CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Wednesday, June 22, 1994

Appeal No. AP-93-056

IN THE MATTER OF an appeal heard on January 19, 1994, under section 81.19 of the *Excise Tax Act*, R.S.C. 1985, c. E-15;

AND IN THE MATTER OF decisions of the Minister of National Revenue dated March 31, 1993, with respect to notices of objection served under section 81.17 of the *Excise Tax Act*.

BETWEEN

CAPITOL RECORDS - EMI OF CANADA LIMITED **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is dismissed.

Lise Bergeron
Lise Bergeron
Presiding Member

Charles A. Gracey
Charles A. Gracey
Member

Robert C. Coates, Q.C.
Robert C. Coates, Q.C.
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-93-056

CAPITOL RECORDS - EMI OF CANADA LIMITED **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

This is an appeal under section 81.19 of the Excise Tax Act of determinations of the Minister of National Revenue rejecting applications for a refund of sales tax claimed to have been paid in error. The issue in this appeal is whether sales tax was paid in error within the meaning of the relevant provisions of the Excise Tax Act.

HELD: *The appeal is dismissed. The Tribunal is not persuaded that the appellant paid sales tax in error. In the Tribunal's view, the correspondence indicates that the appellant made a conscious and informed decision as to the manner in which its sales tax would be calculated. The Tribunal is of the view that the appellant, having made a conscious and informed decision, cannot be said to have made an error in the payment of sales tax. In the absence of an error in the payment of sales tax, the appellant has no basis upon which to pursue its claim under section 44 (now section 68) of the Excise Tax Act.*

Place of Hearing:	*Ottawa, Ontario*
Date of Hearing:	*January 19, 1994*
Date of Decision:	*June 22, 1994*
Tribunal Members:	*Lise Bergeron, Presiding Member* *Charles A. Gracey, Member* *Robert C. Coates, Q.C., Member*
Counsel for the Tribunal:	*John L. Syme*
Clerk of the Tribunal:	*Anne Jamieson*
Appearances:	*Rick H. Kesler, for the appellant* *Geoffrey S. Lester, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL | TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-93-056

CAPITOL RECORDS - EMI OF CANADA LIMITED **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: LISE BERGERON, Presiding Member
CHARLES A. GRACEY, Member
ROBERT C. COATES, Q.C., Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) of determinations of the Minister of National Revenue rejecting applications for a refund of sales tax claimed to have been paid in error. The issue in this appeal is whether sales tax was paid in error within the meaning of the relevant provisions of the Act.

Mr. Brian Watson, Vice-President of Finance for Capitol Records - EMI of Canada Limited, testified on the appellant's behalf. Mr. Watson testified that the appellant is in the business of manufacturing various forms of recorded music, including cassette tapes. In 1969, Electrical and Musical Industries Canada Limited (EMI) purchased Kensington Distributors Ltd. (Kensington). EMI was, at that time, owned by Capitol Records, Inc., a U.S. corporation which also owned the appellant. On June 16, 1969, Capitol Records (Canada) Ltd., a predecessor company to the appellant, entered into an agreement with Kensington, whereby Kensington agreed to market and distribute the recorded music products of Capitol Records (Canada) Ltd.

From January 1983 to March 1987, the appellant marketed and distributed 100 percent of its production through Kensington. The appellant's practice was to produce products based on its forecast demands. Kensington would then market the products to a variety of retailers and to some "rack jobbers." Property in the appellant's products did not pass from the appellant to Kensington until the latter had completed a sale to a retailer or rack jobber. At the time of the sale by Kensington, there would be a simultaneous and instantaneous sale from the appellant to Kensington. The appellant and Kensington agreed that the sale price from the appellant to Kensington would be 81.3 percent of the ultimate sale price from Kensington to the retailer or rack jobber.

Mr. Watson gave testimony regarding the production and distribution arrangements of other Canadian manufacturers of recorded music. He also provided testimony regarding the appellant's arrangements with various independent recording companies, whereby the appellant manufactured and distributed recorded music on behalf of those independents.

With respect to the payment of sales tax, Mr. Watson indicated that the appellant paid tax, based not on its sale price to Kensington, but on a formula established by the respondent

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

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pursuant to Excise Memorandum ET 202[2] (Memorandum ET 202). He indicated that the appellant's refund applications were based on the difference between the sales tax calculated and paid by the appellant based on the formula and the sales tax that would have been paid, had it been calculated on the basis of the actual sale price between the appellant and Kensington.

During cross-examination, counsel for the respondent questioned Mr. Watson regarding the relationship between the appellant and Kensington. Mr. Watson testified that, when products were manufactured, they were moved into a warehouse run by Kensington. However, Kensington had no inventory. Property in the appellant's products remained with the appellant until Kensington made a sale to a third party. At that time, property passed through Kensington and on to the third-party purchaser.

Mr. Watson testified that Kensington and the appellant each had their own bank accounts. However, he indicated that Kensington wrote an insignificant number of cheques. He also indicated that all money received by Kensington in a given month was deposited to its account, but, at the end of each month, the balance in Kensington's account was transferred to the appellant's account. Mr. Watson indicated that this was done to make the most efficient use of cash.

Mr. Watson also indicated that the appellant and Kensington shared office space and storage facilities. He indicated that the appellant and Kensington had the same President, Vice-President of Finance, Vice-President of Manufacturing and Distribution, Secretary and Assistant Secretary. He also indicated that the two companies shared accounting, data processing, building maintenance and, for a time, legal services. Mr. Watson testified that, during the period at issue, he did not think that Kensington had any employees per se. The appellant's employees were simply assigned tasks in respect of Kensington's business and operations.

Finally, counsel for the respondent led Mr. Watson through a series of letters which had passed between the appellant and the respondent and which related to the manner in which the appellant's sales tax would be calculated.

In argument, counsel for the appellant submitted that the appeal gave rise to the following three issues:

(1) whether the appellant made sales to Kensington under former subsection 27(1) of the Act;

(2) if so, whether the sales from the appellant to Kensington were made at a reasonable price; and

(3) whether the appellant paid sales tax in error.

Counsel for the appellant argued that, notwithstanding the fact that they were related companies, the appellant and Kensington could enter into agreements for the sale of goods which would fall within the provisions of former section 27 of the Act. In support of that proposition, counsel referred the Tribunal to the Federal Court of Appeal's decision in

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2. Values for Tax, Department of National Revenue, Customs and Excise, December 1, 1975.

Her Majesty the Queen v. Vanguard Coatings and Chemicals Ltd.[3] and to the Tribunal's decision in *2284791 Manitoba Ltd. v. The Minister of National Revenue*.[4]

Counsel for the appellant made extensive argument on the reasonableness of the purchase price paid by Kensington to the appellant for its products. Essentially, he argued that the Tribunal should consider transactions between the appellant and independent recording companies and use the price paid by the appellant to those independents as a means of satisfying itself that the price paid by Kensington to the appellant was reasonable.

Counsel for the appellant argued that the respondent, having on a previous occasion taken the position that Memorandum ET 202 was merely an administrative policy, could not come before the Tribunal in the present case and argue that Memorandum ET 202 should supersede the relevant provisions of the Act.

With respect to the question of whether tax had been paid "in error," counsel for the appellant cited *Jack Herdman Limited v. The Minister of National Revenue*,[5] *Park City Products Limited v. The Minister of National Revenue*[6] and *Allan G. Cook Limited v. The Minister of National Revenue*.[7] Counsel argued that, in paying sales tax pursuant to Memorandum ET 202 and, thereby, paying more tax than it would have had to pay had it simply paid tax in accordance with section 27 of the Act, the appellant had paid tax in error.

Counsel for the respondent referred, in argument, to the series of letters which passed between the appellant and the respondent in respect of the calculation of sales tax. Counsel argued that those letters provided evidence that the appellant had voluntarily entered into an arrangement whereby it would pay tax on the basis of Memorandum ET 202, rather than on the basis of the wording of the Act. In counsel's submission, the appellant was aware that there were two ways of calculating the sales tax payable.

Counsel for the respondent also argued that, during the period at issue, the appellant and Kensington were a single economic entity. In support of this argument, counsel cited the facts that he had elicited during cross-examination regarding the appellant and Kensington's common employees and shared facilities and services. Counsel submitted that, upon the sale of the appellant's products by Kensington to retailers and rack jobbers, there was only one sale, that is, from Kensington to those third parties. Counsel, in essence, argued that the purported sale from the appellant to Kensington was a fiction. In counsel's submission, as there was only one sale, there was only one price upon which sales tax could be calculated.

In the Tribunal's view, it is not in dispute that, during the period at issue, the appellant calculated and paid sales tax in accordance with the "determined value" provisions of Memorandum ET 202 and the departmental ruling card coded 3700, card no. 33.[8] The appellant

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3. [1988] 3 F.C. 560.
4. Appeal No. AP-91-232, October 28, 1993.
5. 83 D.T.C. 5274, Federal Court of Appeal, Court File No. A-682-81, May 25, 1983.
6. Canadian International Trade Tribunal, Appeal No. AP-92-128, September 21, 1993.
7. *Ibid.*, Appeal No. 3074, August 29, 1989.
8. Records, Phonograph - Value for Sales Tax, November 12, 1969. This ruling card is now coded 3700/33-1 Passive and was transferred to passive effective January 1, 1991, because of the Goods and Services Tax.

claimed that, as a consequence of using that methodology, it had paid more tax than it was liable to pay under the Act.

The Tribunal views section 44 (now section 68) of the Act as fundamental to this appeal, which, during the period at issue, provided as follows:

> *Where a person, otherwise than pursuant to an assessment, has paid any moneys in error, whether by reason of mistake of fact or law or otherwise, and the moneys have been taken into account as taxes, penalties, interest or other sums under this Act, an amount equal to the amount of those moneys shall, subject to this Part, be paid to that person if he applies therefor within two years after he paid the moneys.*

Counsel for the appellant relied on the Federal Court of Appeal's decision in the *Herdman* case and the Tribunal's decisions in the *Park City* and *Cook* cases in support of his argument that the appellant paid tax in error. However, the Tribunal is of the view that each of those cases is distinguishable from the present case. In both those cases, there was evidence that the appellants, that were found to have paid tax in error, were unaware that there was an alternative method of calculating their sales tax payable.

In the *Herdman* case, the Federal Court of Appeal found that the amounts "were paid in error by a person who was not responsible for them and who was induced to pay them by representations of the Department that that person was liable to the Crown for them.[9]" The Federal Court of Appeal went on to find that the appellant was unaware that it was paying tax in accordance with an alternative scheme. In the *Park City* case, there was evidence that the appellant, that was found to have paid tax in error, was unaware of the Alternative Tax Accounting Method applicable to its particular business and that it continued to pay sales tax, unaware that there had been changes to the Act which affected its sales tax liability. Finally, in the *Cook* case, the Tribunal made the following finding:

> *However, and more importantly, at the beginning of 1987, the appellant was not aware of the financial implications for it of using one method over the other for the balance of the year. The necessary information for the calculation of tax liability for the year 1987 using one method over another was not available until well into the 1987 paving season. Firstly, the determined values established by the Department, to take effect in July 1987, were not available until April 1987. Secondly, the actual (or even estimated) costs of production to be used in the fair market value calculations were not available until well into the 1987 season. Consequently, the appellant could not make an informed choice, in early 1987, as to the method to be selected for tax calculation. It did not have full knowledge of the financial consequences of that selection. Only after weighing the financial outcomes resulting from the different methods can a choice be made.*[10]

The Tribunal has reviewed the correspondence that passed between the parties from 1970 into the 1980s relating to the method of calculation of sales tax in respect of sales of the appellant's products. The Tribunal notes that virtually all of the correspondence either originated with or was sent to the appellant's "in-house" counsel, Mr. W. John MacLeod. The only exception to this pattern comes in the form of two letters sent to the respondent by D. Williamson, who is identified in the correspondence as the appellant's "Chief Accountant."

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9. *Supra*, note 5 at 5278.
10. *Supra*, note 7 at 13.

Having reviewed the referenced correspondence, the Tribunal is not persuaded that the appellant paid sales tax in error. In the Tribunal's view, the correspondence indicates that the appellant made a conscious and informed decision as to the manner in which its sales tax would be calculated. The Tribunal is of the view that the appellant, having made a conscious and informed decision, cannot be said to have made an error in the payment of sales tax. In the absence of an error in the payment of sales tax, the appellant has no basis upon which to pursue its claim under section 44 (now section 68) of the Act.

Accordingly, the appeal is dismissed.

Lise Bergeron
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