



Ottawa, Thursday, June 27, 1991

Appeal No. 2669

IN THE MATTER OF an application heard on
February 25, 1991, under section 59 of the *Excise Tax Act*,
R.S.C., 1970, c. E-13.

BETWEEN

ICAM TECHNOLOGIES CORPORATION

Applicant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is allowed. The activities carried on by the applicant constitute the manufacturing or production of goods. Further, the Tribunal finds that the machinery and apparatus purchased by the applicant were used primarily and directly in the manufacturing or production of goods and in the development of goods for manufacture or production by it.

Kathleen E. Macmillan

Kathleen E. Macmillan
Presiding Member

Arthur B. Trudeau

Arthur B. Trudeau
Member

Sidney A. Fraleigh

Sidney A. Fraleigh
Member

Robert J. Martin

Robert J. Martin
Secretary

UNOFFICIAL SUMMARY

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ICAM TECHNOLOGIES CORPORATION

Applicant

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THE MINISTER OF NATIONAL REVENUE

Respondent

This is an application under section 59 of the Excise Tax Act (the Act) where the applicant seeks a declaration by this Tribunal that it is entitled to an exemption of sales tax pursuant to section 29 of the Act.

HELD: *The appeal is allowed. The activities carried on by the applicant constitute the manufacturing or production of goods. Further, the Tribunal finds that the machinery and apparatus purchased by the applicant were used primarily and directly in the manufacturing or production of goods and in the development of goods for manufacture or production by it.*

*Place of Hearing: Ottawa, Ontario
Date of Hearing: February 25, 1991
Date of Decision: June 27, 1991*

*Tribunal Members: Kathleen E. Macmillan, Presiding Member
Arthur B. Trudeau, Member
Sidney A. Fraleigh, Member*

*Clerk of the Tribunal: Nicole Pelletier
Counsel of the Tribunal: Gilles B. Legault*

*Appearances: Patrice Marceau, for the applicant
Hughes G. Richard, for the respondent*

Cases Cited: *The Queen v. York Marble, Tile and Terrazzo Ltd. 68 D.T.C. 5001; Canadian Wirevision Limited v. The Queen, [1978] 2 F.C. 577; In re Heinrich Kleifges and in re Citizenship Act, [1978] 1 F.C. 734; Re owners, Strata plan VR 29 and Registrar Vancouver Land Registration et al., (B.C. S.C.) 91 D.L.R. (3d) 528; Re Rai (Ontario Court of Appeal) 106 D.L.R. (3d) 718; La ville de Jacques-Cartier v. Joseph Napoléon B. Lamarre, [1958] S.C.R. 108; Gruen Watch Co. of Canada v. Attorney General of Canada, (1950) C.T.C. 440; The Royal Bank of Canada v. Deputy Minister of National Revenue, 81 D.T.C. 5301.*

Appeal No. 2669

ICAM TECHNOLOGIES CORPORATION

Applicant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

TRIBUNAL: KATHLEEN E. MACMILLAN, Presiding Member
ARTHUR B. TRUDEAU, Member
SIDNEY A. FRALEIGH, Member

REASONS FOR DECISION

This is an application under section 59 of the *Excise Tax Act*¹ (the Act) where the applicant seeks a declaration by this Tribunal that it is entitled to an exemption of sales tax pursuant to section 29 of the Act.

ISSUE AND APPLICABLE LEGISLATION

This application raises two issues. First, whether the Tribunal, or previously the Tariff Board, has jurisdiction to hear this application since section 59 was repealed before the filing of this application. The second issue is whether the computers and ancillary equipment purchased by the applicant are entitled to an exemption under any of the exempting subparagraphs 1(a)(i), (ii) and (iii) of Part XIII, Schedule III.

For the purpose of this application the relevant legislation reads as follows:

27.(1) There shall be imposed, levied and collected a consumption or sales tax of nine percent on the sale price of all goods

(a) produced or manufactured in Canada

...

29.(1) The tax imposed by section 27 does not apply to the sale or importation of the goods mentioned in Schedule III, other than those goods mentioned in Part XIII of Schedule III that are sold to or imported by persons exempt from consumption or sales tax under subsection 31 (2).

59.(1) Where any difference arises or where any doubt exists as to whether any or what rate of tax is payable on any article, on transportation by air or on the amount charged for a taxable service under this Act, the Tariff Board constituted by the Tariff Board Act may declare what rate of tax is payable thereon or that the article, transportation by air or amount charged for the taxable service is exempt from tax under this Act.

1. R.S.C., 1970. c. E-13, as amended.

SCHEDULE III

PART XIII

1. All the following:

(a) machinery and apparatus sold to or imported by manufacturers or producers for use by them [primarily and] directly in

(i) the manufacture or production of goods,

(ii) the development of manufacturing or production processes for use by them, or

(iii) the development of goods for manufacture or production by them,

...

[effective February 16, 1984, S.C. 1985, c. 3, subs. 36 (1) and s. 48]

FACTS AND EVIDENCE

During the period of assessment, the applicant, ICAM Technologies Corporation (ICAM), was in the business of developing and marketing custom made software and standard or generic software for use in Computer-Aided Design (CAD) and Computer-Aided-Manufacturing (CAM) applications.

On September 9, 1985, the Department of National Revenue (the Department) assessed the applicant for an amount of \$65,605.64 (arrears, penalties and interest) pertaining to the purchase of computers and ancillary equipment. The assessment period covered June 1, 1982, to July 31, 1985.

In a letter dated September 27, 1985, the applicant expressed its disagreement and asked for a re-consideration of the assessment. However, the Department confirmed the assessment on March 7, 1986.

The applicant then contested the assessment before the Appeal Directorate. The Department acknowledged receipt of the applicant's letter on May 8, 1986. On May 9, 1986, the applicant amended its brief. On October 16, 1986, an officer of the Tax Interpretation Branch at the Department confirmed the assessment. Finally, on October 29, 1986, the applicant filed an application before the Tariff Board pursuant to section 59 of the Act.

These dates are important because of the issue as to whether the Tribunal, which replaces the Tariff Board, has jurisdiction to hear the case.

At the hearing, the applicant called three witnesses. The first was Mr. Sandox-Cox, Executive Director of the Canadian Manufacturing Advanced Technology Exchange, who described the advancements in traditional manufacturing processes as a result of CAD/CAM systems, such as those sold by ICAM. The applicant also called Professor David Bonham, of the Department of Mechanical Engineering, University of New Brunswick, who explained the interaction between the software

programs and the machine tools used on the factory floor. According to Professor Bonham, the software programs become an essential part of the machine tools, whether these tools are numerically controlled or computer controlled. In the opinion of both these experts, the applicant was in the manufacturing business.

Mr. John Nassr, President of the applicant company, also appeared as a witness. Mr. Nassr testified that during the assessment period the company was in the process of shifting between a concentration on custom-design software for specific clients to generic or "off-the-shelf" software for multiple users. The witness referred to Exhibit A-12, a schedule showing that a declining proportion of the company's sales was accounted for by custom designed software between 1982 and 1987.

Mr. Nassr described how custom and generic software were developed by the applicant. For custom designed software, the customer would submit information such as the design and geometry of the part or piece it wished to manufacture, and the specifications of the manufacturing materials, production processes and tools utilized in its factory. The applicant would generate a punched tape capable of instructing the customer's tools and machines to perform the steps necessary to manufacture the part desired. The applicant's end result, the punched tape, was developed by manipulating and iterating data and, often, by experimenting on site with the customer's own tools and machines. In the development stage, the applicant used punched cards to process and manipulate the information. At the final stage, the program was transferred from punched cards to a mylar-coated metal tape. The punched tape and some basic instructions were what was delivered to the client.

According to Mr. Nassr, roughly 10 years ago the company realized that there was a growing market in the development of software for small computers and began concentrating on generic programs. Mr. Nassr explained that ICAM's generic software allows the manufacturer itself to develop the information that previously would have been contained on a punched tape.

Mr. Nassr referred the Tribunal to company brochures outlining the types and capabilities of its "off-the-shelf" software. Between 1982 and 1985, ICAM sold some 200 to 300 copies of its generic software programs. The software is sold either in the form of a tape, disk or diskette, whatever the customer specifies.

In response to questions by counsel for the respondent, Mr. Nassr testified that the bulk of the applicant's employees' time is spent developing software programs. Similarly, the equipment for which the exemption is requested - computers, terminals, tablets and modems - is primarily devoted to software development and its duplication onto tape or disk. In the case of generic software, programs can take several years to develop. Mr. Nassr acknowledged that it can take only seconds to transfer a program to a disk or tape.

Counsel for the respondent drew Mr. Nassr's attention to invoices from the applicant to a number of its clients. The witness explained that although for one contract, that with Pratt and Whitney Aircraft (Exhibit A-7), the applicant was paid on an hourly basis, the invoice stipulated the delivery of tapes for specific part numbers. Mr. Nassr also explained that ICAM used the word "licence" on its invoices on the recommendation of its lawyers. The company took a number of steps, including the use of non-disclosure, non-reproduction agreements, to prevent the duplication of its generic software. Unauthorized duplication was not a serious concern in the case of custom-designed software.

The respondent also called a witness, Mr. Jim Pyeon, one of its employees. The witness had conducted an audit of the applicant between December 1984 and July 1985, covering the assessment

period from June 1, 1982, to July 1, 1985. The witness explained that he had assessed the applicant because, in his opinion, ICAM was providing an engineering service.

The witness also stated that software was not considered by the respondent to be taxable goods under the Act.

In cross-examination, the witness referred to an administrative policy entitled *Programme de logiciel informatique* (Computer Software Programs) (Exhibit B-3) published in the *Excise News*, January 1979, No. 28, and on which he had relied to conclude that the applicant was providing engineering service. When asked by the applicant's counsel to differentiate between the types of software set forth in the directive and the software produced by the applicant, the witness was unable to answer. Nor was he able to answer whether, pursuant to the directive, other types of software could be considered manufacturing and processing.

ARGUMENTS

Counsel for the applicant argued that the two questions that must be determined by the Tribunal are whether the applicant is involved in manufacture or production and whether the software programs are goods.

On the question of what is manufacturing, counsel noted that there is no definition in the Act or the *Income Tax Act* for "manufacture." Counsel referred to the *York Marble*² case of the Supreme Court of Canada, which found that " ... manufacture is the production of articles for use from raw or prepared material by giving to these materials new forms, qualities and properties.... "

Relying on the definition set out in this case, counsel argued that in the case of generic software, new qualities and properties are given to a diskette or tape. Hundreds of copies of the software were marketed based on its qualities or abilities. In this respect, counsel maintained, it is similar to a car that is advertised on the basis of its qualities and attributes. Like a car, the software is sold at a certain price per unit and not at rate per service performed.

With respect to custom designed software, counsel maintained that previously useless tape was given new properties. As a result, the tape was made an integral and necessary part of a machine.

According to counsel, if the words of the statute are given an ordinary, natural interpretation, the applicant would qualify as a manufacturer under the Act. Counsel further argued that the sense in which people in the trade view "manufacturer or producer" should be taken into account in the Tribunal's decision. Accordingly, counsel urged the Tribunal to accept the opinion of the two experts appearing for the applicant that the latter is a manufacturer.

Counsel for the applicant pointed out that the Department has accepted the applicant as a manufacturer or processor under the *Income Tax Act* and allowed a deduction for manufacturing and processing profits. Further, the applicant received a grant from the Department of Regional Economic Expansion on the basis that it was a facility for the manufacturing of CAD/CAM.

2. *The Queen v. York Marble, Tile and Terrazzo Ltd.* 68 D.T.C. 5001.

Concerning what part of the applicant's operations constitute manufacturing, the applicant's counsel argued that the operations are integrated and cannot be viewed in a disjointed way. The process begins with an idea or need in the industry and ends with a program. According to counsel, this is the view the Department has adopted in applying the *Income Tax Act* to computer programmers.

On the second question of whether the software constitutes "goods," counsel maintained that there can be no doubt that tapes or disks are goods. In any event, it is not necessary to have tangible goods to be entitled to the exemption. In this regard, counsel cited *The Royal Bank of Canada*³ case that, in counsel's view, concluded that electricity was considered goods for the purposes of the Act.

As a final point, counsel dismissed the copyright issue as irrelevant for the purpose of this appeal. Although information contained in a book, record or computer disk can be copyrighted, this does not prevent these items from being considered goods.

Counsel for the respondent began his argument by explaining that, in order to qualify for the exemption, the applicant must be considered a manufacturer or producer. In this regard the respondent, as did the applicant, relies on the definition these words received in the *York Marble* case. In counsel's view, the applicant created rather than manufactured the software programs and then licenced their use. Consequently, the programs are not articles of trade in the usual sense. The applicant's activities are more akin to the process of creating a literary or musical work and not the production or manufacturing of goods.

Further, the respondent argued that the applicant is best described as a provider of service. This is indicated by the fact that provincial governments, in their tax treatment of software, classify it as a service.

The respondent also contended that the concept of manufacturing and producing for the purpose of the Act involves the notion of tangible goods and cited several cases supporting this view. According to counsel, software is not considered tangible goods, but an intellectual right. To sustain this argument the respondent maintained that the medium used by the applicant conveys only the software and has not received new properties or forms; that a computer must read the software into its own memory before the software can be used; and that the software can be reproduced on other tape or disk, the old medium being then able to receive another software. Finally, the respondent adds that the magnetic or electronic impulse that records computer software can be compared to television signals that were not viewed as goods, i.e., tangible moveable property, in the *Canadian Wirevision*⁴ case that dealt with the *Income Tax Act*.

With respect to the exemption set forth in subparagraph 1(a)(ii), the respondent argued that the exemption refers to the development of a plant equipment suitable to the production of specific goods and not software computers used with production equipment. The respondent is also of the opinion that it is not the applicant but its client, by using the software bought, that engage in the "manufacturing or production process" to which that exemption refers.

On a more inclusive approach, the respondent stated that the applicant is rather a creator than a producer or manufacturer. ICAM, he contends, is in the programming business. Most of the time spent by its employees is in programming. Furthermore, it is the respondent's submission that the

3. *The Royal Bank of Canada v. Deputy Minister of National Revenue*, 81 D.T.C. 5301.

4. *Canadian Wirevision Limited v. The Queen*, [1978] 2 F.C. 577.

applicant does not manufacture diskettes, but develops programs. Diskettes, in themselves, have no value. It is the information they carry that has a high value. In this regard, counsel for the respondent insisted that the punching of the tapes takes only few minutes and that the reproduction of diskettes, a few seconds. Counsel, therefore, urged the Tribunal to recognize that less than one percent of the use of the equipment in issue was for that purpose.

After the hearing, the Tribunal received new evidence from the respondent's counsel. This documentary evidence pertains to the area of public information and relates to declarations made by the applicant, with respect to companies' declaration under provincial and federal companies laws, that it carries on services activities. Counsel for the applicant did not really object to the new evidence leaving it to the Tribunal whether to accept it or not. However, it did present few arguments with respect to the new evidence. In view of the evidence offered at the hearing, the Tribunal considered that the new evidence and the information it provided added nothing new in this instance.

FINDING OF THE TRIBUNAL

At the outset of the hearing, the Tribunal had to consider whether it had the jurisdiction to hear the application. This was a question that had been raised by the respondent in earlier submissions. Although counsel for the respondent indicated at the hearing that he was prepared to accept the Tribunal's jurisdiction in this matter, the Tribunal considered it was its duty to examine this issue on its own accord.

In this instance, the Tribunal observes that section 59 had been repealed effective May 1, 1986,⁵ that is, before the date of the application on October 29, 1986, but still after the applicant had initiated various steps leading normally to that application. In the Tribunal's view, the application provided by section 59 can be assimilated to an appeal, revision or remedy and, therefore, constituted an "accruing right" under section 43 of the *Interpretation Act*⁶ as established by the jurisprudence.⁷ The Tribunal also finds that the remedy provided by section 59 is more than a mere matter of procedure and, consequently, without any indication to the contrary from the legislator in the repealing act, the Tribunal finds that the repeal of that section did not have the effect of depriving the applicant of its right to an application (see the decision of the Supreme Court of Canada in *La ville de Jacques-Cartier*⁸). Finally, the Tribunal notes that the repealing act did not have any effect on the Tariff Board constitution and, thus, that the Tariff Board now replaced by the Tribunal⁹ was still existing at the time of the application. Therefore, in view of section 43 of the *Interpretation Act* and the relevant jurisprudence, the Tribunal accepts that it has jurisdiction in this matter.

The main issue facing the Tribunal is whether the machinery and apparatus purchased by the applicant should be exempt from taxation under the Act on the basis that it was used in the

5. *An Act to amend the Excise Tax Act and the Excise Act and to amend other Acts in consequence thereof*, S.C. 1986, c. 9, subs. 46 (2).

6. *Interpretation Act*, R.S.C., 1985, c. I-21.

7. *In re Heinrich Kleifges and in re Citizenship Act*, [1978] 1 F.C. 734; *Re owners, Strata plan VR 29 and Registrar Vancouver Land Registration et al.*, (B.C. S.C.) 91 D.L.R. (3d) 528; *Re Rai* (Ontario Court of Appeal) 106 D.L.R. (3d) 718.

8. *La ville de Jacques-Cartier v. Joseph Napoléon B. Lamarre*, [1958] S.C.R. 108.

9. *An Act to establish the Canadian International Trade Tribunal and to amend or repeal other Acts in consequence thereof*, R.S.C., 1985 (4th Supp.) c. 47, s. 52.

manufacture or production of goods, in the development of manufacturing or production processes for use by it, or in the development of goods for manufacture or production by it. To find for the applicant, the Tribunal would have to conclude, first, that the applicant is a manufacturer or producer of goods and, second, that the equipment purchased by the applicant was used in connection with one or more of the three above-mentioned activities as provided by the exempting subparagraphs of subsection 1(a) of Part XIII, Schedule III.

It is apparent to the Tribunal that the legislation provides no clear guidance as far as computer software is concerned. Nor has there been jurisprudence brought to the Tribunal's attention that would assist in determining whether software programs constitute manufactured or produced goods for the purposes of the Act. However, the Tribunal notes that Revenue Canada has not considered software to be goods for the purposes of the Act and, therefore, it is not taxable under the provisions of section 27. While the Tribunal is aware of the Department's interpretation with respect to section 27 of the Act, it must examine the particular facts and circumstances of this case in determining whether the provisions of Part XIII, Schedule III encompass the activities carried on by the applicant.

The Tribunal does not accept the argument of counsel for the applicant that it should give special weight to the opinions of its expert witnesses as to the applicant's status as a manufacturer. This case concerned the interpretation of words such as "goods" and "manufacture," terms that do not have any particular meaning in the trade. It is well established in the jurisprudence that when words in a statute have no special industry or technical meaning, the words should be given their common and ordinary meaning, as indicated by dictionary definitions. The opinion evidence of experts should be accorded no particular relevance in interpreting the statute in these instances.

In summary, the Tribunal took note of the various interpretations urged on it by both parties in the case. Neither the views of software experts testifying at the hearing nor those of Revenue Canada in applying the Act were particularly determinative in dissuading the Tribunal that the relevant terms contained in the schedule should be given their common, ordinary meaning.

In assessing whether the activities of the applicant constituted the manufacture or production of goods, the Tribunal relied on evidence relating to the marketing, development and processing of the applicant's software and on jurisprudence concerning the meaning of the terms "manufacture or production" and "goods."

The Supreme Court of Canada, citing an earlier case of the Quebec Superior Court, provided in *York Marble* the following definition of manufacturing:

... manufacture is the production of articles for use from raw or prepared material by giving to these materials new forms, qualities and properties or combinations whether by hand or machinery. (p. 5003)

Applying the Court's test to the facts of this case, the Tribunal finds that the activities carried on by the applicant do give new forms, qualities and properties to materials, and that, therefore, the applicant is a manufacturer. Testimony established that in the case of custom software, the applicant punched holes in magnetic tape, thereby giving it a new physical form. For generic software, the applicant's processes gave the disk or tape new magnetic properties. In both cases, the medium was given new qualities and properties that allowed it to perform certain functions that it had been unable to perform previously. Its inherent capabilities were changed as a result of the applicant's operations. The diskettes or tapes, useless to the purchaser without the software, now have a utility because of the new properties received.

The Tribunal recognizes that the facts of this case are different from those facing the Court in *York Marble*. The *York Marble* case dealt with raw material, marble slabs, which were submitted to various processes including matching, grouting, rodding, gluing and polishing. In this case, the applicant deals not with raw materials but prepared materials. Recognizing that the applicant's operations may not constitute manufacturing in the traditional sense of the word, the Tribunal is disposed to paraphrase the Supreme Court of Canada in the *York Marble* case, and is convinced that the process in which the applicant was engaged could as well constitute "production" as established in the *Gruen Watch*¹⁰ case where the mere insertion of a movement into a watch case was found to constitute the production of a watch.

The Tribunal also places weight on the fact that the applicant supplied a physical item to its clients as part of the terms of its contract. Each transaction involved a "deliverable," a product that was left behind and could be used by the purchaser on his or her own terms. The software was priced on a per unit basis in all but a few cases. Clients were not charged an hourly rate based on the amount of time or effort expended in developing the program.

The Tribunal considers it immaterial that it takes only seconds to infuse the medium with the information developed by the applicant, but can take several years to develop the information itself. This does not suggest to the Tribunal that its manufacturing or production process is any less real. High-value added, knowledge-based products derive the majority of their value from the intelligence that underlies them. It seems arbitrary to disqualify these products as manufactured goods simply on the basis that raw material or production costs constitute a small proportion of their worth.

The respondent has argued that the activities carried on by the applicant were more in the nature of a service than manufacturing or production. The delivery of the tangible tape or disk was a minor or incidental part of its contract with its clients. The intangible element, the information contained on the tape or disk, is what the customer is interested in. This, argued the respondent, is indicated by the fact that the value of the computer disk accounted for a mere four dollars out of contracts worth several hundred dollars.

The Tribunal is aware that the applicant also sells a service when it sells a software program. This is especially true in the case of custom software where the client's special needs must be reflected in the program designed. In the Tribunal's view, however, this is not greatly different from the situation of many manufactured or produced goods that are specifically designed with customer's needs in mind or followed up by considerable after-sales service. It does not seem practical to deny that goods were manufactured or produced simply because their delivery was preceded, followed up or accompanied by service activities.

The Tribunal does not accept the respondent's argument that software is disqualified from consideration as manufactured or produced goods because it is covered by copyright provisions. Examples abound of manufactured or produced goods protected by some form of patent, copyright or trade protection. Drugs, video cassettes or books would fall into this category. The fact that the design, creativity or intelligence that goes into them is protected from duplication does not, in the Tribunal's mind, mean that they are not manufactured or produced goods.

10. *Gruen Watch Co. of Canada v. Attorney General of Canada*, (1950) C.T.C. 440.

Having determined that the applicant is engaged in the manufacturing or production of goods, it remains for the Tribunal to determine whether the machinery and apparatus sold to the applicant were used primarily and directly in the manufacture or production of goods, in the development of manufacturing or production processes for use by it, or in the development of goods for manufacture or production by it.

Testimony by the applicant's president established that 90 percent of the time of the computer equipment at issue was devoted to the development of software programs. The actual transfer of the programs onto disk or tape took only seconds, whereas years can be expended developing and perfecting the software.

Based on this testimony, the Tribunal finds that the equipment purchased by the applicant falls within the meaning of exempting subparagraph 1(a)(i). Moreover, the Tribunal finds that, even if one were to adopt a narrow view of the meaning of "manufacture" or "production" and restrict it only to the actual transfer of the program onto the medium, an operation taking only seconds, one would still find the applicant's equipment eligible for exemption from tax on the basis that it was "for use in the development of goods for manufacture or production" pursuant to exempting subparagraph 1(a)(iii) and has been used primarily and directly for that purpose.

CONCLUSION

In the Tribunal's view, the activities carried on by the applicant constituted the manufacturing or production of goods. Further, the Tribunal finds that the machinery and apparatus purchased by the applicant were used primarily and directly in the manufacturing or production of goods and in the development of goods for manufacture or production by it. Accordingly, the application should be granted.

Kathleen E. Macmillan

Kathleen E. Macmillan
Presiding Member

Arthur B. Trudeau

Arthur B. Trudeau
Member

Sidney A. Fraleigh

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