CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Monday, April 5, 1993

Appeal No. AP-91-201

IN THE MATTER OF an appeal heard on November 17, 1992, 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 29, 1991, with respect to a notice of objection served under section 81.17 of the *Excise Tax Act*.

BETWEEN

152633 CANADA INC./SAKO AUTO LEASING **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is dismissed. The Tribunal finds that the three vehicles in issue qualify as capital property and, thus, are excluded from "inventory" for which the federal sales tax inventory rebate is available.

Sidney A. Fraleigh
Sidney A. Fraleigh
Presiding Member

Kathleen E. Macmillan
Kathleen E. Macmillan
Member

Michèle Blouin
Michèle Blouin
Member

Michel P. Granger
Michel P. Granger
Secretary

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UNOFFICIAL SUMMARY

Appeal No. AP-91-201

152633 CANADA INC./SAKO AUTO LEASING **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The issue in this appeal is whether the appellant is entitled to a federal sales tax inventory rebate pursuant to section 120 of the Excise Tax Act. The Tribunal must determine whether the goods in issue, being three motor vehicles, should be classified as inventory goods or as capital property. If the goods in issue are found to be capital property, the appellant is not entitled to the rebate.

***HELD**: The appeal is dismissed. The rebate is only available for goods held in inventory on January 1, 1991. The expression "inventory" does not include capital property that, for purposes of the Excise Tax Act, means capital property as defined in the Income Tax Act, excluding Class 12 and 14 goods as described in the Income Tax Regulations. Capital property, as defined in the Income Tax Act, includes depreciable property which is defined to include property in respect of which a taxpayer is allowed to take a capital cost allowance in determining its business income for a taxation year. The evidence is that the appellant claimed a capital cost allowance in respect of the three vehicles in issue, which vehicles are not described in Class 12 or 14 of the Income Tax Regulations. As such, the vehicles in issue are considered capital property and excluded from the definition of "inventory."*

Place of Hearing:	*Ottawa, Ontario*
Date of Hearing:	*November 17, 1992*
Date of Decision:	*April 5, 1993*
Tribunal Members:	*Sidney A. Fraleigh, Presiding Member* *Kathleen E. Macmillan, Member* *Michèle Blouin, Member*
Counsel for the Tribunal:	*David M. Attwater*
Clerk of the Tribunal:	*Janet Rumball*
Appearances:	*Alain Ménard, for the appellant* *Alain Lafontaine, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-91-201

152633 CANADA INC./SAKO AUTO LEASING **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: SIDNEY A. FRALEIGH, Presiding Member
KATHLEEN E. MACMILLAN, Member
MICHÈLE BLOUIN, 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). The appellant, 152633 Canada Inc./Sako Auto Leasing (Sako), made an application for a federal sales tax (FST) inventory rebate pursuant to section 120 of the Act[2] in respect of three motor vehicles, claiming $7,009.00. The claim was rejected on the basis that the "goods included in the rebate are capital property therefore not considered to be held for sale, lease or rental." The appellant objected to the determination, which was confirmed in a notice of decision of the Minister dated November 29, 1991.

The issue in this appeal is whether the appellant is entitled to an FST inventory rebate pursuant to section 120 of the Act. The Tribunal must determine whether the goods in issue, being three motor vehicles, should be classified as inventory goods that cannot, pursuant to the Act, include capital property. If the goods in issue are found to be capital property, the appellant is not entitled to the rebate.

Mr. Gregory N. Korsos, Vice-President of the appellant company, served as one of the appellant's witnesses. He indicated that Sako is primarily in the business of leasing vehicles and, currently, has approximately 2,200 units on the road. Of these, approximately 100 to 120 are rented on a daily basis. Part of Sako's business is selling new and used vehicles. The witness testified that, in an average year, Sako sells about 25 new vehicles.

The normal route followed by Sako in leasing a vehicle is to have a leasing consultant determine what kind of vehicle is best suited for the lessee, gather credit information and some history of the customer, and provide pricing information to suit the lessee's budget. With this information, the leasing consultant develops a lease, quoting the monthly payment and the residual value of the vehicle at the end of the lease. If a deal is to be completed, the lessee is requested to visit Sako's offices to sign the lease and to make a deposit on the lease to close the deal. The vehicle is then purchased from a dealer. During cross-examination, the witness confirmed that Sako would purchase the vehicle once a lease was signed.

When dealing with known clientele, a vehicle is purchased by Sako on the basis of a request to lease a particular vehicle without a signed lease or deposit.

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1. R.S.C. 1985, c. E-15.
2. S.C. 1990, c. 45, s. 12.

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Mr. Korsos testified that, even with a signed lease, the final destination of a vehicle is not certain until the vehicle is registered to the lessee and delivered. He cited examples where a customer refused delivery of the vehicle or died before delivery. It is the practice of Sako, he noted, not to sue on a lease for refusal to accept delivery.

Payment must be made within 10 days of receipt of the vehicles by Sako from its vehicle dealers. Short-term financing is placed on a vehicle until it can be financed on a long-term basis. The witness stated that Sako's creditors finance the vehicle as a stock or inventory item until the master lease is signed and the credit taxed and sent to the lessee. He indicated that two of the vehicles, the 1991 Buicks, received on or about December 21, 1990, were financed as inventory. The third vehicle, received on or about December 28, 1990, went straight into long-term financing.

A vehicle lease order was signed on November 7, 1990, by Gestion Jantur Inc. for a 1991 Buick Regal Ltd. GranSport. However, this vehicle was ultimately leased to Litho-Creations Enr. and delivered on January 7, 1991. In cross-examination, the witness agreed that the two parties had the same address and that both lease agreements were signed by the same person. The second vehicle, also a 1991 Buick, was leased by order signed on November 7, 1990, to Gray Electric Supplies Inc. The vehicle was delivered on January 14, 1991. The two Buicks were financed on December 24, 1990, as inventory and put into long-term financing, one on January 29, 1991, and the other on January 17, 1991. The third vehicle is a Ford Super Cargo truck, leased by order signed on December 19, 1990. It was received by Sako on December 28, 1990, and delivered on January 15, 1991. It went directly into long-term financing.

Mr. Korsos testified that FST was paid on the three vehicles and that the anticipated FST rebate was passed on to the lessee. He indicated that when a vehicle is purchased, it goes into the inventory account of the appellant and is moved to the net investment account and capitalized when the vehicle is licensed or put on active long-term leasing.

The appellant's second witness was Mr. George Karidis, a chartered accountant who has served as the appellant's auditor for the past three years. Mr. Karidis testified that, for accounting purposes, when Sako purchases a vehicle, it is placed in the inventory account. From the time that the vehicle is delivered to the lessee until the end of the lease term, it is accounted for in "net investment in financed leases." During this time, the vehicle is generating revenue for Sako. At the end of the lease term, the lessee has the option of purchasing the vehicle or returning it to Sako. When returned, the vehicle is taken from the investment account and placed on the inventory account until it is sold. As such, on Sako's year-end financial statements, the inventory account includes vehicles that are waiting to be leased or that have been returned on expiry of a lease.

The witness testified that, when a vehicle is leased, it becomes capital property and is capitalized for tax purposes. At Sako's year end, being June 30, capital cost allowance (CCA) was taken on the three vehicules in issue. Under the *Income Tax Act*, in the year of acquisition, 15 percent of the value of the vehicle can be taken as CCA, and, in subsequent years, 30 percent of the value of the asset can be taken as CCA. However, he added that, for accounting purposes, depreciation is taken on the vehicle only from the day that it is put on the road. He mentioned that, if Sako's year end had been December 31, the three vehicles would have been in the inventory account, and no CCA would have been taken. In fact, CCA is not taken on any property at year's end if accounted for in inventory.

During cross-examination, the witness stated that "depreciable property" is "property that will have some kind of future use and would be absorbed in the future to generate revenue." In other words, it is property that loses value as it is being used. He stated that, when a vehicle is leased, it loses value. When asked if a product ceases to be depreciable property if depreciation is not taken on the goods, he answered in the negative, stating that it ceases to be depreciable property when it stops generating revenue for its intended purpose. He confirmed that CCA was taken at year's end on the three vehicles in issue.

Counsel for the respondent called one witness, Mrs. Denise Bussière, a certified general accountant (CGA), who worked as an appeal officer with the Department of National Revenue for three years. She conducted an investigation of Sako subsequent to its objection to the Minister's determination to deny the FST rebate. She described to the Tribunal her reasoning for concluding that the vehicles in issue were capital property and, thus, did not qualify for the FST rebate.

In argument, counsel for the appellant reminded the Tribunal that, in the interpretation of taxation statutes, the courts have set aside the strict interpretation rule in favour of the more liberal "words-in-total-context approach with a view to determining the object and spirit of the taxing provisions.[3]" Counsel further argued that, if any doubt remains, the Tribunal should rule in favour of the taxpayer.[4] It was submitted that the rebate provisions were intended to avoid double taxation, a situation that would occur if the appellant were denied the rebate.

In reviewing the evidence, counsel for the appellant argued that, approximately 60 percent of the time, there was no lease agreement signed before a vehicle was ordered. In those situations where a lease was signed, it only became complete when the vehicle was delivered to the lessee. Leases are often redrafted before delivery of a vehicle as conditions change, a situation which occurred for two of the vehicles in issue. Until the time of delivery, a signed lease represents only a moral commitment to lease a vehicle, and it is not certain until that time whether the vehicle will be leased, put in the short-term rental fleet or sold.

For accounting purposes, all new vehicles go into the inventory account. When leased, they go into the account for net investment in financed leases. If put into the rental fleet, they go into a specific account for that purpose. In both these instances, they become capital property. If a vehicle is sold, it is stricken from the inventory account.

No CCA was claimed on vehicles in the inventory account. On December 31, 1990, the three vehicles in issue were in the inventory account. It is clear, therefore, that as of January 1, 1991, the vehicles in issue were in inventory and held for taxable supply by way of sale, lease or rental. Though the three vehicles were purchased on the strength of signed leases, it was not certain that they would be leased until actually delivered. Counsel argued that the vehicles became capital property only when they started to earn income.

Counsel for the respondent argued that, when a lease agreement was signed, it became a binding contract. Therefore, on November 7 and December 19, 1990, when the leases for the Buicks and Ford Super Cargo truck, respectively, were signed, the vehicles became capital property. Counsel reminded the Tribunal that CCA was taken on the three vehicles at Sako's business year end.

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3. See, e.g. *Lor-Wes Contracting Ltd. v. Her Majesty the Queen*, [1985] 2 C.T.C. 79 at 83 (F.C.A.); [1986] 1 F.C. 346 at 352.

4. See, e.g. *Fries (W.) v. Canada*, [1990] 2 C.T.C. 439 (S.C.C.); [1990] 2 S.C.R. 1322 at 1323.

To reiterate the issue in general terms, the Tribunal has to determine whether the appellant is entitled to an FST inventory rebate pursuant to subsection 120(3) of the Act.[5] This provision states in part:

> *Subject to this section, where a person who, as of January 1, 1991, is registered under Subdivision d of Division V of Part IX 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.*

For purposes of this appeal, "inventory" is defined at subsection 120(1) of the Act as:

> *"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 taxable supply (within the meaning assigned by subsection 123(1)) by way of sale, lease or rental to others in the ordinary course of the person's business,*
>
> *...*
>
> *and that are not*
>
> *(c) capital properties of the person.*

"Capital property" is defined at subsection 123(1) of the Act as:

> *"capital property", in respect of a person, means property that is, or would be if the person were a taxpayer under the Income Tax Act, capital property of the person within the meaning of that Act, other than property described in Class 12 or 14 of Schedule II to the Income Tax Regulations.*

The expression "capital property" is defined in paragraph 54(*b*) of the *Income Tax Act*[6] as:

> *"capital property" of a taxpayer means*
>
> *(i) any depreciable property of the taxpayer, and*
>
> *(ii) any property (other than depreciable property), any gain or loss from the disposition of which would, if the property were disposed of, be a capital gain or a capital loss, as the case may be, of the taxpayer.*

The *Income Tax Act*[7] defines "depreciable property" at paragraph 13(21)(*b*) as:

> *"depreciable property" of a taxpayer as of any time in a taxation year means property acquired by the taxpayer in respect of which the taxpayer has been allowed, or would, if the taxpayer owned the property at the end of the year and this Act were read without reference to subsection (26), be entitled to, a deduction under regulations made under paragraph 20(1)(a) in computing income for that year or a previous taxation year.*

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5. *Supra*, note 2.
6. S.C. 1970-71-72, c. 63.
7. S.C. 1991, c. 49.

Pursuant to paragraph 20(1)(*a*) of the *Income Tax Act*[8] and the *Income Tax Regulations*[9] (the Regulations) made thereunder, a taxpayer is entitled to take a CCA deduction in calculating its income for the taxation year.

The Tribunal interprets the definition of "depreciable property" to mean property in respect of which the taxpayer was allowed to take a CCA deduction or would have been allowed to take such a deduction if it had owned the property at the end of its taxation year. The uncontroverted evidence is that Sako took a CCA deduction in respect of the three vehicles in issue. Therefore, at any particular time in its taxation year and, for purposes of this appeal, specifically on January 1, 1991, the three vehicles in issue qualified as depreciable property. As depreciable property, the vehicles are considered capital property.

Before goods that are capital property, as defined in the *Income Tax Act*, are excluded from the definition of "inventory," as defined in subsection 120(1) of the Act, the Tribunal must determine whether they are described in Class 12 or 14 of Schedule II to the Regulations. If the goods are so described, they are excluded from the definition of "capital property" for purposes of the Act. Class 12 includes a disparate list of property not included in any other Class. Class 14 includes property that is a patent, franchise, concession or licence with defined exceptions. It is clear to the Tribunal that the vehicles in issue do not fall within Class 12 or 14 of the Regulations. As such, for purposes of the Act, the vehicles are considered capital property and excluded from the definition of "inventory." As goods must be in inventory on January 1, 1991, to qualify for the rebate available pursuant to subsection 120(3) of the Act, the Tribunal concludes that the appellant is not entitled to a rebate in respect of the three vehicles in issue.

Accordingly, the appeal is dismissed.

Sidney A. Fraleigh
Sidney A. Fraleigh
Presiding Member

Kathleen E. Macmillan
Kathleen E. Macmillan
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Michèle Blouin
Michèle Blouin
Member

8. *Supra*, note 6.
9. C.R.C., c. 945.