CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Thursday, May 30, 1996

Appeal No. AP-95-071

IN THE MATTER OF an appeal heard on January 11 and February 13, 1996, 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 31, 1995, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

ADVANCE-INTERFACE ELECTRONIC INC. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is dismissed.

Raynald Guay
Raynald Guay
Presiding Member

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

Desmond Hallissey
Desmond Hallissey
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-95-071

ADVANCE-INTERFACE ELECTRONIC INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The issue in this appeal is whether the appellant is a manufacturer or producer of computers under the Excise Tax Act and, thus, liable for federal sales tax based on their sale price.

***HELD**: The appeal is dismissed. The evidence shows that the appellant had computers prepared for sale by assembling various components as required. Though a separate company actually assembled the components, the two companies were so closely related and the appellant asserted such control that the Tribunal concluded that the related company was acting for the appellant. As such, the appellant fell within the meaning of "manufacturer or producer" at paragraph 2(1)(f) of the Excise Tax Act.*

Place of Hearing:	*Ottawa, Ontario*
Dates of Hearing:	*January 11 and February 13, 1996*
Date of Decision:	*May 30, 1996*
Tribunal Members:	*Raynald Guay, Presiding Member* *Robert C. Coates, Q.C., Member* *Desmond Hallissey, Member*
Counsel for the Tribunal:	*David M. Attwater*
Clerk of the Tribunal:	*Anne Jamieson*
Appearances:	*Rick H. Kesler, for the appellant* *Lubomyr Chabursky, for the respondent*

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-95-071

ADVANCE-INTERFACE ELECTRONIC INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: RAYNALD GUAY, Presiding Member
ROBERT C. COATES, Q.C., Member
DESMOND HALLISSEY, Member

REASONS FOR DECISION

This is an appeal pursuant to section 81.19 of the *Excise Tax Act*[1] (the Act) of an assessment of the Minister of National Revenue for the period from March 1, 1989, to December 31, 1990, for federal sales tax (FST) not remitted by the appellant on taxable sales to its customers. In the notice of decision, the respondent indicated that the appellant supplied computer parts to a closely related company for assembly into computers on its behalf. As the respondent was of the opinion that the appellant retained ownership and proprietary rights to the computers during their assembly, the appellant was considered the manufacturer of the computers and liable for FST based on their sale price. The appellant was assessed for the difference between the taxes that it remitted and the taxes owing on the taxable sales of the computers.

The issue in this appeal is whether the appellant is a manufacturer or producer of computers under the Act and, thus, liable for FST based on their sale price.

For purposes of this appeal, the relevant provisions of the Act read as follows:

> *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.*
>
> *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,*
>
> *...*

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

> *(f) 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.*

The appellant's witness was Mr. Keith Radford, Chief Accountant for Advance-Interface Electronic Inc. He testified that, during the period covered by the assessment, the appellant was a wholesaler of computer components located in Markham, Ontario. Some of the components were acquired from Pacific Rim countries, such as the People's Republic of China, Taiwan and Singapore, and others were acquired domestically. In addition to components such as motherboards, power supplies and various computer chips, the appellant imported keyboards, mice and monitors. Mr. Radford told the Tribunal that the components were acquired in a fully manufactured state. On importation, FST was paid on the goods.

When acquired, the components were received into the appellant's inventory system. Referring to Exhibit A-5, Mr. Radford testified that the components were sold from inventory to the appellant's customers. The appellant would produce a sales order for its records, and the customers would receive an invoice for the components (Exhibit A-4). The terms of payment varied from "net 30 days" to "C.O.D." to "cheque on delivery." He added that the customers knew that they were only buying computer components from the appellant.

The components were then given to Advance-Interface Technologies Inc. (Technologies) for assembly into the computer required by the customer. Mr. Radford added that, except for their assembly, no activities were performed on the individual components prior to their incorporation into the finished computer. Technologies issued an invoice to the customer for its assembly services and remitted FST in respect of this activity. Of total sales of components, approximately 60 percent were sold as computers assembled by Technologies and 40 percent were sold, as is, to third parties.

Mr. Radford explained that the appellant and Technologies were separate companies. Technologies employed and paid 10 or 11 employees. It had an employer number assigned by the Department of National Revenue (Revenue Canada), to which it remitted income tax for its employees (Exhibit A-7). In addition, Technologies had a separate bank account and filed income tax returns with Revenue Canada. Full financial records were kept for Technologies, including income statements and a balance sheet. It operated out of a segregated area located within the appellant's premises (Exhibit B-7). The appellant also had its own employees, including administrative and sales staff.

During cross-examination, Mr. Radford said that the appellant owns the components until the computer is assembled. When asked whether title to the components remains with the appellant until the computers are delivered and paid for by the customers, Mr. Radford answered, "Up until we produce an invoice, yes, until it is delivered." In this regard, counsel for the respondent brought to Mr. Radford's attention a condition of sale found on an invoice issued by the appellant to its customers (Exhibit A-4), which states that "[t]he above mentioned products remain our property until full payment has been received." Mr. Radford agreed with counsel that full payment is received after a computer has been delivered and an invoice has been issued. Furthermore, clients were asked to issue a single cheque payable to "Advance Interface," covering the cost of the components and the assembly services.

Mr. Radford explained that a sales representative of the appellant would complete an order form based on a customer's needs. From there, a work order was created and transferred to Technologies, together with the necessary components. Mr. Radford agreed with counsel for the respondent that Technologies had to consult with and receive approval from the appellant to change a component specified in a work order.

On questions from the Tribunal, Mr. Radford explained that, when the appellant received payment from a customer, it did not issue a separate cheque to Technologies for its assembly services. He added that the appellant "[did] not give money to Technologies," rather "through bookkeeping work [the appellant] produced the financial statements." As such, Technologies had a bank account that contained no money, and its employees were paid out of funds from the appellant's bank account.

Counsel for the appellant argued that the appellant sold computer components to its customers. With regard to the condition of sale found on the appellant's invoice (Exhibit A-4), counsel noted that a similar condition was contained on Technologies' invoices for the services that it rendered. As both companies were asserting proprietary rights to the goods, the conditions were, therefore, meaningless.

Counsel for the appellant noted that an essential element in the formation of a contract is the intention of the parties to enter into the sale of goods.[2] The intention of the parties can be discovered by looking at what they said and did, both orally and in writing. It was argued that Mr. Radford's evidence was clear that the appellant's customers understood that they were buying components from the appellant and that their assembly was done subsequently by a separate company for a separate fee. Furthermore, a sale of goods may occur, though delivery of the goods and payment may occur later.[3]

With regard to the meaning of "manufacturer or producer" found at paragraph 2(1)(*b*) of the Act, counsel for the appellant noted that it pertains only to goods being manufactured. In other words, this paragraph does not apply to a person, firm or corporation engaged in production activities. Mr. Radford's evidence was that the appellant acquired fully manufactured components and performed no additional manufacturing or production activities on those components. Furthermore, his evidence was to the effect that making computers is akin to snapping parts together. Counsel argued that this activity is similar to placing a watch movement into a watch case, which was found to constitute production and not manufacture.[4]

Counsel for the appellant noted that the Tribunal has consistently relied on the definition of "manufacture" adopted by the Supreme Court of Canada in *Her Majesty the Queen v. York Marble, Tile and Terrazzo Limited*:

> *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*.[5]

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2. Counsel for the appellant referred to G.H.L. Fridman's Sale of Goods in Canada, 4th ed. (Scarborough: Thomson Canada, 1995).
3. *Ibid*.
4. *Gruen Watch Company of Canada Ltd. v. Attorney General of Canada*, [1950] O.R. 429 (H.C.).
5. [1968] S.C.R. 140 at 145.

Counsel for the appellant argued that manufacture involves raw materials and that the computer components used by Technologies were fully manufactured goods. Therefore, Technologies is a producer, and not a manufacturer, of computers.

With regard to paragraph 2(1)(*f*) of the Act, counsel for the appellant argued that it applies to persons who prepare goods for sale, which is a class distinct from either manufacturers or producers.[6] As Technologies was a producer of computers, this provision does not apply to its activities. Furthermore, as the sale of computer components occurred prior to their assembly by Technologies, the assembly was not done to prepare goods for sale.

In addition, the appellant did not prepare the goods for sale by itself, nor was Technologies acting for the appellant. The appellant was in the business of importing and selling computer components, and Technologies was acting for the customers that purchased the components. Counsel for the appellant submitted that there was no agency agreement between the two companies, that the appellant did not supervise or conduct the production process, that it did not set the specifications to which the computers would be produced (as that was done by the customers),[7] that the invoice for the production of the goods was issued by Technologies and that the appellant held no patents, licences or other rights over the computers.

In other arguments, relying on *His Majesty the King v. B.C. Brick and Tile Company*,[8] counsel for the appellant submitted that the appellant and Technologies did not constitute a single business entity for tax purposes.[9] Furthermore, it was completely legitimate for the appellant to organize its affairs for the sole purpose of reducing its tax liability, so long as it did not violate a tax avoidance provision of the Act or the transaction was not a sham.[10]

Counsel for the respondent argued that, in this case, the application of paragraphs 2(1)(*b*) and (*f*) of the Act requires the existence of a principal-agent relationship between the appellant and Technologies. Counsel noted that Technologies worked out of the appellant's premises and used the same telephone and facsimile numbers, that its invoice documents and conditions of sale were similar and that it shared the same president, vice-president and accountant. Counsel further noted that the appellant assembled the computers prior to Technologies' creation and business continued "as usual" subsequently (Exhibit B-8); that Technologies needed the appellant's approval to change a component specified in a work order; that customers were asked to issue a single cheque to "Advance Interface" for the cost of both the components and the assembly services; that there were no real transfers of money between the companies; that Technologies had no money in its bank account and its employees were paid by the appellant; and that Technologies was performing work only for the appellant.

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6. In support of this proposition, counsel for the appellant referred to *MCA (Canada) Ltd. v. The Minister of National Revenue*, Canadian International Trade Tribunal, Appeal No. AP-90-123, August 11, 1992.
7. See *Ford Motor Company of Canada Limited v. The Minister of National Revenue* (1994), 85 F.T.R. 116 (F.C.T.D.).
8. [1935] C.T.C. 110 (Ex. Ct.).
9. See, also, *His Majesty the King v. Leon L. Plotkins*, [1938-39] C.T.C. 138 (Ex. Ct.).
10. *Stubart Investments Limited v. Her Majesty the Queen*, [1984] 1 S.C.R. 536.

According to the documents tendered in Exhibit A-4, an "order form" was completed on the date on which a customer made an order. According to a condition of sale found on the appellant's invoices to its customers, the goods sold remain the appellant's property until full payment has been received. Counsel for the respondent concluded that the date of sale was not the date on which an order was made, but rather the date on which full payment for the goods had been received by the appellant. Furthermore, there is no evidence that the customers understood that they were purchasing computer components and not an assembled computer. Counsel submitted, therefore, that, with respect to paragraph 2(1)(*b*) of the Act, the appellant held a proprietary or sales right to the goods during their assembly, as it held title to the goods at that time. With regard to paragraph 2(1)(*f*) of the Act, counsel argued that the computers were assembled prior to their sale.

According to *York Marble*, "manufacture" is the act of making goods from either raw or prepared materials. Counsel for the respondent submitted that each of the computer components is a prepared material which, when put together, makes a functional computer. Furthermore, the computers exhibit forms, qualities and properties not exhibited by the components. In distinguishing the facts of this case from those in *Gruen Watch*, where the Ontario Supreme Court found that a certain activity constituted production and not manufacture, counsel noted that the watch movements in that case were completely functional before being placed into watch cases. In contrast, the computer components were not operational before their assembly into the functional computer. Counsel argued, therefore, that the act of assembling computers constituted manufacture.

Counsel for the respondent argued that the application of paragraph 2(1)(*f*) of the Act does not require there to be manufacture as defined in *York Marble* or production as defined in *Gruen Watch*. In this case, it is sufficient for the appellant to be engaged in assembly. Revenue Canada has defined "assemble" to mean:

> *[t]he act of assembling; [t]he act of fitting together the parts of a machine or the like; [t]o collect (things) into one place; [t]o fit or join together[;] [t]o join in any way*.[11]

Furthermore, in considering the meaning of "assembles[12]" as used in paragraph 2(1)(*f*) of the Act, the Federal Court of Canada, in *Fiat Auto Canada Limited v. The Queen*, cited the following definitions of "assemble" and "assembly":

> *[assemble] to bring together ... to fit together various parts of so as to make it into an operative whole*
>
> *[assembly] the act or process of building up a complete unit (as a motor vehicle) using parts already in themselves finished manufactured products ... a collection of parts so assembled as to form a complete machine, structure or unit of machine*.[13]

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11. Memorandum to all Regional Directors, 9270-15, ET/PS 231, regarding marginal manufacturing (paragraph 2(1)(*f*) of the Act), dated March 9, 1981.
12. In 1985, paragraph 2(1)(*f*) of the Act was amended, at which time the word "assembles" was replaced by the word "assembling," S.C. 1985, c. 3, s. 1.
13. [1984] 1 F.C. 203 at 209.

Counsel for the respondent explained that Technologies took various computer components and fitted them together to form a functional computer. This way, the customers were buying whole computers and not merely a collection of parts. Counsel argued that this work constituted "assembling" as used in paragraph 2(1)(*f*) of the Act.

In determining what the appellant sold, be it computer components as claimed by counsel for the appellant or computers as claimed by counsel for the respondent, the Tribunal must determine when the sale occurred. To make this determination, the Tribunal must establish when the property in the goods was transferred from the appellant to its customers.[14] The Tribunal believes that the property in the goods was transferred to the customers at such time as the parties to the contract intended it to be transferred.[15] Based on the evidence, the Tribunal is of the opinion that the parties intended property in the goods to be transferred upon payment of the purchase price, which occurred after issuance of an invoice and delivery of a computer. As such, the appellant sold computers that were prepared for sale by Technologies.

The Tribunal was persuaded by the condition of sale found on the invoices issued by the appellant to the customers, specifically, that "[t]he above mentioned products remain our property until full payment has been received," in concluding that the appellant sold computers. Mr. Radford's testimony also supported the conclusion that the appellant intended the property in the computers to be transferred after delivery of the computers. As argued by counsel for the respondent, there is no direct evidence that the appellant's customers held a contrary intention. The Tribunal believes that this condition of sale is not rendered meaningless because a similar condition was contained on Technologies' invoices. Samples of these invoices available to the Tribunal do not list any products; rather, they merely indicate "[a]ssembly services." Furthermore, the evidence indicates that Technologies never had any property rights in the goods that it could assert. As such, the Tribunal can only conclude that this condition is meaningless on Technologies' invoices or that reference to "our property" is a collective reference that includes the appellant.

The Tribunal also believes that Technologies was acting for the appellant in preparing the computers for sale. The evidence summarized by counsel for the respondent illustrates a relationship within which Technologies lacked sufficient independence from the appellant to say that it was acting on its own. The Tribunal was particularly persuaded that Technologies was acting for the appellant because Technologies required the appellant's consent to change a component specified in a work order issued to it by the appellant.

Furthermore, the Tribunal believes that, through Technologies, the appellant had computers prepared for sale by "assembling" various components. The evidence was that Technologies fit together various computer components, or snapped together fully manufactured components as argued by counsel for the appellant, making an operable computer. Considering the definitions tendered by counsel for the respondent, the Tribunal believes that these activities constitute "assembling" in the grammatical and ordinary sense of the word as used in paragraph 2(1)(*f*) of the Act.

Finally, counsel for the appellant did not suggest, nor does the evidence indicate, that the appellant prepared the computers in a retail store for sale in that store exclusively and directly to customers. As such, the appellant has met all the conditions of paragraph 2(1)(*f*) of the Act and is not excluded therefrom. The

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14. *Sale of Goods Act*, R.S.O. 1980, c. 462, ss. 2(3).
15. *Ibid*., ss. 18(1).

Tribunal concludes, therefore, that the appellant was a manufacturer or producer within the meaning of paragraph 2(1)(*f*) of the Act and was liable for FST based on the sale price of the computers that it manufactured or produced and sold to its customers.

As the Tribunal has found the appellant to fall within the meaning of manufacturer or producer at paragraph 2(1)(*f*) of the Act, it considers it unnecessary to consider whether the appellant would also qualify as a manufacturer or producer under paragraph 2(1)(*b*) of the Act.

Accordingly, the appeal is dismissed.

Raynald Guay
Raynald Guay
Presiding Member

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

Desmond Hallissey
Desmond Hallissey
Member