CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Friday, August 15, 1997

Appeal No. AP-96-105

IN THE MATTER OF an appeal heard on April 15, 1997, under section 67 of the *Customs Act*, R.S.C. 1985, c. 1 (2nd Supp.);

AND IN THE MATTER OF a decision of the Deputy Minister of National Revenue dated October 30, 1996, with respect to a request for re-determination under section 63 of the *Customs Act*.

BETWEEN

ARMSTRONG BROS. TOOL CO. **Appellant**

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed in part. The matter is returned to the respondent for re-appraisal of the value for duty of the goods in issue in a manner consistent with the reasons for this decision.

Lyle M. Russell
Lyle M. Russell
Presiding Member

Robert C. Coates, Q.C.
Robert C. Coates, Q.C.
Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Michel P. Granger
Michel P. Granger
Secretary

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

UNOFFICIAL SUMMARY

Appeal No. AP-96-105

ARMSTRONG BROS. TOOL CO. **Appellant**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

The appellant had a warehouse in Mississauga, Ontario, to which tools were shipped for subsequent sale to customers in Canada. The appellant appealed the respondent's decision that the value for duty of the tools must be determined using the transaction value of identical or similar goods. The issues in this appeal are: (1) whether goods that are imported without a sale for export can be valued using the transaction value of identical or similar goods; (2) if goods imported without a sale for export can be valued using the transaction value of identical or similar goods, whether one of these methods should be used in this case; and (3) if the value for duty of the imported tools should be appraised on the basis of the deductive value of the tools, whether the profit and general expenses reflected in the sale price of the tools should be deducted from the unit price of the tools.

HELD: The appeal is allowed in part. Use of the transaction value of identical or similar goods to determine the value for duty of goods requires that the goods be imported pursuant to a sale for export. As such, the deductive value method should be used. As the sales in Canada were not made on an agency/commission basis, the proper deductions under subsection 51(4) of the *Customs Act* were for profits and expenses. Only profits and expenses incurred in Canada, that were in connection with the sales in Canada, are allowed.

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	April 15, 1997
Date of Decision:	August 15, 1997
Tribunal Members:	Lyle M. Russell, Presiding Member Robert C. Coates, Q.C., Member Arthur B. Trudeau, Member
Counsel for the Tribunal:	David M. Attwater
Clerk of the Tribunal:	Anne Jamieson
Appearances:	Brenda C. Swick-Martin and Kenneth H. Sorensen, for the appellant R. Jeff Anderson, for the respondent

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-96-105

ARMSTRONG BROS. TOOL CO. **Appellant**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: LYLE M. RUSSELL, Presiding Member
ROBERT C. COATES, Q.C., Member
ARTHUR B. TRUDEAU, Member

REASONS FOR DECISION

This is an appeal under section 67 of the *Customs Act*[1] (the Act) from a decision of the Deputy Minister of National Revenue made under section 63. The appellant appealed the respondent's decision that sections 49 and 50 were the proper methods of valuation for certain goods imported into Canada during the period from July 1993 to October 1995.

The appellant is a manufacturer of tools. It is based in Chicago, Illinois, with factories in Chicago and Fayetteville, Arkansas. During the period in question, the appellant had a warehouse in Mississauga, Ontario, to which tools were shipped for subsequent sale to customers in Canada. The tools remained the property of the appellant until they were sold. The general manager and staff working at the warehouse were salaried employees of the appellant and not agents remunerated through commissions.

The tools were sold to the appellant's customers after importation in sales that were unknown at the time of importation. The appellant's first witness, Mr. Jeff McNamara, said that sales from the warehouse were to distributors at the wholesale trade level.[2] A customer typically placed an order directly with the warehouse. The order was entered into an order entry system and then picked, packed and shipped directly to the customer. Mr. McNamara said that the appellant retained title to the tools until they were shipped to the customer. After delivery, the customer was invoiced from the warehouse and would pay by cheque, in Canadian funds.

To promote sales, the appellant used independent representatives, who were remunerated through commissions.[3] The appellant's second witness, Mr. John A. Tatasciore, explained that these agents were responsible for calling on the appellant's customers to present the appellant's product line and to ensure that they were receiving good customer service and good product quality. Tools were not purchased through the agents. The agents were paid out of the appellant's Chicago office, based on invoices issued by the Mississauga warehouse. Mr. Tatasciore told the Tribunal that he considered the commissions to be a marketing expense incurred by the appellant.

1. R.S.C. 1985, c. 1 (2nd Supp.). All statutory references in this appeal are to the *Customs Act*.
2. Mr. McNamara added that the distributors sell to end users of the tools.
3. The use of commissioned representatives ended in December 1995.

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Mr. McNamara explained that some goods were sold prior to importation and shipped directly to customers. He said that these goods represented about one percent, by value, of all goods shipped to Canada. Mr. McNamara explained that such sales were typically high priority sales needed on an expedited basis.[4]

Mr. McNamara told the Tribunal about the appellant's price lists and that new lists were published when there were price increases, new items were introduced or old items discontinued. He explained that a price list represented a starting point from which the appellant applied discounts. The standard discounts offered by the appellant were list price less 50 percent and a further 10 percent. On top of the standard discounts, there were other discounts available. Therefore, if the appellant wanted to increase the price of a tool, it would publish a new price list.[5] Alternatively, if it wanted to lower a price to a particular customer, it would simply apply another discount in addition to the standard discounts.

The appellant's third witness was Ms. Hélène Lecours, a chartered accountant, who was qualified as an expert in the field of chartered accountancy with specialized knowledge in the field of customs valuation. For purposes of this appeal, Ms. Lecours calculated the value for duty of an example tool (Exhibit A-3) using the deductive value method for the years ending December 31, 1993, 1994 and 1995 (Exhibit 11.1). She provided extensive testimony to illustrate her calculations, speaking to such matters as discounts from list price and profits and general expenses associated with sales of the tools.

The issues in this appeal are:

(1) whether goods that are imported without a sale for export can be valued using the transaction value of identical or similar goods (section 49 or 50);

(2) if goods imported without a sale for export can be valued using the transaction value of identical or similar goods, whether one of these methods should be used in this case, as the identical and similar goods used by the Department of National Revenue (Revenue Canada) for purposes of valuing the imported tools were sold under different conditions (e.g. different quantities at different times); and

(3) if the value for duty of the imported tools should be appraised on the basis of the deductive value of the tools, whether the profit and general expenses reflected in the sale price of the tools should be deducted from the unit price of the tools.

The relevant provisions of the Act read as follows:

> 47.(1) The value for duty of goods shall be appraised on the basis of the transaction value of the goods in accordance with the conditions set out in section 48.
>
> (2) Where the value for duty of goods is not appraised in accordance with subsection (1), it shall be appraised on the basis of the first of the following values, considered in the order set out herein, that can be determined…
>
> (*a*) the transaction value of identical goods...
> (*b*) the transaction value of similar goods...
> (*c*) the deductive value of goods; and
> (*d*) the computed value of the goods.

4. Mr. McNamara gave, as an example, the Hibernia oil project in Newfoundland.
5. The last two times that a new price list was issued occurred on May 15, 1994, and March 1, 1997.

49.(1) Subject to subsections (2) to (5), where the value for duty of goods is not appraised under section 48, the value for duty of the goods is, if it can be determined, the transaction value of identical goods, in a sale of those goods for export to Canada, if that transaction value is the value for duty of the identical goods and the identical goods were exported at the same or substantially the same time as the goods being appraised and were sold under the following conditions:

(*a*) to a purchaser at the same or substantially the same trade level as the purchaser of the goods being appraised; and

(*b*) in the same or substantially the same quantities as the goods being appraised.

50.(1) Subject to subsections (2) and 49(2) to (5), where the value for duty of goods is not appraised under section 48 or 49, the value for duty of the goods is, if it can be determined, the transaction value of similar goods, in a sale of those goods for export to Canada, if that transaction value is the value for duty of the similar goods and the similar goods were exported at the same or substantially the same time as the goods being appraised and were sold under the following conditions:

(*a*) to a purchaser at the same or substantially the same trade level as the purchaser of the goods being appraised; and

(*b*) in the same or substantially the same quantities as the goods being appraised.

51.(1) Subject to subsections (5) and 47(3), where the value for duty of goods is not appraised under sections 48 to 50, the value for duty of the goods is the deductive value of the goods if it can be determined.

(2) The deductive value of goods being appraised is ... the price per unit...

(3) For the purposes of subsection (2), the price per unit, in respect of goods being appraised, identical goods or similar goods, shall be determined by ascertaining the unit price, in respect of sales of the goods at the first trade level after importation thereof to persons who

(*a*) are not related to the persons from whom they buy the goods at the time the goods are sold to them, and

(*b*) have not supplied, directly or indirectly, free of charge or at a reduced cost for use in connection with the production and sale for export of the goods any of the goods or services referred to in subparagraph 48(5)(*a*)(iii),

at which the greatest number of units of the goods is sold where, in the opinion of the Minister or any person authorized by him, a sufficient number of such sales have been made to permit a determination of the price per unit of the goods.

(4) For the purposes of subsection (2), the price per unit, in respect of goods being appraised, identical goods or similar goods, shall be adjusted by deducting therefrom an amount equal to the aggregate of

(*a*) an amount, determined in the manner prescribed, equal to

(i) the amount of commission generally earned on a unit basis, or

(ii) the amount of profit and general expenses, including all costs of marketing the goods, considered together as a whole, that is generally reflected on a unit basis

in connection with sales in Canada of goods of the same class or kind as those goods.

Counsel for the appellant argued that the value for duty of goods can be determined by using the transaction value of identical or similar goods only if both the goods being valued (the tools) and the identical or similar goods were subject to a sale at the time of importation. In support of this proposition, counsel referred to paragraphs 49(1)(*a*) and 50(1)(*a*), which require that the identical or similar goods, respectively, be sold "to a purchaser at the same or substantially the same trade level as the purchaser of the goods being appraised." It is not sufficient for the goods being appraised to be sold after being imported into Canada.

It was submitted that, as the appellant's tools were not imported pursuant to a sale, their value for duty cannot be appraised using the transaction value of identical or similar goods.

Under the deductive value method, the value for duty is based on a "price per unit" (subsection 51(2)), which is determined according to subsection 51(3). In this regard, counsel for the appellant submitted that the predominant price per unit of the goods is the appellant's catalogue price less the standard distributor discounts of 50 and 10 percent. The price per unit is adjusted pursuant to subsection 51(4) by taking certain deductions therefrom.

As to these deductions, counsel for the appellant submitted that there were no commissions earned on the sales of the tools. As such, the price per unit of the tools should be adjusted by deducting both the profit and general expenses that are generally reflected in the sale price of the tools in connection with sales in Canada. Referring to the testimony of Ms. Lecours and Exhibit 11.1, counsel submitted that deductions should be allowed for profit before taxes plus administrative expenses and selling expenses[6] incurred in Canada in relation with sales in Canada and selling expenses[7] incurred in the United States in relation with sales in Canada.

Counsel for the respondent argued that goods can be valued using the transaction value of identical or similar goods even if they were not imported pursuant to a sale. Otherwise, sections 49 and 50 would be redundant, since all sales at the time of importation would logically then only fit within the purview of section 48 and all others could then only fit within section 51.

As the tools were not imported pursuant to a sale for export to Canada, section 48 does not apply. Therefore, pursuant to subsection 47(2), the value for duty of the tools is to be determined using the transaction value of identical goods and, if this provision does not apply, the value for duty of similar goods. Counsel for the respondent submitted that the goods used by Revenue Canada to determine the value for duty of the tools were identical or similar to the tools being appraised. Furthermore, referring to Memorandum D13-5-1,[8] counsel submitted that the identical or similar goods were imported "at the same or substantially the same time as the [tools] being appraised."

The appellant's selling prices were determined according to a Canadian price list that remained the same regardless of whether the tools were sold for export to Canada or imported for subsequent sale. Therefore, subject to adjustments for differences in the conditions of sale, the value for duty using the transaction value of identical or similar goods sold for export to Canada should be the same as the value for duty of the goods imported for subsequent sale.

With regard to the second issue, counsel for the respondent argued that, although the identical or similar goods were sold under different conditions than the tools being appraised (e.g. different trade level and in different quantities), this does not make sections 49 and 50 inapplicable. Subsections 49(3) and 50(2) allow for adjustments to be made to the transaction value of the identical or similar goods for these differences. In fact, Revenue Canada made such adjustments to the identical or similar goods when

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6. These included regional field selling expenses, salaries, employee benefits, automobile travel, meals and entertainment.
7. These included advertising, promotion and marketing.
8. *Application of Sections 49 and 50 of the Customs Act*, Department of National Revenue, Customs and Excise, June 1, 1986.

determining the value for duty of the tools. These included adjustments to account for sales at different trade levels, the discounts offered by the appellant on its selling prices and adjustments for transportation costs.

With regard to the third issue, counsel for the respondent argued that, if the deductive value method is applicable, the amount for profit and general expenses claimed by the appellant is not an allowable deduction. Rather, the amount of commission generally earned is allowable. Referring to Commentary 15.1 of the Technical Committee on Customs Valuation,[9] it was submitted that "a deduction for commission would normally occur where the sale in the country of importation of the goods being valued was or is to be made on an agency/commission basis.[10]"

A deduction for profit and general expenses should not be allowed because it would distort the "actual value" of the imported goods. Such deductions would result in a value for duty that reflects the appellant's costs of production. Counsel for the respondent argued that the deductive value method contemplates a sale of goods to Canada and a resale of those goods within Canada. As such, the value for duty of goods should include the cost of producing the goods, plus profits earned on the sale of the goods and general expenses incurred in bringing the goods to Canada.

As to expenses incurred, counsel for the respondent argued that the appellant performed many activities outside Canada in connection with the importation and subsequent sale in Canada of the tools. In fact, the activities performed in Canada are minimal. Therefore, an "industry average" deduction for profits earned and expenses incurred would fail to account for this fact and result in an excessively large deduction.

The Tribunal notes that, pursuant to subsection 47(1), "[t]he value for duty of goods shall be appraised on the basis of the transaction value of the goods in accordance with the conditions set out in section 48." Both parties agree, as does the Tribunal, that section 48 does not apply because the tools were not imported into Canada pursuant to a sale for export. Thus, pursuant to subsection 47(2), the value for duty of the tools must be determined on the basis of the alternative methods considered in the order set out in that provision of the Act.

Counsel for the respondent submitted, therefore, that the value for duty of the tools should be determined according to section 49 or 50, being the transaction value of identical or similar goods. Counsel for the appellant argued that the value for duty of the tools cannot be determined by one of these methods, as they apply only where the goods being appraised have been imported into Canada pursuant to a sale. Rather, counsel for the appellant argued that the value for duty must be determined using the deductive value method under section 51.

The Tribunal is in agreement with counsel for the appellant that, for goods to be appraised according to the transaction value of identical or similar goods, they must have been imported into Canada pursuant to a sale for export. In support of this conclusion, the Tribunal notes that paragraphs 49(1)(*a*) and 50(1)(*a*) require that the identical or similar goods be sold "to a purchaser at the same or substantially the same trade level as the purchaser of the goods being appraised" (emphasis added). Reference to a "purchaser of the goods being appraised" satisfies the Tribunal that these goods must have been sold. Furthermore, as section 51 provides for a method of valuation with reference to a sale subsequent to importation, the Tribunal

9. *GATT Agreement and Texts of the Technical Committee on Customs Valuation*, Customs Co-operation Council, Brussels.

10. *Ibid.* Commentary 15.1, "Application of Deductive Value Method," paragraph 12.

is satisfied that, for purposes of sections 49 and 50, the sale must have been coincident with the importation of the goods being appraised.

Pursuant to subsection 51(1), the value for duty of imported goods is the deductive value of those goods. The deductive value of goods is the "price per unit" of those goods as determined according to subsection 51(3), with certain adjustments provided pursuant to subsection 51(4).

According to subsection 51(3), the price per unit of goods being appraised is the "unit price" of the goods "at which the greatest number of units of the goods is sold" to certain persons. Counsel for the appellant submitted, and the Tribunal accepts, that the unit price of the tools can be determined by taking the appellant's catalogue list prices and subtracting the standard distributor discounts of 50 and 10 percent. There may also be other standard discounts available to Canadian customers, such as a cash discount, that may be considered in determining the "predominant" unit price of the tools. There was no suggestion that the appellant's customers were related to the appellant or that they supplied any goods or services for use in connection with the production or sale of the tools.

From the price per unit, subsection 51(4) provides for certain adjustments. Counsel for the appellant argued that a deduction from the price per unit of the tools for profit and general expenses should be made, while counsel for the respondent argued that a deduction for the amount of commission paid to the appellant's independent representatives should be made.

The Tribunal is of the view that sales of the tools in Canada were not made on an agency/commission basis.[11] Instead, the appellant shipped the tools to its own branch warehouse for storage and subsequent sale therefrom. The appellant's customers typically placed orders directly with the warehouse, where they were entered into an order entry system. The tools were shipped directly from the warehouse to the customers, who were then invoiced by the warehouse. In contrast, the appellant's representatives were used to promote, but not make, sales. Although they were paid a commission for marketing the appellant's tools and providing customer service, the Tribunal is of the view that such commissions are not those contemplated in subparagraph 51(4)(*a*)(i).

In illustrating the adjustments to the price per unit of the tools for profit and general expenses, counsel for the appellant submitted that a broad meaning should be given to the expression "in connection with sales in Canada" found at paragraph 51(4)(*a*). The effect of such an interpretation is to allow an adjustment for profits earned in Canada and expenses incurred in both Canada and the United States in relation with sales of the tools in Canada. With this proposition, however, the Tribunal cannot agree.

In understanding the meaning of the expression "in connection with sales in Canada," the Tribunal had regard to the greater context within which this expression is contained, as well as the object and intention of Parliament in providing an adjustment to the price per unit of goods. The Tribunal is of the view that the adjustments to the price per unit provided by subsection 51(4) are "to deduct the markup which is usually added in [Canada], so as to reduce the selling price to a value which can properly be said to have applied at the stage of importation, rather than at the later stage of resale.[12]" In the Tribunal's view, that deduction for

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11. *Ibid.*
12. S.L. Sherman and H. Glashoff, *Customs Valuation: Commentary on the GATT Customs Valuation Code* (New York: ICC Publishing S.A., 1988) at 214. In describing the deductive value method at 69, the authors indicate that: "Deductive Value (DDV) is calculated as the resale price of the goods in question (or comparable imported goods) in the country of importation, less [certain] costs incurred in the country of importation" (emphasis added).

markup is limited to profits earned and expenses incurred in Canada. This way, the price per unit of the goods is reduced to a reasonable approximation of their value at the time of importation.

It is clear from a reading of section 51 that the focus of the deductive value method for determining value for duty is on the "sales of ... goods at the first trade level after importation." It is from this transaction that the predominant price per unit is determined and adjustments made therefrom. In the Tribunal's view, therefore, the adjustments allowed under subsection 51(4) relate to markups reasonably made to account for profits and expenses on this transaction. Thus, for there to be a "connection with sales in Canada," the profits and expenses must have occurred in Canada just as the transaction occurred in Canada. That being said, although an expense was incurred in Canada, it may have been paid from abroad.

The Tribunal also notes that the Act requires the respondent to base the deduction on profits and expenses "considered together as a whole, that is generally reflected" in "goods of the same class or kind" as those being appraised and not just the profits and expenses for the actual goods being appraised.

Unfortunately, counsel for the respondent provided very little, if any, assistance to the Tribunal in evaluating the profit and expenses claimed by the appellant as identified in Exhibit 11.1. The Tribunal would expect that, in an appeal of this nature, particularly when it is the first of its kind, counsel would be in a position to address the opposing party's case and provide the Tribunal with the information necessary to address the issues raised. As such, the Tribunal returns the matter to the respondent for re-appraisal of the value for duty of the tools in a manner consistent with these reasons.

Accordingly, the appeal is allowed in part.

Lyle M. Russell
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Presiding Member

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Robert C. Coates, Q.C.
Member

Arthur B. Trudeau
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