CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Thursday, October 28, 1993

Appeal No. AP-91-232

IN THE MATTER OF an appeal heard on February 18, 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 29, 1991, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

2284791 MANITOBA LTD. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed.

Michèle Blouin
Michèle Blouin
Presiding Member

Desmond Hallissey
Desmond Hallissey
Member

Lise Bergeron
Lise Bergeron
Member

Michel P. Granger
Michel P. Granger
Secretary

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CANADIAN INTERNATIONAL TRADE TRIBUNAL | TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

UNOFFICIAL SUMMARY

Appeal No. AP-91-232

2284791 MANITOBA LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

During the assessment period, August 1, 1988, to October 31, 1989, the appellant, which carries on business under the name Technicrete Precast, manufactured concrete precast wall sections called "Waffle-Crete," for use in the construction of buildings. The appellant is 75-percent owned by Mrs. Ronda Homenko and 25-percent owned by an unrelated employee. All of the appellant's sales during the relevant period were made to Homenko Builders Inc., which is 100-percent owned by Mrs. Ronda Homenko's husband, Mr. Lawrence Homenko. Prior to the assessment period, Homenko Builders Inc. had the goods in issue manufactured for it by a non-related company, which used certain moulds or forms provided by Homenko Builders Inc. There are two issues in this appeal. First, whether the appellant and Homenko Builders Inc. are "related persons" within the meaning of subsection 2(2.2) of the Excise Tax Act. Second, if they are related, whether the appellant charged Homenko Builders Inc. a "reasonable sale price" for the goods in issue, within the meaning of subsection 58(1) of the Excise Tax Act.

HELD: *The appeal is allowed. The sale prices charged by the appellant to a related company were reasonable in the circumstances, evaluating them as if the appellant had been dealing with the related company at arm's length at the time of the transactions at issue.*

Place of Hearing:	*Winnipeg, Manitoba*
Date of Hearing:	*February 18, 1993*
Date of Decision:	*October 28, 1993*
Tribunal Members:	*Michèle Blouin, Presiding Member* *Desmond Hallissey, Member* *Lise Bergeron, Member*
Counsel for the Tribunal:	*Hugh J. Cheetham*
Clerk of the Tribunal:	*Janet Rumball*
Appearances:	*Kornelius Loewen, B.A., C.A., for the appellant* *Frederick B. Woyiwada, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-91-232

2284791 MANITOBA LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: MICHÈLE BLOUIN, Presiding Member
DESMOND HALLISSEY, Member
LISE BERGERON, 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) dated November 29, 1991.

During the assessment period, August 1, 1988, to October 31, 1989, the appellant, which carries on business under the name Technicrete Precast, manufactured concrete precast wall sections or panels called "Waffle-Crete," for use in the construction of buildings. The appellant is 75-percent owned by Mrs. Ronda Homenko and 25-percent owned by an unrelated employee. All of the appellant's sales during the relevant period were made to Homenko Builders Inc. (Homenko Inc.), which is 100-percent owned by Mrs. Ronda Homenko's husband, Mr. Lawrence Homenko. Mr. Homenko is also General Manager of 2284791 Manitoba Ltd. Prior to the assessment period, Homenko Inc. had the panels manufactured for it by a non-related company, which used certain moulds or forms provided by Homenko Inc. Homenko Inc. obtained the right to use these forms under a licensing agreement with the owner of patent rights in them. By agreement dated May 6, 1988, Homenko Inc. assigned its rights to manufacture "Waffle-Crete" to the appellant and, as noted, once the appellant began production, Homenko Inc. satisfied its needs through purchases from the appellant.

By notice of assessment dated December 15, 1989, the Minister assessed the appellant for unpaid taxes in the amount of $8,930.80, including interest and penalty, on the basis that, under subsection 58(1) of the Act, the appellant made sales to a related person at a less than "reasonable sale price." On January 3, 1990, the appellant objected to the assessment on the basis that the price used by the appellant was reasonable and that the appellant's first year of operations was not representative of its true gross margin and, thus, not effective for determining a reasonable price. By notice of decision dated November 29, 1991, the Minister accepted the appellant's representations with respect to gross margin, but, in doing so, used an average gross margin under which he found that the appellant still owed $4,936.20, including interest and penalty.

There are two issues in this appeal. First, whether the appellant and Homenko Inc. are "related persons" within the meaning of subsection 2(2.2) of the Act. Second, if they are related, whether the appellant charged Homenko Inc. a "reasonable sale price" for the goods in issue,

1. R.S.C. 1985, c. E-15.

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within the meaning of subsection 58(1) of the Act and, if not, whether the respondent used the appropriate method of establishing a "reasonable sale price."

The relevant portions of subsection 58(1) of the Act read as follows:

> *for the purposes of this Part and Part III, where goods that were manufactured or produced ... in Canada are sold ... by the manufacturer or producer thereof to a person with whom the manufacturer or producer was not dealing at arm's length ... for a sale price that is less than the sale price (in this subsection referred to as the "reasonable sale price") that would have been reasonable in the circumstances if the manufacturer or producer and that person had been dealing at arm's length at that time, the manufacturer or producer shall be deemed to have sold the goods at that time for the reasonable sale price.*

At the outset of the hearing, the appellant's representative indicated that, with respect to the first issue, the appellant had never disputed the fact that the two companies in question were related. Therefore, the hearing proceeded to consider the second issue.

The appellant's representative called one witness, Mr. Lawrence Homenko. Mr. Homenko explained that, in the three years preceding the commencement of operations by the appellant, Homenko Inc. had panels made for it by two local companies. He stated that, at the end of its business relationship with these other companies, Homenko Inc. was being charged about $2.50/sq. ft. for plain panels and about $2.75/sq. ft. for exposed panels. Mr. Homenko testified that the appellant used these prices as the basis for establishing prices at which the appellant would sell the goods in issue to Homenko Inc. The witness also suggested that these prices were reasonable when compared to prices charged by the only other manufacturer of "Waffle-Crete" in Canada of which he was aware, that is located in Kelowna, British Columbia. Mr. Homenko also noted that the goods in issue are used in the "low end" of the building market for primarily small one-storey commercial buildings.

During cross-examination, Mr. Homenko agreed that the invoices tendered in evidence relating to purchases by Homenko Inc. from these other companies were dated either a year or several months before the beginning of the assessment period. Mr. Homenko explained that the forms used to make the panels were purchased from the patent holder in the United States and that Homenko Inc., and now the appellant, had paid a yearly fee to use the expression "Waffle-Crete" when using the product made with the forms. Mr. Homenko confirmed that he did not charge those companies, which previously made panels for Homenko Inc., a fee to use the forms. Mr. Homenko also stated that, between 1985 and 1988, the price charged to Homenko Inc. for panels did not change. He also noted that some of the appellant's invoices to Homenko Inc. showed that the price charged by the appellant was higher than that charged by these other companies. In responding to questions from the Tribunal relating to the latter point, Mr. Homenko indicated that the prices were consciously set higher to avoid any trouble.

Counsel for the respondent called one witness, Mr. Amado Mendoza, Senior Auditor with the Department of National Revenue. Mr. Mendoza was the official who performed the initial audit of the appellant with respect to setting the "reasonable sale price" for the goods in issue. Mr. Mendoza indicated that the respondent took the position that, as all the relevant transactions occurred between related companies, the respondent, under the Act, should determine a reasonable sale price based on criteria established by the respondent. The witness then described the three methods used by the respondent in such circumstances and discussed why the first two methods, which he described as the comparable uncontrolled price method

and the resale price method, were considered not appropriate in this case. Mr. Mendoza continued by explaining how he originally applied the third method, the cost plus method, and how this application was revised following the appellant's objection to the original assessment.

During cross-examination, Mr. Mendoza stated that the sales between the appellant and third parties were not appropriate for use under the comparable uncontrolled price method because this method refers to sales by the company at issue to third parties and not from third parties to the company at issue. Mr. Mendoza also testified in examination-in-chief, cross-examination and re-examination with respect to the appellant's initial financial statements which covered 5- and 12-month periods of time, respectively, and the profit margins reported in those statements.

The appellant's representative began his argument by questioning the industry percentages (profit margins) attributed to the appellant for purposes of the respondent's determination of a "reasonable sale price." He submitted that these margins did not reflect the low end of the construction business which, he indicated, has lower margins. The appellant's representative also explained the differences in the appellant's financial statements. The appellant's representative discussed the prices charged by the appellant to Homenko Inc. and submitted that the appellant had done its utmost to reflect a realistic market value for the product and reiterated that the appellant had specifically priced the goods at prices higher than those charged by non-related companies to avoid the problems that it was now experiencing. He also suggested that the costs of production of these non-related companies would be lower than the appellant's costs because, unlike the appellant, these companies mix their own concrete and, thus, avoid paying the margin that the appellant has to pay to buy the concrete that it puts into the forms. In rebuttal evidence, the appellant's representative submitted that the fact that the appellant did not charge non-related companies for use of the forms should be considered a non-issue, as the forms were transferred to the appellant by Homenko Inc. and depreciated by the appellant in its financial statements.

Counsel for the respondent first submitted that the evidence presented by the appellant was not sufficient to satisfy its onus of showing that the respondent's assessment was incorrect. Counsel suggested two reasons why the Tribunal should ignore the evidence with respect to sales from companies dealing at arm's length with the appellant. First, these transactions occurred well before the transactions at issue. Second, these other companies used the appellant's forms and paid no fee for doing so. If the costs associated with using the forms had been passed on, he submitted, then the price charged by these companies would clearly have been significantly higher, though he admitted that he did not know what that price would be. Counsel also submitted that the information regarding pricing received from the company in Kelowna, British Columbia, should be disregarded because the geographic market from which this information is derived is considerably different from the market in which the appellant is located. Finally, with respect to the three methods applied by the respondent to determine a "reasonable sale price," counsel stated that these methods not only reflect common sense but are also consistent with generally accepted accounting principles.

The Tribunal is of the opinion that the appellant did charge Homenko Inc. a "reasonable sale price" for the panels in issue within the meaning of subsection 58(1) of the Act and, therefore, that the appeal should be allowed. The Tribunal comes to this conclusion by interpreting the wording of subsection 58(1) of the Act to operate as follows: (i) the manufacturer or producer at issue is entitled to establish a sale price with a party with whom it is not dealing at arm's length; (ii) this price will be the price used as the basis for determining any tax payable under the Act, if it is reasonable in the circumstances if the manufacturer or

producer and the person with whom it is dealing had been dealing at arm's length (i.e. this price is found to be a "reasonable sale price"); (iii) the manufacturer or producer will only be deemed to have sold the goods in question for a "reasonable sale price" if no sale price was established or the sale price that was set was a sale price that was less than the sale price which would have been reasonable in the circumstances (i.e. a price less than a "reasonable sale price"); and (iv) where the manufacturer or producer is deemed to sell at a "reasonable sale price," the respondent may establish such price under one of the various methods discussed above. In other words, once it has been determined that the transactions at issue are between related companies and a sale price is involved, one must first evaluate whether this price is, itself, a "reasonable sale price," and it is only if this price is found not to be a "reasonable sale price" that one goes on to consider a deemed price and whether such a deemed price was arrived at using the appropriate method in the context of the facts of a particular case.

In this case, the Tribunal is persuaded that the prices charged by the appellant to Homenko Inc. were reasonable in the circumstances, evaluating them as if the appellant and Homenko Inc. had been dealing at arm's length at the time that the sales were made. While the transactions on which the appellant relied did occur some time prior to the specific transactions at issue, the Tribunal is of the view that this time difference is not sufficient to invalidate a comparison, particularly in light of the fact that there was uncontroverted evidence that the prices for the panels had not changed in over three years. Further, the Tribunal notes that some of the transactions between the appellant and Homenko Inc. took place at prices that were significantly higher than the prices at which Homenko Inc. purchased panels from non-related companies and that the appellant consciously priced at these levels in its efforts to establish a realistic market price. With respect to the argument of counsel for the respondent that the prices from non-related companies were artificially low because they did not take into account costs associated with the licensing fee that Homenko Inc. had to pay for use of the forms, the Tribunal is of the view that these costs are at least offset by the higher prices charged by the appellant and the additional costs that it incurred in having to buy rather than mix its concrete.

Accordingly, the appeal is allowed.

Michèle Blouin
Michèle Blouin
Presiding Member

Desmond Hallissey
Desmond Hallissey
Member

Lise Bergeron
Lise Bergeron
Member