CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Friday, January 22, 1993

Appeal No. AP-91-231

IN THE MATTER OF an appeal heard on October 20, 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 27, 1991, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

RIGHT WAY AUTO DECOR & SIGNS LTD. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed in part, and the matter is referred back to the Minister of National Revenue for reconsideration in a manner not inconsistent with the Tribunal's reasons.

Desmond Hallissey
Desmond Hallissey
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Sidney A. Fraleigh
Sidney A. Fraleigh
Member

Michel P. Granger
Michel P. Granger
Secretary

365 Laurier Avenue West
Ottawa, Ontario K1A 0G7
(613) 990-2452 Fax (613) 990-2439

365, avenue Laurier ouest
Ottawa (Ontario) K1A 0G7
(613) 990-2452 Téléc. (613) 990-2439

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UNOFFICIAL SUMMARY

Appeal No. AP-91-231

RIGHT WAY AUTO DECOR & SIGNS LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The issue in this appeal is the determination of the proper percentage to be deducted from the appellant's sale price for costs of installation in calculating the sale price of the goods on which tax is imposed pursuant to section 50 of the Excise Tax Act.

HELD: *The appeal is allowed in part, and the matter is referred back to the Minister of National Revenue for reconsideration in a manner not inconsistent with the Tribunal's reasons.*

Place of Hearing:	*Edmonton, Alberta*
Date of Hearing:	*October 20, 1992*
Date of Decision:	*January 22, 1993*
Tribunal Members:	*Desmond Hallissey, Presiding Member* *Arthur B. Trudeau, Member* *Sidney A. Fraleigh, Member*
Counsel for the Tribunal:	*Shelley Rowe*
Clerk of the Tribunal:	*Dyna Côté*
Appearances:	*Emil Alexander Sawchuk, for the appellant* *Linda Wall, for the respondent*

365 Laurier Avenue West
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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-91-231

RIGHT WAY AUTO DECOR & SIGNS LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: DESMOND HALLISSEY, Presiding Member
ARTHUR B. TRUDEAU, Member
SIDNEY A. FRALEIGH, Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) from a decision of the Minister of National Revenue (the Minister).

The issue in this appeal is the determination of the proper percentage to be deducted from the appellant's sale price for costs of installation in calculating the sale price of the goods on which tax is imposed pursuant to section 50 of the Act. The issue arises as a result of an audit of the appellant conducted by the Department of National Revenue (Revenue Canada) in September 1990 for the period from December 1, 1987, to July 25, 1990, at which time it was determined that the appellant was not entitled to deduct 50 percent from the sale price of its customized vinyl lettering (decals) for allowable costs of installation as it had been doing throughout the period covered by the audit. Based on the results of the audit, the respondent took the position that the appellant was only entitled to a 25-percent deduction from the sale price for costs of installation in accordance with the provisions of the *Erection or Installation Costs Regulations*[2] (the Regulations). The respondent's view on this issue changed, as seen in the brief, and it was argued that the appellant was entitled to a deduction of 33 percent from the sale price for costs of installation.

Mr. Emil Alexander Sawchuk, President of Right Way Auto Decor & Signs Ltd., appeared and testified on behalf of the appellant. He described how the appellant produces decals which are computer designed and cut out of rolls of self-adhesive vinyl. The decals in issue were sold at a price that included installation (supply and install). Mr. Sawchuk estimated that 58 to 60 percent of his business is supply and install.

Mr. Sawchuk presented a series of photographs, as Exhibit A-2, to explain that the installation procedure involves cleaning of the surface, layout of the lettering, squeegeeing of the lettering onto the surface and, finally, the application of heat to the lettering. The decals may be installed on a variety of surfaces such as vehicles, equipment, sign boards and windows. He maintained that, since the decals vary in size and shape, and the surfaces to which they are applied also vary, the costs of installation differ significantly from one decal to another.

1. R.S.C. 1985, c. E-15.
2. SOR/83-136, Canada Gazette Part II, Vol. 117, No. 4, p. 625, February 4, 1983.

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As a general rule, the price charged by the appellant for installation is double the cost of the decal without installation. However, Mr. Sawchuk testified that the costs of installation include: (1) the cost of labour (including the removal of any materials on the surface prior to installation), which is determined on a commission basis of 30 to 35 percent of the supply and install sale price for both employees and independent contractors; (2) the cost of equipment (i.e. heat guns, heat lamps, solvent supplies, special towels, rented scaffolding and ladders, etc.); (3) vehicles; (4) travel to off-site jobs; and, finally, (5) a profit component. In cross-examination by counsel for the respondent, Mr. Sawchuk stated that he did not keep a record of the costs of installation for each decal, but that he could verify the accuracy of his figures from his accounting records.

Exhibit A-3, a floor plan of the appellant's plant at the corner of 178 Street and 109 Avenue in Edmonton, Alberta, was introduced to demonstrate that, of a total area of 4,890 sq. ft., 3,210 sq. ft. were dedicated to the provision of installation services, and the remaining 1,680 sq. ft. were used for office space and manufacturing. Mr. Sawchuk stated that the current plant was not the same plant as the one occupied at the time of the audit. However, he stated that the latter plant on Spruce Street in Spruce Grove, Alberta, was larger in area.

Counsel for the respondent called one witness, Mr. Cameron George Tees, an audit officer with Revenue Canada for three years, who conducted the audit of the appellant. Mr. Tees explained that, in conducting the audit, he reviewed a sample of the appellant's work orders, similar to Exhibit A-1 introduced by the appellant, and determined that there was no evidence as to the actual costs of installation. As a result, he decided to approach the audit by choosing 1989 as a sample year. He reviewed the actual costs of labour, based on a T-4 summary, and the costs for subcontract labour, utilities and vehicle expenses, and arrived at a figure for allowable costs of installation as provided under sections 5 and 7 of the Regulations and as discussed in Excise Memorandum ET 205.[3] Mr. Tees then compared the total allowable costs of installation to the total supply and install sales as per the appellant's invoices and, accordingly, determined that the appellant was entitled to deduct 25 percent of its sale price for costs of installation.

When asked by counsel why he had changed his figure from 25 to 33 percent, Mr. Tees said that he was asked by a departmental litigation officer to review the appellant's data. Mr. Tees stated that, as a result of his second review, he decided to add other costs into the figure for the total allowable costs of installation, such as vehicle insurance, repairs, maintenance, leasing, utilities and equipment rental, which he was able to quantify based upon the appellant's financial statements.

In cross-examination by Mr. Sawchuk, it was established that, in arriving at the figure for total allowable costs of installation, Mr. Tees did not take into account the building rent and other overhead costs associated with the installation portion of the appellant's business, such as administration and warranty costs.

In argument, Mr. Sawchuk reiterated that only one third of the appellant's business is supply only. On the basis that such a large proportion of the appellant's business is dedicated to installation services, he argued that the percentage to be deducted from the sale price for costs of installation should not be 25 percent, or even 33 percent as suggested by the respondent,

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3. Department of National Revenue, Customs and Excise, March 29, 1989.

but that it should be at least 50 percent. He submitted that Mr. Tees, in conducting the audit, had failed to allocate a proportion of overhead costs, such as building rent, administration and warranty costs, and that a proportion of these costs should be allocated to the costs of installation. In support of this contention, he referred to paragraph 5(1)(*q*) of the Regulations, which reads as follows:

> *an amount representing overhead costs as determined in accordance with generally accepted accounting principles to the extent that the costs are set up to provide for specific items considered to be allowable costs of installation.*

Counsel for the respondent argued that the methods for determining deductible costs of installation for the purpose of the Act are prescribed in the Regulations. Since the appellant does not sell goods without installation which are identical to its installed goods, its costs of installation must be determined in accordance with sections 5 to 7 of the Regulations. Counsel argued that the appellant has the burden of proving that all of the costs that it has claimed as costs of installation fall within the parameters of sections 5 to 7 of the Regulations. In addition to identifying the costs, the appellant must also support its claim with documentary evidence as required by section 8 of the Regulations and as was decided by the Tribunal in *Meubles M.S. Enr. v. The Minister of National Revenue*[4] and *Les Cuisines M.S. Inc. v. The Minister of National Revenue*.[5] Further, counsel argued that the appellant has the burden of proving that the assessment was incorrect and that, to do so, it had to show that there were errors, omissions or oversights in the audit forming the basis of the assessment. Counsel relied on the decision of the Tribunal in *Sarto Plante Inc. v. The Minister of National Revenue*[6] to support her argument that, in challenging the audit, the appellant must do more than simply allege errors and must explain and provide evidence of such errors and shortcomings. Counsel argued that the appellant has not satisfied either burden of proof.

Counsel for the respondent pointed out that rent and warranty are not specifically mentioned in section 5 of the Regulations. Further, she argued that overhead cannot be interpreted to include rent and warranty since paragraph 5(1)(*q*) of the Regulations requires that overhead relate to items listed under paragraphs 5(1)(*a*) to (*p*) as allowable costs of installation. Since rent, warranties and administrative costs are not specifically enumerated as allowable costs of installation, counsel argued that any overhead relating to these items cannot be claimed under paragraph 5(1)(*q*) of the Regulations. Further, with respect to the appellant's contention that warranty costs should be taken into consideration, counsel argued that costs for protection from contingencies that may not occur should not be included. She also pointed out that the warranties could not be called overhead since they are negotiable, and the terms vary in length and amount of coverage.

Pursuant to clause 46(*c*)(ii)(A) of the Act, the costs of installation of goods manufactured or produced in Canada may be excluded from the calculation of the sale price of those goods. The Regulations provide four methods for the calculation of such a deduction. Where the manufacturer or producer does not regularly sell identical goods at a price that does not include installation, the cost of installation is an amount equal to the aggregate of various costs enumerated in section 5 of the Regulations. In the alternative, section 7 of the Regulations provides that the costs of installation may be determined as a percentage of the sale price equal

4. Appeal No. AP-90-215, November 20, 1991.
5. Appeal No. AP-90-216, November 20, 1991.
6. Appeal No. AP-90-017, March 16, 1992.

to the costs of installation of all goods sold as a percentage of the aggregate of the prices at which the goods were sold in the previous year. These last two methods are qualified in section 8 of the Regulations, which states that all costs of installation determined under section 5 or 7 of the Regulations shall be supported by documentary evidence. Finally, in lieu of the above three methods, the costs of installation may be determined by reference to the Schedule to the Regulations which indicates that goods, such as those in issue, are allowed a 10-percent deduction for costs of installation.

Since the appellant does not regularly sell identical goods at a price that does not include installation, the cost of erection or installation should be determined in accordance with either section 5 or 7 of the Regulations. In this particular situation, the costs of installation were determined in accordance with section 5 of the Regulations. This section provides that the cost of installation is to be an amount equal to the aggregate of actual costs for labour, transportation, accommodation, equipment, materials, rentals, utilities, depreciation and overhead.

The allowable costs of installation are enumerated in paragraphs 5(1)(*a*) to (*p*) of the Regulations. The words "overhead costs" in paragraph 5(1)(*q*) are qualified by the words "to the extent that the costs are set up to provide for specific items considered to be allowable costs of installation." The specific items considered to be allowable costs of installation are listed in paragraphs 5(1)(*a*) to (*p*). The Tribunal interprets the words in paragraph 5(1)(*q*) with regard to their ordinary meaning and concludes that they mean that there must be some relationship between the allowable costs of installation and the overhead item which is being claimed as a cost of installation.

In the Tribunal's view, administrative costs, such as secretarial help and the ordering of supplies, and costs associated with the building, such as rent, are costs related to, and which "provide for," the allowable costs of installation. The Tribunal recognizes that rent and administrative costs are not specifically enumerated in paragraphs 5(1)(*a*) to (*p*) of the Regulations; however, there are administrative costs associated with the payment of wages, unemployment insurance, group insurance, pension plans, workmen's compensation, equipment rentals and depreciation. Further, the building in which the appellant carries on business is necessary to provide an infrastructure for the installation process which is comprised of all of the allowable costs of installation. This view is consistent with the definition of "overhead" in The New Lexicon Webster's Dictionary of the English Language:[7]

> *due to charges necessary to the carrying on of a business*
> ...
> *expenses which are a general charge to a business and cannot be allotted to a particular job or process (e.g. rent, light, depreciation, administration, insurance, as opposed to materials, wages etc.).*

The Tribunal does not agree with the respondent's interpretation of paragraph 5(1)(*q*) of the Regulations, namely, that any allowable overhead costs are limited to the items specified in paragraphs 5(1)(*a*) to (*p*). It is the Tribunal's view, instead, that a plain reading of paragraph 5(1)(*q*) directs the reader to look at overhead costs not covered in paragraphs 5(1)(*a*) to (*p*), as long as the costs are incurred to provide for items specifically listed as allowable costs of installation and are determined in accordance with generally accepted accounting principles. Overhead is an accepted component of cost allowances, and it would make no sense to have a

7. New York: Lexicon Publications, Inc., 1987, p. 715.

separate section for overhead, unless it was in reference to those precise items not specifically identified in paragraphs 5(1)(*a*) to (*p*) of the Regulations.

In the Tribunal's view, overhead in paragraph 5(1)(*q*) of the Regulations can and should be interpreted to include such costs as rent and administrative costs, but only the portion of those costs relating to the installation process.

Accordingly, the appeal is allowed in part, and the assessment and the audit on which it is based are referred back to the Minister for reconsideration of the proper percentage to be deducted from the appellant's supply and install sales for costs of installation. More particularly, the respondent is directed to review the appellant's overhead costs with a view to including a portion of them in the calculation of the appellant's actual costs of erection and installation.

Desmond Hallissey
Desmond Hallissey
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Sidney A. Fraleigh
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Member