CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Tuesday, March 8, 1994

Appeal No. AP-91-182

IN THE MATTER OF an appeal heard on November 1, 1993, 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 November 8, 1991, with respect to a notice of objection served under section 81.17 of the *Excise Tax Act*.

BETWEEN

LIGHT TOUCH STENOGRAPHIC SERVICES LTD. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is dismissed.

Sidney A. Fraleigh
Sidney A. Fraleigh
Presiding Member

Anthony T. Eyton
Anthony T. Eyton
Member

Robert C. Coates, Q.C.
Robert C. Coates, Q.C.
Member

Michel P. Granger
Michel P. Granger
Secretary

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TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

UNOFFICIAL SUMMARY

Appeal No. AP-91-182

LIGHT TOUCH STENOGRAPHIC SERVICES LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The appellant is a wholesaler of parts and supplies for stenotype machines and also a repairer of the machines. A customer may purchase one of three maintenance agreements, depending on the desired degree of protection against the cost of replacement parts, labour and maintenance. For a fixed cost, a customer will be protected for a certain period of time against the failure of certain components and the associated labour costs. The issue in this appeal is whether the goods held by the appellant for use in fulfilment of its equipment maintenance agreements and preventative maintenance agreements qualify as inventory for purposes of a federal sales tax inventory rebate under section 120 of the Excise Tax Act.

HELD: *The appeal is dismissed. For purposes of this appeal, inventory includes goods "held ... for sale, lease or rental separately, for a price." The Tribunal interprets this to exclude situations where the title to goods is transferred to a customer during the provision of services to that customer for a fixed price. In addition, the Tribunal considers the goods used by the appellant under its maintenance agreements to be goods consumed or used in fulfilment of those agreements. As such, subsection 120(2.1) of the Excise Tax Act deems those goods not to be held for sale, lease or rental.*

Place of Hearing:	*Calgary, Alberta*
Date of Hearing:	*November 1, 1993*
Date of Decision:	*March 8, 1994*
Tribunal Members:	*Sidney A. Fraleigh, Presiding Member* *Anthony T. Eyton, Member* *Robert C. Coates, Q.C., Member*
Counsel for the Tribunal:	*David M. Attwater*
Clerk of the Tribunal:	*Anne Jamieson*
Appearances:	*Garry D. Bratland, for the appellant* *Anne M. Turley, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-91-182

LIGHT TOUCH STENOGRAPHIC SERVICES LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: SIDNEY A. FRALEIGH, Presiding Member
ANTHONY T. EYTON, Member
ROBERT C. COATES, Q.C., Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) of a determination of the Minister of National Revenue (the Minister) rejecting, in part, the appellant's application for a federal sales tax (FST) inventory rebate made under section 120[2] of the Act.

On or about January 2, 1991, the appellant filed an application for an FST inventory rebate in the amount of $3,164.49 with respect to its tax-paid inventory held on January 1, 1991. On May 14, 1991, the Minister issued a notice of determination rejecting, in part, the application on the basis that certain goods were not held for taxable supply by way of sale, lease or rental as provided in section 120 of the Act. The Minister approved $1,740.47 of the appellant's claim, leaving $1,424.02 in dispute. Responding to a notice of objection, the Minister issued a notice of decision, dated November 8, 1991, allowing the objection, in part, in the amount of $585.43 and confirming the remainder of the determination in the amount of $838.59. The amount allowed was the result of an upward adjustment to the percentage of goods destined for sale. Light Touch Stenographic Services Ltd. then appealed the determination to the Tribunal.

The issue in this appeal is whether the appellant is entitled to the FST inventory rebate with respect to the remainder of the goods held in its inventory on January 1, 1991. Specifically, the Tribunal must determine whether goods held by the appellant for use in fulfilment of its equipment maintenance agreements and preventative maintenance agreements qualify as inventory under the Act.

The appellant's rebate application was made under subsection 120(3) of the Act, which states:

> *(3) Subject to this section, where a person who, as of January 1, 1991 ... has any tax-paid goods in inventory at the beginning of that day,*
> *(a) where the tax-paid goods are goods other than used goods, the Minister shall, on application made by the person, pay to that person a rebate in accordance with subsections (5) and (8).*

1. R.S.C. 1985, c. E-15.
2. S.C. 1990, c. 45, s. 12, as amended by S.C. 1993, c. 27, s. 6.

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The word "inventory" is defined to mean:

> *120. (1) In this section,*
>
> *"inventory" of a person as of any time means items of tax-paid goods that are described in the person's inventory in Canada at that time and that are*
>
> *(a) held at that time for sale, lease or rental separately, for a price or rent in money, to others in the ordinary course of a commercial activity of the person.*
>
> *(2.1) For the purposes of paragraph (a) of the definition "inventory" in subsection (1), that portion of the tax-paid goods that are described in a person's inventory in Canada at any time that can reasonably be expected to be consumed or used by the person shall be deemed not to be held at that time for sale, lease or rental.*

Mr. Garry D. Bratland, President of Light Touch Stenographic Services Ltd., appeared on behalf of the appellant. He described the appellant as a wholesaler of parts and supplies for stenotype machines and also as a repairer of the machines. He explained that a customer may purchase one of three maintenance agreements (bronze, silver or gold) depending on the desired degree of protection against the cost of replacement parts, labour and maintenance. For a fixed cost, a customer will be protected for a certain period of time against the failure of certain components and the associated labour costs. The silver and gold agreements include a preventative maintenance within a 12-month period and replacement of approximately $7 of minor components. Mr. Bratland asserted that only 0.01 percent of the appellant's parts and supplies are used in fulfilment of the agreements. He explained that the cost of the agreements is determined by the average cost of doing the repairs that are covered. He described the agreements as insurance policies for his customers.

Counsel for the respondent called Mr. Fred W. Katayama, an auditor for the Department of National Revenue, as the respondent's witness. Mr. Katayama told the Tribunal that, after a review of the appellant's books and records and using October and November 1990 as a sample, he determined that 45 percent of the appellant's goods were used in fulfilment of the maintenance agreements. He also explained why a subsequent audit of the appellant's records, covering a four-month period, resulted in an upward adjustment to the percentage of goods determined to be sold and not consumed or used in fulfilment of the maintenance agreements.

Mr. Bratland, on behalf of the appellant, argued that all of the parts and supplies held by the appellant were tax-paid goods held in inventory for sale. He explained that, when goods are used to repair or maintain a stenotype machine under an agreement, the goods are not consumed, as shampoo is consumed by a hairdresser. In addition, he noted that FST was paid at 13.5 percent, yet the Act allows a rebate at only 8.1 percent.

Counsel for the respondent argued that section 120 of the Act authorizes a rebate on any tax-paid inventory of "new goods that are unused" held by a registrant on January 1, 1991, where the goods are for "sale, lease or rental separately, for a price or rent in money, to others in the ordinary course of a commercial activity."

Although the goods in issue are tax-paid goods, counsel for the respondent argued that they do not qualify as inventory as they were not held for "sale, lease or rental separately, for a price," but were destined to be consumed in the performance of a maintenance agreement with the appellant's customers. In support of this interpretation, counsel referred to

subsection 120(2.1) of the Act, which indicates that goods consumed or used are deemed not to be sold.

Counsel for the respondent argued that the words "goods ... for sale [or] lease" were intended by Parliament to distinguish between a contract for the sale of goods and a contact for the supply of services. The test for determining whether a contract is one for the sale of goods or for the supply of services is to ask the question: what is the substance of the contract? If the substance is the production of something to be sold and the transfer of property therein to a buyer, then the contract is for the sale of goods. But, if the substance of the contract is the skill and labour of the supplier in the performance of work for another, then that is a contract for work and labour, notwithstanding that property and some materials may pass under the contract as an accessory thereto. Counsel submitted that the appellant's inventory used in fulfilment of the maintenance agreements does not qualify as goods for sale.

The goods in issue are held for use in a maintenance agreement and are not billed separately from the agreement. They are incidental to the supply of a service, which the appellant is required to perform under the terms of the agreements. All the items included within these agreements are supplied for a fixed price (i.e. the total price of the agreement, which includes labour and materials). Beyond the minor components, valued at $7, which are supplied as part of the annual reconditioning of machines covered by the silver and gold maintenance agreements, major, and some costly, inventory items are supplied under all three of the fixed price maintenance agreements in the event of a specified component failure.

To date, the Tribunal has held that a person is entitled to an FST inventory rebate with respect to goods supplied to a customer while the person is providing a service to that customer.[3] However, the reasoning of the Tribunal has been impacted by the retroactive amendments to the FST inventory rebate provisions of the Act.[4] Specifically, the definition of "inventory" has been amended to require that goods must be "held ... for sale, lease or rental separately, for a price ... in money." In addition, section 120 of the Act was further amended by adding subsection 120(2.1), which states that the portion of a person's tax-paid goods "that can reasonably be expected to be consumed or used by the person shall be deemed not to be held at that time for sale, lease or rental."

The Tribunal interprets the requirement that goods be "held ... for sale ... separately, for a price" to exclude situations where the title to goods is transferred to a customer during the provision of services to that customer for a fixed price. In addition, the Tribunal considers the goods used by the appellant under its maintenance agreements to be goods consumed or used in fulfilment of those agreements. As such, subsection 120(2.1) of the Act deems those goods not to be held for sale, lease or rental.

In determining what percentage of the appellant's goods could "reasonably be expected to be consumed or used" in this way, the respondent audited the appellant's records. The second audit, covering a four-month period of sales by the appellant, determined that approximately 26.5 percent of the appellant's goods were consumed or used in fulfilment of the maintenance agreements. The Tribunal considers this to be a good proxy to what could

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3. *Northern Aircool Engines Co. v. The Minister of National Revenue*, Appeal No. AP-92-104, September 21, 1993, and *P.R.E.P. Consulting Ltd. v. The Minister of National Revenue*, Appeal No. AP-92-002, March 19, 1993.

4. *Supra*, note 2, assented to June 10, 1993, and made retroactive to December 17, 1990.

reasonably be expected to be consumed or used and, thus, not sold, leased or rented by the appellant. As goods must be held for sale, lease or rental to qualify as inventory for an FST inventory rebate, this percentage of the appellant's goods do not qualify.

With regard to the tax factor of 8.1 percent used to calculate the appellant's FST inventory rebate, the Tribunal notes that it is prescribed by regulation.[5] It is outside the scope of the Tribunal's jurisdiction to vary the tax factor within a class of goods.

Accordingly, the appeal is dismissed.

Sidney A. Fraleigh
Sidney A. Fraleigh
Presiding Member

Anthony T. Eyton
Anthony T. Eyton
Member

Robert C. Coates, Q.C.
Robert C. Coates, Q.C.
Member

5. *Federal Sales Tax Inventory Rebate Regulations*, SOR/91-52, December 18, 1990, Canada Gazette Part II, Vol. 125, No. 2 at 265.