CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Wednesday, August 31, 1994

Appeal Nos. AP-93-140 and AP-93-142

IN THE MATTER OF appeals heard on March 24 and 25, 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 June 11, 1993, with respect to notices of objection served under section 81.17 of the *Excise Tax Act*.

BETWEEN

J P L INTERNATIONAL DIFFUSION INC. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeals are dismissed.

Charles A. Gracey
Charles A. Gracey
Presiding Member

Sidney A. Fraleigh
Sidney A. Fraleigh
Member

Lise Bergeron
Lise Bergeron
Member

Nicole Pelletier
Nicole Pelletier
Acting Secretary

333 Laurier Avenue West
Ottawa, Ontario K1A 0G7
(613) 990-2452 Fax (613) 990-2439

333, avenue Laurier ouest
Ottawa (Ontario) K1A 0G7
(613) 990-2452 Téléc. (613) 990-2439

CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

UNOFFICIAL SUMMARY

Appeal Nos. AP-93-140 and AP-93-142

J P L INTERNATIONAL DIFFUSION INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

These are appeals under section 81.19 of the Excise Tax Act of two determinations of the Minister of National Revenue. The appellant sold certain hair care products that it manufactured to persons who were deemed, under paragraph (d) of the definition of "manufacturer or producer" in subsection 2(1) of the Excise Tax Act, to be manufacturers or producers and who were also licensed manufacturers under the Excise Tax Act. The appellant paid sales tax on those goods. However, under paragraph 50(5)(g) of the Excise Tax Act, the appellant was not liable to pay tax on those sales. The appellant claimed that it had paid sales tax in error and applied for a refund. The appellant's refund application was rejected. The issue in these appeals is whether the appellant has paid sales tax in error.

HELD: *The appeals are dismissed. At all material times, there was an alternative arrangement for the payment of sales tax in existence pursuant to which the appellant could have opted to pay tax on certain of its sales, notwithstanding the fact that it had no legal obligation to do so. In the Tribunal's view, the central issue in these appeals is whether, in paying the sales tax that it was not obligated by law to pay, the appellant was operating under the mistaken belief that it was obliged by law to do so or whether the appellant was aware of the alternative arrangement for the payment of sales tax and had voluntarily opted for that arrangement. On the basis of the evidence adduced, the Tribunal concludes that the appellant was aware of the alternative arrangement for the payment of sales tax and that it voluntarily opted to remit sales tax in accordance with that arrangement.*

Place of Hearing:	*Ottawa, Ontario*
Dates of Hearing:	*March 24 and 25, 1994*
Date of Decision:	*August 31, 1994*
Tribunal Members:	*Charles A. Gracey, Presiding Member* *Sidney A. Fraleigh, Member* *Lise Bergeron, Member*
Counsel for the Tribunal:	*John L. Syme*
Clerk of the Tribunal:	*Janet Rumball*
Appearances:	*Paul E. Hawa, for the appellant* *Stéphane Lilkoff, for the respondent*

333 Laurier Avenue West
Ottawa, Ontario K1A 0G7
(613) 990-2452 Fax (613) 990-2439

333, avenue Laurier ouest
Ottawa (Ontario) K1A 0G7
(613) 990-2452 Téléc. (613) 990-2439

CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal Nos. AP-93-140 and AP-93-142

J P L INTERNATIONAL DIFFUSION INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: CHARLES A. GRACEY, Presiding Member
SIDNEY A. FRALEIGH, Member
LISE BERGERON, Member

REASONS FOR DECISION

These are appeals under section 81.19 of the *Excise Tax Act*[1] (the Act) of two determinations of the Minister of National Revenue. Both determinations are in respect of the appellant's application for a refund of sales tax that the appellant alleged that it paid in error. The appeals are, in all substantive respects, identical. The only difference between the two is that Appeal No. AP-93-140 relates to tax paid in respect of the appellant's sales during the period from November 1, 1988, to June 30, 1989, whereas Appeal No. AP-93-142 relates to tax paid in respect of the appellant's sales during the period from July 1, 1989, to November 30, 1990.

The appellant is in the business of manufacturing and selling various hair care products, which both parties agreed are "cosmetics" within the meaning of subsection 2(1) of the Act. During the periods at issue, the appellant sold goods that it manufactured to, among others, distributors and salons. The appellant was, at all material times, a licensed manufacturer under the Act. Paragraph 50(1)(*a*) of the Act imposes a consumption or sales tax on the sale price of goods produced or manufactured in Canada, which is payable by the producer or manufacturer of those goods. However, paragraph 50(5)(*g*) of the Act provides an exception to paragraph 50(1)(*a*) and states that:

> *Notwithstanding anything in subsection (1), the consumption or sales tax shall not be payable on goods*
>
> ...
>
> *(g) sold to or imported by a person described in paragraph (d) of the definition "manufacturer or producer" in subsection 2(1) who is a licensed manufacturer under this Act, if the goods are cosmetics.*

Paragraph 50(5)(*g*) of the Act, together with paragraph (*d*) of the definition of "manufacturer or producer" in subsection 2(1) of the Act, excludes certain of the sales made to distributors and salons by the appellant by virtue of paragraph 50(1)(*a*) of the Act. In effect, paragraph 50(5)(*g*) makes the distributors and salons liable to pay sales tax on those goods upon their resale. Notwithstanding the provisions of the Act, in the late 1970s, the Department of National Revenue (Revenue Canada) entered into an alternative arrangement[2] for the payment of sales tax (alternative tax arrangement), which it negotiated with the Allied Beauty Association (the ABA). Pursuant to that arrangement, notwithstanding the provisions of the Act, a cosmetics manufacturer could sell its goods to distributors on a "tax-included" basis. The sales tax collected

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

2. That arrangement is described in Excise Communiqué 58/T1, Persons Who Sell Cosmetics to Professional Users, Department of National Revenue, Customs and Excise, July 1981.

by the manufacturer would then be remitted to Revenue Canada. Upon resale of the goods by the distributor to a third party, the distributor would pay sales tax on the difference between the price for which it sold the goods to the third party and the price at which it purchased those goods from the manufacturer.

An example may help to illustrate how the alternative tax arrangement worked. If a manufacturer sold goods to a distributor, under that arrangement, it would include in its price to the distributor (e.g. $10) sales tax calculated at the applicable rate (e.g. 13.5 percent). The tax collected by the manufacturer would then be remitted to Revenue Canada. Upon resale of the goods, the distributor would pay sales tax to Revenue Canada only on the amount of its "markup." Through the operation of this arrangement, the total amount of sales tax owing on the distributor's sale price would be remitted to Revenue Canada, albeit in two instalments.

The appellant sold the products that it manufactured to persons who were deemed, under paragraph (*d*) of the definition of "manufacturer or producer" in subsection 2(1) of the Act, to be manufacturers or producers and who were also licensed manufacturers under the Act. The appellant paid sales tax on those goods. However, under paragraph 50(5)(*g*) of the Act, the appellant was not liable to pay tax on sales made to deemed manufacturers.

The issue in these appeals is whether the appellant has paid sales tax in error when it paid tax on sales which, under paragraph 50(5)(*g*) of the Act, were not subject to tax.

Mr. Jean-Pierre Louis, President of J P L International Diffusion Inc. (JPL), testified on behalf of the appellant. He testified that he established the company in 1987. He also indicated that he was formerly employed for five or six years as a sales representative for Guay Beauty Inc., a distributor of hair care products. Mr. Louis testified that, during the time that he was with Guay Beauty Inc., he never had the occasion to discuss sales tax with his customers. He further indicated that, in establishing and operating JPL, he never consulted with lawyers or chartered accountants with respect to tax matters. He also indicated that, although JPL is a member of the ABA and he has attended various ABA functions from time to time, he never spoke with anyone at the ABA regarding the appellant's liability for sales tax. Mr. Louis added that, while the hair care industry is a very friendly and close industry, he never spoke to other manufacturers or distributors about how or if they paid sales tax.

Mr. Louis also testified that, in 1988, JPL purchased a company called Clajac Distributors Ltd. (Clajac), which was also in the business of manufacturing and selling hair care products. He indicated that he did not have any discussions with the principals of Clajac regarding how they were dealing with the payment of sales tax.

Finally, Mr. Louis testified that the appellant paid the sales tax because it was under the impression that it was obliged to pay the tax.

Mr. Emad Raphaël, Vice-President, Finance of JPL, also testified on behalf of the appellant. He indicated that he was responsible for all of the appellant's accounting and financial matters, including the payment of sales tax. Mr. Raphaël testified that, when JPL was established, he met with an official of Revenue Canada who advised him that the appellant would be required to pay sales tax on the sale price of its goods.

Mr. Raphaël also gave testimony regarding the circumstances surrounding the discovery of the alleged error. He indicated that, in the fall of 1990, he was approached by Ninecan Management Inc. (Ninecan), a consulting firm, that offered to review JPL's records to determine

whether the appellant could save any money on its various tax and duty remittances. Mr. Raphaël agreed to allow Ninecan to review the appellant's records. Mr. Ali Hirji of Ninecan subsequently visited the appellant's premises and reviewed its records. At that time, Mr. Hirji advised Mr. Raphaël that the appellant was not liable to pay tax on sales that it made to persons falling within the meaning of paragraph 50(5)(*g*) of the Act. Mr. Raphaël testified that his reaction to this advice was one of shock. He immediately advised Mr. Louis. At that point in time, it was agreed that Ninecan would examine all of the appellant's sales records and remittance forms and produce a refund claim to be submitted to Revenue Canada.

During cross-examination, Mr. Raphaël indicated that Revenue Canada sent him a letter following his aforementioned meeting with one of its officials. Mr. Raphaël testified that he had the letter in his files, but that he had not brought it with him to the hearing.

Mr. Hirji also gave testimony on behalf of the appellant. His testimony, regarding the discovery of the alleged error, was consistent with the testimony of Mr. Louis and Mr. Raphaël.

Mr. Joseph P. Iannuzzi, President of Wella Canada, Inc., testified on behalf of the respondent. In addition to being President of the ABA from 1985 to 1987, Mr. Iannuzzi indicated that he had been on the ABA's Board "on and off" for the past 20 years. Mr. Iannuzzi described the history of sales tax in respect of hair care products from the 1970s onward and, in particular, described the alternative tax arrangement negotiated by Revenue Canada and the ABA. During cross-examination, Mr. Iannuzzi indicated that he had never discussed the alternative tax arrangement with anyone employed by JPL. He also expressed the opinion that the appellant would not have had any reason to have known about that arrangement since JPL was established subsequent to the negotiation and introduction of the alternative tax arrangement.

Mr. Kenneth Wise, President of Can-Rad Beauty Limited and of Meter Beauty Products Limited, also testified on behalf of the respondent. Both companies are distributors of professional beauty aids to hairstylists and health clubs. Mr. Wise testified that it was standard in the industry for manufacturers, such as the appellant, to include sales tax in their prices to distributors. Both Can-Rad Beauty Limited and Meter Beauty Products Limited bought goods from the appellant. He testified that, to his knowledge, sales tax was included in the price of the goods that these two companies purchased from the appellant. He also indicated that he had never discussed the payment of sales tax with the appellant.

Finally, Mr. Pierre Hétu, Controller of Guay Beauty Inc., testified on behalf of the respondent. Mr. Hétu indicated that he had no evidence that the appellant was aware of the alternative tax arrangement. However, like Mr. Wise, he pointed out that the alternative tax arrangement was widely known and used in the hair care industry.

The Tribunal is of the view that certain matters are not in dispute in these appeals. First, during the periods at issue, the appellant was not liable, under the Act, to pay tax on sales of hair care products that it made to persons falling within the meaning of paragraph 50(5)(*g*) of the Act. Second, the appellant paid tax on all of its sales of hair care products, including sales made to persons falling within the meaning of paragraph 50(5)(*g*) of the Act. While the payment of tax by the appellant on such sales was not required by the Act, it was entirely consistent with the alternative tax arrangement negotiated by Revenue Canada and the ABA.

The issue in these appeals is whether, in paying tax in respect of sales to persons falling within the meaning of paragraph 50(5)(*g*) of the Act, the appellant has paid sales tax in error. Counsel for the respondent and counsel for the appellant both argued primarily with respect to

the nature of the error contemplated by section 68 of the Act. Both counsel also made argument in respect of the knowledge of the appellant's principals regarding the alternative tax arrangement at the time that the appellant remitted sales tax that it claimed to have paid in error. On the basis of those arguments, the Tribunal is of the view that these appeals turn on a single question of fact. In paying sales tax, if the appellant was aware of the alternative tax arrangement and voluntarily opted for that arrangement, it cannot be said that the appellant paid sales tax in error. Conversely, if the appellant paid sales tax in the mistaken belief that it was required by the Act to do so, then the appellant paid tax in error and is entitled to a refund.

Determining what knowledge or belief was held by the appellant's principals at the time that sales tax was paid is a difficult task. This is particularly true in light of the fact that the payment of the sales tax is equally consistent with the notion that they paid sales tax in the mistaken belief that they were obliged by law to do so and with the notion that they were aware of the alternative tax arrangement and had voluntarily opted for that arrangement. In such cases, the Tribunal must attempt to discern, from all the circumstances and from the representations made by the witnesses, where the truth lies.

The Tribunal has considered the testimony of the witnesses for the appellant to the effect that they were unaware of the alternative tax arrangement, as well as the testimony of the witnesses for the respondent who declared that they had never discussed the alternative tax arrangement with the appellant's principals.

The Tribunal has also considered the fact that, when the sales tax was allegedly paid in error, Mr. Louis had been involved in the hair care industry for a number of years. From 1981 to 1987, he was a sales representative for a distributor of hair care products. In 1987, he established his own company, JPL, which is a manufacturer of a variety of hair care products. The appellant is not an insubstantial company. The records indicate that, during the period from July 1, 1989, to November 30, 1990, the appellant sold in excess of $10 million of hair care products. In 1988, the appellant purchased Clajac, a company located in Abbotsford, British Columbia. In short, it is clear to the Tribunal that Mr. Louis is a businessman of considerable skill and sophistication. In addition, the Tribunal considered Mr. Louis' testimony to the effect that the hair care industry, from the manufacturers to the distributors to the salons and retailers, is very close and friendly and that he frequently communicated with a number of persons within the industry. Mr. Louis also indicated that the appellant was a member of the ABA and that he regularly attended its meetings. Moreover, the evidence indicates that the alternative tax arrangement was widely used by manufacturers and distributors.

On the basis of all of the evidence, the Tribunal is not persuaded that the appellant paid sales tax in error. In light of the fact that the alternative tax arrangement was a standard in the hair care industry and the fact that the appellant's principals had both been involved in that industry for a considerable period of time, the Tribunal would require some compelling evidence to convince it that the appellant was unaware of the alternative tax arrangement. The Tribunal is of the view that such evidence has not been presented. If the appellant had produced the letter that Mr. Raphaël received from Revenue Canada, it may have assisted the Tribunal in this regard. On the basis of the evidence adduced, the Tribunal concludes that the appellant was aware of the alternative tax arrangement and voluntarily decided to remit sales tax in accordance with that arrangement.

More precisely, the Tribunal wishes to state that it is of the view that the alternative tax arrangement was not law and that the appellant was in no way obliged to conduct its affairs in conformity with that arrangement. Had the appellant not wished to collect sales tax and

remit it to Revenue Canada, it would have been entirely within its rights not to opt for that arrangement. However, having voluntarily opted for the arrangement, the appellant cannot now say that it has paid tax in error.

For the foregoing reasons, the appeals are dismissed.

Sidney A. Fraleigh
Sidney A. Fraleigh
Member

Lise Bergeron
Lise Bergeron
Member

SEPARATE REASONS OF MEMBER GRACEY

I agree with my colleagues in this matter; however, I would characterize the case somewhat differently. Simply put, I do not believe that the central issue is whether the appellant knew or did not know of the existence of the alternative tax arrangement referred to in the majority reasons. The evidence is clear that the appellant used the method developed by Revenue Canada and the ABA, a policy sought by the ABA and designed for its convenience. In my opinion, the utilization of that policy extinguishes the right of one who used it to claim that it paid taxes in error. One has to realize that, in utilizing the alternative tax arrangement, the appellant did remit taxes that it was not obligated by law to remit, but the appellant also included the quantum of that tax in its sale price pursuant to the alternative tax arrangement. Thus, I cannot agree that the appellant paid any taxes in error, and that conclusion would not be altered whether it did so knowingly or not.

I distinguish this case from *Jack Herdman Limited v. The Minister of National Revenue*[3] cited by the appellant on the basis that, in that case, there was an element of coercion on the part of Revenue Canada to induce the appellant to pay taxes after the tax-exempt sale of goods for which the appellant was not liable for the tax.

Charles A. Gracey
Charles A. Gracey
Presiding Member

3. (1983), 48 N.R. 144 (F.C.A.).