CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Tuesday, April 19, 1994

Appeal No. AP-92-109

IN THE MATTER OF an appeal heard on September 22, 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 July 30, 1992, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

JOMITEK INC. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed in part (Presiding Member Macmillan dissenting in part).

Kathleen E. Macmillan
Kathleen E. Macmillan
Presiding Member

Anthony T. Eyton
Anthony T. Eyton
Member

Charles A. Gracey
Charles A. Gracey
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-92-109

JOMITEK INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The appellant is an engineering company engaged in energy management, such as the development and supply of energy management systems for electricity. Its principal business activities are the provision of engineering services, the designing of customized computer software, the application and installation of microcomputer-based control and monitoring systems and the sale of computer hardware to accommodate the designs. The appellant was assessed on four separate contracts for unpaid taxes on certain aspects of the contracts. The appeal involves several issues: (1) whether the various engineering services provided by the appellant are taxable under the Excise Tax Act; (2) whether the software created by the appellant for its customers is taxable under the Excise Tax Act; (3) whether goods imported by the appellant and shipped directly to its customers are taxable on their value for duty or on their sale price to those customers; and (4) whether the assessment of penalty and interest against the appellant with respect to one of the contracts should be vacated.

HELD: *The appeal is allowed in part. The majority of the Tribunal finds that the engineering services and software are not taxable under the Excise Tax Act. In addition, it finds that tax is payable on the sale price of the computer system produced by the appellant from the various imported hardware components and that it cannot waive the penalty and interest imposed on the appellant (Presiding Member Macmillan dissenting in part).*

Place of Hearing:	*Ottawa, Ontario*
Date of Hearing:	*September 22, 1993*
Date of Decision:	*April 19, 1994*
Tribunal Members:	*Kathleen E. Macmillan, Presiding Member* *Anthony T. Eyton, Member* *Charles A. Gracey, Member*
Counsel for the Tribunal:	*David M. Attwater*
Clerk of the Tribunal:	*Janet Rumball*
Appearances:	*Philippe M. Capelle, for the appellant* *Robert P. Hynes, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-92-109

JOMITEK INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: KATHLEEN E. MACMILLAN, Presiding Member
ANTHONY T. EYTON, Member
CHARLES A. GRACEY, Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) of an assessment of the Minister of National Revenue (the Minister). By notice of assessment dated June 19, 1991, the appellant was assessed for unpaid taxes, penalty and interest in the amount of $49,416.00 to June 30, 1990, for the period from September 1, 1987, to December 31, 1990. On July 30, 1992, an objection to this assessment was allowed in part. The part allowed related to amounts assessed with regard to a contract that was not fully completed and, therefore, not fully invoiced due to the purchasing company, AATCO, going bankrupt. The revised amount was $54,267.82 to July 31, 1992. Jomitek Inc. then appealed the assessment to the Tribunal.

Mr. Lawrence Fish, President and founder of Jomitek Inc., served as witness for the appellant. Mr. Fish explained that the appellant is an engineering company engaged in energy management, such as the development and supply of energy management systems for electricity. Its principal business activities are the provision of engineering services, the designing of customized computer software, the application and installation of microcomputer-based control and monitoring systems and the sale of computer hardware to accommodate the designs.

Mr. Fish explained that all contracts with the appellant's customers were structured in three parts: engineering services (consulting), software development and hardware necessary for the project. Mr. Fish told the Tribunal that the contracts were structured this way based on instructions from the Department of National Revenue (Revenue Canada). Mr. Fish made reference to two letters from Revenue Canada. The first letter, dated May 11, 1987, stated in part:

> *Where such software is prepared by your firm and is included in the sale of hardware of your manufacture, sales tax applies on the hardware only. However, a verifiable value for the software must be established for tax purposes.*

To ensure that the appellant's practice was consistent with this letter, Mr. Fish requested a further interpretation subsequent to an audit by Revenue Canada. The second letter, dated May 31, 1991, stated in part:

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

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As a manufacturer of the hardware system any associated engineering costs for the system excluding the costs for software outlined above (if applicable), form part of the selling price as defined under section 42 of the Excise Tax Act for purposes of federal sales tax.

The letter further indicated that:

Also separate charges for software programs on tape or diskette, training of employees, and system acceptance testing and maintenance and support services carried out after the installation would not attract sales tax.

Mr. Fish described the four contracts to which this appeal relates. The first contract was with AATCO to provide an emergency power controlling system. The first phase of this project involved developing a series of specifications that ultimately went out to tender to various contractors. Mr. Fish explained that the contractors invited the appellant to bid on elements of the overall project to build the system to those specifications.

The appellant responded to three elements of the project. The first element involved the development of a computer system to perform the functions required to monitor and control electrical power in the Sir Leonard Tilley Building. Counsel for the appellant referred to an exhibit from the appellant's brief which itemized and described the work done by the appellant. Item A, described as "shop drawings and manuals," outlined the methodology of interconnecting or installing the system in the building and its operation. Item B, described as "hardware 'products' section," included the computer products and instrumentation required to perform the functions. Item C, described as "EPCS software package(s)," related to the software that was developed to meet the needs of the system. Item D, described as "engineering services section," included any other service relating to training and system acceptance testing. The appellant paid tax on item B only. Mr. Fish did not explain the other work that was itemized on the exhibit. However, in the appellant's brief, it is indicated that tax was also paid on item H, "section 16622 hardware," and item M, "manual synch panel." It was submitted in the brief that tax was not paid on the other items, as they pertained to the provision of services.

Mr. Fish noted that the appellant did not receive all payments under the contract, as the contractor went bankrupt before completion of the project. However, the appellant was assessed on the total contract price. On questions from the Tribunal, Mr. Fish acknowledged that, as a result of the notice of decision of the Minister, the appellant was not taxed on moneys not received under the contract. He explained, however, that the appellant was taxed on the software and engineering services provided pursuant to that contract, to which it objects.

The second contract involved a sale to Newfoundland Light & Power Co. Limited (NLP). Mr. Fish explained that the appellant was engaged to analyze NLP's communications system for problems and to create a preliminary design specification (a proposed solution) to meet its needs. Mr. Fish asserted that the appellant was paid as a consultant with no expectation of further work. Counsel for the appellant referred to a letter addressed to the appellant from NLP, dated March 18, 1988, which authorized the appellant "to commence work only on the first step of the PROJECT." The letter went on to state that:

In the event that NLP does not approve the Design Specification submitted by JOMITEK, the PROJECT shall not proceed and there shall be no further obligations between NLP and JOMITEK.

If NLP approves the Design Specification, NLP and JOMITEK shall execute a formal Agreement to govern completion of the PROJECT.

The agreement between the appellant and NLP was approved by Mr. Raymond J. Schofield of NLP on July 19, 1988. In explaining his understanding of the contract, Mr. Fish said that the appellant was to develop a software program to meet NLP's needs, to assist in procuring and assembling the necessary computer hardware and to provide engineering services pertaining to the system's installation and testing. He noted that the engineering fees were primarily in respect of software development, installation and testing of the system.

The third contract was with Stoney Creek Hydro-Electric Commission (SCH), which is an electrical utility. Mr. Fish explained that the appellant did some preliminary consulting work to define SCH's data acquisition needs. On this basis, SCH had the appellant develop the software to drive a data acquisition system and to procure the necessary instrumentation to meet its needs. The appellant imported hardware from a U.S. supplier and had it shipped to SCH. Mr. Fish explained that the appellant was the importer of record and that it subsequently sold the equipment to SCH, keeping a commission on the sale. Sales tax was charged only on the hardware (and presumably remitted to Revenue Canada), based on the duty-paid value of the goods and not on their sale price to SCH.

In the fourth contract, the appellant was a subcontractor on a project for the Regional Municipality of Ottawa-Carleton (RMOC). The appellant charged sales tax on its work. However, well into the project, the appellant received a copy of a letter from the RMOC indicating that the goods supplied by the appellant were being used for a tax-exempt purpose. Mr. Fish explained that, in response to receiving this letter, he called Revenue Canada and was informed that the appellant should deduct from future remittances to Revenue Canada the moneys already remitted under the contract with the RMOC. The credit was drawn down for approximately eight months until the appellant was informed to discontinue the practice during an audit. Apparently, the appellant was told that it should apply for a refund, which it did, but the application was rejected. Subsequent to a March 1990 audit, the appellant was assessed penalty and interest on these sales when they were determined not to have been made under tax-exempt circumstances. In response to a question from the Tribunal, Mr. Fish stated that it is possible that the general contractor, which was the appellant's customer, applied for a refund of the taxes remitted to Revenue Canada.

Counsel for the respondent called one witness, Ms. Sudha Dukkipati, who is an auditor with Revenue Canada. Ms. Dukkipati was involved in the audit of the appellant's refund application in respect of the contract involving the RMOC. She told the Tribunal that a review of the appellant's application for refund of taxes remitted to Revenue Canada in respect of this contract revealed that the appellant was not entitled to the refund and that it had already taken some internal deductions in lieu of applying for the refund. A full audit of the appellant was then conducted.

Ms. Dukkipati explained that the appellant's contracts are all-inclusive price contracts that include software and hardware. She explained that, based on past rulings of Revenue Canada, the total sale price of the contract is taxable except for things specifically excluded or specifically identified. As such, the AATCO contract was taxable on its total sale price less the cost of installation and any other allowable deduction. Ms. Dukkipati confirmed that the assessment of the appellant was varied so that it was not taxed on the unbilled portion of the contract. In response to questions from the Tribunal pertaining to the AATCO and NLP contracts, Ms. Dukkipati indicated that, if the appellant's software had been application software

(as opposed to basic operational software) and had been billed separately, it would not have been taxed by Revenue Canada.

With regard to taxes paid on the RMOC project, Ms. Dukkipati suggested that the appellant would only have been exempt from paying taxes if it had qualified for the direct shipment exemption pursuant to Excise Memorandum ET 307.[2] She explained to the Tribunal how this administrative concession worked, what the appellant was required to establish with Revenue Canada before it could take advantage of the concession and why it had not been entitled to the exemption. As the appellant was not exempt from paying taxes, it had not paid taxes in error. Further, as it was not entitled to a refund of moneys paid in error, it could not take an internal deduction from taxes to be remitted to Revenue Canada in lieu of applying for the refund.

With regard to the work done for NLP, Ms. Dukkipati told the Tribunal that Revenue Canada concluded that the work was governed by a single contract. As such, the total sale price of the contract was taxable.

In conclusion, Ms. Dukkipati said that the appellant designs, develops and produces computer systems, which include both software and hardware. As an integrated system, the software is dependent on the hardware, and the engineering services provided by the appellant are related to the system. Therefore, the contracts are taxable subject to the deductions allowed by section 42 of the Act.

This appeal involves several issues:

1. whether the various engineering services provided by the appellant are taxable under the Act;

2. whether the software created by the appellant for its customers is taxable under the Act;

3. whether goods imported by the appellant and shipped directly to SCH are taxable on their value for duty or on their sale price to SCH; and

4. whether the assessment of penalty and interest against the appellant with respect to the RMOC contract should be vacated.

With regard to the AATCO contract, counsel for the appellant argued that the engineering services provided by the appellant pertain to the installation of the goods and not to the design of the hardware equipment. As such, the services do not relate to the goods sold.

With regard to the sale to NLP, the appellant's position was that the taxes that it remitted on this sale were based on there being two different contracts in existence: a consulting contract and a software development contract. No sales tax was charged on the consulting work, and there was no expectation of any further work after the first contract was completed. When the contract for the development of software was completed, Revenue Canada insisted on taxing the software, hardware and consulting. In the appellant's notice of objection, it was contended that tax does not apply to "unbundled software" that, in and of itself, would not be taxable. Counsel

2. Direct Shipment Exemption, Department of National Revenue, Customs and Excise, December 1, 1975.

for the appellant argued that the engineering services provided by the appellant are not manufacturing or production for purposes of the Act.

Counsel for the appellant reminded the Tribunal that, prior to its decision in *ICAM Technologies Corporation v. The Minister of National Revenue*,[3] the production of software was not considered the production of goods. Counsel noted that the contracts with AATCO, NLP and SCH were completed prior to the *ICAM* decision. He submitted that the law applicable to this appeal is the law as it stood at the time that the appellant was assessed.

As to the sale to SCH, counsel for the appellant contended that sales tax should only be paid on the duty-paid value of the goods rather than on their final sale price to the customer.[4] Counsel argued that the appellant was neither the manufacturer nor the producer of the computer hardware that it provided to SCH as part of its computer design and engineering project and, as such, should not be liable for tax on the total value of the project.[5]

With regard to the assessment of penalty and interest on unpaid taxes from the RMOC project, counsel for the appellant argued that the appellant was entitled to the direct shipment exemption to which Ms. Dukkipati referred. With regard to the letter received by the appellant in May 1987, counsel argued that the doctrine of estoppel could be invoked because its application would not preclude the Minister from exercising his statutory authority.[6] In addition, he contended that the doctrine of legitimate expectation could be applied.[7]

With regard to the sale to AATCO, counsel for the respondent agreed with the appellant that taxes were not owing on the outstanding moneys. He reminded the Tribunal that the notice of decision of the Minister revised the amount of unpaid taxes, penalty and interest owed by the appellant. Counsel argued that the engineering services provided by the appellant related to the sale of the goods. Where engineering service charges relate to goods manufactured and where they are sold under taxable conditions, the tax applies to the total charge, including engineering and design services, even though they are billed separately. Only where there are separate charges for software programs on tape or diskette, training of employees, and system acceptance testing and maintenance and support services, and where these are carried out after the installation, would there be no sales tax liability.

As to the sale to NLP, counsel for the respondent argued that there was a single contract, while the alleged second contract is a letter authorizing the appellant to proceed with the first phase of the project. Counsel referred to the letter from NLP to the appellant, dated March 18, 1988, submitting that it was authorization for the first phase of the project, which, if accepted, was to be followed by the execution of "a formal Agreement to govern completion of the PROJECT." Further, the "Schedule of Payments" and the "Bill of Materials" make it obvious that it was the intent of both parties that the transactions in question be viewed as parts of one project governed by one contract.

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3. Appeal No. 2669, June 27, 1991.
4. Without explaining its relevance, counsel for the appellant referred to *MCA (CANADA) Ltd. v. The Minister of National Revenue*, Canadian International Trade Tribunal, Appeal No. AP-90-123, August 11, 1992.
5. See the *MCA (Canada) Ltd.* decision, *ibid.*
6. *The Minister of Employment and Immigration v. Mohinder Singh Lidder*, [1992] 2 F.C. 621, and *Minister of Employment and Immigration v. Mokhtar Bendahmane*, [1989] 3 F.C. 16.
7. See the *Bendahmane* decision, *ibid.*

With regard to the "unbundled software," counsel for the respondent noted that the law on this point changed as a result of the *ICAM* decision, in which it was decided that the production of software constitutes the production of goods for purposes of the Act. He argued that tax applies to the total sale price, including engineering and design services, even when billed separately. Should the Tribunal find that there were two contracts, the respondent's alternative position would be that the software was manufactured by the appellant and would be taxable, given the *ICAM* decision.

With regard to the sale to SCH, counsel for the respondent argued that, under subsection 50(1) of the Act, the appellant was liable to pay tax on the goods imported into Canada. However, as a licensed manufacturer which imported partly manufactured goods to be incorporated into other goods, the appellant could import the goods without the imposition of tax under paragraph 50(5)(*b*) of the Act. The goods became taxable when sold, unless sold under tax-exempt conditions. However, the goods were not sold under tax-exempt conditions. If the appellant paid taxes when the goods were imported and again when sold, it was entitled to apply for and receive a refund of the taxes paid in error on the imported goods.

It is the respondent's position that these goods were imported by the appellant for use by the appellant in fulfilment of its obligations under a contract with its customers. It is irrelevant where the appellant chose to have the goods delivered, as it was the purchaser of the goods. As with the AATCO contract, sales tax should have been remitted on the value of the sale of the manufactured goods, as a whole, to the appellant's customers.

With regard to the RMOC contract, counsel for the respondent argued that the appellant took unauthorized internal deductions with respect to taxes allegedly paid in error on exempt sales and for bad debts. Noticing some irregularity, Revenue Canada asked the appellant to file a refund application as the proper means to recover an overpayment of tax. Counsel submitted that, in doing so, the respondent was not commenting on the validity of the appellant's claim that taxes had been overpaid. The moneys were refunded in September 1990. However, during a later reconciliation, it was discovered that the refund was paid in error, as the sales were not made under tax-exempt conditions. This led to an audit that was further extended, as other irregularities were discovered. The sale in question was to a contractor which was not entitled to tax-exempt purchases. The normal procedure where the contractor sells under tax-exempt conditions would be for the contractor to apply for a refund.

Subsection 81.39(1) of the Act states that, where a person has received a payment to which that person is not entitled, the amount of the payment is deemed to be a tax under the Act and is payable to the respondent. Subsection 81.39(5) of the Act requires that penalty and interest be paid where an amount is deemed to be tax under subsection 81.39(1) of the Act and has not been paid within the time therein required. Counsel for the respondent submitted that penalty and interest were properly assessed with respect to the refund paid in error, as required by subsection 81.39(5) of the Act. There is no provision in the Act for either the Minister or the Tribunal to vacate the imposition of penalty and interest.

As a preliminary issue, the Tribunal had to determine whether the respondent can be bound by representations made in writing by its officials and departmental ruling cards concerning the tax treatment of computer software. This was information on which the appellant relied in conducting its affairs. In spite of the clear and unequivocal advice provided by Revenue Canada officials, which was later altered, it is a well-established principle that the Crown is not bound by the representations made and the interpretations given to taxpayers by

officials of the government. In *Joseph Granger v. Canada Employment and Immigration Commission*,[8] it was stated that:

> *In Canadian tax law, the courts have consistently held that the Crown is not bound by the representations made and interpretations given to taxpayers by authorized representatives of the Department, if such representations and interpretations are contrary to clear and peremptory provisions of the law.*[9]

Consequently, the Tribunal has no option but to interpret the law in this instance without regard to the advice provided to the appellant by Revenue Canada officials.

As to the sale to SCH, the Tribunal believes that tax is payable on the sale price of the computer system, which incorporated the various imported goods. In essence, counsel for the respondent argued that the appellant imported certain hardware that was used in the manufacture or production of a computer system. As the imported goods were incorporated into the greater system, they constituted partially manufactured goods that were exempt from tax on their importation, under paragraph 50(5)(*b*) of the Act.

The Tribunal believes that the appellant produced a computer network. As stated in *The Minister of National Revenue v. Enseignes Imperial Signs Ltée*,[10]

> *a thing can be produced by carrying out a very simple operation. What matters is not the complexity of the operation but its result. A thing is produced if what a person does has the result of producing something new; and a thing is new when it can perform a function that could not be performed by the things which existed previously.*

The Tribunal believes that the components of the computer system could not perform the functions conducted by the system itself. As such, the appellant produced something new when it produced the computer system. As tax is payable by the producer on the sale price of goods produced in Canada, the appellant was liable for tax based on the sale price of the imported hardware incorporated into the computer system.

As one of the issues before the Tribunal is whether tax is payable on the sale price of the computer system and not whether the appellant is liable for tax at the time of importation of the goods or exempt therefrom, the Tribunal considers it unnecessary to address issues relating to the classification of the imported goods as partly manufactured goods. It notes, however, that the determination as to whether an article is a partly manufactured product rests solely with the Minister, under section 42 of the Act. In this regard, the Tribunal would expect counsel for the respondent to tender evidence of such a determination, if it is to be argued that goods are exempt from tax on their importation as partly manufactured goods.

With regard to the RMOC contract, the Tribunal notes that Mr. Fish acknowledged that the appellant's immediate customer was the electrical contractor with which it was contractually bound. The appellant did not make a sale to a tax-exempt user and was not entitled to a refund of taxes paid in error under section 68 of the Act. The fact that the final customer, the RMOC, has tax-exempt status does not absolve the appellant of its liability for the tax. Ms. Dukkipati explained how the appellant may have availed itself of the direct shipment exemption under the

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8. [1986] 3 F.C. 70, affirmed [1989] 1 S.C.R. 141.
9. *Ibid.* at 86.
10. Federal Court of Appeal, unreported judgement, File No. A-264-89, February 28, 1990 at 4.

circumstances. However, the Tribunal was offered no evidence that the appellant met the administrative requirements to take advantage of the exemption.

In its brief, the appellant claimed to have been improperly assessed penalty and interest, presumably because it was acting on the alleged instructions of Revenue Canada. It asked the Tribunal for relief from the penalty and interest. However, the Tribunal does not have the jurisdiction to cancel or reduce a penalty. Nor does its jurisdiction extend to varying or vacating any interest that has been imposed on default in paying taxes.[11]

With regard to the AATCO contract, it was submitted in the appellant's brief that certain items were not subject to tax, as they pertained to the provision of services. These included item A, "shop drawings and manuals;" item C, "EPCS software package(s);" item D, "engineering services section;" items E and J, "commissions;" and item I, "section 16622 software." Counsel for the respondent argued that these items would be taxable, as they relate to the sale of the computer system, which constitutes manufactured or produced goods. In support of this proposition, counsel argued that the "sale price" of the computer system included both "the amount charged as price,[12]" and "any amount that the purchaser is liable to pay to the vendor by reason of or in respect of the sale in addition to the amount charged as price.[13]" In the alternative, counsel argued that the software would be independently taxable according to the Tribunal's reasoning in the *ICAM* decision.

The Tribunal does not believe that the definition of "sale price" casts a boundless net over all payments by a purchaser coupled to the sale of manufactured or produced goods. The Tribunal, commenting on the definition of "sale price" in *Sunset Lamp Manufacturing Company Ltd. v. The Minister of National Revenue*,[14] stated that:

> *liability for tax is imposed on the total value realized by the vendor by reason of, or in respect to, the sale of its goods.... In effect, the vendor is asked to pay tax on the net realized value it received for, or in respect to, the sale of its goods.*[15]

The Tribunal does not believe that the price paid for the services provided by the appellant, including the provision of customized software, was part of the net realized value that the appellant received for, or in respect to, the sale of the computer system. The AATCO contract encompassed a wide range of goods and services and, in the Tribunal's view, it is possible to divide the contract into distinct components. The Tribunal is persuaded by the testimony of Mr. Fish regarding the stand-alone nature of the hardware and service elements of the contracts. Mr. Fish testified that many of the hardware components were off-the-shelf items, such as IBM personal computers that could be purchased by the customers from other sources. With respect to this hardware, the appellant acted in the nature of a distributor. In view of this, the Tribunal restricts the definition of sale price of the computer system to those aspects of the contract that pertain to hardware and system operating software and excludes the charges relating to engineering services and customized software development. Similarly, tax

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11. *Les Presses Lithographiques Inc. v. The Minister of National Revenue*, Canadian International Trade Tribunal, Appeal No. 2997, June 26, 1989, and *Oerus Corporation Ltd. v. The Minister of National Revenue*, Canadian International Trade Tribunal, Appeal No. AP-91-056, September 3, 1992.
12. Subparagraph (*a*)(i) of the definition of "sale price" under section 42 of the Act.
13. Subparagraph (*a*)(ii) of the definition of "sale price" under section 42 of the Act.
14. (1992) 5 T.C.T. 1016, Appeal No. AP-89-032, December 12, 1991.
15. *Ibid.* at 1017.

would be payable on the commissions that AATCO was liable to pay on its purchase of the hardware incorporated into the computer system.

The first issue with respect to the NLP project is whether the development of a preliminary design specification should be considered part of the contract for the sale of the computer system and, therefore, subject to tax. In the Tribunal's view, the wording of the March 18, 1988, letter from NLP to the appellant makes it clear that this early work was removed from the contract, governing completion of the overall project. The letter stipulates that the customer was under no obligation to proceed to a further phase. However, if the preliminary design specification were accepted, a separate formal agreement would be struck to govern completion of the project. In view of the plain meaning of this letter, the Tribunal considers the preliminary design agreement to be akin to consulting services that are separate from the contract involving the sale of computer hardware. As such, the amount that NLP paid to the appellant for these services is not included in the sale price of the hardware.

The second issue with respect to the NLP project is whether the amounts payable for the customized software form part of the sale price of the computer system produced by the appellant. For the above-mentioned reasons, the Tribunal does not believe that the price paid for the customized software was part of the net realized value that the appellant received for, or in respect to, the sale of the computer system.

The final issue is whether the creation of customized software is the manufacture or production of goods within the meaning of the Act and, thus, taxable under paragraph 50(1)(*a*) of the Act. In support of this proposition, counsel for the respondent referred to the *ICAM* decision where, he submitted, the Tribunal decided that the production of software constituted the production of goods for the purposes of the Act and that the appellant in that case was a manufacturer for the purposes of the Act. In contrast, counsel for the appellant argued that the appellant was providing engineering services that, prior to the *ICAM* decision, had consistently been held by Revenue Canada not to be taxable.

With respect to the *ICAM* decision, the majority of the Tribunal believes that the customized software in issue is, indeed, the sort of thing that may be considered intellectual property. Revenue Canada has not previously regarded such things as goods within the meaning of the Act, which is to say for purposes of taxation, and has issued interpretation bulletins, ruling cards and communications to the industry to make it clear that such things were not considered taxable. It is the opinion of the majority of the Tribunal that the creation of customized software, as was done by the appellant, was not the manufacture or production of goods as contemplated by the Act. As such, it would not be taxable under section 50 of the Act.

Accordingly, the appeal is allowed in part.

Anthony T. Eyton
Anthony T. Eyton
Member

Charles A. Gracey
Charles A. Gracey
Member

PARTIAL DISSENTING OPINION OF PRESIDING MEMBER MACMILLAN

Having been a member of the panel that decided the *ICAM* case, I find it impossible to agree with my colleagues on the narrow issue concerning the taxation of customized software. The activities carried on by the appellant in this instance closely resemble the factual situation that was before the Tribunal in the *ICAM* case. In my opinion, for the reasons set out in detail in the *ICAM* decision, the production of customized software constitutes the production of goods. Consequently, I would have found the software portion of the appellant's contracts to be taxable under subsection 50(1) of the Act.

Kathleen E. Macmillan
Kathleen E. Macmillan
Presiding Member