Canadian International Trade Tribunal
Tribunal canadien du commerce extérieur

CANADIAN INTERNATIONAL TRADE TRIBUNAL

Appeals

DECISION AND REASONS

Appeal No. AP-2013-017

Double J Fashion Group Inc.

v.

President of the Canada Border Services Agency

Decision and reasons issued
Friday, March 14, 2014

Canada

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IN THE MATTER OF an appeal heard on November 14, 2013, pursuant to subsection 67(1) of the *Customs Act*, R.S.C. 1985, c. 1 (2nd Supp.);

AND IN THE MATTER OF seven decisions of the President of the Canada Border Services Agency, dated April 12, 2013, with respect to a request for re-determination, pursuant to subsection 60(4) of the *Customs Act*.

BETWEEN

DOUBLE J FASHION GROUP INC. **Appellant**

AND

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

DECISION

The appeal is dismissed.

Jason W. Downey
Jason W. Downey
Presiding Member

Dominique Laporte
Dominique Laporte
Secretary

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	November 14, 2013
Tribunal Member:	Jason W. Downey, Presiding Member
Counsel for the Tribunal:	Jidé Afolabi
Acting Manager, Registrar Programs and Services:	Lindsay Vincelli
Registrar Officer:	Haley Raynor
Acting Registrar Support Officer:	Sara Pelletier

PARTICIPANTS:

Appellant	**Counsel/Representative**
Double J Fashion Group Inc.	Michael Kaylor
Respondent	**Counsel/Representative**
President of the Canada Border Services Agency	Aileen Jones

WITNESSES:

Tony Pak Vice-President, International Distribution Sweet People Apparel	Kemel Hadad Chief Executive Officer Double J Fashion Group Inc.
Michael Feldman Vice-President, Finance Double J Fashion Group Inc.	Simon Poitras Senior Officer, Trade Compliance Canada Border Services Agency

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STATEMENT OF REASONS

BACKGROUND

1. This is an appeal filed by Double J Fashion Group Inc. (Double J) on May 28, 2013, pursuant to subsection 67(1) of the *Customs Act*,[1] from decisions of the Canada Border Services Agency (CBSA) issued pursuant to subsection 60(4) on April 12, 2013, and contained in seven Detailed Adjustment Statements.

2. The issue in this appeal is whether certain payments (the payments in issue) made by Double J to its vender based in the United States, Sweet People Apparel (Sweet People), with regard to the import of the "Miss Me" line of clothing (the goods in issue), form part of the "price paid or payable" pursuant to the transaction value method of computing the value for duty of goods as set out in subsection 45(1) and section 48 of the *Act*.

PROCEDURAL HISTORY

3. On November 7, 2011, the CBSA initiated an import accounting compliance verification with regard to the value for duty of the goods in issue imported by Double J in the 2010 calendar year.[2]

4. During the verification, the CBSA noticed that Sweet People issued two separate invoices for every shipment of the goods in issue sold to Double J. While one invoice covered the unit price of the goods in issue, the other, regarding amounts referred to as distribution fees, always represented 67% of the first invoice issued.[3]

5. Subsequent to the verification, the CBSA determined that, regardless of the name ascribed to the payments made pursuant to the second invoice, they were part of the export sales terms for the goods in issue pursuant to the Distribution Agreement between Double J and Sweet People and, thus, were part of the price paid or payable for the goods in issue.[4]

6. On October 9, 2012, the CBSA issued an interim report to Double J with regard to the verification, informing Double J of its determination and inviting comments.[5]

7. On October 12, 2012, the CBSA issued a final report to Double J with regard to the verification, and on October 17, 2012, the CBSA issued Detailed Adjustment Statements with regard to the goods in issue, pursuant to section 59 of the *Act*.[6]

8. Subsequent to requests for further re-determinations filed by Double J on November 28, 2012, pursuant to section 60 of the *Act*, as well as the provision of views by Double J on December 19, 2012, the CBSA issued preliminary decisions on March 19, 2013, and final decisions pursuant to subsection 60(4) of

1. R.S.C. 1985, c. 1 (2nd Supp.) [*Act*].
2. Exhibit AP-2013-017-08C, Vol. 1 at para. 4.
3. *Ibid.* at para. 6.
4. *Ibid.* at para. 7.
5. *Ibid.* at para. 8.
6. *Ibid.* at paras. 9-10; Exhibit AP-2013-017-08A (protected), Vol. 2, Tab 5.

the *Act* on April 12, 2013. The decisions reaffirmed the CBSA's position that the payments in issue are in respect of the sale of goods for export and are thus part of the "price paid or payable" for the goods in issue.[7]

9. On May 28, 2013, Double J filed its notice of appeal with the Tribunal pursuant to subsection 67(1) of the *Act*.[8]

10. On November 14, 2013, the Tribunal held an oral hearing regarding the appeal.

11. In advance of the hearing, Double J had notified the Tribunal of its intention to request that a portion of the CBSA's written submissions, pertaining to email correspondence between Double J and another one of its suppliers, be struck from the record as irrelevant to this appeal. However, the Tribunal was informed at the hearing that the parties had reached an accommodation allowing the CBSA to assert that the email correspondence constitutes evidence of Double J's rationale for receiving two invoices with regard to importations, with Double J continuing to maintain that the CBSA has merely used the email correspondence as the premise for an unproven allegation, one completely unrelated to the facts at hand.[9] Noting the accommodation reached by the parties, the Tribunal sees no need for the further consideration of Double J's original request.

12. At the hearing, Double J called three witnesses: Mr. Tony Pak, Sweet People's Vice-President of International Distribution; Mr. Kemel Hadad, Double J's Chief Executive Officer; and Mr. Michael Feldman, Double J's Vice-President of Finance. In addition, the CBSA called one witness: Mr. Simon Poitras, Senior Officer, Trade Compliance, CBSA.

13. While the Distribution Agreement between Double J and Sweet People, the characterization of which is of seminal importance to this appeal, was placed on the record by Double J as a confidential document, Double J relinquished said confidentiality at the hearing.[10] In addition, Double J relinquished the confidentiality of certain portions of its financial records which had been submitted to the Tribunal with regard to this appeal.[11]

LEGAL FRAMEWORK

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

15. Subsections 47(1) and 48(1), (4) and (5) of the *Act* provide in relevant parts 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.
>
> **48.** (1) . . . the value for duty of goods is the transaction value of the goods if the goods are sold for export to Canada to a purchaser in Canada and the price paid or payable for the goods can be determined . . . .

7. Exhibit AP-2013-017-08C, Vol. 1 at paras. 11-14.
8. *Ibid.* at para. 15.
9. *Transcript of Public Hearing*, 14 November 2013, at 4-6.
10. *Ibid.* at 25-26.
11. *Ibid.* at 39-40.

> (4) The transaction value of goods shall be determined by ascertaining the price paid or payable for the goods when the goods are sold for export to Canada and adjusting the price paid or payable in accordance with subsection (5).
>
> (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
>
> . . .
>
> (iv) royalties and licence fees, including payments for patents, trade-marks and copyrights, in respect of the goods that the purchaser of the goods must pay, directly or indirectly, as a condition of the sale of the goods for export to Canada, exclusive of charges for the right to reproduce the goods in Canada,
>
> . . .

16. In section 45 of the *Act*, "price paid or payable" and "transaction value" are defined as follows:

> "price paid or payable", in respect of the sale of goods for export to Canada, means the aggregate of all payments made or to be made, directly or indirectly, in respect of the goods by the purchaser to or for the benefit of the vendor.
>
> "transaction value", in respect of goods, means the value of the goods determined in accordance with subsection 48(4).

17. In summary, section 47 of the *Act* stipulates that the primary basis for determining the value for duty of imported goods is the transaction value of those goods. Section 48 sets out a number of conditions that must exist with regard to the use of the transaction value method. Thus, there must be a sale for export, there must be a purchaser in Canada, and it must be possible to ascertain the price paid or payable.

18. The price paid or payable is defined in the *Act* as encompassing the aggregate of all payments that satisfy a five-part criteria, which can be restated as follows:

- made or to be made;
- directly or indirectly;
- by the purchaser;
- to or for the benefit of the vendor; and
- in respect of the sale of goods for export to Canada.

19. As the conditions set out in subsection 48 of the *Act* exist, there is no contest in this appeal regarding the ability to utilize the transaction value method. Further, there is no divergence between the parties regarding the first four elements of the criteria set out above.[12] The sole disagreement between Double J and the CBSA concerns whether the fifth element of the criteria set out above is applicable to the payments in issue, that is, in essence, whether the payments in issue are in respect of the sale of goods for export to Canada.[13]

12. Exhibit AP-2013-017-08C at 10-13; Exhibit AP-2013-017-04A at 1.
13. While the statutory definition of "price paid or payable" uses the phrase "in respect of", paragraph 48(5)(*a*)(iv) of the *Act* uses the phrase "as a condition of". It can thus be concluded, for the purposes of the transaction value

POSITIONS OF PARTIES

Double J

20. In arguing that the payments in issue are not—using the exact legislative construction set out in subsection 48(1) of the *Act*—part of the "price paid or payable for the goods", Double J referred to the jurisprudential interpretation of the word "for" as set out in *Toronto Transit Commission v. Canada (National Revenue)*[14].

21. In *Toronto Transit*, the Federal Court of Appeal stated that the word is indicative of a thing being "closely connected" to another. Double J asserted that the legal issue before the Tribunal with regard to the payments in issue is bifurcated, with a first part being whether or not the payments form part of the price paid or payable as defined in section 45, and a second part being whether or not the payments are actually for the goods in issue.[15] The implication of this assertion is that payments that form part of the price paid or payable may nonetheless be excluded from the transaction value of imported goods on the basis that they were not made for the goods, possibly due to the lack of a close connection to the goods.

22. In addition, Double J argued that the facts in this appeal are parallel to those in *Simms Sigal & Co. Ltd. v. Commissioner of the Canada Customs and Revenue Agency*,[16] a case which also concerned an importer of apparel, and one in which the Tribunal determined that certain payments did not form part of the price paid or payable.

23. In *Simms Sigal*, the importer had obtained exclusive distribution rights in Canada in exchange for the payment of a distribution fee calculated as a percentage of annual net sales and paid on a quarterly basis. The distribution fee did not appear on any commercial invoice issued at the time of importation, and the agreement stipulated a minimum distribution fee that Simms Sigal was required to pay. In the portion of the decision referenced by Double J, the Tribunal reasoned as follows:

> In the Tribunal's opinion, the distribution fee paid by Simms Sigal to Anne Klein in accordance with the Agreement does not form part of the transaction value, since it does not constitute a payment made in respect of the goods purchased by Simms Sigal. The Tribunal does not accept the proposition advanced by the Commissioner that all payments made by a purchaser to or for the benefit of a vendor are to be included in the transaction value. The definition of "price paid or payable" provided in the *Act* makes clear that only those payments made in respect of the goods are included. Although the expression "in respect of" is quite broad, the Tribunal is of the view that, given the context relating to the sale of goods for export, this does not cover the distribution fee paid to Anne Klein for exclusive distribution rights or services.
>
> . . . The evidence does not indicate that the distribution fee represented anything other than the value to Simms Sigal of the exclusive Canadian distribution rights and services.
>
> . . . As discussed above, the Tribunal is satisfied by the evidence put forward by Simms Sigal that the value of the services and exclusive distribution rights covered by the distribution fee is over and above the purchase value of the goods themselves. Consequently, the Tribunal is of the view that the

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method of determining the value for duty of goods, that payments made "as a condition of" fall within the ambit of payments made "in respect of".

14. 2010 FCA 33 (CanLII) [*Toronto Transit*].
15. *Transcript of Public Hearing*, 14 November 2013, at 137.
16. (27 May 2013), AP-2001-016 (CITT) [*Simms Sigal*].

> distribution fee is separate from the price paid or payable in respect of the goods and is not to be added to the purchase price of those goods pursuant to subparagraph 48(5)(*a*)(v) of the *Act*.[17]
>
> [Underlining in original]

24. Further, Double J asserted with regard to the Distribution Agreement between it and Sweet People that the Supreme Court of Canada has consistently held that the legal relationships of taxpayers should, in tax cases, be respected and not re-characterized unless they were found to constitute a sham.[18] Double J additionally referred to jurisprudence in support of the related proposition that the contractual intent of the parties to an agreement is to be determined by reference to the words used in drafting the agreement, and when the resulting agreement is clear and unambiguous on its face, it is unnecessary to consider extrinsic evidence.[19]

CBSA

25. For its part, the CBSA argued that regardless of the number of invoices issued, the business arrangement between Double J and Sweet People, pursuant to which the latter would issue two invoices with regard to each shipment, is caught by the definition of "price paid or payable" as contained in the *Act*, since that definition refers to the "aggregate of all payments".[20]

26. Second, the CBSA contended that the terms of the Distribution Agreement between Double J and Sweet People require the payments in issue as a condition of the sale of the goods in issue and, further, that amounts paid are related solely to the purchase price of the goods in issue.[21]

27. In support of its contention, the CBSA referenced clause 6(b) of the Distribution Agreement, which establishes ongoing discounts from Sweet People's wholesale price, set at 56.75% for goods shipped from outside the United States and 54.5% for goods shipped from within the United States.

28. The CBSA then referenced the distribution fee payable by Double J with regard to every purchase, which clause 6(f) of the Distribution Agreement sets at 67% of the remainder of the purchase price after the application of whichever of the two discounts is relevant to any given transaction.[22]

29. The CBSA argued that since the distribution fee is clearly linked to the discounts that establish every purchase price, the distribution fee is directly related to and thus "in respect of" the sale of goods for export to Canada.[23] In essence, the CBSA's contention is that, as set out by the Distribution Agreement, the distribution fee is a percentage of every post-discount purchase price, which is added to the post-discount purchase price with the result that a total purchase price is derived.

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17. Exhibit AP-2013-017-04A at 3-4.
18. *Ibid*. at 6-7; *Transcript of Public Hearing*, 14 November 2013, at 137-38. In this regard, Double J referred to *Shell Canada Ltd. v. Canada*, [1999] 3 SCR 622 [*Shell*]; *Industries Perron Inc. v. Canada*, 2013 FCA 176 (CanLII); *Continental Bank Leasing Corp. v. Canada*, [1998] 2 SCR 298 [*Continental Bank*].
19. Exhibit AP-2013-017-04A at 7-9. With regard to that proposition, Double J referred to *Jockey Canada Company v. President of the Canada Border Services Agency* (20 December 2012), AP-2011-008 (CITT) [*Jockey*]; *Canada v. General Motors of Canada Ltd*., 2008 FCA 142 (CanLII) [*General Motors*].
20. Exhibit AP-2013-017-08C at 11-12.
21. *Ibid*. at 13-14.
22. Exhibit AP-2013-017-04B, Tab 2 (protection waived).
23. Exhibit AP-2013-017-08C at 14-15.

30. The CBSA noted that the Distribution Agreement allows for a reduction of the distribution fee in the event that Sweet People should not provide some services. The CBSA, however, contended that the only services set out in the Distribution Agreement are the discounts, which is further supportive of the conclusion that the distribution fee is linked to the discounts, and that the total purchase price of the goods in issue results from calculations that involve both.[24]

31. Also, with regard to the Distribution Agreement, the CBSA contended that the payments in issue are not in respect of an exclusive right to distribute the goods in issue, since exclusivity as set out in the Distribution Agreement is contingent on a yearly minimum purchase requirement, which is not tied to the payments in issue. Further, the CBSA contended that the payments in issue are not royalty fees, since the Distribution Agreement refers to the grant of a royalty-free trademarks license.[25]

32. Third, the CBSA referred to the jurisprudential definition of "in respect of" as set out in the Supreme Court of Canada's decision in *Nowegijick v. The Queen*.[26] In *Nowegijick*, the Court indicated that the words "in respect of" are "of the widest possible scope" and are probably "the widest of any expression intended to convey some connection between two related subject matters." The CBSA noted that the Tribunal applied that reasoning in *PMI Food Equipment Group Canada v. Deputy M.N.R.*,[27] in which the Tribunal went on to state that a payment is in respect of goods "where it is not a general payment unaffected by the specific goods being imported."[28]

33. The CBSA then argued that, in this instance, the payments in issue are in respect of the sale of goods for export since they are affected by those goods. In making its argument, the CBSA referred to the Tribunal's reasoning in *Chaps Ralph Lauren and Modes Alto-Regal, Inc. v. Deputy M.N.R.*,[29] in which the Tribunal opined that since the amount of certain royalty payments were "based on the net sales of the imported goods in Canada", they were "affected by the specific goods imported." The CBSA drew a parallel, asserting that since the payments in issue vary solely according to the post-discount purchase price of the goods imported, they are in respect of those goods.[30]

34. Fourth, the CBSA relied on the financial records of Double J, indicating that those records do not treat the payments in issue as genuine distribution fees. The CBSA noted that for the year 2010, the distribution fees paid by Double J to Sweet People are identifiable on the former's Trial Balance Work Sheet, but are not listed in the Schedule of Expenses in the former's Financial Statements, leaving open the conclusion that they must have been included in the Cost of Sales. The CBSA further noted that the payments in issue were not included in Schedule 29 of Double J's Corporation Income Tax Return, which requires Double J to list certain kinds of payments made to a foreign third party, inclusive of royalties, management fees and payments for "other services".[31]

24. *Ibid.* at 15.
25. *Ibid.* at 15-16.
26. [1983] 1 SCR 29 [*Nowegijick*].
27. (10 January 1997), AP-95-123 (CITT) [*PMI Food*].
28. Exhibit AP-2013-017-08C at 16. The test was earlier articulated in *Polygram Inc. v. Deputy M.N.R.C.E.* (7 May 1992), AP-89-151 and AP-89-165.
29. (22 December 1997), AP-94-212 (CITT).
30. Exhibit AP-2013-017-08C at 17-18.
31. *Ibid.* at 18-19.

ANALYSIS

35. It is ideal to commence by setting out portions of the Distribution Agreement that are relevant to the circumstances of this appeal. The terms of the Distribution Agreement that are applicable to the payments in issue are as follows:

> **6. Sales and Payment Terms and Conditions.**
>
> (a) Payment Terms. Sweet People shall issue invoices to acknowledge all PO's placed by Distributor and delivered by Sweet People. Sweet People requires pre-payment of all invoices via wire transfer to an account designated by Sweet People or irrevocable letter of credit from an approved financial institution.
>
> (b) Discounts. From the Effective Date until June I, 2012, Distributor will receive a 56.75% discount from Sweet People's United States wholesale price if the Products are shipped directly from outside of the United States and a 54.5% discount when the Products are shipped from the United States. Distributor shall pay a fee of $30 per sample requested plus shipping charges. From June 1, 2008 to the end of the Term, discounts and prices are subject to change from time to time by Sweet People at its sole discretion.
>
> . . .
>
> (f) Distribution Fee. Distributor shall pay to Sweet People a distribution fee equal to 67% of the purchase price paid by Distributor to Sweet People as set forth in Section 6(b) above.[32]

36. Mr. Hadad testified that Double J did not negotiate the terms of the Distribution Agreement. Instead, it took over the Distribution Agreement at the request of Sweet People after the death of Sweet People's former Canadian distributor. Mr. Hadad indicated that he had tried to re-negotiate the terms of the Distribution Agreement in the past, but Sweet People showed no interest in altering the terms.[33]

37. Both Mr. Feldman and Mr. Pak testified that the distribution fee payments represented consideration for advertising and marketing services provided to Double J by Sweet People.

38. In that regard, reference was made to clause 5(c) of the Distribution Agreement, which stipulates in part that "Sweet People grants Distributor the right to use Sweet People's showrooms in the United States and at Sweet People's booths in Las Vegas to sell the Products upon Sweet People's prior written consent, which shall not be unreasonably withheld; provided, that any such sales shall be to customers whose locations are in the Territory."

39. Specifically, Mr. Feldman testified that access to Sweet People's showrooms and trade show booths is vital to Double J because product visibility, and the resulting hype it generates, is very important in the business of fashion. In addition, Double J is able to secure new client orders right at Sweet People's trade show booths.[34]

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32. Clause 3(a) makes clear that "POs" are purchase orders, and clause 4(a) makes clear that the term of the Distribution Agreement ends on June 1, 2012, with the result that the discount indicated in clause 6(b) covers the entirety of the term of the Distribution Agreement.
33. *Transcript of Public Hearing*, 14 November 2013, at 75-81.
34. *Ibid.* at 16-19.

40. Additionally, Mr. Pak testified that Sweet People spends about $900,000 on the four annual trade shows it participates in; two in Las Vegas and two in New York. That amount constitutes the lion's share of the worldwide total of $1.5 million spent annually by Sweet People on all of its advertising and marketing.[35]

41. Additionally, reference was made to clause 5(e) of the Distribution Agreement, which stipulates that "Sweet People will provide Distributor with marketing research information on trends and sales clinics in order to assist Distributor to maximize the sale of the products in Canada." Mr. Feldman testified that these services were important to Double J.[36] In cross-examination, Mr. Pak testified that the totality of Sweet People's Canadian market research occurred in the form of informal discussions it undertook, from time to time, with Double J regarding marketing tools that may be useful in the Canadian market; these discussions appeared to be quite limited.[37]

42. Regarding advertising, Mr. Pak testified that Sweet People publicizes the goods in issue in magazines based in the United States but which are distributed internationally. This allows for indirect distribution within Canada, resulting in a benefit to Double J.[38]

43. However, with regard to the measurability of contractual benefits, all of Double J's witnesses testified that neither it nor Sweet People had undertaken an evaluation of the actual requirements of Double J in terms of advertising and marketing for the goods in issue and, further, that no evaluation had ever been done in regard to whether the distribution fee payments, indexed as they are against the post-discount purchase price, represent or outstrip actual value for money.

44. Specifically questioned on this issue, the witnesses for Double J essentially shrugged off any actual cost-for-value analysis, mentioning that it did not really matter as long as they were making money and that everyone was satisfied.[39]

45. In essence, the evidence before the Tribunal is that the costs to Double J for advertising and marketing of the goods in issue pursuant to the Distribution Agreement can vary greatly; it could be a figure one year and a substantially altered figure in any other year, all dependent on Double J's sales volume. It is however foreign to any increase in advertising or marketing undertaken by Sweet People to the benefit of Double J pursuant to the Distribution Agreement.

46. Having thus characterized the distribution fee and the oral assertions of Double J regarding what the fee procures from Sweet People, it is important to briefly outline the machinations of the formula created through the combined operation of clauses 6(b) and (f) of the Distribution Agreement.

47. Both Mr. Pak and Mr. Hadad testified that Sweet People sells the goods in issue to Double J at the same "free on board" or FOB cost at which it purchases those goods from its own suppliers, based in China as well as Vietnam, with Double J assuming the cost of freight.[40]

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35. *Ibid.* at 20, 62.
36. *Ibid.* at 20-21.
37. *Ibid.* at 60-61.
38. *Ibid.* at 21-22.
39. *Ibid.* at 75-81. Notably, Mr. Feldman testified that the measurability of the benefit of the distribution fee payments vis-à-vis the advertising and marketing services provided by Sweet People was not important to Double J.
40. *Ibid.* at 12, 71.

48. Mr. Hadad further testified that, at the time of sale, Sweet People issues two invoices, one for the Asian FOB cost, which is paid by Double J at once, and the other for the 67% distribution fee, which is paid by Double J approximately one month later.[41]

49. By way of an example, Mr. Feldman provided the calculation for an item with a wholesale selling price of $42.00. After discounting 56.75% from that wholesale price, 43.25% or approximately $18.14 represents the FOB cost and is the subject of the first invoice. Then, 67% of $18.14, or $12.15, represents the distribution fee and is the subject of the second invoice.[42]

50. The totality of Double J's distribution fee payments to Sweet People was approximately $1.1 million in 2010.[43] Mr. Pak indicated that, in the United States, Sweet People sells directly to department stores and simply charges the wholesale prices of the goods it sells.[44] The Canadian contract appears to be unique within Sweet People's distribution model.

51. With the relevant factual and testimonial landscape thus traversed, the Tribunal can turn its attention to jurisprudence.

52. As noted earlier, Double J, in arguing that the payments in issue are not in respect of the sale of goods for export to Canada, relied on *Simms Sigal*. In addition to the payment of a distribution fee, *Simms Sigal* is similar to the present appeal in a number of other ways.

53. In that decision, Ann Klein, Simms Sigal's supplier, granted Simms Sigal access to its showrooms in New York, in addition to the provision of advance samples, showroom food, printed materials and sales aids.

54. However, *Simms Sigal* also diverges from the present appeal in a number of ways. For example, the distribution fee was paid on a quarterly basis, independent of the importation of goods into Canada. Further, the facts in *Simms Sigal* included an instance in which Simms Sigal was of the opinion that it wasn't receiving value for money with regard to the services provided by Ann Klein. At that time, Simms Sigal halted the distribution fee payments, an act which Ann Klein accepted.

55. While the Tribunal is of the opinion that the timing of payments is not determinative with regard to the question of whether or not such payments are in respect of the sale of goods for export to Canada, the Tribunal believes the characterization of such payments, as a condition of export or otherwise, can be instructive.

56. A divergence of note between this appeal and the *Simms Sigal* decision relates to how the suppliers in each case characterized the distribution fees in their respective agreements. While Ann Klein was willing to forgo the fee and simply halt services in the event that Simms Sigal stopped certain payments, Mr. Pak testified, on behalf of Sweet People, that such a thing would be unacceptable to Sweet People and that such

41. *Ibid.* at 74.
42. *Ibid.* at 41-46. Double J provided this calculation to show that the distribution fee is within a percentage range that is the commercial norm for such fees. The calculation also shows that the payment structure set out in the Distribution Agreement results in upward pressure on the Canadian prices of the goods relative to United States prices. In the example given, the Canadian wholesale price, at which Double J would sell the item to its own clients, stands at $67 after the introduction of a profit margin.
43. Exhibit AP-2013-017-08A at 161 (protection waived).
44. *Transcript of Public Hearing*, 14 November 2013, at 69-70.

an event would trigger a consideration in changing its Canadian distributor should Double J withhold any of the distribution fees.[45]

57. Also as noted earlier, Double J relied on a number of cases, including *Shell* and *Continental Bank*, with regard to the proposition that, in tax cases, the legal relationships of taxpayers should not be re-characterized unless they are found to constitute a sham.

58. The Tribunal is of the opinion that the following excerpt from *Shell* is instructive:

> 39. This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form. But there are at least two *caveats* to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer's *bona fide* legal relationships. To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect.
>
> [Underlining added for emphasis, references omitted]

59. Further, the Tribunal finds the following excerpt from *Continental Bank*, in which Bastarache J. of the Supreme Court of Canada espoused the approach outlined in *Orion Finance Ltd. v. Crown Financial Management Ltd.*,[46] to be useful with regard to the facts in this appeal:

> 21. . . . Once the documents are accepted as genuinely representing the transaction into which the parties have entered, its proper legal categorisation is a matter of construction of the documents. This does not mean that the terms which the parties have adopted are necessarily determinative. The substance of the parties' agreement must be found in the language they have used; but the categorisation of a document is determined by the legal effect which it is intended to have, and *if when properly construed the effect of the document as a whole is inconsistent with the terminology which the parties have used, then their ill-chosen language must yield to the substance*.
>
> [Emphasis added]

60. Thus, a line of jurisprudence exists pursuant to which the courts have recognized that the label or terminology attached to a portion of an agreement, or a transaction emanating from an agreement, may differ from its actual legal effect. In such instances, the yielding of the former to the latter can justifiably be effected.

61. The workings of the jurisprudence are a bit more nuanced than Double J's restatement would allow. Re-characterization is not barred save for a finding that a sham exists; it is permissible where the mere misuse of terminology exists. Certainly, the jurisprudence does not support the conclusion that the divergence between terminology and legal effect is adequate to ground the finding that an agreement is deceitful and thus constitutes a sham. An agreement is not rendered illegitimate by reason of deceit merely for want of proper terminology.[47]

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45. *Ibid.* at 91.
46. [1996] 2 B.C.L.C. 78 (C.A.).
47. *Continental Bank* provides, in paragraph 20, a pithy explanation of the rationale for finding an agreement to be a sham.

62. Other cases have considered the similar concern of contractual ambiguity. Thus, for instance, in *General Motors*, the Federal Court of Appeal opined as follows:

> 32. In *Eli Lilly and Co. v. Novopharm Ltd.* and in *United Brotherhood of Carpenters and Joiners of America, Local 579, v. Bradco Construction Ltd.*, the Supreme Court of Canada addressed that very issue. At issue in *Eli Lilly* . . . was whether a supply agreement entered into by Apotex Inc. and Novopharm Ltd. constituted a sublicence so as to justify the termination by Eli Lilly of Novopharm's compulsory licence for the drug nizatidine. Writing for the Court, Iacobucci J. enunciated the following at paragraphs 54 to 59:
>
> > 54 The trial judge appeared to take *Consolidated-Bathurst* to stand for the proposition that the ultimate goal of contractual interpretation should be to ascertain the true intent of the parties at the time of entry into the contract, and that, in undertaking this inquiry, it is open to the trier of fact to admit extrinsic evidence as to the subjective intentions of the parties at that time. In my view, this approach is not quite accurate. The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. Evidence of one party's subjective intention has no independent place in this determination.
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> > 55 Indeed, it is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face. In the words of Lord Atkinson in *Lampson v. City of Quebec*: ". . . the intention by which the deed is to be construed is that of the parties as revealed by the language they have chosen to use in the deed itself. . . .[I]f the meaning of the deed, reading its words in their ordinary sense, be plain and unambiguous it is not permissible for the parties to it, while it stands unreformed, to come into a Court of justice and say: 'Our intention was wholly different from that which the language of our deed expresses. . . .'"
> >
> > 56 When there is no ambiguity in the wording of the document, the notion in *Consolidated-Bathurst* that the interpretation which produces a "fair result" or a "sensible commercial result" should be adopted is not determinative. Admittedly, it would be absurd to adopt an interpretation which is clearly inconsistent with the commercial interests of the parties, if the goal is to ascertain their true contractual intent. However, to interpret a plainly worded document in accordance with the true contractual intent of the parties is not difficult, if it is presumed that the parties intended the legal consequences of their words. This is consistent with the following dictum of this Court, in *Joy Oil Co. v. The King*: ". . . in construing a written document, the question is not as to the meaning of the words alone, nor the meaning of the writer alone, but the meaning of the words as used by the writer.'"
> >
> > 57 In my view, there was no ambiguity to the contract entered into between Apotex and Novopharm. No attempt was made to disguise the true purpose of the arrangement, or the circumstances surrounding its drafting. Clearly, the agreement was meant to minimize the deleterious effects of the amendments to the Patent Act, which were expected to and did eventually place severe restrictions on the former scheme of compulsory licensing, by maximizing the access of each party to as wide a variety of patented medicines as possible. This was to be accomplished by obliging each party to obtain such material for the other in the event that one party possessed a licence which the other lacked and could no longer readily obtain. All of this is evident on a plain reading of the recitals to the supply agreement. *Leaving aside the question of circumventing the legislation, which has no bearing on the interpretation of the contract, the parties' intentions are clear on the face of the agreement.* Accordingly, it cannot properly be said, in my view, that the supply agreement contains any ambiguity that cannot be resolved by reference to its text. No further interpretive aids are necessary.
> >
> > 58 More specifically, there is no need to resort to any of the evidence tendered by either Apotex or Novopharm as to the subjective intentions of their principals at the time of drafting. Consequently, I find this evidence to be inadmissible by virtue of the parol evidence rule: see *Indian Molybdenum Ltd. v. The King*.
> >
> > 59 Moreover, even if such evidence were required, that is not the character of the evidence tendered in this case, which sheds no light at all on the surrounding circumstances. It consisted only of the subjective intentions of the parties: Mr. Dan's subjective intention at the time of drafting and Dr. Sherman's subjective intention to implement the agreement in a certain way.

[Italics added for emphasis, references omitted]

63. In addition, in *Jockey*, the Tribunal opined as follows:

> 103. However, when a transaction has been reduced to writing through an agreement between two parties, *extrinsic evidence is, in general, inadmissible to contradict, vary, add to or subtract from the terms of the document.* This is especially the case when the transaction at issue is between two sophisticated corporations.
>
> 104. Indeed, a review of the authorities pertaining to the admissibility of extrinsic evidence in the context of the interpretation of a contractual document indicates that, *failing a finding of ambiguity in the document under consideration*, it is not open to a court to consider extrinsic evidence and that, even where there is ambiguity, evidence only of a party's subjective intention is not admissible.
>
> 105. In this appeal, the Tribunal finds that there is no ambiguity in the Sales & Distribution Agreement entered into between JII and JCC. It is clear that the parties' intention was to make the agreement applicable to the sale of goods manufactured by third parties for JII to JCC, irrespective of the geographical origin of these goods. Therefore, Mr. Tolensky's evidence that the parties actually intended something different at the time of the drafting and execution of the agreement is not admissible. The most important tool in order to ascertain the parties' intention at the time of the contract is present in the language of the agreement itself.
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> [Emphasis added, footnote omitted]

64. In essence, this related line of jurisprudence stands for the proposition that ambiguity can only be found if the intention of the parties is not clear on the face of an agreement. It is only in such instances that extrinsic evidence is admissible with regard to any bid to properly characterize the extant terms of the agreement.

65. Taken together, a possible restatement of the full complement of the jurisprudence referenced is the proposition that when terminology in an agreement differs from its actual legal effect, the intention of the parties is not clear, and, in such an instance, the agreement can justifiably be termed ambiguous. On such an occasion, re-characterization is permissible, and extrinsic evidence can be utilized in that regard. It should be noted that a finding of ambiguity is far removed from that of a sham. It should also be noted that the linchpin in this restatement is the actual legal effect of the terms of the agreement.

66. Conclusions regarding the actual legal effect of the terms of an agreement can be reached through a probing of its operation by the parties to it, undertaken in the context of the text of the agreement itself. Thus, to re-characterize is not to rewrite, it is to clarify legal effect.

67. In the instance at hand, the Distribution Agreement sets out what appears to be a clear, albeit related, formula regarding the calculation of both purchase prices and distribution fees. However, the testimonies of Double J's witnesses, taken in the context of the text of the Distribution Agreement, call into question the actual legal effect of the workings of that formula. In essence, the witness testimonies of Double J itself and the contractual text have introduced the question of whether the formula serves dual and separate legal purposes, that of payments for goods and payments for services, or a dual but inextricably linked legal purpose, that of payments for goods in concert with payments for services.

68. Regarding the above, Mr. Pak testified that, at the time of purchase and pursuant to clause 6(b) of the Distribution Agreement, Double J pays Sweet People the very same amount at which Sweet People

procures the goods in issue from its own Asian suppliers.[48] Thus, the operation of clause 6(b) results in a sale at cost only, without any provision for a profit margin.

69. Also, at the time of purchase and pursuant to clause 6(f), Double J receives an invoice for a distribution fee calculated as a percentage of the clause 6(b) payment, which Double J pays to Sweet People within a month.[49] While the distribution fee can vary greatly in any given year due to the method of its calculation, the benefits ascribed to it in the testimony of the witnesses remain constant and have not been assessed by Double J or Sweet People with regard to a monetary value.

70. Now, should clause 6(f) not exist in the Distribution Agreement, on the basis of the reasoning in *General Motors*, there would be no ambiguity in the operation of clause 6(b), and the Tribunal would have to conclude that Sweet People intended the legal consequence of the words in the Distribution Agreement, which in such an instance would bind it to a commercial contract ascribing obligations but devoid of profit.

71. However, clause 6(f) does exist in the Distribution Agreement, and, while clause 6(b) is clear in tying payments to product shipments, indicating discounts will be granted if or when "Products are shipped", no measurable performance or granted right is tied to the payments required in clause 6(f).

72. The testimony on the record is that clause 6(f) covers advertising and marketing. Should that testimony be considered in the context of the text of the Distribution Agreement, it becomes clear that there is no mode of measurement established to tie the payments to the advertising and marketing. In other words, value for money is not and cannot be gauged.[50]

73. Further, clauses 5(c) and (e) of the Distribution Agreement, as earlier outlined, ascribe obligations to Sweet People without a contractual link to measurable payments.

74. Thus, should the advertising and marketing services set out in the Distribution Agreement be isolated, Double J would have no way of knowing whether it had paid enough for the services received, and Sweet People would have no way of knowing whether it has provided enough services for the payments received. This is a little surprising for sophisticated commercial entities such as those at hand.

75. As a result, the Tribunal is faced with identifying the actual legal effect of three distinct strands—payments for goods without a profit margin; unbounded payments, without an indication of measurable performance or the grant of rights; and services to be performed without an indication of measurable payments.

76. Further, it is noteworthy that the payments are irrevocably tied, one to the other. This is particularly intriguing where the parties to the Distribution Agreement have testified that they are indifferent to measuring the benefits of the unbounded payments. This is a critical point of departure from *Simms Sigal*, in

48. *Transcript of Public Hearing*, 14 November 2013, at 12, 71.
49. *Ibid*. at 74.
50. While clause 5(h) provides that Double J will be entitled to a negotiated reduction in the distribution fee should Sweet People "not provide some of the services", that stipulation falls short of making the distribution fee measurable against the services since it merely means the fee payments can remain unbounded as long as the same services are received, but can be renegotiated should the services be reduced. In essence, the clause rationalizes the services without rationalizing the fees. This reading is buttressed by the testimony of Mr. Pak on page 91 of the *Transcript of Public Hearing*, in which he indicated Sweet People would consider changing its Canadian distributor if Double J moved to actually rationalize the fees by withholding installments over and above a threshold representing value for money.

which the Tribunal noted that ". . . Mr. Simms testified that Simms Sigal was very satisfied with the value received for the distribution fee under the Agreement."[51]

77. Seen another way, the Tribunal has before it an agreement with tied payments for goods and services, and with the full complement of the profits that can accrue to one party to the agreement dependent solely on what the parties to the agreement have characterized as the payments for services, so much so that should the other party move to rationalize service payments the entire agreement becomes untenable to the first party.

78. If the Tribunal chooses to ignore the opaque realities introduced by clauses 5(c), 5(e) and 6(f) of the Distribution Agreement, absurdities would result.

79. For instance, the Tribunal would have to ground the conclusion that of Sweet People's total global advertising and marketing budget of $1.5 million, a single one of its distributors in a territory that is not the largest of its markets, Double J ends up covering $1.1 million or 73% of its total worldwide marketing expenses. If anything, this appears out of sync with the advertising and marketing benefits received. Both *General Motors* and *Jockey* support the reasoning that extrinsic evidence from both parties to a contract is permissible with regard to resolving such absurdities and properly characterizing opaque, or ambiguous, contracts.

80. The reviewed clauses of the Distribution Agreement, taken together, along with witness testimony from both parties to the Distribution Agreement, support the conclusion that the actual legal effect of those clauses is not to ensure payments discretely for goods and services, but to ensure payments for goods and services inextricably linked. Thus, to pay for the goods is to pay for the services, and vice versa.

81. Double J testified that it has attempted to renegotiate the Distribution Agreement, essentially to eliminate the ambiguities in a way that a discrete separation is formed between payments for goods and payments for services. However, Sweet People has remained inflexible, maintaining that the fees be for the delivery of goods and services inextricably linked. To this end, Mr. Hadad testified:

> You're putting me on the spot here because I've tried to get [the distribution fee] down *but it was our way or the highway*. I do understand, because of the price difference between Canada and the U.S.A. and we are basically much more expensive, but this was the demands.[52]
>
> [Emphasis added]

82. Double J governs its accounting behavior on the basis that the two payments covering goods and services are inextricably linked. Thus, in its accounting records, both payments are reflected as "Costs of Sales". Explaining the rationale for including the distribution fee payments within the Costs of Sales section, Mr. Feldman testified that ". . . any item that is included in cost of sales has a costing effect to the unit cost of the jean[s], and we're very accurate in our accounting for that."[53] In evidentiary terms, this is similar to the facts in *Jockey*. The appellant in that decision also maintained books and records identifying the actual quantum of payments made to acquire imported goods. Where the books and records of an appellant are out of sync with its testimony, the burden of reconciling that discrepancy, such that the Tribunal may not find the former singularly compelling, rests with the appellant.

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51. *Simms* at 5.
52. *Transcript of Public Hearing*, 14 November 2013, at 75.
53. *Ibid.* at 29. In addition, at page 82, Mr. Feldman indicated that "[f]or internal accounting costing purposes we consider the FOB translated into Canadian dollars, the freight and duty, and a buying commission, if it exists, and a distribution fee, if it's based on the cost, on the FOB."

83. Since the goods and services are inextricably linked within the Distribution Agreement, each set of transactional payments made pursuant to the Distribution Agreement is, in aggregate, "in respect of" the goods as well as "in respect of" the services. In this regard, the Tribunal finds the reasoning in *Nowegijick*, with regard to the characterization of the phrase "in respect of", compelling. If the payments are connected to the goods at all, they are in respect of the goods, with no limitation introduced by a simultaneous connection to services.

84. Taken another way, on the basis of the jurisprudence in *PMI Food*, should the payments be affected by the goods being imported, they are in respect of the goods, and once that conclusion is reached, there is no basis to curtail it on the ground that the payments are affected in tandem by services.[54]

85. A final ambiguity appears to exist between the terminology used to describe the payments in issue in the Distribution Agreement, "distribution fees", which on a plain reading would engage subparagraph 48(5)(*a*)(iv) of the *Act*, and the characterization of the payments in issue by Double J's witnesses as being for advertising and marketing. However, the Tribunal is satisfied that the payments in issue are, pursuant to paragraph 48(5)(*a*), "already included in the price paid or payable" by way of the extant Distribution Agreement at the time of importation.

DECISION

86. On the basis of the foregoing, the Tribunal is satisfied that the payments in issue are connected to, or affected by, the goods in issue. Thus, the payments in issue are in respect of the sale of goods for export to Canada and form part of the price paid or payable pursuant to the transaction value method of computing the value for duty of goods as set out in subsection 45(1) and section 48 of the *Act*.

87. The appeal is dismissed.

Jason W. Downey
Jason W. Downey
Presiding Member

54. Further, the Tribunal is not compelled by the assertion of Double J that payments that form part of the price paid or payable may nonetheless be excluded from the transaction value of imported goods on the basis that they were not made "for" the goods. The *Act* has not set up a test pursuant to which imported goods can have a price paid or payable a subset of which is for the goods and the remainder of which is for some undisclosed purpose.