CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Tuesday, May 17, 1994

Appeal No. AP-92-375

IN THE MATTER OF an appeal heard on December 1, 1993, 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 December 24, 1992, with respect to notices of objection served under section 81.17 of the *Excise Tax Act*.

BETWEEN

PALMER JARVIS ADVERTISING **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed.

Charles A. Gracey
Charles A. Gracey
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Lise Bergeron
Lise Bergeron
Member

Michel P. Granger
Michel P. Granger
Secretary

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

UNOFFICIAL SUMMARY

Appeal No. AP-92-375

PALMER JARVIS ADVERTISING **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The appellant is an advertising agency that contracts with clients to create commercials that are recorded on master tapes by independent production studios. The issue in this appeal is whether the appellant is a manufacturer or producer of master tapes under subsection 50(1) of the Excise Tax Act or, alternatively, a deemed manufacturer of those goods within the meaning of the definition of "manufacturer or producer" under subsection 2(1) of the Excise Tax Act, in which case the appellant would not be entitled to a refund of sales tax.

HELD: *The appeal is allowed. The appellant is not a manufacturer or producer within the traditional meaning of these words, and the production studios are not its agents. Therefore, the appellant is not a manufacturer or producer under subsection 50(1) of the Excise Tax Act. Furthermore, as the making of master tapes is not manufacturing but production, paragraph (b) of the expanded definition of "manufacturer or producer" under subsection 2(1) of the Excise Tax Act does not apply.*

Place of Hearing:	*Vancouver, British Columbia*
Date of Hearing:	*December 1, 1993*
Date of Decision:	*May 17, 1994*
Tribunal Members:	*Charles A. Gracey, Presiding Member* *Arthur B. Trudeau, Member* *Lise Bergeron, Member*
Counsel for the Tribunal:	*Gilles B. Legault*
Clerk of the Tribunal:	*Nicole Pelletier*
Appearances:	*Werner H.G. Heinrich, for the appellant* *Linda J. Wall, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL | TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-92-375

PALMER JARVIS ADVERTISING **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: CHARLES A. GRACEY, Presiding Member
ARTHUR B. TRUDEAU, Member
LISE BERGERON, Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) of two determinations that rejected the appellant's refund applications. These determinations were later confirmed by the Minister of National Revenue.

The appellant is an advertising agency that contracts with clients to create radio and television commercials that are recorded on master tapes and copied onto cassettes by independent production studios. The appellant applied for refunds of sales tax under section 68 of the Act for tax remitted in error with respect to sales of the master tapes. There is no contention as to the amount claimed, which is said to represent the difference between the tax paid on the cost of the master tapes and the tax charged on the sales of the commercials.

The issue in this appeal is whether the appellant is a manufacturer or producer of master tapes under subsection 50(1) of the Act or, alternatively, a deemed manufacturer of those goods within the meaning of the definition of "manufacturer or producer" under subsection 2(1) of the Act, in which case the appellant would not be entitled to a refund of sales tax.

At the hearing, the Tribunal heard the testimony of Mr. Robert Schneider, a chartered accountant who prepared the refund applications on behalf of the appellant. Mr. Schneider testified that the refund applications were based on a ruling card issued by the Department of National Revenue.

The Tribunal also heard the testimonies of Ms. Janice Bulger and Ms. Cynthia Rogers. Ms. Bulger is Business Manager of one of the production studios, and Ms. Rogers is Broadcast Producer of Palmer Jarvis Advertising. Ms. Rogers stated that the production of a commercial is normally requested by a client and arranged through a fairly standard working agreement. A script is written, and an estimate of the cost of the production is prepared. The client must then approve both the script and the estimate. A script that requires voice direction, sound effects and music is called a complex script and is sent for quotation to a production studio. The "talent," i.e. the person who reads the commercial, is normally hired and paid by the appellant. However, in the case of a complex script, the talent is generally hired by the production studio, in which case the studio bills the appellant. In both cases, the talent must

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

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be approved by the appellant. The music, either original or already recorded, is provided by the studio and approved by the appellant.

Ms. Rogers further explained that the appellant reserves the studio when it is ready for the recording session. At the studio, everyone is given a copy of the script, and Ms. Rogers informs both the engineer and the talent of the type of reading that is expected. Although the producer of the music track may give instructions to the talent as to voice level, Ms. Rogers retains creative control over the process and approves the recording. Ms. Bulger testified, however, that the recording process is controlled by the studio's engineer. Once recording is completed, the engineer and the producer mix the tape, which means that they set the level and quality of sound effects and music. The end product is once again approved by Ms. Rogers before she sends a copy to the client for final approval. Copies from the master tape onto cassettes are then made for the radio stations. Ms. Rogers also testified that the appellant has a copyright on the commercial, but uses the music subject to a licensing agreement. Finally, the master tape remains with the studio and is insured by the studio for the amount that it cost to produce.

Counsel for the appellant argued that the appellant is not the manufacturer or producer of the master tapes under subsection 50(1) of the Act. Those words, counsel argued, must be given their ordinary meaning. According to dictionaries, they mean that a person physically transforms or alters something to create something new. Counsel maintained, in this regard, that it is the production studio that actually transforms a blank tape into something new. Counsel also argued that the appellant is not a deemed manufacturer within the meaning of the expanded definition of "manufacturer or producer" under subsection 2(1) of the Act. Counsel maintained, in this regard, that paragraph (*b*) of that definition only applies to goods that are being manufactured rather than produced and that the recording operations in which the studios are involved are known in the trade as production. Counsel relied on the Tribunal's decision in *MCA (Canada) Ltd. v. The Minister of National Revenue*,[2] in which it concluded that mere reproduction of videocassettes and simple packaging thereof are not manufacturing, but production activities, and that production is not a condition of paragraph (*b*) referred to above. Counsel pointed out that the only difference between the *MCA* case and the making of the master tapes in this case is that, in *MCA*, the sound was copied from a tape while, in this case, the sound comes from the talent who speaks into a microphone. Counsel also submitted that this process is similar to that used in a motion picture film and that, according to a departmental ruling card, the making of a motion picture film is production. Counsel submitted, in this regard, that departmental policy and interpretation are important factors to consider. Finally, counsel concluded that it is reasonable to consider, as an aid to interpretation, the generally accepted commercial view of the operation under review and that the making of master tapes, as revealed by the evidence, is viewed as production.

Counsel for the respondent submitted that the onus is on the appellant to prove that it is not a manufacturer or producer under the Act and, thus, entitled to a refund. Counsel adopted a threefold position against the appellant's claim. She first argued that the appellant is a manufacturer or producer within the traditional meaning of these words because the appellant is the central and controlling force in the creation of the master tapes, even though the studio provides the facilities and equipment to record the commercials. Counsel maintained, in this regard, that there is ample evidence that the appellant has complete control over the making of the commercials. She referred to the making of the master tapes as a continuous

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2. Appeal No. AP-90-123, August 11, 1992.

process in which the studio is a mere executant. Counsel submitted that the fact that the appellant has no control over specific technical work, such as that executed by the engineer, does not alter the fact that the appellant has control over the entire process. Counsel further submitted that, if the Tribunal is of the view that the studio, and not the appellant, is the manufacturer or producer, it remains that the studio is an agent of the appellant, as the evidence revealed that the latter is the controlling and directing mind behind the operation. Finally, counsel argued that, if the Tribunal rejects the first two arguments, the appellant, however, falls within the definition of "manufacturer or producer" under subsection 2(1) of the Act. Counsel distinguished the *MCA* decision on the ground that the mere copying and packaging of videocassettes contrasts with the making of master tapes in the case at hand. Counsel also referred to the Tribunal's decision in *ICAM Technologies Corporation v. The Minister of National Revenue*[3] in which the punching of holes in magnetic tape and the transfer of software onto tapes or disks were found to give those goods new physical form and properties, respectively, as well as new qualities. In light of that decision, counsel argued that the making of the master tapes should also be found to be manufacturing operations under the expanded definition of "manufacturer or producer."

The Tribunal is of the view that the appeal should be allowed. Firstly, the Tribunal considers that the appellant is not the manufacturer or producer of the master tapes in issue under subsection 50(1) of the Act. It is the studios that make the master tapes and that copy the commercials created by the appellant onto cassettes. Secondly, the studios with which the appellant carries on business are not its agents. In *Palmolive Manufacturing Co. (Ontario) Ltd. v. The King*,[4] the Supreme Court of Canada had to determine which price, that paid by a selling company to a manufacturing company or that paid by the public to the selling company, was the actual sale price for purposes of the excise tax provisions of the *Special War Revenue Act, 1915*.[5] The Supreme Court of Canada held that the selling company was responsible for the tax calculated on its sale price to the public. It found that the manufacturing company was essentially a department of the selling company, that no real sale had taken place in the open market between those companies and, therefore, that the manufacturing company was acting merely as an agent of the selling company. The evidence in this case is rather different. In the case of a complex commercial, the appellant receives a quotation and accepts or rejects the quotation of a production studio. In fact, the only authority that the appellant exercises over the studio is its creative supervision. That is not sufficient, however, to make the studio an agent of the appellant.

Finally, as decided in the *MCA* case, paragraph (*b*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act applies only to "goods being manufactured." The Tribunal finds in this case that the making of master tapes is not manufacture within the meaning of that provision. Firstly, the Tribunal is of the view that the legal test in *Her Majesty the Queen v. York Marble, Tile and Terrazzo Limited*[6] for the interpretation of the word "manufactured" under subsection 50(1) of the Act, i.e. whether raw or prepared materials are being given new forms, qualities and properties or combinations whether by hand or machinery, still requires an assessment as to the degree of transformation when the raw or prepared material is transformed into a new article. Without that assessment, the distinction between the words "production" and "manufacturing," also recognized by the Supreme Court of Canada,

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3. Appeal No. 2669, June 27, 1991.
4. [1933] S.C.R. 131.
5. S.C. 1915, c. 8.
6. [1968] S.C.R. 140.

would indeed be useless since, for instance, even goods that are produced and not manufactured acquire new qualities and properties. Secondly, the Tribunal considers that the expanded definition of "manufacturer or producer" under subsection 2(1) of the Act must be interpreted in light of its context. Consequently, although it recognizes that the recording of a commercial on a master tape requires sophisticated equipment and, undoubtedly, that such tape acquires new qualities and properties, the Tribunal is of the view that those are not the result of the kind of process that Parliament most likely intended when it restricted the expanded definition under paragraph (*b*) to "goods being manufactured." In this regard, the Tribunal also gives weight to the evidence that recording is referred to as production in the trade, as well as in the departmental ruling card coded 1160/55 Passive.[7]

For the foregoing reasons, the Tribunal allows the appeal.

Charles A. Gracey
Charles A. Gracey
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Lise Bergeron
Lise Bergeron
Member

7. The ruling card indicates that it was transferred to passive on February 9, 1989, as it was determined that recording is producing and does not come within paragraph 2(1)(*b*) of the Act.