

Ottawa, Tuesday, June 3, 1997

Appeal No. AP-96-002

IN THE MATTER OF an appeal heard on September 10, 1996,
under section 67 of the *Customs Act*, R.S.C. 1985, c. 1
(2nd Supp.);

AND IN THE MATTER OF a decision of the Deputy Minister of
National Revenue dated February 7, 1996, with respect to a
request for re-determination under section 63 of the *Customs Act*.

BETWEEN

CAPITAL GARMENT CO. INC.

Appellant

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE

Respondent

DECISION OF THE TRIBUNAL

The appeal is allowed.

Arthur B. Trudeau

Arthur B. Trudeau
Presiding Member

Michel P. Granger

Michel P. Granger
Secretary

UNOFFICIAL SUMMARY

Appeal No. AP-96-002

CAPITAL GARMENT CO. INC.

Appellant

and

THE DEPUTY MINISTER OF NATIONAL REVENUE

Respondent

This is an appeal under section 67 of the *Customs Act* from a decision of the Deputy Minister of National Revenue dated February 7, 1996, made under section 63 of the *Customs Act*. The appellant is an importer of apparel and owner of a design facility in Canada, Capital Design Group, which produces original designs of apparel. The appellant has apparel manufactured abroad from designs produced by Capital Design Group, which apparel it subsequently imports.

As part of the process ultimately leading to the manufacture of the apparel, the appellant provides, free of charge, the foreign manufacturer with graded paper patterns (GPPs) produced in Canada for each garment size. The issue in this appeal is whether the GPPs constitute assists under subparagraph 48(5)(a)(iii) of the *Customs Act* as ruled by the respondent and, if so, whether their value must be added to the transaction value of the imported goods in order to determine the value for duty of the apparel.

HELD: The appeal is allowed. The Tribunal is of the view that the GPPs constitute “design work” necessary for the production of the imported goods and, accordingly, that they fall within clause 48(5)(a)(iii)(D) of the *Customs Act*. However, since the work associated with the GPPs is undertaken in Canada, they are not dutiable under paragraph 48(5)(a).

The basis for the Tribunal’s decision in this regard is that, in its view, grading is but one step in the design process, albeit one that takes place towards the end of that process. The definition of the term “design,” as contained in *Webster’s Unabridged Dictionary of the English Language*, refers to “an outline, sketch, or plan, as of the form and structure of a work of art, an edifice, or a machine to be executed or constructed.” A “plan” is, moreover, defined as “a formulated and esp. detailed method by which a thing is to be done; a design or scheme.” In the Tribunal’s view, these definitions would encompass the grading element in the manufacture of garments. The Tribunal notes the testimony of the witnesses to the effect that, before computerization, grading was often undertaken in-house by a company’s design group. In the Tribunal’s view, the simple fact that grading is now done off-site and that, in this case, it is computerized does not take it outside the scope of that which is considered to be design work. A witness, moreover, acknowledged that the graders would never unilaterally alter a grading rule without the appellant’s approval.

Place of Hearing: Ottawa, Ontario
Date of Hearing: September 10, 1996
Date of Decision: June 3, 1997

Tribunal Member: Arthur B. Trudeau, Presiding Member

Counsel for the Tribunal: Heather A. Grant

Clerk of the Tribunal: Margaret Fisher

Appearances: Peter E. Kirby, for the appellant
Deborah Johnston and Stéphane Lilkoff, for the respondent

Appeal No. AP-96-002

CAPITAL GARMENT CO. INC.

Appellant

and

THE DEPUTY MINISTER OF NATIONAL REVENUE

Respondent

TRIBUNAL: ARTHUR B. TRUDEAU, Presiding Member

REASONS FOR DECISION

This is an appeal under section 67 of the *Customs Act*¹ (the Act) from a decision of the Deputy Minister of National Revenue dated February 7, 1996, made under section 63 of the Act. The appeal was heard by one member of the Tribunal.²

The appellant is an importer of apparel and owner of a design facility in Canada, Capital Design Group (Capital Design), which produces original designs of apparel. The appellant has apparel manufactured abroad from designs produced by Capital Design, which apparel it subsequently imports.

As part of the process ultimately leading to the manufacture of the apparel, the appellant provides, free of charge, the foreign manufacturer with graded paper patterns (GPPs) produced in Canada for each garment size. The issue in this appeal is whether the GPPs constitute assists under subparagraph 48(5)(a)(iii) of the Act as ruled by the respondent and, if so, whether their value must be added to the transaction value of the imported goods in order to determine the value for duty of the apparel.

The relevant provisions of section 48 of the Act read as follows:

(5) The price paid or payable in the sale of goods for export to Canada shall be adjusted
(a) by adding thereto amounts, to the extent that each such amount is not already included in the price paid or payable for the goods, equal to

(iii) the value of any of the following goods and services, determined in the manner prescribed, that are supplied, directly or indirectly, by the purchaser of the goods free of charge or at a reduced cost for use in connection with the production and sale for export of the imported goods, apportioned to the imported goods in a reasonable manner and in accordance with generally accepted accounting principles:

(B) tools, dies, moulds and other goods utilized in the production of the imported goods,

(D) engineering, development work, art work, design work, plans and sketches undertaken elsewhere than in Canada and necessary for the production of the imported goods.

1. R.S.C. 1985, c. 1 (2nd Supp.).

2. Section 3.2 of the *Canadian International Trade Tribunal Regulations*, added by SOR/95-27, December 22, 1994, *Canada Gazette* Part II, Vol. 129, No. 1 at 96, provides, in part, that the Chairman of the Tribunal may, taking into account the complexity and precedential nature of the matter at issue, determine that one member constitutes a quorum of the Tribunal for the purposes of hearing, determining and dealing with any appeal made to the Tribunal pursuant to the Act.

The first witness to be called to testify at the hearing on behalf of the appellant was Mr. Luc Dupont from the Department of National Revenue. Mr. Dupont testified in regard to the nature of the Technical Committee on Customs Valuation, as well as case studies and opinions issued by that body.

The second witness to appear on behalf of the appellant was Mr. Armand Cymbalista, President of Capital Garment Co. Inc. Mr. Cymbalista began his testimony by describing his background and that of the appellant in the garment-making industry. He went on to describe the various steps in the manufacture of a garment, with particular focus on these steps in the context of the appellant's business. His testimony in this regard can be summarized as follows. To begin, an idea for a design is conceived. The idea is then conveyed to Capital Design which creates a pattern on soft paper, and then on hard paper, from which an original sample of the garment is made. Once the sample garment is approved, the pattern is sent to Grad-Tech Industries Ltd. (Grad-Tech), the subcontractor for the grading of the patterns. From the pattern, Grad-Tech makes a "sloper." A sloper is a length of soft paper on which all the pattern pieces for a particular garment in a specific size are drawn, one size after the other. The various slopers for the different sizes of a design constitute the GPPs at issue.

Once in receipt of the sloper, the manufacturer cuts out the pieces and traces them onto hard paper. The manufacturer then produces a counter sample of the garment in any size to send to the appellant for approval. Once approved, the manufacturer creates a "marker." A marker is a length of soft paper on which each pattern piece, comprising various sizes of a particular garment, are laid down and drawn in the most efficient manner in order that the least amount of fabric is used in making the garment.

In Mr. Cymbalista's view, slopers represent the appellant's specifications to the manufacturer as to what it wants the manufacturer to produce. Grad-Tech also prepares a mini-marker for each garment, which is then sent to the foreign manufacturer in order to establish a base line in terms of fabric consumption. Generally, the manufacturer prepares its own markers, including pattern pieces, from an even greater number of sizes than those included on Grad-Tech's marker, in order to use even less fabric in the production of the garments.

Mr. Cymbalista testified that soft paper patterns are not used to cut fabric. Such paper moves and can cause mistakes to be made in tracing the pattern onto the fabric. Mr. Cymbalista indicated that a distinction is made between "design" and "production" and that the GPPs constitute part of the design portion of the garment-manufacturing business. For the "design" stage of the business, one garment is made, while in the "production" stage, a thousand garments are made. He suggested that it is only once the pattern is put onto the hard paper and the marker is made for the production process does the production process begin.

In cross-examination, Mr. Cymbalista indicated that grading does not require the use of computers, but that it can be done by hand. While the appellant's foreign manufacturers are capable of doing the grading, Mr. Cymbalista prefers to have it done in Canada so that he can have control over the results. The appellant chooses to have Grad-Tech do the grading off-site because Capital Design does not use computers when it grades, thereby making the process more time-consuming.

Mr. Cymbalista further indicated that, although the foreign manufacturer could make the garment from instructions or a sketch, grading is required in order to have control over the fit. Grad-Tech grades according to the specifications given to it by the appellant. Mr. Cymbalista acknowledged that, essentially, the difference between GPPs and hard paper patterns is the type of paper used for each.

The only witness to appear on behalf of the respondent, under subpoena, was Mr. David Abramovitch, one of the owners of Grad-Tech. Mr. Abramovitch set out the steps performed by Grad-Tech in grading a

sample garment in conjunction with a hard paper pattern of the sample. He indicated that each pattern piece has certain grade rules applied to it according to the customer's specifications. Once the pieces have been graded, the specifications are put into a computer for digitizing in order to produce the complete size range for the particular garment. This step involves entering certain points from each pattern piece into the computer, resulting in a hard copy of each size in the computer. He indicated that human involvement is key in this process. While each client usually has standard grade rules or specifications for its designs, the client may change these rules depending upon the particular fabric to be used. He emphasized that the graders at Grad-Tech cannot unilaterally alter any grade rules, even if they believe that an adjustment to the rule ought to be made. In all cases, they would have to obtain approval for such an adjustment from the client, as grading is part of the design of the specific garment and the rules are specific to the client.

Mr. Abramovitch testified that grading is a necessity in the garment-manufacturing industry. Grad-Tech uses special software and computer equipment to do its grading. Grade rules are kept for each client until such time as the client no longer retains Grad-Tech's services. Grad-Tech's employees, moreover, have a background in the garment industry and in design. Mr. Abramovitch indicated that, while Grad-Tech does grading, marker-making, cutting and fusing, it does not make patterns or create styles.

In cross-examination, Mr. Abramovitch testified that the services that Grad-Tech provides to the appellant would be considered a traditional garment industry design activity, now computerized. He further acknowledged that grading would be considered within the scope of computer-assisted design, as suggested by an article on the topic contained in *Canadian Apparel Manufacturer Magazine*.³

In argument, counsel for the appellant submitted that, in considering the issue in this appeal, the Tribunal should take into account, as a policy matter, that, by specifically providing that the value of design activity performed in Canada is not to be added to the value for duty of imported goods, the legislators intended to encourage design work to be carried out in Canada.

Turning to the specific provisions of the Act at issue, counsel for the appellant submitted that the GPPs do not constitute assists since they are not "for use in connection with the production and sale for export of the imported goods," emphasizing the words "for use in ... production." Specifically, counsel argued that the GPPs are merely the purchaser's specifications to the manufacturer as to what the purchaser wants to purchase. In support of the appellant's position, counsel referred to a U.S. Customs Service ruling, which held that certain patterns, sketches and prototype garments were not assists because they instructed the manufacturer on what to produce as opposed to how to produce it.⁴

If, however, the Tribunal were to consider a connection to exist between the GPPs and production of the imported goods, then counsel for the appellant submitted that the GPPs clearly fall within clause 48(5)(a)(iii)(D) of the Act, namely, as "engineering, development work, art work, design work, plans and sketches," which are not subject to duty where they are undertaken in Canada. Counsel submitted that the GPPs do not fall within clause 48(5)(a)(iii)(B) along with "tools, dies, moulds," as the GPPs are not used in the actual production of the garments. Counsel argued that design and production are two distinct elements and that production only begins once the manufacturer obtains the marker and begins to cut the fabric.

3. (Ste-Anne-de-Bellevue, Quebec: CTJ-Inc., 1994—), July/August 1996, Vol. 20, No. 4 at 20.

4. Department of the Treasury, U.S. Customs Service, CLA-2 CO:R:CV:VS, 543064 MK.

Counsel for the appellant then turned to various definitions of the terms “tool,” “die” and “mould,” arguing that the GPPs do not meet any of these definitions.⁵ By contrast, counsel submitted that the GPPs meet the definition of “design.”⁶ Specifically, to design means to make a preliminary sketch of or to draw the plan of a future building, etc. With respect to the respondent’s position, that the GPPs fall into clause 48(5)(a)(iii)(B) of the Act, counsel argued that the GPPs are not “used in production” and that their value enters into the imported goods only to the extent that they are used up or worn out in the process of producing the goods.⁷ Counsel also referred to Memorandum D13-4-8 in further support of the appellant’s position.⁸

In regard to the respondent’s reliance on Case Study 8.1,⁹ counsel for the appellant submitted that it is not applicable to the present situation on its facts, as it assumes that the patterns in that study were used in the production of goods. Furthermore, in counsel’s view, such studies should be given little weight, if any, given their origin. In any event, there is no ambiguity in the legislation to warrant referring to international agreements and other extrinsic aids.

Counsel for the respondent submitted that the GPPs are items with a function akin to a mould or die, used in the production of imported goods and, accordingly, that they should be factored into the transaction value of the imported goods. In support of the respondent’s position, counsel elaborated on four specific points: (1) the GPPs are supplied by the appellant to the foreign manufacturer free of charge to assist in the production process; (2) the GPPs do not fall within the ambit of clause 48(5)(a)(iii)(D) of the Act because they do not constitute one of the enumerated items listed in that clause; (3) GPPs are goods that serve a function similar to a mould, die or tool because they are used physically like a mould, such that they ultimately shape or size the imported garments; and (4) GPPs cannot be viewed separately from hard paper patterns—they are both used for the purposes of producing the imported garments.

In further elaboration of the second point, counsel for the respondent argued that, in order for items to fall within clause 48(5)(a)(iii)(D) of the Act, they must be one of the items specifically enumerated. In dismissing the idea that the GPPs constitute any one of the enumerated items, counsel first submitted that the GPPs cannot be considered to be “design work,” as they simply reflect the sizing of the goods, while assists referred to in clause 48(5)(a)(iii)(D) are intangibles, or the fruits of intellectual or creative input, which the GPPs clearly are not.

Counsel for the respondent then argued that the GPPs cannot constitute “sketches” or “plans,” also referred to in clause 48(5)(a)(iii)(D) of the Act. They submitted that “sketches” are what are used to make the initial pattern, which is subsequently sized through the grading process. Furthermore, the GPPs do not

5. Tool: “mechanical implement, usu. held in hand, for working upon something”; die: “engraved stamp for coining, striking medal, embossing paper, etc.; hollow mould for shaping extruded metal, cutting screw-thread, etc.”; and mould: “pattern or template used by mason, bricklayer, etc.,” *The Concise Oxford Dictionary of Current English*, 7th ed. (Oxford: Clarendon Press, 1982) at 1128, 266 and 660 respectively.

6. Design: “make preliminary sketch of ...; draw plan of (future building etc.)”; and designer: “draughtsman who makes plans for manufacturers,” *ibid.* at 259.

7. S.L. Sherman and H. Glashoff, *Customs Valuation: Commentary on the GATT Customs Valuation Code* (Paris: ICC Publishing, 1988).

8. *Assists (Customs Act, section 48)*, Department of National Revenue, Customs and Excise, June 1, 1986.

9. Annex IV to Doc. 39.000 E, Technical Committee on Customs Valuation of the World Customs Organization.

constitute “designs,”¹⁰ as the definition of that term refers to drawings and sketches conveying information and not to items such as the GPPs. In counsel’s view, the work done by Capital Design would constitute design work, but not the work done by Grad-Tech. They submitted that grading is a process distinct from design work.

In describing the work performed by Grad-Tech, counsel for the respondent emphasized that the human involvement in grading is essentially limited to writing down numbers on cardboard, inputting them into a computer, manipulating the pattern on the computer screen and, finally, printing out the pattern. In counsel’s view, there is no creative element involved in this process.

Counsel for the respondent distinguished the U.S. Customs Service ruling on which the appellant relied on the basis that the facts of the case show that the issue was the characterization of pre-grading pattern-making work and that it did not consider the grading process itself.

Counsel for the respondent further argued that the list of assists referred to in clause 48(5)(a)(iii)(D) of the Act, unlike those provided for in the other clauses, is exhaustive because of the language of the provision. Whereas clauses (A), (B) and (C) use open-ended language, clause (D) does not. Accordingly, only if items are expressly identified in clause (D) can they fall within that clause. By contrast, clause (B) is non-exhaustive. Therefore, it includes items other than those specifically identified, provided they are similar to the identified items. In this regard, counsel submitted that the GPPs effectively constitute templates and that they are similar to moulds, dies and tools in that they are used to “shape” the finished goods.¹¹

In respect of the relevance of Case Study 8.1, counsel for the respondent submitted that it is a useful interpretative aid since it pertains to multiple paper patterns such as GPPs. Counsel submitted that the words of the provisions, such as the meaning of “other goods” in clause 48(5)(a)(iii)(B) of the Act, are ambiguous and, therefore, that resort can be had to such interpretative aids. Counsel further submitted, in response to counsel for the appellant’s argument that items listed in clause (B) must be worn out, that the GPPs eventually wear out because of their fragility. In any event, such a requirement is not specified in the legislation.

10. Design: “a preliminary plan, sketch, or concept, for the making or production of a building, machine, garment ... an example or a completed version of a sketch”; and sketch: “a rough, slight, merely outlined, or unfinished drawing or painting, often made to assist in making a more finished picture ... conveying a general idea of something,” *The Concise Oxford Dictionary of Current English*, 9th ed. (Oxford: Clarendon Press, 1995) at 366 and 1300 respectively. Design: “an outline, sketch, or plan, as of the form and structure of a work of art, an edifice, or a machine to be executed or constructed”; and sketch: “a simply or hastily executed drawing or painting, esp. a preliminary one, giving the essential features without the details ... a rough design, plan, or draft, as of a book,” *Random House Unabridged Dictionary*, 2nd ed. (New York: Random House, 1993) at 539 and 1791 respectively. Plan: “a formulated and esp. detailed method by which a thing is to be done; a design or scheme,” *The Concise Oxford Dictionary of Current English*, (Oxford: Clarendon Press, 1990) at 910.

11. Die: “any of various devices for cutting or forming material in a press or a stamping or forging machine”; mold: “a hollow form or matrix for giving a particular shape to something in a molten or plastic state”; and tool: “the design or ornament impressed upon the cover of a book,” *Random House Unabridged Dictionary*, 2nd ed. (New York: Random House, 1993) at 551, 1238 and 1995 respectively. Mould: “hollow form into which molten metal etc. is poured or soft material is pressed to harden in required shape,” *The Concise Oxford Dictionary of Current English*, 7th ed. (Oxford: Clarendon Press, 1982) at 660.

Counsel for the respondent submitted, contrary to the appellant's position, that the GPPs are not purchase orders or specifications. They simply instruct the manufacturer as to what the purchaser wants the manufacturer to make. Counsel submitted that the GPPs are used in the production process, specifically to make the cardboard patterns. They are, in counsel's view, an essential part of the production process, without which the exact sizes of the garments cannot be obtained. If the GPPs were not made in Canada, they would have to be made abroad and, as such, the GPPs would benefit the foreign manufacturer.

In support of the respondent's view, that the GPPs are a part of "production," counsel for the respondent referred to the definition of the verb "to produce" in the decision in *The Consumers' Gas Company v. The Deputy Minister of National Revenue for Customs and Excise*.¹² They submitted that "production" is a process that results in "something" and that anything that is essential to achieving that result is part of the production process.

In making general comments about the nature of dutiable assists, counsel for the respondent submitted that duties are imposed on assists because, if such items were not supplied by the importer free of charge or at a reduced cost, the manufacturer would have to do this work itself because it is essential to the production process. As such, these items should be included in the transaction value of the goods because they essentially constitute a partial payment by the importer to the foreign manufacturer. From a policy perspective, counsel submitted that such items are dutiable to protect Canadian manufacturers because it would otherwise make it less expensive to manufacture garments abroad and would negatively impact manufacture in Canada.

In reply, counsel for the appellant emphasized that the grading done by Grad-Tech was generally done in the past by Capital Design and that it does not become other than design work simply because a separate company is performing the work. In response to counsel for the respondent's argument that assists referred to in clause 48(5)(a)(iii)(D) of the Act are intangibles whereas the GPPs are not, counsel submitted that the GPPs, like the items listed in clause (D), are a concrete expression of intangible work.

Pursuant to paragraph 48(5)(a) of the Act, in determining the transaction value of imported goods for the purposes of ascertaining their value for duty, the price paid or payable in the sale of the goods for export to Canada must be adjusted to reflect the value of certain goods and services supplied by the purchaser free of charge or at a reduced cost, which goods and services are for use in connection with the production and sale for export of the goods. The issue in this appeal is whether the GPPs supplied by the appellant to its foreign manufacturers free of charge constitute such goods or services and, if so, whether they are dutiable. The two possible clauses into which the GPPs might fall are clause (B), which includes "tools, dies, moulds and other goods utilized in the production of the imported goods," and clause (D), which includes "engineering, development work, art work, design work, plans and sketches undertaken elsewhere than in Canada and necessary for the production of the imported goods."

The Tribunal is of the view that the GPPs fall within the scope of subparagraph 48(5)(a)(iii) of the Act as they are supplied directly by the appellant free of charge to the manufacturer and, more importantly, they are "for use in connection with the production and sale for export of the imported goods." In the Tribunal's view, the above-cited phrase broadly encompasses the different types of relationships that are specified between the goods and services at issue and the imported goods. At this point, the issue is which clause includes the GPPs.

12. "To bring forth, bring into being or existence. To bring (a thing) into existence from its raw materials or elements," [1976] 2 S.C.R. 640 at 648.

The Tribunal is of the view that the GPPs constitute “design work” necessary for the production of the imported goods and, accordingly, that they fall within clause 48(5)(a)(iii)(D) of the Act. However, since the work associated with the GPPs is undertaken in Canada, they are not dutiable under paragraph 48(5)(a).

The basis for the Tribunal’s decision in this regard is that, in its view, grading is but one step in the design process, albeit one that takes place towards the end of that process. The definition of the term “design,” as contained in *Webster’s Unabridged Dictionary of the English Language*,¹³ refers to “an outline, sketch, or plan, as of the form and structure of a work of art, an edifice, or a machine to be executed or constructed.”¹⁴ A “plan” is, moreover, defined as “a formulated and esp. detailed method by which a thing is to be done; a design or scheme.”¹⁵ In the Tribunal’s view, these definitions would encompass the grading element in the manufacture of garments. The Tribunal notes the testimony of the witnesses to the effect that, before computerization, grading was often undertaken in-house by a company’s design group. In the Tribunal’s view, the simple fact that grading is now done off-site and that, in this case, it is computerized does not take it outside the scope of that which is considered to be design work. Mr. Cymbalista, moreover, acknowledged that the graders would never unilaterally alter a grading rule without the appellant’s approval.

The Tribunal further notes that both Mr. Cymbalista and Mr. Abramovitch testified that they considered grading to be part of the design portion of the garment-manufacturing business, and not part of the production portion. Moreover, the article regarding computerization in the design room contained in *Canadian Apparel Manufacturer Magazine* similarly suggests that grading is included in design work.

Although counsel for the respondent argued that the GPPs specifically fall within the scope of clause 48(5)(a)(iii)(B) of the Act, the Tribunal notes that no reason was given by counsel for reaching this conclusion. Assists referred to in clause 48(5)(a)(iii)(B) are “tools, dies, moulds and other goods,” which are specifically “utilized in the production of the imported goods.” The Tribunal was not persuaded that the GPPs were included in this clause, as the GPPs are not “like” the three enumerated items, in that they are not used directly in the production of the imported garments. The listed items physically shape or form raw materials in order to produce other goods, namely, the imported items, whereas the GPPs’ connection to the raw materials used to produce the imported garments is one step removed from their actual production.

Based on the foregoing, the Tribunal concludes that the GPPs do not reflect dutiable assists under subparagraph 48(5)(a)(iii) of the Act.

The Tribunal disagrees with counsel for the appellant that the GPPs do not constitute assists generally, within the meaning of subparagraph 48(5)(a)(iii) of the Act, because they are not “for use in ... production.” Subparagraph 48(5)(a)(iii) only requires that assists be used in connection with production and not necessarily in production, as asserted by counsel for the appellant. The requirement that the goods be used in connection with production is, in the Tribunal’s view, broader than the requirement that the goods be used in production.

Arthur B. Trudeau

Arthur B. Trudeau
Presiding Member

13. (New York: Portland House, 1989).

14. *Ibid.* at 391.

15. *The Concise Oxford Dictionary of Current English* (Oxford: Clarendon Press, 1990) at 910.