

Ottawa, Monday, August 19, 1991

Appeal No. 3035

IN THE MATTER OF an appeal heard on April 25, 1991,
under section 81.19 of the *Excise Tax Act*, R.S.C., 1985,
c. E-15;

AND IN THE MATTER OF a decision of the Minister of
National Revenue dated January 21, 1988, with respect to a
notice of objection filed under section 51.15 (now 81.15) of the
Excise Tax Act.

BETWEEN

SCUBS MARKETING LTD.

Appellant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is dismissed. The appellant did not establish to the satisfaction of the Tribunal that it did not use any patent or sales right to the goods being manufactured for it and, as such, is deemed to be the manufacturer in accordance with paragraph 2(1)(b) of the *Excise Tax Act*.

Robert J. Bertrand, Q.C.
Robert J. Bertrand, Q.C.
Presiding Member

W. Roy Hines
W. Roy Hines
Member

Michèle Blouin
Michèle Blouin
Member

Robert J. Martin
Robert J. Martin
Secretary

Ottawa, Monday, August 19, 1991

Appeal No. 3036

IN THE MATTER OF an appeal heard on April 25, 1991,
under section 81.19 of the *Excise Tax Act*, R.S.C., 1985,
c. E-15;

AND IN THE MATTER OF a decision of the Minister of
National Revenue dated January 21, 1988, with respect to a
notice of objection filed under section 51.15 (now 81.15) of the
Excise Tax Act.

BETWEEN

582760 ONTARIO LIMITED

Appellant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is dismissed. The appellant did not establish to the satisfaction of the Tribunal that it did not use any patent or sales right to the goods being manufactured for it and, as such, is deemed to be the manufacturer in accordance with paragraph 2(1)(b) of the *Excise Tax Act*.

Robert J. Bertrand, Q.C.

Robert J. Bertrand, Q.C.

Presiding Member

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UNOFFICIAL SUMMARY

Appeal No. 3035

SCUBS MARKETING LTD.

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

Appeal No. 3036

582760 ONTARIO LIMITED

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

These appeals were originally filed pursuant to section 51.19¹ of the Excise Tax Act (the Act) against decisions of the Minister of National Revenue (the Minister) deeming Scubs Marketing Ltd. (Scubs) and 582760 Ontario Limited (582760 Ltd.) to be manufacturers. The audit period against 582760 Ltd. commenced April 1, 1984, and ended December 31, 1985, while the audit period against Scubs covered the period from September 1, 1983, to August 31, 1986. By Notices of Assessment dated October 24, 1986, 582760 Ltd. was assessed for an amount owing of \$138,618.28 and Scubs was assessed for an amount owing of \$63,764.77. Both assessments were on the basis that the appellants were deemed to be manufacturers pursuant to paragraph 2(1)(b) of the Act.

By Notices of Objection dated January 20, 1987, both appellants argued to the contrary. By Notices of Decision dated January 21, 1988, the Minister allowed the objections in part, adjusting the amounts owing to \$61,639.15 against 582760 Ltd. and \$24,760.99 against Scubs. On August 8, 1988, the appellants appealed these decisions to this Tribunal's predecessor, the Tariff Board.

HELD: *The appeals are dismissed. The appellants did not establish to the satisfaction of the Tribunal that they did not use any patent or sales right to the goods being manufactured for them and, as such, are deemed to be the manufacturers in accordance with paragraph 2(1)(b) of the Excise Tax Act.*

Place of Hearing: Ottawa, Ontario
Date of Hearing: April 25, 1991
Date of Decision: August 19, 1991

1. Now section 81.19.

Tribunal Members: *Robert J. Bertrand, Q.C., Presiding Member*
 W. Roy Hines, Member
 Michèle Blouin, Member

Counsel for the Tribunal: *David M. Attwater*

Clerk of the Tribunal: *Nicole Pelletier*

Appearances: *Gerald McGuire, for the appellant*
 Gilles Villeneuve, for the respondent

Appeal No. 3035

SCUBS MARKETING LTD.

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

Appeal No. 3036

582760 ONTARIO LIMITED

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

TRIBUNAL: ROBERT J. BERTRAND, Q.C., Presiding Member
W. ROY HINES, Member
MICHÈLE BLOUIN, Member

REASONS FOR DECISION

ISSUE AND APPLICABLE LEGISLATION

The issue in these appeals is whether Scubs Marketing Ltd. (Scubs) and 582760 Ontario Limited (582760 Ltd.) are manufacturers of disposable ice cube molds pursuant to the *Excise Tax Act*² (the Act) and, as such, liable for taxes based on the sale price of the goods.

For purposes of these appeals, the relevant provisions of the Act are:

2. (1) *In this Act,*

...

"manufacturer or producer" includes

...

(b) any person, firm or corporation that owns, holds, claims or uses any patent, proprietary, sales or other right to goods being manufactured, whether by them, in their name or for or on their behalf by others, whether that person, firm or corporation sells, distributes, consigns or otherwise disposes of the goods or not,

...

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

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

SCHEDULE III

PART I

COVERINGS OR CONTAINERS

1. Usual coverings or usual containers sold to or imported by a manufacturer or producer for use by him exclusively in covering or containing goods of his manufacture or production that are not subject to the consumption or sales tax, but not including coverings or containers designed for dispensing goods for sale or designed for repeated use.

2. All of the following usual coverings or usual containers when for use exclusively for covering or containing goods not subject to the consumption or sales tax:

...

(k) bottles for food or drink.

3. Materials for use exclusively in the manufacture of the tax-exempt goods mentioned in sections 1 and 2 of this Part.

PART V

FOODSTUFFS

1. Food and drink for human consumption (including sweetening agents, seasonings and other ingredients to be mixed with or used in the preparation of such food and drink) ...

3. Articles and materials for use exclusively in the manufacture or production of the tax-exempt goods mentioned in sections 1 and 2 of this Part.

...

PART XI

MISCELLANEOUS

...

14. Ice.

3. Now section 51(1).

...

FACTS AND EVIDENCE

These are appeals originally filed pursuant to section 51.19⁴ of the Act against decisions of the Minister of National Revenue (the Minister) deeming Scubs and 582760 Ltd. to be manufacturers. The audit period against 582760 Ltd. commenced April 1, 1984, and ended December 31, 1985, while the audit period against Scubs covered the period from September 1, 1983, to August 31, 1986. By Notices of Assessment dated October 24, 1986, 582760 Ltd. was assessed for an amount owing of \$138,618.28 and Scubs was assessed for an amount owing of \$63,764.77. Both assessments were on the basis that the appellants were deemed to be manufacturers pursuant to paragraph 2(1)(b) of the Act.

By Notices of Objection dated January 20, 1987, both appellants argued to the contrary. However, by Notices of Decision dated January 21, 1988, the Minister allowed the objections in part, adjusting the amounts owing to \$61,639.15 against 582760 Ltd. and \$24,760.99 against Scubs. On August 8, 1988, the appellants appealed these decisions to this Tribunal's predecessor, the Tariff Board.

The appellants were not represented at the hearing by independent counsel. Mr. Gerald McGuire, President of the companies, represented both firms as witness and counsel. The owner and sole shareholder of the companies during the assessment period was Mr. McGuire's wife. She purchased Scubs in January 1984. Prior to that date, Scubs was a wholly owned subsidiary of Northern Plastics Ltd., and 582760 Ltd. became a wholly owned subsidiary of Scubs in January 1986.

Evidence presented at the hearing (Exhibit B-1) shows that the appellant Scubs entered into a licensing agreement on November 19, 1980, with a Danish company, Vangedal Plast A/S, for the exclusive right in Canada "to make, have made, use and sell" disposable ice cube molds covered by the patentee's rights. The agreement was to remain in effect until December 31, 1983, and would be renewed automatically for a two-year period if certain sales performance conditions were satisfied.

A second agreement was signed on February 14, 1985, between, on the first part, Erling Vangedal-Nielsen (the patentee) and Scubs International Ltd. (the licensor) and, on the second part, William Gerald McGuire (the licensee). This latter agreement, entered into some 14 months after the original agreement had been scheduled to lapse, gave Mr. McGuire the exclusive right to "make, use, exercise and vend the Invention throughout the Territory (Canada), to the exclusion of all other persons, including the Licensor and the Patentee." The 1985 agreement was for a period of five years if not prolonged.

Scubs first started to sell the disposable ice cube molds in March 1981, about four months after the first licensing agreement was signed. It continued to sell the same type of disposable bags throughout the assessment period. Mr. McGuire testified that the bags correspond to the invention that has been patented.

Pursuant to both agreements, the licensee was to pay the licensor a royalty in consideration of the licence. Evidence presented during cross-examination clearly established that royalties (or

4. Now section 81.19.

commissions as Mr. McGuire preferred to call them) were paid. The statement of operations for Scubs for the year ended March 31, 1984, includes an entry of \$2,416 for royalties. The general ledger trial balance of the same firm shows a debit of \$1,405.51 against royalties for August 1986 and a debit of \$26,383 against royalties for the year to date. An entry for royalties also appears in the schedule of expenses for 582760 Ltd. for the period from April 5, 1984, to December 31, 1985, totalling \$54,964.

The second licensing agreement specified that the licensor was the owner of the trademark "Scubs" and that the licensee could use the trademark and the licensor's design for packing material. However, Mr. McGuire introduced the certificate of trademark registration No. 273559 (Exhibit A-10) confirming that the trademark "Scubs" was registered to him on November 5, 1982.

ARGUMENTS

Two additional matters were raised in the course of the hearing by counsel for the appellants. The first concerned the correctness of the actual assessments made by Revenue Canada. Mr. McGuire was not ready to present evidence on this question and agreed that it was secondary to the main issue as stated above. The second concerned the appellants' request that the goods be considered as tax exempt on the grounds that they are described in Schedule III under Part I, Coverings or Containers; Part V, Foodstuffs; or Part XI, Miscellaneous. This matter had not been raised in either the notice of objection or in the appellants' earlier submissions to the Tribunal. As such, the respondent was not in a position to address the issue.

Final argument for the appellants was submitted in writing by Mr. McGuire and has been taken into account by the Tribunal in this decision.

Mr. McGuire argued that the appellants should not be deemed to be the manufacturers of the ice cube molds because: they did not own or have a patent right to the goods during the manufacturing process; they did not hold a right under the *Patent Act*; they did not have control over the manufacture and sale of the product prior to their receipt of the finished ice cube molds; they were not required to purchase from the physical manufacturer exclusively; they did not finance or own raw material inventories of the physical manufacturer; and because the relationship between them and the physical manufacturers during the assessment period was that of arm's length buyer and seller.

Mr. McGuire maintained that no licence agreement existed with the Danish firm following the expiry of the first agreement on December 31, 1983, and that the subsequent agreement entered into on February 14, 1985, was between the patentee/licensor and Mr. McGuire, not the appellants. Further, he argued that the first licence agreement was not renewed after its expiry date of December 31, 1983, and that a new licence was issued in February 1985. Production of the ice cube mold bags continued throughout this period, which was not contested or challenged by the patentee. Mr. McGuire contended that even though a written licence agreement existed, such an agreement did not provide the licensee the right to defend the patent or protect its exclusivity. Moreover, while the companies paid a commission to the licensor (Scubs International Ltd.), it was for services rendered for either acquiring information or supplying different products. With respect to the question of the ownership of the trademark "Scubs," Mr. McGuire referred to the registration certificate and stressed that the trademark is used for corporate identity purposes on a variety of products sold by the firms.

Counsel for the respondent, Mr. Gilles Villeneuve, argued that the appellants were the legal manufacturers of the ice cube molds because they used the patent right and the trademark right and held a sales right for the bags manufactured by Northern Plastics Ltd. and Jordan Plastics Ltd. In this connection, counsel noted that the patentee was granted a Canadian patent number, which number is

reproduced on the packages containing the ice cube molds, that a patent licence can be in written or oral form, that a licence is not an assignment of a patent right, but that a patent licensee uses a patent right. Counsel focussed on the "use" criteria of paragraph (2)(1)(b) of the Act and referred to certain jurisprudence supporting the view that a licence to a patent is a use of a patent right. In this regard, both the first and second agreements confer the right on the licensee to use the patent.

Counsel for the respondent argued that Mr. McGuire was, in fact, Scubs and 582760 Ltd., and held the licence as agent for them. Moreover, the ice cube molds were manufactured for the appellants since only they had a licence to sell the goods in Canada. In support of his position, Mr. Villeneuve noted that Scubs was named as the licensee in the first licensing agreement. While the second agreement named Mr. McGuire as the licensee, he was acting as agent for the companies in that he entered into an agreement to manufacture and sell ice cube molds when he had never manufactured and sold these products in his own right during the period in question. Further, the second agreement in several clauses clearly refers to a company rather than an individual being involved in these transactions, and the financial statements for the appellants establish that provision was made for the payment of royalties until August 1986, including the period between January 1984 and February 1985, when there was no written agreement, inferring that an oral agreement existed during that period. In the latter connection, counsel noted that the second agreement, although signed on February 14, 1985, required the licensee to pay royalties starting on January 1, 1985, and included a provision permitting the licensee to use the trademark "Scubs."

REASONS

With regard to the correctness of the assessment, the Tribunal finds it difficult to address the issue. As mentioned, the respondent was not alerted to it becoming an issue at the hearing and did not attempt to defend it. The Tribunal notes, however, that the appellants had the onus of proving it wrong, but did not present any such evidence.

With regard to the alleged tax-exempt status of the goods, the Tribunal cannot agree with the assertions of the appellants. The goods at issue are plastic bags that serve as ice cube molds. They are not used for covering or containing goods of the appellants' manufacture or production, they cannot be considered "bottles," they clearly are not "food or drink for human consumption" and, though they are designed to make ice cubes, they are not "ice."

The main issue of these appeals is whether the appellants are manufacturers of the ice cube bags which, for purposes of the Act, is essentially a question of fact. In order to succeed in their appeals, the appellants must clearly establish that they did not hold, claim, own or use any patent, proprietary, sales or other rights to the goods being manufactured for or on their behalf by Northern Plastics Ltd. or Jordan Plastics Ltd. In the Tribunal's view, they have not done so.

While it is the right of all taxpayers to arrange their affairs in a manner to minimize their tax burden, care must be exercised to ensure that taxes are levied in accordance with the law.

In order to appreciate the situation before the Tribunal, it is necessary to analyse the evidence concerning both the relationships between the parties involved and the licensing agreements. The first licensing agreement, which was effective during the period November 19, 1980, to December 31, 1983, the period that predated the assessment, includes a clause providing for automatic renewal. While no specific evidence was adduced as to whether the agreement was, in fact, renewed automatically, financial statements for the appellants show that royalties were provided for or paid during the period between January 1984 and February 1985, and that the second licensing agreement

dated February 14, 1985, included a provision for the payment of royalties from January 1, 1985. While this is not conclusive proof that the first agreement applied throughout 1984, no substantive evidence to the contrary was provided to the Tribunal.

The second agreement was operative during the remainder of the audit period. The Tribunal is cognizant that neither of the appellants was party to this agreement. However, it is the Tribunal's opinion that the appellants could "use" a patent or another right without actually owning the right or being contractually bound to the party or parties furnishing that right. The word "use" implies the act of employing or utilizing for or with some aim or purpose. By Mr. McGuire's own admission, the licensee was permitted to have the ice cube molds produced and subsequently sell them without conflict from the patent owner. The licensee was also given these rights to "the exclusion of all other persons." The appellants were the ones, in fact, that employed or utilized these rights for economic gain. It was for the use of these rights that the appellants paid royalties.

CONCLUSION

The appeals are dismissed. The appellants did not establish to the satisfaction of the Tribunal that they did not use any patent or sales right to the goods being manufactured for them and, as such, are deemed to be the manufacturers in accordance with paragraph 2(1)(b) of the Act.

Robert J. Bertrand, Q.C.

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