CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Wednesday, May 31, 1995

Appeal No. AP-92-282

IN THE MATTER OF an appeal heard on October 24, 1994, 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 October 26, 1992, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

P.A. BOTTLERS LTD. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed in part, and the matter is returned to the respondent to calculate the appropriate allowance for transportation costs to be applied to the appellant's sales in the relevant period, with penalty and interest to be adjusted accordingly.

Arthur B. Trudeau
Arthur B. Trudeau
Presiding Member

Charles A. Gracey
Charles A. Gracey
Member

Lyle M. Russell
Lyle M. Russell
Member

Michel P. Granger
Michel P. Granger
Secretary

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UNOFFICIAL SUMMARY

Appeal No. AP-92-282

P. A. BOTTLERS LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The appellant is a Coca-Cola franchise bottler, with franchise areas in Saskatchewan and Manitoba, that is in the business of producing, bottling and selling soft drinks, juices, carbonated water and other products to both retailers and wholesalers. The appellant also sells canned beverages which it purchases on a tax-paid basis. Hence, the canned beverages are not taxable. There are two issues in this appeal: (1) whether the appellant's calculation of transportation costs was made in accordance with the Excise Tax Act and its regulations; and (2) whether the Tribunal has any jurisdiction to waive penalty and interest assessed under the Excise Tax Act.

***HELD**: The appeal is allowed in part. The Tribunal is of the view that it is appropriate to allocate part of total expenses to costs associated with tax-exempt goods and to remove both revenue from sales of canned beverages and costs associated with delivering such products from total expenses prior to developing a transportation factor for the deduction of the transportation costs that the appellant is entitled to claim in determining the sale price on which federal sales tax is calculated. The Tribunal agrees with counsel for the appellant that, in the context of the appellant's operations, weight is an appropriate factor to use in apportioning transportation costs between tax-exempt and taxable goods because the evidence shows that this is the key distinguishing factor between them.*

Place of Hearing:	*Saskatoon, Saskatchewan*
Date of Hearing:	*October 24, 1994*
Date of Decision:	*May 31, 1995*
Tribunal Members:	*Arthur B. Trudeau, Presiding Member* *Charles A. Gracey, Member* *Lyle M. Russell, Member*
Counsel for the Tribunal:	*Hugh J. Cheetham*
Clerk of the Tribunal:	*Anne Jamieson*
Appearances:	*John R. Beckman, Q.C., 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-92-282

P.A. BOTTLERS LTD. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: ARTHUR B. TRUDEAU, Presiding Member
CHARLES A. GRACEY, Member
LYLE M. RUSSELL, Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) of a decision of the Minister of National Revenue dated October 26, 1992.

The appellant is a Coca-Cola franchise bottler that is in the business of producing, bottling and selling soft drinks, juices, carbonated water and other products to both retailers and wholesalers. The appellant also sells canned beverages which it purchases on a tax-paid basis. Hence, the canned beverages are not taxable. The appellant has a manufacturing facility in Prince Albert, Saskatchewan, and distribution operations in Yorkton, Saskatchewan, and in Thompson and The Pas, Manitoba.

By notice of assessment dated February 28, 1989, the respondent assessed the appellant the sum of $488,738.83 for the period from July 1, 1985, to December 31, 1988, for unpaid taxes, interest and penalty. By notice of objection dated May 26, 1989, the appellant objected to the assessment. On June 27, 1989, the respondent issued a reassessment which amended the original assessment by allowing more for transportation costs, crediting the appellant for certain bad debts and revising certain penalty and interest charges. As a result, the amount assessed for unpaid taxes, penalty and interest was $486,554.27. The appellant objected to the reassessment. By notice of decision dated October 26, 1992, the respondent allowed the appellant's objection in part and varied the notice of assessment. The amount outstanding as at October 26, 1992, was $790,981.60 in unpaid taxes, penalty and interest.

The appellant initially raised a number of issues in its appeal. At the hearing, counsel for the appellant advised the Tribunal that only two issues remained outstanding between the parties: (1) whether the appellant's calculation of transportation costs was made in accordance with the Act and its regulations; and (2) whether the Tribunal has any jurisdiction to waive penalty and interest assessed under the Act. With respect to the second issue, counsel for the appellant stated that, although he would not be speaking to it, the appellant did not want to be seen as abandoning this issue, should the case be appealed. Counsel for the respondent submitted that the Tribunal has no jurisdiction to vary penalty and interest, except to the extent that an assessment, on which penalty and interest have been assessed, is itself varied. In support of this position, he referred to previous decisions of the Tribunal.[2]

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1. R.S.C. 1985, c. E-15.
2. See, for example, *Les Presses Lithographiques Inc. v. The Minister of National Revenue*, Appeal No. 2997, June 26, 1989.

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With respect to the first issue, the Tribunal notes that the appellant distributes both taxable goods that it manufactures and similar goods that it does not manufacture but purchases on a tax-paid basis. These goods differ primarily in their packaging. The taxable goods are packaged in glass containers, and the tax-exempt goods are packaged in aluminum cans. That the appellant should be permitted to deduct transportation costs incurred in transporting tax-exempt goods is not in dispute. As noted, what is disputed is the method that the appellant seeks to employ in removing these costs.

The relevant provisions of the Act read, in part, as follows:

> *46. For the purpose of determining the consumption or sales tax payable under this Part,*
>
> *(c) in calculating the sale price of goods manufactured or produced in Canada, there may be excluded*
>
> *(ii) under such circumstances as the Governor in Council may, by regulation, prescribe, an amount representing*
>
> *(B) the cost of transportation of the goods incurred by the manufacturer or producer in transporting the goods between premises of the manufacturer or producer in Canada, or in delivering the goods from the premises of the manufacturer or producer in Canada to the purchaser, where the goods are sold at a price that includes those costs of transportation,*
>
> *determined in such manner as the Governor in Council may, by regulation, prescribe*.

The relevant provisions of the *Sales Tax Transportation Allowance Regulations*[3] (the Regulations) read, in part, as follows:

> *4.(2) Where goods on which consumption or sales tax is payable under Part V of the Act are transported by a conveyance owned, leased or rented by the manufacturer or producer of the goods, the amount excluded in respect of the cost of that transportation shall include only those costs related to the ownership, leasing or rental and operation of the conveyance, that are allocated to the goods in accordance with generally accepted accounting principles applied on a consistent basis, including*
>
> *(a) operating expenses such as licence fees, insurance premiums, fuel costs, oil and grease costs, servicing and repair costs and wages of drivers;*
> *(b) depreciation; and*
> *(c) rental and lease payments.*

Counsel for the appellant called one witness, Mr. Marc A. Hauser, General Manager of P.A. Bottlers Ltd. Mr. Hauser described the appellant's franchise territory that included various areas in Saskatchewan and Manitoba. He stated that central to this matter is the question of whether adjustments should be made in the appellant's deduction for transportation costs relating to the distribution of tax-exempt goods, namely, beverages packaged in aluminum cans. Mr. Hauser explained that, prior to June 1988, it was against the law to sell canned beverages in Saskatchewan, south of the 56th parallel, or, in other words, except in the most northerly parts of the province. As far as Mr. Hauser knew, the exception was related to the fact that the cost of transporting cans to the north was less than the cost of transporting bottles and other

3. SOR/83-95, January 21, 1983, Canada Gazette Part II, Vol. 117, No. 3 at 497.

containers because a conveyance could carry more cans than bottles, as cans are lighter. Mr. Hauser noted that there was no such restriction in Manitoba during the relevant period.

Mr. Hauser indicated that he agreed with the summary of expenses prepared by the respondent, noting that the total expenses included all transportation costs, including all costs relating to tax-exempt goods. He explained that the appellant's accounting records allowed it to develop an allocation for tax-exempt goods based on weight, because the records for vehicles used to distribute the goods includes the weight of each load of product on a vehicle. Mr. Hauser noted that his allocation for tax-exempt goods rose from 8.0 percent in 1986 to 18.8 percent in 1988, when the distribution of cans was no longer restricted in Saskatchewan. In response to a question from the Tribunal, Mr. Hauser explained that the "factors" for tax-exempt goods developed by the appellant differed from the transportation factors developed by the respondent in that the appellant's factors were meant to be used to establish an amount for the cost of delivering the tax-exempt goods. To establish a final transportation factor, this amount and the amount of revenue received from sales of the tax-exempt beverages would be removed from total transportation costs and total revenue, respectively.

During cross-examination, Mr. Hauser agreed that not all trips of the appellant's vehicles included tax-exempt goods. He also agreed that the appellant's allocation did not provide for a weight ratio on the basis of sales revenue. With respect to questions as to whether certain expenses were directly related to transportation or whether they varied by weight, Mr. Hauser stated that salaries did vary with respect to weight to the extent that the drivers who took loads to northern Saskatchewan or Manitoba could carry more product, because the cans are lighter. As a result, the revenue earned on the trip could be higher and, as they were paid a commission, their salaries turned out to be higher than those of drivers delivering loads that did not include tax-exempt goods. He also stated that truck lease and repair expenses depended on weight to the extent that trucks were leased on the basis of product that was to be hauled, and the nature of repairs needed would vary depending on the weight of product hauled. Mr. Hauser agreed that line and hauled expenses incurred in 1986, 1987 and the first half of 1988 would have only related to product transported to Yorkton and that this would not have included tax-exempt goods.

In argument, counsel for the appellant submitted that the approach taken by the respondent in developing a factor based on the ratio of total expenses to total revenue would work if the cost of delivering tax-exempt and taxable goods was the same. However, he argued, the evidence is that these two costs are not the same. An allocation for the cost of delivering tax-exempt goods is reasonable because it costs less to deliver these goods. He noted that this fact is reflected not only in Mr. Hauser's evidence but also in the fact that total costs went down in 1988, when cans could be shipped anywhere in Saskatchewan, not just north of the 56th parallel.

Counsel for the appellant also submitted that the appellant's approach was consistent with the Act and the Regulations. He referenced subsection 4(2) of the Regulations, which provides that the costs identified in subsection 4(1) are to be allocated to the goods on which sales tax is payable under the Act in accordance with generally accepted accounting principles (GAAP), applied on a consistent basis. He submitted that the respondent did not allocate those costs to the "goods" because the respondent allocated costs to both tax-exempt and taxable goods.

With respect to GAAP and how they should be applied in this case, counsel for the appellant referred the Tribunal to the following passage from the Canadian Institute of Chartered Accountants Handbook:

> *The method selected for determining cost should be one which results in the fairest matching of costs against revenues regardless of whether or not the method corresponds to the physical flow of goods.*[4]

Finally, counsel for the appellant referred the Tribunal to the decision of the Supreme Court of Canada in *Johns-Manville Canada Inc. v. Her Majesty The Queen*[5] and submitted that this case directed the Tribunal to use a common sense approach in applying taxing provisions to the business of a particular taxpayer. He also submitted that the case stood for the proposition that, in the face of two equal ways of doing things, the Tribunal should choose the one that benefits the taxpayer or, put colloquially, that a tie goes to the taxpayer.

Counsel for the respondent submitted that section 46 of the Act provides that a taxpayer must clearly establish the transportation costs incurred where the goods are sold at a price that includes such costs. Counsel indicated that, in this case, the appellant has suggested, and the respondent, to a degree, has accepted, that it is impractical or difficult to make a direct relationship between the costs of delivery and the sale price of the goods. This is why the respondent permitted the use of an estimate to establish a transportation factor. However, counsel submitted that the appellant is in effect asking for further estimates to be introduced into the calculations. Counsel submitted that, at this point, one no longer has the kind of matching of costs against revenue required by GAAP. Rather, the introduction of further estimates by the appellant would destroy the matching principle and result in no reliable match between costs and revenue. In addition, counsel argued that Mr. Hauser's testimony on cross-examination showed that a number of the items that make up the appellant's transportation costs, such as line and hauled expenses, bear no relationship to the weight of the goods being transported, while others, such as truck repairs and salaries, bear only a weak relationship to weight.

Counsel for the respondent submitted that the respondent's approach in this case does take into account the difference between tax-exempt and taxable goods by assuming that, essentially, they bear the same relationship. Counsel also noted that there was no information before the Tribunal with respect to weight/sales ratio, which, he submitted, would be necessary to make the allocations that the appellant is suggesting. Further, he submitted that it was not possible to come up with an accurate formula which properly captures GAAP, where complicating factors such as deliveries in different geographic areas are involved. Finally, counsel submitted that the appellant's approach, using weight as a factor, underestimates revenue and overestimates transportation costs and, in the end, is the least accurate of the options before the Tribunal.

In reply, counsel for the appellant agreed that some expense items may not have much to do with weight, but that others, such as salaries, are underrepresented in weight factors suggested by the appellant.

The Tribunal first notes that the parties are in agreement about the essence of the issue before the Tribunal, that is, what allowance may be made for tax-exempt goods in developing a transportation factor for the appellant for purposes of the appellant's transportation deduction under section 46 of the Act and section 4 of the Regulations. As noted above, the appellant is suggesting that an amount for tax-exempt goods be removed from its transportation costs before its overall transportation factor is calculated. This would result in the appellant's transportation costs being reduced prior to the calculation of its transportation factor, which would result in a higher factor and, therefore, a greater reduction.

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4. CICA Handbook, Vol. 1 (Toronto: Canadian Institute of Chartered Accountants, 1968-.) at 3030.13.
5. [1985] 2 S.C.R. 46.

The evidence shows that, with respect to the payment of federal sales tax, the appellant sells two types of goods, i.e. tax-exempt and taxable goods. The Tribunal is of the view that it is not reasonable, in the circumstances of this case, to allocate on the basis of revenue because the evidence shows that costs with respect to these two different types of goods are different. It is, therefore, appropriate to allocate part of total expenses to costs associated with tax-exempt goods and to remove both revenue from sales of canned beverages and costs associated with delivering such goods from total expenses prior to developing a transportation factor for the deduction of transportation costs that the appellant is entitled to claim in determining the sale price on which federal sales tax is calculated. The Tribunal agrees with counsel for the appellant that, in the context of the appellant's operations, weight is an appropriate factor to use in apportioning transportation costs between tax-exempt and taxable goods because the evidence shows that this is the key distinguishing factor between them. A number of pieces of evidence persuade the Tribunal that it is cheaper to deliver cans than bottles or other containers. These include Mr. Hauser's testimony, the fact that transportation costs declined in 1988, after cans were allowed throughout Saskatchewan, and the increase in the weight factor for 1988 as compared to earlier years.

With respect to counsel for the respondent's argument that a number of items on the list of expenses bear little or no relationship to the weight of the goods being transported, the Tribunal agrees with counsel for the appellant that these items, for instance, line and hauled expenses, would be offset by other items, such as salaries, which would be underrepresented.

With respect to the issue of interest and penalty, the Tribunal agrees with counsel for the respondent that the Tribunal has no jurisdiction to vary penalty and interest, except to the extent that an assessment, on which penalty and interest have been assessed, is itself varied.

Therefore, the appeal is allowed in part, and the matter is returned to the respondent to calculate the appropriate allowance for transportation costs to be applied to the appellant's sales in the relevant period, with penalty and interest to be adjusted accordingly.

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