

Ottawa, Monday, June 1, 1992

Appeal No. AP-90-003

IN THE MATTER OF an appeal heard on March 19, 1992,
under section 81.19 of the *Excise Tax Act*, R.S.C., 1985,
c. E-15, as amended;

AND IN THE MATTER OF a decision of the Minister of
National Revenue dated March 23, 1990, relating to a notice
of objection served under section 81.17 of the
Excise Tax Act.

BETWEEN

BEACON CHRISTIAN HIGH SCHOOL

Appellant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is allowed, and the Tribunal refers the matter back to the Minister of National Revenue for reconsideration on a basis not inconsistent with its reasons.

Desmond Hallissey
Desmond Hallissey
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Charles A. Gracey
Charles A. Gracey
Member

Robert J. Martin
Robert J. Martin
Secretary

UNOFFICIAL SUMMARY

Appeal No. AP-90-003

BEACON CHRISTIAN HIGH SCHOOL

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

In computing its sales tax refund under section 68.26 of the Excise Tax Act, the appellant used the "simplified method" for purchases of approximately \$185,000 of labour and materials and the "identification method" for purchases of approximately \$58,000 of materials only. The latter materials were acquired, at cost, from one member of the appellant's association who owns a construction company, and there was no charge for the labour. The issue is whether, in calculating the amount of its sales tax refund, the appellant is entitled to use the "identification method" in relation to one category of invoices and the "simplified method" with respect to the rest of the invoices pertaining to the same construction project. If the answer to the first issue is no, how should transactions involving materials sold at cost price and donated labour be treated for the purpose of section 76 of the Excise Tax Act and the relevant regulations and policies?

HELD: *The appeal is allowed. There is nothing in Memorandum ET 406 indicating that the kind of transactions in this appeal have been taken into account in establishing the "simplified method." In other words, can the simplified method properly deal with transactions where labour costs are not charged and goods are acquired at cost price? The Tribunal finds that, in this case, the condition set forth in subsection 3(2) of the Formula Refunds Regulations that the Minister take into account "the nature of and the parties to the transaction" is not met. The Tribunal also finds that once the nature of these transactions, and the parties involved, are taken into account, there are no valid grounds for adding the amount of these purchases to the "total contract payment" from which a 66-percent reduction factor will apply. The Tribunal therefore refers the matter back to the Minister for reconsideration on a basis not inconsistent with these reasons.*

*Place of Hearing: Ottawa, Ontario
Date of Hearing: March 19, 1992
Date of Decision: June 1, 1992*

*Tribunal Members: Desmond Hallissey, Presiding Member
Arthur B. Trudeau, Member
Charles A. Gracey, Member*

Counsel for the Tribunal: Gilles B. Legault

Clerk of the Tribunal: Janet Rumball

Appeal No. AP-90-003

BEACON CHRISTIAN HIGH SCHOOL

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

TRIBUNAL: DESMOND HALLISSEY, Presiding Member
ARTHUR B. TRUDEAU, Member
CHARLES A. GRACEY, Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act* (the Act).¹ The Tribunal notes that the parties filed an Agreed Statement of Facts on January 23, 1992, and have asked the Tribunal to proceed on the basis of the written documentation before it in accordance with Rule 25 of the *Canadian International Trade Tribunal Rules*.²

The appellant is a charitable, non-profit Christian school. Between June 30, 1987 and December 20, 1988, it constructed an addition to its school building. Federal sales tax was paid in respect to the material purchased by, or on behalf of, the appellant for the construction project. According to the appellant's notice of objection, in computing its sales tax refund, the appellant used the "simplified method" for determining its sales tax refund for purchases of approximately \$185,000 of labour and materials. The appellant also used the "identification method" for determining its sales tax refund for purchases of approximately \$58,000 of materials only. The latter materials were acquired at cost price from one member of the appellant's association who owns a construction company and who did not charge any markup on the materials or labour fees. According to the Agreed Statement of Facts, the appellant thereby claimed a refund of \$8,372.80 using both methods. The claim was disallowed and re-calculated by Revenue Canada using only one method, the "simplified method," hence a reduction of \$1,588.14. The appellant objected to that determination, which was, nevertheless, confirmed by the respondent on the grounds that "the legislation allows the applicant to choose only one of the prescribed methods outlined in Memorandum ET 406."³

The issue is whether, in calculating the amount of its sales tax refund, the appellant is entitled to use the "identification method" in relation to one category of invoices and the "simplified method" with respect to the balance of invoices pertaining to the same construction project. If the answer to the first issue is no, how should transactions involving materials sold at cost and donated labour be treated for the purpose of section 76 of the Act and the relevant regulations and policies?

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1. R.S.C., 1985, c. E-15, as amended.
 2. SOR/91-499, Canada Gazette Part II, Vol. 125, No. 18, p. 2912, August 14, 1991.
 3. Notice of Decision 90898RE, March 23, 1990.

Under the Act, any educational institution can obtain a refund of sales tax for materials purchased in the construction of a building for that institution. Section 68.26 of the Act reads as follows:

68.26 *Where tax under Part VI has been paid in respect of any materials and the materials have been purchased by or on behalf of*

(a) a school, university or other similar educational institution for use exclusively in the construction of a building for that institution,

...

an amount equal to the amount of that tax shall, subject to this Part, be paid to that institution, organization or corporation if it applies therefor within two years after the materials were purchased.

The "identification method," which, briefly, consists of identifying the exact amount of sales tax paid, is nothing more than the application of this provision.⁴ However, the Act provides an exception for circumstances where the amount of sales tax is difficult to determine:

76. *Where circumstances render it difficult to determine the exact amount of any payment that may be made pursuant to any of sections 68 to 68.29 or any deduction that may be made under section 73 or 74, the Minister, with the consent of the person to whom the payment or by whom the deduction may be made, may in lieu of that amount make a payment pursuant to, or authorize a deduction under, that section in an amount determined, in such manner as the Governor in Council may by regulation prescribe, to be the exact amount of the payment or deduction.*

The *Formula Refunds Regulations*⁵ (the Regulations), which ultimately led to the adoption of the "simplified method", were adopted pursuant to former section 47C (now section 76) of the *Excise Tax Act*.⁶ Section 3 of the Regulations reads as follows:

3.(1) Where by the Act a person is entitled

(a) to make a deduction from tax payable by him,

(b) to a refund of tax paid, or

(c) to receive a payment from the Minister in an amount equal to tax paid,

and circumstances exist that render it difficult to determine the exact amount of

4. See also *The Board of Governors of the University of Alberta and Her Majesty The Queen*, Federal Court of Canada, Trial Division, T-604-89, August 28, 1991, under appeal.

5. Consolidated Regulations of Canada, 1978, c. 591.

6. R.S.C., 1952, c. 100 as amended by S.C. 1966, c. 40, s. 6.

such deduction, refund or payment by the Minister, the amount of the deduction, refund or payment by the Minister shall, where the person consents, be determined in the manner set out in subsection (2).

(2) The exact amount of deduction, refund or payment by the Minister, determined for the purpose of subsection (1), shall be equal to the tax that would have been paid at the time of imposition of the tax on the goods on a price or value determined by reducing

(a) the sale price of the goods in the transactions in respect of which the deduction, refund or payment by the Minister is applied for, or

(b) the contract price where the goods were used in carrying out a contract and no sale price of the goods in the transactions in respect of which the deduction, refund or payment by the Minister is applied for can be established,

by a percentage thereof determined by the Minister after taking into account the class of the goods and the nature of and parties to the transaction that resulted in the application for a deduction, refund or payment by the Minister.
(emphasis added)

The last paragraph of subsection 3(2) of the Regulations is the basis for the establishment of the "simplified method" in section 8 of Memorandum ET 406.⁷ Briefly summarized, the method consists in fixing a percentage that will extract non-taxable factors such as profit and labour. That percentage will be applied to the entire cost of a construction project from which certain non-taxable fees and provincial taxes will be excluded to reflect more accurately the amount of sales tax paid on materials. Then, the applicable rate of sales tax will be applied, which will ultimately indicate the amount of sales tax refundable.

The main argument raised by the appellant is that the "simplified method" assumes that a prime contractor is involved in the construction project and that all labour charges are included in the contract price at standard industry rates. In other words, the appellant contends that the method was not established by taking into account free volunteer labour and materials sold at cost, as in this case. The appellant therefore concluded that it was not allowed the full refund of sales tax to which it was entitled under the Act.

The respondent stated that the "simplified method," at section 8 of Memorandum ET 406, requires that it be applied to the "total contract payment" which includes "all payments to contractor(s) related directly to the preparation of the site, construction and equipping of the building(s), whether covered by a single contract or a series of contracts related to different phases of the project." The respondent argued that the prohibition from using both methods prevents distortion and ensures that the refund payments are equal to the amount of sales tax paid. Distortion would occur, he contended, if the appellant were authorized to use the identification

7. Schools, Universities, Public Libraries and Student Residences, Ottawa, June 28, 1985.

method for invoices covering materials only. The respondent submitted that both instances of the Federal Court of Canada, as well as the Tribunal, recognize that these methods cannot be applied simultaneously for the same construction project.⁸

The Tribunal is of the view that the facts in this appeal distinguish it from the other cases relied upon by counsel for the respondent. The appellant used the "simplified method" with respect to invoices for labour and materials, but switched to the "identification method" because one of its suppliers, who also installed the goods, did not charge any markup on the materials, and the labour was donated. As did the Federal Court of Canada, as well as the Tribunal in *County of Wheatland*, the Tribunal recognizes the Minister's policy to refuse taxpayers the possibility to use simultaneously both methods of computing sales tax in calculating a sales tax refund when dealing with one construction project. The question that the Tribunal faces then is whether transactions at cost price and involving no labour cost, as the one at issue, should be included without distinction in the "total contract payment" for purposes of applying the "simplified method." To that question, the Tribunal answers in the negative. The Tribunal recalls that the "simplified method" set forth in Memorandum ET 406 is a policy adopted pursuant to the Regulations. Subsection 3(2) of the Regulations requires that the Minister take into account "the nature of and the parties to the transaction" before reducing by a percentage:

(a) the sale price of the goods in the transactions in respect of which the deduction, refund or payment by the Minister is applied for, or

(b) the contract price where the goods were used in carrying out a contract and no sale price of the goods in the transactions in respect of which the deduction, refund or payment by the Minister is applied for can be established, ...

The Tribunal is of the view that there is nothing in Memorandum ET 406 indicating that the kind of transactions leading to this appeal have been taken into account in establishing the "simplified method" or, in other words, indicating that the simplified method can properly deal with transactions where labour costs were not charged and materials were acquired at cost price. Therefore, the Tribunal finds that, to the extent that this method is applied without distinction as in the case at point, the condition set forth in subsection 3(2) of the Regulations that the Minister take into account "the nature of and the parties to the transaction" before reducing the contract price is not met. The Tribunal also finds that once the nature of these transactions and the parties involved are taken into account, there are no valid grounds for adding the amount of these purchases to the "total contract payment" from which a 66-percent reduction factor will apply. Such a factor should not be applied with respect to these transactions. That this results in the application of a formula mixing the principles of both methods is, for the Tribunal, not significant in light of the Regulations.

8. *Re Kamloops School Board* (District No. 24)(1987), 87 DTC 5199 (F.C.A.); *The Board of Governors of the University of Alberta v. Her Majesty The Queen*, Federal Court of Canada, Trial Division, T-604-89, August 28, 1991; *County of Wheatland No. 16 v. The Minister of National Revenue*, Canadian International Trade Tribunal, Appeal No. 2894, January 13, 1992.

Moreover, as for the distortion that would be created, the respondent has not convinced the Tribunal that a distortion, resulting in a refund of a greater amount than the exact amount of sales tax paid, could result from the exclusion of the transactions relating to the materials purchased from the supplier who has not charged a markup or labour fees.

Considering the facts of this case, the Tribunal allows the appeal and refers the matter back to the Minister for reconsideration on a basis not inconsistent with these reasons.

Desmond Hallissey
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Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

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