CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Tuesday, September 16, 1997

Appeal No. AP-96-201

IN THE MATTER OF an appeal heard on June 5, 1997, 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 September 30, 1996, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

RAYTHEON CANADA LIMITED **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed.

Arthur B. Trudeau
Arthur B. Trudeau
Presiding Member

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

Lyle M. Russell
Lyle M. Russell
Member

Susanne Grimes
Susanne Grimes
Acting Secretary

333 Laurier Avenue West
Ottawa, Ontario K1A 0G7
(613) 990-2452 Fax (613) 990-2439

333, avenue Laurier ouest
Ottawa (Ontario) K1A 0G7
(613) 990-2452 Téléc. (613) 990-2439

CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

UNOFFICIAL SUMMARY

Appeal No. AP-96-201

RAYTHEON CANADA LIMITED **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

The appellant was the successful bidder for the supply and installation of an air traffic control system for the Government of Canada. To fulfil the contract, the appellant entered into subcontracts with SED Systems Inc. (SED) for the supply of certain display units and with DY-4 Systems Inc. (DY-4) for the supply of certain processor units. The issue in this appeal is whether the appellant or, alternatively, SED and DY-4 are the manufacturers or producers of the display units and processor units. Specifically, the respondent claims that the appellant is the "deemed" manufacturer of the display units pursuant to paragraph (*b*) or (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the *Excise Tax Act*. The respondent further claims that the appellant is the "traditional" manufacturer or producer of the processor units, as these terms have been defined in case law.

HELD: The appeal is allowed. The Tribunal is of the view that the conditions of paragraphs (*b*) and (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the *Excise Tax Act* have not been met with respect to the manufacture of the display units. The Tribunal is satisfied that a true vendor-purchaser relationship existed between SED and the appellant. Furthermore, the Tribunal does not accept the view espoused by counsel for the respondent to the effect that the processor units were merely parts of an air traffic control system manufactured by the appellant. Rather, the Tribunal is of the view that, upon acceptance by the appellant, the processor units were fully manufactured goods capable of functioning as designed.

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	June 5, 1997
Date of Decision:	September 16, 1997
Tribunal Members:	Arthur B. Trudeau, Presiding Member Dr. Patricia M. Close, Member Lyle M. Russell, Member
Counsel for the Tribunal:	David M. Attwater
Clerk of the Tribunal:	Anne Jamieson
Appearances:	Glenn A. Cranker and Randall J. Hofley, for the appellant Frederick B. Woyiwada and Kathleen McManus, for the respondent

333 Laurier Avenue West
Ottawa, Ontario K1A 0G7
(613) 990-2452 Fax (613) 990-2439

333, avenue Laurier ouest
Ottawa (Ontario) K1A 0G7
(613) 990-2452 Téléc. (613) 990-2439

CANADIAN INTERNATIONAL TRADE TRIBUNAL | TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-96-201

RAYTHEON CANADA LIMITED **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: ARTHUR B. TRUDEAU, Presiding Member
DR. PATRICIA M. CLOSE, Member
LYLE M. RUSSELL, Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) of an assessment[2] of the Minister of National Revenue. By notice of objection, the appellant objected to the finding that it was the manufacturer or producer of certain goods and, thus, liable for tax thereon and to the taxation of certain engineering services. By notice of decision, the respondent allowed the objection with respect to the engineering services, but confirmed the assessment with respect to the balance.

The appellant is a subsidiary of Raytheon Company of the United States (Raytheon USA). The appellant was the successful bidder for the supply and installation of modernized radar display equipment and radar data processing systems for 41 air traffic control systems for the Government of Canada. To fulfil the contract, the appellant entered into subcontracts with SED Systems Inc. (SED) for the supply of certain display equipment and with DY-4 Systems Inc. (DY-4) for the supply of certain processor units.

With regard to the display units, Raytheon USA supplied certain technology and know-how to SED to facilitate manufacture. It was engaged in quality control and factory acceptance testing of the equipment. Some major components incorporated into the display units were provided by Raytheon USA. The appellant paid federal sales tax (FST) based on the sale price of the display units from SED.

With regard to the processor units, the appellant subcontracted with DY-4 for the supply of fully manufactured processor units. Software written by the appellant was loaded onto the processor units, which allowed them to interface with other equipment. The appellant paid FST based on the sale price of the processor units from DY-4.

The issue in this appeal is whether the appellant or, alternatively, SED and DY-4 are the manufacturers or producers of the display units and processor units. Specifically, the respondent claims that the appellant is the "deemed" manufacturer of the display units pursuant to paragraph (*b*) or (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act. The respondent further claims that the appellant is the "traditional" manufacturer or producer of the processor units, as these terms have been defined in case law.

---

1. R.S.C. 1985, c. E-15.
2. Notice of Assessment No. SWO 0119, dated February 25, 1993.

The significance of this decision lies in the amount of FST to be paid on the sale of the goods. Under paragraph 50(1)(*a*) of the Act, FST is payable by the manufacturer or producer of the goods when they are sold. If SED and DY-4 are the manufacturers or producers of the goods, then FST is payable on their sale price to the appellant. Alternatively, if the appellant is the manufacturer or producer of the goods, then FST is payable on the sale price of the goods from the appellant to the Government of Canada. As such, according to the appellant's witness, Mr. Howard F. Jones, the cost of training, design work and ensuring quality standards would be taxed.

The relevant provisions of the Act are as follows:

> 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,
>
> (*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,
>
> 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, in any case ... by the producer or manufacturer at the time when the goods are delivered to the purchaser or at the time when the property in the goods passes, whichever is the earlier.

With regard to the display units, counsel for the appellant submitted that, for the appellant to be a deemed manufacturer under paragraph (*b*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act, two conditions must be met:

(1) the appellant must own or use certain proprietary, sales or other rights to the display units made by SED; and

(2) there must be a principal-agent relationship between the appellant and SED.[3]

Counsel for the appellant pointed to the government contract, the SED subcontracts and the working relationship between the parties as evidence that a true vendor-purchaser relationship existed between the appellant and SED. Although Raytheon USA assisted the appellant during the pre-production and early production phases, SED remained wholly in charge of manufacturing the display units. That the appellant provided certain components to SED is not, according to counsel, determinative of whether the appellant is the deemed manufacturer of the display units.

With regard to the appellant being the manufacturer or producer of the processor units, counsel for the appellant submitted that a manufacturer is someone who produces articles for use from raw or prepared

---

3. *Gerrard-Ovalstrapping, Division of EII Limited* v. *The Minister of National Revenue*, Canadian International Trade Tribunal, Appeal No. AP-93-289, September 26, 1994.

materials by giving to these materials new forms, qualities and properties or combinations.[4] A producer creates something new that can perform a function that could not be performed by things which existed previously.[5] DY-4 fully manufactured the processor units. These units are analogous to computers and, as such, should not be considered as parts. On completion, the processor units were capable of processing radar data and auxiliary signals into data streams that are readable by display units. The appellant, counsel argued, neither gave the processor units new forms, qualities and properties or combinations nor caused them to perform a function which they could not perform previously. The appellant merely supplied the software, which DY-4 copied onto the programmable read-only memory chips inserted into the processor units.

With regard to the appellant being the manufacturer or producer of the display units, counsel for the respondent submitted that the appellant holds a proprietary or sales right to the display units. As proof, counsel pointed to the subcontract agreement between the appellant and SED (the SED Agreement), under which vesting of title in and to all materials, parts, work-in-progress, work and finished work is given to the appellant. Counsel referred to early case law where holding a proprietary or sales right to goods being manufactured was sufficient to satisfy the Exchequer Court of Canada that the criterion of paragraph (*b*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act had been met.[6]

As to the second criterion, counsel for the respondent submitted that, to the extent that a principal-agent relationship must be found, it only has to apply with respect to the manufacturing of the goods and not for all purposes. In arguing that SED was manufacturing for or on behalf of the appellant, counsel pointed to several provisions of the SED Agreement where SED agreed to work in full conformity with the requirements of the agreement, to comply with directions and to suspend performance of the work on the appellant's instructions. In addition, the appellant had the right to observe all tests and inspections of the goods, as well as to inspect the goods. The appellant also transferred technology to SED and supplied detailed specifications for the display units being manufactured and some of the components incorporated into the display units.

Counsel for the respondent also submitted that the appellant is the deemed manufacturer or producer of the goods under paragraph (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act. It was submitted that, while SED "assembled" the display units by fitting various parts together and given that the appellant supplied some of the components, SED was acting on behalf of the appellant.

With regard to the appellant being the manufacturer or producer of the processor units, counsel for the respondent submitted that the appellant's activities were such that they caused the processor units to perform or function in a manner in which they were otherwise incapable. This was accomplished, in part, by incorporating into the processor units software written by the appellant. The processor units were used in a fully functional air traffic control system manufactured by the appellant and, hence, they were a part or component of goods that were manufactured in the traditional sense by the appellant.

The Tribunal is of the view that the conditions of paragraphs (*b*) and (*f*) of the definition of "manufacturer or producer" under subsection 2(1) of the Act have not been met with respect to the

---

4. *Her Majesty the Queen* v. *York Marble, Tile and Terrazzo Limited*, [1968] S.C.R. 140.
5. *The Minister of National Revenue* v. *Enseignes Imperial Signs Ltée* (1990), 116 N.R. 235, Federal Court of Appeal, File No. A-264-89, February 28, 1990.
6. *The King.* v. *Reuben Shore* (1949), 49 D.T.C. 570 (Ex. Ct.); and *Turnbull Elevator Co. of Canada Ltd.* v. *The Queen* (1962), 63 D.T.C. 1001 (Ex. Ct.).

manufacture of the display units. The Tribunal is satisfied that a true vendor-purchaser relationship existed between SED and the appellant. As such, SED was not acting as an agent for the appellant for purposes of manufacturing or assembling the display units.

In making this decision, the Tribunal acknowledges that there was a transfer of technology from the appellant to SED, that SED built the display units to print[7] using some parts supplied by the appellant and that SED was subject to subcontract management and source inspections. That being said, the Tribunal is of the view that SED exercised sufficient independence and control over its operations to conclude that it was not acting as a mere agent for the appellant in the manufacture of the display units.

The Tribunal was not persuaded that a transfer of technology or that building to print was indicative of an agency arrangement. The transfer of technology was required for the appellant to provide the socio-economic benefits required by the contract for the supply of the air traffic control system to the Government of Canada. The Tribunal does not view this as inconsistent with the custom manufacture provided by SED. As to building to print, or custom manufacture as described by the appellant's witness, Mr. Ray Braun of SED, the Tribunal was persuaded that the role of the appellant or Raytheon USA was more in the nature of providing design services and ensuring a required level of quality than acting as the principal in the manufacture of the display units. As described by Mr. Braun, it was SED that developed the manufacturing processes and purchased those materials[8] necessary to manufacture the display units.

Furthermore, the Tribunal was persuaded that the audits conducted by Raytheon USA of SED's configuration management system and its quality control systems are consistent with subcontracting and custom manufacture; so, too, is factory testing before acceptance of a custom-manufactured product.

As to the supply of materials by the appellant, the Tribunal was persuaded by Mr. Braun's testimony that this is a common practice with custom manufacture. It is not inconsistent with a true vendor-purchaser transaction.[9]

In concluding that a vendor-purchaser relationship existed between the appellant and SED, the Tribunal notes that the contract between the appellant and SED specifies that neither party is the agent of the other, that SED developed the manufacturing processes by which the display units were made, that, save for the materials supplied by Raytheon USA, the materials necessary to manufacture the display units were purchased on SED purchase orders and paid for by SED, that SED offered a warranty on the display units and that title to the display units remained with SED until after inspection and acceptance of the display units.

As to the processor units, the Tribunal does not accept the view espoused by counsel for the respondent to the effect that they were merely parts of an air traffic control system manufactured by the appellant.

---

7. Mr. Robert C. Brabant of Raytheon Electronic Systems described the appellant as the design agent for the displays. The appellant provided SED with a set of drawings that included electrical schematics, mechanical assembly drawings and a parts list and specifications of things that had to be custom manufactured rather than purchased.

8. Other than those provided by the appellant or Raytheon USA.

9. See, for example, *Security Card Systems Inc.* v. *The Minister of National Revenue*, Canadian International Trade Tribunal, Appeal No. AP-94-167, August 28, 1995.

The appellant's contract with the Government of Canada was for the design, supply and installation of a complete air traffic control system and would provide training to Canadians and other socio-econonic benefits to Canada. Thus, the contract included numerous non-taxable services, as well as taxable goods. The Tribunal is of the view that, upon acceptance by the appellant, the processor units were fully manufactured goods capable of functioning as designed. This did not change because specific application software, supplied by the appellant, was copied onto the processor units and because they were later incorporated into an air traffic control system by the appellant. The Tribunal views the processor units as complete stand-alone units. Thus, it was the sale between DY-4 and the appellant that was taxable, not the contract price between the appellant and the Government of Canada for the total system.

Accordingly, the appeal is allowed.

Arthur B. Trudeau
Arthur B. Trudeau
Presiding Member

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

Lyle M. Russell
Lyle M. Russell
Member