Taxes and tariffs: Can you deduct the duty?

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For years, global trade without tariffs has allowed supply chains to function smoothly and reliably. Although factors like pricing, supplier choices, and customer relationships have always played a role, the lack of tariff-related obstacles created a stable norm—one that is now facing major upheaval.

Regardless of whether a company's transactions involve related or independent parties, many of the insights from our recent article, "The Price is Right? The role of transfer pricing across supply chains of multinational companies", remain relevant. Parties who are not related to their suppliers or customers should still:

- evaluate their risks, and their tolerance for risk, in this new environment;
- make adjustments in the near term, like shifting to or adding suppliers and customers in tariff-free jurisdictions; and
- consider long-term restructuring of their business to manage tariff cost.

In addition, Canadian taxpayers should carefully consider whether tariffs can be deducted, and the legal basis for making such claims.

What you need to know

U.S. tariffs on exported goods

Since Canadian exporters are not legally responsible for paying tariffs imposed by the U.S. in their current form, they cannot claim a direct deduction for these tariffs. However, if a Canadian exporter lowers the price of sales inventory to help a U.S. buyer offset the impact of tariffs, the resulting decrease in revenue may function similarly to a deductible expense. Still, this adjustment stems from pricing changes rather than a direct tariff payment.

Canadian tariffs on imported goods

The deductibility of a retaliatory tariff imposed by the Canadian government for imports into Canada (Canadian Tariff) depends on various factors and may fall into one of the following categories:

1. **Income deduction in the year incurred:** Canadian Tariffs could be added to the cost of goods sold, or deducted as goods consumed as part of the business operations. However, whether an expense qualifies as tax-deductible is a legal matter rather than an accounting issue.[1] Determining whether a tariff deduction as part of the cost of goods sold or operating expenses accurately reflects a taxpayer's yearly profit (or if it constitutes a capital outlay to maintain a U.S. customer base, for example) remains an open question.[2]
2. **Deductible as part of the tax depreciation of a capital asset:** For imported depreciable capital property, the tax depreciation pool (undepreciated capital cost, or UCC) is based on the taxpayer's "capital cost," a term not defined in the *Income Tax Act* (Canada) (Tax Act). While UCC calculations include countervailing and anti-dumping duties (CAD Duties), Canadian Tariffs do not fall under this category, nor are they expected to in the future. Whether Canadian Tariffs can be added to UCC depends on whether they are part of "capital cost," which requires a legal and factual analysis.
3. **Non-deductible capital outlay (other than depreciable property):** If a Canadian Tariff is neither a business expense nor an addition to UCC, it may be a non-deductible capital outlay unless a specific provision allows otherwise. While subsection 20(1)(vv) of the Tax Act permits deductions for CAD Duties, it does not apply to Canadian Tariffs. This suggests tariffs could be non-deductible unless added to UCC, or deducted in the year incurred.

BLG can assist

We offer extensive expertise across all areas of Canadian tax and international tax, complemented by deep experience in audit and litigation matters as well as timely knowledge from our International Trade group. Our team is well equipped to support companies navigating the complexities of a rapidly evolving global business environment. Contact us for help navigating your tax and international trade needs.

Footnotes

[1] *Canderel Ltd. v Canada*, [1998] 1 SCR 147 at para 37.

[2] *Mann v R.*, 2007 TCC 732 at para 21.

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