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NAFTA Origin Verifications— A Canadian Perspective***

As we quickly approach a new century and, for that matter, a new millennium, we can reflect upon a century that witnessed a turbulent global trade policy. Indeed, at one time or another in this century trade policies were variously centered upon protectionist tariff barriers, regional trade blocs, multilateral trade associations, and free trade areas or custom unions. As we approach the year 2000, however, support is firmly in favor of free trade at both the multilateral and regional levels.

Evidence of this flourishing support for a liberal international trade regime abounds. The most stark example is the almost exponential growth in the participation in the multilateral trading system. From its inception following Bretton Woods, when membership was reserved to a few select countries, the General Agreement on Trade and Tariffs including its successor, the World Trade Organization (WTO), has evolved into an institution that counts 128 member countries and, with China, Saudi Arabia, and Russia knocking on its door, promises to continue growing.

In addition to the rise of the multilateral trade regime, the last quarter century also saw the formation of a number of bilateral and regional free trade areas and customs unions. One such example is the North American Free Trade Agreement (NAFTA)[1] between Canada, Mexico, and the United States (Party or Parties).

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1. North American Free Trade Agreement, drafted Aug. 12, 1992, revised Sept. 6, 1992, U.S.-Can.-Mex., 32 I.L.M. at 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA].

The purpose of a free trade area (FTA) and customs union (CU) is to enhance the liberalization of trade (ideally covering goods, services, and investments) through the reduction or elimination of both tariff and nontariff barriers, thereby encouraging and promoting further specialization and cross-border commerce within the FTA or CU. To the extent that such liberalization and increased trade do not divert trade from other WTO countries through the creation of new or discrete barriers, a FTA or CU, at least theoretically, advances the goal of expanding market access for goods (and services and investments).[2] In fact, the above goals of FTAs and CUs are stated in the WTO Agreement itself. According to the Preamble to the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, WTO members assert that FTAs and CUs, properly instituted, lead "to the expansion of world trade" and that FTAs and CUs should "facilitate trade between the constituent territories and not . . . raise barriers to the trade of other Members with (sic) such territories."[3] The NAFTA mimics this support for FTAs in both its Preamble and in article 102, concerning the objectives of the NAFTA.[4]

Although the goal of the WTO and thus, inferentially, its members, is to reduce barriers to trade, FTAs and CUs provide accelerated tariff reduction and elimination benefits to those within its ambit. FTAs, for a lack of a better term, are private member's clubs. FTAs and CUs establish rules that allow the customs administrations of its member countries to determine whether a good which is shipped from one member to another member qualifies as an originating good. Only an originating good is entitled to preferential tariff treatment.

The NAFTA creates an elaborate scheme for determining origin. The scheme, which is found in article 401,[5] essentially establishes separate rules for: (i) goods that are wholly obtained or produced in the territory of a Party; (ii) goods that are produced entirely in the territory of one or more Parties exclusively from originating materials; and (iii) goods that are produced with both originating and nonoriginating materials. In order to qualify as NAFTA originating, and thus be entitled to preferential tariff treatment, a good must satisfy the applicable origin requirements.

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2. This article is only concerned with trade in goods.

3. *Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, in* THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS—THE LEGAL TEXTS, 31 (1994).

4. For example, the Preamble to the NAFTA states that the Parties are resolved to "[b]uild on their respective rights and obligations under the General Agreement on Tariffs and Trade and other multilateral and bilateral instruments of cooperation;" NAFTA, *supra* note 1, preamble, 32 I.L.M. at 397, while, similarly, paragraph 1(a) of article 102 states that one of the objectives of the NAFTA is to "eliminate barriers to trade in, and facilitate cross-border movement of, goods and services between the territories of the Parties." NAFTA, *supra* note 1, art, 102(1)(a), 32 I.L.M. at 297.

5. NAFTA, *supra* note 1, art. 401, 32 I.L.M. at 349. Additional rules are also provided by the NAFTA for both automotive goods and textiles and apparel.

This article does not canvass the origin determination scheme in article 401. Instead, it focuses on the rules by which the customs authorities of each Party may verify that a good for which a NAFTA preferential tariff rate is claimed is, in fact, entitled to such a rate. This process is known as origin verification or origin audit. Through the NAFTA's verification procedures, the Parties can ensure both that their rules of origin requirements are not circumvented or abused and that only goods that are entitled to preferential tariff rates receive such treatment.

This article thus explores the verification procedures established under article 506 of the NAFTA. Furthermore, particular emphasis is given to Canada's implementation of that regime. Section I therefore examines the administration of origin verification audits in Canada. Section II then examines the specific verification rules established under article 506 of the NAFTA and, following that examination, Canada's implementation of those rules. With respect to the latter, the various record-keeping requirements, as well as the actual practice of desk audits and site verifications, are explored. Once the rules and methods of conducting a verification audit are fully canvassed, section III explores issues concerning enforcement and penalties within a Canadian context. Finally, section IV offers a few brief conclusions.

I. Administration of Origin Verification Audits in Canada

Before reviewing the verification provisions of the NAFTA generally, and Canadian legislation and regulations specifically, this section serves as a brief introduction to the administration of NAFTA origin verification determinations in Canada. In this respect, certain language is employed, such as origin audits and verification units, which will be clearer—it is hoped—following the discussion of verifications in section II below. An initial review of the administrative aspects of origin verifications, however, will help provide a context in which to examine the more intricate and detailed discussion of origin verifications in the following section.

The Customs and Trade Administration Branch of Revenue Canada (CTAB or Revenue Canada) is responsible for administering and conducting NAFTA origin verifications. On July 1, 1997, the CTAB underwent a substantial reorganization. These changes are reflected below.

The CTAB is comprised of a national headquarters office in Ottawa (Headquarters) and six regional branch offices (Regional Office).[6] As well, the CTAB is divided into seven divisions, two of which are particularly relevant to origin verifications and audits: the Trade Policy and Interpretation Directorate (TPID) and the Process Policy Directorate (PPD). Although NAFTA origin operational

6. The Regional Trade Administration Services offices are divided as follows: Atlantic (Halifax); Quebec (Montréal and Québec); Northern Ontario (Ottawa); Southern Ontario (Toronto, Hamilton and London); Prairie (Winnipeg and Calgary); and Pacific (Vancouver).

and legislative policies, as well as the framework by which audits and verifications are executed, are established at the Headquarters level, Headquarters and the Regional Office are fairly autonomous.

As noted, the TPID and the PPD are vested with responsibility over origin audits and verifications. The TPID is divided into the following divisions: (i) Trade Incentive Programs; (ii) Valuation Policy; (iii) Dispute Resolution; and (iv) Nomenclature and Tariff Treatment Policy. It is the latter division, the Nomenclature and Tariff Treatment Policy (NTTP) division, that develops policy regarding origin audits and verifications.[7]

Separate from the TPID, the PPD is responsible for the more mechanical and operational aspects of customs and border services. The PPD is divided into the following divisions: (i) Program Integration Division; (ii) Licensing, Revenue Accounting, Courier, and LVS Division; (iii) Commercial Import and Export Process Division; (iv) Traveller and Postal Division; and (v) Commercial Client Services and Origin Audit and Verification Division. It is this latter group, the Commercial Client Services and Origin Audit and Verification Division (CCS), that is responsible for providing the framework for the conduct of origin audits and verification. More particularly, it is the Origin Audit Group (OAG) and the Origin Verification Group (OVG), both of which are constituted under the CCS,[8] that are primarily responsible for origin audits and verifications.

Specific responsibility over origin audits is mandated to the OAG and the OVG.[9] The OAG is responsible for both conducting audits for goods in which NAFTA originating status is premised on a regional value content requirement (RVC), and for audits that are intrinsically complex and require a strong background in accounting and auditing. Indeed, what sets the OAG apart from the Regional Office and, to a lesser extent, the OVG is that all of its line officers are designated accountants. They are, therefore, specially trained to examine and to conduct complex audits.

The OVG, on the other hand, works much more closely with the Regional Office in the conduct of relatively straightforward verifications, such as for goods in which NAFTA preferential treatment is claimed on the basis of a tariff classification change in accordance with annex 401 of the NAFTA. Hence, it is the OVG that coordinates with the Regional Office both with respect to its operations and to site visits. In sum, the OAG and the OVG conduct audits for the automotive

7. The TPID is further divided into the following groups: (i) Tariff Treatment; (ii) International Nomenclature; (iii) Machinery Products; (iv) Electrical Products; (v) Transportation, Scientific, Plastics and Specialty Products; (vi) Minerals, Metals, Forest Products & Textiles; and (vii) Food Products and Chemical Products.

8. CCS is divided into the following eight sections: (i) Ministerial Correspondence; (ii) Client Information Services; (iii) Service Quality; (iv) Special Projects; (v) Origin Verification; (vi) Automated Information Services; (vii) Policy Monitoring; and (viii) Origin Audit.

9. In addition to goods imported under the NAFTA, the OAG and OVG are also responsible for goods imported under both the Canada-Chile Free Trade Agreement and the Canada-Israel Free Trade Agreement.

sector (the former group principally being the one responsible for such audits), take referral work from the Regional Offices (*i.e.*, when a matter is either too complex and/or voluminous to be left solely to the Regional Offices level), and undertake general trouble-shooting and random audits.

The Regional Offices also have audit teams responsible for all imports in which NAFTA preferential tariff treatment is claimed and that enter through their specific region. Thus, other than when a matter is referred to the OAG or OVG at Headquarters, the Regional Offices can undertake a wide cross-section of audits directly at the regional level.

As noted, although responsibility for NAFTA origin verification audits by the CTAB is divided between Headquarters and the Regional Offices, the relationship between the two is not hierarchical or one of control. To begin with, an Assistant Deputy Minister is assigned responsibility over each region. Furthermore, despite policy being devolved directly from the NTTP, at Headquarters, and notwithstanding that the OAG and the OVG take referrals from the Regional Offices, neither the OAG nor the OVG directly controls the work or assignments performed by the Regional Offices.[10] The two levels—Headquarters and Regional Offices—thus work side-by-side, with the more technical work being performed by the auditors at Headquarters, while day-to-day audits are split between both levels of audit teams.

II. The Rules Governing NAFTA Origin Verifications

In a recent brochure published by Revenue Canada, entitled *What to Expect from a NAFTA Verification*, which is intended to assist importers, exporters, and producers, Revenue Canada explains that there are five "objectives" or things which a NAFTA origin verification seeks to reveal: "nonqualifying operations," "transshipment," "tariff classification change," "regional value content," and "tariff treatment."[11] The purpose of an origin verification, therefore, is to ensure that only goods that are entitled to preferential tariff treatment in fact receive such treatment. This is necessary since, like any taxation or customs measure, a certain amount of trust is conferred upon importers, exporters, and producers to only claim NAFTA preferential tariff rates for goods that are entitled to such treatment. The origin verification procedures, therefore, provide a mechanism by which each Party can confirm whether a good qualifies as NAFTA originating.

The following subsections examine, first, the custom verification procedures under chapter five of the NAFTA, and second, Canada's legislation and regulations that implement those rules and procedures.

10. In fact, in order to ensure that there is not a duplicity and overlap of work performed by the two levels, particularly with respect to trouble-shooting and random audits, CTAB operates a database of ongoing files in order to limit that risk.

11. REVENUE CANADA, WHAT TO EXPECT FROM A NAFTA VERIFICATION (Ottawa: Government of Canada, 1996), at 4-5.

A. NAFTA Article 506

Article 506 of the NAFTA sets forth the general rules for conducting an origin verification. As the name verification suggests, the purpose of the said article is to ensure—or verify—that goods in which NAFTA origin is claimed, and thus to which preferential tariff treatment is accorded, are, in fact, originating. Since an origin verification can ultimately result in a loss of preferential tariff rates and, presumably, in substantial costs to an importer, the NAFTA sets out detailed rules for conducting a verification. Furthermore, these rules are expanded upon by the Uniform Regulations agreed to by the Parties pursuant to article 511 of the NAFTA.[12] Accordingly, this subsection briefly explores both the scope of and procedure for conducting origin verifications under article 506 of the NAFTA. A more detailed analysis of origin verifications under Canadian law is provided in the subsequent subsection.

The NAFTA envisions two methods for conducting an origin verification. The first method requires the customs administration of a Party to correspond with an exporter or producer in the territory of another Party. The second method is much more intrusive and requires the customs administration of a Party to visit the premises of a producer, exporter, or supplier of materials in the territory of another Party.[13]

In both cases, an exporter or producer that completes and signs a Certificate of Origin (CO), as well as an importer that claims preferential tariff treatment, is expected to maintain records substantiating that claim. In the case of a producer or exporter, records must be kept for a period of five years from the date in which a CO was signed, while in the case of an importer, records must be retained for five years from the date of importation.[14] As a matter of course, and particularly when there is a regional value content requirement, records must be maintained in accordance with the Generally Accepted Accounting Principles (GAAP) of the Party from which a subject good is exported.[15] A customs adminis-

12. With respect to origin verifications, Revenue Canada has stated its commitment to the Uniform Regulations in its Memorandum D11-4-18. [Revenue Canada, Memorandum D11-4-18 (September 29, 1995).]

13. NAFTA, *supra* note 1, art. 506(1), 32 I.L.M. at 359.

14. NAFTA, *supra* note 1, art. 505, 32 I.L.M. at 359. Pursuant to paragraph (a) of article 505, an exporter and producer is required to maintain all records that pertain to the claim of NAFTA origin status. This includes, for example, any documents related to: "(i) the purchase of, cost of, value of, and payment for, the good that is exported from its territory, (ii) the purchase of, cost of, value of, and payment for, all materials, including indirect materials, used in the production of the good that is exported from its territory, and (iii) the production of the good in the form in which the good is exported from its territory. . . ." An importer should maintain all information, including a CO, concerning the importation of a good into the territory of a Party. Paragraph (b) of article 505 provides that a Party may specify those documents that an importer must retain.

15. NAFTA, *supra* note 1, art. 506(8), 32 I.L.M. at 360. In Canada, reference should be, generally, to the Handbook of the Canadian Institute of Chartered Accountants.

tration that receives records and other business documents must keep such records in strict confidence and protected from disclosure.[16]

As mentioned, the customs administration of a Party can either conduct its verification through correspondence or by visiting the premises of a producer or exporter. Since the latter procedure can have a disruptive effect and be particularly time consuming to the party who is the subject of a visit, the NAFTA prescribes a number of conditions and procedural safeguards on the conduct of an on-site verification.

The first requirement is that an exporter or producer cannot be surprised or ambushed by a visit. In accordance with the voluntary nature of NAFTA origin verifications, a producer or exporter must be forewarned of a pending visit. NAFTA article 506(2) provides that, when a Party intends to conduct an on-site verification visit, notice of that intent must be provided to the exporter or producer who is the subject of the visit, to the exporter's or producer's customs administration in whose territory the visit is to occur (*e.g.*, when Canada visits an American producer in the United States, Canada must inform the U.S. Department of Commerce of the pending visit) and, upon the request of the customs administration of the Party in whose territory the visit is to occur, the exporter's or producer's embassy in the territory of the Party conducting the visit (*i.e.*, in the above example, the U.S. Embassy in Canada). Upon receipt of such notice, the producer or exporter may or may not provide consent.[17]

Consent is not, however, mandatory. The customs administration of the producer or exporter who is the subject of the verification may, within fifteen days of receiving notice, request that the verification visit be postponed for a period of up to sixty days, unless the customs administrations of both Parties agree upon a longer period.[18] Failure to provide consent within thirty days of receiving notice, however, may result in preferential tariff treatment being withheld on the goods that would have been the subject of the visit.[19]

When a producer or exporter grants a verification visit, the producer or exporter may nominate two persons to act as independent observers.[20] Although paragraph

16. NAFTA, *supra* note 1, art. 507(1), 32 I.L.M. at 360. Paragraph 2 of article 507 provides that confidential information provided to a customs administration under this provision "may only be disclosed to those authorities responsible for the administration and enforcement of determinations of origin, and of customs and revenue matters." *Id.*

17. NAFTA, *supra* note 1, art. 506(3), 32 I.L.M. at 360. According to paragraph 3 of article 506, the notification must include: the identity of the customs administration issuing the notice; the name of the producer or exporter in whose premises a visit is requested; the date and place of the visit; the object and scope of the visit; the names and titles of the officers who will be performing the visit; a description of the good that is the subject of the visit; and the legal authority for the verification visit.

18. NAFTA, *supra* note 1, art. 506(5), 32 I.L.M. at 360. When a visit is postponed as a result of such a request, the customs administration conducting the visit cannot use this postponement against the exporter or producer (article 506:6).

19. NAFTA, *supra* note 1, art. 506(4), 32 I.L.M. at 360.

20. *Id.* art. 506(7).

7(a) provides that such observers may "[n]ot participate in a manner other than observers," this provision is generally considered not to preclude an exporter or producer from requesting that its solicitor be present and participate in a more active role than as a mere observer (at least as that term is described in that paragraph).[21] Rather, article 506:7 was included in the NAFTA at the insistence of Mexico who, apparently for the purposes of its domestic law, required the inclusion of such a provision in the Agreement.[22]

Following a verification, whether by correspondence or by on-site visit, the customs administration who conducted the verification must provide its findings in writing, including any facts or law on which it relied, to the producer or exporter who was the subject of the verification.[23] As discussed below, when a Party revokes preferential tariff treatment because a subject good does not qualify as NAFTA originating, the Uniform Regulations require that such notification include information as to the date of the revocation and the period in which the exporter or producer may supply additional information to the customs administration responsible for the determination.

Furthermore, pursuant to article 506:11, when the decision to revoke preferential tariff treatment is based on a tariff classification or a value applied by a Party to the component materials of a subject good that differs from the value or classification applied by the Party from which the subject good was exported, the Party may not revoke preferential tariff treatment until it provides written notice to both the importer and the party responsible for completing the CO.[24] A Party may not revoke preferential tariff treatment under paragraph 11, *i.e.*,

21. For example, in respect to article 506(7), Donald Harrison and Kenneth Weigel note that: "We understand that the NAFTA drafters intended these limitations to apply to officials of the government of the exporter or producer, not outside accountants and attorneys for the exporter or producer." Donald Harrison and Kenneth G. Weigel, *Customs Provisions and Rules of Origin Under the NAFTA*, 27:1 INT'L LAW. 647 (1993). Furthermore, there is nothing in the NAFTA that specifically limits the participation of third parties that are not designated as observers. Thus, all of the rights and procedural guarantees available to a person under the laws of its territory would apply to a verification visit.

22. This was confirmed in conversations with a number of customs officials at Revenue Canada who were involved in negotiating the customs enforcement procedures of the NAFTA.

23. NAFTA, *supra* note 1, art. 506(9), 32 I.L.M. at 360.

24. As the article does not specifically address the issue of materials, it is worth noting that, according to article VI:26 of the Uniform Regulations, the material or materials provided in paragraphs 11 through 13 of article 506 refer to "materials that are used in the production of the good or that are used in the production of a material that is used in the production of the good." Furthermore, article VI:28 elicits a number of procedures under article 506 of the NAFTA and under article VI of the Uniform Regulations, including those pertaining to the manner in which an audit must be conducted, notification requirements, the right to appoint observers, and a provision concerning the delivery of notice, that must be followed when an origin verification of a material or materials is undertaken. When a producer or supplier either denies access to its records, fails to respond to a verification letter or questionnaire, does not consent to a verification visit within 30 days of receiving notice, or does not cooperate in any other manner, the customs administration undertaking the verification audit is entitled to treat the subject material or materials as non-NAFTA originating [article VI: 29 UNIFORM REGULATIONS].

on the basis of the origin of the component materials, when an advance ruling under article 509 (or other similar decision) by the Party from which the good was exported found the material to be originating, or when a producer or exporter relied upon its customs administrations having in the past consistently treated the subject material as entitled to the classification or value being claimed.[25] The one caveat to this exception, however, is that the ruling or decision must have been given prior to the verification.

Although a NAFTA origin verification is intended to apply against the goods that are the subject of a verification, article 506:10 provides that when a producer or exporter evinces a "[p]attern of conduct . . . of false or unsupported representations . . . Party may withhold preferential tariff treatment to identical goods exported or produced by such person until that person establishes compliance with Chapter Four (Rules of Origin)."

Since the Parties were required to and did implement Uniform Regulations pursuant to NAFTA article 511, there is relative harmony in the customs administration and enforcement between the NAFTA Parties. That being said, there are some differences in the verification and enforcement procedures between the three countries that demand exploration. Accordingly, the following subsection (and the sections thereafter) examines NAFTA origin verification procedures from the perspective of Canadian law.

B. NAFTA Origin Verifications Under Canadian Law

The records and verifications provisions of article 505 and article 506 of the NAFTA, respectively, as well as the Uniform Regulations pursuant to article 511 of the NAFTA, were implemented and incorporated under Canadian law pursuant to the Customs Act and Customs Tariff, and the regulations thereto, including the NAFTA Verification of Origin Regulations,[26] NAFTA Rules of Origin Regulations (ROR),[27] Exporters' and Producers' Records Regulations (EPRR),[28] and the Imported Goods Records Regulations (IGRR).[29] This subsection builds upon the preceding one by examining the relevant statutory and regulatory requirements governing verification audits in Canada. In order to organize the discussion, the subsection is further divided into the following two subheadings: (i) Record-Keeping and (ii) Verification Audits.[30]

25. NAFTA, *supra* note 1, art. 506(12)(a), 32 I.L.M. at 360.
26. SOR/94-15.
27. SOR/94-14.
28. SOR/93-556.
29. SOR/86-1011.
30. It is important to keep in mind throughout this article that Canadian law only governs persons who are subject to Canada's jurisdiction. In terms of producers or exporters outside of Canada, Canada's (Revenue Canada) reach to such persons exists only to the extent (and presumably in accordance with NAFTA articles 505 and 506) that the United States and Mexico law permits. Such limits on jurisdiction must not be lost when considering the municipal law aspects of verification audits.

1. *Record-Keeping*

It goes without saying that the primary method by which Revenue Canada may verify the origin of goods and materials is through records maintained by importers, producers, exporters, and suppliers. Canada thus requires that all relevant documents be maintained for at least six years (as opposed to the five year minimum prescribed by the NAFTA).[31]

With respect to importers, section two of the IGRR requires that importers retain records relating to the following for commercial goods[32] imported into Canada: "(a) the origin, marking, purchase, importation, costs and value of the commercial goods; (b) payment of the commercial goods in Canada; (c) the disposal of the commercial goods in Canada; and (d) any application for an advance ruling made under subsection 43.1 of the [*Customs*] *Act* in respect of the commercial goods." All such records must be kept at the importer's place of business, or any other place designated by the Minister of Revenue Canada,[33] and must be kept in a manner suitable to permit a customs officer "to perform detailed audits of the records and to obtain or verify the information on which a determination of the amount of the duties paid, payable, deferred or relieved was made."[34] Failure to either keep records or to deny access to such records to customs officials may result in NAFTA preferential tariff treatment being withdrawn from the goods to which those records apply.[35]

Similar record-keeping requirements are also imposed on exporters and producers under the EPRR.[36] Every exporter or producer of goods to a NAFTA country which claims NAFTA tariff rates must complete and sign a CO certifying the goods to be NAFTA originating.[37] When an exporter signs the CO, the exporter must retain all documents that relate to the following:

- the origin, purchase, importation, costs and value of the commercial goods;
- payment for the commercial goods;
- the usage to which the commercial goods are put in Canada; and

31. See section 2 of the Imported Goods Records Regulations (IGRR), and section 3 of the Exporters' and Producers' Regulations (EPRR), respectively.

32. Commercial goods are defined for the purposes of the IGRR and EPRR to include any good "for sale or for any industrial, occupational, commercial, institutional or other like use."

33. Customs Act, § 40(1).

34. IGRR, § 4. Section 5 of the IGRR provides that such records may be copied by any form of image processing process or machine that complies with the *National Standard of Canada, CAN/CGSB-72.11-93, Microfilm and Electronic Imaging as Documentary Evidence*, published by the Canadian General Standards Board; while section 6 of the IGRR provides that, as long as it can be related back to the source documents and is capable of producing accessible and readable copies, records may be stored on machine-sensible data media.

35. IGRR, §§ 7, 8.

36. Note that, unless otherwise stated, for the purposes of this section of the article *only*, reference to exporters and producers is to exporters and producers in Canada. Reference to exporters and producers elsewhere in this article, on the other hand, is to exporters and producers in either the United States or Mexico.

37. Customs Act, § 97.01(1).

- the exportation of the commercial goods[;]
- all records that relate to an application for, or receipt of, any advance ruling by the customs administration of a NAFTA country on the origin or marking of the commercial goods; and
- all written representations received from the producer of the commercial goods that state that the commercial goods meet the rules of origin set out in or contemplated by NAFTA.[38]

The above documents must be kept for six years from the date of exportation.

When a CO is signed by a producer, a producer must also retain for six years from the date that the CO is signed all records that relate to the production of a good, including its direct and indirect costs, such as through direct and indirect materials, that are incurred in producing a good.[39] Any documents relating to a previous advance ruling by the customs administration of a NAFTA country concerning the origin or the marking of the subject good or the materials or indirect materials used in production of the good also must be retained.[40]

Subject to the notification and consent procedures discussed below, all records must be made available for inspection by an officer conducting a verification visit, including the provision of making space available for that purpose.[41] The same provisions for copying and maintaining goods on a machine-sensible data media that apply to importers also apply to the records kept by exporters and producers in Canada.[42]

Finally, section 8 of the EPRR empowers U.S. and Mexican customs officials to request the inspection of all available records related to the claim of NAFTA origin tariff treatment. Failure by a Canadian exporter or producer to maintain or provide access to records that are relevant to determining whether a good is

38. EPRR, §§ 3, 4.

39. Section 2(1) of the NAFTA Rules of Origin Regulations (ROR) defines indirect materials as any good used in the production, testing, or inspection of a good, but which is not physically incorporated into the good, or any good which is used in the maintenance of a building or in the operation of equipment associated with the production of a good, including:

(a) fuel and energy,
(b) tools, dies and moulds,
(c) spare parts and materials used in the maintenance of equipment and buildings,
(d) lubricants, greases, compounding materials and other materials used in production or used to operate equipment and buildings,
(e) gloves, glasses, footwear, clothing, safety equipment and supplies,
(f) equipment, devices and supplies used for testing or inspecting the other goods,
(g) catalysts and solvents, and
(h) any other goods that are not incorporated into the good but the use of which the production of good can reasonably be demonstrated to be part of that production.

40. EPRR, § 5. Furthermore, article V:5 of the Uniform Regulations provides that when in the course of auditing a producer's records it is apparent that the producer has not maintained its records in accordance with the generally accepted accounting principles of its home NAFTA country, the said producer will be given 60 days in which to make the necessary adjustments to its records.

41. *See* UNIFORM REGULATIONS, *supra* note 24, art. V:3.

42. *See* EPRR, *supra* note 31, §§ 6, 7.

NAFTA originating may result in preferential tariff treatment being denied to the good exported from Canada.[43]

2. *Verification Audits*

The NAFTA Verification of Origin Regulations (VOR) allows for three types of verification audits: (i) verification letters;[44] (ii) verification questionnaires;[45] and (iii) verification visits.[46] The following subsections are divided into (i) the former two methods of audits—letters and questionnaires, and (ii) verification visits.

a. Verification Letters and Questionnaires—Desk Audits

Verification letters and questionnaires, often referred to as "desk audits" by Canadian customs officials, are the most common method of origin audits. For everyone involved in an origin audit process—from an exporter or producer to a customs official—wide use of desk audits is welcome in light of the tremendous expense and time-consuming nature of verification visits.

As noted, authority for verification letters and audits in Canada derives from article 506:1 of the NAFTA generally, and, more particularly, through both the Uniform Regulations and the VOR. A verification letter or questionnaire may be sent by either registered mail, by another method that produces a confirmation of receipt, or by regular mail.[47] A letter or questionnaire must specify:

(a) the identify of the customs administration of the officer sending the verification letter or verification questionnaire;
(b) a description of the goods that are the subject of the verification of origin or of the materials that are used in the production of those goods;[48] and
(c) the period within which the verification letter must be answered or the verification questionnaire must be completed and returned, which period, except in the case of a verification letter under section 12,[49] shall not be

43. *See* UNIFORM REGULATIONS, *supra* note 24, art. V:4; NAFTA VERIFICATION OF ORIGIN REGULATIONS § 15 [hereinafter VOR].

44. A verification letter refers to a request for information by Revenue Canada concerning the origin of a good that is the subject of a verification audit, VOR, *supra* note 43, § 2.

45. A verification questionnaire is similar to a verification letter, only that the former contains specific questions that are asked of exporters or producers generally. *Id.*

46. A verification visit refers to "the entry into a place or premises for the purposes of conducting a verification of origin of goods under paragraph 42.1(1)(a) of the [*Customs*] *Act*." *Id.*

47. *See* UNIFORM REGULATIONS, *supra* note 24, art. VI:15.

48. Although not required by law, Revenue Canada generally limits its audits to the period between the date it notifies an exporter or producer of its intent to conduct an audit and its final determination.

49. For example, a verification in respect of a producer of a motor vehicle who has elected to average its regional value content calculation over its fiscal year. In such a case, section 12 of the VOR provides that a customs officer may send a verification letter to the said producer requesting the submission of cost information that demonstrates the actual costs incurred in the production of the category of motor vehicles for which the election was made. The said motor vehicle producer must respond to the information request no later than the later of: (i) 180 days from the end of its fiscal year, or (i) 60 days from the date that the verification letter was sent. *See* VOR, *supra* note 43, § 12.

less than 30 days after the date on which the verification letter or the verification questionnaire was sent.[50]

Unless Revenue Canada already considers a particular good to be likely nonoriginating, an initial information request is fairly innocuous. Furthermore, assuming that Revenue Canada is satisfied with the information provided, no additional information will be requested (note that when a producer or exporter fails to respond to an initial request, Revenue Canada is obligated to follow-up the initial letter or questionnaire with a subsequent one)[51] and the producer or exporter may continue to claim preferential tariff treatment for its subject good.

Somewhat different from the United States, which, apparently, relies most heavily upon verification letters for conducting desk audits, Revenue Canada prefers verification questionnaires. Except when Revenue Canada already suspects the merits of a claim to be of NAFTA originating status, the first questionnaire sent to a producer or exporter (or both) is basic. The composition and structure of the initial verification questionnaire was agreed to jointly by the Parties to the NAFTA pursuant to article VI:9 of the Uniform Regulations, and annex VI.9(1) thereto.

The verification questionnaire may be sent to an exporter or producer of a good, and/or to a supplier of materials used in the production of a good. Ultimately, Revenue Canada may send a questionnaire to any person who can help in substantiating the origin of a good. The said verification questionnaire requires that the following information be provided to Revenue Canada:

- the production process;
- a list of the nonoriginating materials or materials of unknown origin (*i.e.*, all unknown materials may be treated as nonoriginating by Revenue Canada), and their corresponding six-digit or eight-digit Harmonized System Number (HS),[52] and the same for originating materials or components (intermediate materials that qualify as originating may be included in this figure). With respect to the latter, an exporter or producer must also provide the basis for its claim that a good qualifies as originating;
- a statement as to the type of information used in determining that the subject good is NAFTA originating; and
- additional questions to be answered by checking a yes or no box concerning, among other things: any previous classification rulings; whether the de minimis provisions of article 405 of the NAFTA were used; whether any of the materials qualified as originating under the rules respecting fungible materials in article 406 of the NAFTA; whether the sale was to a person

50. VOR, *supra* note 43, § 11.

51. *See* VOR, *supra* note 43, § 13; UNIFORM REGULATIONS, *supra* note 24, art. VI:16(a).

52. For a good explanation of the HS from a Canadian perspective, see: David M. Attwater, *The General Rules for the Interpretation of the Harmonized Commodity Description and Coding System from a Canadian Perspective*, 30 INT'L LAW. 757 (1996).

at arm's length; and whether a RVC calculation was used and, if so, whether the transaction value method or net cost method was used. The response to these yes or no questions impacts whether and what type of further questions will be elicited from a producer or exporter.[53]

Once completed, the verification questionnaire must be signed by someone with knowledge of the information being attested to[54] and with authority to sign the document on behalf of the addressee.

As mentioned, failure to respond to an information request will not automatically lead to preferential tariff treatment being withdrawn or denied.[55] Pursuant to section 13 of the VOR, Revenue Canada must send a subsequent letter or questionnaire to the exporter or producer. An exporter or producer that receives a subsequent verification letter or questionnaire has thirty days (either from the date it was received when it is sent by a method that procures a confirmation of receipt, or from the date it was sent when any other method is used)[56] in which to complete the information and return it to Revenue Canada. Failure to respond to a subsequent information request, unlike the initial one, may result in the denial of preferential tariff treatment.[57]

According to annex VI.9(3) of the Uniform Regulations, the customs administration of a Party "may send a more specific questionnaire, according to the

53. A copy of the questionnaire is on file with both the authors and *The International Lawyer* Editorial Office, Southern Methodist University School of Law, P.O. Box 750116, 3315 Daniel Avenue, Dallas, TX 75275-0116.

54. When a producer or exporter claims a good to be originating but is unable to substantiate such a claim for "reasons beyond [its] control," in determining how to treat that good Revenue Canada must take into account a host of enumerated factors, such as whether there is enough evidence to make a determination, any past advance rulings, and so forth. Similarly, when a person that supplied a material used in production of a good claims the material to be originating but is unable to substantiate that claim, or when in listing a value for a material for the purposes of determining the regional content value of a good there is no evidence in which to confirm its accuracy, when such a lack of evidence is due to "reasons beyond [its] control," once again, Revenue Canada must take into account a number of enumerated factors when determining how to treat the subject material. ROR, *supra* note 39, § 15.

55. This is true despite the fact that article VI:16(b) of the Uniform Regulations provides that a subsequent verification letter or questionnaire may be accompanied by a letter of intent to withdraw the NAFTA preferential tariff rate over the good that is the subject of the verification. This is so because paragraph 17 of article VI of the Uniform Regulations provides that the exporter or importer who has received such a letter of intent has 30 days in which to respond, which as discussed below, mirrors the time that is required to submit any subsequent letter or questionnaire. However, by not initially responding to an information request, in addition to sparking the ire and suspicion of Revenue Canada, it speeds up the process of revoking preferential tariff treatment by 30 days, though, in itself, does not result in the loss of preferential tariff treatment. UNIFORM REGULATIONS, *supra* note 24, art. VI:16(b).

56. A subsequent verification letter or questionnaire must be sent by a method that produces a confirmation of receipt if requested by an exporter's or producer's customs administration. *See* UNIFORM REGULATIONS, *supra* note 24, art. VI:16(a)(i).

57. As discussed *infra*, even when a notice of intention to withdraw preferential tariff treatment is provided, article VI:19(a) requires, *inter alia*, that a person subject to such a revocation must be entitled to provide Revenue Canada with further information.

information required to determine whether the good that is the subject of the verification is an originating good." In this regard, Canada designed and often uses five types of highly specific and comprehensive questionnaires that vary depending on the nature of the claim to NAFTA originating status: (1) goods wholly obtained or produced entirely in the territory of one or more of the parties; (2) goods produced entirely in the territory of one or more of the parties exclusively from originating materials; (3) tariff change; (4) regional value content—transaction value method; and (5) regional value content—net cost method. In addition to the questions and information required under such questionnaires, Revenue Canada is free to ask any supplementary questions it deems necessary in order to make a determination.[58] The various questionnaires are briefly examined in sequential order below.

b. Goods Wholly Obtained or Produced Entirely in the Territory of One or More of the Parties[59]

When NAFTA preferential tariff treatment is claimed on the basis that a good is "wholly obtained or produced entirely in the territory of one or more of the parties," Revenue Canada may provide a producer or exporter with a further questionnaire designed specifically for such goods. The questionnaire seeks to ensure that the good, and the materials used in producing that good, meet the exhaustive definition of "goods wholly obtained or produced entirely in the territory of one or more of the parties" provided both by article 415 of the NAFTA and section 4(1) of the Uniform Regulations. Accordingly, field 3 of the questionnaire requires an exporter or producer to provide a detailed description of the good being exported to Canada, while field 8 requires that all of the materials used in the production of the good, as well as the identity and address of suppliers, be provided.

In addition to the above, the said questionnaire requires that information as to the identity of the exporter and, when different from the exporter, the producer, the HS number (Canadian) to six digits, and detailed information with respect to the production process of the good, be provided. The questionnaire must be signed and dated and, thereafter, sent to Revenue Canada within the requisite period of time.

c. Goods Produced Entirely in the Territory of One or More of the Parties Exclusively from Originating Materials[60]

Similar to the previous questionnaire, the verification questionnaire under this category is also straightforward. The aim is simply to ensure that a good claimed

58. UNIFORM REGULATIONS, *supra* note 24, art. VI:19(a), annex VI.9(5).

59. A copy of the questionnaire is on file with both the authors and *The International Lawyer* Editorial Offices, Southern Methodist University School of Law, P.O. Box 750116, 3315 Daniel Avenue, Dallas, TX 75275-0116.

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as NAFTA originating in fact complies with the origin requirements in chapter four of the NAFTA. Thus, the verification questionnaire requires information respecting the production process, HS number, and identity of the exporter and, when different, the producer.

d. Tariff Change[61]

The NAFTA treats certain nonoriginating goods as NAFTA originating when they are subjected to a sufficient degree of processing in a NAFTA Party so as to undergo an enumerated tariff classification change pursuant to annex 401 of the NAFTA. This is known as a tariff classification change or switch. The one caveat to claiming a good as NAFTA originating on the basis of a tariff classification change is that, other than when there is a de minimis quantity of nonoriginating materials present,[62] all nonoriginating materials must undergo the prescribed switch.[63] Accordingly, the tariff change verification questionnaire is divided into two sections: section A, which requires a producer or exporter to outline the applicable tariff classification change; and section B, which covers nonoriginating materials that, as a whole, qualify as de minimis under article 405 of the NAFTA.

The first entries in section A pertain to the identity of the producer, the name and tariff classification of the good, and a description of the good. The next section, and the one particularly relevant to this verification questionnaire, requires the Party completing the questionnaire to list and describe (the questionnaire entreats entrants to describe their goods with as much specificity as is possible in order to assist Revenue Canada) all nonoriginating materials or materials of unknown origin in descending order of importance. This list must be accompanied by the identity of the supplier of the material, the relevant tariff classification number of the material, and confirmation (*i.e.*, by checking the yes box appropriately) that the subject material has undergone the necessary tariff

61. A copy of the questionnaire is on file with both the authors and *The International Lawyer* Editorial Offices, Southern Methodist University School of Law, P.O. Box 750116, 3315 Daniel Avenue, Dallas, TX 75275-0116.

62. In order for a good that consists of some amount of nonoriginating materials to qualify as NAFTA originating, the total value of all nonoriginating materials that do not undergo the applicable tariff classification change must not be more than 7% (or 9% for a good classified under heading No. 24.02 of the HS; *e.g.*, cigars, cigarettes, and tobacco substitutes) of the transaction value of the good, adjusted to an F.O.B. basis, or, when the transaction value is not available or acceptable under subsections 2(1) or (2) of schedule III of the ROR, respectively, of the total cost of the good. Note, however, that the de minimis provisions do not apply to certain goods enumerated in annex 401 to the NAFTA. Although of purely interest sake, the recently signed Canada-Chile Free Trade Agreement (CCFTA), which is expected to enter into force on June 2, 1997, provides an accepted de minimis level of 9%, and applies more broadly than the de minimis provision of the NAFTA since many of the exclusions against using the de minimis rule provided in the NAFTA are absent from the CCFTA.

63. For the purposes of determining whether a good qualifies as NAFTA originating on the basis of the tariff classification method, indirect materials, packaging materials and containers for retail sale, and packaging materials and containers for shipment are not considered. NAFTA, *supra* note 1, arts. 408-10, and as incorporated into Canadian law, ROR, *supra* note 27, pt. IV, §§ 7(11)-15.

classification change. Additionally, action A requires that a description be given of both the production process[64] and all originating materials (in descending order of importance and, if applicable, accompanied by the identity of the person who supplied the material),[65] as well as a statement as to whether there was a previous advance ruling concerning such materials and/or whether the accumulation provisions of the NAFTA are being relied upon.

Section B, concerning the de minimis quantity of nonoriginating materials in a good, must be completed only when a nonoriginating material is present after the applicable tariff classification switch was made. Similar to section A, the top portion of section B requires the name and address of the producer, as well as the name of the good, its applicable tariff classification number and, to the extent possible, a thorough description of the good. After recording this information, space is provided in order to record the de minimis calculation.[66]

Finally, both sections A and B must be signed and dated, certifying that the information is true and accurate.

e. Regional Value Content—Transaction Value Method[67]

Pursuant to annex 401 of the NAFTA, certain goods must consist of a minimum RVC. Simply stated, this means that certain goods may qualify as NAFTA originating on the basis that, through some level of origin materials and/or processing in a NAFTA Party, such goods have a requisite connection to or content of a NAFTA Party. As the amount is expressed in terms of a percentage, a good may satisfy a RVC requirement when a requisite minimum percent of its value derives from the territory of a NAFTA Party.

The NAFTA prescribes two methods for calculating RVC: (i) the transaction value (TV) method and (ii) the net cost (NC) method. When the TV method is used, a good must have at least 60 percent RVC, while under the NC method, 50 percent is required for establishing RVC. The difference in the requisite minimum percentage rates reflects the fact that under the TV method a producer

64. The description should include the sequence of producing the good and the country in which that process was conducted. Also, according to the explanatory notes to the verification questionnaire, the person completing the questionnaire should indicate each time that the good crossed the U.S.-Mexico border and its customs value as provided in section 2 of the ROR (*i.e.*, for Mexico, the valor en aduana as determined in accordance with the Ley Aduanera, converted to Mexican currency, and for the United States, the value determined by U.S. Customs Service in accordance with section 402 of the Tariff Act of 1930, as amended, converted to U.S. currency) at that particular stage in its production. If available, a copy of the U.S. or Mexican customs document should be attached to the questionnaire.

65. When an exporter or producer relies on any representations by a supplier as to the origin of a material, the exporter or producer should obtain a written statement to that effect from the supplier. This statement must be retained for six years.

66. Reference to monetary values must be in a consistent currency, regardless of whether it be in Canadian or U.S. dollars or Mexican pesos.

67. A copy of the questionnaire is on file with both the authors and *The International Lawyer* Editorial Offices, Southern Methodist University School of Law, P.O. Box 750116, 3315 Daniel Avenue, Dallas, TX 75275-0116.

can include all of its costs and profits as though such costs and profits occurred in a NAFTA Party. While an exporter or producer is free to use either method,[68] the one caveat is that in certain cases enumerated under section 6(6) of the ROR only the NC method may be used for calculating RVC.

When NAFTA originating status is claimed on the basis that, through the TV method, a good meets the minimum RVC requirement, Revenue Canada may require an exporter or producer to complete a questionnaire entitled "regional value content—transaction value method." Unlike the questionnaires already discussed, this one is much more complex, comprehensive, and, for a lack of a better term, onerous. This questionnaire is divided into the following three sections: (A) Transaction Value Method; (B) Intermediate Material; and (C) De Minimis Calculation.

Section A must be completed whenever the TV method is employed in order to satisfy a RVC requirement. This section consists of four questionnaires that essentially include two groups:[69] the first such group consists of three questionnaires that pertain to the actual calculation of TV, while the second group consists of a single questionnaire requiring background information.[70]

The three questionnaires concerning the calculation of the TV are divided on the basis of: (i) the "transaction value of the good," (ii) the "value of materials," and (iii) a "summary" of the two preceding questionnaires. After completing the general information at the top of each questionnaire, an exporter or producer must identify the subject good and its HS number. Following this entry, an exporter or producer must enter the amount paid or payable plus any additions not in the price paid or payable (such as selling commissions and brokerage fees, packing costs, royalty and license fees, and so forth), and then subtract any deductions (such as duties and taxes paid in the country in which the buyer is located with respect to the construction, erection and assembly, maintenance, and so forth related to the good after it has been sold to the buyer) from that amount. The amount derived from the above calculation must then be carried forward to the "summary" questionnaire in order to be recorded in the box concerning the TV of the good.

Once the TV of the good is calculated, the next step is to complete the questionnaire specific to materials. This questionnaire requires that the following be listed: each material and, when nonoriginating material or materials of unknown origin (*i.e.*, that are treated as nonoriginating) are used, its tariff classification number; the name and address of the supplier; whether the material has undergone an

68. ROR, *supra* note 27, § 6(1).

69. Reference here to four questionnaires is only for the purposes of explanation and illustration. In reality, Canadian customs officials refer to the questionnaire as being a single questionnaire.

70. Such background information includes the following: whether fungible materials are used and, if so, the inventory management method employed, the method for costing materials, whether the transaction was at arm's length, whether there was an advance ruling with respect to the good, past sales, and so forth.

appropriate tariff classification switch; and its unit value (which is recorded on the basis of whether, essentially, it is originating or nonoriginating).[71] Additionally, the value of any intermediate material claimed must be carried over to this questionnaire.

The total value derived must be carried forward to the "summary" questionnaire. The "summary" questionnaire then requires an exporter or producer to calculate the RVC of the good, which is the TV minus the total value of the nonoriginating goods, divided by the TV and then multiplied by 100. Provided that the calculation results in an amount equal to or greater than sixty, a good qualifies for RVC on the basis of the TV method.

Section B, which is made up of three questionnaires, applies whenever a producer designates any self-produced material that is incorporated in a good, and which otherwise qualifies as an originating material under the ROR,[72] as an intermediate good. If, however, the intermediate material is subject to an RVC requirement, a producer may not designate any other self-produced material that is subject to a RVC requirement as an intermediate material.[73] The RVC of an intermediate material is calculated on the basis of the NC method.

The first questionnaire in section B concerns the "value of materials." This questionnaire is identical to its sister questionnaire in section A under the same title. After performing a calculation similar to the one under its sister questionnaire, the amount appearing under "total intermediate material" must be carried over to the appropriate box in the third questionnaire (summary). Following this step, in accordance with subsections 6(11) through (13) of the ROR, the second questionnaire, entitled "net cost of the good," requires an exporter or producer to calculate the value of a good on the basis of the NC method. Again, the specific requirements for this calculation are provided in the instructions to "Step 3, section B" of the questionnaire (also see the explanation of the final type of questionnaire below). Once the net cost of a good is calculated, that amount must be carried over to the "summary" questionnaire in order to determine the RVC.

Finally, section C must be completed when originating status is claimed despite the existence of a de minimis amount of nonoriginating materials. This questionnaire is identical to the one concerning a claim based on de minimis in section

71. See the definition of value of a material in step 3 of the instructions to completing section A of this questionnaire.

72. ROR, *supra* note 27, § 7(5)(a). The designation of a self-produced material as an intermediate material is solely at the discretion of the producer of that material. Also, only the producer of the material is entitled to claim it as an intermediate material. However, pursuant to section 7(8), when a producer designates a self-produced material as an intermediate material and later it is determined that the material does not qualify as originating under the ROR, provided that the producer has not yet been formally notified of such in writing, the producer may rescind its election of the material as an intermediate material. Any such rescission is without prejudice to the producer's right of review and appeal of the determination of the origin of the subject material. *Id.* § 7(9).

73. *Id.* § 7(10)(c).

B of the "Tariff Change" questionnaire. The questionnaire must be signed and dated in order to certify the truth and accuracy of its content.

f. Regional Value Content—Net Cost Method[74]

A producer or exporter may elect to use the NC method rather than the TV method for calculating RVC. Essentially, this method determines RVC as a percent of the net cost to produce a subject good. The NC method may be used, for example, when it: (i) results in a more favorable percent rate than possible under the TV method, or (ii) when section 6(6) of the ROR provides that the TV method may not be used, or (iii) following an unfavorable verification of a TV calculation, an exporter or producer may elect to claim NAFTA originating status through the NC method.[75] For the most part, the "regional value content—net cost method" questionnaire is identical to the one above concerning the TV method, including being divided into three sections. As a result of such similarity, the "regional value content—net cost method" questionnaire is only reviewed in brief below.

The first step in completing the questionnaire is to record all of the basics, including the name, address, and telephone number of the producer; the name and appropriate tariff classification of the subject good; and the period that the questionnaire covers. Following this, the questionnaire requires that a producer or exporter calculate the total value of originating and nonoriginating material, as well as materials of unknown origin, that were used in the production of a subject good. This questionnaire is identical to the one used for calculating the value of materials in the questionnaire for the TV method (section (A) of that questionnaire).

Once the value of materials has been determined and carried over to the "summary" questionnaire, the next step is to calculate the net cost of the good. This questionnaire is identical to the one in section (B) of the "regional content—transaction value method" questionnaire concerning intermediate materials. Accordingly, other than the costs associated with the value of the materials, which are included in the previous questionnaire, an exporter or producer must list all of the costs, originating and nonoriginating, of producing the good, minus sales promotions, marketing and after-sales service costs, royalties, shipping and packing, and nonallowable interest costs that are included in the total cost.[76] This amount is then carried forward to the "summary" questionnaire and, with the

74. A copy of the questionnaire is on file with both the authors and *The International Lawyer* Editorial Offices, Southern Methodist University School of Law, P.O. Box 750116, 3315 Daniel Avenue, Dallas, TX 75275-0116.

75. ROR, *supra* note 27, § 6(7). The same right of re-election is not available when the NC method is used. *Id.*

76. A producer may elect from among three methods for calculating the net cost of a good. ROR, *supra* note 27, § 6(11).

calculations made for the value of the other materials, the RVC must be determined.

In addition to determining the net cost of the good, which must be used in every case that the NC method is used, this questionnaire also includes separate questionnaires that cover both intermediate materials and a claim of NAFTA origin status on the basis of a de minimis calculation. As these questionnaires were already mentioned with respect to the TV method, they are not discussed further here. Once the questionnaire is completed, it must be signed in order to confirm and certify its accuracy.

g. Verification Visits—Site Verification

In addition to, or in lieu of, a desk audit, NAFTA article 506(1)(b) provides that the customs administration of a Party may conduct a verification at the premises of a producer or exporter in the territory of another Party. A verification visit, commonly referred to as a site verification by Canadian customs officials, can be for the purpose of reviewing the relevant documents pertaining to a claim of NAFTA originating status, as discussed *supra*, and/or to observe the facilities used in the production of a subject good. In accordance with the intrusive nature of site verifications, not to mention the related costs, time, and disruption incurred by exporters and producers, the Uniform Regulations generally, and the VOR specifically, establish a host of procedural requirements and safeguards governing the conduct of such visits.

Verification audits are performed by the customs administration of a Party in the territory of another Party. It is one thing for a desk audit to be sent to an exporter or producer in the territory of another country; it is quite another thing, however, for the customs administration of another party to actually show up at the door of an exporter or producer in that exporter's or producer's country. Yet, this is precisely what the NAFTA permits.[77]

Pursuant to section 4 of the VOR, Revenue Canada may visit the premises of an exporter or producer, or a producer or supplier of a material used in the production of a subject good, in either Mexico or the United States.[78] Other than making certain changes to formally include producers and suppliers of materials,

77. Since the customs administration of one Party does not have jurisdiction over an exporter or producer in the territory of another Party, each Party must permit—in law—the customs administration of the other Party to enter into its territory. The NAFTA is the vehicle under which such authority was granted. However, as noted, the limits to such jurisdiction must not be lost. For example, when Canada determines that a producer or an exporter in Mexico or the United States has fraudulently claimed a good to be NAFTA originating, Canada cannot, other than by denying preferential tariff treatment over such goods, sanction that exporter or producer. Instead, Canada's only remedy is to inform the exporter's or producer's customs administration, who are left to investigate the matter further.

78. Most of the provisions of the NAFTA, such as nominating an observer and allowing for the temporary postponement of a verification visit on the request of the customs administration in whose territory the visit will be conducted, are brought forward into the Canadian regulations.

the VOR imposes the same notification requirements prescribed by the NAFTA.[79] As well, a verification visit may only be conducted after Revenue Canada has received the consent of the person whose premises are being audited.[80] Failure to provide consent within thirty days of receipt of notice may result in NAFTA preferential treatment being withdrawn from the goods that were the subject of the visit.[81]

Verification visits are not generally used by Revenue Canada as a first resort. The reason for this is obvious. Site verifications are costly and disruptive. However, when Revenue Canada is suspicious of a claim of NAFTA origin status, or is not completely satisfied with the information it has received through a desk audit, it may visit the premises of an exporter, producer, and/or supplier of materials used in production of a subject good.[82] Unlike the United States who, since 1994, has sharply increased the number of its verification visits in Canada, the number of visits by Revenue Canada to the premises of exporters, producers, and suppliers of materials in the United States during that same period has remained relatively constant and minimal.[83] The difference in the number of verification audits through on-site visits by Canadian and U.S. customs authorities in the other's territory is demonstrated graphically in Appendix A of this article. The wide variance in the numbers is somewhat surprising. One possible explanation, however, may be that, whereas visits by U.S. customs officials tend to occur over two or three short days, a site verification visit by Revenue Canada can take upwards of two or three weeks. Thus, since Revenue Canada's visits are much more comprehensive, Revenue Canada tends to be less liberal in its decision to pursue this avenue of origin verification.

III. Enforcement and Penalties

Once an origin verification audit has been completed, Revenue Canada must consider the evidence and determine: (i) whether it requires more information in order to render a decision or (ii) whether it should accept or deny a claim for NAFTA preferential tariff treatment. In the event of the latter, the NAFTA, and the regulations thereto, requires Revenue Canada to notify the appropriate parties of its decision and, when the decision results in an increase in the customs duties

79. VOR, *supra* note 26, § 5. See the discussion of verification visits in section II(a) of this article.

80. Notice of a proposed verification visit must be sent by registered mail or some other manner that procures a receipt of service. UNIFORM REGULATIONS, *supra* note 24, art. VI, § 4.

81. VOR, *supra* note 26, § 114. Also, section 42.1(1) of the Customs Act provides that, when consent is not provided by an exporter or producer within the prescribed time, preferential tariff treatment may be withdrawn.

82. In truth, however, neither the NAFTA nor the Uniform Regulations prescribe a minimum threshold requirement for conducting a site verification. A decision to conduct a visit, therefore, may be in practice subject to arbitrariness and unpredictability.

83. The authors made this comparison using computer record information provided to them by Revenue Canada officials.

owed, provide a right of redetermination and, ultimately, an appeal. This section briefly examines such requirements under Canadian law.

A. Duty to Inform

Article 506:9 of the NAFTA provides that when a determination is made concerning whether a subject good qualifies as NAFTA originating, and thus entitled to preferential tariff treatment, the customs authority must inform the exporter or producer whose good was the subject of the visit of its decision. This requirement has been incorporated into Canadian law pursuant to section 42.2(2) of the Customs Act. Accordingly, once Revenue Canada completes its origin verification and makes its determination, the responsible customs officer must provide the exporter or producer with a statement as to whether the good qualifies for NAFTA preferential tariff treatment. Such notice must set out any findings of fact or law on which the customs officer's decision was based.[84]

When Revenue Canada decides to grant preferential tariff treatment to a subject good, the exporter or producer may continue to claim its good as NAFTA originating, while the importer can continue to pay duties (if any) on that basis. When, on the other hand, Revenue Canada decides to deny preferential tariff treatment for the goods that were the subject of an audit, Revenue Canada must comply with a number of procedural requirements before it may implement its decision. These requirements, and the resulting rights accorded both to importers and to exporters and producers, are discussed below.

B. Denial of NAFTA Preferential Tariff Treatment

A Party cannot compel a producer or exporter of another Party to undergo a NAFTA verification.[85] To begin with, other than through the NAFTA verification procedures, a Party does not have jurisdiction over a national of another Party. Thus, for example, when Revenue Canada believes that an exporter or producer has fraudulently claimed a good as being NAFTA originating, the only recourse that Revenue Canada has against that exporter or producer is to inform the latter's customs administration authority. The only direct recourse against an exporter or producer in such a case is to withdraw or deny NAFTA preferential tariff treatment from the subject good.

Revenue Canada may deny NAFTA preferential tariff treatment when: (i) an exporter or producer fails to respond to a (subsequent) desk audit or does not consent to a site visit;[86] (ii) either refuses to provide access to its records in a manner sufficient to allow Revenue Canada an opportunity to make a determina-

84. Customs Act, § 42.2(3).

85. Of course, this does not apply to an importer who can be required to (i) submit to a verification visit, and/or (ii) open its books and records to Revenue Canada. Customs Act, §§ 42-43.

86. VOR, *supra* note 26, §§ 16, 14; Customs Act, § 42.1(2).

tion or does not maintain its records in accordance with the GAAP of its home country;[87] or (iii) upon an audit, Revenue Canada determines that the subject good does not qualify as NAFTA originating (or possibly that additional duties are required as a result of the good being improperly classified).[88] Under such circumstances, if Revenue Canada decides to deny preferential tariff treatment to a good that is the subject of an audit, Revenue Canada must provide notice of its intent.[89]

Furthermore, pursuant to section 17(1) of the VOR, the notice above must also include a statement informing the exporter or producer of the custom officer's intent to redetermine the origin of the good under section 61 of the Customs Act and to afford an exporter or producer an opportunity to make comments and to provide additional information. Additionally, the notice must provide the date in which the preferential tariff treatment will be withdrawn or denied, and the period in which the producer or exporter may submit its response.[90]

On the basis of an initial determination, and any additional information supplied to the customs officer, a final determination of the origin of the goods must be rendered.[91] When a customs officer holds that a good is not eligible for NAFTA preferential tariff treatment, that decision may not take effect until proper notice of the decision is provided both to the importer and to the person who completed the CO.[92]

Furthermore, an importer or person who completed a CO must be given up to ninety days in which to establish that, in claiming NAFTA originating status for the subject good, it: (i) relied upon an advance ruling pursuant to article 509 of the NAFTA, or other ruling under article 506(12) of the NAFTA; or (ii) relied in good faith to its detriment upon consistent treatment[93] accorded to the subject

87. VOR, *supra* note 26, § 15.

88. Customs Act, § 42.2. Additionally, pursuant to section 42.4(2) of the Customs Act, Revenue Canada, under the authority of the Minister, may deny or withdraw preferential tariff treatment to identical goods (as defined under article 514 of the NAFTA) when the exporter or producer made false representations that the identical goods exported to Canada are entitled to NAFTA preferential tariff treatment.

89. UNIFORM REGULATIONS, *supra* note 24, § 20(b).

90. According to Revenue Canada's Memorandum D11-4-20, when the statement is sent to an exporter or producer in Mexico, the notice must be sent in a manner that provides a confirmation of receipt and the period given thereafter to respond must be at least 30 days; while, when a statement is provided to an exporter or producer in the United States, the said exporter or producer must be given at least 30 days in which to respond from the date that the notice was sent. Revenue Canada, Memorandum D11-4-20, March 3, 1994, at 18.

91. Customs Act, §§ 57.1, 61.

92. Customs Act, § 42.3(1).

93. According to VI:22 of the Uniform Regulations, consistent treatment for the purpose of NAFTA article 506(12) means:

> [T]he established application by the customs administration of a Party that can be substantiated by the continued acceptance by that customs administration of the tariff classification or value of identical materials on importations of the materials into its territory by the same importer over a period of not less than two years immediately prior to the date that the Certificate of Origin for the good that is the subject of the

good by the NAFTA Party from which the good was exported. Following this period, preferential tariff treatment may be denied or withdrawn. Under such circumstances, the only recourse available to an importer or to a person who completed the CO is to invoke the redetermination provisions of the Customs Act.

C. Redetermination and Appeal

The first level of redetermination available to an importer or person who has completed a CO is to make a request to a designated customs officer. Pursuant to sections 57.1(3.2) and 60 of the Customs Act, a person has ninety days in which to request a review and further redetermination of the origin of the goods. This period can be extended to two years when the Minister deems it advisable. The documentation that must accompany such a request is outlined in Appendix B to Revenue Canada's Memorandum D-11-6-4. The requesting Party should, for example, provide: "(a) descriptive illustrations, literature, samples, drawings, or catalogues specifically relating to the goods that are the subject of the request; (b) supporting documentation such as end-use certificates, National Customs Rulings, Certificates of Origin, special authority applications and relevant file numbers, information on the end product into which the commodity in question is to be incorporated when end use of goods is a factor;" and so forth.[94] Following receipt of such information, the designated officer must, "with all due dispatch," render a decision[95] and, thereafter, notify the person who made the redetermination request. An importer has ninety days in which to pay any additional duties and interest owed, including the Goods and Services Tax, or, when an appeal is made to the Deputy Minister under section 63 of the Customs Act, to post security.[96]

When a person "deems himself aggrieved by a decision of the Deputy Minister made pursuant to section 63 or 64," the Deputy Minister's redetermination decision may be appealed to the CITT.[97] An appeal of the Deputy Minister's decision must be made within ninety days from the date of receipt of the Deputy Minister's decision. Notice of an appeal must be given both to the Deputy Minister and to the Secretary of the CITT. Upon receiving a request to convene a hearing, the

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determination under article 506(1) was completed, provided that with respect to those importations:

(a) such materials had not been accorded a different tariff classification or value by one or more district, regional or local offices of that customs administration on the date of such determination; and

(b) the tariff classification or value of such materials is not the subject of a verification, review or appeal by that customs administration on the date of such determination.

94. Revenue Canada, Memorandum D11-6-4 (June 6, 1995).
95. Customs Act, § 60(3).
96. *Id.* § 62.
97. *Id.* § 67.

Secretariat must publish notice of the hearing in the *Canada Gazette* at least twenty-one days before the matter is to be heard. The CITT must permit anyone who enters an appearance with the CITT on or before the day of the hearing to appear before the CITT on that matter.

The final stage of appeal is to the Federal Court. Accordingly, within ninety days of the CITT's decision, any person who appeared before the CITT, the person that requested the appeal under section 67 of the Customs Act, or the Deputy Minister may seek leave of a justice of the Federal Court to appeal the CITT's decision.[98] Any such appeal must be restricted to questions of law. The Federal Court may, thereafter, make any finding or order or refer the matter back to the CITT for a rehearing. At the date of publication, a Notice of Ways and Means Motion had been tabled that would extend the period for making redeterminations to four years and streamline the levels of appeal.[99]

D. Refunds

Although not neatly falling within the general heading of this section, namely, "Enforcement and Penalties," it is prudent to make mention here of section 74 of the Customs Act. Section 74(1) permits the Minister to grant a refund on all or part of the duties paid when: (i) the imported goods have suffered damage, destruction, or deterioration between the time they arrived in Canada and the time they were released; (ii) the quantity of the good released is less than that for which duties were paid; (iii) the goods are of a quality inferior than that to which duties were claimed; or (iv) preferential tariff treatment was either not claimed or duties were overpaid.

In terms of the last noted category, section 74(1)(c.1) specifically provides that the Minister may grant a refund to an importer who imported goods from a NAFTA country but failed to claim preferential tariff treatment, while subparagraph (c.2) of that section allows for a refund when duties are overpaid. It should be noted, however, that the refund provision does not apply to an overpayment of duties when such overpayment is a result of an erroneous origin determination, tariff classification, or appraisal of value for duty. In such a case, an importer must invoke the redetermination provisions mentioned in subsection III(c) of this article.

A request for a refund must be submitted in writing and must include any evidence necessary to support the application. As well, Revenue Canada must be afforded an opportunity to examine the goods in order to verify the claim. Interestingly, section 72 establishes two time limitation periods based on the

98. *Id.* § 68.

99. Notice of Ways and Means Motion respecting the importation of duties and other taxes, tabled on October 7, 1997.

nature of the application. When a request for a refund is on the basis that the goods were imported from a NAFTA country, but which preferential tariff treatment was not claimed (under section 71(1)(c.1)), the request must be submitted within one year.[100] In all other cases in which a refund may be claimed, including when duties were overpaid on goods arriving from a NAFTA Party, a request for a refund may be made within two years.[101]

E. Enforcement Mechanisms and Penalties

Generally, there are two main enforcement mechanisms available to Revenue Canada: (i) it can redetermine the origin of goods and assess additional duties when a NAFTA preferential rate is denied or (ii) it can deny NAFTA preferential tariff treatment on an ongoing basis. Both options are discussed below.

Requests for redetermination of origin were already canvassed in subsection III(c). Such a right is also available to Revenue Canada. Accordingly, pursuant to section 61 of the Customs Act, a customs officer, as of right within ninety days of the importation, and within two years when deemed advisable, may redetermine the origin of a good to which NAFTA preferential tariff treatment was claimed.[102] The general rights of appeal described above also apply to a redetermination made on Revenue Canada's initiative.[103]

Another drastic measure available to Revenue Canada is to deny NAFTA preferential treatment on future shipments. Paragraph 10 of NAFTA article 506 provides that:

> [w]here verifications by a Party indicate *a pattern of conduct* by an exporter or a producer of false or unsupported representations that a good imported into its territory qualifies as an originating good, the Party may withhold preferential tariff treatment to identical goods exported produced by such person until that person establishes compliance with Chapter Four (Rules of Origin).[104]

This provision essentially allows Revenue Canada to reverse the presumption that a good is originating, subject to a verification audit, and instead requires an exporter or producer to establish that its identical goods, as defined under article 514 of the NAFTA, do in fact qualify as NAFTA originating. To date, this provision of the NAFTA has not been invoked often by Revenue Canada. One reason for such limited use may be that, in reality, it is often difficult to establish whether a subject good qualifies as being an identical good (*i.e.*, must be "the same in all respect, including physical characteristics, quality and reputation . . .") to goods previously imported.

100. Customs Act, § 74(3)(b)(i).

101. Customs Act, § 74(3)(b)(ii).

102. Pursuant to section 57(3.1), sections 58 to 72 apply to goods for which NAFTA preferential treatment under NAFTA is claimed.

103. Customs Act, § 63.

104. (Emphasis added).

As well, Revenue Canada is still contemplating what it will consider to constitute a pattern of conduct. Some aid in this determination, however, is provided in section VI:21 of the Uniform Regulations, whereby the phrase pattern of conduct is defined as:

> [R]epeated instances of false or unsupported representations by an exporter or producer of a good in the territory of a Party that are established by the customs administration of another Party on the basis of not fewer than two origin verifications of two or more importations of the goods that result in not fewer than two written determinations being sent to that exporter or producer pursuant to article 506(9) that conclude, as a finding of fact, that Certificates of Origin completed by that exporter producer with respect to identical goods contain false or unsupported representation.

Considering the infancy of the NAFTA generally, and verification audits specifically, Revenue Canada is still mapping out how it will use the pattern of conduct provisions of the NAFTA.

Other than through a denial of NAFTA preferential tariff treatment, Revenue Canada does not have jurisdiction to formally prosecute and sanction exporters and producers in the territory of Mexico or the United States. When Revenue Canada suspects that a fraud has been committed, its power is restricted to referring the matter to the exporter's or producer's own customs authority. Furthermore, a finding that a good does not qualify as NAFTA originating may be an honest though mistaken belief as to the proper tariff classification or value of a good (or materials used in a good). As a result, the main penalty prescribed under NAFTA article 506, and the Canadian legislation and regulations thereto, is to withdraw or deny preferential tariff treatment to the subject good. Of course, in many instances this may result in substantial costs to an importer.

Notwithstanding the above, when an exporter or producer has a history of claiming NAFTA originating status for identical goods that in fact are not NAFTA originating, or when an offense is committed by a Canadian importer, additional penalties than those mentioned above are also available to Revenue Canada.[105]

In terms of an importer,[106] it goes without saying that Revenue Canada's reach over an importer is greater than its reach over a producer or exporter in the territory of another Party. As a result, to the extent that an importer violates the Customs Act, or any regulations thereto, an importer is subject to the penalties prescribed under sections 160 (*e.g.*, when an importer denies access to its records under section 42 of the Customs Act)[107] or 161 (*i.e.*, any offense not enumerated under section 160) of the Customs Act.

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105. As mentioned in Section II.A on record-keeping, Revenue Canada also has jurisdiction to sanction exporters, producers, and suppliers in Canada (*e.g.*, for failing to keep records or for fraudulently claiming a nonoriginating good to be originating).

106. As stated, this also applies to Canadian producers and exporters (*e.g.*, when either U.S. or Mexican customs officials inform Revenue Canada that it suspects a Canadian producer or exporter of fraudulently claiming a nonoriginating good as originating).

107. *I.e.*, on summary conviction or indictment.

IV. Conclusion

Rules of origin requirements serve as a means by which customs authorities can classify goods for the purposes of applying tariff rates. As discussed in section II, as FTAs and, to a much lesser extent, CUs continue to flourish, it is increasingly important from a commercial perspective for producers, exporters, and importers to meet the rules of origin requirements established under these trade arrangements. Only goods that qualify as originating are entitled to preferential tariff treatment.

The NAFTA's rules of origin requirements are found in chapter four of the Agreement. Essentially, the NAFTA recognizes the following classes of goods as originating: (i) goods that are wholly grown in the territory of a Party; (ii) goods that are produced entirely in the territory of one or more Parties exclusively from originating materials; and (iii) goods that, while produced with both originating and nonoriginating materials, meet the origin requirements of chapter four. When a good qualifies as NAFTA originating, it is entitled to the preferential tariff rates prescribed by the NAFTA.

Because the tariff rates provided under the NAFTA are, in many cases, lower than those provided under the multilateral trade system (*e.g.*, under MFN tariff rates), producers, exporters, and importers have an incentive to characterize their goods as originating. Verification procedures, therefore, serve as a mechanism whereby the NAFTA Parties can ensure that only goods that are entitled to NAFTA preferential tariff rates receive such treatment.

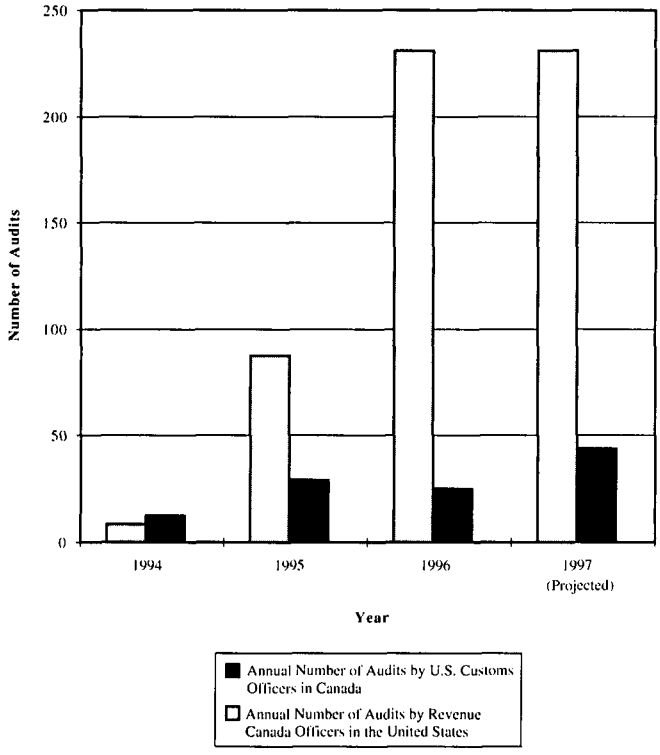
The NAFTA's verification procedures are set out in article 506 of the Agreement. Furthermore, pursuant to article 511 of the NAFTA, the Parties established Uniform Regulations that ensure that, *inter alia*, their verification procedures are relatively consistent. Canada implemented its rules and procedures governing origin verifications under both its Customs Act and its Customs Tariffs, and the various regulations thereto.

Although there is relative harmony in the origin verification procedures among the Parties, a few differences exist. Canada, for example, makes wide use of verification questionnaires. As well, Revenue Canada and U.S. Customs seem to view verification visits in a slightly different manner. Site verifications conducted by U.S. Customs, for example, generally take a few short days, while those conducted by Revenue Canada often take two or three weeks. This difference likely explains the much wider use of site verifications by U.S. Customs in Canada, than by Revenue Canada in the United States.

This article explored the rules and procedures of origin verifications established under the NAFTA, and then examined how those rules and procedures were implemented under Canadian law. As well, the article explained the administration of verification audits by Revenue Canada. Essentially, these rules and procedures continue to serve as the primary way in which Revenue Canada can ensure that only goods that are entitled to NAFTA preferential tariff rates receive such tariff treatment.

Appendix A

Annual Number of Verification Audits Through On-Site Visits by U.S. Customs Officers in Canada and by Revenue Canada Officers in the United States



Year	Annual Number of Verification Audits Through On-Site Visits by U.S. Customs in Canada	Annual Number of Verification Audits Through On-Site Visits by Revenue Canada in the United States
1994	10	12
1995	87	28
1996	229	23
Up to March 1, 1997	38	7
1997 (Projected)**	228	42

**The 1997 Projection is based on a constant rate over the course of 1997.

((Unofficial) Data Provided Courtesy of Revenue Canada)