Canada Q&A

Question 1. What are the potential risks associated with higher tariffs and what mitigation strategies are recommended given the current state of affairs?

- Lower Demand:
  - Canadian companies relying on cross-border supply chains may face logistical and financial challenges.
  - Higher prices on Canadian goods in the U.S. market could reduce demand as U.S. buyers seek cheaper alternatives, including domestic suppliers.
  - This drop in exports may slow Canada's economic growth, especially in sectors like manufacturing, agriculture, and natural resources.
- Rise in Costs:
  - Tariffs will increase production costs by raising the price of imported materials and finished products.
  - Businesses may absorb these costs or pass them on to consumers, leading to inflationary pressures.
  - Higher prices for both Canadian and U.S. consumers could reduce purchasing power and dampen consumption and investment.
- Delayed Investments:
  - Growing uncertainty surrounding trade relations may cause businesses on both sides of the border to delay investments. This delay could further hinder economic growth.

Recommended Mitigation Strategies:

- Diversification of Markets:
  - Encourage businesses to explore new export markets to reduce dependency on the U.S.
- Supply Chain Optimization:
  - Invest in alternative supply chain solutions to minimize disruptions caused by tariffs.
- Strategic Price Adjustments:

    - Businesses should evaluate pricing strategies to absorb tariff costs without significantly impacting consumer demand.
- Government Support Programs:
    - Governments could provide financial assistance or incentives to businesses facing high tariff-related costs to help mitigate the negative economic impact.
- Enhanced Trade Negotiations:
    - Engage in continuous trade negotiations with key partners to lower tariffs or seek exemptions for crucial sectors.

Question 2. Enforcement Strategies and What to Avoid

Enforcement Strategies:

- Enforcement by Canada Border Services Agency (the "CBSA"):
    - Canada announced its two-phase tariff package of applying 25% tariffs on $155 billion worth of imported goods, beginning immediately with a list of goods worth $30 billion and later increasing to $155 billion worth of goods, the Canadian government has not announced definitive enforcement strategies.
    - On April 2, 2025, President Trump announced that, starting April 5, 2025, the U.S. will impose (i) 25% tariffs on foreign-made automobiles; and (ii) reciprocal tariffs on trading partners, ranging from 10% to 49%, equivalent to at least half of what they charge the U.S. For Canada, the existing fentanyl/migration IEEPA orders will still remain in effect and are unaffected by these tariffs.
    - Per the White House Fact Sheet dated April 2, 2025, USMCA compliant goods will be subject to a 0% tariff, non-USMCA compliant goods will be subject to a 25% tariff, and non-USMCA compliant energy and potash will be subject to a 10% tariff.
    - An example of how the current tariff landscape applies is that Canadian oil or gas would be exempt from the tariffs if it meets the USMCA Rules of Origin requirements, such as the limit of 40% dilution by volume during the transportation process, as outlined in Chapter 27 of the Rules of Origin.
    - The Trump Administration has stated that in the event the existing fentanyl/migration IEEPA orders are terminated, USMCA compliant goods

would continue to receive preferential treatment, while non-USMCA compliant goods would be subject to a 12% reciprocal tariff.

    - On April 3rd, 2025, Canada announced in response that it would match the 25% tariffs on non-USMCA compliant automobiles.
    - The CBSA will be responsible for collecting the tariffs as a surtax while they remain in effect. As such, we can likely expect increased auditing and border investigations to ensure proper enforcement of the retaliatory tariffs.

- Impact of Uncertainty:
    - The lack of clear enforcement strategies from the Canadian government could lead to uncertainty.
    - International companies may be hesitant to establish operations in Canada, despite benefits such as lower labor costs and a favorable exchange rate, due to concerns about unpredictable tariff enforcement.

What to Avoid:

- Incorrect or Under-Reporting of Tariffs:
    - Avoid incorrectly reporting or under-reporting tariffs, as this could trigger increased audits and investigations, leading to penalties and supply chain disruptions.
- Under-Reporting Goods Covered by USMCA:
    - Be cautious about under-reporting goods that may be covered by the USMCA, especially if a reprieve is given.
    - Recent reports indicate that only approximately 38% of Canadian goods shipped to the U.S. have been imported on a USMCA-compliant basis, as many companies have not completed the required paperwork. However, economists estimate that between 75% and 90% of Canadian exports to the U.S. comply with the USMCA rules and could therefore qualify for the one-month reprieve.
    - Likewise, misreporting could lead to complications if goods are wrongly subjected to tariffs when they should be exempt.

Question 3. Practical Tips and Case Studies – Current Observations

Practical Tips for Responding to the Tariffs Landscape:

- Tip 1: Determine if Your Product is Eligible for USMCA Relief and Preferential Tariff Treatment:
    - On April 2, 2025, President Trump announced that, starting April 5, 2025, the U.S. will impose (i) 25% tariffs on foreign-made automobiles; and (ii) reciprocal tariffs on trading partners, ranging from 10% to 49%, equivalent to at least half of what they charge the U.S. However, these tariffs do not apply to Canada.
    - Per the White House Fact Sheet dated April 2, 2025, USMCA compliant goods will be subject to a 0% tariff, non-USMCA compliant goods will be subject to a 25% tariff, and non-USMCA compliant energy and potash will be subject to a 10% tariff.
    - If the existing fentanyl/migration IEEPA orders are terminated, USMCA compliant goods would continue to receive preferential treatment, while non-USMCA compliant goods would be subject to a 12% reciprocal tariff.
    - As such, Canadian and Mexican companies exporting to the U.S. should be prepared to comply with USMCA rules if they are not already.
    - Understand the Rules of Origin:
        - USMCA uses specific rules to determine if a good qualifies as originating from one of the participating countries (Canada, Mexico, or the U.S.).
        - Goods meeting the qualification may be eligible for preferential tariff treatment or qualify for duty drawbacks.
    - Key Provisions to Review:
        - Article 4.2: Goods made entirely from raw materials sourced within USMCA countries automatically qualify as originating products. If a product is made entirely from materials produced in Canada, the U.S., or Mexico, it can be considered to originate from one of these countries.
            - Substantial Transformation: If the goods undergo substantial transformation in a USMCA country, resulting in a new product with a different name, character, or use, they may qualify for preferential treatment, provided they meet specific rules.
        - Article 4.3 and Regional Value Content (RVC): Goods must have a minimum percentage of value sourced from USMCA countries (typically 50-60%, with 75% for automotive products) to qualify.

        - Article 4.4 and Specific Product Rules: Certain products, like textiles and apparel, may have additional or different rules of origin.
    - Assess Eligibility from the Canadian Perspective:
        - Rules from the Canadian *Determination of Country of Origin for the Purpose of Marking Goods (USMCA Countries) Regulations* and USMCA *Rules of Origin Regulations* will ultimately govern preferential tariff treatment under USMCA.
    - What is Eligible?
        - Natural Resources: Typically items like oil, gas, timber, and minerals, extracted or grown within USMCA countries, are eligible.
        - Agricultural Products: Similar to natural resources, these are eligible if they are grown or harvested within Canada, the U.S. or Mexico without external inputs.
    - For goods with external inputs, companies should consider the following factors:
        - Substantial Transformation: Has the product undergone significant changes in the production process that make it a new product with a different classification?
        - Indirect Materials: Consider whether there are materials used in production that are not incorporated into the final product but are still required.
        - Production Location and Regional Value Content: Assess where goods are produced, not just exported, and evaluate the percentage of value sourced from USMCA countries.
        - Customs Control and Shipping/Transshipment: Review the various rules around customs control and the movement of goods to determine if they qualify under USMCA rules.
    - By ensuring goods meet these rules, companies could potentially benefit from reduced tariffs rates or qualify for duty drawbacks under the USMCA.
- Tip 2: Review Contractual Obligations
    - Payment and/or Pricing Clauses:
        - Review agreements to determine liability for tariffs, considering provisions about taxes, duties, and tariffs.

        - Look for clauses that may allow for amendments or automatic price adjustments based on external factors like tariffs.
        - Check if standard "Incoterms" have been used. These terms, derived from the International Chamber of Commerce, outline the responsibility for risks, such as insurance provisions and the risk of loss. Update these terms accordingly.
    - *Force Majeure* Clause:
        - Assess whether a *force majeure* clause can be invoked in response to tariffs, though rising costs alone may not be enough.
        - Consider adjusting the standard threshold for invoking a *force majeure* clause, which typically requires performance to be rendered effectively impossible by unforeseen or extraordinary events, to a lower threshold to accommodate tariff impacts, such as hindrance of performance or significant monetary impacts.
        - Review obligations to mitigate and next steps if a party is intending to rely on this clause.
    - Termination Clauses:
        - Review termination clauses for opportunities to terminate contracts due to tariffs, changing market conditions or regulatory shifts.
        - Ensure compliance with notice requirements and the duty of good faith in contract terminations is upheld.
    - Agreements in Negotiation:
        - For contracts still being negotiated, explicitly address potential tariff impacts to avoid ambiguity.
- Tip 3: Conduct Thorough Due Diligence in M&A Transactions
    - Ensure target companies are compliant with import/export reporting, tariff impact, tax compliance and inventory management.
    - Be prepared for heightened scrutiny on cross-border flows due to increased audits and investigations by the U.S. government.
- Tip 4: Explore Alternative Markets, Adjust Pricing Strategies, and Enhance Operational Efficiencies
    - Conduct a risk assessment to understand tariff exposure and develop a mitigation strategy for both supply and demand.

    - Diversify supply chains to source materials from different jurisdictions, leveraging free trade agreements such as the Canada-European Union Comprehensive Economic and Trade Agreement. Agreements such as this could remove a significant portion of tariffs, and many non-tariffs trade barriers.
    - Be mindful of the risks of changing suppliers, including potential delays, quality issues, and regulatory challenges.
- Tip 5: Be Prepared for Additional Costs and Delays in Routine Processes
    - Employers with U.S. operations may face increased costs related to immigration compliance and potential visa delays due to heightened screening.
    - Consider the impact of tariffs on the broader supply chain, including indirect effects on vendors and customers.
- Tip 6: Identify Opportunities in the New Trade Landscape
    - Removal of Interprovincial Trade Barriers:
        - Review any new efforts by the provinces to reduce internal trade barriers and labor mobility costs to explore sourcing options within Canada.
        - Focus on the Canadian markets and highlight the "Made in Canada" origin to appeal to domestic consumers.
- Tip 7: Apply for Duty Relief and Duty Drawback Programs
    - Drawback Program:
        - Take advantage of refunds on duties paid by Canadian businesses for goods that are exported in the same condition or consumed in manufacturing.
    - Duties Relief Program:
        - Canadian businesses may utilize this program to import goods duty-free if the goods are eventually exported or used in production for export.
    - General Requirements:
        - Ensure proof of origin documents are maintained for all imported goods subject to exceptions under the USMCA.
- Tip 8: Leverage Government Support Programs

- Explore Incentives under the new Trade Impact Program:
  - Canada announced it would be launching the Trade Impact Program to help ease the negative impacts of the U.S. tariffs on the Canadian economy while supporting Canadian businesses and workers consisting of
    - CAD$5 billion fund to help businesses expand into new markets and navigate tariff-related challenges.
    - CAD$500 million in loans for businesses directly impacted by tariffs.
    - CAD$1 billion in new financing to reduce financial barriers for specific industries, such as the Canadian agriculture and food industry.

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