

Ottawa, Monday, June 3, 1991

Appeal No. 3006

IN THE MATTER OF an appeal heard on February 19, 1991,
under section 81.19 of the *Excise Tax Act*, R.S.C., 1985,
c. E-15;

AND IN THE MATTER OF a determination of the Minister
of National Revenue dated February 4, 1988, to which a notice
of objection was served under section 81.15 of the *Excise Tax
Act*.

BETWEEN

VERSALAB INC.

Appellant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is dismissed. For the transactions in issue, the appellant has not satisfied the Tribunal that it met the essential requirements of Excise Memorandum ET 307, which would have allowed it to sell eligible goods to Total Lab Furniture Ltd., tax exempt.

Arthur B. Trudeau

Arthur B. Trudeau
Presiding Member

Kathleen E. Macmillan

Kathleen E. Macmillan
Member

Sidney A. Fraleigh

Sidney A. Fraleigh
Member

Robert J. Martin

Robert J. Martin
Secretary

UNOFFICIAL SUMMARY

Appeal No. 3006

VERSALAB INC.

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

This is an appeal under section 81.19 of the Excise Tax Act by Versalab Inc. from a decision of the Minister of National Revenue disallowing an objection and confirming an assessment. By a notice of assessment dated November 12, 1986, the appellant was assessed for the period commencing January 1, 1983, and ending July 31, 1986, against certain transactions. The appellant objected to the assessment on the grounds that it was exempt from tax liability, pursuant to Excise Memorandum ET 307. By a notice of decision dated February 4, 1988, the Minister of National Revenue disallowed the objection on the basis that the appellant had not met the fundamental requirements of the Excise Memorandum ET 307 and thus could not rely upon it for a tax exemption.

HELD: *The appeal is dismissed.*

Place of Hearing: Ottawa, Ontario
Date of Hearing: February 19, 1991
Date of Decision: June 3, 1991

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

Counsel of the Tribunal: David M. Attwater

Clerk of the Tribunal: Nicole Pelletier

Appearances: Mitchell M. Richler, for the appellant
Geoffrey S. Lester, for the respondent

Appeal No. 3006

VERSALAB INC.

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

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

REASONS FOR DECISION

ISSUE AND APPLICABLE LEGISLATION

This is an appeal under section 51.19 of the *Excise Tax Act*¹ (the Act) by Versalab Inc. (Versalab) from a decision of the Minister of National Revenue dated February 4, 1988. The respondent determined that the appellant did not meet the fundamental requirements of Excise Memorandum ET 307 (the memorandum) and thus disallowed its objection to the assessment.

The issue in this appeal is whether the appellant satisfied the conditions of the memorandum for the transactions in issue and is entitled to use its administrative concessions thus exempting it from the assessed sales tax.

The relevant provisions of the Act to this appeal are:

27. (1)² There shall be imposed, levied and collected a consumption or sales tax at the rate specified in subsection (1.1) on the sale price of all goods

(a) produced or manufactured in Canada

(i) payable, ... by the producer or manufacturer at the time when the goods are delivered to the purchaser or at the time when the property in the goods passes, whichever is the earlier,

...

1. R.S.C., 1970, c. E-13, presently section 81.19.
2. R.S.C., 1970, c. E-13, presently subsection 50(1).

29. (1)³ *The tax imposed by section 27 does not apply to the sale or importation of the goods mentioned in Schedule III....*⁴

44.2⁵ *Where tax under Part III or V has been paid in respect of any goods and subsequently the goods are sold to a purchaser in circumstances that, by virtue of the nature of that purchaser or the use to which the goods are to be put or both such nature and use, would have rendered the sale to that purchaser exempt or relieved from that tax under subsection ... 29(1) ... an amount equal to the amount of that tax shall, subject to this Part, be paid to the person who sold the goods to that purchaser if the person who sold the goods applies therefor within two years after he sold the goods.*

The Department of National Revenue, Customs and Excise (the Department), in December 1975, issued the memorandum entitled Direct Shipment Exemption, which represented an alternative to the use of section 44.2 above.

The preamble of the memorandum reads as follows:

*If you are licensed as a manufacturer or wholesaler for purposes of the Excise Tax Act and sell taxable goods to a person not entitled to exemption, but you ship or deliver the goods **directly** to a third person who is entitled to exemption, you may sell the goods exempt from sales and/or excise taxes provided you comply with the conditions outlined in this memorandum. This will relieve your customer of the necessity of filing a refund claim to recover the tax otherwise payable.*

The relevant instructions are:

1. Tax will not apply to taxable goods sold by a licensed manufacturer or a licensed wholesaler to a second person not entitled to exemption and resold by the latter to a third person under tax exempt conditions provided the following conditions are met:

(a) The licensed first person ships or delivers the goods directly to the tax exempt third person.

(b) The licensed first person has on file

(1) a certified copy of the third person's purchase order (or original purchase order) bearing the exemption certificate(s) applicable, the licence number(s) where required and showing the quantities and description of the goods.

3. R.S.C., 1970, c. E-13, presently subsection 51(1).

4. The goods in issue would usually be tax exempt pursuant to Schedule III under the provisions, for example, of: Part III, Education; Part VIII, Health; and Part XIII, Production Equipment etc., upon purchase by tax exempt or licensed users.

5. R.S.C., 1970, c. E-13, presently section 68.2.

(2) proof of the direct shipment or delivery, such as the bill of lading from the common carrier or a delivery receipt, and

...

*(c) The sales invoice from the licensed first person must indicate that tax exemption has been allowed and that the goods were shipped or delivered **directly** to the tax exempt third person.*

2. Price information may be eliminated from the certified copy of the purchase order sent to the licensed manufacturer or licensed wholesaler.

...

4. Paragraphs 1 and 2 of this memorandum will apply to taxable goods sold to contractors or others who resell goods on a supply and install or erect basis if these goods are delivered directly to the tax exempt third person and a responsible officer of that third person signs for the goods and acknowledges acceptance of them under contract.

FACTS AND EVIDENCE

The appellant is a licensed manufacturer engaged in the manufacture of laboratory furniture and equipment, including fume hoods, sinks, cabinets, etc., made of stainless steel. For the assessment period commencing January 1, 1983, and ending July 31, 1986, the appellant sold certain goods to Total Lab Furniture Ltd. (Total Lab), which had ordered the goods for subsequent sale on supply and install contracts to third parties or end users.

By a notice of assessment dated November 12, 1986, the appellant was assessed in the following amounts for the relevant transactions: taxes unpaid, \$60,006.27; interest, \$10,777.12; and penalty, \$13,906.54, for a total amount owing of \$84,689.93. By a notice of objection dated February 10, 1987, the appellant objected to the assessment on the grounds that it satisfied the requirements of the memorandum. By a notice of decision dated February 4, 1988, the respondent disallowed the objection and refused to vacate the assessment on the grounds that the appellant had not established its entitlement to the provisions of the memorandum.

Pursuant to the Act, the appellant's sales to Total Lab and other installers should have been made on a tax-paid basis since the installers were not entitled to an exemption from tax. However, the ultimate destination of the goods manufactured by the appellant to the order of Total Lab was to third parties that were ordinarily exempt from liability to pay federal sales tax. Under specified circumstances as described in the memorandum, the Department will permit a licenced manufacturer to sell goods to a second party exempt from sales tax if it ships directly to an exempt third party. Relying upon this, the appellant sold to Total Lab on a tax-exempt basis.

At the hearing, counsel for the respondent advised the Tribunal and the appellant that, since the assessment, certain payments had been made by one of Versalab's clients, a firm by the name of Mobec, which reduced the appellant's tax liability to \$36,739.93, plus interest and penalty.

As part of its brief, the appellant submitted copies of invoices to Total Lab covering the transactions during the period 1983 to 1986 that had been disallowed and for which tax was assessed and payable. In addition, the appellant provided copies of purchase orders by tax-exempt third parties placed upon Total Lab for the installation of the goods during the period 1983 to 1986, as well as other documentation attesting to the fact that the end users were licensed or exempt. Only sales to Total Lab are at issue in this appeal.

Mr. C. Gonthier, President of Versalab, and Mr. M. Koshelowsky, President of Total Lab, testified for the appellant at the hearing. Mr. Richler who was acting for the appellant actually represented Total Lab's interests as he claimed Total Lab could be held indirectly liable for the outstanding taxes of the appellant.

The following steps lead to an order for the manufacture and sale of laboratory goods: Total Lab submits to Versalab plans of a laboratory project; Versalab examines the plans and estimates cost of production to determine the price it will charge Total Labs for the goods; upon obtaining the order, Versalab manufactures the goods according to the final plans and specifications provided by Total Lab or the project architect. The identity of the final user is known by Versalab at the time it produces the goods.

According to the testimony, a packing slip was prepared by Versalab and provided to the truck driver. Although prior to 1980, Versalab shipped the goods to the job site with its own truck, for the period in issue, goods were shipped either by commercial carrier or by Total Lab's own truck. Versalab sold f.o.b. its plant.

Delivery of the goods was made directly to the job site. Mr. Koshelowsky testified that proof of this consisted in the fact that Total Lab did not have a plant nor a warehouse in which it could store the goods, as it conducted its operation from a private home. Also, at the job site, the goods were received by Total Lab and not by the ultimate purchaser. The witness further testified that it would not be possible or logical to have an officer of the end user sign for the goods as contemplated by the strict terms of the memorandum.

Documentary evidence provided by the appellant and examined at the hearing consisted of invoices for the sale of goods from Versalab to Total Lab. On the invoices, instructions regarding shipping indicate only "*même*" in French or "same" in English. Upon cross-examination, Mr. Gonthier indicated that "*même*" should not be taken to indicate that the goods were shipped to Total Lab's billing address, but that it meant that the goods were to be shipped to the address of the project care of Total Lab. Furthermore, the name of the end user and location of the laboratory, referred to as "project," were identified on the shipment's packing slip.

Mr. Gonthier, under cross-examination, also indicated that Versalab relied heavily on the instructions of Total Lab as to whether federal sales tax should be included or not on the invoice. Furthermore, he added that, from experience, he usually knew if the project was tax exempt or not. In addition, the invoice indicated that the goods were sold pursuant to the memorandum (i.e., for a tax-exempt final user). In cases where the final user was not tax exempt, federal sales tax would be charged on the invoice.

With regard to the absence of supporting documentation as required by the memorandum, Mr. Koshelowsky indicated that he could not produce the documentation when requested by Revenue Canada. When asked why, he indicated that it would require research and talking to different people, and that he was limited in time. He also indicated that the auditor did not request that he produce certain documentation. Such documentation was not produced at the hearing. However, Mr. Koshelowsky indicated that, if necessary, he would hire temporary help to assist in the location of the documents.

The respondent called one witness, Mr. Vita, the auditor with Revenue Canada who performed the 1986 audit leading up to the assessment under appeal.

Mr. Vita testified that Versalab was assessed taxes of some \$60,000 on sales that it had made to Total Lab and other non-licensed installers, because, during the audit, Versalab was unable to show that it had the documentation to satisfy all the requirements of the memorandum.

According to Mr. Vita, Versalab had very few bills of lading from independent parties. In those instances where Versalab was able to produce a purchase order from a tax-exempt third party and shipping was done by someone other than Total Lab, Mr. Vita allowed the exemption claim. Mr. Vita also testified that Versalab was unable to supply him with any delivery receipts from the end user.

The central issue raised by Mr. Vita was that Versalab did not meet the direct shipment requirements outlined in the memorandum. In Mr. Vita's view, the instruction: "the licensed first person ships or delivers the goods directly to the tax exempt third party" meant that either Versalab had to perform the shipment of the goods directly to the tax-exempt third party or that Versalab had to have the goods shipped directly by commercial carrier. There could be no direct shipment, as required by the memorandum, if the goods were picked up and shipped by Total Lab's truck, because possession of the goods had to remain with Versalab until they reached the third party.

In addition, Mr. Vita testified that certain transactions involved four parties such as a situation where a general contractor contracts for goods and services from installers such as Total Lab for subsequent sale to the ultimate end user. The memorandum only provided for third-party transactions. Furthermore, the third party (i.e., the general contractor) in such instances was not licenced or tax exempt. Mr. Vita explained that if four parties are involved, refund claims for taxes could be made by general contractors where none had been paid. Therefore, four-party transactions were not allowed under the memorandum.

The witness further testified that the Department had assessed Versalab back in November 1981, an issue involving the memorandum and the direct shipment requirement. He indicated that it was Department policy to provide a copy of the memorandum to the party being assessed and to explain the nature of the assessment. He also indicated that the earlier assessment involved transactions with Total Lab.

ARGUMENTS

The appellant argues that the memorandum is merely an administrative policy and not law. Accordingly, its provisions and in particular paragraph 4 must be subject to a practical interpretation.

With regard to the requirement that the goods be delivered directly to the tax-exempt third party, the appellant contends that, in most cases, they were shipped directly by public carrier. However, sometimes it was more convenient to use Total Lab's truck to make the deliveries. These latter instances occurred where people on the job site were waiting to install the goods and a public transporter could not make the deliveries on time. Also, with larger contracts, Total Lab's truck was used to move the goods that would not fit into a single public transporter's truck. It was added that the memorandum does not state that another transport company must be used; nor does it state that the second party (Total Lab) can't make the delivery.

With regard to the requirement that a responsible officer of the third party sign for the goods under the contract, the appellant states that it was furnished with delivery receipts either from the common carrier or from Total Lab on behalf of the third party. The appellant adds that these delivery receipts or slips do not indicate everything in detail, and the third party would not be able to identify separately what they were signing for. The best proof of the acceptance of the goods under contract is the architect's approval of the payment for the project and full payment of the contract price by the third party.

With regard to the fourth-party transactions, the appellant referred to them as "red herrings." It was claimed that they represent a "cop-out" for the Department for being a little bit loose in its handling of refund claims by general contractors.

In summation, the appellant claims to have met all the conditions of the memorandum and, as such, is entitled to the tax exemption it provides.

The respondent argues that the appellant is legally bound to pay federal sales tax pursuant to subsection 50(1) [formerly subsection 27(1)] of the Act on sales to parties that do not provide exemption certificates. The appellant, however, is entitled to rely upon any Departmental policy or practice that would exempt it from tax liability, such as the memorandum, but when relying on such administrative concession, the appellant must strictly comply with the requirements of the memorandum.

The respondent further argues that whether the appellant did in fact comply with all the conditions is a question of fact to be determined in light of the admissible evidence. Therefore, the onus is on the appellant to show that the Department's position is wrong.

The respondent concludes that no evidence or, alternatively, insufficient evidence has been lead by the appellant to discharge its burden of proof.

REASONS

The issue to be decided in this case is whether the appellant has met the requirements of the memorandum. It was evident to the Tribunal that if the Department was to permit manufacturers to sell on a tax-exempt basis, they would have to satisfy three basic conditions. First, that there was an order placed by a tax-exempt end user. Second, that the goods were shipped directly to the eligible end user and not held in inventory at some intermediate point. Third, that the goods, on supply and install contracts, were accepted by the tax-exempt user. In short, the essential requirements imposed by the memorandum create a paper trail from the manufacturer to the tax -exempt user. This is presumably to assure that goods on which tax is not paid are only used in tax-exempt applications.

At the hearing, the appellant produced several purchase orders from tax-exempt end users, thereby satisfying the first of the memorandum's basic requirements.

The main reason why certain transactions were not allowed is because Total Lab had taken possession of the goods on Versalab's premises, and therefore, the transactions do not meet the direct shipment requirement. When a common carrier was used to transport the goods, bills of lading provided documentary proof of shipment to the tax-exempt user. There were no bills of lading or delivery receipts in the case of shipments made by Total Lab. The Tribunal is of the opinion that the Department asserted an unduly restrictive interpretation of the direct shipment requirement by disqualifying all transactions where Total Lab did the delivery although there was verbal testimony that Total Lab shipped the goods directly to the premises of the tax-exempt end user. Nonetheless, the Tribunal agrees that the Department is entitled to have proof of direct shipment by way of delivery receipts in order to complete the paper trail requirements of the memorandum. This documentary proof was not provided at the hearing.

The memorandum contains a third basic requirement for supply and install contracts; acceptance of goods under contract by a responsible officer of the tax-exempt user. The Tribunal is sympathetic to the appellant's argument that this requirement does not accord well with commercial reality, particularly at large construction sites. However, it is not unreasonable that such documentary proof be requested and insisted upon especially as it was Total Lab that did the direct shipment.

A review of the evidence and testimony indicates that while the appellant may well have satisfied some of the requirements of the memorandum, it did not satisfy the essential paper trail requirements imposed by the memorandum. The Tribunal is of the opinion that the Department is justified in requiring a reasonable paper trail to ensure audit of transactions and prevent abuse of the direct shipment provisions. It is therefore incumbent upon the manufacturer to satisfy the requirements of the memorandum if it is to take advantage of the benefits contained therein.

CONCLUSION

The appeal is dismissed. For the transactions in issue, the appellant has not satisfied the Tribunal that it met the essential requirements of the memorandum, which would have allowed it to sell eligible goods to Total Lab, tax exempt.

Arthur B. Trudeau

Arthur B. Trudeau
Presiding Member

Kathleen E. Macmillan

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Sidney A. Fraleigh

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