Canadian International Trade Tribunal | Tribunal canadien du commerce extérieur

Ottawa, Wednesday, February 11, 2004

Appeal No. AP-2002-096

IN THE MATTER OF an appeal heard on April 29, 2003, under subsection 67(1) of the *Customs Act*, R.S.C. 1985 (2d Supp.), c. 1;

AND IN THE MATTER OF a decision of the Commissioner of the Canada Customs and Revenue Agency dated August 2, 2002, with respect to a request for re-determination under subsection 60(4) of the *Customs Act*.

BETWEEN

BROWNS SHOE SHOPS INC. **Appellant**

AND

THE COMMISSIONER OF THE CANADA CUSTOMS AND REVENUE AGENCY **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed.

Pierre Gosselin
Pierre Gosselin
Presiding Member

James A. Ogilvy
James A. Ogilvy
Member

Meriel V.M. Bradford
Meriel V.M. Bradford
Member

Michel P. Granger
Michel P. Granger
Secretary

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UNOFFICIAL SUMMARY

Appeal No. AP-2002-096

BROWNS SHOE SHOPS INC. — **Appellant**

AND

THE COMMISSIONER OF THE CANADA CUSTOMS AND REVENUE AGENCY — **Respondent**

This is an appeal pursuant to subsection 67(1) of the *Customs Act* (the *Act*) from a decision of the Commissioner of the Canada Customs and Revenue Agency (the Commissioner) dated August 2, 2002, made under subsection 60(4) of the *Customs Act* pertaining to the re-appraisal of the value for duty of various Aquatalia footwear imported by Browns Shoe Shops Inc. (Browns) between February 1, 2000, and January 31, 2001. The issue is whether the fees paid by Browns to Krasnow Enterprises Ltd./621 South should be added to the price paid or payable for the imported footwear pursuant to subsection 45(1) and subparagraph 48(5)(*a*)(i) of the *Act*. Browns submits that these fees are non-dutiable buying commissions, whereas the Commissioner submits that they are to be included in the value for duty of the imported goods.

HELD: The appeal is allowed. Browns buys footwear directly from various Italian manufacturers. The details surrounding Browns' orders, including the choice, specifications and price of the goods, and quality control and logistics issues are managed by 621 South/Mr. Marvin Krasnow under instructions from Browns. The Tribunal finds no evidence of a conflict of interest, nor does it have any reason to believe that the relationship between Browns and 621 South/Mr. Krasnow is a sham. Rather, the Tribunal finds that the parties have entered into a legitimate buying agency agreement, which provides for the payment of a commission. The Tribunal finds that this commission is a legitimate payment for the services of a buying agent representing the purchaser abroad, which, therefore, falls within the exception provided in subparagraph 48(5)(*a*)(i) of the *Act*.

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	April 29, 2003
Date of Decision:	February 11, 2004
Tribunal Members:	Pierre Gosselin, Presiding Member James A. Ogilvy, Member Meriel V.M. Bradford, Member
Counsel for the Tribunal:	Michèle Hurteau Eric Wildhaber
Clerk of the Tribunal:	Anne Turcotte
Appearances:	Michael Kaylor, for the appellant Jean-Robert Noiseux, for the respondent

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Appeal No. AP-2002-096

BROWNS SHOE SHOPS INC. — Appellant

AND

THE COMMISSIONER OF THE CANADA CUSTOMS AND REVENUE AGENCY — Respondent

TRIBUNAL: PIERRE GOSSELIN, Presiding Member
JAMES A. OGILVY, Member
MERIEL V.M. BRADFORD, Member

REASONS FOR DECISION

This is an appeal pursuant to subsection 67(1) of the *Customs Act*[1] from a decision of the Commissioner of the Canada Customs and Revenue Agency (the Commissioner) dated August 2, 2002, made under subsection 60(4) of the *Act* pertaining to the re-appraisal of the value for duty of various Aquatalia footwear imported by Browns Shoe Shops Inc. (Browns) between February 1, 2000, and January 31, 2001. The issue is whether the fees paid by Browns to Krasnow Enterprises Ltd./621 South should be added to the price paid or payable for the imported footwear pursuant to subsection 45(1) and subparagraph 48(5)(*a*)(i) of the *Act*. Browns submits that these fees are non-dutiable buying commissions, whereas the Commissioner submits that they are to be included in the value for duty of the imported goods.

EVIDENCE

Mr. Barry Klar, Treasurer and Chief Financial Officer of Browns Shoe Shops Inc., testified on behalf of Browns. He indicated that Browns worked with Mr. Marvin Krasnow in selecting the footwear that it buys from Italian manufacturers, which bears the Aquatalia label. Mr. Krasnow processes the orders, and follows up on delivery, quality control, inspection, claims and any problems that relate to the merchandise that is shipped to Browns in Montréal, Quebec, directly from various Italian manufacturers. He stated that the decision of which footwear to buy rests with Browns, which pays the manufacturers directly. He also indicated that, before finalizing an order, Browns sometimes requires Mr. Krasnow to secure modifications from the manufacturers to the models of footwear that it is shown; these may be required for price, quality, design or fashion purposes. Mr. Klar stated that Browns pays a 10 percent buying commission on the invoice cost for this service to, depending on the transaction, Krasnow Enterprises Ltd., Krasnow Enterprises Inc. or 621 South, three companies in which Mr. Krasnow has interests. A standard retail industry buying agency agreement between Browns and 621 South covers this relationship, even though the agreement is signed by 621 South per Marvin Krasnow only and not by Browns.

1. R.S.C. 1985 (2d Supp.), c. 1 [*Act*].

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Mr. Klar specified that, instead of using the names of the various factories from which the footwear is bought, the name “Krasnow Enterprises Ltd.” and the symbol “KRA” appear on various purchase orders under the heading “FOURNISSEUR/VENDOR” for this particular style of merchandise. Mr. Klar stated that, despite these indications, the vendor is always the Italian manufacturer from which the footwear is sourced.

Mr. Klar stated that Browns knows that Krasnow Enterprises Ltd. is also a purchaser and importer in its own right, of Aquatalia footwear. He confirmed that Browns purchases all its Aquatalia footwear through Mr. Krasnow, the creator and owner of that trademark. This is the only such buying agency agreement into which Browns has entered; its other footwear is purchased by its own representatives directly from manufacturers.

Mr. Klar testified that Browns pays no royalty in respect of the Aquatalia trademark.

Mr. Krasnow, principal of Krasnow Enterprises Ltd., a Canadian company, and Krasnow Enterprises Inc., a U.S. corporation, and owner of 621 South, also a U.S. corporation, testified on behalf of Browns. Krasnow Enterprises Ltd. owns the trademark “Aquatalia by Marvin K.”. Mr. Krasnow testified that he has always personally interceded in performing the obligations incumbent upon 621 South with respect to the buying agency agreement between that company and Browns. He stated that he had no financial interest in any of the factories that manufacture the Aquatalia footwear, nor had he received any commissions of any sort from such manufacturers. Mr. Krasnow does product development, but does not provide raw materials to these manufacturers. He also testified that all the design and pattern work is done at the manufacturers’ factories.

Mr. Krasnow confirmed that Browns buys directly from the manufacturers on a first-costs basis and pays him, as a buying agent, a commission of 10 percent of the manufacturer-invoiced amounts. He testified that, for tax loss purposes, these payments are made to 621 South, whose sole line of business now is to act as the buying agent. Mr. Krasnow agreed to this arrangement, which departs from his normal business model, i.e. an importer that distributes and sells product on a landed basis, because of the mutual benefit that this relationship created in terms of the increase in volumes and, consequently, the reduced first costs. Mr. Krasnow indicated that the relationship also allowed the Aquatalia footwear to benefit from an increase in profile due to its presence in Browns’ stores. He also confirmed that Browns is not bound to purchase any product that he proposes and that he negotiates price and style changes with Browns and then with the manufacturers, but that he does not consult Browns on the choice of a manufacturer. Mr. Krasnow stated that the relationship with Browns never involved charging a royalty.

Ms. Ginette Berthelet, Compliance Verification Officer, Canada Customs and Revenue Agency (CCRA), testified on behalf of the Commissioner. Ms. Berthelet testified having conducted a multiprogram customs audit of Browns’ footwear business (excluding handbags) with another CCRA compliance verification officer, Mr. Sébastien Perras. They prepared a questionnaire intended to ascertain the business relationship between Browns and 621 South. Mr. Klar completed this questionnaire. Ms. Berthelet testified that the audit concluded that the relationship between 621 South and Browns went beyond a true buying agency agreement, since Browns, the alleged principal, did not control all the activities of 621 South, its alleged agent.

Ms. Berthelet stated the reasons for the above conclusion: (1) 621 South picked the factories that would manufacture the Aquatalia footwear; (2) Browns could not source the Aquatalia footwear without Mr. Krasnow's intervention; (3) the Aquatalia footwear owes its existence to Mr. Krasnow; and (4) the audit ascertained that 621 South did not always act in Browns' interest because a true buying agent would limit itself to inspecting the merchandise, but Mr. Krasnow went beyond this in deciding whether the goods met his own criteria before affixing his Aquatalia trademark and, therefore, also had an interest in the manufacture of the goods. In this respect, Ms. Berthelet testified that she found Mr. Krasnow to be acting more as a vendor.

Ms. Berthelet also testified that it was her understanding that Browns did not purchase the Aquatalia footwear from the manufacturers, but rather from Mr. Krasnow.

ARGUMENT

Browns submitted that the terms of the buying agency agreement into which it entered with 621 South have been adhered to and that the evidence confirms that, having ordered various Aquatalia footwear through the "good offices" of 621 South, it purchased the imported goods directly from various manufacturers and paid 621 South a commission for its services.

Browns submitted that it has always known that Krasnow Enterprises Ltd. wears another hat, that of importer/purchaser and distributor of Aquatalia footwear in its own right. Both parties were able to benefit from a better price due to the increase in total volumes created by the combination of their purchases. In Browns' view, the record indicates that, for these transactions, 621 South, therefore, always acted in Browns' best interest and, citing the Supreme Court of Canada in *Shell Canada Ltd. v. Canada*,[2] as long as there is no indication that the relationship is a sham, and Browns submits that there is none in this instance, taxpayers are permitted to structure their transactions in a manner that minimizes tax.

Browns argued that, with the exception of the selection of what factories produce the imported goods, its agency buying agreement with 621 South conforms to the Supreme Court of Canada's restatement of the law of agency as found in *R. v. Kelly*.[3] In particular, Browns submitted that: it controls the relationship; it is not forced to choose any of the products offered in the Aquatalia line of footwear; it negotiates price concessions and style modifications; and it decides the size of its purchases and shipping instructions. Browns further instructs 621 South to resolve any problems, such as late deliveries and quality defects, which it does in Browns' best interest. Browns also stressed the fact that 621 South does not own any of the factories that manufacture the goods ordered by Browns, nor does it receive any payments from them.

Browns submitted that there is clear legal separation between it and its agent, 621 South, as well as between its agent and Krasnow Enterprises Ltd., which owns the Aquatalia trademark. Browns likened the facts in this appeal to those in the Tribunal's decisions in *Chaps-Ralph Lauren v. Deputy M.N.R.*[4] and *Sherson Marketing Corporation v. Deputy M.N.R.*,[5] wherein the buying agency agreements were found to be non-dutiable. Browns also submitted that a statement made by the Federal Court of Appeal in

2. [1999] 3 S.C.R. 622 (S.C.C.) at 644-45 [*Shell Canada*].
3. [1992] 2 S.C.R. 170 at 183-84 [*Kelly*].
4. (1 November 1995), AP-94-190 and AP-94-191 (CITT).
5. (27 July 2000), AP-98-002 (CITT).

Utex Corporation v. Deputy M.N.R., Commissioner of Customs and Revenue[6] should be dispositive of this appeal.

Browns added that the facts in this appeal are distinguishable from those that were before the Federal Court of Appeal in *Signature Plaza Sport Inc. v. M.N.R.*[7] because the alleged agent, Manhattan Industries Inc. (Manhattan), not only owned certain trademark rights but also provided its manufacturer with patterns and fabric from which garments were made. In that instance, the factories were not the vendors of the goods, but merely subcontractors. The Federal Court of Appeal found that Manhattan was the vendor. In contrast, Browns submitted that 621 South provides no such materials to the manufacturers that it retains and never holds title to the goods purchased by Browns.

The Commissioner submitted that the alleged commission or fee paid to 621 South (or what he refers to as the Krasnow Group) should be added to the value for duty of the imported Aquatalia footwear because Browns was required to use the services of 621 South for such purchases. Such an alleged commission or fee is not a *bona fide* buying commission, as provided for in the *Act*, because the so-called agent: (1) is, in fact, the vendor of the goods in issue since it owns the Aquatalia trademark; (2) causes the goods bearing that trademark to come into existence; (3) sources its production through various factories according to its own criteria; and (4) does not act as Browns' buying agent.

The Commissioner, citing the Tribunal's decision in *Mexx Canada Inc. v. Deputy M.N.R.*,[8] stated that the alleged commission or fee paid to 621 South cannot be considered non-dutiable because the work that it does goes much further than that of an agent representing a purchaser abroad in respect of a sale. The Commissioner submitted that this can be ascertained by way of a detailed analysis of the contractual and true business relationship that exists between Browns and 621 South/the Krasnow Group; indeed, the Commissioner submitted that the Federal Court of Appeal's decision in *Signature Plaza* requires the Tribunal to undertake such an analysis.

The Commissioner added that the facts in this appeal cannot be likened to those in the cases cited by Browns, where the Tribunal found that the holder of a trademark can also be recognized as an agent, because of the degree of control exercised by Mr. Krasnow over the Aquatalia line of footwear; indeed, he builds his own collection, promotes the Aquatalia trademark on his Web site, decides what products are to be manufactured to bear that name and has stated that he is "selling shoes". In this regard, the Commissioner refers to the answers provided by Mr. Klar in response to the questionnaire administered during the course of the CCRA's audit to the effect that Mr. Krasnow has the footwear manufactured to bear his trademark if the footwear meets his criteria.[9] The Commissioner also contends that the purchases made by Browns through Mr. Krasnow account for only a small portion of Browns' business.

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6. (7 March 2001), A-28-00 (F.C.A.) at para. 8: "There is no evidence in the record that Fabco, in providing services to Utex Corporation, failed in some respects to act in the interests of the appellant but even if there were, that by itself would not be sufficient to establish that the fees paid to Fabco are outside the exception set out in subparagraph 48(5)(a)(i) of the *Act* as fees paid to the agent of a purchaser for the service of representing the purchaser abroad in respect of the sale."
7. (1994), 169 N.R. 321 (F.C.A.) [*Signature Plaza*].
8. (16 February 1995), AP-94-035, AP-94-042 and AP-94-165 (CITT).
9. Respondent's Brief, Tab 10.

Accordingly, the Commissioner contended that Browns' required use of the services of 621 South/the Krasnow Group precludes the existence of a *bona fide* agency relationship; rather, this relationship, in all its essential characteristics, is that of a vendor-purchaser. Re-characterization of this relationship is permissible in this instance, in accordance with the Supreme Court of Canada's decision in *Shell Canada*, restating *Continental Bank Leasing v. Canada*,[10] because the label attached by the taxpayer to the particular transaction, in this case a buying agency agreement, does not properly reflect its legal effect, which here is that of a vendor-purchaser relationship. Absent such a re-characterization, the Commissioner suggested, in the alternative, that the Tribunal simply decide that the fees paid by Browns to 621 South/the Krasnow Group do not fall within the exception provided in subparagraph 48(5)(*a*)(i) of the *Act*.

DECISION

Section 44 of the *Act* states that "[w]here duties, other than duties or taxes levied under the *Excise Tax Act* or the *Excise Act*, are imposed on goods at a percentage rate, such duties shall be calculated by applying the rate to a value determined in accordance with sections 45 to 55."

Subsection 48(5) of the *Act* reads in part 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
>
> (i) commissions and brokerage in respect of the goods incurred by the purchaser thereof, other than fees paid or payable by the purchaser to his agent for the service of representing the purchaser abroad in respect of the sale.

Section 45 of the *Act* defines the term "price paid or payable" in respect of the sale of goods for export to Canada as meaning "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".

The Tribunal is of the view that, for the purposes of the buying agency agreement in issue, 621 South is indistinguishable from the person, Mr. Krasnow, since it is he who acts as the provider of the services for which 621 South is paid. The Tribunal also notes the uncontroverted evidence adduced at the hearing to the effect that Mr. Krasnow is part owner of Krasnow Enterprises Ltd. and full owner of 621 South but, that relation aside, the two companies are unrelated.

Although a document on record dated May 29, 2000, instructs Browns to pay the commission provided in the agreement between Browns and 621 South to "Krasnow Enterprises",[11] the Tribunal accepts the testimony adduced at the hearing[12] to the effect that this commission is paid to 621 South. Similarly, notwithstanding the indication "KRASNOW ENTREPRISES LTD." on the line "FOURNISSEUR/VENDOR" in the purchase orders on record,[13] the Tribunal accepts the evidence adduced at the hearing that Browns buys Aquatalia footwear directly from the various Italian factories that,

10. [1998] 2 S.C.R. 298 (S.C.C.) at 304.
11. Respondent's Brief, Tab 7 at 2.
12. *Transcript of Public Hearing*, 29 April 2003 at 13.
13. Respondent's Brief, Tabs 14, 15.

from time to time, are used to manufacture these products.[14] To the Tribunal's satisfaction, Messrs. Klar and Krasnow have explained the foregoing as having resulted from the anomalous nature of the relationship between Browns and 621 South per Mr. Krasnow. Indeed, the Tribunal accepts that Browns has no buying agency agreements other than the one at issue and that Mr. Krasnow, via 621 South, has departed from his usual business model in order to accommodate Browns' margin requirements.

The Tribunal further accepts that this arrangement is advantageous to both Browns, 621 South, and, ultimately, Mr. Krasnow; on the one hand, Browns is able to have access to the footwear that it wants, at the right price, as well as manage this part of its foreign sourcing activities; on the other hand, the products bearing the "Aquatalia by Marvin K." trademark benefit from the high-end cachet that comes from access to Browns' retail outlets and compensation in the form of a commission. The Tribunal is, therefore, not convinced that 621 South/Mr. Krasnow has any "control" in its relationship with Browns.

Rather, it is Browns that controls the relationship. Indeed, it is Browns, not 621 South/Mr. Krasnow, that chooses the specific items of footwear that it wants (and only such items), which can be specifically tailored to its requirements, including fashion and price; Browns directs Mr. Krasnow in dealing with quality control issues and logistics; and ultimately, Browns has secured controlled access to what amounts to its own tailor-made Aquatalia footwear without the payment of a royalty.

Furthermore, there is no evidence that Browns is dissatisfied with any of Mr. Krasnow's choices of manufacturers or that Browns has relinquished any control in this area. Quite to the contrary, satisfaction with manufacturers seems not to have been an issue and, , the evidence leads the Tribunal to believe that, by engaging in direct buying relationships with the various manufacturers[15] that are used from time to time, Browns is consenting to these manufacturing decisions, if not tacitly approving of them. In this regard, the Tribunal notes that it heard ample evidence that problems with specific manufacturers, including quality control or logistics issues, are resolved by Mr. Krasnow under instructions from Browns. Accordingly, the Tribunal is of the view that, if a particular manufacturer proved to be unsatisfactory, Browns would direct Mr. Krasnow to find a lasting solution or to switch production to a manufacturer that satisfies its needs.

The Tribunal notes that there is no evidence of an ownership relationship between any of the factories that manufacture the Aquatalia footwear and 621 South or any of Krasnow Enterprises Ltd., Krasnow Enterprises Inc. or Mr. Krasnow himself, nor is there evidence of any payment by such manufacturers to any of the aforementioned. The Tribunal further accepts that Browns knew that Mr. Krasnow's activities included the purchase, import, distribution and sale of Aquatalia footwear for purposes other than the relationship that links him with Browns.

Accordingly, the Tribunal finds no evidence of a conflict of interest, nor does it have any reason to believe that the relationship between Browns and 621 South/Mr. Krasnow is a sham. Indeed, the Tribunal finds no indication that either party has departed from the requirements of the law of agency, as restated by the Supreme Court of Canada in *Kelly*.

14. *Ibid.*, Tabs 7, 15.
15. *Ibid.*

For the foregoing reasons, the Tribunal views the buying agency commission as a legitimate payment for the services of a buying agent representing the purchaser abroad, which, therefore, falls within the exception provided in subparagraph 48(5)(*a*)(i) of the *Act*. Consequently, the appeal is allowed.

Pierre Gosselin
Pierre Gosselin
Presiding Member

James A. Ogilvy
James A. Ogilvy
Member

Meriel V.M. Bradford
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Member