMCA” deal is the greatest ever.

Having said that, “standing up” to Trump may play well with Canada’s voters, who are still trying to digest the US president’s 25% tariff on US imports of Canadian steel and 10% tariff on aluminum imposed under his executive authority and justified on the basis that Canada poses a strategic “national security” threat to the United States.

Yes indeed, interesting times, these.

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The CRA’s hybrid debt project

In October 2015, the Organization for Economic Development and Cooperation (OECD) concluded numerous reports related to its Base Erosion and Profit Shifting (BEPS) project, including the report related to Action 2 – Neutralising the Effects of Hybrid Mismatch Arrangements.

Hybrid debt mismatch arrangements include multiple deductions for a single expense, a deduction in one country without corresponding taxation in another country, and multiple foreign tax credits for one amount of foreign tax paid.

With this heightened awareness and guidance, the Canada Revenue Agency (CRA) initiated a project undertaking to review certain taxpayers’ hybrid debt arrangements with a view to determining whether or not the debts and related interest expenses were in accordance with Canada’s Income Tax Act and the OECD’s recent guidance.

The CRA’s project includes roughly 300 taxpayers with audits at varying stages. In general, we have noted that CRA is very aggressive in the positions it takes.

The CRA has continually been increasing its focus on financial transactions and gaining valuable experience in understanding these transactions.

Hybrid debt arrangements typically involve very material dollar amounts for our clients, resulting in significant exposure to adjustments by CRA audit teams. The CRA is also considering the application of transfer pricing penalties equivalent to 10% of any transfer pricing adjustments assessed.

These audits are developing a pattern whereby the CRA is seeking guidance and assistance from the CRA Headquarters International Large Business Directorate in pursuing the recharacterization of these hybrid debt structures pursuant to paragraphs 247(2)(b) and (d) of the Income Tax Act.

EY is developing a nationally coordinated approach to deal with these audits using the knowledge gained from several of the ongoing audits.

We’re recommending that our clients take immediate action to review their existing financial loan arrangements to:

• Perform a debt capacity analysis on the borrower’s standalone basis to determine reasonableness.

• Review terms and conditions, including the interest rates, of loans to determine if amounts are arm’s-length terms and conditions.

• Review the terms of the loans. Shorter terms carry less audit risk, whereas CRA views longer terms not to be reflective of arm’s-length terms.

• Review for prepayment options. Adding penalties in for prepayment options can assist in avoiding interest rate recharacterizations and adjustments.

If debt arrangements are already under the CRA’s scrutiny, contact EY for the latest insight on these audits.

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Changes to the CRA’s Voluntary Disclosure Program

As of 1 March 2018, the CRA introduced changes to its Voluntary Disclosure Program (“VDP”) to restrict both access to the program and the benefits of the program.

The new policy introduced two tracks for VDPs. The first track is the General Program, which is similar to the previous VDP program such that penalty relief and partial interest relied on maybe available. The second track is a Limited Program wherein there is only limited relief available.

Under the Limited Program, the only relief available is that a taxpayer will not be referred for criminal prosecution with respect to the disclosure, and will not be charged gross negligence penalties where the facts support that a taxpayer is liable for such penalties. Any other potential penalties are not eligible for relief under the Limited Program.

The Limited Program provides limited relief where there is an element of intentional conduct by a taxpayer. The CRA will consider factors such as the dollar amounts involved, the use of offshore vehicles to avoid detection, the number of years of non-compliance, the sophistication of the taxpayer, and where the disclosure is made after a public statement by the CRA on the particular issue or the CRA has issued correspondence on the matter.

The CRA has stated that corporations with gross revenue in excess of CDN$250 million will only be considered under the Limited Program.

To be considered a valid disclosure, an application must meet the following five conditions:

- It must be voluntary.
- It must be complete.
- It must involve the potential application of a penalty.
- It must include information that is at least one year past due.
- It must include payment of the estimated tax owing.

This fifth condition of including payment of the estimated tax owing is new from the previous policy.

Unfortunately, the CRA has decided to discontinue the availability of filing a no-names submission under the VDP.

The CRA has also commented that any transfer pricing issues will now be referred to the Transfer Pricing Review Committee (“TPRC”) for consideration. The TPRC is a headquarters committee responsible for the determination of whether transfer pricing penalties are applicable to transfer pricing adjustments being assessed. It should be noted that the waiver of transfer pricing penalties will not be considered under the Limited Program.

Clients would be well advised to consider seeking advisor guidance to avoid the pitfalls of the CRA’s new VDP policies.

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APA Program update

During its 2011 fiscal year, the Canadian Advance Pricing Arrangements (APA) program made significant changes in its approach to accepting APA applicants. This involved greater due diligence during the earliest phases of an APA request, including the requirement for more content in pre-filing presentations and responding to additional written questions before proceeding with the APA process.

The intent of the change was to improve program efficiency, as the CRA would have information that had been historically provided later in the process, and this would allow the agency to make better decisions on the suitability of the APA applicant. Applicants viewed the changes as restrictive, as many interested in the program were not accepted despite responding to the program's information requests. There was also a perception at the time that the program changes were made to limit entry into the APA program to allow the CRA to obtain control of an all-time high inventory.

Recent communications with the APA Program would suggest that the changes have paid off. The program's closing APA balance is the lowest inventory count in more than a decade and the program is signaling that it's open for business. The program has streamlined the process for information requests and will provide a written summary of its questions with the expectation the responses will be included in the APA submission. With four experienced APA teams managing inventory, case workload is moving quickly and APAs are being completed earlier than the program's internally targeted timelines.

Considering these recent developments, now may be the time to discuss the benefits of an APA, or to revisit discussions of an APA, with your clients. With the program operating efficiently and the CRA's willingness to consider accepting more applicants into the program, access has improved significantly.

The CRA has approximately 500 international auditors and a significant budget to address compliance issues relating to international transactions. It continues to leverage BEPS initiatives and plans to make us of Country-by-Country Reporting and the increased use of Exchange of Information with other tax authorities. All of this leads to additional audit exposure, and the risk of audit is at an all-time high.

Transfer pricing controversy remains at the forefront of most tax leaders’ concerns. An APA is a great alternative for managing transfer pricing controversy; it provides prospective tax certainty and eliminates potential audit and transfer pricing penalty exposure.

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Canadian Federal Court Of Appeal confirms the existence of common interest privilege in Canada

At the beginning of 2017, we summarized a Federal Court of Canada (FCC) decision, *Minister of National Revenue v Iggillis Holdings Inc. and Ian Gillis*, 2016 FC 1352, in which the FCC found that common interest privilege (CIP) in an advisory context (i.e., outside of a litigation privilege context) was not a valid form of solicitor-client privilege. That decision was appealed to the Federal Court of Appeal (FCA). The FCA heard the appeal on 2 October 2017 and overturned the FCC’s earlier decision.

The underlying facts are not overly complex. Ian Gillis and Iggillis Holdings Inc. (the taxpayers) were involved in the purchase and sale of a business to a purchaser corporation, Abacus Capital Corporations Mergers and Acquisitions (Abacus). The taxpayers and Abacus were represented by different lawyers. As is often the case, the tax lawyers for the vendor and purchaser discussed the tax consequences of the proposed purchase and Abacus’s lawyers prepared and shared with the taxpayers’ lawyers a memo summarizing the tax consequences of the transactions. After the taxpayers’ lawyers provided their comments on the memo, Abacus’s lawyers finalized the memo and provided a copy to the taxpayers’ lawyers.

In the course of an audit, the CRA demanded a copy of the memo. The taxpayers refused to provide a copy on the basis that it was protected by CIP. The CRA then applied to the FCC seeking a court order to compel disclosure of the memo. In this case, the CIP claimed to protect the memo from disclosure by the taxpayers was advisory CIP. Advisory CIP pertains to communications between lawyers whose clients share a common interest that is not related to litigation or anticipated litigation (often in a commercial transaction context). The FCC reviewed Canadian and US case law and a US academic article, and found that advisory CIP was not a valid form of solicitor-client privilege.

The taxpayers appealed the FCC’s decision.

The FCA found in favour of the taxpayers and allowed their appeal. Given that the memo was made up almost exclusively of opinions on the legal effects of the transaction, the FCA found that there would be no loss of evidence if the memo were not disclosed. The FCA also found that the FCC’s statements regarding advisory CIP were general statements of policy, but that the test applicable should have been whether a superior court of the province from which the matter arises (in this case Alberta and British Columbia) would find that the memo was protected from disclosure by solicitor-client privilege.

CIP is strongly implanted in Canadian law, and in particular the provinces of Alberta and British Columbia. It was not appropriate for the FCC to rely on US case law to effectively overturn the case law from the courts of Alberta and British Columbia. As there was sufficient common interest between Abacus and the taxpayers, the FCA found that CIP protected the memo from being disclosed to the CRA.

The CRA sought leave from the Supreme Court of Canada to appeal. On 25 October 2018, the Supreme Court of Canada refused to grant the CRA leave. Without leave, the FCA’s decision is final.

Despite its status in Canadian law, not all common law jurisdictions recognize the doctrine that relates to CIP. In particular, there is divergent recognition and application even across different jurisdictions in the US.

When one is involved in transactions that involve multiple jurisdictions, one should be mindful of how these jurisdictions view CIP before sharing documents with lawyers of the other parties of a transaction and relying on the doctrine.

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New GST/HST and QST issues affecting nonresidents

New QST registration requirements for nonresidents

In its most recent budget tabled on 27 March 2018, the Quebec Government communicated its intention to implement a new mandatory specified registration system effective as of 1 January 2019 for nonresidents of Canada. Similar rules will also be put into place for Canadian residents outside of Quebec effective 1 September 2019, but with a scope of application extended to the sales of goods.

This mandatory specified registration system will apply to suppliers with no physical or significant presence in Quebec (nonresident suppliers) to ensure that in a digital context, Quebec sales tax (QST) is collected and remitted and to minimize tax avoidance.

Under this new specified registration system, nonresident suppliers of taxable intangible personal property and services (not goods) made in Quebec will be required to collect and remit QST on these supplies made to specified Quebec consumers. A “specified Quebec consumer” is defined as a person who is not registered for QST and whose usual place of residence is in Quebec. These new rules also apply to digital property and services distribution platforms that control key elements of transactions such as billing, transaction terms and conditions and delivery terms with specified Quebec consumers.

The mandatory registration will not apply to nonresidents who make taxable supplies in Quebec to Quebec consumers (individuals) of less than CDN$30,000 during the last 12 months. The new specified registration system will work independently from the current QST registration system. However, a nonresident who is required to register under the new specified QST registration system will be able to elect to register for the general QST registration system if the registration requirements provided for under the existing legislation are met.

Input tax refunds (ITRs) will not be available under the specified registration system. Therefore, in certain circumstances it might be more beneficial for a nonresident to register under the general registration system, requiring cumulatively a GST registration.

New penalties will apply for non-compliance with the new rules found under the specified registration system.

Changes to the CRA’s Voluntary Disclosure Program

Effective 1 March 2018, the Canada Revenue Agency (CRA) changed certain elements and requirements of applications made to its Voluntary Disclosure Program (VDP).

The requirements that an application be voluntary, complete and involve the application or potential application of a penalty or interest remain the same. However, under the new program, an application can now be submitted as long as the information concerned is at least one reporting period past due as opposed to at least one year past due.

Payment of the estimated tax owing must now be included at the time of the application. Previously, the CRA allowed for a non-binding no-name predisclosure discussion, but this option has now been eliminated. Full names must be disclosed at the time of the application, as well as the name of the advisor who provided assistance with the matter being disclosed, if applicable.
There are now three tracks available under the VDP:

- Track 1 for wash transactions: There is 100% penalty and interest relief.
- Track 2 under the general program for reasonable errors where there is no presence of gross negligence or deliberate avoidance of tax: There is 50% relief from interest and full relief from penalties.
- Track 3 under the limited program for GST/HST collected and not remitted, deliberate or willful default or carelessness amounting to gross negligence and for large businesses (defined as having gross revenue in excess of CDN$250 million in at least 2 of the last 5 taxation years, including revenue of any related entities): There is no interest relief and only relief from gross negligence penalties.

As with the former program, there is relief from prosecution under all circumstances.

Another requirement under the new VDP is that participants falling under the limited program have to waive some objection and appeal rights to receive relief under the VDP.

Taking these changes into consideration, taxpayers should discuss the potential implications, liabilities and risks with a tax professional prior to filing an application under the new VDP.

**Areas of risk**

We’ve seen an increase in audits and assessments in which the CRA and Revenu Québec have denied input tax credits (ITCs) claimed on the GST paid on importation claimed by the importer of record when the importer of record is not the owner of goods (the de facto importer).

The CRA and Revenu Québec are of the view that only the de facto importer can claim back the GST paid on importation as an ITC. This has been an ongoing trend and an area that is problematic for importers and anyone making cross-border supplies. Contracts and documentation to this effect should be reviewed by a tax professional to establish the validity of the tax authority’s position.

Further, ITCs and ITRs being claimed by the improper entity (e.g., not the entity indicated on the invoice) is also an area of focus of the CRA and Revenu Québec. Generally, only the recipient of a supply is entitled to claim the GST/HST/QST paid on the supply as an ITC or ITR.

In addition, to claim ITCs and ITRs, it is important that the invoices or any other documentation such as contracts meet the documentary requirements, as this has been another area of scrutiny by the tax authorities. The documentary requirements include:

- Supplier or intermediary’s name, or the name under which it does business
- Date of the invoice
- Total amount paid or payable for all supplies
- Supplier’s or intermediary’s GST/HST registration number (and QST or PST registration numbers where such taxes apply)
- The amount of tax payable, where the amount paid or payable for the supply does not include the amount of GST/HST
- The provincial sales taxes applicable and the amount of provincial sales taxes payable, where provincial sales taxes, other than the provincial component of the HST apply (supplies in British Columbia, Saskatchewan, Manitoba or Quebec) and the supplier is registered for such taxes
• A statement to the effect that the GST/HST is included in the amount paid or payable, where the amount paid or payable includes the amount of GST/HST
• Status of each supply where the invoice includes both taxable and exempt supplies
• Recipient’s name or the name of the recipient’s agent or duly authorized representative
• Terms of payment
• Description of the property

Intercompany transactions
Another area in which we have seen an increase in audits and assessments is intercompany transactions.

Supplies made between related parties are generally subject to GST/HST/QST when these supplies are made or deemed to be made in Canada. Agreements between the parties need to be closely reviewed to establish if the supply is subject to GST/HST/QST or if the place of supply rules would apply to deem the supply to be made outside of Canada and therefore not subject to GST/HST/QST.

Depending on the terms of the agreement and the registration status of the parties, there is also a possibility that the supply is zero-rated under the exported supplies provisions. An election to deem supplies made between closely related entities to be made for nil consideration, therefore not subject to GST/HST/QST, is only available to Canadian corporations and partnerships and must be filed with the tax authorities. Even if a nonresident is registered for GST/HST/QST purposes, they will not be eligible for such an election.

An area that has been problematic lately is the CRA challenging the eligibility of Canadian corporations and partnerships to enter into such an election when there are foreign entities in the corporate structure. This is an area that should be monitored by nonresidents that have entities in Canada and which should be challenged if an audit or assessment is issued on these grounds, as this position is not consistent with the legislation.

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US-Canada trade tensions continue as Canadian and US steel and aluminum tariffs remain in force

Effective 1 June 2018, the United States followed through on its announcement to remove the Canadian exemption from the global “national security” interest tariffs imposed on US imports of steel and aluminum products at the rates of 25% and 10%, respectively. These tariffs were based on a previous finding by the US Department of Commerce under section 232 of the Trade Expansion Act of 1962, which concluded that the import of Canadian steel and aluminum products threatened US “national security” interests.

In response, effective 1 July 2018 Canada imposed a 25% or 10% surtax on steel and aluminum products and many consumer goods originating in the United States under two retaliatory surtax orders. Canada Border Services Agency (CBSA) issued Customs Notice 18-08 clarifying the application of the surtaxes, adding certain exceptions and confirming that the Duties Relief Program and Duty Drawback Program relieving measures will apply to covered goods.

In addition, as of 11 October 2018, a remission order is available for certain goods affected by the Canadian surtaxes.

Tariff countermeasures

The imported goods originating in the US that are subject to Canada’s countermeasures are listed under three tables released by the Department of Finance:

- Table 1 goods are subject to a 25% surtax and cover primary iron and steel products, including bars, rods, tubes, pipes and wires.
- Table 2 goods are subject to 10% surtax and cover primary aluminum products and many finished aluminum goods.
- Table 3 goods are also subject to a 10% surtax applicable to many consumer goods, including food products, household products, recreational goods and, not surprisingly, wood and paper products.


Clarifying points of interest

It’s important to note that goods listed in Tables 1, 2 and 3 (which correspond to Schedules 1 and 2 of the United States Surtax Order (Steel and Aluminum) and the Schedule to the United States Surtax Order (Other Goods) that are also listed under provisions in Chapters 98 and 99 of the Schedule to Canada’s Customs Tariff) are subject to the surtaxes, even though they are entitled to a preferential tariff rate of customs duty under these concessionary Chapters (usually duty free), subject to a few exceptions in Chapter 98. The exceptions include conveyances and containers engaged in international commercial transportation, temporary imports of conveyances and baggage for non-commercial purposes, travelers’ exemptions (e.g., the 48-hour or 7-day exemptions) and certain settler’s effects.

Duties relief or drawback is available

Canada's Duties Relief Program and Duty Drawback Program continue to be available to importers for surtaxes paid or otherwise owing by Canadian businesses that meet the programs' requirements. This means that duty deferral can apply to the surtax subject goods that are destined for re-export or as inputs therefor, and duty drawback can apply where the goods are exported or destroyed without use in Canada or are used as inputs in exported goods.

Duty Drawback Program

The Duty Drawback Program provides a refund of the surtax imposed under the orders for goods that are:

- Exported in the same condition as imported;
- Further processed then exported;
- Display or demonstration; or
- Used as inputs to produce other goods for export.

To obtain a refund, qualifying importers must complete the appropriate claim form and attach all necessary documentation to substantiate the import, export and processing (if applicable).

Duties Relief Program

The Duties Relief Program provides for relief of the surtaxes at time of importation, as long as one of the following conditions is met:

- Goods are exported in the same condition as imported;
- Goods are imported for further processing and exported;
- Goods are displayed or demonstrated in Canada; or
- Goods are used in the production or development of goods for export.

Importers must apply in advance to the CBSA, demonstrating that their recordkeeping is satisfactory to support a request for duty relief and that the subject goods qualify.

The CBSA will conduct an onsite validation and, once approved, an authorization number will be provided that will grant the importer relief from payment of the surtax at the time of importation. It will remain the obligation of the importer to pay the surtax if goods become non-qualifying post-importation. Note that authorization does not apply retroactively; surtaxes paid on goods imported prior to receiving authorization can be recovered through a drawback claim once the goods are exported from Canada.

If the goods are sold or transferred to another company in Canada, that company must be registered under the Duties Relief Program to benefit from the relief of the surtax.
The United States Surtax Remission Order – Order in Council and Customs Notice Published

The United States Surtax Remission Order² issued 10 October 2018 was accompanied by the CBSA’s release of Customs Notice 18-16 on 11 October 2018. Finance Canada has published formal regulations, in keeping with past implementations of Orders made under section 115 of the Customs Tariff, in the 31 October 2018 edition of the Canada Gazette.

The Remission Order was made following numerous applications by Canadian importers to the federal Interdepartmental Remission Committee for remission of the surtaxes imposed in response to the US steel and aluminum tariffs. It was concluded that certain goods covered by the United States Surtax Order (Steel and Aluminum)³ are in short supply or there is no supply available in the Canadian market for manufacturing inputs.

In addition to this short-supply remission policy available to all importers of eligible goods listed in the Schedules to the Remission Order, the Interdepartmental Remission Committee is continuing its analysis of specific requests from Canadian companies, including those related to imports of surtax subject goods under contractual obligations existing prior to 31 May 2018.⁴ Remission applications are also expected to continue to be processed under the exceptional circumstances criterion.

Covered goods and other remission conditions

The Remission Order provides for the relief from or refund of surtaxes paid on:

- Imports of US-origin steel and aluminum where there is no supply or temporary short supply to minimize negative effects on the Canadian economy
- Certain pleasure vessels in situations of pre-existing contractual obligations prior to 31 May 2018 and imported into Canada on or after 1 July 2018 and subject to surtaxes
- Goods imported temporarily for repair, alteration or storage

Each category is subject to specific conditions in the Remission Order, the administration of which by the CBSA is set out in Customs Notice 18016. In all cases, remission is available retroactively to 1 July 2018 and can apply upon importation on a go-forward basis with proper import documentation coding.

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²SOR/2018-0205 PC 2018-1272.
³SOR/2018-152.
⁴“Backgrounder – Relief for Canadian Businesses from Countermeasures on Certain U.S. Imports.”
Emergency global safeguard surtax imposed on importation of certain steel goods for 200 days pending CITT injury inquiry

On 11 October 2018, the Canadian Department of Finance announced a new 25% global safeguard surtax on steel products, subject to a Canadian International Trade Tribunal (CITT) injury inquiry, with exceptions for certain free trade partners, lesser-developed countries entitled to the general preferential tariff and US-origin goods already subject to the surtax, intended to prevent diversion of foreign steel products into Canada.

This safeguard surtax applies on seven categories of steel goods (multiple tariff items) to imports from all countries, other than the US and certain free trade agreement and lesser-developed countries, under the Order Imposing a Surtax on the Importation of Certain Steel Goods. This new provisional global safeguard surtax is implemented effective 25 October 2018 and will apply for 200 days thereafter, or be implemented for up to four years, depending on the conclusion of an inquiry into serious injury to Canadian producers by the CITT due 3 April 2018, to which the matter has been referred pursuant to section 55 (1) of the Customs Tariff.

This provisional surtax applies to steel goods imported without a shipment-specific import permit, which can be applied for and issued under the guidance provided by Global Affairs Canada’s Notice to Importers No. 911. Global Affairs Canada will administer a tariff rate quota (TRQ) regime similar to the agriculture TRQs. It’s important to note that nonresident importers will not be able to qualify for import permits under the quota regime for the new provisional safeguard surtax.

Goods covered by this surtax will be subject to the TRQ import permit process administered jointly by Global Affairs Canada and the CBSA. Notice to Importers No. 911 outlines the available quota levels for the seven categories of subject goods, but makes no reference to a quota allocation scheme. Subject to further policy modifications or clarifications from Global Affairs Canada, it appears that import permits will be issued within 50-day quota cycles to any applicant (without requiring an ongoing quota “allocation”), on a first-come-first-served basis at import levels that are not expected to cause injury to Canadian producers.

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5 “Government of Canada Stands Up for Steel and Aluminum Businesses and Workers.”
6 SOR/2018-0206, PC 2018-1273.
7 PC 2018-1275.
8 Notice to Importers: Item 82 – Steel Goods (Serial No. 911).
United States-Mexico-Canada Agreement (USMCA) to replace NAFTA

On 1 October 2018, the United States (US) President announced an agreement with Canada to replace the existing North American Free Trade Agreement 1994 (NAFTA) between the US, Mexico and Canada to be called the United States - Mexico - Canada Agreement (USMCA or the Agreement).\(^9\) While not effective immediately (NAFTA will continue into 2019 or even longer depending on the US legislative and implementation process), it is a new agreement and there are some significant changes (for example, it can impact Canada (by affecting Canadian foreign subsidiaries) as some US treaties predicate limitation of benefit or derivative benefits on being resident of a country that is a party to NAFTA\(^10\)). USMCA follows seven rounds of NAFTA renegotiations, not all of which involved Canada directly, that took place over the course of 13 months and comes roughly 30 days after the US and Mexico announced a similar “preliminary agreement in principle” to modernize NAFTA.\(^11\)

The agreement was signed by all parties on 30 November 2018. The USMCA must be subsequently ratified by the legislatures of all three countries and implementing legislation and regulations must be drafted before it will enter into force.

The United States Trade Representative (USTR) published the full text of the USMCA on 1 October 2018,\(^12\) and released details on how the USMCA will achieve stated objectives to modernize previous commitments made under NAFTA, including major changes to market access for supply-managed agricultural products (including dairy, chicken, eggs, sugar and peanuts); rules of origin for automobiles, automotive parts and textiles; increased thresholds for low-value (de minimis) cross border shipments subject to informal duty-free entry procedures; enhanced patent protection for biologic drugs and longer copyright protection; and investment dispute settlement rules as discussed below.\(^13\)

What has not changed significantly, thankfully for Canadian businesses, was the “Chapter 19” binational panels for trade remedy law reviews (an important win for Canadian businesses affected by US Anti-dumping and Countervailing (AD/CV) decisions adversely impacting Canada such as softwood lumber and paper products recently) now found in Chapter 10 of the USMCA, the NAFTA Visa rules for temporary entry, and government procurement in the case of Canada (Canada did not accept the US-limited procurement provisions for Mexican companies and the World Trade Organization rules will continue to apply to Canada-US procurement). In addition, the NAFTA “Chapter 20” institutional and state-to-state dispute settlement provisions remain intact (now in Chapters 30 and 31 of the USMCA).


\(^10\) See the United States/Luxembourg Income Tax Convention Article 24(4) for an example requiring 95% of shares to be owned by residents of a state that is a party to NAFTA.


\(^12\) Text of the USMCA is available at: https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/united-states-mexico.

The proposed USMCA consists of 34 chapters, compared to the 22 chapters contained in NAFTA, and covers new areas such as labour, the environment, anti-corruption and regulatory policy, among others. Notably, it also includes numerous Annexes and Explanatory Notes and 12 Side Letters. Four of those Side Letters specifically grant Canada and Mexico important concessions pertaining to the ongoing US investigation into tariffs on imported automobiles and automotive parts. A similar agreement, however, was not reached on the punitive special “national security” tariffs currently imposed on imported Mexican and Canadian steel and aluminum.

As discussed below, the USMCA requires ratification by all three countries and implementation before it becomes effective. Ratification is possible this year, with final implementation by mid next year. Publication of the text provides businesses with a critical opportunity to now analyze the proposed text in advance, assess its impact on their operations, and evaluate necessary changes to business to take advantage of the new rules.

Key provisions of the USMCA

Rules of origin (Chapter 4)

The USMCA proposes major changes to the way that automobiles and automotive parts qualify for preferential treatment. The USMCA raises the regional value content (RVC) threshold for automobiles from 62.5% to 75%. Particular RVC requirements vary based on the type of vehicle or parts under consideration. While tariff shift rules (where applicable) remain in the proposed USMCA, the tracing list is eliminated. The USMCA also adds a new labour value content rule requiring that 40%–45% of auto content be produced by workers earning at least US$16 per hour, although it will be difficult to trace this. Lastly, finished vehicle producers will be required to purchase 70% North American steel and aluminum of the total such content.

The USMCA also includes stricter rules of origin for other industrial products such as chemicals, steel-intensive products, glass and optical fiber. For textiles and apparel, the USMCA limits rules contained in NAFTA that permitted the use of certain non-NAFTA inputs. For a textile or apparel finished product to now qualify for preferential treatment under the USMCA, it requires that certain inputs incorporated into the finished product, such as sewing thread, pocketing fabric, narrow elastic bands, and coated fabric, also be made in the same region as the finished product. For example, if a finished blouse is manufactured in Mexico, these inputs must originate in Canada, Mexico and/or the US.

Trade in agriculture – market access (Chapter 3)

Under the proposed USMCA, Canada has agreed to provide limited market access to US exports of dairy, poultry (turkey and chicken) and eggs. Likewise, the US has agreed to provide limited market access to Canadian exports of dairy, peanuts and peanut products, and sugar.

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15 USMCA Chapter 4.
16 For example, while light vehicles would require 75% RVC, heavy vehicles would require 70%. The RVC for auto parts, on the other hand, would range from 65%–75% depending on whether these are considered “core,” “principal” or “complementary.”
17 For origin qualification purposes, the tracing provision allows certain components to be deemed originating notwithstanding their country of origin.
18 The specific calculation of the labour value content considers manufacturing costs, technology and assembly expenditures.
19 Seventy percent of an Original Equipment Manufacturer’s annual purchases of aluminum and steel would have to be from the US, Mexico or Canada.
and sugar products. New tariff rate quotas will be introduced by both nations in order to facilitate these concessions. Canada also agreed to eliminate milk price classes 6 and 7 and adopt measures to limit the impact of its surplus skim milk production on external markets such as the introduction of export surcharges.

**Other significant provisions**

The USMCA includes the following key provisions:

- Establishes procedures that streamline certification and verification of rules of origin
- Certification of origin is now allowed to be made by the exporter, producer or importer of the goods
- Maintains duty free treatment for originating goods, prohibition on export duties and other charges, as well as waiver of customs' processing fees
- Adds transparency to import and export licensing procedures
- Increases the de minimis shipment free entry values for Canada and Mexico (Chapter 7):
  - Mexico will provide duty free entry for shipments valued at or below US$100, while maintaining duty and tax free treatment for shipments at or below US$50. Shipments at or below US$100 will be subject to minimal formal entry procedures.
  - Canada will provide duty free entry for shipments up to CA$150 and raise its de minimis level from CA$20 to CA$40 for shipments eligible for non-taxable importation under federal taxation regimes (e.g., imported free of import Goods and Services Tax). However, provincial taxes, which may apply in the case of business-to-consumer import transactions, are not covered by the negotiated outcomes. Shipments at or below CA$150 will be subject to minimal formal entry procedures, assuming they otherwise qualify for informal line clearance options.
- NAFTA’s Article 303 restrictions on duty deferral and duty drawback have been incorporated into Chapter 2 of the USMCA
- Chapter 20 includes 10 years of data protection for biologic drugs and a robust scope of products eligible for protection, and copyright protection in Canada will be extended from “life plus 50 years” to “life plus 70 years”
- Incorporation of the substance of the NAFTA Chapter 19 dispute settlement provisions into the USMCA Chapter 10
- Temporary entry provisions for business visitors under the USMCA (Chapter 16) appear essentially unchanged in substance from that in NAFTA Chapter 16
- Significantly, as this was a major fear in Canada, the Government procurement rules between the US and Canada will continue to operate according to the rules established under the WTO Agreement on Government Procurement (GPA). The USMCA’s procurement chapter (Chapter 13) will only affect US-Mexico procurement and will not impact Canadian suppliers.
- Cultural institution exemptions existing in NAFTA are preserved for the most part in the USMCA
- Partial Section 232 relief for Mexico and Canada
  - Significantly, nothing in the USMCA addresses the existing punitive tariffs imposed by the US under Section 232 on Canada and Mexico origin steel and aluminum products. This is subject to future negotiations.
• Two Side Letters provide Mexico and Canada with relief in the event that the US imposes punitive tariffs on imports of automobiles and automotive parts under Section 232 of the Trade Expansion Act of 1962 (Section 232):
  • Exclusion from Section 232 duties for the first 2.6m passenger vehicles imported from Canada and for the first 2.6m passenger vehicles imported from Mexico
  • Exclusion from Section 232 duties for light trucks imported from Canada and Mexico
  • Exclusion from Section 232 duties for the first US$32 billion worth of auto parts imported from Canada and the first US$108 billion worth of parts imported from Mexico
• Two Side Letters establish a mandatory consultation process in the event that the US imposes Section 232 measures:
  • The US must provide a 60-day grace period from the date of imposition of any Section 232 duties before they take effect to allow for consultations
  • Mexico and Canada have the right to take measures of equivalent commercial effect, including World Trade Organization rights to challenge a Section 232 measure
• Article 32.10: Non-Market Country FTA:
  • Under this article, a party to USMCA that intends to commence free trade agreement negotiations with a non-market country must inform the other parties to USMCA at least three months prior to commencing negotiations
  • Upon request of another party, a party intending to commence free trade negotiations with a non-market country shall provide as much information as possible regarding the objectives for those negotiations, including the full text of the proposed agreement for review.
  • More importantly, entry by a party into a free trade agreement with a non-market country will allow the other parties to terminate USMCA on six months’ notice and replace USMCA with a bilateral agreement.
• Entry into force, expiration, renewal and withdrawal provisions are set out in Chapter 34:
  • The Agreement will enter into force on the first day of the third month following the notification of the last country to complete its domestic processes required for implementation of the Agreement
  • The Agreement will automatically terminate after 16 years of entry into force unless each country agrees to extend for another 16 years
  • The Agreement will be reviewed by the countries every six years to determine whether changes are needed
  • Countries may withdraw from the Agreement with six month’s written notice. In the event that one country withdraws, the Agreement remains in effect for the other countries.
What to expect next?

In Canada, after being introduced in the form of an implementing bill by Government, the USMCA must first be put to a vote in the House of Commons and Senate after a full review by Parliament pursuant to Parliamentary Sub-Committees’ reports and debate. This process will likely take several months. Supplemental legislation would then need to be drafted and passed where required, although much of this would already be in existence under the existing NAFTA or CUSFTA (Canada-United States Free Trade Agreement) legislation. In Mexico’s case, it still needs to be ratified by the legislature before it is directly implemented into law. The US process is more complex.

Once the Agreement is ratified by the legislatures of the US, Mexico and Canada, the USMCA will enter into force no sooner than three months from the date of the last country’s notification that all implementing laws are in place. The ratification process is therefore likely to continue well into 2019 before becoming effective.
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