Canada Border Services Agency | Agence des services frontaliers du Canada

Ottawa, July 8, 2009

MEMORANDUM D13-4-13

In Brief

POST-IMPORTATION PAYMENTS OR FEES
"SUBSEQUENT PROCEEDS"

(*Customs Act*, Section 48)

1. This memorandum provides information on the treatment of post-importation payments and management or administration fees referred to as "subsequent proceeds" in the calculation of the value for duty made under the transaction value method.

2. The memorandum also includes new references to sources of the Canada Border Services Agency (CBSA) information.

Printed in Canada

Canada

Canada Border Services Agency | Agence des services frontaliers du Canada

Ottawa, July 8, 2009

MEMORANDUM D13-4-13

POST-IMPORTATION PAYMENTS OR FEES "SUBSEQUENT PROCEEDS" (*Customs Act*, Section 48)

This memorandum explains how payments made after goods are imported into Canada are treated within the transaction value provisions of the *Customs Act*, with particular emphasis on the types of post-importation payments generally called "subsequent proceeds." As well, the treatment of management or administration fees is explored, as a type of "subsequent proceed". Reference is provided to the memoranda that explain how other types of post-importation payments may be treated. Examples of various types of post-importation payments or fees and their treatment for valuation purposes by the Canada Border Services Agency (CBSA) are provided in Appendix A.

TABLE OF CONTENTS

LEGISLATION

Subsection 48 (1), *Customs Act*

48. (1) Subject to subsections (6) and (7), the value for duty of goods is the transaction value of the goods if the goods are sold for export to Canada to a purchaser in Canada and the price paid or payable for the goods can be determined and if

(c) where any part of the proceeds of any subsequent resale, disposal or use of the goods by the purchaser thereof is to accrue, directly or indirectly, to the vendor, the price paid or payable for the goods includes the value of that part of the proceeds or such price is adjusted in accordance with subparagraph (5)*(a)*(v); …

Subparagraph 48(5)*(a)*(v), *Customs Act*

48. (5) The price paid or payable in the sale of goods for export to Canada shall be adjusted

(a) by adding thereto amounts, to the extent that each such amount is not already included in the price paid or payable for the goods, equal to

(v) the value of any part of the proceeds of any subsequent resale, disposal or use of the goods by the purchaser thereof that accrues or is to accrue, directly or indirectly, to the vendor.

Subparagraph 48(5)*(c)*

48. (5) The price paid or payable in the sale of goods for export to Canada shall be adjusted

(c) by disregarding any rebate of, or other decrease in, the price paid or payable for the goods that is effected after the goods are imported.

Subsection 45. (1), *Customs Act*

Definitions

45. (1) In this section and sections 46 to 55.

"price paid or payable", in respect of the sale of goods for export to Canada, means the aggregate of all payments made or to be made, directly or indirectly, in respect of the goods by the purchaser to or for the benefit of the vendor;

"sufficient information", in respect of the determination of any amount, difference or adjustment, means objective and quantifiable information that establishes the accuracy of the amount, difference or adjustment;

GUIDELINES AND GENERAL INFORMATION

General Policy

1. There are various types of payments that can be made in respect of imported goods. Those for which a determination can be made at the time of importation should be included in the price paid or payable as outlined in subsection 48(1) of the *Customs Act*. Other post-importation payments are referred to as "Subsequent Proceeds." The transaction value provisions of the *Customs Act* require that subsequent proceeds be added to the price paid or payable to properly determine the value for duty of imported goods (subparagraph 48(5)*(a)*(v)). As well, certain payments for financial transactions, such as dividends may be considered as exclusions to the additions to the price paid or payable.

POST-IMPORTATION PAYMENTS OR FEES

2. The expressions "post-importation payments or fees" and "subsequent proceeds" do not appear in the *Customs Act*. It includes any type of payment made by a purchaser after the importation of goods into Canada. Payments made after the importation of goods can be remitted to the vendor of the goods or to a third party, and may have to be included in the value for duty of the imported goods.

3. To establish the value for duty of imported goods under the transaction value method, there are several kinds of post-importation payments that must be examined:

(a) any payments based on the resale of the goods that cannot be related by the importer to services received;

(b) management or administration fees, as addressed further in this memorandum, and subject to the exceptions outlined;

(c) contributions to research and development. See Appendix A;

(d) contributions for worldwide marketing or promotion. See Appendix B;

(e) overhead expenses related to the manufacturing of the goods but not captured in the selling price and recovered after the importation of goods (see Memorandum D13-4-3, *Customs Valuation: Price Paid or Payable (Customs Act, Section 48)*);

(f) interest on deferred payments (see Memorandum D13-3-13, *Customs Valuation: Interest Charges for Deferred Payment for Imported Goods (Customs Act, Sections 48 to 53)*);and

(g) other payments made after importation (see Memorandum D13-4-7, *Adjustments to the Price Paid or Payable (Customs Act, Section 48)*).

4. It is important to determine the nature of each payment to apply the appropriate valuation provisions of the *Customs Act*.

"SUBSEQUENT PROCEEDS"

Definition of "Subsequent Proceeds"

5. The expression "subsequent proceeds" mentioned in paragraph 3 is a practical term used to simplify the phrase: "the value of any part of the proceeds of any subsequent resale, disposal or use of the goods by the purchaser thereof that accrues or is to accrue, directly or indirectly, to the vendor" found in subparagraph 48(5)*(a)*(v) of the *Customs Act.*

Guidelines

6. Subsequent proceeds must be added to the price paid or payable and form part of the transaction value of goods as required by subparagraph 48(5)*(a)*(v) of the *Customs Act*.

7. Subsequent proceeds are a type of post-importation payments. They are subject to two conditions:

(a) the payments accrue directly or indirectly to the vendor of the goods (in this instance the use of the word accrue means to increase the amount you have by adding to it); and,

(b) the payments are based on, or a result of, the resale, disposal or use of the goods in Canada:

(i) a resale exists where a person who has sold goods or property to a purchaser sells them again to someone else; for valuation purposes resale can also mean the further sale of imported goods by the purchaser to someone else which is the definition employed in this memorandum.

(ii) disposal or use means the sale, pledge, giving away, utilization, consumption or any other disposition of a good.

8. The terms of the payments, whether based on a percentage of the resale price of the goods, fixed on a per-unit amount, lump sum payments, or by any other agreed to formula, are often negotiated under a separate contract, and the payments themselves remitted separately from the payment for the goods. Whether or not a formula exists for the terms of the subsequent proceed, the fact that payments are sent by a purchaser to a vendor means these amounts (subject to certain conditions outlined in this memorandum) must be added to the price paid or payable to establish the value for duty.

9. The *Customs Act* anticipates that some payments made to or for the benefit of the vendor after the importation of goods may not be included in the invoice price for the goods, and it ensures, through Section 48 of the Act, that they are added to the price paid or payable. Nowhere in the *Customs Act* or the *World Trade Organization (WTO) International Valuation Agreement* is there a requirement that these subsequent proceeds must be "a condition of sale" of the goods or be "in respect of the goods" being imported.

Rather, the mere fact that such payments exist requires that they be added to the price paid or payable.

10. Subsequent proceeds usually occur in situations where the purchaser is related to the vendor, but they could also happen in unrelated party transactions. Since payments made after the importation are generally remitted separately from the payment for the goods themselves, importers often do not include them in the value for duty.

11. For example, a purchaser in Canada pays $100 for pens in a sale for export to Canada. Under a separate agreement, the purchaser agrees to pay 10% of the resale price of the pens to the vendor. The purchaser resells the pens in Canada for $200. The part of the proceeds of the subsequent resale that must be added to the value for duty is 10% of $200, or $20. The $20 represents the part of the proceeds of the subsequent resale of the goods, which must be added to the price paid or payable.

MANAGEMENT OR ADMINISTRATIVE FEES

12. Management and/or administration fees are one type of payment that should be examined to determine whether they are "subsequent proceeds" or exclusions to the additions to the price paid or payable. "Management and/or administration fees" are not defined in the *Customs Act*; as such, there is no legislative basis for their exclusion as an addition to the price paid or payable. CBSA allows the exclusion of management fees and/or administrative services as a discretionary administrative policy based on CBSA's definition of management fees and/or administrative services. The definition generally includes the functions of planning, direction, control, coordination, systems or other functions at a managerial level. These functions may involve services for various departments of a business, such as accounting, financial, legal, electronic data processing, employee relations, management consultation, labour negotiations, taxation, relating to management and/or administration.

13. Sometimes, in addition to selling goods, vendors will offer management and/or administration services to their purchasers. This is common between related parties, particularly in multinational groups where one member will provide services to other members within the group.

14. To illustrate, a Canadian importer purchases goods from its parent company located in the United States. The related parties have determined their affairs are best organized by centralising some or all of the management functions. Both parties enter into an agreement where the vendor performs these activities for the importer for a fee. The payments for these services are made separately from any payments related to the purchase of goods.

15. Payments made for management and/or administration services may meet the criteria to be subsequent proceeds, since the payments are remitted to the vendor after the importation of goods and they are often based on the resale, disposal, or use of the goods in Canada. However, in certain circumstances (as outlined in paragraph 12), CBSA allows some payments made for management or administration services to be excluded from the subsequent proceeds provisions of the Act.

16. To determine whether they can be excluded, the three following elements are examined:

(a) the services must have been rendered for the operation of the business in Canada;

(b) the amount of the charge must be in accordance with an arm's length charge; and

(c) the services provided are justified for the operation of the business in Canada.

Services Rendered

17. The question of whether a payment was made in respect of identifiable management and/or administration services depends on the nature of the service provided and whether the services were actually performed. A foreign related party company may charge a management fee amount to its subsidiary for a number of services including, for example, a management consultation when in fact the specific service may not have happened. Furthermore, there might not be an agreement to specifically charge for such an amount and the specific billing for the exact service may not have been submitted. In such circumstances this charge would not meet the requirements of CBSA's administrative policy on excluding a recognized management fee from the value for duty and would be added to the price paid or payable.

18. The importer is responsible for keeping sufficient and appropriate evidence, which establishes the nature of the services and proves that they were truly provided for the operation of the business in Canada. The basis used must be available for examination by CBSA, for instance, a management fee charged by a U.S. parent company to its Canadian subsidiary that is based on a percentage of sales in Canada may not bear any relation to the actual value of the services rendered.

19. It is important to take notice that for the management and/or administration services to be considered rendered, no portion of the amount charged should be for services already provided by Canadian personnel.

Amount of the Charge

20. Management and/or administration services are often centralized to share the costs between numbers of related companies. In cases where costs of services are distributed among various departments, branches, or subsidiary corporations, (including the purchaser in Canada), not only must the amounts themselves be comparable to the price that would be charged by an unrelated party, but also the method of allocation of these costs must be reasonable

and appropriate to the circumstances of the importer's business.

21. The fees charged must be comparable to the price that would be charged in Canada by an unrelated party engaged in a similar transaction. For example: If a purchaser pays a fee for bookkeeping services to a parent vendor of the goods, the amount charged for the services must be consistent with fees that would be charged by independent parties providing similar services.

> **Note:** CBSA does not arbitrarily set benchmark values of what a reasonable charge should be, as the burden of proof lies with the importer to substantiate that the amount of the charge in question is reasonable.

22. To determine whether the amount charged for management fees and/or administrative services is fair, consideration is given to the amount of the fee in relation to the services performed by the vendor and the benefit derived by the purchaser in Canada. A parent company may provide services that are not part of its principal business but the charge should not exceed industry standards. Note that industry standard charges of unrelated service providers contain an element of profit and CBSA recognizes the same might be true for related party management and/or administrative service fees. However, it should also be noted that an excess amount of profits claimed on such services might be challenged by CBSA.

23. The apportionment of management fees and /or administrative services costs between related parties should be based on a comprehensive review of the expenses; this process should be carried out in advance of determining the share allocated to the Canadian importer. The basis of allocation should result in costs being shared in proportion to the benefits received, for example, the allocation of costs of a centralized department based on an estimate of time spent on duties performed for each entity (branch, subsidiary, etc.). Note that management fees and/or administrative services costs determined after the fact are more likely to be challenged by CBSA. In all cases the basis used for charging a fee must be available for examination by CBSA.

Justified Services

24. The allowable management and/or administration fees excluded from the amount of subsequent proceeds added to the price paid or payable does not include amounts for services not related to the Canadian operation. For that reason, in order to be considered a legitimate fee for management and/or administration services, an importer must establish that the specific activity performed by their related party is a service for which a charge is justified. In an arm's length relationship, the unrelated Canadian business would be willing to pay for management and/or administrative services only to the extent that the service is needed and delivers some kind of benefit.

25. Determining whether or not a charge is for a justified activity involves the following question: Would the importer for whom the management and/or administrative services is being carried out either have been willing to pay for the activity if performed by an unrelated service provider or have performed the activity itself? Where it would not have been reasonable to expect the importer to either pay an unrelated service provider for the activity or to perform it itself, it is unlikely that any charge for the activity would be justified.

26. A parent company may provide services that are not part of its principal business and, therefore, the amount charged may not be representative of industry standards. CBSA will consider such circumstances on a case-by-case basis. However, it should be noted that profits realized on such services might be challenged by CBSA. For example: An arm's length corporation would not bear the costs of a shareholders meeting of another corporation; therefore, a subsidiary would not bear any costs of a parent's shareholders meeting or it would not pay fees for a promotional service that did not take place in Canada for a product not sold in Canada.

Common Methods of Charging for Management and/or Administrative Fees

27. Vendors providing services to purchasers will charge for these services using various methods. The most common methods are:

> *(a)* The total cost incurred by the vendor is distributed amongst the recipients of the management and/or administration services based on their usage. For example, the recipient who has the largest volume of operations will be charged a larger percentage of the total cost.
>
> *(b)* Payments are based on a percentage of the net sales of the goods. For example, 10% of the net sales will be remitted to the vendor.

28. The method found in *(a)* is a legitimate approach that accurately reflects the real costs associated with management and administration. The problem presented by the method found in *(b)* is that it does not necessarily meet the requirement that the payment must be for the services rendered for the operation of the business in Canada. The amount of the charge is required to accurately reflect the actual management and administrative costs for Canadian operations and not a percentage based on other criteria. In situations where the scenario in *(b)* presents itself, further substantiation of actual costs would be required in order to meet the requirements of sufficient information.

29. At times, amounts paid are casually described as payments for management or administration services, but they are in substance amounts for something else. For example, in related party transactions, there is some flexibility between the parties to debundle (break down or

segment) the price, meaning that certain overhead expenses are excluded from the selling price. Vendors sometimes attempt to recover manufacturing overhead expenses later by charging them to the purchaser as management or administration fees. However, since no identifiable management or administration services have been rendered, the amounts paid would have to be added to the price paid or payable for the goods, as they represent a form of compensation for the imported goods.

OTHER POST-IMPORTATION CONSIDERATIONS

Unsupported Amounts/Sufficient Information

30. Subsection 45(1) of the *Customs Act* defines "sufficient information" to be the objective and quantifiable information that establishes the accuracy of the amount, difference or adjustment. The decision as to whether a sufficient quantity of evidence has been obtained will be influenced by its quality. Although CBSA will consider evidence that is persuasive, this may not preclude the corroboration by more conclusive evidence in the importer's books and records. Occasionally, importers may be unable to provide the necessary information proving that a payment, or a portion of a payment, relates to an identifiable service for the Canadian operations, or that it is in accordance with the arm's length principle. In such cases, where the cost of the service was based on the disposal, resale, or use of the goods, the unsupported amount will have to be included in the value for duty as a subsequent proceed.

31. CBSA will initially presume that service fees are dutiable with the provision that this can be rebutted with evidence from the importer indicating that the fees are in accordance with the arm's length principle, and that they relate to justifiable services that were actually rendered for the Canadian operation. Importers must be able to provide "sufficient information" pursuant to subsection 45(1) to justify exclusion of the fees from the value for duty.

32. Importers must have documentation that describes:

(a) the nature of the service for which payment is made

(b) the basis on which it is paid; and

(c) the proof that actual services are being provided and paid for.

33. These documents might include commercial invoices, agreements, and/or other proof of payment, depending on the circumstances.

34. Where the subsequent proceed will be a calculation based on a percentage of sales or similar criteria known at the time of importation then, based on that calculation and previous years sales, importers must calculate the future payment at the time of importation.

Year End Adjustments

35. Year-end adjustments to the selling price of the goods and made payable to the vendor of the goods, are a post-importation payment and should be added to the price paid or payable to establish the value for duty. Memorandum D11-6-6, *Self-Adjustments to Declarations of Origin, Tariff Classification, Value for Duty, and Diversion of Goods*, outlines the policy on self-adjustment of accounting information relating to the value for duty.
Paragraph 48(5)*(c)* of the Act provides that adjustments to "the price paid or payable in the sale for export to Canada shall be adjusted … by disregarding any rebate of, or other decrease in, the price paid or payable for the goods that is effected after the goods are imported."

Financial Transactions

36. Dividends are not subsequent proceeds and, therefore, are not to be included in the value for duty. This has been recognized in the WTO Valuation Agreement which states that, "The price actually paid or payable refers to the price for the imported goods. Thus the flow of dividends or other payments from the buyer to the seller that do not relate to the imported goods are not part of the customs value."

37. The term "dividends or other payments" refers to financial transactions rather than proceeds related to the purchase and resale of goods. Proceeds are profits made on the resale of imported goods and are therefore related to the goods. Dividends are also profits, but they are shared by stockholders or shareholders and relate to the firm's overall business, not just to the purchase or resale of the imported goods. Determining whether an amount is a dividend (or some other kind of payment that might or might not be included in the price paid or payable) is done by the definitions and requirements found in Canadian Tax Law. Therefore, excludable payments of dividends to related party foreign vendors must meet the non-resident Part XIII tax requirements of the *Income Tax Act*. Sufficient information in the form of CRA dividend payment forms must be provided in order to demonstrate that the payment to a non-resident (related or non-related) is a dividend.

38. "Other payments" that are not to be included in the value for duty are usually financial instruments of some type and include:

(a) the issue, assumption, redemption, and repayment of a debt;

(b) the issue, redemption, and acquisition of share capital; and

(c) any other financing activities.

Time Element

39. A payment is to be added to the price paid or payable, even if the actual amount that is remitted to the vendor may not be known until after the goods are imported. The timing

of a payment whether it is at the time of importation, at the time of the sale of the goods, or some time after importation, is irrelevant. These payments must be included in the value for duty.

Reporting of Subsequent Proceeds

40. At the time of importation, it may be difficult for importers to determine the value of subsequent proceeds and, consequently, the amount to be added to the price paid or payable. This is especially true for payments that are based on a percentage of future sales, the resale, disposal, or use of the goods in Canada.

41. Importers should estimate the amount of a subsequent proceed at time of accounting and add it to the price paid or payable for goods. Information such as previous years' data or sales forecasts can be used to support the estimate. If the finalized subsequent proceed is different from the estimate, a self-correction of value for duty may be necessary. Refer to Memorandum D11-6-6, *Self-Adjustments to Declarations of Origin, Tariff Classification, Value for Duty, and Diversion of Goods.*

Additional Information

42. Appendix A contains information on how to interpret Research and Development fees within the context of subsequent proceeds.

43. Appendix B contains information on how to interpret Marketing and Promotional fees within the context of subsequent proceeds.

44. Appendix C contains examples that illustrate various types of post-importation payments or fees and their treatment for valuation purposes.

45. For more information on post-importation payments or fees and/or subsequent proceeds and how they are treated for value for duty purposes, contact the CBSA's Border Information Service at **1-800-461-9999** for service in English or **1-800-959-2036** for service in French.

APPENDIX A

RESEARCH AND DEVELOPMENT FEES

This appendix defines the payments and fees that will be considered as research and development, which are to be added as subsequent proceeds to the price paid or payable.

Research and Development

1) Research and development (R&D) is not specifically mentioned in the *Customs Act*, but payments on account of research and development are considered captured by the expression "subsequent proceeds," as an addition to the price paid or payable

2) Development is mentioned in 48(5)*(a)*(iii)(D) of the *Customs Act* in another context - Assists. Development work that is provided as an assist is not to be confused with Development work in the context of subsequent proceeds. An assist is provided by the purchaser to the vendor for a reduced cost or free of charge. Whereas, development work as described in this D-memo is a cost incurred by the vendor and passed on to the purchaser as a part of the price paid or can be paid to the vendor separately.

Research

3) The term research refers to planned study undertaken with the hope of gaining new scientific or technical knowledge and understanding. Such studies may or may not be directed towards a specific practical aim or application.

4) The following are examples of activities that typically would be included in research:

(a) laboratory research aimed at the discovery of new knowledge;

(b) searching for commercial applications of new research findings; and

(c) conceptual formulation and design of possible product or process alternatives.

Development

5) The term development refers to the translation of research findings or other knowledge into a plan or design for new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

6) The following are activities that typically would be included in development:

(a) testing in search for, or evaluation of, product or process alternatives;

(b) design, construction and testing of pre-production prototypes and models; and

(c) design of tools, jigs, moulds and dies involving new technology.

7) It is recognized that the costs of production of goods is usually much higher than the costs of providing the goods to an additional purchaser. If affiliates were only charged for marginal costs of production and distribution, leaving R&D costs to the producer, too little investment would occur. Further, there may be economies of scale and scope in centralizing R&D facilities and resources.

8) The Organization for Economic Co-operation and Development (OECD,) Transfer Pricing Guidelines for Multinational Enterprises (MNE) and Tax Administrations recommends a benefit-cost approach whereby R&D expenditures are charged out to affiliates based on their actual and expected benefits. Noting however, that affiliates should not be double charged for work they carry on themselves.

9) In general, payments to the vendor of goods by the purchaser in a sale for export to Canada for research and development are considered as an addition to the price paid or payable for the goods, and are to be included in the value for duty, as prescribed by subsection 48(5) of the *Customs Act*. These would include research expenditures that can be regarded as part of a continuing activity required to maintain an enterprise's business and its competitive position and development activities normally undertaken with a reasonable expectation of commercial success and future benefit arising from increased revenue or from reduced costs.

Exclusions

10) However, payments may be excluded from the subsequent proceeds provisions of the *Customs Act* when the foreign vendor is contracted to do research for the Canadian importer where all costs and risk of failure are born by the Canadian company, and ownership of research accrues to the Canadian company. The Canadian company owns all the intangibles developed through the research and therefore owns the profits that may result from the research.

APPENDIX B

MARKETING AND PROMOTIONAL FEES

This appendix defines the payments and fees considered as marketing and promotional that are not to be added as subsequent proceeds to the price paid or payable.

1) Marketing and promotional fees are types of payments that may be included in the definition of “Subsequent Proceeds”. To determine if marketing or promotion fees are not to be included as subsequent proceeds the importer of the goods will be required to substantiate the receipt of justified services relevant to the payments.

Justified Services

2) CBSA recognizes that marketing and promotional operations are often conducted on a global basis by Multi-National Enterprises. A corporate head office or one party of a multinational group may purchase advertising or conduct promotion for a particular product which is imported into Canada as well as distributed internationally. The advertisement may be shown throughout the world where the product is distributed. If the costs are then billed back to the Canadian importer of the goods on a prorated basis the payment would be considered an exclusion to the addition of “subsequent proceeds” to the price paid or payable. The importer of the goods must be prepared to substantiate that the fees have been allocated in an equitable manner and maintain objective and quantifiable data, which supports the manner and amount allocated.

3) Alternately, a corporate head office may also provide marketing and promotional services for a vast array of products which are distributed through subsidiaries worldwide, each marketing specific, unrelated products, unique to their locations. The Canadian subsidiary may be required to contribute a lump sum or percentage of the earnings on imported goods, which were sold in Canada, to the marketing branch of the corporate head office. If the marketing fee charged cannot be related to the specific product(s), which are imported and sold in Canada, then the fees cannot be identified as legitimate services the Canadian subsidiary received. The fees paid by the Canadian subsidiary will increase the cost to the Canadian consumer while inflating the profit or offset expenses incurred by the corporate identity. Accordingly this type of marketing or promotional fees would be found to be a “ subsequent proceed” that must be added to the price paid or payable.

4) The following examples illustrate various types of marketing and promotional fee scenarios and their treatment for valuation purposes under the transaction value method. These examples are by no means exclusive or exhaustive of the various fees that may be encountered within the scope of this memorandum, nor are the methods of compiling the exclusions or additions to the price paid or payable restricted to the methods outlined. The importer is expected to devise a verifiable methodology for this purpose from the information that is relevant to the specific situation.

(a) A USA based international company procured international television advertising for a product line, which is sold internationally including Canada. The corporate head office charges a marketing fee of $93,750.00 to the Canadian subsidiary. The international net sales of the product line amount to $9,500,000.00 of which Canadian sales account for $1,425,000.00 (15%) The advertising costs incurred by the corporate head office was $625,000.00 The fee charged Canada of $93,750.00 (which is 15% of the $625,000.00 cost) is a reasonable allocation based on the Canadian sales representing 15% of the total sales, accordingly the fee would be a valid exclusion and not be added to the price paid or payable.

(b) A similar USA based international company incurred $500.000.00 marketing and promotional expenses on international sales, however they did not provide any assistance to the Canadian subsidiary in promoting the product in Canada. The sales figures are the same as in example *(a)*, with the Canadian subsidiary providing a payment of $75,000.00 (which is 15% of the $500,000.00 cost) to the parent company. As there were no services provided to the Canadian subsidiary this is not a valid exclusion and is considered a “subsequent proceed” which must be added to the price paid or payable.

(c) Another Canadian subsidiary imports and sells one product, of many unrelated products that the US parent markets in the USA through four other subsidiary retailers. Total USA and Canadian sales amount to $10,000,000.00 of which Canadian sales account for $1,500,000.00 (15%). Corporate marketing and promotional costs are $2,000,000.00 annually which is split between the subsidiaries on an equal 1/5th basis of $400,000.00 each. As the fee paid is not distributed between the subsidiaries based on their usage of the service provided the fees will be considered a “subsequent proceed”. If the importer can provide “sufficient information” to determine what portion of the fee relates to actual services provided for the product sold in Canada, that portion only of the fee would be considered a valid exclusion from the subsequent proceeds.

APPENDIX C

EXAMPLES OF POST-IMPORTATION PAYMENTS OR FEES AND THEIR TREATMENT UNDER THE TRANSACTION VALUE METHOD

This appendix contains various business scenarios involving post-importation payments or fees. An explanation of the reasoning for the determination of the dutiable status of the payments or fees is provided below each example. These examples are for illustration only, as there are many other situations.

Situation A – At the end of the financial year, a Canadian importer remits 75% of net profits made over the year to its foreign parent vendor as dividends paid from after-tax earnings.

Conclusion A – The payment the importer made to the parent company is not the type intended by subparagraph 48(5)*(a)*(v) of the *Customs Act* since it is a dividend distribution. Dividends are profits shared by stockholders and relate to a firm's overall business. Therefore, the 75% of net profits remitted to the parent vendor should not be added to the price paid or payable. It should be noted that importers must be able to substantiate all amounts reported as dividends through their financial statements and income tax returns specifically through the use of the income tax dividend payments to non-residents system as previously noted in paragraphs 31 & 32.

Situation B – An importer buys goods from its related parent corporation and sells them domestically in Canada making a profit. Part of the profit is returned to the parent corporation as a dividend and reported as such both on the importer's financial statements and to Canada Revenue Agency (CRA). This dividend is excluded from being added to the price paid or payable. Part of the remaining Canadian profit is returned to the parent in another account. When questioned concerning this account the importer cannot provide "sufficient information" for a reasonable explanation of why this amount should be excluded from being considered a "subsequent proceed."

Conclusion B – Given this situation, the importer must add the amount in this account to the price paid or payable.

Situation C – A parent company located in the United States owns a subsidiary in Canada. The Canadian subsidiary operates in accordance with the parent's corporate policies. The Canadian subsidiary imports goods purchased from its parent and pays 10% of the gross profits resulting from the total annual sales. The importer demonstrates that this payment is made in accordance with corporate policy to reimburse the parent for loans or other financial services provided. The amount paid is considered reasonable for these types of services.

Conclusion C – Like the dividends in Situation B, amounts paid to a vendor in the form of financial instruments are not to be included in the price paid or payable.

Situation D – An importer purchases goods from its foreign parent. In exchange for management services provided by the parent, the importer remits 5% of the net sales of goods purchased from the parent at the end of each year. The management fees are paid under a contract that defines the services and specifies an estimate of the annual cost. The total costs for the year is estimated in the contract at $250,000. During the course of a review, it is disclosed that the importer's net sales of goods purchased from the parent are $5,000,000. Through a review of the importer's books and records, it is substantiated that the entire $250,000 post-importation fees paid under the management/service contract are attributable to the actual services rendered according to the terms of the contract. In addition, the importer provides information confirming that this amount is consistent with amounts paid over the past three years for the same services rendered.

Conclusion D – In the above example, there is no addition made to the price paid or payable under subparagraph 48(5)*(a)*(v) as the importer was able to present objective and quantifiable information establishing that the additional fees were paid for genuine services rendered pursuant to an agreement separate from the sale of goods and not simply further payment for the goods (unlike situation B where no such information was made available). The importer was also able to demonstrate that the fees paid for these services did not differ significantly from fees paid previously for the same services provided. However, this example reflects situations where sales and prices are stable or flat year after year. It is difficult to imagine management or service costs being directly proportionate at a set percentage year after year by agreement when sales are rapidly expanding. For example, the launch of a new product may increase service costs for one year. A windfall or one-time large sales contract could abnormally raise sales revenue for one year and not unduly raise service costs. In such cases, the CBSA expects these fees to be substantiated.

Situation E – As in situation D, an importer purchases goods from its parent company. Under a service fee contract, the importer agrees to remit to the parent 5% of its net sales of goods purchased from the parent at the end of the year for services rendered. This contract contains no estimate of the amount of the service fees payable, but clearly specifies the nature of the services undertaken.

At the end of the year, the importer has net sales of goods purchased from the foreign parent in the amount of $10,000,000. The importer remits 5% ($500,000) to the vendor in accordance with the terms of the contract. A review indicates that only $100,000 of the $500,000 made as post importation payments can be traced to actual services rendered under the contract. Additional information from the importer's past performance indicates that the importer paid approximately $100,000 to the vendor for the previous five consecutive years for the same services received.

Conclusion E – In this situation, $400,000 must be added to the price paid or payable to form part of the value for duty, as this amount is considered to be further payment for the goods. Barring extenuating circumstances, it should be noted that if the importer paid the vendor five times the amounts paid previously for the same services, this indicates strongly that the amount of fees paid is not reasonable for services provided according to the service fee contract. Regarding the remaining $100,000, as sufficient information was made available substantiating that this amount was paid for identifiable services rendered pursuant to the terms of the service fee contract, no adjustment is required for this amount.

Situation F – A Canadian subsidiary of a U.S. company is starting up. As a result, it requires assistance from its parent. A three-year management fee agreement, which is separate from the agreement to buy goods, is undertaken requiring the subsidiary to pay to the parent 10% of its net sales as a management fee. The services covered by this agreement are clearly documented. During the Canadian subsidiary's first year of operation, sales of $100,000 are realized and, accordingly, a management fee of $10,000 is paid. However, the true cost to the parent in assisting their subsidiary in negotiating leases, incorporating the business, acquiring and installing computer systems totals $100,000.

In the second year, the Canadian subsidiary has sales of $750,000 and, accordingly, pays a management fee of $75,000. The assistance received from their parent in year two amounts to $50,000. In the third year, sales are $750,000 and a fee of $75,000 is paid. The value of the actual services provided by the parent totals $10,000. Service contracts should be reviewed annually.

Conclusion F – Even though the cost to the parent of providing the identifiable services does not equal the amount received by the subsidiary in any individual year, at the end of the three years, the total services received by the Canadian subsidiary equal the total fee paid to the parent. Under this start-up scenario, it is appropriate to consider more than one year's services in establishing that the payment or fee for the services provided is reasonable.

Situation G – An importer purchases equipment, including installation at the importer's premises at a cost of $100,000 from a foreign vendor. The importation document reflects a value of $85,000. Later, the vendor sends technical staff to the importer's premises to install the equipment and provide training to the Canadian staff. The vendor invoices the importer $15,000 for "setup and service charges."

Conclusion G – The type of additional payment described in this situation would not form part of the value for duty regardless of when it is made. Since the payment represents a charge incurred for specified services after the importation of the goods, it is not included in the value for duty pursuant to clause 48(5)(b)(ii)(A). Therefore, the transaction value is $85,000 ($100,000 - $15,000).

In this situation, it should be noted that any reasonable payments made for expenses incurred for construction, erection, assembly, or maintenance of, or technical assistance provided in respect of the goods after they are imported, are specifically excluded from the price paid or payable by clause 48(5)*(b)*(ii)(A) of the *Customs Act*. Subsequent proceeds envisaged under subparagraph 48(5)*(a)*(v) must not be confused with the sort of post-importation payments provided for under clause 48(5)*(b)*(ii)(A).

Situation H – A Canadian importer purchases goods from its foreign parent (the vendor). In exchange for management services, the purchaser agrees to pay the vendor 3% of the net sales of the goods. The importer's net sales for the year are $10,000,000. Under the terms of the agreement, the importer remits $300,000 to the vendor for services rendered. However, the agreement does not specify any estimates of the costs for services. As well, the importer is unable to demonstrate the manner in which the $300,000 was allocated to the services allegedly performed on its behalf.

Conclusion H – Given these limited facts, the proceeds paid by the importer represent an addition to the price paid or payable under subparagraph 48(5)*(a)*(v).

REFERENCES

ISSUING OFFICE –

Origin and Valuation Division
Trade Programs Directorate
Admissibility Branch

HEADQUARTERS FILE –

HEG 79070-4-4

LEGISLATIVE REFERENCES –

Customs Act, sections 32, 45 and 48

OTHER REFERENCES –

D11-6-6, D13-3-13, D13-4-3, D13-4-4, D13-4-7, D13-4-9
GATT Customs Valuation Code
WTO Valuation Agreement
OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

SUPERSEDED MEMORANDA "D" –

N/A

Services provided by the Canada Border Services Agency are available in both official languages.