# MEMORANDUM D13-4-5

Ottawa, April 9, 2001

**SUBJECT**

**TRANSACTION VALUE METHOD FOR RELATED PERSONS**
**(*CUSTOMS ACT*, SECTION 48)**

This Memorandum explains the treatment of sales between related persons by the Canada Customs and Revenue Agency (CCRA) in determining the value for duty of imported goods under the transaction value method (section 48 of the *Customs Act*).

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## GUIDELINES AND GENERAL INFORMATION

1. The definition of "related persons" is contained in subsection 45(3) of the *Customs Act*. For more information, see Memorandum D13-3-2, *Related Persons (Customs Act, Sections 45 to 53)*.

2. Subsection 48(1) of the *Customs Act* contains the requirements which have to be met before an importer may use the purchase price in the sale for export to Canada as the basis for calculating the value for duty and declaring to customs that the transaction value method is appropriate. One of these requirements, contained in paragraph 48(1)*(d)*, states that the transaction value method can be used when the purchaser and the vendor are not related to each other at the time of the sale. However, if they are, paragraph 48(1)*(d)* permits the transaction value method to be used in cases where:

*(a)* their relationship did not influence the price paid or payable for the goods; or

*(b)* the importer of the goods demonstrates that the transaction value of the goods meets one of the requirements, or "test values," set out in subsection 48(3) of the Act.

In other words, the importer must satisfy himself that the relationship between the vendor and the purchaser had no effect on the selling price of the goods. To do so, the importer must examine how the price was determined between the related parties and keep that evidence on file to support his decision to use the transaction value method.

3. The CCRA will be able to accept the transaction value method in most importations involving sales between related persons. It is also expected that importers will be able to satisfy themselves more easily and more often of the acceptability of prices between related persons than they will be able to demonstrate that the transaction value meets one of the test values, as mentioned above in paragraph 2*(b)*. The information requirements for the test values are described in paragraphs 4 to 13. Paragraphs 14 to 19 contain the information requirements for establishing the acceptability of prices for the purposes of subparagraph 48(1)*(d)*(i) of the *Customs Act*.

**Test Values**

4. Subparagraph 48(1)*(d)*(ii) of the *Customs Act* provides one of the approaches that establish the acceptability of a transaction value in a sale between related persons. In this approach, described fully in subsection 48(3) of the *Customs Act* and section 3 of the *Valuation for Duty Regulations*, the importer must demonstrate that the transaction value of the goods being appraised closely approximates one of the following test values:

*(a)* the transaction value of identical goods or similar goods in a sale of those goods for export to Canada between a vendor and purchaser who are not related to each other at the time of the sale;

*(b)* the deductive value of identical goods or similar goods; or

*(c)* the computed value of identical goods or similar goods.

5. In order to use one of the values referred to in subsection 48(3) as a test, that value must meet two criteria:

*(a)* the goods to which the test value relates must be exported at the same or substantially the same time as the goods being appraised; and

*(b)* the test value used must be the value for duty of the goods to which it relates.

6. If the deductive or computed value referred to in paragraph 4*(b)* or *(c)* represents the value for duty in a sale of identical or similar goods between related parties, additional care should be taken before using that value as a test value. It must be ensured that the percentage for profit and general expenses used to compute the deductive or computed value was formally approved by the CCRA. The percentage for profit and general expenses used for the deductive value calculation must have been the percentage that was generally reflected in connection with sales in Canada of goods of the same class or kind as those being appraised. For the computed value, the percentage for profit and general expenses used must have been the percentage generally reflected in connection with export sales to Canada of goods of the same class or kind as those being appraised.

**The Time Element**

7. Generally, the expression “if exported at the same or substantially the same time” will be taken to mean a period beginning 30 days prior to and extending to 30 days following the date of export of the goods being appraised. However, for certain transactions, such as seasonal fruit or vegetables where values fluctuate frequently, it may be appropriate to narrow the time period mentioned above. On the other hand, for other types of goods, e.g., goods of a capital nature, the period of time may need to be extended.

8. The time element should be carefully examined in the light of the circumstances surrounding a particular transaction as it may constitute an important factor in determining whether the transaction value closely approximates a test value.

**Comparison of Values: "Closely Approximates"**

9. It must be noted that the decision as to whether the transaction value closely approximates a test value should take into account any relevant factors and differences, including those set out in section 3 of the *Valuation for Duty Regulations*. For example, if there was a difference of $10 between the transaction value of the goods being appraised and that of identical goods, the circumstances of both sales would be examined to ascertain whether there were any factors which would account for that difference, such as a difference in trade levels or quantities purchased. A difference in trade level may account for $8, leaving a difference in values of $2. If it could not be accounted for otherwise, it would have to be determined whether the $2 difference was commercially significant, as defined in the following paragraph (see subparagraph 3*(a)*(iv) of the *Valuation for Duty Regulations*). Similarly, if there was no difference between the transaction value and the test value, the circumstances of both sales would be examined to ensure that, taking into account any factor, the values would still not differ.

**"Commercially Significant"**

10. The decision as to whether a difference between the transaction value of the goods being appraised and the test value is commercially significant will be made after all other relevant factors have been taken into account. An assessment of the commercial significance of a difference in values would take into account that market conditions and pricing practices may vary from industry to industry. However, as a guide to importers, differences in values of 5% or less of the transaction value of the goods being appraised will not normally be considered to be "commercially significant."

11. A difference in value greater than 5% need not preclude the acceptance of a transaction value provided the importer can demonstrate that such a difference is not commercially significant.

**Other Considerations**

12. When an importer successfully demonstrates that the transaction value closely approximates a test value previously accepted by the CCRA, it is not necessary to examine the question of influence under subparagraph 48(1)*(d)*(i) of the *Customs Act* in respect of the same importation. However, a test value must be available for each importation. Therefore, the test values will vary to respect the time element mentioned in paragraphs 7 and 8.

**The Relationship Did Not Influence the Price**

13. In the absence of an acceptable test value, the importer may try to establish the acceptability of prices between related companies, under subparagraph 48(1)*(d)*(i) of the *Customs Act*. The information requirements are less well defined than for a test value, and there are many ways in which an importer and the CCRA can reach a conclusion that the price is not influenced.

14. Neither the *Customs Act* nor the International Valuation Agreement adopted by the World Trade Organization (WTO), upon which the valuation provisions of the *Customs Act* are based, detail the information to be used in establishing that a relationship has not influenced the price in a sale of goods for export. Whichever way an importer chooses to establish the acceptability of the price, his conclusions should be supported by factual evidence. The object of the exercise is to establish that the selling price is not significantly different from the price that would have been charged to an unrelated purchaser, given identical circumstances except for that of relationship.

15. The Organization for Economic Co-operation and Development (OECD) published a report entitled *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. This report sets out several methods of pricing goods in order to achieve a price which could reasonably have been expected in similar circumstances had the vendor and the purchaser not been related. These methods are illustrated in paragraph 16. The CCRA will accept, for valuation purposes, a price paid or payable which is derived from one of the methods set out in the OECD's report, unless there is information on prices available which is more directly related to the specific importations. Copies of documents issued by the OECD may be obtained from the OECD's Web site at **www.oecd.org** or they may be ordered from a local book retailer.

16. The following methods are examples of ways of establishing that a price is not influenced by the relationship. They have been listed in the order that they are most likely to be used because of the availability of information. It must be emphasized that this list does not contain all of the possible methods of establishing the acceptability of prices between related companies, and it is not the CCRA's intention to be restrictive in this regard:

*(a)* The vendor has sales to unrelated customers in Canada who purchase under basically the same conditions as those of a related purchaser. The importer has evidence which shows that the vendor's prices to unrelated customers in Canada are the same as those paid by the importer, that the unrelated purchasers are at the same trade level and buy approximately the same quantities, under the same terms and conditions as does the importer. This method is similar to the first possible test value indicated in paragraph 4*(a)* except that the vendor's prices to unrelated customers used here are not the specific value for duty declared to customs.

*(b)* The vendor does not sell to unrelated purchasers in Canada and the goods sold are of types that have recognized prices established by the workings of the free market economy, e.g., commodities such as copper, zinc, or sugar. The importer is able to show that information on pricing is available in, for example, the financial press or commodity trade journals, and that the published prices are those at which the importer did, and any other person could, buy the subject goods.

*(c)* The vendor has sales to unrelated customers in Canada who purchase under conditions that are different from those pertaining to the related purchaser, and differences in price can be justified by these differences in conditions. For example, the related purchaser is at the distributor level of trade, but the unrelated Canadian customers are at the wholesale level and buy in smaller quantities than the related purchaser. In this example, the importer could provide evidence to show that, although the vendor's price to the wholesalers is higher, the difference is accounted for by economies realized by the vendor in dispatch costs, larger production runs, selling costs, overhead costs, bad debt expenses, etc. It would be necessary for the importer to obtain this evidence from the vendor.

*(d)* The vendor sells to unrelated purchasers in countries other than Canada, including the vendor's domestic market, at the same price and under basically the same or similar conditions as to the related purchaser in Canada. In order for this method to be accepted, the countries to which the sales are made must be developed countries with free economies comparable to that of Canada. In order for the importer to use this method of establishing the acceptability of prices, the vendor would need to supply the importer with details of sales to unrelated purchasers in a country other than Canada. Evidence relating to trade level, volume of purchases, and terms and conditions of sale would also be required in order to ensure that the sales to the unrelated customers and to the related purchaser in the sale for export to Canada were truly comparable.

*(e)* The vendor has sales to unrelated purchasers, as in paragraph 16*(d)*, but under conditions which are different from those pertaining to the related purchaser in the sale for export to Canada, and the differences in price can be justified by these differences in conditions. In addition to the documentation detailed for paragraph 16*(d)*, the importer would need evidence to show that, although the vendor's price to the unrelated purchasers is different, the difference is accounted for by economies realized by the vendor in dispatch costs, larger production runs, selling costs, overhead costs, bad debt expenses, warranty costs, etc. It would be necessary for the importer to obtain this evidence from the vendor.

*(f)* The related purchaser in Canada operates as an independent profit centre which is free to purchase the imported goods, or comparable goods which can serve as a substitute, from unrelated suppliers, where price is the principal determining factor in deciding suppliers. This position could be supported by evidence that the purchaser frequently or always obtains quotations before deciding on the supplier and does, in fact, purchase from the source offering the best terms, considering quality of product and general terms and conditions of sale. The purchaser would not be compelled to obtain quotations for every purchase because the CCRA recognizes that it is normal business practice for an unrelated purchaser, having established a satisfactory source of supply at an acceptable price, to order goods without obtaining competitive bids for each purchase. It is normal, prudent business practice to conduct a periodic review of purchase prices, and evidence of such a review or reviews will exist in most situations.

*(g)* The Canadian purchaser's gross margin percentage on sales in Canada of goods purchased from unrelated suppliers is not markedly different from the gross margin percentage realized on sales of comparable goods purchased from a related vendor. In this method, the importer may demonstrate that the percentage gross margin earned over the landed cost of goods purchased from a related supplier is very close to the percentage gross margin earned on comparable goods imported from unrelated suppliers. Care would have to be exercised when using this method to ensure that the gross margin percentage used is derived from sales where the terms of sale and marketing conditions are basically the same. For example, it would not be realistic to compare the gross margins realized on products advertised by the foreign vendor to the margins realized on products where the purchaser is responsible for the cost of advertising. In addition, the purchaser's gross margin would have to be comparable to the industry margin.

**Note**: Evidence in support of this method should be available from the Canadian purchaser's files. Where there is an effective competition in an industry, the importer may be able to use a published, industry-wide gross margin percentage applicable to the type of products being reviewed, if there are sufficient details available to ensure comparability of trade levels, marketing conditions, and terms of sale.

*(h)* The vendor's percentage net profit on sales to the related purchaser in Canada is comparable to the percentage net profit realized on sales of comparable products to unrelated purchasers located in Canada or another country, if that country's free-market economy is comparable to the Canadian economy.

**Note**: This method can be difficult to use and any profit comparison would have to be made with care. This method may be used principally in cases where semi-finished products are transferred between related companies. The use of the net profit rather than the gross profit allows a comparison without the effect of different allocations of general, selling, and administration expenses and of production costs in situations involving sales to different trade levels, e.g., sales to co-manufacturers versus distributors. It is recognized that problems may prevail with regard to a fair and equitable assignment of total costs to different products. This method may well be used to confirm the conclusions reached by other means. Complete co-operation on the part of the foreign vendor is a pre-requisite in using this method as the documentation requirements would relate to the vendor's confidential costing, profit, and pricing records. Importers who are considering this method should contact the Trade Policy and Interpretation Directorate at the address shown in paragraph 22 for assistance in deciding what documentary evidence is necessary to establish the acceptability of prices.

*(i)* Other methods may have to be used to meet special conditions, e.g., a sale to a related manufacturer in Canada of semi-finished products where the vendor's entire output is sold to related purchasers. It may be necessary to establish the reasonableness of the selling price by examining the level of profit of each of the related parties in relation to factors such as the capital employed, the relative risk undertaken, the effort exerted or expenses incurred, or the use of industry norms for net yield expectations. Some of these methods are discussed in the OECD report. The documentation requirements will vary from method to method. Importers considering one of these methods should contact the Trade Policy and Interpretation Directorate.

*(j)* In the event that the vendor sells only to related purchasers, the importer may, in addition to the methods outlined in paragraph 16*(i)*, be able to show that a genuine bargaining process occurs. This will normally be revealed by evidence that prices originally proposed by the related person in the position to dictate terms are adjusted as a result of the bargaining process, and that a reasonable sharing of total profits results. Evidence to show that prices were merely discussed is not considered to be sufficient information to show that prices are not influenced by the relationship. Alternative sources of supply of comparable goods may also exist and, if they do, prices from these other sources should not differ to any material degree.

17. In examining the effect of any “differences” in conditions of sale referred to or implied in paragraphs 16*(c)*, *(d)*, *(e)*, and *(h)*, an importer should take into consideration the factors set out in section 3 of the *Valuation for Duty Regulations* (see Memorandum D13-1-1). For example, where a related purchaser must bear the cost of advertising and warranty repairs which unrelated purchasers are not responsible for, it is reasonable to expect that the vendor will reduce the unit selling price to the related purchaser by the full unit cost of the advertising and warranty expense which the vendor does not now incur. As a second example, where the related purchaser is buying on more favourable credit terms than those applicable to unrelated purchasers (say 90 days versus 30 days), the unit cost to the related purchaser would be expected to be increased by the vendor’s cost of 60-day credit.

18. The importer who uses the price between related companies as the basis for the transaction value and who satisfies himself of the acceptability of that price must retain on file the information justifying his conclusion. That information may be examined by the CCRA at any time along with other information and documents in support of an importation of goods into Canada and the accompanying documents of account. Information supporting the continued use of prices between related companies should be reviewed periodically, especially on the occasion of a change in business conditions or terms of sale.

19. If the CCRA performs a review of information and evidence provided by the importer and others, and believes that the relationship has influenced the price paid or payable for the goods, the importer will, in all cases, be notified in writing of the grounds for such belief. The importer will be given ample opportunity to rebut the CCRA’s conclusion and may submit additional information in support of the original declaration regarding the acceptability of the purchase price.

**Additional Information**

20. The World Customs Organization’s (WTO ) Technical Committee on Customs Valuation issued Advisory Opinions based on the Committee’s interpretation of the WCO’s International Valuation Agreement. Since the international agreement is to be applied in a uniform manner by all countries which have adopted its provisions, the CCRA will use these Advisory Opinions in reaching decisions whenever there is no clear conflict with Canadian legal precedents.

21. In cases of particular difficulty and where there is no Canadian precedent, the importer or the CCRA may, for the purposes of obtaining guidance and direction, consult decisions or rulings by other countries which have adopted the WCO’s International Valuation Agreement. Such decision or ruling would have to be viewed in the light of the Canadian legislation and Advisory Opinions from the WTO’s Technical Committee.

22. Further information and assistance on customs valuation matters may be obtained by writing to:

Director<br>
Origin and Valuation Policy Division<br>
Trade Policy and Interpretation Directorate<br>
Canada Customs and Revenue Agency<br>
9th floor<br>
191 Laurier Avenue West<br>
Ottawa ON  K1A 0L5

## REFERENCES

**ISSUING OFFICE –**

Origin and Valuation Policy Division
Trade Policy and Interpretation Directorate

**LEGISLATIVE REFERENCES –**

*Customs Act*, section 48
*Valuation for Duty Regulations*, section 3

**HEADQUARTERS FILE –**

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**SUPERSEDED MEMORANDA "D" –**

D13-4-5, March 30, 1989

**OTHER REFERENCES –**

D13-1-1, D13-2-2
International Valuation Agreement adopted by the World Trade Organization (WTO)
Advisory Opinions issued by the Technical Committee on Customs Valuation of the World CustomsOrganization (WCO)
*Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* issued by the OECD

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**This Memorandum is issued under the authority of the Commissioner of Customs and Revenue.**