

Ottawa, Thursday, January 27, 1994

Appeal No. AP-92-338

IN THE MATTER OF an appeal heard on July 9, 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 24, 1992, with respect to a notice of objection served under section 81.17 of the *Excise Tax Act*.

BETWEEN

McCAIN FOODS LIMITED

Appellant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is allowed (Presiding Member Hines dissenting).

W. Roy Hines

W. Roy Hines
Presiding Member

Anthony T. Eyton

Anthony T. Eyton
Member

Charles A. Gracey

Charles A. Gracey
Member

Michel P. Granger

Michel P. Granger
Secretary

UNOFFICIAL SUMMARY

Appeal No. AP-92-338

McCAIN FOODS LIMITED

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

The issue in this appeal is whether the imported components for a Hansen-Rice potato storage and handling unit qualify for exemption from federal sales tax under paragraph 1(a) of Part XIII of Schedule III to the Excise Tax Act as "machinery and apparatus ... imported by manufacturers or producers for use by them primarily and directly in ... the manufacture or production of goods."

HELD: *The appeal is allowed. The majority of the Tribunal is convinced that the Hansen-Rice potato storage and handling unit was specifically designed as a potato storage and conditioning system. It was purchased by the appellant and erected on the Borden, Prince Edward Island, site for this particular purpose. The majority of the Tribunal concludes that the imported components come within the purview of paragraph 1(a) of Part XIII of Schedule III to the Excise Tax Act as being for use "primarily and directly in ... the manufacture or production of goods" (Presiding Member Hines dissenting).*

Place of Hearing: Ottawa, Ontario
Date of Hearing: July 9, 1993
Date of Decision: January 27, 1994

Tribunal Members: W. Roy Hines, Presiding Member
Anthony T. Eyton, Member
Charles A. Gracey, Member

Counsel for the Tribunal: Robert Desjardins

Clerk of the Tribunal: Janet Rumball

Appearances: W. Jack Millar, for the appellant
Geoffrey S. Lester, for the respondent

Appeal No. AP-92-338

McCain Foods Limited

Appellant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

TRIBUNAL: W. ROY HINES, 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 a determination confirmed by the Minister of National Revenue on November 24, 1992.

The appellant imported into Canada from the United States specifically designed components for three potato storage and handling units (the units). Manufactured by Hansen-Rice Inc., these units were installed at the appellant's potato-processing facility located in Borden, Prince Edward Island. Federal sales tax (FST) was paid on the components at the time of importation into Canada. On May 31, 1991, the appellant claimed a refund of the FST paid. The determination disallowed such refund. A notice of objection was subsequently served on September 20, 1991. On November 24, 1992, the respondent issued a notice of decision confirming the determination. The appellant filed a notice of appeal with the Tribunal on February 17, 1993.

The issue in this appeal is whether the imported components for the units qualify for exemption from FST under paragraph 1(a) of Part XIII of Schedule III to the Act as "machinery and apparatus ... imported by manufacturers or producers for use by them primarily and directly in ... the manufacture or production of goods."

There is agreement between the parties that (1) the appellant was a licensed manufacturer for FST purposes, (2) the components were imported by the appellant for the purpose of providing storage for potatoes to be used in the production of potato products at its Borden manufacturing facility, (3) the imported prefabricated components for the units were installed on concrete foundations, and (4) certain additional machinery and equipment (ducting, fans and humidity and refrigeration equipment) were purchased in Canada and added to the units by local contractors.

Mr. John R. Walsh, Crop Scientist with McCain Foods Limited, appeared as a witness for the appellant. He testified that the Borden facility was built in 1991 to produce French fries. The imported components were seen as an integral part of the design of this new manufacturing facility. In response to questions from counsel for the respondent, Mr. Walsh stated that these components did not perform any mechanical function nor give new forms, qualities or properties

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

to the potatoes. In describing the production process involved, Mr. Walsh explained that, when potatoes are received at the Borden facility, they are inspected and graded by size, colour and quality. Then, they are either sent for immediate processing or forwarded to the units. The potatoes destined for immediate processing are unloaded, washed, sliced into shapes and blanched. They are then fried, frozen, packaged and stored in a "frozen" warehouse to await delivery to customers. It appears that the output of the Borden facility is sold primarily in the United States for institutional use.

As to the potatoes that are forwarded to the units, Mr. Walsh testified that those units are specifically designed and built for potato storage and improvement. The units are very expensive and embody the best technology available to ensure and maintain the quality of potatoes. Once the potatoes are placed in the units, the objective is to create the ideal environment to minimize deterioration and improve potato quality by using a ventilation system to force air through the potatoes and achieve the desired temperature and humidity. Mr. Walsh also told the Tribunal that the units have a unique secondary ventilation system which consists of a cavity between the outside surface and the inside wall through which air is forced in order to help maintain a more uniform temperature. This prevents condensation on the inside wall, as well as cold spots along the outside surface.

Before the potatoes reach the long-term holding phase or storage stage, they are dried, cured, preconditioned and cooled — all of which takes place within the units. The potatoes are normally in storage for six to seven months, until they are released for the actual production during the subsequent months of May, June and July. At that time, if the potatoes do not have the desired colour, they are put through a reconditioning phase. When ready for processing, the potatoes in the units are pulled up onto a conveyor by a device called a "spudnik," moved from the conveyor to a "binpiler" and, from there, to a special bulk body truck. The truck then carries the potatoes to the receiving area of the processing plant where they are unloaded onto the washer. The distance between the units and the processing plant is about 100 metres.

Counsel for the respondent sought to establish, through Mr. Walsh, that the units could be used for purposes other than storing potatoes. In response, Mr. Walsh confirmed that it would be possible to place other objects (e.g. vehicles) in the structure. However, as he told the Tribunal, the appellant does not do so. In his view, because of the high cost of the specialized units versus cheaper general storage facilities, it is unlikely that vehicles or other goods would be stored in the units.

In disposing of this appeal, the Tribunal must determine whether the prefabricated components for the units constitute machinery and apparatus and, if so, whether they were imported by the appellant for use primarily and directly in the production of goods.

With respect to the first point, counsel for the appellant argued that the units clearly meet the criteria for apparatus. In this regard, he referred to the case law, including decisions of the Tribunal. Using dictionary definitions, he argued that the term "apparatus" has a broad meaning. It is defined in The Random House Dictionary of the English Language² as "any complex instrument or mechanism for a particular purpose." In Webster's Third New International Dictionary of the English Language,³ "apparatus" is defined as "a collection or set of materials, instruments, appliances, or machinery designed for a particular use." Counsel

2. Second ed. (New York: Random House, 1987) at 100.

3. (Springfield: Merriam-Webster, 1986) at 102.

argued that the units were a collection or set of materials designed for a particular purpose — to store and preserve potatoes that are ready for processing, when needed. He cited a number of precedents in support of his position that goods need not perform a mechanical function to qualify as apparatus. Counsel further mentioned *Consolidated Denison Mines Limited and The Rio Tinto Mining Company of Canada Limited et al. v. The Deputy Minister of National Revenue for Customs and Excise*,⁴ where the Exchequer Court referred to the definition of the word "complex," i.e. something that consists of parts. In counsel's view, the units qualify as apparatus, whether considered as parts or taken as a whole finished product.

On the other hand, counsel for the respondent argued that the goods in issue are not apparatus within the meaning of paragraph 1(a) of Part XIII of Schedule III to the Act since they do not perform a mechanical function and are not an integral part of the production process. In other words, without the goods, the production process could still take place. Counsel further submitted that the units could not be regarded as part of an integrated system which itself is used primarily and directly in the production process. He maintained that the imported goods, once assembled, merely create an environment for the controlled storage of potatoes in which other equipment (e.g. fans, refrigeration equipment) can function.

As to the second point, counsel for the appellant stated his view that the production process begins when raw materials (the potatoes) are delivered to the production site. In this connection, he referred to paragraph 21 of Excise Memorandum ET 303⁵ (Memorandum ET 303) which states that "[p]roduction commences at the receiving area on the manufacturer's manufacturing premises for materials utilized in the manufacture or production of goods." Counsel also noted that paragraph 19 of the same document provides an exemption from sales tax for "[e]quipment purchased by manufacturers or producers for use by them in controlling the temperature and moisture content of materials being processed."

Counsel for the appellant referred at length to the jurisprudence in support of his proposition that the components were used by the appellant "directly" in the manufacture of potato products. More particularly, he focused on decisions of the Federal Court of Appeal in *The Deputy Minister of National Revenue for Customs and Excise v. Amoco Canada Petroleum Company Ltd.*⁶ and *Coca-Cola Ltd. v. The Deputy Minister of National Revenue for Customs and Excise*.⁷ In the first case, the Court concluded that a broad rather than a narrow meaning should be given to the word "directly," i.e. defined as "without any intervening medium." In the second case, the Court concluded that it is not essential that each piece of apparatus give new forms, qualities or properties to the materials being processed, but that the equipment and apparatus merely be part of the process giving new forms, qualities or properties to these materials. Counsel also referred to the Tribunal's decision in *Esso Resources Canada Limited v. The Minister of National Revenue*.⁸ In this case, the Tribunal stated that, for machinery or apparatus to fall within the exemption clause, there must be a close connection or nexus between the machinery or apparatus used in the production of goods and the process from which the goods are produced. Counsel submitted that the goods in issue met the criteria set out in the *Esso Resources* case. In

4. 63 D.T.C. 1191 (Ex. Ct.).

5. Production Equipment, Department of National Revenue, Customs and Excise, March 20, 1989.

6. (1985), 86 D.T.C. 6008 (F.C.A.).

7. [1984] 1 F.C. 447.

8. Appeal No. 2984, December 4, 1989, 2 T.C.T. 1241.

the same vein, counsel also referred to the Tribunal's decision in *BHP-Utah Mines Ltd. v. The Minister of National Revenue*.⁹

Finally, counsel for the appellant sought to distinguish the present case from the Tribunal's decision in *Bulk-Store Structures Inc. v. The Minister of National Revenue*¹⁰ on the grounds that the components imported by McCain Foods Limited (1) are part of the secondary ventilation system which is part of the production process, (2) are specifically designed for the storage of potatoes, and (3) are imported and used by a manufacturer in the production process. In closing argument, counsel referred specifically to the legislative requirement that the apparatus be used "primarily" in the manufacture of goods. In his view, there had been no suggestion that the goods in issue were not used primarily in the manufacture of potato products. In fact, counsel told the Tribunal that the goods were used "exclusively" for this purpose.

Counsel for the respondent contended that the appellant did not demonstrate that the units contribute to, or are engaged in, manufacturing by giving new forms, qualities or properties to raw materials, i.e. potatoes. In his view, the issue is the existence or not of a causal connection or link between the imported components and the end result of the production process, i.e. potato products such as French fries. He argued that the imported components, with their insulation, did not contribute to the production of potato products; rather, they passively provided the controlled environment in which potatoes could be stored. He submitted that the necessary connection or "nexus" does not exist in the present instance. In conclusion, counsel maintained that one could not distinguish this case from the *Bulk-Store* case in which the Tribunal concluded that modular wooden panels did not have a direct role in transforming the raw material into a finished product.

There is no doubt, in the Tribunal's view, that the units, once erected, constitute essentially a building or a structure similar, in most respects, to any other storage facility. Indeed, the evidence before the Tribunal is that, prior to the acquisition of these units, the potato products of the appellant were manufactured from supplies taken from its own storage facilities or from those maintained by individual farmers, none of which has the attributes ascribed to the advanced units. Thus, the main advantage of the units would appear to be their capacity to assist in maintaining and, perhaps, improving the quality of the raw potato stock as the season progresses. Nonetheless, in order to achieve this advance in quality control, a variety of materials, parts and machinery had to be brought together to construct the units and enable them to operate and function in the desired manner. The system would not exist and could not function if any of the components were not present in the finished structure.

Accordingly, in the Tribunal's opinion, the goods in issue, whether taken as a whole finished product or as parts of an integrated system for the storage and preservation of potatoes, satisfy the criteria of the definition of the term "apparatus." In arriving at this decision on the first point, the Tribunal is particularly aware of previous judicial decisions on this very question. The uncontradicted evidence clearly establishes that the units are specifically designed and manufactured to achieve a particular objective relating to the preservation of potatoes. The units, together with the ancillary computer control equipment, ducts, fans and humidity and refrigeration equipment, carry out various mechanical operations to dry, cure, precondition and cool the potatoes and the units themselves.

9. Appeal No. AP-91-047, March 19, 1993.

10. Appeal No. AP-91-161, July 20, 1992, 5 T.C.T. 1301.

The second question to be determined is whether the imported components are, according to paragraph 1(a) of Part XIII of Schedule III to the Act, "for use ... primarily and directly in ... the manufacture or production of goods." More specifically, the Tribunal must decide whether the storing and limited preconditioning of potatoes in the units can be considered as falling within the purview of the tax exemption.

At first, the majority of the Tribunal would like to underline that Memorandum ET 303 indicates as tax exempt "[e]quipment purchased by manufacturers or producers for use by them in controlling the temperature and moisture content of materials being processed." It may be reasonably assumed that this position rests upon an interpretation of the tax exemption mentioned above. Interestingly, the term "equipment" is defined in The Concise Oxford Dictionary of Current English¹¹ as "outfit, tools, apparatus, necessary for expedition, job, warfare, etc." Thus, the term "equipment" includes apparatus. It would appear that Memorandum ET 303 would apply in the present instance.

The majority of the Tribunal is of the view that a number of precedents are relevant to this case. Thus, in *Horton CBI Limited v. The Deputy Minister of National Revenue for Customs and Excise*,¹² the Tariff Board found that fuel storage tanks were necessary to safeguard a plant against interruption in the service of a train normally supplying the oil. It seems to the Tribunal that there is a parallel between tanks which store fuel destined to run a plant on a standby basis and an apparatus, such as the units, where raw materials are stored and preconditioned for further processing. Furthermore, according to the testimony of Mr. Walsh, the potatoes stored in the units are essential to the continuous operation of the processing plant during the three months of the year immediately prior to the new harvest season. In the Tribunal's view, there would appear to be a more obvious and closer nexus in the case of stored potatoes than in the case of standby oil supplies. In the Tribunal's decision in *Golden Bear Operating Company Ltd. v. The Minister of National Revenue*,¹³ fuel tanks on a tank farm were found to be used primarily and directly in the production of goods. As to the essential nature of such a tank farm, it was a storage facility for the fuel required to generate electricity. In a similar vein, it can be said that the units constitute a storage facility for goods (i.e. potatoes) waiting to be processed.

In the *Amoco* case, the Federal Court of Appeal considered the question of whether pipelines carrying liquid hydrocarbons from a gas-processing plant to a fractionation plant were used directly in the production of salable products. The Court held that the pipelines were used directly in such production. On the issue of close proximity, it stated that "[t]here is no rational reason for the imposition of any arbitrary point of commencement of the nature of those postulated in the absence of a specific statutory direction."¹⁴ Counsel for the respondent sought to distinguish the *Amoco* case and the present instance on the basis that the pipeline constitutes a direct connection whereas, in the case at hand, the potatoes are delivered by bulk body trucks. The majority of the Tribunal does not consider that such an arbitrary distinction should be made to conclude that a pipeline method of delivery offers a more direct nexus or connection than the method of delivery using specialized vehicles.

Furthermore, evidence was adduced before the Tribunal as to why the units were located about 100 m from the processing plant and not connected directly to it. These various

11. Seventh ed. (Oxford: Clarendon Press, 1982) at 326.

12. (1977), 6 T.B.R. 415.

13. Appeal No. AP-92-072, May 17, 1993, 1 G.T.C. 4107.

14. *Supra*, note 6 at 6012.

considerations include a better safeguard in case of fire, the need to accommodate future expansion of the processing plant and the convenience of having a storage facility, allowing for easier access to the potatoes than would have been the case if this facility had been connected directly to the processing plant.

The majority of the Tribunal is of the view that the phrase "for use ... primarily and directly" is intended to convey the meaning of being directly and primarily involved in the manufacture or production of goods. This phrase does not necessarily imply or mean a direct physical connection.

Therefore, the majority of the Tribunal is convinced that the units were specifically designed as a potato storage and conditioning system. It was purchased by the appellant and erected on the Borden site for this particular purpose. The majority concludes that the imported components come within the purview of paragraph 1(a) of Part XIII of Schedule III to the Act as being "for use ... primarily and directly in ... the manufacture or production of goods."

In light of the foregoing reasons, the majority of the Tribunal allows the appeal.

Anthony T. Eyton

Anthony T. Eyton

Member

Charles A. Gracey

Charles A. Gracey

Member

DISSENTING OPINION OF PRESIDING MEMBER HINES

On the question of whether the units constitute an apparatus, I am in full agreement with the reasons given by the majority of the Tribunal. However, I do not agree that the units are used primarily and directly in the manufacture or production of goods within the meaning of paragraph 1(a) of Part XIII of Schedule III to the Act.

Over the years, the Tribunal has been confronted with many appeals dealing with whether or not certain things are "machinery and apparatus" and whether they are used "primarily and directly" in the manufacture of goods. These cases clearly provide guidance to the Tribunal in deciding these matters, but, in the end, each particular case must be decided on its own merits. This is especially so given that exemption from taxation is the exception in tax legislation, and the burden is on the appellant to establish that it fully meets the terms of the legislation providing the exemption.

The imported components in the present instance consist of prefabricated structural steel panels with insulation specifically designed for incorporation into the units. The units

themselves do not perform any mechanical function nor do they actively facilitate the conversion of potatoes to potato products. I agree with counsel for the respondent that the imported components, once constructed into a unit, essentially create the physical environment enabling the storage and quality improvement of the raw materials, i.e. the potatoes. The technological advances claimed with respect to the units are obviously beneficial to producers of potato products; however, the units are not essential to the process of making potato products such as French fries. In this connection, I note that Memorandum ET 303 does not provide an exemption from FST on equipment used to control the ambient temperature or humidity of manufacturing or production facilities.

According to Mr. Walsh, at the appellant's Borden facility, potatoes on receipt are either sent for immediate processing or stored in the units. In the case of the latter, according to the evidence before the Tribunal, the potatoes remain in storage for some six to seven months, at which time they are moved by a bulk body truck about 100 m to the processing plant. It is only at that time, i.e. when the raw potatoes reach the processing plant, that the potatoes which were in the unit reach the processing or production stage. Then, these potatoes are treated in the same manner as potatoes received directly from the farmers' fields or from alternative storage facilities.

In my view, there are two distinct operations involved in the present case. The first relates to the storage and quality control of potatoes in storage facilities and the second relates to the production of potato products for delivery to customers. Clearly, the imported components are primarily and directly used in the construction of the storage facility used in the first operation. However, it is my view that this operation is removed from the processing operation since (1) it occurs in a separate building, (2) it does not assist or have a direct role in transforming the raw potatoes into potato products, and (3) it requires the intervention of handling equipment to move the raw potatoes from the storage facility to the processing plant. I would not deny that there is a relationship between these two operations, but, in my view, there does not exist a sufficiently close connection or nexus between the imported components and the production of potato products.

Accordingly, I would dismiss the appeal.

W. Roy Hines
W. Roy Hines
Presiding Member