



Ottawa, Friday, March 15, 2002

**Appeal No. AP-99-088**

IN THE MATTER OF an appeal heard on November 6, 2001,  
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 February 17, 1999, with respect to a  
notice of objection served under section 81.15 of the *Excise Tax  
Act*.

**BETWEEN**

**MONTECRISTO JEWELLERS INC.**

**Appellant**

**AND**

**THE MINISTER OF NATIONAL REVENUE**

**Respondent**

**DECISION OF THE TRIBUNAL**

The appeal is dismissed.

Zdenek Kvarda  
Zdenek Kvarda  
Presiding Member

Richard Lafontaine  
Richard Lafontaine  
Member

Peter F. Thalheimer  
Peter F. Thalheimer  
Member

Michel P. Granger  
Michel P. Granger  
Secretary



UNOFFICIAL SUMMARY

Appeal No. AP-99-088

MONTECRISTO JEWELLERS INC.

Appellant

AND

THE MINISTER OF NATIONAL REVENUE

Respondent

This is an appeal pursuant to section 81.19 of the *Excise Tax Act* from an assessment of tax owing in regard to the sale of jewellery manufactured by the appellant. The assessment resulted from an audit and was based on several assumptions of fact and estimates of value of sales of taxable goods. The appellant argued that the assessment was speculative and based on erroneous facts and assumptions. It argued that the value of sales of taxable goods was less than that determined by the auditor and that, as a small manufacturer and in accordance with the *Small Manufacturers or Producers Exemption Regulations*, it was in fact exempt from the payment of tax.

**HELD:** The appeal is dismissed. The case law is clear that the onus is on the taxpayer to successfully challenge the assumptions upon which an assessment is based. In this regard, the appellant has not provided any credible evidence that would discharge this onus. As such, the assessment stands, and the appeal is dismissed.

Places of Videoconference

Hearing: Hull, Quebec, and Vancouver, British Columbia  
Date of Hearing: November 6, 2001  
Date of Decision: March 15, 2002

Tribunal Members: Zdenek Kvarda, Presiding Member  
Richard Lafontaine, Member  
Peter F. Thalheimer, Member

Counsel for the Tribunal: John Dodsworth

Clerks of the Tribunal: Anne Turcotte  
Margaret Fisher

Appearances: Jonathan L. Williams, for the appellant  
Susanne Pereira, for the respondent



**Appeal No. AP-99-088**

**MONTECRISTO JEWELLERS INC.**

**Appellant**

**AND**

**THE MINISTER OF NATIONAL REVENUE**

**Respondent**

TRIBUNAL: ZDENEK KVARDA, Presiding Member  
RICHARD LAFONTAINE, Member  
PETER F. THALHEIMER, Member

**REASONS FOR DECISION**

The appellant sells jewellery from its retail store in Vancouver, British Columbia. On January 8, 1997, and following an audit, the appellant was assessed excise tax in the amount of \$18,373.17 in relation to jewellery manufactured and sold between December 1, 1992 and August 31, 1995.

Mr. Pasquale Cusano, the sole owner of the appellant, testified that, in addition to its retail sales, the appellant purchases raw materials, such as gems and precious metals, that are used to manufacture finished jewellery. He testified that he personally hires contractors to manufacture the jewellery, which is done largely in an area at the back of the appellant's store. Mr. Cusano testified that he is also sole owner of a number of other companies and that jewellery is also manufactured by these companies during specified periods throughout the year. The goods are then sold back to the appellant by the related companies in order to be sold on the retail market. Mr. Cusano's other companies do not have separate places of business, and all have the same mailing address as the appellant.

Mr. Cusano testified that the purpose of manufacturing the jewellery in the name of his other companies during specific periods of the year is to keep the sales value of jewellery manufactured by each of these companies, in any given year, below \$50,000. According to the *Small Manufacturers or Producers Exemption Regulations*,<sup>1</sup> companies whose sales of otherwise taxable goods that they have manufactured are less than \$50,000 are considered to be small manufacturers and are not required to remit tax.

Mr. Cusano testified that some of the invoices relied upon to arrive at the assessment did not pertain to purchases of raw materials, as assumed by the auditor, but instead evidenced purchases of finished goods that were sold as such. Therefore, the amounts identified in the invoices were erroneously used by the auditor in estimating the sales of jewellery manufactured by the appellant and for which tax was owed. Mr. Cusano also stated that some of the manufactured goods remained in inventory at the end of the assessment period and were not sold, such that no tax was payable on them during the assessment period. He further pointed out that all of the appellant's purchases of raw materials were on a tax-paid basis.

Mr. Cusano testified that his records do not trace the raw materials that are bought through to the manufacturing process and subsequent sale, such that he cannot identify when specific raw materials are sold or whether they remain in inventory. However, he did state that the appellant does not sell loose stones. He also stated that, at the time of the audit, he was willing to show the auditor the appellant's inventory of jewellery and to explain which invoices pertained to purchases of raw materials and which pertained to purchases of finished goods, but that he was not given the opportunity.

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1. S.O.R./82-498 [hereinafter Regulations].

The respondent's witness was Ms. Monica Tang, a tax auditor employed by the Canada Customs and Revenue Agency (CCRA). Ms. Tang testified that she conducted the audit of the appellant that led to the assessment of excise tax on sales of manufactured jewellery. She also testified that she first came to the appellant's premises in order to do a Goods and Services Tax (GST) audit, which was completed. While on the appellant's premises, she determined that an excise tax audit should be done, given the invoices that showed that the appellant had purchased a large quantity of raw materials from suppliers, such as loose stones, casting grain, gold plate and loose pearls.

Ms. Tang testified that she concluded that the appellant used these materials to manufacture finished jewellery that was sold. This conclusion was based on: (1) her observation that an area of the store was obviously dedicated to the manufacture of jewellery; (2) the absence of evidence that would indicate that the loose stones and precious metals were sold "as is"; and (3) her assumption that the raw materials were not left in inventory. This last assumption was based on her review of the appellant's records, which indicated that its opening inventories did not differ much from its closing inventories. In calculating the assessment amount, Ms. Tang obtained the value of loose stones and precious metals purchased by the appellant and manufactured into finished jewellery from the invoices that she examined, as well as from the appellant's general ledger. She testified that she examined approximately 50 purchase invoices. The dollar value of raw materials purchased was then "grossed up" to obtain the total value of manufactured jewellery that the appellant sold in each of the years of the assessment period. This "gross up" was determined by multiplying the value of raw materials purchased in each year by the sales to purchase ratio for each year reported by the appellant on its income statements. The total value of sales of jewellery for each year was then reduced by 25 percent, in accordance with CCRA procedures.<sup>2</sup>

While the assessment period included all of 1993 and 1994, the audit only covered part of 1992 and 1995. In order to determine the annualized sales for these years, Ms. Tang took the value of raw materials purchased during those parts of the year covered by the assessment and prorated the amounts over the entire year.

Ms. Tang then reduced the value of the total purchases for each year by the GST that the appellant would have paid in relation to the purchases. On this basis, she calculated that, in each of the years covered by the assessment, the sales of manufactured jewellery exceeded the \$50,000 threshold established in the Regulations. Ms. Tang therefore concluded that the appellant was not a small manufacturer during these years and should have remitted tax on its sales of jewellery. Excise tax owed by the appellant was then calculated by multiplying this constructed value of sales for each year covered by the assessment by the excise tax rate of 10 percent. This amount was reduced by subtracting tax paid by the appellant on the purchase of the raw materials. The amount of the assessment is the total amount of excise tax owed over the assessment period, calculated in this manner, together with penalty and interest.

Ms. Tang testified that the assessment is not "cast in stone", that the practice is to explain the assessment to the taxpayer and that any adjustments that the taxpayer feels should be made would be considered, after supporting documentation was submitted. She also acknowledged that she might have included amounts in relation to purchases of raw materials that were, in fact, finished goods. Ms. Tang further testified that, in 1996, she attempted to set up a meeting with Mr. Cusano and, subsequently, the appellant's accountant regarding her estimate of tax liability, but was told that she should process the assessment and that the appellant would appeal it. She testified that she eventually met with Mr. Cusano after the assessment was issued, but evidence refuting the assessment was not presented then or at any other time.

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2. As outlined in Excise Communiqué 72/T1, *To Jewellers Licensed Under the Excise Tax Act*, Department of National Revenue, Customs and Excise, April 1982.

## ARGUMENT

The appellant argued that the audit performed by the respondent was highly speculative and based on various assumptions of fact of which the auditor had no proof. The auditor did not know whether raw materials purchased by the appellant had been manufactured and sold, nor had she determined if any raw materials remained in inventory. The appellant further took issue with the fact that the auditor did not review all the invoices regarding purchases of raw materials, but instead took a sample of such invoices. It further pointed out that all its purchases of raw materials were on a tax-paid basis.

The appellant referred to Mr. Cusano's testimony that, in general, some of the invoices upon which Ms. Tang relied in conducting the audit pertained to purchases from suppliers that only sold finished jewellery, not raw materials. It further referred to testimony to the effect that some of the raw materials and manufactured goods remained in inventory at the end of the assessment period and were not sold. The appellant argued that, since this jewellery, which is not subject to tax, was included in the respondent's audit report that led to the assessment at issue, the entire assessment was invalid. On this basis, it asked that the Tribunal allow the appeal or, in the alternative, that a re-assessment be ordered, to allow for an examination of invoices to see which pertained to raw materials and which pertained to finished goods.

The respondent argued that the onus is on the appellant to prove that the respondent's assessment is incorrect and that, in the present case, the appellant did not introduce any evidence that would contradict the assumptions on which the assessment was based. Although the respondent agreed that the assessment constituted only an estimate of tax liability, the assumptions made were reasonable. The respondent argued that the Tribunal should accept it as proof, on the balance of probabilities that such tax was owed. Further, despite having numerous opportunities to do so, the appellant failed to provide documentary evidence in this regard, such as invoices of goods sold or its inventory list.

The respondent argued that the appellant is liable for excise tax as a manufacturer of jewellery, taxable goods according to subsection 23(1) and Schedule I of the *Excise Tax Act*,<sup>3</sup> that is delivered to a purchaser. The appellant is a manufacturer for the purposes of the Act, given that the appellant purchased the raw materials and contracts out the manufacture of the jewellery. The respondent argued that the appellant is not a small manufacturer for the purposes of the Regulations, given that the respondent's audit showed that the appellant's sales of manufactured goods exceeded \$50,000 in each of the years of the assessment period. Further, the appellant has provided no evidence to support the contention that this manufactured jewellery remained in inventory. Given that the appellant has repeatedly failed to produce records to dispute the assessment, the respondent submitted that no purpose would be served in ordering a re-assessment.

## DECISION

By virtue of subsection 23(1) and Schedule I of the Act, tax should be imposed, levied and collected on jewellery when sold to a purchaser by the manufacturer. However, according to the Regulations, manufacturers that sell goods that are otherwise subject to excise tax are exempt from payment of that tax if the value of such goods sold or manufactured for their own use does not exceed \$50,000 per calendar year.

It is clear from the evidence that raw materials were purchased and that they were either manufactured into jewellery by the appellant or used in the manufacture of jewellery on behalf of the appellant. Invoices made out in the appellant's name and included in the respondent's audit report that was put in evidence in this appeal clearly show that the appellant purchased raw materials, such as precious

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3. R.S.C. 1985, c. E-15 [hereinafter Act].

stones and metals. As sole owner of the appellant, Mr. Cusano oversaw the purchase of raw materials, their manufacture by companies of which he was also the sole owner and their subsequent sale to the appellant. None of the raw materials were sold as such, but were used in the manufacture of jewellery. On this basis, the Tribunal finds that the appellant is a manufacturer by virtue of the definition of “manufacturer” found in subsection 2(1) of the Act.<sup>4</sup>

Based on the testimony of both the appellant’s and the respondent’s witnesses, the Tribunal also concludes that the jewellery manufactured by the appellant was sold by the appellant. In fact, the appellant did not suggest otherwise. It argued that the total value of jewellery that it sold did not exceed \$50,000 in any of the years covered by the assessment and that, therefore, by virtue of the Regulations, it was not required to pay tax.

In this regard, the appellant argued that some of the jewellery that it manufactured or that was manufactured on its behalf remained in inventory and was not sold. It also argued that, during the audit, the respondent’s auditor incorrectly included in its audit invoices that pertained to purchases of finished jewellery. Since this finished jewellery was then sold as is, no tax was owing pursuant to the Act in regard to these items, such that their purchase price was improperly included by the auditor in making the calculations of tax owing for the purposes of the assessment. The appellant also referred to the fact that it purchased the raw materials “tax in”, which was not taken into account in the assessment.

The problem faced by the Tribunal in considering the appellant’s arguments is that no real evidence was submitted to substantiate these arguments. It is clear that the appellant bore the onus of rebutting the assumptions made by the respondent in making the assessment, on the balance of probabilities. As stated by the Tribunal:<sup>5</sup>

It is settled law that the burden of proof in challenging an assessment or a determination of the Minister rests upon the taxpayer. . . . The Minister, typically, bases an assessment or a determination on some assumptions and, then, it is up to the taxpayer who has knowledge of the underlying facts to rebut these assumptions. The Tribunal notes, however, that recent case law suggests that the onus may sometimes shift to the Minister where no assumptions have been pleaded or where some or all of the pleaded assumptions have been successfully rebutted. In such a case, the Minister may bear the ordinary burden to prove the facts which support a position unless those facts have already been put in evidence by the taxpayer.

Further, the initial onus borne by the appellant to rebut the respondent’s assumptions is met where the appellant makes out at least a *prima facie* case.<sup>6</sup>

In this regard, Mr. Cusano testified, in general, that the appellant did maintain an inventory of jewellery. However, the appellant did not provide any evidence, such as inventory records, that would establish that jewellery manufactured by the appellant remained in inventory and was not sold, nor was there any evidence of the value of such inventory. In fact, Mr. Cusano testified that he did not keep records that would establish where he obtained the jewellery that remained in inventory. In the Tribunal’s view, the

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4. “[M]anufacturer or producer” is defined, in part, as follows:

(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.

5. *Michelin Tires (Canada) v. MNR* (22 March 1995), AP-93-333 at 19 (CITT). See also, for example, *M.N.R. v. Leung*, [1994] 1 F.C. 482; *Pollock v. Canada* (1993), 161 N.R. 232 (FCA).

6. *Hickman Motors v. Canada*, [1997] 2 S.C.R. 336.

appellant has not discharged the onus placed on it as a taxpayer to rebut the respondent's assumption that the jewellery manufactured by the appellant was sold.

Similarly, the appellant did not successfully challenge the value that the respondent placed on the raw materials that it purchased, which the respondent then used to estimate the value of taxable sales as outlined in the audit report and as explained by Ms. Tang. The appellant did not introduce sufficient evidence that would establish that the respondent's calculations were incorrect.

At the hearing, Mr. Cusano referred to a small number of invoices that had been included in the audit report introduced into evidence by the respondent. For the most part, his testimony confirmed that the appellant did, in fact, purchase raw materials. Although three of these invoices seemed to refer to purchases of finished jewellery, this was not entirely clear, nor was it clear whether the items to which he referred were then sold as finished jewellery or used as raw materials. Significantly, no other specific testimony, invoices or other evidence was presented to the respondent during the audit, at subsequent meetings or to the Tribunal in this appeal that would indicate that the value that the auditor put on purchases by the appellant of raw materials in the assessment was incorrect. In the Tribunal's view, the appellant has not provided sufficient credible evidence challenging the respondent's assumption in this regard that would shift the onus of proof to the respondent.

With respect to the appellant's concern that its purchases of raw materials were made on a "tax in" basis, it is clear from Ms. Tang's evidence that the appellant was credited for such amounts for the purposes of the assessment.

Although the respondent has assessed the appellant tax pursuant to the Act based on assumptions of fact, which, it was admitted, are not "cast in stone", it is clear that the appellant bears the onus of proof of mounting a credible challenge to those assumptions. The appellant provided very little evidence and, in the Tribunal's view, no credible evidence that would establish a *prima facie* case challenging the respondent's assessment.

Consequently, the appeal is dismissed.

Zdenek Kvarda  
Zdenek Kvarda  
Presiding Member

Richard Lafontaine  
Richard Lafontaine  
Member

Peter F. Thalheimer  
Peter F. Thalheimer  
Member