CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Friday, April 21, 1995

Appeal No. AP-94-075

IN THE MATTER OF an appeal heard on November 3, 1994, 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 March 1, 1994, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

TEE-COMM ELECTRONICS INC. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed.

Lise Bergeron
Lise Bergeron
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

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

Michel P. Granger
Michel P. Granger
Secretary

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UNOFFICIAL SUMMARY

Appeal No. AP-94-075

TEE-COMM ELECTRONICS INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

This is an appeal under section 81.19 of the Excise Tax Act of an assessment in respect of sales of integrated receivers and descramblers, consisting of satellite receivers (receivers) and descrambler modules (descramblers), made during the period from April 1, 1986, to September 30, 1989. The issue in this appeal is whether the respondent correctly determined that the insertion of descramblers into the backs of receivers by the appellant constituted production or manufacture and that the appellant was, therefore, liable for federal sales tax in respect of sales of the receivers and descramblers pursuant to subparagraph 50(1)(a)(i) of the Excise Tax Act..

***HELD**: The appeal is allowed. In the Tribunal's view, the descramblers are not raw or prepared materials, as contemplated by the commonly accepted interpretation of "manufacture," nor does the action of inserting a descrambler into the back of a receiver give the descrambler new forms, qualities and properties or combinations. Moreover, the Tribunal is not persuaded that the appellant has, through the act of inserting the descramblers into the backs of the receivers, caused the descramblers or the receivers to be able to perform a function that they could not previously perform. The Tribunal finds that the function of the descrambler is distinct from that of the receiver and, although the descrambler may enhance the quality of the reception of the receiver, it does not play an integral or inseparable part in the operation of the receiver, which can function without the descrambler.*

The Tribunal finds that the insertion of the descrambler into the back of the receiver, like the installation of the radio into the car in Fiat Auto Canada Limited v. The Queen, does not constitute assembly. In the Tribunal's view, the insertion of the descrambler into the back of the receiver does not involve any alterations to the receiver and is akin to placing a video cassette into a video cassette recorder.

Finally, the Tribunal is not persuaded that the appellant's activities constitute preparing goods for sale by packaging or repackaging. Rather, the insertion of the descramblers into the backs of the receivers was done for the purpose of testing, and the descramblers were left in the backs of the receivers for shipment to dealers which had purchased both a descrambler and a receiver for resale.

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Place of Hearing:	*Ottawa, Ontario*
Date of Hearing:	*November 3, 1994*
Date of Decision:	*April 21, 1995*
Tribunal Members:	*Lise Bergeron, Presiding Member* *Arthur B. Trudeau, Member* *Robert C. Coates, Q.C., Member*
Counsel for the Tribunal:	*Shelley Rowe*
Clerk of the Tribunal:	*Anne Jamieson*
Appearances:	*Thomas B. Akin and Neil E. Bass, for the appellant* *Geoffrey S. Lester, for the respondent*

CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-94-075

TEE-COMM ELECTRONICS INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: LISE BERGERON, Presiding Member
ARTHUR B. TRUDEAU, 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 an assessment in the amount of $269,630.62 in respect of sales of integrated receivers and descramblers, consisting of satellite receivers (receivers) and descrambler modules (descramblers), made during the period from April 1, 1986, to September 30, 1989. It was clarified at the hearing that the amount of the assessment at issue is $154,364.03, which relates to "manufactured goods treated as jobbed goods in error."

The appellant was, at all material times, a licensed manufacturer which imported receivers from the Republic of Korea and descramblers from the United States. The appellant paid federal sales tax (FST) on the duty-paid value of the receivers and descramblers at the time of importation.

Mr. Robert A. Kavelman, a chartered accountant, appeared on behalf of the appellant. Mr. Kavelman was employed by the appellant as Vice-President of Finance until June 1994. He was also its Secretary and one of its directors during the period from June 1986 until June 1994. While employed by the appellant, Mr. Kavelman dealt with the Department of National Revenue (Revenue Canada) concerning the issue in this appeal.

As described by Mr. Kavelman, the appellant sells residential satellite television equipment to dealers in Canada and the United States. Mr. Kavelman explained that a satellite system is composed of an antenna, which is parabolic in shape, with a feed horn in the centre that collects microwave signals transmitted by a satellite and a coaxial cable through which the signals are fed to a receiver and processed so that they are readable by a television set. A system may also include a descrambler which unscrambles signals and, ultimately, allows for additional channels.

Mr. Kavelman introduced the "Tee-Comm Satellite Equipment Catalogue" which includes a list of prices for individual components of a satellite system, as well as the prices for packages that might include two or more components of a system. According to Mr. Kavelman, this list was used as a marketing tool to encourage dealers to buy full systems as opposed to individual components.

A receiver was described by Mr. Kavelman as a device capable of receiving approximately 100 broadcast signals through a satellite dish. A descrambler may be inserted into the recessed port in the

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

back of a receiver by way of a connector on the back of the descrambler that enables it to interface with the receiver. If a descrambler is inserted into the back of a receiver, that receiver is then capable of receiving approximately 40 additional premium pay channels, provided the user subscribes to those premium pay channels. If the user is not a subscriber, the signals received will be scrambled and such that they may not be clearly viewable or may not have any sound.

Mr. Kavelman explained that, for the purposes of quality control testing, the appellant inserted descramblers into the receivers. After testing, and providing that a dealer had ordered a descrambler, the appellant would ship the receiver with the descrambler inserted into the back of it. Since most dealers purchased both a receiver and a descrambler, most descramblers were not removed prior to shipment.

The issue in this appeal is whether the respondent correctly determined that the insertion of descramblers into the backs of receivers by the appellant constituted production or manufacture and that the appellant was, therefore, liable for FST in respect of sales of the receivers and descramblers pursuant to subparagraph 50(1)(*a*)(i) of the Act..

Counsel for the appellant submitted that the insertion of the descrambler into the receiver does not constitute manufacture or production since it does not result in the production of an article from raw or prepared materials nor does it give the receiver new forms, qualities and properties. In counsel's view, the receiver and descrambler, separately, are fully manufactured and completely functional equipment and, as such, cannot, at the time of importation, be considered raw or prepared materials from which an article is produced.

Relying on the decisions of the Federal Court of Canada in *Fiat Auto Canada Limited v. The Queen*[2] and of the Tribunal in *F.D. Jul Inc. v. The Minister of National Revenue*,[3] counsel for the appellant submitted that manufacture or production only occurs if the operations performed result in a new product capable of performing a new function which it could not previously perform. Counsel referred to the fact that the receiver is capable of receiving both scrambled and unscrambled signals without a descrambler and submitted that, with a descrambler, the receiver functions in exactly the same way except that scrambled signals, once received, are then sent through the descrambler.

Counsel for the appellant submitted that, based on the decision of the Federal Court of Canada in *The Queen v. Stuart House Canada Limited*,[4] in order for the Tribunal to find that the appellant's activities are manufacture, it must find that the receiver cannot be used by an ordinary user before the descrambler is inserted into it. Counsel submitted that this requirement is not met, since the dealers to which the appellant sold the receivers and descramblers removed the descramblers from the receivers prior to reselling them and supplied their customers with modified descramblers.

In the view of counsel for the appellant, the appellant's activities do not fall within the extended meaning under paragraph (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act. Counsel submitted that the insertion of the descrambler is analogous to the installation of the radios into

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2. [1984] 1 F.C. 203.
3. [1993] 1 G.T.C. 4015, Appeal No. AP-90-183, January 18, 1993.
4. [1976] 2 F.C. 421.

the cars in the *Fiat* decision, which was considered to be adding a convenience as opposed to assembling a car.

With respect to the phrase "prepares goods for sale" in the extended meaning under paragraph (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act, counsel for the appellant submitted that it means to change, alter or enhance the commercial presentation of the goods in anticipation of sale.[5] Counsel argued that the appellant did not prepare the goods for sale for the following reasons: (1) the receivers were already sold since, before placing their orders with the appellant, the dealers had sold the receivers to final users; and (2) the descramblers were left in the receivers for shipping purposes, as was the case in *SMED Manufacturing Inc. v. The Minister of National Revenue*,[6] and not for the purpose of preparing the goods for sale.

Finally, relying on the decision in *Gene A. Nowegijick v. Her Majesty the Queen*,[7] in which the Supreme Court of Canada stated that "[a]dministrative policy and interpretation are not determinative but are entitled to weight and can be an 'important factor,'[8]" counsel for the appellant suggested that it would assist the Tribunal to review the Revenue Canada Ruling 1105/115.[9] Counsel submitted that the insertion of the descrambler is analogous to plugging printed circuit boards into central processing units which was not considered to be manufacture or production in Ruling 1105/115.

Counsel for the respondent submitted that the receiver is given new forms, qualities and properties or combinations by the addition of the descrambler. Counsel submitted that the combination of the receiver and the descrambler results in a new product since it is a new form and/or combination that can receive approximately 40 more channels than the receiver alone. Moreover, counsel argued that the descrambler changes the receiver into a product that produces clearer channels than does the receiver alone, thereby enhancing the main function of the receiver. To support his argument, counsel referred to the fact that the appellant has different stock codes and descriptions for the receiver alone and for the receiver with a descrambler.

It was submitted by counsel for the respondent that the facts in the *Fiat* decision are distinguishable from the facts in this appeal because the addition of the descrambler, unlike the radio and speakers installed in the car, enhances the main function of the receiver.

Relying on the decision of the Federal Court of Canada in *ECG Canada Inc. v. The Queen*,[10] counsel for the respondent submitted that the appellant's activities constituted packaging or repackaging within the meaning of paragraph (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act and that the receivers and descramblers were not packaged or repackaged out of necessity for shipping safety, but that they were combined and repackaged to ensure their merchantable quality and to conform to the appellant's stock item numbers and prices.

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5. Memorandum of the Department of National Revenue to regional directors dated July 6, 1981, and entitled Principles and Philosophy of Marginal Manufacturing.
6. [1994] 2 G.T.C. 5127, Canadian International Trade Tribunal, Appeal No. AP-93-081, May 17, 1994.
7. [1983] 1 S.C.R. 29.
8. *Ibid.* at 37.
9. Assembly Manufacturing in a Retail Store, March 31, 1988.
10. [1987] 2 F.C. 415.

Counsel for the respondent submitted that the appellant misconstrued Ruling 1105/115. Counsel interpreted the ruling card as providing that a retailer, that plugs circuit boards into a mother board of a central processing unit, in a retail store, for direct sale to a customer, is performing a traditional manufacturing operation as opposed to an assembly operation. In counsel's view, the facts of this appeal are more analogous to those in Revenue Canada Ruling 1140/122,[11] which provides that it is manufacture to plug an optional circuit board into a central processing unit and to sell the "upgraded" unit at an all-inclusive price.

In order for the Tribunal to find that the appellant was correctly assessed FST in respect of its sales of the descramblers, the Tribunal must find that the insertion of descramblers into the backs of receivers constitutes manufacture or production within the meaning of paragraph 50(1)(*a*) of the Act which provides that FST shall be imposed on goods produced or manufactured in Canada.

The phrase "produced or manufactured in Canada" has been interpreted by the Tribunal and its predecessors in several appeals, and the Tribunal has consistently relied upon the following definition of "manufacture" taken from *Minister of National Revenue v. Dominion Shuttle Company Limited*[12] and adopted by the Supreme Court of Canada in *Her Majesty the Queen v. York Marble, Tile and Terrazzo Limited*:[13]

> *manufacture is the production of articles for use from raw or prepared material by giving to these materials new forms, qualities and properties or combinations whether by hand or machinery.*[14]

In the Tribunal's view, the descramblers are not raw or prepared materials as contemplated by the commonly accepted interpretation of "manufacture" nor does the action of inserting a descrambler into the back of a receiver give the descrambler new forms, qualities and properties or combinations.

In considering what interpretation to give to the words "raw or prepared materials" in the Supreme Court of Canada's definition of "manufacture," the Tribunal found it instructive to look at the specific facts in *York Marble*. In that case, the Court decided that imported marble slabs, cut from a large block, in varying thicknesses and sizes, with rough, unfinished surfaces and edges, which were cut, sized, grinded, polished and finished, were raw or prepared materials that had been given new forms, qualities and properties or combinations. The Tribunal also found the decision of the Tariff Board in *Skega Canada Limited v. The Deputy Minister of National Revenue for Customs and Excise*,[15] on which the appellant relied, to be helpful. In *Skega*, while applying the test of manufacture from *York Marble*, the Tariff Board found that the phrase "manufactures of rubber" denoted products of a completed manufacturing process ready for use in their designed function. In the Tribunal's view, unlike the marble slabs in *York Marble*, the descramblers in issue are fully manufactured goods that have not undergone any process to change their form, quality and properties or combinations and are ready for use.

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11. Insertion of Optional Circuit Boards in Electronic Equipment - Whether Manufacturing, August 15, 1984.
12. (1933), 72 Que. S.C. 15.
13. [1968] S.C.R. 140.
14. *Ibid.* at 145.
15. (1983), 9 T.B.R. 50.

The Tribunal also considered whether the insertion of the descrambler constituted production. The following is the generally accepted interpretation of the word "production" as stated by the Federal Court of Canada in *The Minister of National Revenue v. Enseignes Imperial Signs Ltée*[16] in referring to *Gruen Watch Company of Canada Ltd. v. Attorney General of Canada*:[17]

> *A thing is produced if what a person does has the result of producing something new; and a thing is new when it can perform a function that could not be performed by the things which existed previously.*[18]

Again, the Tribunal found it instructive, in applying this interpretation of "production," to consider it in the context of the specific facts of *Gruen Watch* and *Enseignes Imperial*. In *Gruen Watch*, it was found that the act of putting imported watch movements into a tin or aluminum case and, in some cases, attaching wristbands or bracelets, to adapt the watches to household or personal use, constituted production. In *Enseignes Imperial*, the Federal Court of Canada found that the act of reconditioning used signs, consisting of a metal box with fluorescent tubes and encasing a transparent plastic cover on which is painted the name of a company, by cleaning, repairing and repainting them, constituted production. The Court stated that the used signs, when reconditioned, transmitted a new advertising message and, as such, performed a new function.

In the Tribunal's view, the appellant has not, through the act of inserting the descrambler into the back of the receiver, caused the descrambler or the receiver to be able to perform a function that it could not previously perform. Unlike the watch movements in *Gruen Watch* and the used signs in *Enseignes Imperial*, which could not have been used to perform their respective functions without having undergone certain changes, the functions of the descrambler and the receiver continued to be the same regardless of the appellant's act of inserting the descrambler in the back of the receiver. The Tribunal finds that the function of the descrambler is distinct from that of the receiver and, although the descrambler may enhance the quality of the reception of the receiver, it does not play an integral or inseparable part in the operation of the receiver, which can function without a descrambler.

The phrase "producer or manufacturer" in paragraph 50(1)(*a*)(i) is modified by paragraph (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act, which provides that a manufacturer or producer includes the following:

> *any person who, by himself or through another person acting for him, prepares goods for sale by assembling, blending, mixing, cutting to size, diluting, bottling, packaging or repackaging the goods or by applying coatings or finishes to the goods, other than a person who so prepares goods in a retail store for sale in that store exclusively and directly to consumers.*

In interpreting and applying this definition for the purposes of this appeal, the Tribunal relies, in large part, on the decision of the Federal Court of Canada in the *Fiat* case, which, in the Tribunal's view, involved facts very similar to the facts in this appeal. In *Fiat*, the Court considered whether a company that imported

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16. (1990), 116 N.R. 235, Federal Court of Appeal, File No. A-264-89, February 28, 1990.
17. [1950] O.R. 429, [1950] C.T.C. 440.
18. *Supra*, note 16 at 239.

cars from Italy and had another company install radios and speakers in the cars on its behalf, was a manufacturer or producer and was, therefore, liable to pay FST on the sales of the cars. The Court found that the installation of the radios and speakers did not constitute manufacture or production since the vehicles could have operated without the radios, and there was no change in form, qualities or combinations of the vehicles. The Court also found that the installation of the radio in the car constituted the addition of a convenience, but that it was not an assembly. In making that finding, the Court defined the word "assemble" as "to fit together various parts of so as to make it into an operative whole."

In the Tribunal's view, the insertion of the descrambler into the back of the receiver is similar to the installation of a radio into a car and does not constitute assembly. In fact, the Tribunal finds that it is even more clear in this case than it was in the *Fiat* case that the activities do not constitute assembly. The insertion of the radio in the car in the *Fiat* case involved much more extensive changes than does the insertion of the descrambler into the back of the receiver, which does not involve any alterations to the receiver and is akin to placing a video cassette into a video cassette recorder. Moreover, the insertion of the descrambler into the back of the receiver is not done for the purpose of making the receiver into an operative whole since the receiver can receive signals without the descrambler.

Finally, the Tribunal is not persuaded that the appellant's activities constitute preparing goods for sale by packaging or repackaging. The Tribunal is persuaded by the explanation of the appellant's witness that the appellant inserted the descramblers into the backs of the receivers for the purpose of quality control testing and that, in most cases, the descramblers were not removed prior to shipment to dealers for shipping purposes, since most dealers purchased both a descrambler and a receiver. This is similar, in the Tribunal's view, to the case in *SMED* in which the Tribunal found that goods already sold and put into packaging for the purposes of shipment are not goods prepared for sale by packaging or repackaging.

Accordingly, the appeal is allowed.

Lise Bergeron
Lise Bergeron
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

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