KPMG

TaxNewsFlash

Canada

New U.S. and Canadian Tariffs — Prepare for Trade Challenges

February 3, 2025
No. 2025-06

UPDATE

Following the issue of this tax publication, the media announced that the United States would hold off on levying tariffs against Canada for 30 days.

Canadian exporters and importers will soon face significant U.S. and Canadian tariffs that are set to begin on February 4, 2025. The United States recently announced that it will impose a 25% tariff on "all articles that are products of Canada", except for imports of energy resources which will be subject to a 10% tariff. In response, the Canadian federal government announced new 25% tariffs on various U.S. goods, the first phase of which is also scheduled to come into effect on February 4, 2025. Businesses across Canada will be significantly affected by these tariffs, which apply in addition to any other current import-related tariffs, fees and charges. These tariffs are expected to have broad consequences for the Canadian economy, including on businesses, supply chains, workers and the price of goods.

As these tariffs are expected to have an immediate impact, Canadian exporters and importers only have a short time to assess how their supply chains and operations may be affected. Canadian businesses should also determine whether they may be eligible for Canadian tariff relief under the Canada's Department of Finance's remission program. Given the immediate challenges presented by these new tariffs, it's important to contact your KPMG adviser to help you consider the effects of this change, including understanding the new remission rules and submission process.

Background
After the U.S. election, president-elect Donald Trump posted on social media that he was considering an executive order to enact a 25% tariff on all products entering the United States from Canada and Mexico, starting as early as January 20, 2025.

For details, see *TaxNewsFlash-Canada* 2024-45, "U.S. Vows 25% Tariffs on Imported Canadian Goods".

New U.S. tariffs

The United States announced that it will impose a 25% tariff on "all articles that are products of Canada", except imports of energy resources which will be subject to a 10% tariff, effective February 4, 2025. The United States said it will impose these new tariffs in addition to any current duties, fees or charges that apply on imported Canadian goods. In addition, the United States also announced:

- The elimination of the duty-free USD $800 exemption, also known as the duty-free *de minimis* rule
- Details on the treatment of goods in transit to the U.S. straddling the effective date of February 4, 2025
- That there would be no allowance for drawback with respect to the new tariffs
- That the United States may increase or expand the new tariffs should Canada retaliate.

In addition to these tariffs on Canadian goods, the United States also announced a 25% tariff on goods from Mexico and a 10% tariff on goods from China. The United States released the details of these measures in a Fact Sheet and an Executive Order issued on February 1, 2025. However, it was announced on February 3, 2025 that the tariffs on Mexico will be delayed for one month.

KPMG observations
Companies should act quickly to consider how these tariffs will affect multiple aspects of their business, including their customs and transfer pricing policies. Note that, although the U.S. Executive Order states that the tariffs will apply to "all articles that are products of Canada", we expect that this refers to imported goods for which the country of origin (e.g., manufacture) is Canada. The United States is expected to clarify which products are affected in a forthcoming U.S. Federal Register Notice.

Customs considerations

These unprecedented trade measures appear to circumvent the CUSMA free-trade agreement for Canadian goods imported to the United States. These measures are expected to apply to goods being imported into the United States with a Canadian country of origin, and not merely goods transiting through Canada into the United States. Canadian businesses may be more impacted where their business operations and supply chains are intertwined with the United States, and some businesses may feel the effects of these measures within the first few days of the new tariffs, depending on their current inventory level.

Businesses must assess how these tariffs will affect various aspects of their operations, including:

- Tariff costs and strategic pricing
- Country of origin and values applied to goods entering the United States
- Current supply chain and related options
- Transfer pricing models and policies
- Risk assessment and management
- Market diversification and options
- Commercial sale and purchase agreements, as well as legal implications.

Transfer pricing considerations

Certain Canadian multinationals may also have to reconsider their existing transfer pricing policies as a result of these tariffs. In particular, this change may affect multinationals that sell goods through a U.S.-related party distributor that earns a guaranteed target operating margin, since the operating margin could be impacted by the tariffs. In light of these potential changes, Canadian businesses may need to focus more on the transfer price the U.S. related party distributor will pay for the goods it purchases, rather than the profits it should earn from its activities, since this may be a more appropriate price in the circumstances.

Generally, adjusting transfer prices can significantly affect customs duties. A lower transfer price leads to a lower customs value, resulting in a lower tariff. This strategy requires careful consideration and implementation and requires a thorough analysis of supply chain and sales structures to determine the lowest possible transfer price while remaining compliant with transfer pricing regulations. Companies should map existing transfer pricing policies, models, and customs positions to identify opportunities for optimization as well as potential risks. In addition, these companies may consider creating internal playbooks and planning for different scenarios to guide decision-making and ensure consistency across the organization. In addition, it can be helpful to conduct impact assessments and financial modeling to quantify the effects of tariffs on the company's financial situation. By implementing these strategies, companies can potentially mitigate the impact of tariffs while maintaining compliance with both transfer pricing and customs regulations.

Duty-free de minimis rule

The United States also stated that it will eliminate the duty-free USD $800 exemption, also known as the duty-free *de minimis* rule.

KPMG observations
E-commerce companies and other Canadian businesses that sell goods imported directly to U.S. customers could be negatively affected by this change, as certain duty-free imports will now subject to a 25% tariff and other duties and import costs if applicable. The Executive Order notes that the duty-free *de minimis* treatment will not be available for the articles described as “all articles that are products of Canada”.

Federal and provincial countermeasures

The Canadian federal government responded to these new U.S. tariffs on Canadian goods by announcing a new 25% tariff on certain imported American goods. This 25% tariff will be implemented in a two-phase process:

- First phase (effective February 4, 2025) — The 25% tariff will apply on $30 billion worth of goods, such as orange juice, peanut butter, wine, spirits, beer, coffee, appliances, footwear, motorcycles, cosmetics, and pulp and paper.

- Second phase (effective 21 days after February 4, 2025) — The 25% tariff will expand to $125 billion worth of other goods, such as passenger vehicles and trucks (including electric vehicles), steel and aluminum products, certain fruits and vegetables, aerospace products, beef, pork, dairy, trucks and buses, recreational vehicles and recreational boats (note that Finance has yet to release the full list of goods subject to the 21-day delay for public comment).

The Department of Finance also said it would consider other non-tariff options if the United States does not reverse its tariffs. Details of the new tariff and list of affected goods were released by the Department of Finance on February 1 and 2, 2025, respectively.

Some provincial governments have announced additional non-tariff measures within their jurisdiction, such as limiting the sale of American alcohol products in stores, reviewing procurement contracts, directing provincial government departments to buy Canadian goods and services, and increasing tolls for certain American commercial vehicles.

Relief measures in Canada — Remission program

Canada's Department of Finance also announced a remission program that is intended to provide limited relief to help mitigate the effects of the new Canadian tariffs on certain Canadian businesses, and released details on the remission process. The remission program essentially provides relief from otherwise applicable tariffs but only in "exceptional and compelling circumstances", based on established guidance.

KPMG observations
Businesses considering submitting a remission request should be aware that they must provide a significant amount of information. Some of these requested details may take time to collect, while other details may need to be marked as confidential and protected.

We can help

Your KPMG adviser can help you assess the effect of these new developments. For more details, contact your KPMG adviser.