BETWEEN:

HIS MAJESTY THE KING, on the Information of the Attorney-General of Canada ..... PLAINTIFF;

AND

LEON L. PLOTKINS, carrying on business under the firm name and style of LION REFINING COMPANY and said LION REFINING COMPANY and LION OILS LIMITED ..... DEFENDANTS.

1937
Sept. 21.
1938
Aug. 15.

Revenue—Sales tax—Special War Revenue Act, R.S.C., 1927, c. 179, s. 85 (a), s. 86, ss. 1 (a & b)—"Manufacturer"—Independent trading units—Partnership and limited company—Liability for tax.

Defendant Plotkins is the sole owner of Lion Refining Company, a partnership engaged in the business of manufacturing petroleum products. Lion Oils Limited is engaged in the marketing and distribution of petroleum products and other articles. Approximately sixty per cent of the business of Lion Oils Limited consists of selling petroleum products manufactured by and purchased from Lion Refining Company. Its business is carried on on premises owned by Lion Refining Company. The accounting and clerical work of both concerns are carried on by the staff of Lion Oils Limited in whose name a banking account is maintained into which are deposited the receipts of both concerns from all sources. The business transactions of each are kept distinct and in separate books. The salaries and wages of officers and employees of both concerns and all bills payable by Lion Refining Company are paid through the common banking account. Lion Refining Company sells to Lion Oils Limited and also to others. The goods are invoiced in the name of Lion Oils Limited. The two concerns share profit and loss in the proportion of $5,700, the paid up capital of Lion Oils Limited, to $20,000, the amount of Plotkins' original investment in Lion Refining Company.

The action is one to recover sales tax assessed upon the selling price of Lion Oils Limited. The Crown alleges that both concerns are to be treated as one business, or, in the alternative, that Lion Refining Company was the agent of Lion Oils Limited and that the sales to it by Lion Refining Company were fictitious and illusory and made with the intent of avoiding payment of the sales tax properly payable.

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Held: That the Lion Refining Company and Lion Oils Limited are independent trading units, and Lion Refining Company is the manufacturer of the petroleum products disposed of and is liable for the sales tax.

INFORMATION exhibited by the Attorney-General of Canada to recover from defendants sales tax alleged due the Crown under the provisions of the Special War Revenue Act, R.S.C., 1927, c. 179, and amendments thereto.

The action was tried before the Honourable Mr. Justice Maclean, President of the Court, at Calgary, Alberta.

H. S. Patterson, K.C. and *A. W. Hobbs* for appellant.

C. J. Ford, K.C. and *J. R. Tolmie* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

THE PRESIDENT, now (August 15, 1938) delivered the following judgment:

This is an Information to recover from Leon L. Plotkins, who carries on the business of manufacturing gasoline, kerosene, tractor fuels, and other petroleum products, under the firm name and style of Lion Refining Company (hereafter to be referred to as "the Refinery"), the sum of $3,873.33, as sales tax, under the Special War Revenue Act, or, in the alternative, to recover from the defendant, Lion Oils Ld. (hereafter to be referred to as "Oils Ld."), the business of which is to a considerable extent concerned with the sale of oil products manufactured by the Refinery, the sum of $3,284.83, and from the Refinery the sum of $588.50, as sales tax.

There are two taxation periods covered by the plaintiff's claim; first, that from September 1, 1932, to August 31, 1933. With this period the Refinery is alone concerned for Oils Ld. had not commenced business operations until February, 1934, and the amount claimed for this period is $588.50. The second period runs from August 31, 1933, to December 31, 1935. In this period the assessment was made against the Refinery on the basis of the sale prices of Oils Ld., for goods sold to it by the Refinery, and not on the sale prices of the Refinery. It is the contention of the plaintiff, in respect of the second taxation period, that both concerns are to be treated as one business and that the sales made by Oils Ld. were sales of the Refinery and

that the latter is liable for the sales tax in respect of the said sales, or, in the alternative, that the Refinery was but the instrument or agent of Oils Ld.; that the operations of the former were in fact the operations of the latter, and that the alleged sales made by the Refinery to Oils Ld. were fictitious and illusory and made with intent to evade payment of the amount of the sales tax properly payable, and that the sales of Oils Ld. to the trade and to consumers are assessable for the sales tax. In the further alternative it is pleaded that if the defendants were not associated or related as principal and agent, they were, nevertheless, interrelated or associated in their said business as is contemplated by a certain regulation governing the computation of sales tax, made and issued under the provisions of the Special War Revenue Act, and under which regulation it is prescribed that in such cases the price at which the goods are regularly sold to *bona fide* independent wholesalers by either of them, in the ordinary course of business, shall be the value upon which the tax is payable.

The provisions of the Special War Revenue Act of particular interest here are s. 85 (*a*), s. 86, subs. 1 (*a*) and subs. 1 (*b*). Sec. 85 (*a*) defines "sale price" as follows:

> 85 (*a*) "sale price" for the purpose of calculating the amount of the consumption or sales tax, shall mean the price before any amount payable in respect of the consumption or sales tax is added thereto, and shall include the amount of other excise duties when the goods are sold in bond; and in the case of goods subject to the taxes imposed by Parts X and XII of this Act, shall include the amount of such taxes; in the case of imported goods the sale price shall be deemed to be the duty paid value thereof.

By s. 86, subs. 1 (*a*) the sales tax is imposed "on the sale price of all goods, produced or manufactured in Canada, payable by the producer or manufacturer at the time of the delivery of such goods to the purchaser thereof." Subs. 1 (*b*) also imposes the sales tax "on the sale price of all goods, imported into Canada, payable by the importer or transferee who takes the goods out of bond for consumption at the time when the goods are imported or taken out of warehouse for consumption." The above provision of the Act is of importance here because it appears that several importations of goods were made by the Refinery either on its own account, or on behalf of Oils Ld., and upon the duty paid value of such importations the sales tax was paid by the Refinery. The plaintiff also invokes

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a regulation which states: "In cases where vendor and purchaser are interrelated, associated, or affiliated concerns, or where one is subsidiary to the other, the price at which the goods are regularly sold to *bona fide* independent wholesalers by either of them, in the ordinary course of business, shall be the value upon which the tax is payable." The validity of this regulation is, I think, subject to grave doubt, but it will not be necessary, upon the facts disclosed here, to consider it in determining the issues in dispute.

The facts concerning the business relations of Plotkins and Oils Ld. are of importance in respect of the second taxation period and it is desirable that they be stated rather fully. Plotkins, in 1932, commenced the business of manufacturing petroleum products under the registered firm name of Lion Refining Company, at or near Calgary, Alberta, and he has since been the sole owner of that business. In 1933 Oils Ld. was incorporated, with a capital of $20,000, the shares being of the par value of $50 each, and shares aggregating the value of $5,700 have been sold and issued, the shareholders numbering eighteen. Plotkins is the holder of but one share in Oils Ld., a qualifying share issued to him at the time of the incorporation of Oils Ld. It is estimated that about sixty per cent of the business of Oils Ld. had its origin in selling to the trade and consumers, petroleum products manufactured by and purchased from the Refinery, and about forty per cent from the sale of such articles as standard gasoline, ethyl gasoline, kerosene distillates, greases, tires and automobile accessories, purchased from other refiners and distributors, and which articles the Refinery did not produce. Oils Ld. owns and operates five or six filling stations in Calgary and Edmonton, Alberta, and is the owner of motor trucks, tanks, pumps and distributing equipment, that is, outside of any office equipment. The Refinery owns certain equipment and oil lands in the State of Montana, U.S.A., besides its refining plant, storage tanks, buildings, etc., in Calgary, the total invested capital now being about $75,000.

Plotkins stated that Oils Ld. was formed originally at his instance for the purpose of marketing the products of the Refinery. Later, he subscribed and paid for seventy shares in that company, in addition, I think, to his qualify-

ing share. At some stage, Plotkins entered into negotiations with one, Beauchemin, and associates, whereby the latter were to undertake to purchase one-half of the authorized capital shares of Oils Ld. and Plotkins was to subscribe for and purchase the remaining half of such shares. However, in the end, Beauchemin and his associates were able only to purchase shares amounting in par value to $5,700, which is the paid up capital of Oils Ld. to-day, distributed among eighteen different shareholders. The original proposal was that Beauchemin and his associates were to invest $10,000 in Oils Ld. and Plotkins an equal amount; and Beauchemin and his associates were also to invest $10,000 in the Refinery. The idea was that each would have the same amount of capital in the Refinery and in Oils Ld., but this scheme failed to materialize. Then, there came a time when Plotkins disposed of his share holdings in Oils Ld. because, it was stated, Beauchemin and his associates did not wish the control of Oils Ld. to be in the hands of Plotkins; the retention of Plotkins' qualifying share in the corporation was owing, it was said, to an oversight in not selling the same, or in not transferring back the same to Oils Ld., I do not know which. Plotkins was, however, appointed manager of Oils Ld. some time after it commenced business, exactly when is not clear.

The business of Oils Ld. is carried on upon the premises of the Refinery, for which, it was said, an allowance by way of rent is made in calculating the administrative expenses of Oils Ld. The accounting and clerical work of both concerns is carried on by the staff of Oils Ld., but whether or not an allowance is made Oils Ld. for such services was not, so far as I recall, explained. The only banking account is in the name of Oils Ld., and into this account the receipts of both concerns from all sources are deposited, but the business transactions of each concern are kept entirely distinct and in separate books. The salaries and wages of officers and employees of both concerns, including the salaries of Plotkins as manager of both Oils Ld. and the Refinery, and all bills payable by the Refinery, upon the proper voucher and order of the Refinery, are paid through this banking account—the Refinery being credited or debited with receipts and payments in

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the books of Oils Ld., as the case may be. The Refinery employs some fifteen or twenty people exclusively for its own operations. All goods sold and delivered by the Refinery to Oils Ld. are duly invoiced to the latter, and it would appear that a settlement is made on annual balances of all debit and credit transactions as between the two concerns, although that is not quite clear from the evidence. Where goods are sold by the Refinery to customers other than Oils Ld., the same are invoiced in the name of Oils Ld., and at prices identical with prices charged Oils Ld. by the Refinery. At times, the Refinery imported or purchased from producers in the domestic market, for the account of Oils Ld., certain goods which it could not supply, and which importations or purchases were delivered over to Oils Ld. at cost, together with the cost of freight and handling. The Refinery and Oils Ld. have a profit and loss sharing arrangement in the proportion of $5,700, the paid up capital of Oils Ld., to $20,000, the amount of Plotkins' original capital investment in the Refinery, as I understand it; the division of profits and losses on this basis is made at the end of each year. It was upon the book entries of sales made to the trade and consumers by Oils Ld., and not upon the selling prices from the Refinery to Oils Ld., that the assessments for the sales tax here in dispute were made.

In February, 1934, the Refinery (as "the Company") and Oils Ld. (as "the Purchasers") entered into an agreement to run for the period of five years, with an option to Oils Ld. to renew the same upon the same terms for a further period of five years, and some of the terms of that agreement perhaps should be mentioned; paragraphs 1, 2, 3, 4, 5, 8, 9 and 11 of the agreement are as follows:

1. The Company shall sell and deliver to the Purchasers and the Purchasers shall purchase and receive of and from the Company the whole of the output of the Company, including gasoline, kerosene, distillate, Gas Oil, Fuel Oils and all other products of any nature.

2. Notwithstanding anything hereinafter mentioned the Purchaser shall purchase exclusively from the Company all products that the Company are ready, willing, and able to supply at price calculated in accordance with Paragraph 8 hereof and are required by the purchaser.

3. All products supplied by the Company to the purchaser under this agreement shall be made according to specifications mutually agreed upon.

4. The purchaser covenants and agrees that the minimum quantity of products to be accepted by it under the terms of this agreement shall not be less than forty thousand (40,000) gallons during each of the months

of November, December, January and February in every year during the currency of this agreement and eighty-five thousand (85,000) gallons in every month of the year not heretofore mentioned.

5. The purchaser covenants and agrees that the minimum quantity set out in clause four (4) hereof shall be increased in every month of each successive year by an amount equivalent to twenty-five (25) per centum of the monthly gallonage agreed to be accepted in each preceding year.

8. The prices of various products supplied to the purchasers under this agreement shall be based on the actual cost to the company plus one cent (1c.) per gallon. The terms of payment shall be cash on receipt of invoice from the Company.

9. The purchasers shall be the sole representatives of the company in regard to the products supplied under this agreement and shall use every endeavour to advertise and push the sale and solicit business for products so supplied by the Company.

11. Notwithstanding anything hereinbefore set out the Company shall, if the purchaser does not accept the minimum quantity agreed to be accepted in any one month, extend for 60 days the time for acceptance of such quantity, and have the right to dispose of the difference between the quantity actually accepted and the quantity agreed to be accepted to any other purchaser. Any number of gallons in excess of the minimum quantity as hereinbefore set out, actually accepted in any one month shall be construed as accepted in any succeeding month during which the minimum quantity has not been accepted.

The terms of the agreement as to the quantities of goods to be sold and purchased were not fully carried out during the period in question, owing in some cases to the inability of the Refinery to supply the precise goods required by Oils Ld., and in other cases to the non-acceptance by Oils Ld. of the stipulated quantities, and which the Refinery was able to furnish. The provision as to price, cost plus one cent per gallon, was found to be impractical and was not adhered to. With those exceptions the spirit of the agreement was observed by both parties; whether the agreement is presently an enforceable one is perhaps debatable, but in any event I do not think that is of vital importance. We are here concerned with the actual transactions that took place between the two defendants, the true character of the sales in question; and which of the two defendants is taxable upon such sales and the proper basis of assessment.

I may at once dispose of the issues in respect of the first period, and which concern the Refinery alone. There are just two points for decision in respect of that period. The Refinery imported from the United States, or purchased from domestic producers or wholesalers, a considerable quantity of what is known as "gas oil," which it

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sold under the name of "tractor fuel," and sometimes as "gas oil," without further processing or manufacture, and without any change in the structure of such product. Upon such sales the Refinery was assessed as a manufacturer or producer, upon its selling price, or the selling price of Oils Ld., and not on the import or purchase price, which assessments, in my opinion, cannot be sustained, and this I think was conceded. This would be applicable also to the second period, in so far as the same state of facts pertain thereto. There was one other point in issue, the sale price of fuel oil, but that is concluded by the plaintiff agreeing that the price should be reduced from 5 cents to 3 cents per gallon. The only point therefore to be determined in this period is the volume of taxable sales, and unless counsel can agree upon this there will be a reference to determine the amount of the taxation payable and due, because I see no way of doing that myself.

Another point might also be disposed of at this stage. A dispute arose between the Refinery and the Department of National Revenue as to whether the mixing of raw naphtha and gas oil, or raw naphtha and kerosene, constituted a "manufacture," and the Department ruled that it did, and in this I concur. If Oils Ld. engaged in the same practice—my impression is that it did not—it also would be a "manufacturer" and liable for the tax. It is not absolutely clear to me that the ruling of the Department was accepted by the Refinery and that the sales tax was paid on such manufactured goods, but if not then I find that the Refinery is liable for the tax upon the same, in the proper amount.

The principal question for decision is whether it is against the selling prices of the Refinery, or those of Oils Ld., that the tax should be levied, or whether the Refinery should be assessed upon the selling prices of Oils Ld., and in fact it was the latter that was done. Cases of this type always contain perplexing features, and they are difficult to resolve with confidence. The statute imposes the tax upon the producer or manufacturer. The tax must be levied against the sales of the producer or manufacturer unless it be that he is but the agent of another for any of such purposes, and possibly there may be other exceptions. Imposing the tax upon other persons or companies,

outwardly independent of but working in close co-operation with the manufacturer or producer, particularly in selling the goods of the latter, is bound to present difficulties,—first, because the former is not in fact the producer or manufacturer, and secondly, because the selling prices of the former will usually include some of the profit customarily exacted by wholesalers and retailers. In such cases very clear evidence should be required to shift the imposition of the tax from the producer or manufacturer to another. Sec. 98 provides that where goods are sold, in the judgment of the Minister, at less than the fair price, and this means the selling price of the producer or manufacturer, the Minister may determine the fair price. That seems a very suitable and just provision, particularly if the taxpayer has the right of appeal therefrom. This provision of the statute would seem to contain all the machinery necessary for settling all disputes of the nature in question here, which usually is but the contention that the producer or manufacturer has sold his goods at an unfair price, which he seeks to conceal by some subterfuge or another; that is always the question at stake in such cases —largely a question of fact.

I was referred to the *Palmolive* case (1), but I do not think the facts there are similar to the facts of this case. There, it was held that the manufacturing company was merely the agent of the selling company and subject in all things to the direction and control of the latter, and that the operations of the former were the operations of the latter, and there was some evidence to support that finding. I do not think it is possible to say that in the case under consideration the Refinery was the manufacturing agent of Oils Ld., but it might be argued that Oils Ld. was merely the selling agent of the Refinery, and in fact that is one of the contentions here made by the plaintiff. It seems to me that the Refinery and Oils Ld. must be held to be independent trading units, and the agreement and the facts concerning their several activities, I think, support that conclusion. Their business relations were of course intimate and probably so designed for their mutual advantage, but that does not of itself constitute them a single business enterprise for the purposes of the tax, or otherwise. That

(1) (1933) S.C.R. 131.

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requires a state of facts that indubitably points to a business arrangement made to evade the tax, or, that one so dominated and controlled the business of the other that one is obliged to say that the existence of that other was apparent only and not real; I do not think that can be said here. The division of profits and losses on the basis of capital employed by each is a suspicious and unusual circumstance, but that circumstance after all does not go to the question as to which concern was in fact the manufacturer or producer, or to the question of the proper sales price. The Refinery, it is perfectly clear, was the manufacturing concern, and it sold its goods to Oils Ld. which was to sell the same to the trade and consumers, generally at an advanced price which would not be improper. Neither can I see how it can be said that the Refinery was but the agent of Oils Ld., in manufacturing the goods in question. I think, however unusual the practice of the defendants dividing their respective profits and losses, each was an independent trading unit, and each acted on its own behalf. The facts disclosed concerning their several business activities, I think, support such a conclusion. I therefore am of the opinion that, upon all the facts disclosed, it cannot be said that the Refinery was not the manufacturer or producer of the goods in question, or that it was the mere agent of Oils Ld., or that Oils Ld. is not an independent trading unit.

I turn now to the question of the sale prices of the goods in question, by the Refinery, because that is still a matter of importance. There was put in evidence by the Refinery a tabulated statement showing a list of the various named products which it sold to Oils Ld. and the prices charged therefore respectively, and the prices at which such sales were assessed for the tax, which, I understand, in all cases were the selling prices of Oils Ld. to the public. There were also put in evidence invoices showing importations, or purchases from domestic producers, by the Refinery, mostly in 1935, for its own account or that of Oils Ld., of such articles as motor fuel, kerosene distillates, tractor fuel, naphtha and washed naphtha, which the Refinery could not at the time supply Oils Ld. I do not propose to mention all the details of these invoices, or review any of the explanations made concerning them by Plotkins. It

will suffice to say that these invoices show duty paid importations, or purchases from domestic producers, of oil products, which, expressed in imperial gallons, cost the Refinery respectively 9·4, 11·8, 9·8, 7¾, 8·9, 8·4, 10¼, 10¼, 8·5, 8·9, 10, 11·2, 8·4, and 10·3 cents per gallon, and upon these importations and domestic purchases the assessments for the sales tax, stated in the same order, were based upon a selling price of 13, 13½, 12½, 13½, 12½, 13, 12½ 10½, 12·7, 12·7, 12½, 18, 13½, and 14½ cents per gallon respectively. It would appear that in one case the tax was paid when the goods were properly free of the tax; and in one other case the tax paid, inadvertently on the part of both parties it was said, was much higher than was payable. I am not required to make any adjustments in respect of those matters. Upon all these importations and domestic purchases the Refinery made returns on account of sales tax on the basis of the purchase prices, and so far as I can gather the tax thereon was in all cases paid. I have no reason to doubt that the purchases which I have just mentioned might have been made by any one else in wholesale quantities, and upon the same terms as to price. The tax upon these purchases having once been paid I do not understand how it can be said that the tax may be imposed on resales of such purchases; and I was not referred to any provision of the statute authorizing the tax on such resales. In such cases it matters not what were the business relations between the Refinery and Oils Ld. Plotkins stated that he showed, but ineffectually, the investigating officer of the Revenue Department certain of these invoices which would exemplify the principle of assessment for which he was contending, namely, that the tax should not be assessed against the Refinery's importations of goods, or goods purchased from domestic refineries, because the tax had already been paid thereon, or that he was willing to pay the same upon the proper assessment, and that the price of certain goods should not be varied because they were sold under a name different from that under which they were manufactured, imported or purchased. The prices at which the Refinery sold to Oils Ld. were determined largely by the prices at which the Refinery could import similar goods from a certain refinery in the State of Montana, or from domestic manufacturers.

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The importations and domestic purchases illustrated by the invoices referred to seem to have been made in the usual course of business, and there is nothing to indicate that the prices therein mentioned were not the *bona fide* prices current at the time, and at which prices others might have made purchases, from the same vendors, of the corresponding goods.

And there is something further to add. There seems to have been a disagreement between the Refinery and the Revenue Auditor regarding the standard or grade of certain oil products which the Refinery imported or purchased under one name, and sold under another name, for example, a product imported as "gas oil" was sold as "tractor oil," and apparently a distinction was made between them for taxation purposes. Plotkins claimed they were the same thing and upon the evidence before me I feel obliged to hold that in this he was correct. Again the Refinery purchased from the Royalite Oil Co. Ltd. of Turner Valley, Alberta, the manufacturer or producer, a product called "absorption plant gasoline," which the Refinery did not produce, and which it sold as "motor fuel"; any one could have bought the same article for 7½ cents per gallon as did the Refinery; but for this reason the assessment for the sales tax seems to have been fixed at the rate of 13½ cents per gallon, as if it were in fact another article that was sold; this seems to me to be untenable. Again the Refinery did not produce gasoline of the highest standard; the only evidence on the point goes to show that the gasoline produced by the Refinery was of a third grade or standard, and the Refinery claims that this should always have been taken into consideration in ascertaining the current price, and in making the assessment, of its sales of gasoline. I cannot but think that this contention is a correct one in estimating the fair market price of gasoline produced and sold by the Refinery; the Refinery was, I think, obliged to consider this factor as an element in its price-fixing. It seems to me that the revenue officers did not properly approach the matter of the sales tax assessments in question, and this of course was inevitable if they had concluded that the proper basis of assessment against the Refinery was the selling price of Oils Ld. to the trade and the public. Further, it is to be remembered that the

Refinery was not bound to sell its products at precisely the same prices charged by other importers, manufacturers or producers, in Canada; that was never contemplated by the Act, as there might be many very obvious reasons why the prices of the one should be lower or higher than those of the other.

Upon the evidence before me it is my opinion that the Refinery is the party liable for the tax, and that generally it has made returns for the tax in connection with the sale transactions in question here, upon the proper basis, and at the proper prices. However, the evidence perhaps is not complete in respect of every transaction and in some respects it is somewhat confusing, and I hesitate to say that the Information should, at once, be dismissed. If under the terms of this judgment the plaintiff is advised that the prices of some of the sales transactions of the Refinery have not been fully established by the evidence, or that they should be more definitely determined, or, if there is any reasonable ground for a difference of opinion as to the net amount payable by the Refinery under this judgment, then I grant leave to the plaintiff to move within thirty days from the date of this judgment, to show cause why an order should be made directing the appointment of a Referee to take evidence in respect of any of such matters, and to report thereon. However I hope this will not be necessary. Failing such a motion on the part of the plaintiff, within the period mentioned, this action will stand dismissed with costs, but otherwise the matter of costs will be reserved.

Judgment accordingly.