

MEMORANDUM D13-3-13

Ottawa, March 30, 2001

SUBJECT

CUSTOMS VALUATION: INTEREST CHARGES FOR DEFERRED PAYMENT FOR IMPORTED GOODS (CUSTOMS ACT, SECTIONS 48 TO 53)

This Memorandum explains how interest charges for deferred payment of imported goods are treated under the value for duty provisions of the *Customs Act*.

GUIDELINES AND GENERAL INFORMATION

1. This Memorandum provides policy guidelines for interpreting Decision 3.1, "Treatment of Interest Charges in the Customs Value of Imported Goods," adopted by the World Trade Organization (WTO) Valuation Committee, under the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (the International Valuation Agreement).
2. Decision 3.1 examined the issue of financing goods in its broadest sense. The decision states that interest charges for financing arrangements that relate to the purchase of imported goods will not form part of the value for duty, regardless of whether the financing is provided by the vendor, a bank, another individual, or legal person. It shall also apply, if appropriate, where goods are valued under a method other than the transaction value.

Background

3. There are many ways a purchaser can arrange to get the necessary funds to buy goods. A purchaser may buy the goods using his or her own funds. The purchaser may buy the goods after having arranged appropriate financing from a bank, lending institution, or from another person unrelated to the transaction. The purchaser may also secure the financing from the vendor of the goods. In most cases where the purchaser seeks financing from an external source, the person or institution providing the financing will also charge, in return for having provided the financing, interest on the financed amount.
4. If the purchaser has separately arranged the financing with a bank, lending institution, or another person unrelated to the transaction, the amount of interest charged will not effect how the value for duty is calculated, since these other parties are not involved in the sale and importing of the goods. If the financing has been provided by the vendor of the goods, the interest charged does effect how the value for duty is determined.
5. There is a fundamental difference between:
 - (a) an advance of funds by a financial institution to the importer to purchase the goods; and
 - (b) a vendor who extends terms for deferred payment for the purchase of the vendor's own goods.
6. In the latter situation, there is no exchange of funds. There is only an agreement to defer payment over an extended period of time. There is an exchange of title of the goods for a consideration, but the settlement is deferred according to the terms of an agreement. There is no formal financial instrument such as a loan or mortgage agreement.

7. Usually, interest charged by the vendor would be included in the price paid or payable for the goods, since the financing charge meets the definition of price paid or payable (in subsection 45(1) of the *Customs Act*) as “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.”

8. However, this was not the intention of the International Valuation Agreement upon which the valuation provisions of the *Customs Act* are based. As a result, in 1984, the General Agreement on Tariffs and Trade (GATT), which oversaw the application of the International Valuation Agreement, issued Decision 3.1 to deal with interest charged under financing arrangements. Decision 3.1 stated that, subject to certain conditions being fulfilled, financing charges were not to form part of the value for duty, regardless of who provides the financing. While Decision 3.1 relates to financing arrangements provided by any person or institution, the only situation where the financing could potentially have an effect on the determination of the value for duty is when financing is provided by the vendor of the goods in the form of terms for payment. With the advent of the WTO in 1995, GATT Decision 3.1 was adopted by the WTO.

9. It is important to understand why a vendor might choose to provide financing. In some cases, the vendor may wish to either protect or expand its market share in a competitive global economy. One way to achieve this might be for the vendor to provide favourable payment terms for the goods it sells. It may also be that the purchaser is involved in a new business enterprise and, as a result, is considered a high-risk borrower by banks and other lending institutions. As a result, the purchaser may be offered only loans bearing an interest rate above his or her expectations. The vendor may then be willing to provide favourable payment terms, often at a lower interest rate, for the purchase of the goods.

Conditions

10. Decision 3.1 outlines certain conditions that must be met before interest charges for deferred payment can be excluded from the price paid or payable:

- (a) the charges are distinguished from the price actually paid or payable for the goods;
- (b) the financing arrangement was made in writing; and
- (c) when required, the buyer can demonstrate that:
 - (i) such goods are actually sold at the price declared as the price actually paid or payable, and
 - (ii) the claimed rate of interest does not exceed the level for such transactions prevailing in the country where, and at the time when the finance was provided.

11. In addition to the above, for the charge not to form part of the price paid or payable, the Canada Customs and Revenue Agency (CCRA) will require evidence that the purchaser could have bought the goods without incurring a finance charge. As well, the financing arrangement must **not** be considered a condition of sale of the goods. This means that the purchaser must always be entitled to buy the goods at the time of sale without entering into an agreement with the vendor, or a person related to the vendor, to provide financing or terms for payment. The purchaser must also always be entitled to seek financing through other lending establishments. Finally, there must be evidence that the purchaser is taking advantage of the terms for which the interest is being paid. For example:

- (a) A vendor only sells to a purchaser on the basis of extended credit terms (six months). This is the only way the vendor conducts business. In this scenario, since the vendor only sells goods with terms for deferred payment, then the interest charges forms part of the price paid or payable.
- (b) A vendor sells to a purchaser and offers legitimate credit terms (six months) for the goods. In this situation, the interest for deferred payment is not included in the price paid or payable as long as the credit terms meet the stipulations outlined in paragraph 10.

12. Not all cases of payment terms necessarily involve interest for deferred payments. Occasionally, vendors will, in the normal course of business, extend terms of payment, such as “net 30 days” to a purchaser. In these cases, the cost of carrying the financing of the goods for 30 days is inherent as a cost

factor in the purchase price of the goods. As the cost of deferred payment is factored into the purchase price of the goods, it would not constitute a separate charge for financing the goods.

Claimed rates of interest

13. When a purchaser enters into a financing arrangement or arranges terms for payment directly with the vendor, the CCRA may, if it decides to review the claimed rate of interest, take into account the sale between the purchaser and vendor, the relationship of the parties, and the economic factors present at the time of sale. As well, the CCRA may refer to the International Financial Statistics published by the International Monetary Fund (IMF), which list interest rates on a monthly and yearly basis.

14. Customs will not accept a claimed rate of interest which exceeds the level for such transactions prevailing in the country where, and at the time when the financing was provided. In these circumstances, provided that the other conditions are met, customs will only accept a reasonable rate of interest, prevailing in the country where, and at the time when the financing was provided.

15. Copies of the International Financial Statistics are usually available through public libraries or directly from the IMF on a subscription basis at the following address:

International Monetary Fund
Publication Services
Washington DC 20431
USA

Telephone: (202) 623-7430
Fax: (202) 623-7201

Judicial decision

16. The principle that interest charges for deferred payment will not form part of the price paid or payable as long as the conditions outlined in this Memorandum are met was reaffirmed in a decision issued by the Canadian International Trade Tribunal in the appeal filed by DMG Trading Company Limited (Appeal 96-076). You can view this decision at www.citt.gc.ca on the Tribunal's Web site, or you can order a copy of the decision by contacting the Tribunal at the following address:

Canadian International Trade Tribunal
Records and Mail
15th floor, 333 Laurier Avenue West
Ottawa ON K1G 0G7

Telephone: (613) 990-2444 or (613) 990-2446
Fax: (613) 990-2439

17. The Appendix to this Memorandum provides examples of various situations addressed by these guidelines.

APPENDIX

Example 1: The DEMEL Co. purchases and imports ladies leather jackets and declares a purchase price of \$50,000. An additional \$750 is shown separately on the commercial invoice as an interest charge. The net invoice price is shown as \$50,750. DEMEL's written finance agreement with the seller outlines the terms and interest amount owing, based on a stated interest rate. The interest charge applies to a three-month period, that is, 1.5% net 90 days. It can be shown that the interest charge is reasonable for the time period the goods were imported.

Conclusion 1: The importer could have purchased the goods without deferring payment for 90 days, so the importer had the option not to incur the additional interest cost. The interest rate charged is competitive with commercial rates. Therefore, the importer has taken advantage of a written finance agreement with the seller that outlines the terms and interest amount owing. The interest charge is reasonable and is shown separately on the commercial invoice, so it will not be included in the price paid or payable. The price paid or payable is \$50,000.

Example 2: MeBodee Inc. purchases and imports a shipment of shoes from the BareFt Co. in Taiwan. The commercial invoice shows a net invoice price of \$10,000 and is broken down on the invoice as \$8,000 for the shoes and \$2,000 as interest charges for deferred payment. According to the information supplied, BareFt has provided terms of payment for MeBodee's purchase of the shoes, \$10,000 net 60 days. MeBodee does not have the option to purchase the goods without this payment plan from BareFt because the vendor will not sell goods under any other terms. MeBodee declares a value for duty of \$8,000, excluding the interest charges of \$2,000.

Conclusion 2: The terms of the agreement reflect normal business practice for the vendor. It is the vendor's commercial practice to sell goods at the price of \$10,000 net 60 days, and not to sell goods under other terms such as a shorter or longer period of time. Furthermore, to purchase the goods, the importer has no option but to accept the terms offered by the vendor, and the importer cannot avoid the interest payment. As a result, the interest charges must be included in the price paid or payable, even though the invoice purports to break the price into two separate elements. The purchaser must include the interest charges incurred, even though they are declared and invoiced separately. In this scenario, there is no interest for deferred payment. Clearly, the importer cannot purchase the goods under any other terms, and since the interest payment cannot be avoided, the so-called interest charge is included in the price paid or payable. The price paid or payable is \$10,000.

Example 3: MeBodee Inc. purchases and imports a shipment of shoes from the BareFt Co. in Taiwan. The commercial invoice shows a net invoice price of \$10,000 and is broken down on the invoice as \$8,000 for the shoes and \$2,000 as interest charges for deferred payment. According to the information supplied, BareFt has provided terms of payment for MeBodee's purchase of the shoes. As well, MeBodee does have the option to purchase the goods without a finance agreement from BareFt. However, MeBodee has accepted the payment terms offered by BareFt. As a result, MeBodee declares a value for duty of \$8,000, excluding the interest charges. A review conducted by customs determines that the interest charges do not reflect business reality in the country of export at the time the goods were exported. The interest rate charged is higher than the prevailing rates at the time of the importation. Customs' review determined that a reasonable interest rate at the time of importation was 5%.

Conclusion 3: As the interest charges do not reflect business reality in the country of export at the time the goods were exported, the rate of interest claimed was not considered to be commercially realistic. However, the importer did have the option to purchase the goods outright. Therefore, the subsequent review conducted by customs concluded that an interest rate of 5% represented a reasonable interest rate at the time of importation. As a result, the reassessed value for duty would be \$9,500 (\$10,000 – 5%).

Example 4: The Brier Company buys from its parent company and then imports the goods with a declared value of \$1,000. As shown on the commercial invoice, it is given a 3% interest rate for deferred payment for six months. The value for duty declared is \$970, with the \$30 as interest for deferred payment. Upon review, Brier paid the \$970 invoice immediately, and did not take advantage of the terms for deferred payment. In doing this, Brier has reduced the price.

Conclusion 4: Brier is not entitled to this reduction in value. As it always pays the invoice on receipt and never takes advantage of the deferred payment offered, the value for duty of the goods is the full invoice amount of \$1,000.

REFERENCES

ISSUING OFFICE –

Origin and Valuation Policy Division
Trade Policy and Interpretation Directorate

LEGISLATIVE REFERENCES –

Customs Act, sections 48 to 53

HEADQUARTERS FILE –

7034-5-23

SUPERSEDED MEMORANDA “D” –

D13-3-13, June 1, 1986

OTHER REFERENCES –

Decision 3.1 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (the International Valuation Agreement)

Services provided by the Canada Customs and Revenue Agency are available in both official languages.

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