Ottawa, Tuesday, October 28, 1997

Appeal Nos. AP-95-228 and AP-95-229

IN THE MATTER OF appeals heard on June 19, 1997, 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, 1995, with respect to notices of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

LORNA'S FLOWERS LTD. AND MARQUIS FLOWER SHOP LTD. — **Appellants**

AND

THE MINISTER OF NATIONAL REVENUE — **Respondent**

DECISION OF THE TRIBUNAL

The appeals are allowed.

Dr. Patricia M. Close
Dr. Patricia M. Close
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Charles A. Gracey
Charles A. Gracey
Member

Michel P. Granger
Michel P. Granger
Secretary

UNOFFICIAL SUMMARY

Appeal Nos. AP-95-228 and AP-95-229

LORNA'S FLOWERS LTD. AND MARQUIS FLOWER SHOP LTD. **Appellants**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

These are appeals under section 81.19 of the *Excise Tax Act* from decisions of the Minister of National Revenue in which it was found that the appellants were not entitled to federal sales tax (FST) inventory rebates in respect of certain inventory held on January 1, 1991. The inventory was comprised of silk and plastic flowers, arrangements and accessories, dried materials, novelty and gift items, vases, baskets and containers, and plant and floral supplies. The appellants' FST inventory rebate claims were rejected in respect of the inventory used by the appellants to make various floral arrangements, on the basis that those goods were not held for sale "separately" in the ordinary course of the appellants' businesses. The issue in these appeals is whether the goods in issue constitute goods held for sale separately, for a price in money, to others in the ordinary course of the appellants' activities and are, therefore, "tax-paid goods" in "inventory" under section 120 of the *Excise Tax Act*.

HELD: The appeals are allowed. The Tribunal finds that only the goods that were held for sale in the same condition as acquired and not for further manufacture or production were held for sale separately in the ordinary course of the appellants' commercial activities and, therefore, qualify for an FST inventory rebate. Having considered the evidence concerning the nature and use of the goods in issue, the Tribunal is not persuaded that the assembly or intended assembly of certain of the goods in issue into floral arrangements enabled the goods in issue to perform a function that could not previously be performed by those goods or gave those goods new forms, qualities and properties or combinations. Moreover, the goods in issue were sold at a separate and pre-determined retail price, whether or not the goods were sold as a floral arrangement, and there was no additional cost for a floral arrangement.

In addition, the Tribunal notes that the exemption found in paragraph (*f*) of the definition of "manufacturer or producer" in section 2 of the *Excise Tax Act* covers the appellants. Paragraph (*f*) includes "any person who … prepares goods for sale by assembling … other than a person who so prepares goods in a retail store … exclusively and directly to consumers." The Tribunal is persuaded by the evidence that the appellants do prepare goods in a retail store for sale exclusively and directly to customers and, as such, that the appellants are not considered manufacturers or producers for the purposes of the *Excise Tax Act*. It follows, therefore, in the Tribunal's view, that the activities undertaken by the appellants should not be considered manufacture or production for the purposes of the FST inventory rebate provisions of the *Excise Tax Act*.

Places of Video Conference Hearing:	Hull, Quebec, and Calgary, Alberta
Date of Hearing:	June 19, 1997
Date of Decision:	October 28, 1997

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Tribunal Members:	Dr. Patricia M. Close, Presiding Member Arthur B. Trudeau, Member Charles A. Gracey, Member
Counsel for the Tribunal:	Shelley Rowe
Clerks of the Tribunal:	Margaret Fisher and Anne Jamieson
Appearances:	J.P. (Phil) Edmundson, for the appellants Janet Ozembloski, for the respondent

Appeal Nos. AP-95-228 and AP-95-229

LORNA'S FLOWERS LTD. AND MARQUIS FLOWER SHOP LTD. Appellants

and

THE MINISTER OF NATIONAL REVENUE Respondent

TRIBUNAL: DR. PATRICIA M. CLOSE, Presiding Member
ARTHUR B. TRUDEAU, Member
CHARLES A. GRACEY, Member

REASONS FOR DECISION

These appeals were heard by way of video conference in Hull, Quebec, and Calgary, Alberta, under section 81.19 of the *Excise Tax Act*[1] (the Act) from decisions of the Minister of National Revenue dated August 18, 1995, in which it was found that the appellants were not entitled to federal sales tax (FST) inventory rebates in respect of certain inventory held on January 1, 1991. The inventory was comprised of silk and plastic flowers, arrangements and accessories, dried materials, such as dried flowers, novelty and gift items, such as ornamental containers and vases, plant and floral supplies, such as foam, ribbons and wire. The appellants' FST inventory rebate claims were rejected in respect of the inventory used by the appellants to make various floral arrangements, on the basis that those goods were not held for sale "separately" in the ordinary course of the appellants' businesses. The issue in these appeals is whether the goods in issue constitute goods held for sale separately, for a price in money, to others in the ordinary course of the appellants' activities and are, therefore, "tax-paid goods" in "inventory" under section 120[2] of the Act.

Mr. J.P. (Phil) Edmundson, the appellants' general manager, testified that FST was paid on all of the goods in issue, that the goods in issue were acquired before 1991 and that all of the goods in issue were new goods. In describing the appellants' businesses, he stated that the appellants operated out of three retail locations and that half of the floor space in those locations was committed to the display of the retail merchandise and the other half to storage, an office and a design area. He indicated that every product has a separate retail price tag attached to it and that, when individual goods are used to make a floral arrangement, the price for the floral arrangement is the sum of the retail prices for each individual product. The retail price would include a markup to take into account the artistic design involved in making a floral arrangement. According to Mr. Edmundson, the majority of the appellants' businesses involve some artistic design. Generally, floral arrangements are made at the request of a customer to that customer's specifications. However, some floral arrangements are pre-made. The pricing for both the custom-made and pre-made arrangements would be the same, that is, the price would be the sum of the retail prices for each individual product. He estimated that 80 percent of the appellants' sales volume comes from fresh flower and plant sales which, he pointed out, do not attract FST, but do attract the Goods and Services Tax.

The dispute between the appellants and the respondent is whether the inventory constituted "tax-paid goods" held "at that time for sale, lease or rental separately ... to others in the ordinary course of a commercial activity of the person" as required under section 120 of the Act in order for goods to qualify for

1. R.S.C. 1985, c. E-15.
2. Added, S.C. 1990, c. 45, s. 12, as amended by S.C. 1993, c. 27, s. 6.

an FST inventory rebate. The following are the relevant provisions of section 120 of the Act for the purposes of these appeals:

> 120.(1) In this section,
>
> "inventory" of a person as of any time means items of tax-paid goods that are described in the person's inventory in Canada at that time and that are
>
> (*a*) held at that time for sale, lease or rental separately, for a price or rent in money, to others in the ordinary course of a commercial activity of the person.
>
> "tax-paid goods" means goods, acquired before 1991 by a person, that have not been previously written off in the accounting records of the person's business for the purposes of the *Income Tax Act* and that are, as of the beginning of January 1, 1991,
>
> (*a*) new goods that are unused,
>
> (*b*) remanufactured or rebuilt goods that are unused in their condition as remanufactured or rebuilt goods, or
>
> (*c*) used goods
>
> and on the sale price or on the volume sold of which tax (other than tax payable in accordance with subparagraph 50(1)(*a*)(ii) was imposed under subsection 50(1), was paid and is not, but for this section, recoverable.
>
> (2.1) For the purposes of paragraph (*a*) of the definition of "inventory" in subsection (1), that portion of the tax-paid goods that are described in a person's inventory in Canada at any time that can reasonably be expected to be consumed or used by the person shall be deemed not to be held at that time for sale, lease or rental.

The appellants' representative argued that the goods in issue qualify for an FST inventory rebate, as they meet the criteria for "tax-paid goods," and constitute "inventory," as they were held for sale separately to consumers and were individually priced. Moreover, he submitted that there really seems to be no clear formula that was applied to the floral industry at the time that the appellants filed their applications and at the time that the applications were being reviewed by the Department of National Revenue.

Counsel for the respondent submitted that the goods in issue were not held for sale "separately," as they were held by the appellants to be combined and further manufactured or produced into new goods with different forms, qualities and properties or combinations,[3] namely, floral arrangements and novelty or gift items, which were then sold to the appellants' customers. Counsel referred to cases where the courts have held that, where different components are combined to create an article entirely different in appearance, form and function from the original components, the result is a new product.[4] Counsel referred to several decisions of the Tribunal[5] in which, she submitted, it was held that, where something further is to be done to

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3. *Her Majesty the Queen* v. *York Marble, Tile and Terrazzo Limited*, [1968] S.C.R. 140.

4. *The Queen* v. *Stuart House Canada Limited*, [1976] 2 F.C. 421; *Her Majesty the Queen* v. *E.J. Piggott Enterprises Limited,* [1973] C.T.C. 65 at 70, Federal Court - Trial Division, File No. T-971-71, November 27, 1972; and *W.T. Hawkins Limited* v. *The Deputy Minister of National Revenue for Customs and Excise*, [1958] Ex. C.R. 152 at 157, aff'd S.C.C., May 7, 1959.

5. *Impressions Gallery Inc.* v. *The Minister of National Revenue*, Appeal No. AP-93-111, March 14, 1995; *Gerald the Swiss Goldsmith* v. *The Minister of National Revenue*, Appeal No. AP-95-179, February 21, 1997; *Harry M. Gruenberg, Synoda Co. Reg'd* v. *The Minister of National Revenue*, Appeal No. AP-92-252, April 5, 1994; *Codispoti's Creative Jewelry Co. Ltd.* v. *The Minister of National Revenue*, Appeal No. AP-92-199, April 17, 1996; and *Sharp Design Products Inc.* v. *The Minister of National Revenue*, Appeal No. AP-95-178, May 10, 1996.

goods, whether those goods are physically changed and whether the goods are put together to come up with a new form, quality or combination, there is manufacture.

Counsel for the respondent argued that, while FST had been paid on some of the materials and supplies used to produce the finished goods and the goods in process, FST had not been paid or remitted on the sale price of the arrangements or items produced as new and distinct goods. The goods in issue were not, therefore, "tax-paid goods" within the meaning of subsection 120(1) of the Act. Furthermore, counsel submitted that the goods in issue were held by the appellants for their consumption or use in the manufacture or production of such finished goods and are, therefore, expressly excluded from the definition of "inventory" pursuant to subsection 120(2.1) of the Act.

Finally, counsel for the respondent referred to paragraph 2(1)(*e*) of the *Small Manufacturers or Producers Exemption Regulations*,[6] which exempts, from the payment of FST on goods manufactured or produced by them, "persons who manufacture arrangements of artificial or natural flowers or foliage in a retail establishment for the purpose of sale in such retail establishment directly and exclusively to users."

Section 120 of the Act provides, in part, that, in order for goods held in inventory to qualify for an FST inventory rebate, FST must have been paid on the sale price or on the volume sold of the goods and that the goods must be described in the person's inventory in Canada and held for sale, lease or rental separately, for a price or rent in money, to others in the ordinary course of a commercial activity of the person. Subsection 120(2.1) of the Act further provides that tax-paid goods that can reasonably be expected to be consumed or used by the person shall be deemed not to be held at that time for sale, lease or rental.

In the Tribunal's view, only the goods that were held for sale in the same condition as acquired and not for further manufacture or production were held for sale separately in the ordinary course of the appellants' commercial activities and, therefore, qualify for an FST inventory rebate under section 120 of the Act.

The Tribunal adopts the interpretation of "production" in *The Minister of National Revenue* v. *Enseignes Imperial Signs Ltée*.[7] In that decision, the Federal Court of Appeal, referring to the decision in *Gruen Watch Company of Canada Ltd.* v. *Attorney General of Canada*,[8] found that "[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.[9]" The Tribunal also adopts the generally accepted definition of "manufacture" taken from the *Minister of National Revenue* v. *Dominion Shuttle Company Limited*[10] and adopted by the Supreme Court of Canada in *Her Majesty the Queen* v. *York Marble, Tile and Terrazzo Limited*.[11] "Manufacture" was defined in that decision as 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.[12]"

Having considered the evidence of the appellants' witness concerning the nature and use of the goods in issue, the Tribunal is not persuaded that the assembly or intended assembly of certain of the goods in issue into floral arrangements enabled the goods in issue to perform a function that could not previously be

6. SOR/82-498, May 13, 1982, *Canada Gazette* Part II, Vol. 116, No. 10 at 1869.
7. (1990), 116 N.R. 235, Federal Court of Appeal, File No. A-264-89, February 28, 1990.
8. [1950] O.R. 429, [1950] C.T.C. 440.
9. *Supra* note 7 at 4.
10. (1993), 72 Que. S.C. 15.
11. [1968] S.C.R. 140.
12. *Ibid.* at 145.

performed by those goods or gave those goods new forms, qualities and properties or combinations. Moreover, the goods in issue were sold at a separate and pre-determined retail price, whether or not the goods were sold as a floral arrangement. Floral arrangements, whether finished or in process when the inventory was taken or made up later for customers, were priced on the basis of the individual tax-paid goods. There was no additional cost for a floral arrangement. Furthermore, the appellants' records did not differentiate which of the goods were sold individually or as a floral arrangement.

In addition, the Tribunal notes that the exemption found in paragraph (*f*) of the definition of "manufacturer or producer" in section 2 of the Act covers the appellants. Paragraph (*f*) includes "any person who … prepares goods for sale by assembling … other than a person who so prepares goods in a retail store … exclusively and directly to consumers." The appellants' witness testified that any assembling of the goods in issue was undertaken at their retail sites. The appellants' staff served customers and, at the request of customers, assembled the goods in issue into floral arrangements. The Tribunal is persuaded by the evidence that the appellants do prepare goods in a retail store for sale exclusively and directly to customers and, as such, that the appellants are not considered manufacturers or producers for the purposes of the Act. It follows, therefore, in the Tribunal's view, that the activities undertaken by the appellants should not be considered manufacture or production for the purposes of the FST inventory rebate provisions of the Act.

Counsel for the respondent identified several appeals decided by the Tribunal, where it was found that material inputs for such finished goods as cartridges, frames, jewellery and computers were not held for sale separately, but, rather, were held for further manufacture and did not, therefore, qualify for an FST inventory rebate. In the Tribunal's view, the material inputs in those appeals and the activities undertaken in respect of those material inputs are substantially different from the goods in issue in these appeals and from the activities undertaken in respect of those goods.

For the reasons given above, the Tribunal is of the view that the evidence shows that the goods in issue were held for sale separately, for a price, in the ordinary course of the commercial activities of the appellants and, accordingly, the appeals are allowed.

Dr. Patricia M. Close
Dr. Patricia M. Close
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Charles A. Gracey
Charles A. Gracey
Member