Canadian International Trade Tribunal
Tribunal canadien du commerce extérieur

CANADIAN INTERNATIONAL TRADE TRIBUNAL

Appeals

DECISION AND REASONS

Appeal No. AP-2009-016

Tara Materials, Inc.

v.

President of the Canada Border Services Agency

Decision and reasons issued Tuesday, August 3, 2010

Canada

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IN THE MATTER OF an appeal heard on April 14, 2010, pursuant to subsection 67(1) of the *Customs Act*, R.S.C. 1985 (2d Supp.), c. 1;

AND IN THE MATTER OF a decision of the President of the Canada Border Services Agency, dated April 2, 2009, with respect to a request for further re-determination, pursuant to subsection 60(4) of the *Customs Act*.

BETWEEN

TARA MATERIALS, INC. **Appellant**

AND

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

DECISION

The appeal is dismissed.

Stephen A. Leach
Stephen A. Leach
Presiding Member

Dominique Laporte
Dominique Laporte
Secretary

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	April 14, 2010
Tribunal Member:	Stephen A. Leach, Presiding Member
Counsel for the Tribunal:	Alain Xatruch
Research Director:	Audrey Chapman
Research Officer:	Gary Rourke
Manager, Registrar Office:	Michel Parent
Registrar Officer:	Julie Lescom

PARTICIPANTS:

Appellant	**Counsel/Representative**
Tara Materials, Inc.	Michael Kaylor
Respondent	**Counsel/Representative**
President of the Canada Border Services Agency	Zoe Oxaal

WITNESSES:

David L. Twite President Tara Materials, Inc.	Byron Fitzgerald Acting Manager Origin and Valuation Audit Unit Origin and Valuation Division Admissibility Branch Canada Border Services Agency

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STATEMENT OF REASONS

1. This is an appeal filed by Tara Materials, Inc. (Tara) with the Canadian International Trade Tribunal (the Tribunal) pursuant to subsection 67(1) of the *Customs Act*[1] from a decision made on April 2, 2009, by the President of the Canada Border Services Agency (CBSA) pursuant to subsection 60(4).

2. The issue in this appeal is whether the totality of the cotton and polyester/cotton finished artist canvases exported from the United States to Canada by Tara in 2006 (the goods in issue) are entitled to preferential tariff treatment (at the United States Tariff rate) under the *North American Free Trade Agreement*,[2] as claimed by Tara, or whether only 72 percent of the goods in issue are entitled to such preferential treatment, as determined by the CBSA.

PROCEDURAL HISTORY

3. On February 1, 2007, the CBSA notified an importer of the goods in issue that it was conducting a review of the tariff treatment of textile fabrics imported from Tara, the producer of these textile fabrics. Pursuant to sections 35.1 and 40 of the *Act*, it requested that the importer supply the CBSA with all *NAFTA* certificates of origin and commercial invoices pertaining to the textile fabrics imported from Tara for the period from January 1 to December 31, 2006.

4. On March 26, 2007, the CBSA notified Tara that, pursuant to section 42.1 of the *Act*, it would be conducting a verification of the origin of the textile fabrics mentioned above (which include the goods in issue), for which preferential tariff treatment under *NAFTA* had been claimed.

5. From December 3 to 5, 2007, the CBSA conducted an on-site verification visit of Tara's production facilities in Lawrenceville, Georgia, to determine whether the textile fabrics, having been certified as originating goods, met the requirements of *NAFTA* and the *NAFTA Rules of Origin Regulations*.[3]

6. On February 19, 2008, the CBSA advised Tara that some of the textile fabrics that it had exported, including 72 percent of the goods in issue, qualified as "originating" under *NAFTA*. On the same date, the CBSA advised Tara that, pursuant to section 59 of the *Act*, the remaining 28 percent of the goods in issue had been denied preferential tariff treatment under *NAFTA*.

7. On May 15, 2008, Tara filed a request for further re-determination pursuant to subsection 60(1) of the *Act*, wherein it submitted that 100 percent of the goods in issue should be entitled to preferential tariff treatment under *NAFTA*.

8. On April 2, 2009, the CBSA issued its decision under subsection 60(4) of the *Act*, which denied the request and confirmed its prior denial of preferential tariff treatment under *NAFTA* for 28 percent of the goods in issue.

9. On June 22, 2009, Tara filed a notice of appeal with the Tribunal pursuant to subsection 67(1) of the *Act*.

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1. R.S.C. 1985 (2d Supp.), c. 1 [*Act*].
2. *North American Free Trade Agreement between the Government of Canada, the Government of the United Mexican States and the Government of the United States of America*, 17 December 1992, 1994 Can. T.S. No. 2 (entered into force 1 January 1994) [*NAFTA*].
3. S.O.R./94-14.

10. The Tribunal held a public hearing in Ottawa, Ontario, on April 14, 2010. Tara called Mr. David Twite, President of Tara, to testify on its behalf. The CBSA called Mr. Byron Fitzgerald, Acting Manager, Origin and Valuation Audit Unit, Origin and Valuation Division, Admissibility Branch, CBSA, to testify on its behalf. Mr. Fitzgerald was qualified by the Tribunal as an expert in auditing, accounting and *NAFTA* audits.

GOODS IN ISSUE

11. The goods in issue are described as cotton and polyester/cotton finished artist canvases, which are textile products that have been coated with chemicals that permit adherence of paint while protecting the textile fibres from damage. They were produced in various sizes and forms, such as stretched on wooden bars or in rolls, sheets or pads. The materials used to produce the goods in issue included raw canvas (i.e. cotton and polyester/cotton fabric), gesso and, where used, wood.

12. In producing finished artist canvases, Tara used both originating cotton and polyester/cotton fabric (sourced from the United States and Canada) and non-originating cotton and polyester/cotton fabric (sourced from Turkey, India, Belgium and Indonesia).[4] Tara considers that, regardless of its origin, the cotton and polyester/cotton fabric that was used is fungible, i.e. it was commingled in inventory and was used interchangeably in producing finished artist canvases of all styles and sizes.[5]

13. The tariff classification of the goods in issue is not in dispute. At the time of their importation, the goods in issue were classified under tariff item No. 5901.90.10 of the schedule to the *Customs Tariff*[6] as prepared painting canvas and under tariff item No. 5901.90.90 as other textile fabrics. According to Tara, the cotton and polyester/cotton fabric that was used to produce the goods in issue is typically classified in heading No. 52.09.[7]

14. No physical exhibits were filed by the parties.

ANALYSIS

Law

15. Subsection 67(1) of the *Act* provides that "[a] person aggrieved by a decision of the President [of the CBSA] made under section 60 . . . may appeal from the decision to the . . . Tribunal . . . ." Decisions under section 60 include CBSA decisions on the origin of goods.

16. The rules of origin in *NAFTA*, as incorporated into Canadian law, provide criteria for determining whether goods are entitled to preferential tariff treatment. These rules of origin take into account where goods are produced and what materials are used to produce them.

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4. *Transcript of In Camera Hearing*, 14 April 2010, at 12-13, 16. The Tribunal notes that, on April 26, 2010, it requested that Tara review the protected transcript and inform the Tribunal if certain parts, or the totality, of the transcript could be designated as public. On April 30, 2010, Tara informed the Tribunal that the entire protected transcript could be designated as public and, on May 4, 2010, the CBSA informed the Tribunal that it did not object to such designation. Therefore, any subsequent references to the protected transcript in these reasons should be considered as references to a public document.
5. *Transcript of In Camera Hearing*, 14 April 2010, at 10, 13, 16; Tribunal Exhibit AP-2009-016-15B (protected), tab 3 at 13.
6. S.C. 1997, c. 36.
7. Tribunal Exhibit AP-2009-016-06A at para. 9.

17. Chapter Four of *NAFTA* sets out the requirements for goods to qualify as "originating good[s]", while Chapter Five establishes the requirements for certificates of origin. The provisions of Chapter Four and Chapter Five are incorporated into Canadian law under the provisions of the *Act*, the *Customs Tariff* and regulations, such as the *NAFTA Rules of Origin Regulations*, the *Proof of Origin of Imported Goods Regulations*,[8] the *NAFTA Tariff Preference Regulations*,[9] the *Marking of Imported Goods Regulations*,[10] the *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations*[11] and the *NAFTA and CCFTA Verification of Origin Regulations*.[12]

Customs Tariff

18. Subsection 24(1) of the *Customs Tariff* provides the general conditions that must be met in order for goods to be entitled to the benefit of a preferential tariff treatment and reads as follows:

> **24.**(1) Unless otherwise provided in an order made under subsection (2) or otherwise specified in a tariff item, goods are entitled to a tariff treatment, other than the General Tariff, under this Act only if
>
> (*a*) proof of origin of the goods is given in accordance with the *Customs Act*; and
>
> (*b*) the goods are entitled to that tariff treatment in accordance with regulations made under section 16 or an order made under paragraph 31(1)(*a*), 34(1)(*a*), 38(1)(*a*) or 42(1)(*a*), subsection 45(13), section 48 or subsection 49(2) or 49.5(8).
>
> **24.**(1) Sauf disposition contraire des décrets d'application du paragraphe (2) ou d'un numéro tarifaire, les marchandises bénéficient d'un traitement tarifaire prévu par la présente loi, à l'exception du tarif général, si les conditions suivantes sont réunies :
>
> *a*) leur origine est établie en conformité avec la *Loi sur les douanes*;
>
> *b*) elles bénéficient du traitement tarifaire accordé en conformité avec les règlements de l'article 16, ou avec les décrets ou arrêtés pris en vertu des alinéas 31(1)*a*), 34(1)*a*), 38(1)*a*) ou 42(1)*a*), du paragraphe 45(13), de l'article 48 ou des paragraphes 49(2) ou 49.5(8).

19. Therefore, in order for the goods in issue to be entitled to preferential tariff treatment under *NAFTA*, subsection 24(1) of the *Customs Tariff* requires that two conditions be met: (1) proof of origin of the goods must be given in accordance with the *Act* and (2) the goods must be entitled to that tariff treatment in accordance with the applicable regulations or order.

20. With respect to the first condition, subsection 35.1(1) of the *Act* requires ". . . proof of origin, in the prescribed form . . . ." Subsection 6(1) of the *Proof of Origin of Imported Goods Regulations* provides that, where preferential tariff treatment under *NAFTA* is claimed for goods, the importer or owner of the goods must furnish, as proof of origin, a ". . . [c]ertificate of [o]rigin for the goods . . .", although no form for a certificate of origin is prescribed under these regulations.[13]

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8. S.O.R./98-52.
9. S.O.R./94-17.
10. S.O.R./94-10.
11. S.O.R./94-23.
12. S.O.R./97-333.
13. Article I.1 of the *Uniform Regulations for the Interpretation, Application, and Administration of Chapters Three (National Treatment and Market Access for Goods) and Five (Customs Procedures) of the North American Free Trade Agreement*, which were adopted by the Governments of Canada, Mexico and the United States pursuant to Article 511(1) of *NAFTA* (in Canada, these regulations are contained in the Appendix to Memorandum D11-4-18 published by the CBSA), provides that the certificate of origin referred to in Article 501(1) of *NAFTA* is equivalent in substance to the certificate of origin set out in Annex I.1a. Annex I.1a, in turn, makes reference to Form B232 E and also provides instructions for completion of the certificate.

21. In this case, it is not disputed that Tara provided certificates of origin for the goods in issue to importers in Canada. In fact, the evidence on the record indicates that the certificates of origin provided by Tara described the goods in issue by product code and style number for the blanket period from January 1 to December 31, 2006, and certified that the totality of the goods in issue met the origin requirements specified for those goods in *NAFTA*.[14]

22. Therefore, the Tribunal accepts that, insofar as formal requirements are concerned, proof of origin was given in accordance with the *Act*. However, in the Tribunal's view, whether the certificates of origin were correctly completed by Tara (i.e. whether the origin of the goods in issue was correctly stated) ultimately depends on whether the goods in issue were entitled to preferential tariff treatment under *NAFTA* in accordance with the applicable regulations or order—the second condition that must be met under subsection 24(1) of the *Customs Tariff*.

23. Entitlement to the benefit of a preferential tariff treatment under *NAFTA*, in this case the United States Tariff, is determined according to the *NAFTA Tariff Preference Regulations*.

NAFTA Tariff Preference Regulations

24. Paragraph 3(*b*) of the *NAFTA Tariff Preference Regulations* provides as follows:

3. Goods are entitled to the benefit of the United States Tariff where . . . (*b*) in the case of . . . textile and apparel goods, (i) the goods are originating goods, and (ii) the goods are eligible to be marked as goods of the United States in accordance with the *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations*.	**3.** Les marchandises ont droit au bénéfice du tarif des États-Unis lorsque : [...] *b*) dans le cas [...] des textiles et vêtements, elles sont à la fois : (i) des marchandises originaires, (ii) des marchandises admissibles au marquage en tant que marchandises des États-Unis conformément au *Règlement sur la détermination, aux fins de marquage, du pays d'origine des marchandises (pays ALÉNA)*.

25. Therefore, in order for the goods in issue to be entitled to the benefit of the United States Tariff, they must be "originating goods" and eligible to be marked as goods of the United States in accordance with the *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations*.

26. In this case, the parties appear to agree that subparagraph 3(*b*)(ii) of the *NAFTA Tariff Preference Regulations* is not at issue.[15] On the basis of its understanding of the facts of this case, the Tribunal is of the view that all the goods in issue, which are ultimately found to be "originating goods" in accordance with subparagraph 3(*b*)(i), would also be eligible to be marked as goods of the United States in accordance with the *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations*.[16]

14. Tribunal Exhibit AP-2009-016-15B (protected), tab 1; *Transcript of In Camera Hearing*, 14 April 2010, at 22.
15. Tribunal Exhibit AP-2009-016-08A at 11, note 4. Tara did not address this provision in its brief or in argument.
16. In fact, it appears that, regardless of whether the goods in issue are found to be "originating' in accordance with subparagraph 3(*b*)(i) of the *NAFTA Tariff Preference Regulations*, they would be eligible to be marked as goods of the United States. This would be due to the fact that, pursuant to paragraph 4(1)(*c*) of the *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations*, any cotton and polyester/cotton fabric obtained from countries other than the United States and used in the production of the goods in issue would have been considered as having undergone a change in tariff classification specified in the rule set out in Schedule III of the aforementioned regulations for heading No. 59.01 (i.e. the heading in which the goods in issue are classified).

27. Consequently, entitlement to the benefit of the United States Tariff in this case is entirely dependent on whether the goods in issue are determined to be "originating goods".

28. In this respect, subsection 2(1) of the *NAFTA Tariff Preference Regulations* provides as follows:

"originating good" has the same meaning as in subsection 2(1) of the *NAFTA Rules of Origin Regulations*.	« marchandise originaire » S'entend au sens de la définition de « produit originaire » au paragraphe 2(1) du *Règlement sur les règles d'origine (ALÉNA)*.

NAFTA Rules of Origin Regulations

29. Subsection 2(1) of the *NAFTA Rules of Origin Regulations* provides as follows:

"originating good" means a good that qualifies as originating under these Regulations; "originating material" means a material that qualifies as originating under these Regulations.	« matière originaire » Matière qui est admissible à titre de matière originaire aux termes du présent règlement. [...] « produit originaire » Produit qui est admissible à titre de produit originaire aux termes du présent règlement.

30. Section 4 of the *NAFTA Rules of Origin Regulations* sets out various scenarios under which goods can generally be found to originate in the territory of a *NAFTA* country.[17] In this case, the parties agree that finished artist canvases that are produced from originating cotton and polyester/cotton fabric qualify as originating goods. The parties also agree that finished artist canvases that are produced from non-originating cotton and polyester/cotton fabric do not qualify as originating goods.[18]

31. However, there is disagreement between the parties regarding the exact percentage of the goods in issue which are produced, or deemed to be produced, from originating cotton and polyester/cotton fabric and the percentage of the goods in issue which are produced, or deemed to be produced, from non-originating cotton and polyester/cotton fabric. In other words, the parties cannot agree on the percentage of the goods in issue that qualify as originating goods and that are thus entitled to the benefit of the United States Tariff. As previously stated, Tara has claimed that the totality of the goods in issue qualify as originating goods whereas the CBSA has determined that only 72 percent of the goods in issue so qualify.

17. See subsections 4(1), (2), (3) and (4) of the *NAFTA Rules of Origin Regulations*.

18. Paragraph 4(2)(*a*) of the *NAFTA Rules of Origin Regulations* provides that a good originates in the territory of a *NAFTA* country where "each of the non-originating materials used in the production of the good undergoes the applicable change in tariff classification as a result of production that occurs entirely in the territory of one or more of the NAFTA countries . . . ." Both parties agree that the non-originating cotton and polyester/cotton fabric used to produce finished artist canvases does not undergo a change in tariff classification specified in the rule set out in Schedule I to the *NAFTA Rules of Origin Regulations* for heading No. 59.01. The Tribunal notes that this "tariff shift rule" is different from the tariff shift rule mentioned in note 16 (i.e. the tariff shift rule set out in Schedule III of the *Determination of Country of Origin for the Purposes of Marking Goods (NAFTA Countries) Regulations* for heading No. 59.01).

32. The parties' disagreement in this case stems from their diverging views regarding the manner in which the provisions of the *NAFTA Rules of Origin Regulations* that pertain to fungible materials and fungible goods[19] are to be interpreted and applied.

33. Subsection 7(16) of the *NAFTA Rules of Origin Regulations* allows for the use of a number of inventory management methods for the purposes of determining whether fungible materials, that are comprised of originating and non-originating materials, are originating materials and whether fungible goods, that are comprised of originating and non-originating goods, are originating goods. It reads as follows:

> (16) Subject to subsection (16.1), for purposes of determining whether a good is an originating good,
>
> (*a*) where originating materials and non-originating materials that are fungible materials
>
> (i) are withdrawn from an inventory in one location and used in the production of the good, or
>
> (ii) are withdrawn from inventories in more than one location in the territory of one or more of the NAFTA countries and used in the production of the good at the same production facility,
>
> the determination of whether the materials are originating materials may be made on the basis of any of the applicable inventory management methods set out in Schedule X; and
>
> (*b*) where originating goods and non-originating goods that are fungible goods are physically combined or mixed in inventory and prior to exportation do not undergo production or any other operation in the territory of the NAFTA country in which they were physically combined or mixed in inventory, other than unloading, reloading or any other operation necessary to preserve the goods in good condition or to transport the goods for exportation to the territory of another NAFTA country, the determination of whether the good is an originating good may be made on the basis of any of the applicable inventory management methods set out in Schedule X.
>
> (16) Sous réserve du paragraphe (16.1), pour déterminer si un produit est un produit originaire :
>
> *a*) lorsque des matières originaires et des matières non originaires qui sont des matières fongibles;
>
> (i) soit sont retirées d'un stock situé dans un seul emplacement et sont utilisées dans la production du produit,
>
> (ii) soit sont retirées de stocks de matières situés dans plus d'un emplacement à l'intérieur du territoire d'un ou de plusieurs pays ALÉNA et sont utilisées dans la production du produit dans une même installation de production,
>
> l'une des méthodes applicables de gestion des stocks énoncées à l'annexe X peut être utilisée pour déterminer s'il s'agit de matières originaires;
>
> *b*) lorsque des produits originaires et des produits non originaires qui sont des produits fongibles sont matériellement combinés ou mélangés à des stocks et ne font l'objet, avant l'exportation, d'aucune production ni autre opération sur le territoire du pays ALÉNA où ils ont été ainsi matériellement combinés ou mélangés, à l'exception d'un déchargement, d'un rechargement ou de toute autre opération nécessaire à leur maintien en bon état ou à leur transport pour exportation vers le territoire d'un autre pays ALÉNA, l'une des méthodes applicables de gestion des stocks énoncées à l'annexe X peut être utilisée pour déterminer s'il s'agit de produits originaires.

34. Schedule X to the *NAFTA Rules of Origin Regulations* (Schedule X) is divided into two parts: Part I (sections 1 through 9) pertains to the application of inventory management methods for determining whether fungible materials referred to in paragraph 7(16)(*a*) are originating materials; and Part II

19. Subsection 2(1) of the *NAFTA Rules of Origin Regulations* defines "fungible goods" and "fungible materials" as goods or materials "... that are interchangeable for commercial purposes and the properties of which are essentially identical".

(sections 10 through 15) pertains to the application of inventory management methods for determining whether fungible goods referred to in paragraph 7(16)(*b*) are originating goods. Both parts allow for the use of the same four inventory management methods, namely, the specific identification method,[20] the FIFO (first in, first out) method, the LIFO (last in, first out) method and the average method. However, in the context of the present appeal, the focus is primarily on the use of the average method.

35. Section 5 of Schedule X specifies the manner in which the average method applies to fungible materials. It reads as follows:

> **5.** Where the producer or person referred to in section 3 chooses the average method, the origin of fungible materials withdrawn from materials inventory is determined on the basis of the ratio of originating materials and non-originating materials in materials inventory that is calculated under sections 6 through 8.
>
> **5.** Lorsque le producteur ou la personne visé à l'article 3 choisit la méthode de la moyenne, l'origine des matières fongibles retirées du stock de matières est déterminée selon le rapport, calculé conformément aux articles 6 à 8, applicable aux matières originaires et aux matières non originaires du stock de matières.

36. Section 14 of Schedule X specifies the manner in which the average method applies to fungible goods. It reads, in relevant part, as follows:

> **14.** (1) Where the exporter or person referred to in section 12 chooses the average method, the origin of each shipment of fungible goods withdrawn from finished goods inventory during a month or three-month period, at the choice of the exporter or person, is determined on the basis of the ratio of originating goods and non-originating goods in finished goods inventory for the preceding one-month or three-month period that is calculated by dividing . . . .
>
> **14.** (1) Lorsque l'exportateur ou la personne visé à l'article 12 choisit la méthode de la moyenne, l'origine de chaque expédition de produits fongibles retirés du stock de produits finis au cours d'une période d'un mois ou de trois mois, au choix de l'exportateur ou de la personne, est déterminée selon le rapport applicable aux produits originaires et aux produits non originaires du stock de produits finis pour la période précédente d'un mois ou de trois mois, qui est calculé par division : [...].

37. Moreover, in addition to the above, subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* provides that, when fungible materials and fungible goods are withdrawn from the same inventory, the inventory management method used for the materials must be the same as the one used for the goods, and subsection 7(16.2) provides that a choice of inventory management methods is considered to have been made when the relevant customs administration is informed in writing of the choice during the course of a verification. They read as follows:

> (16.1) Where fungible materials referred to in paragraph (16)(*a*) and fungible goods referred to in paragraph (16)(*b*) are withdrawn from the same inventory, the inventory management method used for the materials must be the same as the inventory management method used for the goods, and where the averaging method is used, the respective averaging periods for fungible materials and fungible goods are to be used.
>
> (16.1) Si les matières fongibles visées à l'alinéa (16)*a*) et les produits fongibles visés à l'alinéa (16)*b*) sont retirés du même stock, la méthode de gestion des stocks utilisée à l'égard des matières doit être la même que celle utilisée à l'égard des produits; en outre, si la méthode de la moyenne est utilisée, les périodes respectives choisies à cette fin à l'égard des matières fongibles et des produits fongibles doivent être utilisées.

20. The specific identification method requires that originating and non-originating materials or goods be physically segregated in inventory.

(16.2) A choice of inventory management methods under subsection (16) shall be considered to have been made when the customs administration of the NAFTA country into which the good is imported is informed in writing of the choice during the course of a verification of the origin of the good.	(16.2) Le choix de l'une des méthodes de gestion des stocks prévues au paragraphe (16) est considéré comme ayant été fait si, au cours de la vérification de l'origine des produits, l'administration douanière du pays ALÉNA vers lequel les produits sont exportés en est informée par écrit.

38. According to Tara, subsection 7(16) of the *NAFTA Rules of Origin Regulations* allows for the choice of only one inventory management method for determining whether goods are originating goods—either the materials inventory management method or the goods inventory management method.[21] Tara claimed that it elected to use the "materials method" as provided for under paragraph 7(16)(*a*). It submitted that its use of this method passed verification and that, since 72 percent of the cotton and polyester/cotton fabric withdrawn from inventory in 2006 qualified as originating goods, 72 percent of its production of finished artist canvases for that year also qualified as originating goods. It further submitted that section 5 of Schedule X, unlike section 14, imposes no restrictions on an exporter's ability to allocate its originating goods to exports. In other words, Tara submitted that the average method for determining the origin of materials does not require that exports of finished goods made with fungible materials be designated as originating in accordance with the ratio of originating/non-originating materials withdrawn from inventory. Therefore, Tara claimed that, since the goods in issue constituted less than 72 percent of its total production of finished artist canvases for 2006, all the goods in issue could qualify as originating goods.

39. Moreover, Tara submitted that paragraph 7(16)(*b*) of the *NAFTA Rules of Origin Regulations* does not apply in this instance, as Tara has never claimed that its originating and non-originating finished artist canvases were fungible and there has been no finding to that effect.

40. Finally, Tara submitted that subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* is not applicable in this case because fungible materials and fungible goods were not withdrawn from the same inventory.

41. For its part, the CBSA submitted that Tara chose the average inventory management method to determine whether its fungible cotton and polyester/cotton fabric was originating, which resulted in a finding that 72 percent of the fabric used to produce finished artist canvases in 2006 qualified as originating goods. However, it submitted that its on-site verification of Tara's production activities led it to conclude that finished artist canvases produced from originating and non-originating fungible fabric were originating and non-originating fungible goods and that these fungible goods were not separated in inventory. It therefore submitted that the determination of whether the goods in issue were originating goods had to be made pursuant to paragraph 7(16)(*b*) of the *NAFTA Rules of Origin Regulations*.

42. The CBSA also submitted that its on-site verification led it to conclude that the goods in issue and the originating and non-originating cotton and polyester/cotton fabric used to produce the goods in issue were withdrawn from the same inventory. Therefore, given that, in such circumstances, subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* requires that the same inventory management method be used for the materials and the goods, and given that Tara had already chosen the average method to determine whether its fungible cotton and polyester/cotton fabric was originating, the CBSA determined that the average method was the appropriate method to determine whether the goods in issue were originating goods.

21. Tribunal Exhibit AP-2009-016-06A at paras. 42, 46.

43. The CBSA submitted that, in accordance with section 14 of Schedule X, the origin of each shipment of the goods in issue withdrawn from inventory had to be determined on the basis of the ratio of originating and non-originating finished artist canvases held in inventory. As the CBSA determined that this ratio should be the same as the ratio of originating and non-originating cotton and polyester/cotton fabric, it concluded that only 72 percent of the goods in issue qualified as originating goods.

44. In light of the parties' positions as summarized above, the Tribunal is of the view that there are three principal issues raised by this appeal. First, the Tribunal must determine whether the application of one of paragraph 7(16)(*a*) or (*b*) of the *NAFTA Rules of Origin Regulations* precludes the application of the other. If it does not, it must then determine whether the conditions for application of paragraph 7(16)(*b*) are present in the circumstances of this case. Finally, if paragraph 7(16)(*b*) is found to apply, it must determine whether the conditions for application of subsection 7(16.1) have been met in this case. The Tribunal will address each of these issues in turn, as required.

Are Paragraphs 7(16)(a) and (b) of the NAFTA Rules of Origin Regulations Mutually Exclusive?

45. As stated above, Tara is of the view that subsection 7(16) of the *NAFTA Rules of Origin Regulations* allows for the use of either the "materials" inventory management method or the "goods" inventory management method for purposes of determining whether goods are originating goods. It argued that the word "and" between paragraphs 7(16)(*a*) and (*b*) should be read as meaning "or", or interpreted as such. In this respect, it argued that the word "and" is disjunctive and is meant to effectively give a choice—the selection of either paragraph 7(16)(*a*) or (*b*), but not both. Tara further argued that choosing both paragraphs for purposes of determining the origin of goods would create a conflict and be redundant.

46. Although the CBSA did not directly address this issue, it is clear from its submissions and argument that it does not consider paragraphs 7(16)(*a*) and (*b*) of the *NAFTA Rules of Origin Regulations* as mutually exclusive. In fact, its position in this case is that both paragraphs are applicable—paragraph 7(16)(*a*) to determine the origin of fungible cotton and polyester/cotton fabric and paragraph 7(16)(*b*) to determine the origin of the goods in issue.

47. In the Tribunal's view, it is clear that paragraphs 7(16)(*a*) and (*b*) of the *NAFTA Rules of Origin Regulations* are not mutually exclusive. In other words, the application of one paragraph does not preclude the application of the other. In situations where originating and non-originating fungible materials are withdrawn from an inventory, or inventories, and used in the production of goods, paragraph 7(16)(*a*) allows for the use of a number of inventory management methods to determine the origin of those fungible materials. In situations where originating and non-originating fungible goods are physically combined or mixed in inventory and certain other conditions are met, paragraph 7(16)(*b*) allows for the use of the same inventory management methods to determine the origin of those fungible goods.

48. The Tribunal fails to see how the application of both paragraphs 7(16)(*a*) and (*b*) of the *NAFTA Rules of Origin Regulations* to determine the origin of goods would create a conflict or be redundant. It is clear that each of the paragraphs has different conditions for application and that, while the ensuing determinations of origin are made in respect of the same goods, they are made at different points in time. Paragraph 7(16)(*a*) is used to determine the origin of fungible materials withdrawn from inventory for use in the production of goods. Once the origin of the materials has been determined, the origin of goods that are produced from those materials can also be determined. At that point in time, the goods can either be directly exported or placed in inventory. If the goods are themselves fungible and physically combined or mixed in inventory prior to their exportation, then paragraph 7(16)(*b*) can be used to determine the origin of those fungible goods that are exported from that inventory. However, if the goods are not placed in inventory and are instead directly exported or if the goods are placed in inventory but are not fungible, then paragraph 7(16)(*b*) would not apply.

49. The Tribunal notes that subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* provides support for the successive application of paragraphs 7(16)(*a*) and (*b*) in relation to goods. Subsection 7(16.1) requires that, when ". . . fungible materials referred to in paragraph (16)(*a*) and fungible goods referred to in paragraph (16)(*b*) are withdrawn from the same inventory . . .", the inventory management method used for the materials and the goods must be the same. If paragraphs 7(16)(*a*) and (*b*) were mutually exclusive in relation to a good (i.e. if only one paragraph could apply at any given time), there would be no need for subsection 7(16.1).

50. Therefore, in the Tribunal's view, there can be no doubt that the word "and" between paragraphs 7(16)(*a*) and (*b*) of the *NAFTA Rules of Origin Regulations* bears its normal conjunctive meaning and that these paragraphs must be read together, as necessary, to determine whether goods are originating goods.

Does Paragraph 7(16)(b) of the NAFTA Rules of Origin Regulations Apply in this Case?

51. Both parties agree that, in this case, the conditions necessary for the application of paragraph 7(16)(*a*) of the *NAFTA Rules of Origin Regulations* are present and that, pursuant to this paragraph and section 3 of Schedule X, Tara chose the average inventory management method to determine whether its fungible cotton and cotton/polyester fabric was originating. On the basis of this method, it was determined that 72 percent of the cotton and cotton/polyester fabric used to produce finished artist canvases in 2006 qualified as originating goods.

52. However, the parties disagree as to whether the conditions necessary for the application of paragraph 7(16)(*b*) of the *NAFTA Rules of Origin Regulations* are also present. More specifically, the parties disagree as to whether originating and non-originating finished artist canvases produced by Tara in 2006 were fungible goods.

53. According to Tara, paragraph 7(16)(*b*) of the *NAFTA Rules of Origin Regulations* does not apply in this case, as Tara has never claimed that its originating and non-originating finished artist canvases were fungible and there is no clear evidence on the record which indicates that this was the case. Tara argued that, while finished artist canvases of any given size may be fungible, the finished artist canvases that it produced in 2006, which included the goods in issue, consisted of a mixture of sizes, such that they could not be fungible (i.e. a finished artist canvas of a certain size cannot be commercially interchangeable with a finished artist canvas of a different size).

54. On the other hand, the CBSA submitted that, during its on-site verification of Tara's production activities, it found no evidence to suggest that finished artist canvases produced from originating and non-originating fungible cotton and polyester/cotton fabric differed from each other and, as such, concluded that they were originating and non-originating fungible goods. With respect to Tara's argument that the goods in issue were not fungible because they consisted of a mixture of sizes, the CBSA submitted that the certificates of origin provided by Tara to importers in Canada list each of the different kinds of the goods in issue and indicates which ones are originating goods.[22] It further submitted that Mr. Twite's testimony made it quite clear that finished artist canvases of the same size and style were fungible.

55. Subsection 2(1) of the *NAFTA Rules of Origin Regulations* defines "fungible goods" as goods ". . . that are interchangeable for commercial purposes and the properties of which are essentially identical". While the Tribunal agrees that finished artist canvases of different sizes are not interchangeable for

22. Tribunal Exhibit AP-2009-016-15B, tab 1.

commercial purposes and therefore cannot be considered "fungible goods", it is of the view that fungibility, in this case, must necessarily be determined on a size or style basis. For practical reasons, the goods in issue have been defined to include all sizes and styles of finished artist canvases that were exported to Canada in 2006. However, as noted by the CBSA, the certificates of origin provided by Tara identified each of the different kinds of the goods in issue (i.e. by style) and indicated which ones were originating goods.[23]

56. In the Tribunal's view, the evidence on the record demonstrates that originating and non-originating finished artist canvases of the same size and style are fungible. This was confirmed by Mr. Twite, who testified that finished artist canvases of a certain size and style produced with originating cotton and polyester/cotton fabric could not be differentiated from finished artist canvases of the same size and style produced with non-originating cotton and polyester/cotton fabric and that they are therefore interchangeable for commercial purposes.[24] Mr. Twite also testified that the properties for all components of finished artist canvases of a certain size and style are essentially identical or that, at least, Tara attempts to make them identical.[25] The Tribunal notes that, while minor differences resulting from natural variations in the materials used to produce finished artist canvases may exist, this is not sufficient to conclude that the properties of the finished artist canvases are not essentially identical.[26]

57. Therefore, the Tribunal finds that originating and non-originating finished artist canvases of the same size and style produced by Tara in 2006 were fungible goods. As there is no question that these goods were physically combined or mixed in inventory[27] and did not undergo production or any other operation prior to their exportation,[28] paragraph 7(16)(*b*) of the *NAFTA Rules of Origin Regulations* is applicable and the determination of whether the finished artist canvases are originating goods may be made on the basis of any of the applicable inventory management methods set out in Schedule X.

58. Although Tara chose the average inventory management method to determine whether its fungible cotton and polyester/cotton fabric was originating, its view that paragraph 7(16)(*b*) of the *NAFTA Rules of Origin Regulations* did not apply in this case meant that it did not chose an inventory management method to determine whether its finished artist canvases were originating goods. In order to determine which inventory management method should apply, the Tribunal must first consider whether subsection 7(16.1) applies, in which case, the inventory management method used for the cotton and polyester/cotton fabric and the finished artist canvases must be the same.

Does Subsection 7(16.1) of the NAFTA Rules of Origin Regulations Apply in this Case?

59. Subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* provides that, when ". . . fungible materials referred to in paragraph (16)(*a*) and fungible goods referred to in paragraph (16)(*b*) are withdrawn from the same inventory, the inventory management method used for the materials must be the same as the inventory management method used for the goods . . . ."

23. The Tribunal also notes that the CBSA originally requested that Tara provide, for purposes of the verification exercise that it was conducting, information for "each unique style" of finished artist canvases being reviewed. Tribunal Exhibit AP-2009-016-15A, tab 2.
24. *Transcript of In Camera Hearing*, 14 April 2010, at 19, 20, 36-37.
25. *Ibid.* at 38-39.
26. The Tribunal notes that subsection 2(1) of the *NAFTA Rules of Origin Regulations* defines "identical goods" as goods that ". . . are the same in all respects . . . including physical characteristics, quality and reputation but excluding minor differences in appearance . . . ."
27. *Transcript of Public Hearing*, 14 April 2010, at 12, 158; *Transcript of In Camera Hearing*, 14 April 2010, at 18.
28. *Transcript of In Camera Hearing*, 14 April 2010, at 9; *Transcript of Public Hearing*, 14 April 2010, at 158-59.

60. Tara submitted that subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* is not applicable in this case because fungible materials and fungible goods were not withdrawn from the same inventory. Tara submitted that, as a factual matter, it maintains separate inventories for its cotton and polyester/cotton fabric and its finished artist canvases. It further submitted that subparagraph 7(16)(*a*)(i) of the *NAFTA Rules of Origin Regulations*, which speaks of fungible materials that ". . . are withdrawn from an inventory in one location . . .", suggests that the notion of inventory is tied to physical location. Given that its cotton and polyester/cotton fabric and its finished artist canvases are held in separate rooms (i.e. separate physical locations)[29] and maintained in an inventory system with separate part numbers and group codes,[30] Tara argued that they cannot be deemed to be withdrawn from the "same inventory" and that, thus, subsection 7(16.1) does not apply. In response to questioning from the Tribunal, Tara suggested that fungible materials and fungible goods could be withdrawn from the same inventory in situations where there is one single physically intermingled inventory or when finished goods are also materials used in the production of other goods.

61. On the other hand, the CBSA submitted that the goods in issue and the originating and non-originating cotton and polyester/cotton fabric used to produce the goods in issue were withdrawn from the same inventory. It submitted that, since the term "inventory" is not defined in the *NAFTA Rules of Origin Regulations*, its meaning must be established by having regard to the context in which it is used, which is an accounting context in this case. On this basis, it submitted that "inventory" is defined as the total of a company's assets, regardless of whether these assets are physically segregated. In this regard, Mr. Fitzgerald explained that, from an accounting perspective, it is possible to withdraw materials and goods from the same inventory, even when the materials and the goods are in separate locations.[31] Mr. Fitzgerald added that, in general, a company has one inventory that can consist of raw materials, work in progress and finished goods and that, in many cases, it consists of all three.[32]

62. The Tribunal notes that the term "inventory" is not defined in the *NAFTA Rules of Origin Regulations*. While terms such as "materials inventory" and "finished goods inventory" are defined in Schedule X, they clearly refer to specific types or categories of inventory and, thus, are not of any assistance. As subsection 7(16.1) contemplates materials and goods being withdrawn from the same "inventory", any attempt to define the term "inventory" by reference to definitions that are specific to materials or goods would be viewed as illogical.

63. The parties have argued for definitions of the term "inventory" that are at opposite ends of the spectrum. The CBSA argued that "inventory" should be given a broad meaning (i.e. the total of a company's assets), whereas Tara argued that it should be given a very narrow meaning (i.e. assets that are in the same immediate physical location). The Tribunal is not persuaded that the term "inventory" should be defined as narrowly as Tara suggests. In the Tribunal's opinion, the examples provided by Tara of situations where, it believes, fungible materials and fungible goods could be withdrawn from the same inventory serve to demonstrate that maintaining such a narrow definition of the term "inventory" is neither realistic nor supported by the language of subsection 7(16.1) of the *NAFTA Rules of Origin Regulations*. There is nothing in subsection 7(16.1) which indicates that fungible materials and fungible goods can only be considered to have been withdrawn from the same inventory when the goods are, at the same time, both finished goods and materials used in the production of other goods (i.e. when the same goods are used as finished goods and materials). Subsection 7(16.1) simply speaks of fungible materials and fungible goods, the understanding being that the fungible materials can be the ones that are used to produce the fungible goods.

29. *Transcript of Public Hearing*, 14 April 2010, at 12.
30. *Ibid.* at 27.
31. *Ibid.* at 81-82.
32. *Ibid.* at 77-78.

64. In addition, although having materials and goods physically intermingled in one single inventory would surely meet the requirements of subsection 7(16.1) of the *NAFTA Rules of Origin Regulations*, such a scenario is not realistic and, in fact, quite improbable. By mixing materials and goods together, a company would, in essence, be purposefully creating unnecessary and avoidable difficulties in the management of its inventory. Tara acknowledged as much when it stated that, in considering such a scenario, the practical question of how to distinguish between materials and finished goods had to be left aside.[33] Therefore, it is reasonable to conclude that limiting the applicability of subsection 7(16.1) to this type of scenario would result in this provision seldom being used. In the Tribunal's view, the purpose of subsection 7(16.1), which is to reduce instances of possible manipulation resulting from the selection of different inventory management methods for fungible materials and fungible goods, indicates that the term "inventory" should be interpreted in a broader manner than Tara suggests.

65. It has already been established that Tara's cotton and polyester/cotton fabric and its finished artist canvases are held in separate rooms in the same warehouse in Lawrenceville.[34] In these circumstances, and while not conceding that the term "inventory" should be given as broad a meaning as the CBSA suggests (i.e. the total of a company's assets, even if stored in different warehouses), the Tribunal finds that Tara has withdrawn fungible cotton and polyester/cotton fabric and fungible finished artist canvases from the same inventory. Therefore subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* applies and the inventory management method used for the cotton and polyester/cotton fabric and the inventory management method used for the finished artist canvases must be the same. As Tara chose the average inventory management method to determine whether its fungible cotton and polyester/cotton fabric was originating, the CBSA was justified in applying the average inventory management method to determine whether the goods in issue were originating goods.

66. In accordance with section 14 of Schedule X, the origin of each shipment of finished artist canvases withdrawn from inventory had to be determined on the basis of the ratio of originating and non-originating finished artist canvases held in inventory. As it had already been determined by the CBSA that 72 percent of the cotton and polyester/cotton fabric used to produce finished artist canvases in 2006 qualified as originating goods, it necessarily followed that 72 percent of the finished artist canvases also qualified as originating goods. Therefore, 72 percent of the goods in issue qualify as "originating goods" and are thus entitled to the benefit of the United States Tariff pursuant to paragraph 3(*b*) of the *NAFTA Tariff Preference Regulations*.

67. The Tribunal notes that, even if it had determined that Tara had not withdrawn fungible cotton and polyester/cotton fabric and fungible finished artist canvases from the same inventory and that, as a result, subsection 7(16.1) of the *NAFTA Rules of Origin Regulations* did not apply, Tara would still not have been able to claim that the totality of the goods in issue qualified as originating goods. The only inventory management method under which Tara would have been able to support such a claim would have been the specific identification method. However, section 13 of Schedule X requires that, for purposes of the specific identification method, originating and non-originating fungible finished goods be physically segregated in inventory or that they be marked with an origin identifier. The evidence on the record clearly established that Tara did neither.[35]

33. *Ibid.* at 142.
34. *Ibid.* at 12.
35. *Ibid.* at 12, 47; *Transcript of In Camera Hearing*, 14 April 2010, at 18-19.

DECISION

68. For the foregoing reasons, the Tribunal concludes that only 72 percent of the goods in issue are entitled to the benefit of the United States Tariff, as determined by the CBSA.

69. The appeal is therefore dismissed.

Stephen A. Leach
Stephen A. Leach
Presiding Member