CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Monday, September 26, 1994

Appeal No. AP-93-289

IN THE MATTER OF an appeal heard on April 15, 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 August 18, 1993, with respect to notices of objection served under section 81.17 of the *Excise Tax Act*.

BETWEEN

GERRARD-OVALSTRAPPING, DIVISION OF EII LIMITED **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed.

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-93-289

GERRARD-OVALSTRAPPING, DIVISION OF EII LIMITED **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The issue in this appeal is whether the appellant is the legal manufacturer of certain plastic strapping and thus liable for federal sales tax on the sale price of the goods. If not, the appellant is entitled to refunds of the moneys paid in error that were taken into account as taxes under the Excise Tax Act. Counsel for the respondent argued that the appellant, as the legal manufacturer of the strapping, is liable for federal sales tax under paragraph 2(1)(b) of the Excise Tax Act. In the alternative, counsel submitted that the appellant and Plastex Extruders Inc. constitute a single business entity. As such, Plastex Extruders Inc. acts as the appellant's agent in the manufacturing of the plastic strapping, and no sale of the strapping can occur between the two parties.

HELD: *The appeal is allowed. The Tribunal believes that, for a person, firm or corporation to be considered a legal manufacturer under paragraph 2(1)(b) of the Excise Tax Act, two conditions must be satisfied: (1) the person, firm or corporation must own, hold, claim or use a patent, proprietary, sales or other right to goods being manufactured, and (2) the goods must be manufactured by them, in their name or for or on their behalf by others. The Tribunal finds that the appellant had a sales right to the strapping being manufactured by Plastex Extruders Inc. pursuant to an agreement between Plastex Extruders Inc. and itself. However, a true vendor-purchaser relationship existed between the parties and, thus, the second condition is not met. With regard to the alternative argument advanced by counsel for the respondent, as the relationship was properly described as that of vendor and purchaser, the two parties did not represent a single business entity.*

Place of Hearing:	*Ottawa, Ontario*
Date of Hearing:	*April 15, 1994*
Date of Decision:	*September 26, 1994*
Tribunal Members:	*Lise Bergeron, Presiding Member* *Charles A. Gracey, Member* *Robert C. Coates, Q.C., Member*
Counsel for the Tribunal:	*David M. Attwater*
Clerk of the Tribunal:	*Janet Rumball*
Appearances:	*Robert G. Kreklewetz, for the appellant* *F.B. Woyiwada, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-93-289

GERRARD-OVALSTRAPPING, DIVISION OF EII 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 two determinations of the Minister of National Revenue (the Minister) that rejected two applications for refunds of moneys claimed to have been paid as taxes in error.

The goods in issue are plastic strapping used for packaging. The appellant paid federal sales tax (FST) on the sale price of the goods. However, believing itself a distributor of the strapping, the appellant considered its liability for the FST to be based on its purchase price of the goods. Therefore, on June 12, 1990, and May 11, 1991, the appellant applied for refunds of the FST paid on the difference between its purchase price and the sale price of the strapping for the period from May 1, 1988, to December 31, 1990.

The refund applications were rejected on the basis that the appellant was "considered to be the legal manufacturer [of the strapping] under the provisions of paragraph 2(1)(*b*) of the *Excise Tax Act*." Notices of objection to the determinations were rejected by the Minister on the basis that the appellant "owned, held or claimed sales rights to the strapping at the time it was being manufactured." Gerrard-Ovalstrapping, Division of EII Limited then appealed the determinations to the Tribunal.

The issue in this appeal is whether the appellant is the legal manufacturer of the plastic strapping and thus liable for FST on the sale price of the goods. If not, the appellant is entitled to refunds of the moneys paid in error that were taken into account as taxes under the Act.

For purposes of this appeal, the relevant provisions of the Act state:

> *50. (1) There shall be imposed, levied and collected a consumption or sales tax ... on the sale price or on the volume sold of all goods*
> *(a) produced or manufactured in Canada*
> *(i) payable ... by the producer or manufacturer at the time when the goods are delivered to the purchaser or at the time when the property in the goods passes, whichever is the earlier.*

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

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2. (1) In this Act,

"manufacturer or producer" includes

(b) any person, firm or corporation that owns, holds, claims or uses any patent, proprietary, sales or other right to goods being manufactured, whether by them, in their name or for or on their behalf by others, whether that person, firm or corporation sells, distributes, consigns or otherwise disposes of the goods or not.

The first witness called on behalf of the appellant was Mr. Jack E. White who is, and was during the period covered by the refund applications, the appellant's President and General Manager.[2] He told the Tribunal that the appellant was in the business of supplying systems, equipment and strapping for packaging, bundling and tying various products. As part of this business, the appellant sells plastic strapping and associated equipment. Most of the plastic strapping is purchased from Plastex Extruders Inc. (Plastex). During the period at issue, Mr. White also served as General Manager of Plastex.

Prior to 1977, the appellant satisfied its strapping requirements with imports. However, to sell strapping effectively, it was necessary for the appellant to source domestically.[3] After failed negotiations with the only domestic manufacturer, the appellant looked outside Canada for a manufacturer that would establish a Canadian manufacturing facility. In April 1977, the appellant entered into an agreement (the Agreement) with Plastic Extruders Limited of the United Kingdom (Plastic-U.K.) for the creation of Plastex and the establishment of a facility for the manufacture of plastic strapping in Canada.

Referring to the terms of the Agreement, Mr. White explained that the appellant is a 60-percent owner of Plastex, while Plastic-U.K. owns the remainder. As such, the appellant appoints three of the five directors of Plastex.[4] As part of its contribution to the new venture, Plastic-U.K. supplied the extrusion equipment to manufacture the strapping, the expertise to supervise the installation and start-up of Plastex, and the technical experience and "know-how" to operate the equipment. Though not incorporated into the terms of the Agreement, the appellant rented space in its facility to Plastex at a fair market value. In addition, Plastex was allocated a share of the facility's costs for heat, lighting and water.

Under the terms of the Agreement, the appellant was to provide several management services, including the supervision of production, to Plastex in exchange for a fee. Mr. White explained, however, that the appellant has never provided any supervision of production, nor has it charged a management fee. Instead, the appellant has provided administrative services, such as calculating the payroll, issuing payroll cheques to Plastex employees,[5] issuing purchase orders on behalf of Plastex[6] and maintaining separate accounting records, bank statements and bank accounts for Plastex. In consideration, the appellant charges Plastex for the costs associated with providing these services.

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2. Mr. White was appointed President of Plastex Extruders Inc. in 1990.
3. During cross-examination, Mr. White explained that it was difficult to compete with the domestic manufacturer because of the applicable duty rates and fluctuating exchange rate between the Canadian and U.S. currencies.
4. During the period at issue, the three directors appointed by the appellant were also directors of EII Limited, the appellant's parent company.
5. During cross-examination, it was clarified that Plastex employees are paid from the appellant's account. The appellant then charges this expense to Plastex.
6. Based on a purchase requisition provided by Plastex.

Pursuant to the Agreement, the appellant was appointed the sole and exclusive distributor within North America of the strapping produced by Plastex.[7] The strapping is to be sold at a price "competitive with prices for similar products offered by other manufacturers to customers with whom they are dealing at arm's length.[8]" A mechanism is provided in the Agreement for Plastic-U.K. to have the price reviewed by arbitration if considered uncompetitive. However, according to Mr. White, this procedure has never been used. Mr. White testified that the appellant has no patent or trademark relating to the strapping, nor does it have any right to the strapping while it is being manufactured.

In illustrating the extent to which Plastex is a distinct company, Mr. White told the Tribunal that Plastex has its own telephone number, letterhead, business sign, invoices, line of credit from a bank (there was no cross-financing), bank accounts, cheques and journals. Plastex also pays to insure its assets and files its own tax returns.

The second witness called on behalf of the appellant was Mr. Ken Hillier who is presently Operation Manager of Plastex. Mr. Hillier described such things as: his day-to-day responsibilities as a manager of Plastex; differences in company policy between Plastex and the appellant; the manufacture of strapping; his control over the scheduling of production; the sale of strapping to the appellant; sales of strapping to Ovalstrapping Inc.; Plastex's requisition and payment for raw materials; bills of lading and invoices addressed to Plastex for delivery of plastic resin; his immediate supervisor; and business dealings with Mr. White. He told the Tribunal that Plastex controls its own operations, including the manufacture of strapping.

With regard to the sale of strapping, Mr. Hillier explained that, when a pallet of boxed strapping has been filled and the quality of the product has been confirmed, the appellant is advised. As Plastex retains no inventory, the appellant immediately retrieves the pallet, at which time it obtains title to the goods. Production sheets are filled out daily and submitted to the appellant weekly. The appellant is then invoiced for the strapping on a monthly basis.

Counsel for the appellant acknowledged that, if the Tribunal found that the appellant and Plastex constituted a single business entity or that the provisions of paragraph 2(1)(*b*) of the Act applied, the appellant would have to pay tax based on its sale price of the strapping rather than on its purchase price of those goods.

Counsel for the appellant explained that the argument of a single business entity is based on the premise that a principal cannot sell to its agent. Referring to *His Majesty the King v. Leon L. Plotkins*,[9] counsel argued that the Tribunal must consider the true character of the transactions in question, notwithstanding the terms of the Agreement between Plastic-U.K. and the appellant. For the Tribunal to find that the appellant and Plastex constitute a single business entity "requires a state of facts that indubitably points to a business arrangement made to evade the tax, or, that one so dominated and controlled the business of the other that one is obliged to say that the existence of that other was apparent only and not real.[10]"

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7. Mr. White explained that, despite this provision in the Agreement, Plastex sells approximately 15 percent of its annual production of strapping to Ovalstrapping Inc. of the United States, which is owned by the same holding company that owns the appellant.
8. The Agreement, paragraph 4(g).
9. [1938-39] C.T.C. 138 (Ex. Ct.).
10. *Ibid.* at 147.

As such, the Tribunal would need very clear evidence before it could find a single business entity.

Referring to the facts[11] in the *Plotkins* case, counsel for the appellant submitted that the Exchequer Court of Canada did not find the existence of a single business entity where there existed a stronger nexus between two companies than exists between the appellant and Plastex. In addition, having related directorship between two companies is not sufficient to find the existence of a single business entity.[12] As such, the appellant and Plastex are two separate, though intimate and mutually advantageous, companies.

Counsel for the appellant argued that, for paragraph 2(1)(*b*) of the Act to apply to the appellant, two conditions must be met. First, the appellant must own, hold, claim or use any patent, proprietary, sales or other right to goods being manufactured. Second, the goods must be manufactured for, or on behalf of, the legal manufacturer.

With regard to the first condition, counsel for the appellant submitted that the right must exist while the goods are being manufactured.[13] However, there was no evidence that the appellant had any right to the plastic strapping while it was being manufactured. Rather, the appellant's rights in the strapping arose when it actually purchased the goods sometime after their manufacture.

Counsel for the appellant submitted that an exclusive distribution right to goods does not create a right to the goods during their manufacture.[14] Counsel suggested that the relationship between the appellant and Plastex is akin to a relationship between a manufacturer and an exclusive distributor of "private brand goods," as defined in Excise Memorandum ET 202 in which the expression is defined to mean "goods which in the condition as sold by the manufacturer thereof are for marketing under a brand, trade mark, trade name or any other designation which identifies the goods with a vendor other than the manufacturer of the goods.[15]" It was submitted that it is the policy of the respondent that tax is to be paid on the distributor's

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11. Counsel for the appellant referenced the following facts: (1) the owner of the refinery also owned part, but not all, of the distributor; (2) there was common management between the two companies; (3) the distributor operated out of the refinery's premises and paid rent; (4) the accounting and clerical work was conducted by the distributor's staff; (5) the two companies shared a common bank account, although the books and records of the two companies were kept separate; (6) the accounts payable for both companies and all wages were paid out of the same bank account, and the refinery was charged back for all amounts; (7) each company had its own employees; (8) the two companies had a profit- and loss-sharing arrangement; (9) sales from the refinery to the distributor were properly documented and invoiced; and (10) the two companies had agreed that the distributor would purchase the entire output exclusively from the refinery.

12. *His Majesty the King v. B.C. Brick and Tile Company*, [1935] C.T.C. 110 (Ex. Ct.).

13. *Goodyear Tire and Rubber Company of Canada Limited v. T. Eaton Co., Limited*, 55 D.T.C. 1103 (Ex. Ct.). Counsel for the appellant argued that, though this case was overturned by the Supreme Court of Canada on jurisdictional grounds, the reasoning of the Exchequer Court of Canada is still valid. Counsel submitted that the Minister has adopted this reasoning in its approach to the tax treatment of "private brands." *Infra*, note 16.

14. *Ibid.*

15. Values for Tax, Department of National Revenue, Customs and Excise, December 1, 1975, at 13.

purchase price of these goods.[16] Counsel submitted that, in effect, the respondent has determined that paragraph 2(1)(*b*) of the Act does not apply to goods being manufactured exclusively for a single distributor.

With regard to the second condition, counsel for the appellant submitted that it is only met when the purchaser exercises very close supervision and control over production of the goods.[17] As such, the relationship is much more than that of purchaser and vendor. In this regard, counsel asserted that it has been the policy of the respondent that an agent relationship must exist between the physical manufacturer and purchaser for this condition to be satisfied.[18] It was submitted that the appellant exercised no supervision or control over the production of the plastic strapping. In fact, the relationship between the appellant and Plastex is properly characterized as that of vendor and purchaser. As such, the strapping was not manufactured for, or on behalf of, the appellant.

Counsel for the respondent reminded the Tribunal that the onus is on the appellant to show that the respondent's determination is incorrect. In so doing, the appellant must "clearly establish that [it] did not hold, claim, own or use any patent, proprietary, sales or other rights to the goods being manufactured for or on [its] behalf.[19]"

In arguing that the appellant qualified as a manufacturer under paragraph 2(1)(*b*) of the Act, counsel for the respondent referred the Tribunal to the facts in *The King v. Reuben Shore* and *Turnbull Elevator Co. of Canada Ltd. v. The Queen*.[20] Counsel submitted that, in those cases, the Exchequer Court of Canada found distributors to be the legal manufacturers of goods based on facts[21] similar to those in this case.

Counsel for the respondent submitted that the key element of the respondent's position is the very close relationship between the appellant and Plastex. In reviewing the facts, counsel submitted that Plastex was established in part by the appellant for the sole purpose of providing it with plastic strapping; Plastex occupies the appellant's premises; the plastic strapping manufactured by Plastex is transferred directly to the appellant; Plastex retains no inventory; the appellant has the right to appoint three of five of Plastex's directors; Plastex is supervised by the

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16. See, for example, the Department of National Revenue Rulings 3700/53 Active, Value for Tax of Goods Bearing Manufacturer's and Private Brand Names, November 12, 1970; 3700/57-1 Active, Value for Tax of Private Brand Goods Where Customer Supplies Labels to Physical Manufacturers, June 30, 1970; and 3700/73-1 Active, Value for Tax of Batteries (Electric Storage Batteries), October 2, 1970.

17. *The King v. Reuben Shore*, 49 D.T.C. 570 (Ex. Ct.); *Rexair of Canada Limited v. The Queen*, 58 D.T.C. 1158 (S.C.); *Turnbull Elevator Co. of Canada Ltd. v. The Queen* (1962), 63 D.T.C. 1001 (Ex. Ct.).

18. Department of National Revenue Ruling 1160/32-2 Active, Legal Manufacturers of Patent Rights Goods (Moulds and Dies), April 29, 1987.

19. *Scubs Marketing Ltd. and 582760 Ontario Limited v. The Minister of National Revenue* (1991), 4 T.C.T. 3290 at 3294, Canadian International Trade Tribunal, Appeal Nos. 3035 and 3036, August 19, 1991.

20. *Supra*, note 17.

21. For instance, in the *Reuben Shore* case, the physical manufacturer was manufacturing toys exclusively for the distributor and could not sell them to others. In the *Turnbull Elevator* case, the physical manufacturer was required by contract to sell goods only to the distributor, which was similarly bound to buy the goods being manufactured.

appellant through its directors; under the Agreement, the appellant is fully responsible for the management of Plastex; the goods are being produced to the specifications of the appellant; based on the Agreement, the appellant is the sole and exclusive distributor of the strapping; Plastex is contractually bound to produce all the goods required by the appellant, which is contractually bound to sell those goods; and Plastex produces only on orders of the appellant, except for a small quantity sold to Ovalstrapping Inc. Counsel concluded that Plastex manufactures strapping solely and exclusively for, or on behalf of, the appellant and that, throughout the manufacturing process, the appellant had a sales or proprietary right to the goods being manufactured.

In the alternative, counsel for the respondent argued that, because the appellant and Plastex are so closely related, a sale of the plastic strapping has not occurred between them. It was submitted that a sale can only occur between two parties freely capable of giving a mutual assent.[22] Counsel argued that, because Plastex exists only to satisfy the orders of the appellant, the necessary consent is lacking. As such, a sale, for purposes of assessing the FST, has not occurred between the two parties.

In reply to the alternative argument, counsel for the appellant argued that the courts have found a lack of mutual consent where a principal-agent relationship existed. Counsel reminded the Tribunal of his earlier arguments on the issue of a single business entity.

The question at issue before the Tribunal is whether the appellant is the legal manufacturer of plastic strapping and thus liable for FST based on its sale price of the strapping. Counsel for the respondent argued that the appellant is liable for FST as the legal manufacturer of the strapping under paragraph 2(1)(*b*) of the Act. In the alternative, counsel submitted that the appellant and Plastex constitute a single business entity. As such, Plastex acts as the appellant's agent in the manufacture of the plastic strapping, and no sale of the strapping can occur between the two parties.

In considering whether the appellant and Plastex constitute a single business entity, the Tribunal has paid particular attention to the "actual transactions that took place[23]" between these two parties. The resolution of this issue is largely a question of fact. Based on the evidence and being mindful of judicial precedent,[24] the Tribunal is satisfied that the appellant and Plastex constitute separate entities and that a principal-agent relationship does not exist between these two parties. The Tribunal believes that Plastex manufactures the plastic strapping on its own behalf and subsequently sells the goods to the appellant.

In reaching this conclusion, the Tribunal notes that, although there was common ownership and management between the appellant and Plastex and the business relations between the two parties were intimate, these facts alone do not make them a single business entity. The Tribunal is satisfied that Plastex has sufficient direction and control over its operations to make it more than a mere agent of the appellant. Plastex has its own employees and policies governing their employment; it controls its day-to-day operations, such as the scheduling and supervision of production and the requisition of raw materials; and it invoices the appellant monthly for the plastic strapping for which it receives a fair market value.

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22. See *His Majesty the King v. Colgate-Palmolive-Peet Company, Limited*, [1933] S.C.R. 131 at 138 (per Cannon, J.).
23. *Supra*, note 9 at 145.
24. *Supra*, notes 9, 12 and 22.

Though Plastex carries on business on the appellant's premises, it pays rent at a fair market value and is allocated its share of the costs of the building. In addition, Plastex has separate accounting records, bank statements, bank account and line of credit, and it pays a fee for the administrative services provided to it by the appellant.

With regard to whether the appellant is liable for FST as the manufacturer of the plastic strapping under paragraph 2(1)(*b*) of the Act, the Tribunal notes that "[s]ince the statutory definition of a 'manufacturer or producer' involves a departure from its ordinary meaning and since the liability to tax of a person, firm or corporation depends on whether he or it comes within its meaning it must be established in the case of a person, firm or corporation who is not a manufacturer or producer in the ordinary meaning of the term that before he is held to be a manufacturer or producer within the statutory meaning all the conditions requisite to the applicability of the statutory meaning are present. If any of them are absent the statutory meaning is not applicable and must give way to the ordinary meaning.[25]"

The Tribunal believes that, for a person, firm or corporation to be considered a legal manufacturer under paragraph 2(1)(*b*) of the Act, two conditions must be satisfied:

(1) a person, firm or corporation must own, hold, claim or use a patent, proprietary, sales or other right to goods being manufactured, and

(2) the goods must be manufactured by them, in their name or for or on their behalf by others.

With regard to the first condition, the Tribunal believes that the appellant holds a sales right to the plastic strapping during its manufacture. Under the Agreement, Plastex is contractually bound to produce all of the appellant's reasonable requirements of plastic strapping, and the appellant is required to give reasonable notice to Plastex of its anticipated requirements.[26] In addition, Plastex cannot sell the plastic strapping to others within North America, as the appellant was appointed its sole and exclusive distributor.[27] Although the evidence was to the effect that Plastex also sold plastic strapping to Ovalstrapping Inc., the Tribunal finds it significant that the latter is related to the appellant, for whom the clause is of benefit.

In determining whether the second condition was met, the Tribunal had to establish whether Plastex was manufacturing the plastic strapping on its own behalf and subsequently selling these goods to the appellant. The Tribunal believes that, if a true vendor-purchaser relationship existed between Plastex and the appellant, then the plastic strapping is not manufactured by the appellant, in its name or for or on its behalf by others. In effect, the Tribunal had to determine whether a principal-agent relationship existed between the two parties.

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25. *Supra*, note 13 at 1106.
26. *Supra*, note 8, paragraph 4(d).
27. *Ibid.*, paragraph 4(c).

As stated above, determining whether a principal-agent relationship exists between two parties is largely a question of fact. Based on the facts, the Tribunal believes that such a relationship does not exist between the parties.

Accordingly, the appeal is allowed.

Lise Bergeron
Lise Bergeron
Presiding Member

Charles A. Gracey
Charles A. Gracey
Member

Robert C. Coates, Q.C.
Robert C. Coates, Q.C.
Member