Canadian International Trade Tribunal

Tribunal canadien du commerce extérieur

CANADIAN INTERNATIONAL TRADE TRIBUNAL

Appeals

DECISION AND REASONS

Appeal No. AP-2012-073

Skechers USA Canada, Inc.

v.

President of the Canada Border Services Agency

Decision and reasons issued
Friday, December 13, 2013

Canada

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  DECISION 19

IN THE MATTER OF an appeal heard on September 10, 2013, pursuant to section 67 of the *Customs Act*, R.S.C., 1985, c. 1 (2nd Supp.);

AND IN THE MATTER OF seven decisions of the President of the Canada Border Services Agency, dated December 27, 2012, with respect to a request for re-determination pursuant to subsection 60(4) of the *Customs Act*.

BETWEEN

SKECHERS USA CANADA, INC. **Appellant**

AND

THE PRESIDENT OF THE CANADA BORDER SERVICES AGENCY **Respondent**

DECISION

The appeal is dismissed.

Ann Penner
Ann Penner
Presiding Member

Dominique Laporte
Dominique Laporte
Secretary

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	September 10, 2013
Tribunal Member:	Ann Penner, Presiding Member
Counsel for the Tribunal:	Anja Grabundzija
Manager, Registrar Programs and Services:	Michel Parent
Registrar Officer:	Haley Raynor

PARTICIPANTS:

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STATEMENT OF REASONS

BACKGROUND

1. This is an appeal filed by Skechers USA Canada, Inc. (Skechers Canada) with the Canadian International Trade Tribunal (the Tribunal) pursuant to subsection 67(1) of the *Customs Act*[1] from decisions made on December 27, 2012, by the President of the Canada Border Services Agency (CBSA), pursuant to subsection 60(4), concerning the value for duty of footwear of various styles, imported by Skechers Canada between 2005 and 2011 (the goods in issue).

2. The main issue in this appeal is whether certain payments made by Skechers Canada to the vendor, Skechers USA Inc. (Skechers USA), for research, development and design expenses (hereafter, the R&D payments) must be included in the price paid for the goods in issue and, accordingly, their value for duty for the purposes of the *Act*. More specifically, the issue is whether the R&D payments are sums paid "in respect of" the imported footwear.

3. The CBSA determined that the R&D payments must be included in the price paid or payable.

4. Skechers Canada argued that the R&D payments are not "in respect of" the goods in issue, but rather in respect of certain "intangibles". Therefore, Skechers Canada argued that they cannot be included in the price paid or payable for the goods in issue. Alternatively, Skechers Canada argued that the R&D payments may be added only in part as an adjustment to the price paid or payable under clause 48(5)(*a*)(iii)(D).

PROCEDURAL HISTORY

5. On November 14, 2006, the CBSA informed Skechers Canada that it had initiated a verification audit in order to determine whether the value for duty declared by Skechers Canada in respect of goods imported in 2005 had been calculated in accordance with the requirements of the *Act*.[2]

6. On March 25, 2008, the CBSA informed Skechers Canada of its findings for the calendar year 2005.[3] In sum, the CBSA determined that a portion of the R&D payments should be included in the price paid or payable for the imported goods. Detailed Adjustment Statements were issued pursuant to section 59, and Skechers Canada filed corrections pursuant to section 32.2, as appropriate.

7. Skechers Canada also filed requests for further re-determination pursuant to section 60, arguing that no part of the R&D payments should be included in the price paid or payable for the goods in issue.

8. However, on November 2, 2012, the CBSA issued a preliminary decision letter, taking the position that the *totality* of the R&D payments must be included in the price paid or payable.[4]

9. In line with its preliminary decision, on December 27, 2012, the CBSA issued seven decisions under subsection 60(4), determining that the R&D payments must be included in the price paid or payable in their entirety.

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1. R.S.C., 1985, c. 1 (2nd Supp.) [*Act*].
2. Exhibit AP-2012-008-073-06B (protected), tab 1.
3. *Ibid*., tab 2.
4. Exhibit AP-2012-073-04B (protected), tab 6.

10. Skechers Canada filed this appeal on March 19, 2013.

IMPORT TRANSACTIONS IN ISSUE

11. As previously noted, this appeal concerns the value for duty of various styles of Skechers-brand footwear imported by Skechers Canada between 2005 and 2011.

12. The core business of Skechers Canada and Skechers USA, its sole shareholder, is to design, market and sell Skechers-brand footwear.[5] Skechers USA designs the footwear. The manufacturing is contracted out to off-shore third-party factories.

13. Skechers Canada purchased the goods in issue from Skechers USA. The transfer price for these sales was set by Skechers USA[6] and consisted of the factory invoice price paid by Skechers USA to the third-party manufacturers, plus the costs of transportation to the U.S., warehousing in Skechers USA's distribution centre and an arm's-length profit.[7]

14. Following an audit, the CBSA took the position that the price paid or payable for the goods in issue must include not only the transfer price determined by Skechers USA, but certain other payments that Skechers Canada makes to Skechers USA as well, most important of which for this appeal are the R&D payments.

15. The R&D payments represent a portion of the payments Skechers Canada makes to Skechers USA pursuant to a cost-sharing agreement (CSA).[8]

16. In general terms, the purpose of the CSA is to apportion the costs of research, development, design, advertising and marketing activities that are necessary to develop and maintain the Skechers brand and sell footwear.[9] Based on the evidence, these activities are undertaken by Skechers USA. In turn, Skechers Canada reimburses a part of the associated costs, according to the terms of the CSA.

17. The CBSA determined that the portion of the payments made by Skechers Canada that relates specifically to costs incurred by Skechers USA in respect of *research, design and development*[10] must be included in the price paid or payable for the goods in issue. The CBSA took the position that these particular costs were for ". . . quantifiable and tangible segments of the production process which are necessary for the production of the imported footwear."[11]

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5. Exhibit AP-2012-073-04A at paras. 8, 79, and tab A at 17, 49.
6. *Transcript of Public Hearing*, 10 September 2013, at 10.
7. Exhibit AP-2012-073-04A at para. 52. See also testimony of Mr. Cross, *Transcript of Public Hearing*, 10 September 2013, at 73.
8. Namely, the Amended and Restated Research and Development and Advertising and Marketing Cost-Sharing Agreement, effective as of January 5, 2009, Exhibit AP-2012-073-04B (protected), tab 3, and prior to January 5, 2009, the First Amendment to Research and Development and Advertising and Marketing Cost-Sharing Agreement, effective as of January 1, 2005, Exhibit AP-2012-073-12C (protected), confidential exhibit 10.
9. *Transcript of Public Hearing*, 10 September 2013, at 70-71.
10. This determination excludes, namely, costs associated with advertising and marketing activities which are also shared through the CSA. Skechers Canada provided an example for the year 2011 showing the costs subject to the CBSA's determination. See Exhibit AP-2012-073-04B (protected), tab 5. In the table therein entitled "2011 Canada Cost Share Pooled Costs v2 Adjustment", the R&D payments are in fields 5000 (labeled R&D) and 5100 (labeled Production).
11. Exhibit AP-2012-073-04A at para. 58.

CONTEXT

18. Before going further into the legal framework and the Tribunal's analysis for this appeal, it is important to set the context in which both parties have made their arguments, namely, the process by which Skechers USA undertakes research, design and development activities to sustain the Skechers brand and create Skechers footwear.[12]

19. Skechers Canada emphasized that the Skechers brand is the cornerstone of its business model. The research, design and development activities that Skechers USA undertakes are core functions to maintain and build the brand, thus ensuring that Skechers footwear keeps pace with fashion trends and appeals to consumers.[13]

20. The process by which Skechers develops its brand and creates footwear begins about nine months before the start of a season. Researchers for Skechers USA analyze fashion and lifestyle trends in order to identify themes for the upcoming season. They review contemporary music, television, cinema, fashion, alternative sports and other trendsetting media, travel to major fashion markets, consult with Skechers customers, attend major footwear trade shows and subscribe to various fashion and colour information services.

21. To promote innovation and brand relevance, Skechers USA uses dedicated research and design teams to focus on different product lines. The research and design teams then translate themes into concepts for footwear for their dedicated lines. Skechers USA may sometimes use outside design firms to complement the work of its staff. The research and design teams also produce sketches of new products and/or modify old products and rely on technicians for technical specifications for each style.

22. Physical "prototype samples" are then created based on the technical specifications. They are fabricated by the off-shore third-party manufacturers. Approximately 40,000 to 50,000 prototype samples are produced each year.

23. Skechers USA then undertakes a series of steps to narrow and refine the thousands of prototype samples, in order to select the ultimately successful styles for the season. Specifically, Skechers USA reviews the prototype samples and requests certain changes, after which the manufacturers create modified prototype samples. Mr. Knoepke testified that prototype samples can be changed four to five times,[14] depending on the complexity of the model.

24. Skechers USA's staff then choose so-called "development samples" from the prototype samples. Development samples undergo preliminary "fit and wear testing" over periods of up to four months, by wear testers of different genders, ages and shoe sizes. The research and design teams make further modifications to the styles based on the "fit and wear testing".

25. After further modifications are completed, merchandisers, product managers, marketing, design and sales representatives identify the styles they think will be successful in the retail market.

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12. The research, design and development process was described in Exhibit AP-2012-073-04 at paras. 15-36. At the hearing, Mr. Knoepke agreed that this description is accurate. See *Transcript of Public Hearing*, 10 September 2013, at 27. The Tribunal also had the benefit of viewing a video provided by Skechers Canada, which shows the main steps of the prototype fabrication process.
13. Exhibit AP-2012-073-04A at paras. 8-11.
14. Testimony of Mr. Knoepke, *Transcript of Public Hearing*, 10 September 2013, at 32-33.

26. On the basis of the designs thus retained, orders are placed with the off-shore manufacturers to produce so-called "sales samples", which will be used by Skechers' personnel around the world to solicit sales orders. According to the witnesses, Skechers Canada pays Skechers International II[15] for the cost of the sales samples that it uses; therefore, this expense is not included in the R&D payments in issue.[16]

27. If sufficient orders are received for a given style, Skechers USA issues a purchase order to the factory for the mass production of that style. This triggers another exchange of samples and adjustments between the manufacturers and Skechers USA in order to fine-tune the final specifications.

28. The final step occurs when the manufacturers prepare their tools in accordance with the final specifications and proceed to a so-called "die-test", which, if approved by Skechers USA, allows mass production to begin.

29. Of the 40,000 to 50,000 prototype samples designed and produced every year, approximately 5 000 become actual "successful" footwear styles available for sale.

30. These steps are repeated season after season. Every time a new style is created, or even modified slightly from a previous style, at least part of this creative process must be engaged.[17]

31. Skechers USA purchases about 75 million pairs of shoes per year from the manufacturers.[18] According to the witnesses' testimony, the purchase price includes compensation for the prototypes, tooling, molds, etc., that had to be made to produce particular styles of shoes.[19] The purchase price does *not* cover costs incurred by the manufacturers in respect of the other *unsuccessful* styles. For these, Skechers USA compensates the manufacturers through a separate payment.[20]

32. Skechers Canada purchases footwear from Skechers USA. Skechers Canada is not involved in the footwear design process, other than to occasionally request minor changes to certain styles according to the wishes of a customer.[21]

33. Although Skechers Canada has access to the entire seasonal collection, it usually markets approximately 1,700 of the 5,000 styles available in a given year[22]. These 1,700 styles are chosen by Skechers Canada and its major customers on the basis of trends in the Canadian market. The volumes ordered by Skechers Canada are either added to the purchasing orders from Skechers USA to the manufacturers, or may be already available in Skechers USA's inventory.

34. As stated above, the transfer price for sales from Skechers USA to Skechers Canada consists of the total landed cost of the goods to Skechers USA (i.e. factory invoice price plus shipping and handling), plus a mark-up for warehousing at Skechers USA and for an arm's-length profit to Skechers USA.[23] As such,

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15. Skechers International II is another subsidiary of Skechers USA. It is also a party to the CSA.
16. See *Transcript of Public Hearing*, 10 September 2013, at 62, 82-83.
17. See testimony of Mr. Knoepke, *ibid.* at 52-53.
18. See, for example, testimony of Mr. Beecroft, *ibid.* at 20.
19. See, for example, *ibid.* at 54-56; *ibid.* at 80-81.
20. See the testimony of Mr. Cross, *ibid.*
21. See, for example, testimony of Mr. Beecroft, *ibid.* at 20-21.
22. See, for example, testimony of Mr. Beecroft, *ibid.* at 19. Mr. Beecroft also indicated that, on average, Skechers Canada may import 1.4 million to 1.7 million *pairs* of shoes in a year. See *ibid.* at 20.
23. Exhibit AP-2012-073-04A at para. 52. See also testimony of Mr. Cross, *Transcript of Public Hearing*, 10 September 2013, at 73.

Skechers Canada covers the costs of the moulds and samples in the process leading up to the fabrication of the successful styles imported into Canada as part of the transfer price. However, the transfer price between Skechers Canada and Skechers USA does *not* cover any of the costs associated with the *unsuccessful* prototypes and moulds, or any of the general research/design costs (such as the salaries and expense accounts of Skechers USA's research, design and development staff) incurred by Skechers USA.[24]

35. The R&D payments do, however, ensure that Skechers Canada compensates Skechers USA for part of its costs for the unsuccessful models and for other research/design costs.[25] As explained earlier, the CSA requires Skechers Canada to bear a percentage of the total costs incurred by Skechers USA when undertaking the research, design and development process described above, as well as advertising and marketing expenses. The percentage owed by Skechers Canada in any given year varies: it is calculated according to a formula provided in the CSA, based on a ratio of the anticipated *operating profit* of Skechers Canada and the anticipated total operating profits of all the participants (namely, Skechers USA and Skechers International II).[26] To be clear, the R&D payments are therefore a carve-out of Skechers Canada's cost share pursuant to the CSA, representing that portion which relates specifically to the research, design and development process described in the paragraphs above.

36. Two other agreements between Skechers Canada and Skechers USA bear mentioning at this point, even though they are not directly in issue in this case: the Management Services Agreement and the Canadian Intellectual Property and Propriety Information Licence Agreement.

37. Under the Management Services Agreement,[27] Skechers Canada compensates Skechers USA for certain general and administrative services that Skechers USA performs on its behalf, such as information technology support, accounting, finance and purchasing support.[28]

38. The Canadian Intellectual Property and Proprietary Information Licence Agreement of 2005[29] (the Licence) grants Skechers Canada the right to exploit all intellectual property rights in the brand in Canada, including the sub-licensing of the rights to third parties, in exchange for a lump sum payment.[30] The evidence at the hearing established that Skechers Canada does sub-license its rights in the brand to third parties, typically for clothing accessories.[31]

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24. See also testimony of Mr. Cross, *ibid.* at 83-84.
25. Mr. Cross testified in particular that these costs are covered by various cost departments included in the R&D payments in issue. See *ibid.* at 81-84.
26. See Exhibit AP-2012-073-04B (protected), tab 3, sections 3.4 and 3.5. In addition, the CSA allows for certain adjustments to account for *actual* operating profit or operating margin. See sections 3.6 and 3.7. See also the testimony of Mr. Cross, *Transcript of Public Hearing*, 10 September 2013, at 71. The 2005 CSA used a similar formula. See Exhibit AP-2012-073-12C, confidential exhibit 10, section 4.2. Testimony of Mr. Cross, *Transcript of In Camera Hearing*, 10 September 2013, at 23-25.
27. Exhibit AP-2012-073-04B (protected), tab 2.
28. See, for example, the testimony of Mr. Beecroft, *Transcript of Public Hearing*, 10 September 2013, at 10. See also testimony of Mr. Cross, *ibid.* at 63.
29. Exhibit AP-2012-073-04B (protected), tab 4.
30. See, for example, the testimony of Mr. Cross, *Transcript of Public Hearing*, 10 September 2013, at 64-65.
31. See, for example, the testimony of Mr. Cross, *ibid.* at 66. See also *Transcript of In Camera Hearing*, 10 September 2013, at 47.

LEGAL FRAMEWORK

39. In order to impose customs duties on imported goods under the *Act*, a value must first be attributed to the goods. Section 46 specifies that the value for duty must be determined in accordance with sections 47 to 55.

40. Section 47 provides that the primary basis for determining the value for duty is the "transaction value" of the imported goods of section 48.

41. Subsection 48(4) provides that "[t]he transaction value of goods shall be determined by ascertaining *the price paid or payable* for the goods when the goods are sold for export to Canada and adjusting the price paid or payable in accordance with subsection (5)" [emphasis added].

42. In turn, the "price paid or payable" for the goods is defined as the sum of payments made in respect of those goods. The definition in subsection 45(1) reads as follows:

> "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.
>
> [Emphasis added]

43. The definition of "price paid or payable" therefore requires determining *which* payments are made or to be made "in respect of" the goods.

44. Once the price paid or payable is determined, the *Act* requires that certain adjustments be made to account for particular charges. Clause 48(5)(*a*)(iii)(D), which is relevant in this appeal, provides that the value of specific goods and services, commonly referred to as "assists", provided by the purchaser free of charge or at a reduced cost be *added* to the price paid or payable for the goods under certain conditions. Clause 48(5)(*a*)(iii)(D) reads as follows:

> (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
>
> . . .
>
> (iii) the value of any of the following goods and services, determined in the manner prescribed, that are supplied, directly or indirectly, by the purchaser of the goods free of charge or at a reduced cost for use in connection with the production and sale for export of the imported goods, apportioned to the imported goods in a reasonable manner and in accordance with generally accepted accounting principles:
>
> . . .
>
> (D) engineering, development work, art work, design work, plans and sketches undertaken elsewhere than in Canada and necessary for the production of the imported goods,
>
> . . .

45. However, in order for the transaction value of the goods method of section 48 to properly apply under the *Act*, a number of conditions must also be met. The main conditions are set out in subsection 48(1), which provides as follows in relevant part:

> **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
>
> . . .
>
> (*b*) the sale of the goods by the vendor to the purchaser or the price paid or payable for the goods is *not subject to some condition or consideration*, with respect to the goods, in respect of which a value cannot be determined;
>
> . . .
>
> (*d*) the purchaser and the vendor of the goods are not related to each other at the time the goods are sold for export or, *where the purchaser and the vendor are related to each other at that time*,
>
> (i) their relationship did not influence the price paid or payable for the goods, or
>
> (ii) the importer of the goods demonstrates that the transaction value of the goods meets the requirement set out in subsection (3).
>
> . . .
>
> [Emphasis added]

46. In this case, it is beyond dispute that Skechers USA sold the goods in issue for export to Skechers Canada, which is a purchaser in Canada. The transaction value method is therefore applicable if the remaining three main conditions are met:

- the price paid or payable for the imported goods can be determined;
- the relationship between Skechers Canada and Skechers USA, as related persons,[32] did not influence the price paid or payable for the goods, or the requirement set out in subsection 48(3)[33] is met; and
- the price paid or payable for the goods or their sale for export was not subject to a condition or consideration in respect of which a value cannot be determined.

47. It is only to the extent that the value for duty of imported goods cannot be appraised on the basis of their transaction value that any subsidiary bases of appraisal can be considered.

POSITION OF PARTIES

Skechers Canada

48. The main position of Skechers Canada is that the value for duty of the goods in issue must be determined on the basis of their transaction value and that the R&D payments cannot be part of the "price paid or payable" under subsections 45(1) and 48(4) because they are not "in respect of" the goods.

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32. It is also beyond dispute that Skechers Canada and Skechers USA are related persons within the meaning of the *Act*, Skechers Canada being a wholly owned subsidiary of Skechers USA. See the definition of "related persons" in subsection 45(3).
33. In effect, subsection 48(3) requires the importer to demonstrate that the transaction value of the goods sold to it by a related party closely approximates a surrogate value, for example, the transaction value of identical or similar goods in a sale for export between parties that are not related to each other.

49. Skechers Canada argued that the term "goods" in subsection 45(1) refers to articles of commerce, whereas the R&D payments at issue in this appeal relate to "intangibles", namely, developing the Skechers brand. According to Skechers Canada, the R&D payments are not payments "in respect of" the goods because such ". . . intangibles are not physically incorporated into or consumed in Skechers products, and are not necessary for their production or their basic use as footwear."[34]

50. Skechers Canada further explained that the R&D payments constitute a portion of Skechers Canada's contribution to the development of the Skechers intangibles, which Skechers Canada exploits in Canada pursuant to the Licence. It submitted that the R&D payments ". . . all relate to the creation of the Skechers Intangibles which form the essential core of the brand marketing business Skechers is engaged in" and that "[w]ithout the innovative footwear designs . . . Skechers would not be able to carry on its core business of marketing and selling Skechers branded footwear in the footwear business where brand recognition is an essential element for success."[35]

51. Skechers Canada pointed out that the R&D payments are unrelated to the volume of goods imported. Pursuant to the CSA, the R&D payments are paid periodically and not at the time of importation. Furthermore, the payments would be made even if Skechers Canada did not purchase any goods from Skechers USA in a given year.

52. In the alternative, Skechers Canada argued that the R&D payments may be viewed as "assists" under clause 48(5)(*a*)(iii)(D) and, following the requirements of that clause, may only be added in part to the price paid or payable. While Skechers Canada admitted that clause 48(5)(*a*)(iii)(D) does not technically apply,[36] it suggested that the Tribunal could view the R&D payments through the "assists" prism because they represent an indirect provision (through Skechers USA) of development and design work by Skechers Canada to the Chinese manufacturers to be used in the manufacturing of the imported goods. As such, Skechers Canada argued that the R&D payments could be added only to the extent that they result in actual production of goods that are imported into Canada. Furthermore, Skechers Canada maintained that when applying the criteria in clause 48(5)(*a*)(iii)(D), the proportion of the R&D costs going towards research must also be subtracted because "research" is not an assist under clause 48(5)(*a*)(iii)(D). Skechers Canada suggested two options for apportioning the remaining sums to the imported goods and adding them to the price paid or payable.[37]

CBSA

53. The CBSA's primary position was also that the value for duty of the goods in issue must be appraised on the basis of their transaction value. However, it submitted that the R&D payments are "in respect of" the imported goods and must therefore be included in the price paid or payable for the goods under subsections 48(4) and 45(1).

54. The CBSA argued that, while the Tribunal has stated in previous decisions that it excludes general payments unaffected by the specific imported goods, it must interpret the phrase "in respect of" in the widest possible sense because the phrase was intended to convey some connection between two things.

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34. Exhibit AP-2012-073-04A at para. 72. See also *Transcript of Public Hearing*, 10 September 2013, at 100.
35. Exhibit AP-2012-073-04A at para. 79.
36. *Transcript of Public Hearing*, 10 September 2013, at 111-12, 173-74.
37. These two options will be discussed in more detail in the Analysis section.

55. The CBSA argued that the R&D payments were "in respect of" the goods in issue because the entire research, design and development process to which they relate is necessary for the production of the ultimately successful styles and, therefore, the imported goods. According to the CBSA, Skechers Canada provided no evidence that the imported models could be produced without this process. Further, the CBSA argued that the R&D payments are not general payments because they are based on anticipated net sales.

56. In addition, the CBSA argued that Skechers Canada does not provide "assists" within the meaning of clause 48(5)(*a*)(iii)(D) and that that section does not apply.

57. In the alternative, the CBSA submitted that if the totality of the R&D payments were not included in the price paid or payable, the transaction value method could not be used because some of the conditions prescribed under subsection 48(1) would not be met. In particular, the CBSA submitted that the price could no longer be determined, as the evidence for the required breakdown and apportionment does not exist or is not available. Furthermore, the transaction value method would be inappropriate because the price paid for the goods in issue would have been influenced by the relationship between Skechers Canada and Skechers USA. As a result, the CBSA argued that a different method of appraisal should apply. The CBSA did not specify the appropriate alternative method.

ANALYSIS

58. Both parties agree that the Tribunal should begin by assessing the value for duty according to the transaction value method under section 48. They disagree, however, on whether the R&D payments should be included in the price paid or payable for the goods in issue and, thus, in their transaction value under subsections 45(1) and 48(4). This, then, is the central issue in this appeal.

59. Given the requirements of these provisions, and in order to resolve this appeal, the Tribunal will examine:

(1) whether the R&D payments are "in respect of" the goods and thereby included in the price paid or payable for the goods in issue;

(2) whether there is merit to Skechers Canada's argument that the R&D payments or any part thereof are "assists" of clause 48(5)(*a*)(iii)(D);

(3) whether there is merit to Skechers Canada's argument that the Tribunal should further apportion the amount of R&D payments to the goods in issue, according to one of two options; and

(4) whether there are other requirements that prevent the application of the transaction value as the basis for the appraisal of the value for duty of the goods in issue.

Whether the R&D Payments Are "in Respect of" the Goods in Issue and Thereby Included in the Price Paid or Payable for the Goods in Issue

60. The definition of "price paid or payable" provided in the *Act* makes clear that only those payments made in respect of the imported goods, by a purchaser to or for the benefit of a vendor, are included in the price of the goods.[38]

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38. See *Simms Sigal & Co. Ltd. v. The Commissioner of the Canada Customs and Revenue Agency* (27 May 2003), AP-2001-016 (CITT) at 5 [*Simms Sigal*].

61. The Tribunal's jurisprudence recognizes that the phrase "in respect of" is quite broad.[39]

62. However, it is not without bounds. For example, "[t]he Tribunal has interpreted the phrase 'in respect of the goods' to mean that the payment must not be a general payment unaffected by the specific goods being imported."[40] Similarly, the Tribunal has held that the phrase "in respect of" the goods is not so broad as to include charges that properly relate to some value that is ". . . over and above the purchase value of the goods themselves."[41] In such cases, the Tribunal found that a sufficient link must be established between a particular payment and the imported goods. If such a link could not be established, the given payment could not be included in the price paid or payable for those goods.

63. Ultimately, then, the question of whether a particular payment is "in respect of" the goods is one of fact, requiring the Tribunal to scrutinize the circumstances of every case to determine whether a sufficient link can be established between a particular payment and the goods in issue.

64. In addition, the Tribunal must also be mindful of section 152, which governs the allocation of the burden of proof in any proceedings such as these that involve the importation or exportation of goods. Subsection 152(3) provides that the burden of proof in any question relating, *inter alia*, to the payment of duties on any goods or the compliance with any of the provisions of the *Act* lies on the party to the proceedings other than the Crown. That the appellant has the burden of proving that it has satisfied the requirements of the *Act* in appeals pursuant to section 67 has recently been re-affirmed by the Federal Court of Appeal.[42]

65. In this case, Skechers Canada bears the burden of proving that its value for duty declarations in respect of the goods in issue complied with the relevant provisions of the *Act* or, conversely, that the CBSA did not determine the value for duty of the goods in issue in accordance with the provisions of the *Act*.

66. For this reason, the more specific question in this appeal is whether Skechers Canada has convinced the Tribunal that the CBSA erred in concluding that the R&D payments are "in respect of" the goods in issue. In other words, Skechers Canada must demonstrate that the R&D payments are *not* "in respect of" the goods in issue.

67. In the Tribunal's opinion, Skechers Canada has not discharged its burden of proof and the R&D payments are, indeed, "in respect of" the goods in issue.

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39. See, for example, *Simms Sigal* at 5. It may also be noted that in the context of the *Income Tax Act*, the Supreme Court of Canada commented that "[t]he words 'in respect of' are . . . words of the widest possible scope. They import such meanings as 'in relation to', 'with reference to' or 'in connection with'. The phrase 'in respect of' is probably the widest of any expression intended to convey some connection between two related subject matters." See *R. v. Nowegijick*, [1983] 1 S.C.R. 29, (S.C.C.).
40. See, for example, *Chaps Ralph Lauren, A Division of 131384 Canada Inc. and Modes Alto-Regal, Inc. v. The Deputy Minister of National Revenue* (22 December 1997), AP-94-212 and AP-94-213 (CITT) [*Chaps Ralph Lauren*] at 13; *Polygram Inc. v. The Deputy Minister of National Revenue for Customs and Excise* (7 May 1992), AP-89-151 and AP-89-165 (CITT) at 4.
41. *Simms Sigal* at 6.
42. *Canada (Border Services Agency) v. Miner*, 2012 FCA 81 (CanLII).

The Research, Design and Development Process and the R&D Payments Do Not Concern Intangibles

68. Skechers Canada maintained that the R&D payments were not "in respect of" the goods in issue, but rather in respect of intangibles—namely, the Skechers brand—which ". . . are not physically incorporated into or consumed in Skechers products, and are not necessary for their production or their basic use as footwear."[43] This argument is untenable in light of the evidence.

69. In the Tribunal's view, the evidence establishes that the R&D payments are not in respect of intangibles, but rather in respect of the footwear imported by Skechers Canada.

70. The evidence is clear that the R&D payments are in respect of the research, design and development process that Skechers USA undertakes each season, as explained above, as well as in Skechers Canada's brief and Mr. Knoepke's testimony.[44] The activities and associated costs covered by the R&D payments can all be located somewhere along the continuum of that lengthy and interrelated process.

71. As stated by Mr. Knoepke, the purpose of the process is to develop *footwear*.[45] In the Tribunal's view, the research and design efforts are *directly* aimed at designing the particular Skechers footwear models available each season and giving those shoes the particular features that will make them appealing to their target market.[46] The goods in issue literally have their particular shape, texture and colour *because* of the research, development and design process that they go through. Without this process, the goods in issue would be entirely different products.[47] Therefore, it is the Tribunal's understanding from the evidence that the goods in issue could not have been produced without the research and design process.

72. The evidence establishes that the R&D payments most directly concern the footwear products themselves. In the Tribunal's view, if the process of footwear design and development also goes towards maintaining the popularity or reputation of the Skechers brand, and ultimately allowing the footwear to sell, this type of brand-building is indicative of how well Skechers USA can reflect market preferences in the particular quality footwear it develops each season. The brand, therefore, is intimately related to the imported goods. As a result, the R&D payments remain inseparable from the footwear products themselves.

73. Skechers Canada relied upon the Tribunal's decision in *Simms Sigal* to suggest that "intangibles" relating to the marketing of the brand are not "in respect of" the goods in issue. However, the facts of *Simms Sigal*, which concerned a distribution fee, are easily distinguishable from the facts in this appeal: contrary to the research, development and design activities to which Skechers Canada's R&D payments relate,

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43. Exhibit AP-2012-073-04A at para. 72. See also *Transcript of Public Hearing*, 10 September 2013, at 100.
44. Mr. Cross confirmed that the payments in issue indeed relate to the research and design process described in Skechers Canada's brief and in Mr. Knoepke's testimony. See *Transcript of In Camera Hearing*, 10 September 2013, at 20.
45. As confirmed by Mr. Knoepke, the design activities in issue relate to the design of *footwear*. See *Transcript of Public Hearing*, 10 September 2013, at 30.
46. See, for example, *ibid.* at 52. See also the Skechers 2012 Annual Report, Exhibit AP-2012-073-04A, tab A at 21, which describes product design and development in the following terms: "Our principal goal in product design is to generate new and exciting footwear in all of our product lines with contemporary and progressive styles and comfort-enhancing performance features. . . . We believe that our products' success is related to our ability to recognize trends in the footwear markets and to design products that anticipate and accommodate consumers' ever-evolving preferences. We are able to quickly translate the latest fashion trends into stylish, quality footwear at a reasonable price by analyzing and interpreting current and emerging lifestyle trends."
47. *Transcript of Public Hearing*, 10 September 2013, at 52-54, 57-59.

the distribution fee in *Simms Sigal* covered goods and services unrelated to the design or production of the actual imported garments, but closely tied to their subsequent marketing and sale instead.[48]

A Seamless Interrelated Design Process Is Required for the Production of the Goods in Issue

74. Furthermore, the evidence clearly establishes that the entire research and development effort is necessary to ultimately design, develop and produce the seasonal line of footwear. Indeed, the Tribunal is not convinced by the suggestion that only that part of the R&D payments which relate to costs incurred in designing and developing the particular successful models[49]—to the exclusion of, for example, the costs of producing the prototype samples that did not go into production—is necessary for the production of the goods in issue and, thus, properly considered "in respect of" those goods.

75. On the basis of the evidence, it is reasonable to conclude that the successful styles are not developed in isolation from the unsuccessful ones. Indeed, the opposite appears to be true. Comparing different models and eliminating the vast majority of the 40,000-50,000 prototype samples are significant parts of the research and development process, as described by Skechers Canada and noted above.[50] In the Tribunal's view, it is inevitable that the successful models are chosen when certain features of the unsuccessful ones are rejected to keep the brand in step with current and projected fashion trends. Therefore, the Tribunal agrees with the CBSA where it submits the following:

> The Appellant has submitted no evidence that the imported models can be produced without the Production and R&D activities described in the Appellant's Brief. . . . The Vendor cannot distinguish at the start of the process between those models that will be marketable (and proceed to mass production) and those that will not. Rather, the Vendor must fund the entire production and R&D process to arrive at the end products, only to recoup its expenses from the sales of those end products.[51]

76. The witnesses' testimony supports the Tribunal's conclusion that the design efforts (which the R&D payments cover) are inseparable from the goods in issue and their production. Mr. Knoepke, who has extensive experience with the research and development activities at Skechers, confirmed that every style of Skechers footwear is created by the research, design and development process described above and that the different steps of the research and development process are all interrelated into a common effort towards producing a shoe that customers wish to buy.

77. For example, in response to a question from Mr. Gibbs about whether all of the production and conceptualization and development activities are necessary to produce the 5,000 successful styles,[52] Mr. Knoepke replied what follows:

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48. The distribution fee covered the exclusive right to distribute specific lines of clothing, certain limited rights with respect to the Anne Klein trade name and trademark, as well as miscellaneous services: samples, showrooms, models, showroom food, printed material and sales aids, and telephone, fax and photocopying at Anne Klein's New York location, strategic information, information on trends and market research, staff training and sales clinics, line lists, the services of its international sales department, personal appearances by a design team in Canada, ad material, shop fixture sourcing, national ads in U.S. magazines and other. See *Simms Sigal* at 2.
49. See, for example, *Transcript of Public Hearing*, 10 September 2013, at 101-103.
50. See, for example, AP-2012-073-04A at paras. 15-36. See also *Transcript of Public Hearing*, 10 September 2013, at 28-48.
51. Exhibit AP-2012-073-06A at para. 39.
52. Mr. Gibbs phrased his question as follows: "Would you agree that all of the production and conceptualization and development is a necessary part in arriving at those 5,000 SKUs [i.e. styles] that you mentioned, 5,000 lines that are actually—or styles that are actually chosen?"

> MR. KNOEPKE: It's absolutely necessary to keep the line fresh, and the total number is 5,000, roughly. That doesn't mean that every one of the 5,000 is brand new.[53]
>
> . . .
>
> MR. GIBBS: So it's necessary—as you mentioned, again, it's necessary to go through the complete line of prototypes and testing to produce those final shoes that are sold?
>
> MR. KNOEPKE: Yes.[54]

78. Likewise, in response to a question from the Tribunal, Mr. Knoepke agreed that Skechers USA cannot produce the goods in issue without all of the steps involved in the research, design and production process:

> PRESIDING MEMBER: . . . can Skechers actually produce the shoes that are at issue here, that are imported into Canada, and maintain the brand, which we understand is critical for your company, without the entire research, design, production team and process? How closely linked are those? Can we actually maintain the brand if we don't have the big process in place?
>
> MR. KNOEPKE: No.
>
> PRESIDING MEMBER: Okay. As a similar kind of question to that, it seems like the research, development, design, production activities really are part and parcel of one big effort. You can't really do step 2 without step 1; you can't do step 3 without step 1. It is all one part of a whole; correct?
>
> MR. KNOEPKE: Correct.
>
> PRESIDING MEMBER: You know, we've got the breakdown in times, with different kind of teams playing, but really it's all one big activity at the end of the day, because all of it is geared to producing the shoes. Is that correct, to simplify it?
>
> MR. KNOEPKE: Yes.
>
> . . .
>
> MR. KNOEPKE: One can't do without the other.
>
> PRESIDING MEMBER: Okay. So it's all pieces of a puzzle to create, ultimately, the shoe that a consumer would go and buy?
>
> MR. KNOEPKE: That's correct.[55]

79. Even more, Mr. Cross also admitted that the research and design costs are "indirectly" necessary for the production of the footwear.[56] Mr. Cross qualified the relationship as indirect, not on the basis that any of the research and development activities are not necessary for the production of the Skechers footwear, but rather on the basis of the fact that Skechers Canada's obligation to make the R&D payments would exist even in the absence of sales of footwear. The Tribunal will address this point further below.

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53. *Transcript of Public Hearing*, 10 September 2013, at 52. Mr. Knoepke later explained that, while certain of the yearly 5,000 available styles may be slight modifications, such as colour, from previous models, but that *even in this case*, the styles have to go through part of the process because every new aspect, such as new colours or new materials, needs to be developed. See *ibid.* at 53.
54. *Ibid.* at 53-54.
55. *Ibid.* at 57-59.
56. *Transcript of In Camera Hearing*, 10 September 2013, at 31, 33-34.

80. In argument, Skechers Canada submitted that the different styles of imported footwear are all unique and that their design process is unrelated to one another. In other words, Skechers Canada contested the notion that the entire design effort is needed to create the imported goods.[57] However, the evidence on the record simply does not substantiate this proposition. Rather, it indicates that the design process is an interactive or interrelated one.[58] As such, on this point, Skechers Canada has not discharged the burden of proof imposed on it by subsection 152(3).

81. On the evidence, therefore, Skechers Canada has not established that the R&D payments in issue are not "in respect of" the goods in issue, even on the very test suggested by Skechers Canada—i.e. that the R&D payments ". . . are not physically incorporated into or consumed in Skechers products, and are *not necessary for their production* or their basic use as footwear"[59] [emphasis added].

<u>The R&D Payments Are Not General Payments Unaffected by the Specific Goods in Issue</u>

82. Not only does the Tribunal consider the R&D payments to be necessary for the creation of the footwear, it also considers that a sufficient link can be established between the R&D payments and the goods in issue by examining the way in which the owed amounts are determined. To paraphrase previous Tribunal jurisprudence on the scope of "in respect of",[60] the evidence shows that the R&D payments are not general payments unaffected by the imported goods.

83. Under the CSA, the amounts owed by Skechers Canada are calculated according to Skechers Canada's operating profit. Simply put, and as confirmed by Mr. Cross,[61] under normal market conditions, if the volume of Skechers Canada's imports of the goods in issue go up, its sales and profits would also go up, and so would the amounts owed in R&D payments. The link between the R&D payments and the goods in issue is thus apparent.[62]

84. Skechers Canada argued that the R&D payments could not be considered in respect of the goods because they would still have to be made even if Skechers Canada did not purchase any goods from Skechers USA. Skechers Canada would still have to pay a share of its profits under the CSA, even though, as the owner of the "Skechers Intangibles" in Canada, it could make those profits from selling footwear that it would have had manufactured in Canada, or from licensing the Skechers brand to third parties.[63]

85. However, given the evidence on the record, it is reasonable to conclude that the main part of Skechers Canada's profits in the period at issue in this appeal was based on net sales of footwear. While the witnesses testified that Skechers Canada also generates profits by licensing the Skechers brand to third

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57. *Transcript of Public Hearing*, 10 September 2013, at 163-64.
58. Indeed, Skechers USA does not keep records of research and design activities and costs on a per-model basis, or even for individual product lines or divisions, because its researchers and designers are working on several development projects at any given time. Skechers Canada could not, in any case, provide research and design costing information relating specifically to a given product line or model. See *ibid.* at 86-87; Exhibit AP-2012-073-06B, tabs 4-5.
59. Exhibit AP-2012-073-04A at para. 72. See also *Transcript of Public Hearing*, 10 September 2013, at 100.
60. See, for example, *Chaps Ralph Lauren* at 13; *Polygram Inc. v. The Deputy Minister of National Revenue for Customs and Excise* (7 May 1992), AP-89-151 and AP-89-165 (CITT) at 4.
61. *Transcript of In Camera Hearing*, 10 September 2013, at 29.
62. This conclusion is supported, for example, by the Tribunal's decision in *Chaps Ralph Lauren*, at 13, where the Tribunal concluded that a certain royalty charge was "in respect of" the goods on the basis that ". . . the amount of the royalty payments is based on the net sales of the imported goods in Canada and is, therefore, affected by the specific goods imported."
63. See Exhibit AP-2012-073-04A at para. 74.

parties for use in articles such as clothing accessories,[64] Skechers Canada did not submit any evidence that would substantiate the testimonial evidence with respect to Skechers Canada's profits from licensing and show its importance relative to its total operating profits. And, indeed, the evidence on the record indicates that Skechers Canada's core business is exploiting the brand to sell footwear.[65] Thus, on the basis of the information before it, the Tribunal must conclude that the major proportion of Skechers Canada's operating profits comes from its sales of the goods in issue.

86. In addition, the Tribunal does not accept Skechers Canada's argument that the R&D payments are unrelated to the imported goods in issue because Skechers Canada could opt to source footwear elsewhere than from Skechers USA. All of the footwear sold by Skechers Canada is in fact imported from Skechers USA.[66] While it may be permissible for Skechers Canada, under the applicable agreements with Skechers USA, to source the footwear elsewhere, Skechers Canada does not in fact do so.[67] Such a theoretical possibility is insufficient to dissociate the R&D payments from the goods in issue in the present appeal.

87. Finally, the Tribunal rejects the suggestion that the R&D payments are unrelated to the goods in issue because they are usually not made at the time of importation, but rather are paid periodically in installments throughout the year. The timing of the payments, in and of itself, is of no import. The definition of "price paid or payable" in subsection 45(1) targets all payments "made or to be made" and thus encompasses the present situation.

88. For these reasons, the Tribunal finds that the evidence establishes that the R&D payments in their entirety are "in respect of" the goods in issue.

Whether the R&D Payments or Any Part Thereof Are "Assists" of Clause 48(5)(*a*)(iii)(D)

89. In coming to the conclusion that the totality of the R&D payments are in respect of the goods in issue, the Tribunal is mindful of Skechers Canada's alternative argument that, if the Tribunal finds that the R&D payments concern design work necessary for the production of the imported goods, then only a portion of the R&D payments should be added to the price paid or payable, applying clause 48(5)(*a*)(iii)(D).[68]

90. The Tribunal is also mindful that counsel for Skechers Canada conceded that the R&D payments are not actually assists contemplated by clause 48(5)(*a*)(iii)(D).[69]

91. In this respect, the Tribunal agrees. Indeed, the Tribunal agrees with counsel for both parties that the "assists" provision is aimed at situations where the buyer provides, free of charge or at a reduced cost, some form of assistance—in kind—towards the production of the imported goods, for example, in the form of design work. In this case, however, the R&D payments are just that: payments, and not the provision of any

64. See, for example, testimony of Mr. Beecroft, *Transcript of Public Hearing*, 10 September 2013, at 22.
65. Exhibit AP-2012-073-04A at paras. 8, 79. See also Exhibit AP-2012-073-04A, tab A at 17, 49.
66. *Transcript of Public Hearing*, 10 September 2013, at 21-22.
67. Indeed, Mr. Beecroft's testimony indicates that it "makes more sense" for Skechers Canada to import from Skechers USA. See *ibid.* at 22.
68. Skechers Canada's alternative argument is essentially that the R&D payments may be viewed as assists (in the form of "design work") of clause 48(5)(*a*)(iii)(D), the value of which must be added to the price under that section, but because clause 48(5)(*a*)(iii)(D) *excludes* "research" work from the list of assists, any portion of the R&D payments that relates to research may not be added to the price.
69. *Ibid.* at 111-12, 173-74.

kind of "goods and services", as contemplated by clause 48(5)(*a*)(iii)(D). This type of charge does not fall within the scope of clause 48(5)(*a*)(iii)(D). The Tribunal's conclusion in *Simms Sigal* is apposite:

> The evidence indicates that Simms Sigal did not provide any sketches or designs free of charge or otherwise. Instead, Anne Klein provided sketches or designs to the factories and included their value in the price of the goods. Therefore, no part of the distribution fee is dutiable in accordance with this clause.[70]

92. Skechers Canada argued nevertheless that the R&D payments can be viewed through the prism of clause 48(5)(*a*)(iii)(D) because the R&D payments represent an *indirect* provision of development and design work by Skechers Canada—*through Skechers USA*—to the Chinese manufacturers.

93. However, Skechers Canada did not provide a reason why the Tribunal should apply clause 48(5)(*a*)(iii)(D) to the situation in this appeal, which it admitted was not actually aimed at capturing charges such as the R&D payments in issue.

94. Therefore, the Tribunal does not find a good reason to apply this clause outside of its intended scope.[71] Indeed, doing so would be inconsistent with the Tribunal's determination, on the evidence, that the entirety of the R&D payments are in fact in respect of the goods and must be included in the price paid or payable for the goods pursuant to subsections 48(4) and 45(1).

95. Accordingly, as the assists provision does not deal with the present situation, clause 48(5)(*a*)(iii)(D) has no application and does not bear on the Tribunal's conclusion that the entirety of the R&D payments is "in respect of" the goods in issue within the meaning of subsections 48(4) and 45(1) and included in the price paid or payable.[72]

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70. *Simms Sigal* at 6.
71. The word "indirectly" in clause 48(5)(*a*)(iii)(D) does not extend the scope of that provision to situations where the buyer simply transfers money to the vendor, in consideration of activities undertaken by the vendor. The purpose of the section is to account for situations where the buyer furnishes assistance to his supplier in some form—i.e. by a contribution in kind, free of charge or at a reduced cost—and thus relieves the seller of an expense that it would normally incur and that would normally be included in the transaction price of the goods. See Saul L. Sherman and Hinrich Glashoff, *Customs Valuation: Commentary on the GATT Customs Valuation Code*, Kluwer Law and Taxation Publishers, 1988, at 112. In the Tribunal's view, the word "indirectly" indicates that the buyer may provide such an assist either himself, or through the services of a third party. In the present case, however, there is a straightforward transfer of money from the buyer to the vendor. To the extent that the evidence establishes that the payment is in respect of the goods, it should simply be added as part of the price paid by the buyer to purchase those goods from the seller.
72. Consistent with past jurisprudence of the Federal Court of Appeal, the Tribunal was mindful to not interpret the definition of "price paid or payable" in a manner that would ignore the effect of specific provisions enacted by Parliament. See *Deputy Canada (Minister of National Revenue) v. Charley Originals Ltd.*, 2000 CanLII 15307 (FCA), at para. 17. In that case, the Court noted that to include the cost of certain unused fabric in issue in that case in the price of the goods pursuant to the definition of "price paid or payable" in subsection 45(1) would ignore the effect of subparagraph 48(5)(*a*)(iii) where Parliament has specifically addressed the treatment of materials supplied by the purchaser for use in the production of goods for export. In this case, contrary to the situation in *Charley Originals*, Parliament has *not* specifically provided for the treatment of charges such as the R&D payments issuing from the buyer to the seller. As explained, in clause 48(5)(*a*)(iii)(D), Parliament has only provided for the treatment of the value of design work and other specific assists when they are provided in kind *by the purchaser* on his own account. This provision does not preclude the inclusion of *payments* made by the purchaser to the vendor for the cost of *activities undertaken by the vendor* in the price paid or payable for the goods pursuant to the definition of "price paid or payable" in subsection 45(1).

Whether the Amount of R&D Payments Must Be Further Apportioned to the Imported Goods, According to One of Two Options

96. The Tribunal has already concluded that a sufficient link can be established between the R&D payments (in their entirety) and the goods in issue. The payments are, therefore, "in respect of" those goods and included in their price. In reaching this conclusion, the Tribunal has already largely addressed the arguments in the alternative put forward by Skechers Canada as to why the amount of R&D payments cannot be included in, or added to, the price paid or payable in its entirety.

97. However, the Tribunal will squarely address the remaining arguments raised by Skechers Canada to the effect that the R&D payments must be further apportioned to the goods in issue, on the basis that, as put by counsel for Skechers Canada, ". . . the design costs attributable to goods that are never imported into Canada cannot be added to the value for duty."[73]

98. The Tribunal does not disagree with this proposition. As stated, the Tribunal considers that all of the research and design costs included in the R&D payments are attributable to the goods in issue imported by Skechers Canada. Therefore, the Tribunal disagrees with Skechers Canada's argument that a further apportionment is necessary.

99. At the hearing, Skechers Canada proposed two options for apportioning the R&D costs to the imported goods.

100. First, Skechers Canada proposed subtracting 60 percent of the R&D payments because these amounts relate to the proportion of time spent on research and conceptualization, activities that, in Skechers Canada's submission, are not "in respect of" the goods. Further, Skechers Canada submitted that, of the remaining 40 percent, only the percentage of prototype samples that became actual successful styles could rightly be added to the price paid or payable.[74]

101. The Tribunal cannot accept this option. As explained, the evidence demonstrates that the entire research, design and development process is necessary to create the successful models and, therefore, the goods in issue. Subtracting the research and conceptualization portion, or the portion dealing with the costs associated with the rejected prototypes, would be inconsistent with the evidence, which indicates that the Skechers-brand footwear is obtained through an extensive, interactive process.

102. Second, Skechers Canada proposed dividing the total amount due in R&D payments by Skechers Canada by the entire yearly production of Skechers USA to obtain a "cost per pair" of Skechers Canada's contribution. The cost per pair would then be multiplied by the number of pairs imported yearly by Skechers Canada to apportion the R&D payments to the imported goods.[75] This argument is based on CBSA's Memorandum D13-3-12, which suggests methods for allocating the value of assists to certain imports, within the context of clause 48(5)(*a*)(iii)(D). This administrative guideline suggests that, where a firm carries the cost of design as a general expense without allocation to specific products, an appropriate adjustment to the price of imported goods could be made by ". . . apportioning total design centre costs over total production benefiting from the design centre and adding such apportioned cost on a unit basis [to the

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73. *Transcript of Public Hearing*, 10 September 2013, at 91.
74. Skechers Canada's Aid to Argument, Option 1: Skechers Proposal; *Transcript of Public Hearing*, 10 September 2013, at 115-16.
75. Skechers Canada's Aid to Argument, Option 2: D-Memo Option; *Transcript of Public Hearing*, 10 September 2013, at 130-31.

imported goods]."[76] This argument presumes that Skechers Canada's contribution benefits the total yearly production and, therefore, must be further apportioned to the part of production imported by Canada for the purposes of calculating the amount that benefits the goods imported into Canada.

103. In the Tribunal's opinion, this second option is also inappropriate. The Tribunal considers that the apportionment has already been made by tying the amount of R&D payments to Skechers Canada's profits under the CSA, profits which vary according to its importations.

104. Indeed, the primary purpose of the CSA is to apportion to each party its share of the total research, development and design costs incurred by Skechers USA in designing the yearly Skechers-brand footwear. According to its own terms,[77] the CSA establishes that each party's operating profits constitute the best way to calculate the share born by each party. Operating profits, as explained above and as evidenced in the testimony of Mr. Cross, are normally tied to the volumes of goods imported and sold.[78] In effect, Skechers USA and Skechers Canada have found that the method of allocation based on ratios of operating profits, as provided in the CSA, best apportions the overall research, development and design costs to the production benefiting from them and, in particular, the goods imported by Skechers Canada. As such, the R&D payments owed by Skechers Canada already represent the value of research and design work which has benefitted the volumes of shoes imported by Skechers Canada. In the Tribunal's view, the R&D payments are thus properly part of the price paid or payable for the goods in issue without further adjustments.

105. This conclusion is consistent with prior Tribunal jurisprudence. In *Mexx Canada Inc. v. The Deputy Minister of National Revenue*,[79] certain losses incurred by the vendor were apportioned between several distributors proportional to their share of total purchases of apparel in that fashion season. The Tribunal decided that the resulting payments by a distributor who was an importer in Canada were payments "in respect of" the goods *because* they were thus apportioned. The Tribunal made the following useful comments:

> The fabric charge is "in respect of the goods" *in the sense that it is apportioned among the various Mexx distributors on the basis of their participation in the product line for which the unused fabric was bought*, and the appellant clearly accepted, in purchasing the apparel from Mexx Far East, that the price paid or payable might be subject to retroactive adjustment in this fashion. As Mexx Far East is properly seen as the vendor of the apparel, such payments constitute part of the price paid for the apparel for purposes of determining the transaction value of the apparel.
>
> [Emphasis added]

106. The Tribunal's determination in *Chaps Ralph Lauren*, which was referred to by counsel for both parties, supports the same conclusion. In that case, the Tribunal concluded that a certain payment was "in respect of" the goods on the basis that ". . . the amount of the royalty payments is based on the net sales of the imported goods in Canada and is, therefore, affected by the specific goods imported."[80]

107. In this case, therefore, the Tribunal concludes that a similar type of apportionment (based on operating profits, which themselves are linked to each participant's footwear bought and sold in a given season) of the R&D payments supports the finding that these amounts must be included in the price of the goods *in toto*. As such, it would be inappropriate to further apportion the R&D payments to the imported goods.

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76. Exhibit AP-2012-073-12B.
77. See Exhibit AP-2012-073-04B (protected), tab 3, section 3.4.
78. See testimony of Mr. Cross, *Transcript of In Camera Hearing*, 10 September 2013, at 29.
79. (16 February 1995), AP-94-035, AP-94-042 and AP-94-165.
80. *Chaps Ralph Lauren* at 13.

Whether There Are Other Requirements That Prevent the Application of the Transaction Value as the Basis for the Appraisal of the Value for Duty of the Goods in Issue

108. Given the Tribunal's conclusion that the full amount of the R&D payments must be included in the price paid or payable, there is agreement between the parties that the conditions for applying the transaction value of the goods method of section 48 are met. Indeed, the CBSA argued that some of the conditions for applying that method could not be met only in the case that the R&D payments were not included in the price paid or payable in their entirety. Skechers Canada's position throughout was that the transaction value of the goods method could and must be applied, all conditions being met.

109. The Tribunal agrees. The transaction value of the goods method of section 48 must therefore be applied to the appraisal of the value for duty of the goods in issue.

DECISION

110. The appeal is dismissed.

Ann Penner
Ann Penner
Presiding Member