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Tax Alert – Canada

Navigating through the uncertainty of potential new tariffs on imports of Canadian products into the United States

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 25 November 2024, United States (US) President-elect Donald Trump announced via social media his intention to impose a 25% tariff on all products imported from Canada and Mexico.[1] The president-elect also announced a plan to impose an additional 10% tariff on all imports of Chinese goods, which would apply in addition to existing tariffs currently in place.

The proposed 25% tariff on Canadian imports is a significant increase from the universal 10% tariff proposed by the president-elect during the US election campaign.[2] The president-elect has linked the threatened tariffs to Canadian and Mexican border security and immigration issues. It is unclear at this stage what policy conditions would need to be satisfied by Canada and Mexico with respect to these issues to prevent the imposition of the threatened tariffs.

Importance of the Canada-US trade relationship

Since the US is Canada's largest trading partner, it is highly likely that the proposed tariffs would lead to significant adverse impacts on the Canadian economy.

- As reported by the Office of the Chief Economist, Global Affairs Canada, in 2023, trade overall represented two-thirds of Canada's gross domestic product. Canada's export industry supported nearly 3.3 million Canadian jobs (that is, one out of every six Canadian jobs).[3]

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[1] Reuters. (2024, November 25). "Trump promises 25% tariff on products from Mexico, Canada in 2024."
[2] Reuters. (2024, November 4). "Trump's tariffs would reorder trade flows, raise costs, draw retaliation."
[3] State of Trade 2024: Supply chains.

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- Statistics Canada reported that, in 2023, 77% of Canadian exports were to the US, with a value of approximately $594.5 billion. Imports from the US accounted for 50% of all imports to Canada, with a value of approximately $373.7 billion.[4]
- According to Statistics Canada, in 2023, some of the top Canadian exports to the US included energy products, motor vehicles and parts, consumer products, metal and non-metallic mineral products, forestry products and building and packaging materials, and industrial machinery, equipment and parts.[5]

Possible retaliatory tariffs from Canada

The economic repercussions may also be compounded by the possibility of retaliatory tariffs imposed by Canada. This approach has precedent in Canada. In response to previous measures taken by the US against Canadian products, namely certain steel and aluminum products, Canada swiftly imposed retaliatory tariffs in 2018 under section 53 of the *Customs Tariff*[6] on US imports of steel, aluminum and numerous finished products. The surtax was imposed under the *United States Surtax Order (Steel and Aluminum)* (SOR/2018-152) and the *United States Surtax Order (Other Goods)* (SOR/2018-153).

Canada's retaliatory tariffs were eventually repealed following an agreement between Canada and the US.

Additional tariffs on products from China and beyond

Throughout the US election campaign, President-elect Trump committed to implementing a universal minimum tariff rate of 10% to 20% on all imports, and a separate tariff of over 60% on all Chinese-originated imports.

Most goods of Chinese origin are already subject to additional tariffs in the US as a result of measures under section 301 of the *Trade Act of 1974*.

Whether the additional tariffs imposed on Chinese and Mexican exports to the US may ignite conditions for potential diversion of these products to the Canadian market is an issue that may also need to be monitored closely.

Timeline for application of proposed US tariffs

There are several ways the US may modify tariff rates and impose trade remedies in the US on the basis of national security or economic injury, including under section 232 of the *Trade Expansion Act of 1962*, sections 201 and 301 of the *Trade Act of 1974* and the *International Emergency Economic Powers Act* (IEEPA).

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[4] The International Trade Explorer.
[5] Canadian international merchandise trade by country and by product section, customs-based, annual.
[6] S.C. 1997, c. 36.

While the process for conducting investigations under statutes such as the *Trade Act of 1974* or the *Trade Expansion Act of 1962* may take several months, trade actions taken under the IEEPA can be executed within a matter of weeks. Given that the incoming US administration will take office in January 2025, any decision to impose the above-mentioned tariffs could enter into effect within a relatively short period of time after January 2025.

Canada-US-Mexico Agreement (CUSMA)

The US, Mexico and Canada entered into CUSMA during the US president-elect's first presidential term. CUSMA includes a sunset clause that introduced a "doomsday clock" mechanism, mandating a review every six years to decide on an extension. If CUSMA is not extended, the treaty is subject to a review annually until the expiration date.

During his 2024 campaign, President-elect Trump expressed his intent to invoke the six-year renegotiation provision.[7]

How EY Global Trade can support you to mitigate operational impacts

With the anticipated tariffs on exports to the US, strategic planning before 2025 is imperative. EY Global Trade has a streamlined three-stage strategy to help your business mitigate operational impacts.

- ***Stage 1 – Define current state and model future tariff scenarios using EY's Global Trade Analytics Platform***
  - Use easy-to-access data to rapidly model the current state cost implications of President-elect Trump's tariff agenda.
  - Pinpoint the bottom-line cost burden of future exports to the US and model the impact of new tariff scenarios.
  - Enhance your ability to expedite shipments, reallocate inventory, identify cost exposure on duties and taxes, and identify opportunities to streamline trade flows.
- ***Stage 2 – Execute a short-term mitigation strategy with EY's Global Trade specialists***
  - Assess origin calculations and valuation procedures for customs purposes to ensure the correct classification and origin of goods imported into the US.
  - Adjust pricing strategies to reflect tariff costs, ensure correct duties are assessed and paid and use appropriate customs procedures to enhance trade effectiveness (e.g., first-sale rule, drawback and duty deferral to minimize payable customs duties and taxes).

[7] The Wall Street Journal. (2024, November 4). "Trump's trade threat to Mexico."

- *Stage 3 – Evaluate long-term strategies*
  - Review valuation methodologies, transfer pricing and source of supply of goods and services with US operations.
  - Redesign supply chains and sourcing locations to align to a "new normal" of US trade and tax policy – ensuring regulatory and tax compliance.

Learn more

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