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Tax Alert – Canada

Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) agreement is signed

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

The CPTPP agreement (formerly the 11-member Trans-Pacific Partnership agreement, or TPP-11) was signed by its member states, including Canada, on 8 March 2018. The agreement covers a market of 495 million people with a combined GDP of CAD\$13.5 trillion, or nearly 13.5% of global GDP.

Tariff liberalization commitments under the CPTPP cover over 100,000 tariff lines and over 200 pages of tariff-rate quota commitments for agricultural products. These commitments are expected to provide Canadian exporters with tariff savings of CAD\$428 million per year.

Under the CPTPP, the rules of origin for automotive products are generally less restrictive than those under the North American Free Trade Agreement (NAFTA). In addition, Canada has agreed to provide duty-free in-access quotas for certain poultry, egg products, and dairy imports under the Tariff Rate Quota regime.

Impact on the Canadian automotive industry

All CPTPP countries will remove tariffs on motor vehicles and motor vehicle parts. Canada will remove its 6.1% most-favoured-nation tariff on imports of passenger vehicles over four years through five annual reductions.

Most CPTPP countries will completely remove their tariffs on motor vehicles upon entry into force of the agreement, except for Malaysia and Vietnam who will phase -out their tariffs over 12 years¹.

For motor vehicle parts, Canada and several other CPTPP countries will remove their tariffs (of up to 8.5% for Canada) upon entry into force of the agreement, however:

- ▶ Malaysia and Vietnam will eliminate their tariffs of up to 50% within 10 years
- ▶ Australia will eliminate tariffs of up to 5% within 3 years
- ▶ New Zealand will eliminate tariffs of up to 10% within 7 years
- ▶ Brunei will eliminate tariffs of up to 10% within 7 years²

Under the CPTPP, motor vehicles will be subject to a 45% regional value content (RVC) requirement to acquire originating status. The RVC requirement for motor vehicle parts ranges from 35% to 45%. NAFTA's 62.5% RVC requirement for these goods is significantly higher.

Canadian producers may benefit from the CPTPP by gaining access to new sourcing opportunities in the Asia-Pacific region. However, Canadian producers selling into the US market will be incentivized to source a high percentage of their parts from within North America in order to meet NAFTA rules of origin and avoid significant duty costs at the US border.

Canada and Japan have agreed to incorporate a transitional safeguard measure for originating automotive imports that either party deems to cause serious injury or to facilitate adjustment. For the twelve years following the entry into force of the CPTPP, either party may apply safeguard measures on the other party's originating motor vehicles for a period not exceeding three years. The safeguard measures may be extended by two years if certain requirements are met.³

Impact on the Canadian agricultural industry

Concerning agriculture, Canada has agreed to phase in duty-free in-access quotas for several dairy, egg, and poultry products that are CPTPP originating:⁴

Product	Length of phase-in (years)	Year 1	Final year	Unit of measurement
Milk	19	8,333	56,905	Metric tonnes

¹ <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cptpp-ptpgp/sectors-secteurs/auto.aspx?lang=eng>

² <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cptpp-ptpgp/sectors-secteurs/auto.aspx?lang=eng>

³ Appendix B to Canada's Tariff Schedule to Annex 2-D (Appendix between Japan and Canada on Motor Vehicle Trade)

⁴ <http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/02-ad-03.aspx?lang=eng>

Product	Length of phase-in (years)	Year 1	Final year	Unit of measurement
Cream	14	500	734	Metric tonnes
Skim milk powders	19	1,250	11,014	Metric tonnes
Milk powders	14	1,000	1,138	Metric tonnes
Cream powders	14	100	114	Metric tonnes
Concentrated milk	19	333	2,587	Metric tonnes
Yogurt and buttermilk	19	1,000	7,762	Metric tonnes
Powdered buttermilk	14	750	970	Metric tonnes
Whey powder	11	1,000	Unlimited	Metric tonnes
Products consisting of natural milk constituents	19	667	4,552	Metric tonnes
Butter	19	750	5,121	Metric tonnes
Industrial cheese	19	1,329	9,076	Metric tonnes
Mozzarella and prepared cheese	19	483	3,300	Metric tonnes
Cheeses of all types	19	604	4,126	Metric tonnes
Ice cream and mixes	14	1,000	1,138	Metric tonnes
Other dairy	14	1,000	1,138	Metric tonnes
Broiler hatching eggs and chicks	19	166,667	1,138,093	Dozen eggs equivalent
Chicken	19	3,917	26,745	Metric tonnes, eviscerated product basis
Turkey	19	583	3,983	Metric tonnes, eviscerated product basis
Eggs	19	2,783,333	19,006,158	Dozen eggs equivalent

Importers must apply for an import license to benefit from the in-access quotas. The quotas will be allocated to importers on an annual basis. Unlike under the Canada - EU

Comprehensive and Economic Trade Agreement, applicants who have not previously imported these products will be able to apply for quota access.⁵

Removal of non-tariff and technical barriers to trade

The CPTPP aims to reduce barriers to trade and promote harmonization of standards by incorporating and expanding on the provisions of the Agreement on Technical Barriers to Trade, an international agreement administered by the World Trade Organization that seeks to eliminate undue trade barriers posed by standards, technical regulations and conformity assessments enacted by national laws. As such, Chapter 8 of the Trans-Pacific Partnership (TPP) (as incorporated) establishes general non-discrimination, transparency and regulatory cooperation between the CPTPP parties in order to reduce cross-border redundancies in the technical barriers space and to increase regulatory predictability for importers and exporters. Furthermore, the CPTPP provides specific negotiated outcomes in matters of technical barriers to trade for the following industries:

- ▶ Wine and distilled spirits
- ▶ Information and communications technology products
- ▶ Pharmaceuticals
- ▶ Cosmetics
- ▶ Medical devices
- ▶ Proprietary formulas for prepackaged foods and food additives
- ▶ Organic products

Suspended provisions

The CPTPP's provisions draw directly from the original TPP text. However, under CPTPP, certain original provisions or portions thereof have been suspended. Suspended provisions shall enter into force at future dates, whenever all CPTPP parties agree to end one or several suspensions. Virtually no tariff reduction provision under the CPTPP is affected by these suspensions.

The suspensions relate to certain provisions (or portions thereof) affecting:

- ▶ Intellectual property protection, especially in the pharmaceuticals, life sciences and digital industries
- ▶ Investment, including investor-state agreements and the investor-state dispute settlement arbitration
- ▶ Procedural fairness in government procurement and in approvals for reimbursement of new pharmaceuticals and medical devices by public healthcare institutions
- ▶ International digital transmissions and resolution of telecommunications disputes

⁵ <http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/02-ad-03.aspx?lang=eng>

- ▶ Facilitation of competitive and efficient international parcel delivery services, including commitments respecting express customs processing and duty elimination on low-value shipments
- ▶ Starting dates of certain commitments by Brunei Darussalam and Malaysia

Regarding intellectual property, certain TPP obligations relating to patents and pharmaceuticals have been suspended, including patent term adjustment, which required TPP members to adjust the patent term to compensate for “unreasonable” patent office delays, as well as the TPP obligation on patent term restoration for marketing approval delays. Certain TPP obligations on copyright and related rights were also suspended, including on term of protection. Under this suspension, Canada maintains the flexibility to provide a copyright term of “life of the author plus 50 years,” which is consistent with multilateral standards.

The suspension of provisions related to Investment Agreements and Investment Authorizations prevents foreign investors from bringing forward a case under investor-state dispute settlement when an investment contract has been breached, or when authorization to invest is amended or revoked by government under the Investment Canada Act. The application of investor-state dispute settlement has been suspended in the Minimum Standards of Treatment provisions in the Financial Services chapter of the agreement.

For any of these provisions to return into force, all CPTPP members must agree to do so unanimously.

Side letters

Several side letters were signed between the CPTPP parties. Side letters involving Canada address specific goods or services including:

- ▶ Culture
- ▶ Beef
- ▶ Forestry
- ▶ Agricultural chemical products
- ▶ Motor vehicles
- ▶ Wines and distilled spirits
- ▶ Geographical indications
- ▶ E-commerce

Next step: entry into force

No official date has been set for the entry into force of the CPTPP. According to article 3 of the CPTPP, the agreement may enter into force 60 days after at least six (or 50%) of the CPTPP signatories have provided written notification of the completion of their applicable legal procedures.

As trade tensions continue between Canada and the US over NAFTA and US trade protectionist measures (e.g., softwood lumber), the CPTPP opens new markets for Canadian importers and exporters. In addition, the US withdrawal from the CPTPP provides an

opportunity for Canadian businesses to acquire a larger market share in CPTPP countries. As the CPTPP countries commence finalizing legal procedures to implement the agreement, Canadian importers and exporters should begin considering how they can best leverage sourcing and supply provisioning opportunities under CPTPP rules of origin. Indeed, such planning is all the more imperative given the context of current developments in Canada and ongoing US trade relations. The CPTPP could provide diversification options in a world where North American supply chains across various industries are threatened by political and economic uncertainties.

Learn more

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