CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Friday, August 28, 1998

Appeal No. AP-97-072

IN THE MATTER OF an appeal heard on June 23, 1998, 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 June 20, 1997, with respect to a notice of objection served under section 81.15 of the *Excise Tax Act*.

BETWEEN

KELLOGG CANADA INC. **Appellant**

AND

THE MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is dismissed.

Patricia M. Close
Patricia M. Close
Presiding Member

Peter F. Thalheimer
Peter F. Thalheimer
Member

Richard Lafontaine
Richard Lafontaine
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-97-072

KELLOGG CANADA INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

This is an appeal under section 81.19 of the *Excise Tax Act* from a decision of the Minister of National Revenue dismissing an objection and confirming an assessment for unpaid federal sales tax, interest and penalty. The assessment period was from July 31, 1989, to December 31, 1990.

The appellant produces children's breakfast cereals which often include overwrapped insert premiums. The issue in this appeal is whether the clear plastic envelope (overwrap) used during the assessment period to overwrap the insert premiums is exempt from federal sales tax under section 3, Part V, Schedule III to the *Excise Tax Act* as articles and materials for use exclusively in the manufacture or production of tax-exempt goods, namely, food and drink for human consumption.

HELD: The appeal is dismissed. The Tribunal comes to the conclusion that the insert premiums are not used in the manufacture or production of the children's cereals. Consequently, the Tribunal finds that the overwrap, which owes its presence to the inclusion of the insert premiums in the children's cereal boxes, is not used in the manufacture or production of the children's cereals.

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	June 23, 1998
Date of Decision:	August 28, 1998
Tribunal Members:	Patricia M. Close, Presiding Member Peter F. Thalheimer, Member Richard Lafontaine, Member
Counsel for the Tribunal:	Philippe Cellard
Clerk of the Tribunal:	Anne Jamieson
Appearances:	Steven K. D'Arcy and C. Brent Jay, for the appellant M. Kathleen McManus, for the respondent

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CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal No. AP-97-072

KELLOGG CANADA INC. **Appellant**

and

THE MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: PATRICIA M. CLOSE, Presiding Member
PETER F. THALHEIMER, Member
RICHARD LAFONTAINE, Member

REASONS FOR DECISION

This is an appeal under section 81.19 of the *Excise Tax Act*[1] (the Act) from a decision of the Minister of National Revenue dated June 20, 1997, dismissing an objection and confirming an assessment dated July 23, 1993, in the amount of $97,469.65 for unpaid federal sales tax (FST) on overwrap, interest and penalty. The assessment period was from July 31, 1989, to December 31, 1990.

The appellant, Kellogg Canada Inc., produces breakfast cereals. Some of its breakfast cereals are targeted specifically at the children's market. The appellant often includes a trinket, token or toy (known in the industry as an "insert premium") in the children's cereal boxes. During the assessment period, the appellant had contracts with several premium manufacturers that would manufacture insert premiums for sale exclusively to the appellant, for inclusion in the children's cereal boxes. Once made, the insert premiums were sent to Econ-o-pac Limited (Econ-o-pac). The appellant also had a contract with Econ-o-pac, according to which Econ-o-pac would overwrap the insert premiums in clear plastic envelopes (overwraps) and ship them to the appellant. The appellant would then put the overwrapped insert premiums into the cereal box plastic bags which contain the cereals.

The issue in this appeal is whether the overwrap used by Econ-o-pac to overwrap the insert premiums is exempt from FST under section 3, Part V, Schedule III to the Act as articles and materials for use exclusively in the manufacture or production of tax-exempt goods, namely food and drink for human consumption.

The relevant provisions of the Act are the following:

> 50. (1) There shall be imposed, levied and collected a consumption or sales tax at the rate prescribed in subsection (1.1) on the sale price or on the volume sold of all goods
> (*a*) produced or manufactured in Canada
>
> 51. (1) The tax imposed by section 50 does not apply to the sale or importation of the goods mentioned in Schedule III, other than those goods mentioned in Part XIII of that Schedule that are sold to or imported by persons exempt from consumption or sales tax under subsection 54(2).

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

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Schedule III

PART V

FOODSTUFFS

1. Food and drink for human consumption (including sweetening agents, seasonings and other ingredients to be mixed with or used in the preparation of the food and drink).

3. Articles and materials for use exclusively in the manufacture or production of the tax exempt goods mentioned in sections 1 and 2 of this Part.

During the hearing, two witnesses testified on behalf of the appellant, Ms. Carol Stewart, Marketing Director, and Mr. Karl T. Bergen, a food technologist, both at Kellogg Canada Inc. Ms. Stewart indicated that the insert premium is a critical component of the appellant's marketing strategy for its cereals targeted at the children's market. She stated that insert premiums have a clear impact on sales of those cereals. Several exhibits of insert premiums used during the period at issue were filed. Ms. Stewart indicated that all insert premiums are overwrapped. Mr. Bergen explained that the insert premiums are overwrapped for safety and quality reasons. The overwrap prevents odour and ink transfers from the insert premium to the cereal. Overwrapping of the insert premiums has also an indicative component. It clearly shows the insert premium and demonstrates that the cereal has not come in contact with it. Answering questions from counsel for the respondent, Ms. Stewart acknowledged that children's cereals are still children's cereals, even without premiums, and that the insert premiums are not part of the food. In turn, Mr. Bergen stated that there are no governmental regulations prescribing that insert premiums be placed in children's cereals.

Counsel for the appellant submitted that the overwrap was an article for use exclusively in the manufacture or production of tax-exempt food mentioned in section 1, Part V, Schedule III to the Act. Therefore, it was counsel's position that section 3, Part V, Schedule III to the Act exempted the overwrap from tax. After having referred to cases decided by the Tribunal, counsel submitted that, in order to determine if an article is for use in the manufacture or production of tax-exempt food, it must be determined if the article is incorporated into or otherwise contributes to the marketability and saleability of the tax-exempt food.

According to counsel for the appellant, the witnesses for the appellant have established that the insert premium is a critical component of the marketing strategy of any manufacturer of children's cereals, including the appellant, and that the overwrap is necessary to identify the insert premium and to protect the cereal from being spoilt. Counsel submitted that, accordingly, the overwrap was incorporated into or otherwise contributed to the marketability and saleability of the cereals and is, therefore, tax-exempt under section 3, Part V, Schedule III to the Act. To sustain their position, counsel also referred to an administrative ruling issued by the Department of National Revenue (Revenue Canada), where it ruled that the printed paper slips used in fortune cookies qualify as articles and materials for use in the manufacture or production of tax-exempt food.

Counsel for the respondent submitted that the overwrap in issue was not used in the manufacture or production of the cereals and, consequently, was not tax-exempt under section 3, Part V, Schedule III to the Act. According to counsel, the overwrap did not relate to the tax-exempt cereals or to their production, but rather related to the taxable insert premiums that were inserted in the cereal boxes for marketing purposes. As regards the administrative ruling on fortune cookies, counsel submitted that it was not binding and that, in any case, it was dealing with a unique situation. Counsel suggested that the manufacture or production of a

product cannot include the marketing and the promotion of sales of that product. She submitted that the cases upon which the appellant relies do not support the appellant's position.

For articles or materials to be tax-exempt under section 3, Part V, Schedule III to the Act, they must be for use exclusively in the manufacture or production of the tax-exempt goods mentioned in section 1 or 2, Part V, Schedule III to the Act. The evidence submitted to the Tribunal clearly shows that the overwrap, for which an exemption is claimed, is an article that was only used to overwrap the insert premiums that were included in the children's cereal boxes. The parties agree that the children's cereals are tax-exempt goods mentioned in section 1. Therefore, the question which the Tribunal must specifically address is whether the overwrap is for use in the manufacture or production of the children's cereals. In this context, it must be underlined that the insert premiums themselves must be for use in the manufacture or production of the children's cereals. Indeed, the overwrap cannot be dissociated from the insert premiums because it would not be used were it not for the inclusion of the insert premiums in the cereal boxes.

The Tribunal is of the view that the cases invoked by counsel for the appellant, the most relevant of which are *Label Tech, a division of Pridamor Inc.* v. *The Minister of National Revenue*[2] and *Tetra Pak Inc.* v. *The Minister of National Revenue*,[3] do not support their position.

In *Label Tech*, the Tribunal dealt with labels that were affixed to the wrapping of sandwiches and that identified the food and the ingredients used in making the sandwiches. The Tribunal noted that there was a legal requirement that the sandwiches be identified by a label.[4] In this case, the Tribunal was of the opinion that the labels were an integral part of the process that rendered the sandwiches into marketable and saleable items of commerce. The Tribunal determined that the labels were used in the manufacture or production of the food and were, therefore, tax-exempt.

According to the Tribunal, the insert premiums are not an integral part of the process that renders the children's cereals into marketable and saleable items of commerce. While the inclusion of insert premiums in children's cereal boxes encourages sales, it cannot be said that it would not be possible to bring to the market and sell the children's cereals without insert premiums. In fact, Ms. Stewart stated that the appellant sold children's cereals for a year without including insert premiums.

In *Tetra Pak*, there was a link between the drinking straws for which the appellant claimed an exemption and the juice with which they were used. The Tribunal determined, in that case, that the drinking straws, which were affixed to the boxes containing the juice, were used in the production of the tax-exempt juice. Whereas the straws assisted in consuming the juice, the insert premiums have nothing to do with the consumption of the cereals.

The appellant relied on an administrative ruling issued by Revenue Canada which indicated that Revenue Canada considered that the printed paper slips inserted into fortune cookies were exempt from FST because they were used in the manufacture or production of tax-exempt food.[5] Here again, there was a clear relationship between the article for which an exemption was sought and the tax-exempt product. Indeed, a fortune cookie could hardly be called a fortune cookie were it not for those famous printed paper slips.

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2. Canadian International Trade Tribunal, Appeal No. AP-91-061, August 17, 1992.
3. Canadian International Trade Tribunal, Appeal No. AP-91-147, September 3, 1992.
4. *Consumer Packaging and Labelling Act*, R.S.C. 1985, c. C-38.
5. Revenue Canada Administrative Ruling 5900/23, *Printed Paper Slips for Fortune Cookies*, March 15, 1985.

The Tribunal notes that another administrative ruling issued by Revenue Canada, which was submitted by counsel for the respondent, indicated that an insert premium should be subject to FST.[6]

The Tribunal comes to the conclusion that the insert premiums are not used in the manufacture or production of the children's cereals. Consequently, the Tribunal finds that the overwrap, which owes its presence to the inclusion of the insert premiums in the children's cereal boxes, is not used in the manufacture or production of the children's cereals, as required by section 3, Part V, Schedule III to the Act to be tax-exempt. While it may be a good marketing strategy to insert a premium and advisable to overwrap the premium so that it does not come in contact with the cereal and is easy to identify, neither the insert premium nor the overwrap can be considered as used in the manufacture or production of the children's cereals.

Consequently, the appeal is dismissed.

Patricia M. Close
Patricia M. Close
Presiding Member

Peter F. Thalheimer
Peter F. Thalheimer
Member

Richard Lafontaine
Richard Lafontaine
Member

6. Revenue Canada Administrative Ruling 5505/375-1, *Inserts, Premiums—Tax-Exempt Goods*, March 26, 1984.