Ottawa, January 7, 2014

MEMORANDUM D13-3-13

IN BRIEF

Customs Valuation: Interest Charges for Deferred Payment for Imported Goods

The editing revisions made in this memorandum do not affect or change any of the existing policies or procedures.

Printed in Canada

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Customs Valuation: Interest Charges for Deferred Payment for Imported Goods

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

Legislation

Sections 48 to 53 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 a legal person. This decision shall apply to goods accounted for under any valuation methodology.

Background

3. There are many ways a purchaser can arrange to get the necessary funds to buy goods. The goods may be bought using the purchaser's own funds. The purchaser may buy the goods after having arranged appropriate financing from a bank, a lending institution, or another person unrelated to the transaction. In most cases where the purchaser seeks financing from an external source, the person or institution providing the financing will also charge interest on the financed amount, in return for having provided the financing.

4. Alternatively, the purchaser may secure financing from the vendor of the goods. 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.

5. If the purchaser has separately arranged the financing with a bank, a lending institution, or another person unrelated to the transaction, the amount of interest charged is not included in the calculation of the value for duty of imported goods, since these other parties are not involved in the sale of the goods. If the financing has been provided by the vendor of the goods, the interest charged on the financed amount may be a factor in the calculation of the value for duty of imported goods.

6. 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.

In the first situation, the purchaser obtains financing and makes full payment to the vendor for goods, and makes separate payments to the financial institution to repay the advance. In the latter situation, there is no exchange of funds when the goods are acquired. 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 monetary consideration, but the settlement is deferred according to the terms of the agreement between the purchaser and the vendor. There is no separate formal financial instrument such as a loan or a mortgage agreement, but the vendor may charge the purchaser interest as a result of accepting a deferred payment for the goods.

7. The International Valuation Agreement did not intend for all charges for deferred payment to be included in the value of duty of imported goods, and consequently issued Decision 3.1 to address interest charges under financing arrangements. Decision 3.1 states that financing charges are not to form part of the value for duty regardless of who provides the financing, subject to certain conditions being fulfilled.

Conditions

8. Decision 3.1 outlines the conditions that must be met before interest charges for deferred payment can be excluded from the value for duty:

(a) the charges are distinguished from the price actually paid or payable for the goods;

(b) the financing arrangement was made in writing;

(c) where 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.

9. In addition to the above, the Canada Border Services Agency (CBSA) will also require evidence that the purchaser could have bought the goods without incurring a finance charge, in order to exclude any payment for interest from the calculation of the value for duty. As well, the financing arrangement must not be considered a condition of the 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 conditions for exclusion outlined in paragraph 8 of this memorandum.

10. 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

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

12. The CBSA 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 for exclusion are met, the CBSA will only accept a reasonable rate of interest prevailing in the country where, and at the time when, the financing was provided.

13. The Appendix to this memorandum provides examples of various situations addressed by these guidelines.

Additional Information

14. For more information, within Canada call the Border Information Service at **1-800-461-9999**. From outside Canada call 204-983-3500 or 506-636-5064. Long distance charges will apply. Agents are available Monday to Friday (08:00 – 16:00 local time/except holidays). TTY is also available within Canada: **1-866-335-3237**.

Appendix

Example 1: The DEMEL Co. imports ladies leather jackets, purchased at a price of $50,000. The value for duty declared for the jackets reflects the invoice price. An additional $750 is shown separately on the commercial invoice as an interest charge. The net invoice amount 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 correct value for duty 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 amount 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 a 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 amount for interest charges in the declaration of the value for duty, even though they are itemized separately on the invoice. 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 value for duty 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 amount 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 MeBodee accepts the payment terms offered by BareFt and declares a value for duty of $8,000, excluding the interest charges. A review conducted by the CBSA determines that the amount of interest charged for deferred payment does 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. The CBSA's review determined that a reasonable interest rate at the time of importation to Canada of the goods was 5%.

Conclusion 3: As the interest charges do not reflect the business reality in the country of export at the time the goods were exported, the rate of interest claimed is not considered to be commercially realistic. However, the importer did have the option to purchase the goods outright. Therefore, the subsequent review conducted by the CBSA 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 of the goods would be $10,000 – ($10,000 x 5%) = $9,500.

REFERENCES

ISSUING OFFICE – Trade Programs Directorate	**HEADQUARTERS FILE –** 79040-4-3
LEGISLATIVE REFERENCES – *Customs Act*	**OTHER REFERENCES –** Decision 3.1 of Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (the International Valuation Agreement)
SUPERSEDED MEMORANDA "D" – D13-3-13, March 30, 2001	

Services provided by the Canada Border Services Agency are available in both official languages.

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