

Ottawa, Tuesday, August 6, 1991

**Appeal No. AP-90-055**

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

AND IN THE MATTER OF the Notice of Decision of the  
Minister of National Revenue dated February 28, 1990, with  
respect to a notice of objection filed pursuant to  
section 81.15 of the *Excise Tax Act*.

**BETWEEN**

**THE CLOSET SHOP INC.**

**Appellant**

**AND**

**THE MINISTER OF NATIONAL REVENUE**

**Respondent**

**DECISION OF THE TRIBUNAL**

The appeal is allowed in part. The Tribunal finds that the appellant's closet designers spent half of their time on installation work. Accordingly, the appellant is entitled to exclude 50 percent of the commissions paid to closet designers from the sale price of its goods in determining sales tax payable under the *Excise Tax Act*.

Kathleen E. Macmillan  
Kathleen E. Macmillan  
Presiding Member

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

Arthur B. Trudeau  
Arthur B. Trudeau  
Member

Robert J. Martin  
Robert J. Martin  
Secretary

*UNOFFICIAL SUMMARY*

**Appeal No. AP-90-055**

**THE CLOSET SHOP INC.**

**Appellant**

**and**

**THE MINISTER OF NATIONAL REVENUE**

**Respondent**

*This is an appeal pursuant to section 81.19 of the Excise Tax Act from a decision of the Minister of National Revenue disallowing the appellant's notice of objection and denying its claim that 50 percent of closet designers' commissions represent installation expenses and that dividends paid to the shareholder/manager represent "remuneration" as provided by the Erection and Installation Costs Regulations enacted pursuant to clause 46(c)(ii)(A) of the Excise Tax Act.*

***HELD:*** *The appeal is allowed in part.*

*Place of Hearing:* Ottawa, Ontario

*Date of Hearing:* March 19, 1991

*Date of Decision:* August 6, 1991

*Tribunal Members:* Kathleen E. Macmillan, Presiding Member  
Robert J. Bertrand, Q.C., Member  
Arthur B. Trudeau, Member

*Clerk of the Tribunal:* Nicole Pelletier

*Counsel for the Tribunal:* Gilles B. Legault

*Appearances:* Bernard S. Dales, for the appellant  
Gilles Villeneuve, for the respondent

***Case Cited:*** *Aron Salomon v. A. Salomon and Company, Limited, [1987] H.L.(E.) 22.*

**Appeal No. AP-90-055**

**THE CLOSET SHOP INC.**

**Appellant**

**and**

**THE MINISTER OF NATIONAL REVENUE**

**Respondent**

TRIBUNAL: KATHLEEN E. MACMILLAN, Presiding Member  
ROBERT J. BERTRAND, Q.C., Member  
ARTHUR B. TRUDEAU, Member

**REASONS FOR DECISION**

This is an appeal pursuant to section 81.19 of the *Excise Tax Act*<sup>1</sup> (the Act) from a decision of the Minister of National Revenue in which the appellant seeks a declaration that it is entitled to sales tax deductions pertaining to designers' commissions and shareholder/manager remuneration as provided by the *Erection or Installation Costs Regulations*<sup>2</sup> (the Regulations).

**ISSUES AND APPLICABLE LEGISLATION**

This appeal involves two issues. First, whether a portion of the commissions paid to closet designers can be considered as installation costs and deducted from the sale price of goods in accordance with paragraph 5(1)(m). The second issue is whether dividends paid to the shareholder/manager constitute remuneration and may be included as installation costs within the context of paragraph 5(1)(d).

The relevant provisions of the Act and its relevant regulations read as follows:

**The Act**

42.<sup>3</sup> ...

"sale price," for the purpose of determining the consumption or sales tax, means

(a) except in the case of wines, the aggregate of

- 
1. R.S.C., 1985, c. E-15, as amended.
  2. SOR/83-136, 4 February, 1983, which Excise Memorandum ET 205 duplicates to a certain extent.
  3. Formerly R.S.C., 1970, c. E-13, as amended, subsection 26(1).

...

*(ii) any amount that the purchaser is liable to pay to the vendor by reason of or in respect of the sale in addition to the amount charged as price, whether payable at the same or any other time, including, without limiting the generality of the foregoing, any amount charged for, or to make provision for, advertising, financing, servicing, warranty, commission or any other matter, and*

...

*46.<sup>4</sup> For the purpose of determining the consumption or sales tax payable under this Part,*

...

*(c) in calculating the sale price of goods manufactured or produced in Canada, there may be excluded*

...

*(ii) under such circumstances as the Governor in Council may, by regulation, prescribe, an amount representing*

*(A) the cost of erection or installation of the goods incurred by the manufacturer or producer where the goods are sold at a price that includes erection or installation, or*

...

*determined in such manner as the Governor in Council may, by regulation, prescribe.*

### The Regulations

*3. For the purposes of clause 26(6)(c)(ii)(A) of the Excise Tax Act, the costs of installation, as determined by sections 4 to 7, may be excluded in the calculation of the sale price of goods manufactured or produced in Canada.*

...

*5.(1) Where a manufacturer or producer sells goods at a price that includes installation of the goods but does not regularly sell identical goods at a price that does not include installation, the cost of installation of the goods shall be an amount equal to the aggregate of*

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4. Formerly R.S.C., 1970, c. E-13, as amended, clause 26(6)(c)(ii)(A).

...

*(d) where the supervision or work of installation is carried out by the proprietor or partner of a business, the remuneration of the proprietor or partner of the business attributable to the time spent on the site of installation supervising installation of the goods or carrying out the work of installation may be included in the cost of installation if*

*(i) it can be established that the remuneration is not in excess of the remuneration ordinarily paid to workmen, foremen or superintendents who perform the same type of work, and*

*(ii) adequate records are maintained to substantiate the time spent in supervising or carrying out the work of installation;*

...

*(m) the cost of blue prints and forms used in the field for installation;*

...

8. *A manufacturer or producer shall support all costs of installation determined under section 5 and all calculations described in section 7 by documentary evidence submitted to the Deputy Minister of National Revenue for Customs and Excise.*

## FACTS AND EVIDENCE

The appellant sells and installs custom closet systems to the general public. Each individual closet is specifically designed for an individual customer and then cut, assembled and installed by the company. The component parts of a closet system consist of drawers, uprights and shelves manufactured by the company from a melamine laminate and also include chrome hanging systems.

On December 21, 1988, the respondent assessed the appellant for an amount of \$55,027.17 including unpaid taxes, interest and penalty over the period of June 3, 1985, to June 30, 1988. The appellant filed a notice objecting to that assessment which was received by the respondent on February 2, 1989, and disallowed by way of Notice of Decision dated February 28, 1990. The appellant then appealed that decision to this Tribunal.

At the hearing, the president of The Closet Shop Inc. (Closet Shop), Mrs. Brenda Dales, appeared as a witness and described the company's structure and operations.

Mrs. Dales is the founder and sole shareholder of Closet Shop, which was incorporated in 1979. The operations consist of a showroom, retail outlet and manufacturing plant. The firm has roughly 15 employees including carpenters, installers, sales staff and designers. Mrs. Dales' responsibilities include administration, public relations, closet design, management of the retail shop and supervision of the installation operations.

Mrs. Dales outlined the various steps followed in closet sales, design and installation. The process begins when a client sets up an appointment with one of the appellant's designers. The designer measures the proposed location for the closet and notes problem areas such as vents or access difficulties. Measurements are taken to one-sixteenth of an inch. The designer then consults with the client as to special needs or requirements. For example, the designer will ask the age, height and sex of the closet user or users. Based on the measurements and client's directives, the designer draws up a rough design at the site and discusses it with the client. Occasionally, the designer presents several options.

Once the client and designer generally agree on a rough design, the designer prepares a more detailed drawing and cost estimates. If the client wishes to proceed with the job, she or he signs a copy of the detailed estimate and makes a deposit.

If the order is received, the designer books the installation with the factory and prepares installation drawings and a factory cut sheet. The installation drawings are done to scale on graph paper and contain information for the installers such as customer's name, address, telephone number, the rooms for which the closets are intended and where the house key is located if the client is not at home, etc. Because the designers are not generally present for the closet's installation, and frequently the clients are absent as well, the information provided to the installers must be very complete.

If the job is especially large or if problems arise, the designers will visit the site at the time of the installation. Occasionally small plan changes must be made at the site, but can only be made with the approval of the designer.

The appellant provided the Tribunal with a copy of an analysis done by Mrs. Dales apportioning the amount of time spent by designers on different phases of closet contracts (Addendum to the appellant's brief, at 20). Mrs. Dales explained that the time of designers could be divided into the following five steps:

1. exact measurements
2. consultations with client
3. preparation of installation drawings
4. preparation of the factory list
5. return call at the time of installation.

The analysis was based on five design contracts done by the witness, over the 1986-88 period. The contracts ranged in size from \$550 to \$6,500 and were, in Mrs. Dales view, representative of the appellant's typical business.

The time spent in the various steps was allocated into one of three categories: customer, installation or factory.

According to Mrs. Dales, the measurements taken in stage one are for two purposes: for cost estimates and for installation drawings. Accordingly, half the time spent in stage one was allocated to customer and half to installation. Stage two, which Mrs. Dales described as "making the sale," was considered to fall in the customer category. Stage three was allocated to the installation category and stage four to the factory category. Stage five, the return call, is not always necessary. If a return visit is made, it is considered to fall within the installation category.

Based on the analysis done on the five contracts, installation time accounts for 50 percent of all the time spent by designers on closet contracts. This estimate accords with another analysis filed by the appellant with its brief although the latter refers to contracts not pertaining to the assessment period at issue.

Mrs. Dales explained that designers were paid only by commission on closet sales. In most cases, commissions were set at 15 percent of sale price less installation costs and provincial sales tax. If the designers make no sales, they receive no income. Consequently, one-half of their income is related to installation work.

Mrs. Dales testified that her remuneration is taken either in the form of salary, dividends, or combinations of the two, depending on the recommendations of her accountants. Mrs. Dales does not receive commissions for any design work she does.

Mrs. Dales testified that she oversees all aspects of the appellant's operations. In addition to designing closets for some special clients, she personally approves all closet designs prepared by other designers before they are sent to the factory. She also meets each morning with the carpenters to review installations planned for the day. According to Mrs. Dales, the Revenue Canada auditor verified the amount of time she spent at various tasks by reviewing daily schedules in her day book and by consulting with her factory workers.

## ARGUMENTS

Counsel for the appellant argued first on the question of designers' installation costs. According to counsel, Excise Memorandum ET 205 clearly sets out that blueprints and forms used in the field for installation are allowable deductions from sale price in determining sales tax payable.

In counsel's view, the onus is on the respondent to indicate why he does not accept the appellant's estimates of installation expenses. The appellant has always been very cooperative and forthright in opening its records to scrutiny and has, on two occasions, prepared analyses of the time spent by designers on various functions. These estimates have not been contradicted by any evidence brought by the respondent. Counsel for the appellant argued that the designers' installation effort is capable of the same kind of verification Revenue Canada conducted in assessing the president's time. If Revenue Canada was prepared to investigate the time Mrs. Dales spent on installation work, it should also do so for the designers.

According to the appellant's counsel, the respondent has taken a narrow view of the meaning of the term "commission." In the appellant's case, designers perform many functions that could easily be done by draughtsmen or others. As the evidence showed, their work is quite different from that of people selling jewellery or manufactured items. Rather than focussing on terminology, counsel urged the Tribunal to consider the true substance of the transaction.

On the question of dividends, counsel for the appellant argued that the president was simply arranging her remuneration in a way that put her in the best income tax position. There is no question that she is an active participant in the business who works on a full time basis and thereby is entitled to receive remuneration.

Counsel for the appellant maintained that the appellant's situation is unlike that of a public corporation where dividends are declared by the board of directors. The appellant's president is the sole shareholder of a private company. Consequently, the size and frequency of dividends are within her control. It is not relevant whether her income is in form of dividends or salary.

According to the appellant's counsel, a strict reading of paragraph 5(1)(d) of Excise Memorandum ET 205, which refer to the remuneration of the proprietor or partner of a business, would appear to preclude an officer of a limited company from receiving remuneration. This, in counsel's view, cannot be the intention of the Regulations.

According to counsel for the respondent, the first issue in the appeal is whether the costs incurred by the appellant are in accordance with paragraph 5(1)(m) of the Regulations and are supported by documentary evidence, as required by section 8 of the Regulations. Counsel argued that the onus is on the appellant in this case, and he cited various authorities that have established that the burden of proof is on the taxpayer seeking to reduce his or her tax burden.

The position of the respondent's counsel was that commissions *per se* cannot be directly deductible as an installation cost because they relate to sales, not to installation. This is consistent with the ordinary meaning of the term. However, the respondent recognized that the portion of payments to closet designers that relates to installation can be deducted under the Regulations if the appellant can properly substantiate that the portion does relate to installation. In this instance, the appellant failed to establish beyond either a balance of probabilities or a reasonable doubt that it incurred installation costs pursuant to paragraph 5(1)(m) of the Regulations.

The respondent found the appellant's claim deficient in several respects. First, counsel for the respondent maintained that the documents submitted to Revenue Canada and included in the appellant's brief relate to 1989 which is later than the audit period. Although counsel acknowledged that another set of documents was submitted pertaining to the audit period, the new documents carry less weight because they were not prepared by the designers themselves but by Mrs. Dales. Finally, counsel noted that the sampling was too small to permit any conclusions since only five contracts were analysed out of a total of some 1500 contracts over the relevant time period.

According to the respondent's counsel, the appellant's estimates do not satisfy the Regulations, which require that a taxpayer relying on section 5 to calculate installation costs must support the claim with actual cost records.

As a final point on the issue of installation costs, counsel noted that the respondent was not totally insensitive to the appellant's claim in that he allowed the appellant a deduction of 28 percent under overhead for commission expenses.

On the question of the president's remuneration, counsel for the respondent argued that dividends do not qualify under paragraph 5(1)(d) of the Regulations. The Concise Oxford Dictionary<sup>5</sup> defines remuneration as "pay for services rendered." A reading of paragraphs 5(1)(a) to 5(1)(d) of the Regulations indicates that "remuneration" is used interchangeably with "wages" and "salaries." According to counsel, dividends do not vary proportionately with services rendered but according to the amount of capital invested.

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5. The Clarendon Press, 1982.



Further, the respondent's counsel submitted that the shareholder/manager is neither the proprietor nor the partner of the business. In this respect, counsel cited the case of *Aron Salomon v. A. Salomon and Company, Limited*,<sup>6</sup> which established that the company has an existence distinct from that of its shareholders.

## REASONS

The first question at issue in this appeal is whether the appellant is entitled to deduct commissions paid to closet designers as an installation expense in computing tax payable under the Act.

Based on its examination of the relevant Regulations and the evidence before it, the Tribunal cannot accept the position argued by the respondent that commissions can never be considered as eligible installation expenses since they relate to sales and not to an installation activity. There is nothing in the Regulations that specifically precludes commissions or designer fees from consideration as installation expenses. In the Tribunal's view, the narrow position adopted by the respondent has no grounding in the Regulations themselves.

In this instance, the appellant's closet designers did considerably more than simply make sales. Mrs. Dales' testimony and the documentary evidence filed by the appellant established that the designers took measurements, prepared plans and provided instructions to the carpenter/installers. The Tribunal regards these activities as installation functions and sees no reason in principle to disallow a portion of the designers' income from consideration as installation expenses.

The next question facing the Tribunal is what percentage of designers' commissions should be treated as installation charges, bearing in mind the requirement that the eligible amounts be properly supported.

On this question, the Tribunal found Mrs. Dales' explanation of the analyses prepared by the appellant to be very credible in establishing the time spent by the closet designers on their various activities. Mrs. Dales' expertise in this area was clearly evident. Not only does she have personal experience in closet design but, as company president, she is actively charged with allocating the time and expenses of her employees and understands well the work that they do.

In the Tribunal's view, the time analysis submitted by the appellant and explained by Mrs. Dales meets the conditions of proper documentation as set out in section 8 of the Regulations. The analysis covered almost all years of the assessment period and various sizes of contracts and was representative of the type of work undertaken by the appellant. Short of auditing each and every closet design, the Tribunal is uncertain how one could obtain as indicative a picture of designers' time spent as these analyses provide. Indeed, as it appears from the evidence gathered in the file, Revenue Canada officials had no objection to the same kind of *ex post* analysis of Mrs. Dales' time in calculating the portion of her salary eligible for deduction as installation expenses under paragraph 5(1)(d) of the Regulations.

The Tribunal notes that the results of the time allocations based on the assessment period match those of another time analysis done by the appellant based on 1989 contracts. Although the 1989 contracts fall outside the assessment period for this appeal, it appeared to the Tribunal

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6. [1987] H.L.(E.) 22.

that there is a fairly constant, proportional relationship between measuring, drawing and other "installation" time, and the total time expended on a closet contract. Accordingly, the Tribunal does not believe that more sampling or sampling from different designers would change the results in a meaningful way.

In conclusion, on the issue of designers' commissions, the Tribunal finds the appellant's analysis of the time spent by closet designers on different phases of design contracts, supplemented by Mrs. Dales' explanation of the tasks undertaken by closet designers, establish the appellant's claim that 50 percent of the designers' time is spent on installation work. Consequently, in the Tribunal's view, 50 percent of designers' commissions paid should be deducted from sale price in determining sales tax payable pursuant to section 5 of the Regulations and clause 46(c)(ii)(A) of the Act.

The second issue concerns the eligibility of dividends as allowable installation costs under paragraph 5(1)(d) of the Regulations. In short, can dividends paid to the shareholder/manager be considered as remuneration in applying the Regulations to the Act?

The Tribunal agrees with the arguments made by counsel for the respondent on this issue. In corporate law, dividends are equated with the return of capital to the shareholders. Their size and frequency are dependent on the amount of capital invested and the profitability of the enterprise, and not on the effort expended by the investor. Having elected, for income tax reasons, to receive a portion of her income in the form of dividends, it is not open to the appellant's president to treat the same income as salary for the purposes of the Act. In sum, the Tribunal is convinced that the word "remuneration" in paragraph 5(1)(d) of the Regulations, when read in its context, does not include dividends.

## CONCLUSION

The appeal should be allowed in part. The Tribunal finds that half of the time spent by closet designers for the appellant was spent on installation work. Accordingly, the appellant is entitled to exclude 50 percent of the commissions paid to closet designers from the sale price of its goods in determining sales tax payable under the Act. On the question of dividends paid to the shareholder/manager, the Tribunal finds that the appellant is not entitled to include such dividends as costs of installation in determining sale price under the Act.

Kathleen E. Macmillan

Kathleen E. Macmillan  
Presiding Member

Robert J. Bertrand, Q.C.

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Member

Arthur B. Trudeau

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Member