

CANADA / JUDGMENT

West Fraser Mills Ltd. v. British Columbia

2014 BCSC 2335

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Supreme Court of British Columbia

DECIDED

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2014 BCSC 2335 West Fraser Mills Ltd. v. British Columbia

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

West Fraser Mills Ltd. v. British Columbia,

2014 BCSC 2335

Date: 20141210

Docket: S125878

Registry: Vancouver

Between:

West Fraser Mills Ltd.

Petitioner

And

Her Majesty the Queen in Right of

the Province of British Columbia

Respondent

Before: The Honourable Madam Justice Baker

Reasons for Judgment

Counsel for the Petitioner:

Kimberley L. Cook

Counsel for the Respondent:

Sointula Kirkpatrick

Place and Date of Hearing:

Vancouver, B.C.

October 29, 2013

Place and Date of Judgment:

Vancouver, B.C.

December 10, 2014

- [1] This is an appeal by West Fraser Mills Ltd. ("WFM") from a decision of the Minister of Finance for the Province of British Columbia ("the Province") made under the Social Services Tax Act, R.S.B.C. 1996, c. 411, as amended ("the Act"). The Minister's decision, made on June 13, 2012, affirmed in part a decision of the Social Services Tax Commissioner (the Commissioner") which had denied a claim by WFM, made under s. 82 of the Act, for a refund of social services tax paid on certain items that WFM claimed were "parts" and subject to a "parts exemption". The relevant time ("the relevant period") in issue during which the items in issue were purchased is January 31, 2005 to August 16, 2008.
- [2] The purchased items put in issue in the Petition were electrical cable, hydraulic hose, conveyor belting and chain. At the start of submissions by counsel for the Province, she advised that the Province concedes that the exemption for tax on conveyor belting and chain for items identified in Appendix A to the Province's written submission is no longer in dispute. I understood her to mean that the Province concedes these items are tax-exempt. WFM concedes that 12 and 14 gauge lighting cable is not exempt. WFM presented no evidence about certain items - referred to by the parties as "no evidence items" - and I agree with the Province that WFM's appeal in respect of these items must be dismissed as WFM has failed to prove that these items qualify for exemption.
- [3] Accordingly, the remaining issue is whether items generally described as "electrical cable" (other than 12 and 14 gauge cable) and "hydraulic hose" are "parts" subject to the "parts exemption" and therefore exempt from tax. The parties are agreed that in the event that I decide that some or all of the hose or cable is exempt and allow the appeal in respect of those items, the matter should be referred back to the Commissioner for reconsideration. Counsel for the Province told the Court that the parties have a dispute about whether tax has been paid on some of the items; and that dispute should go back to the Commissioner for determination regardless of the outcome of the appeal. I agree with that submission and so order.

CONCLUSION:

- [4] For the reasons that follow, I am of the view that electrical cable and hydraulic hose are not "parts" subject to the "parts exemption" and are therefore not exempt from tax. The decision of the Commissioner is affirmed in relation to electrical cable, hydraulic hose and the "no evidence items". The matter is remitted back to the Commissioner to calculate the tax payable in respect of those items, as well as the 12 and 14 gauge cable that WFM concedes is not tax-exempt. The matter is also remitted back to the Commissioner to calculate the credit due to WFM in relation to conveyor belting and chain, which the Province has conceded is tax-exempt; and for the determination of whether WFM has actually paid the tax for which it is seeking (and qualifies for) an exemption.

THE FACTS

- [5] In setting out the facts, I have borrowed liberally from the Petition and from the Amended Response to Petition. Facts are also derived from the affidavit evidence of Tom Briggs, who is an engineering manager employed by WFM; and Deborah Brouwer, an appeals officer in the Tax Appeals and Litigation Branch of the Ministry of Finance ("the Ministry").
- [6] Mr. Briggs was cross-examined on his affidavit on May 9, 2013. Although the entire transcript of the nearly three-hour cross-examination was included in the Chambers Record, counsel made only passing reference to the transcript in their submissions. I have read the entire transcript.
- [7] In mid-February 2009, the Ministry received an Application for Refund of tax from WFM. WFM was seeking a refund of sales tax in the amount of \$186,242.20 that it claimed to have paid on items of tangible personal property. WFM claimed the refund on the grounds that the items purchased qualified for the exemption of tax provided for in s. 76(1)(k) of the Act and Division 13 of the Social Service Tax Act Regulations.
- [8] The Application for Refund attached numerous schedules which are included in the Chambers Record.
- [9] The Commissioner, under the Act, allowed \$5,125.09 of the Refund Claim and denied \$181,127.11 on the basis that the items claimed were not "parts" within the meaning of the parts exemption; or were tangible personal property used to make parts and therefore not exempt by reason of s. 79.1 of the Act. The Commissioner's determination was that the items in issue were "materials" that could be used to make parts; but were not themselves "parts".
- [10] The Commissioner also denied some of the refund claimed by WFM on the basis that some items had been duplicated; or had been included in an earlier refund claim; or on the basis that WFM had not actually paid the tax on some of the items for which a refund was claimed.

- [11] WFM appealed the Commissioner's denial of refund to the Minister of Finance pursuant to s. 118 of the Act. The Minister allowed a further refund of \$2,392.12 but affirmed the Commissioner's decision to deny a refund in respect of the balance of \$178,734.99. The Minister set out his decision in a letter to WFM dated June 13, 2012.
- [12] In the letter, the Minister stated that the denial of exemption was based on the determination that the items claimed were not "parts" but rather "bulk materials" for which there was no tax exemption during the relevant period. The Minister pointed out that effective February 18, 2009, the Regulations were amended to provide an exemption for bulk materials. The Minister stated that exempt parts were distinguished from taxable materials by consideration of whether the purchaser had to "modify, process, cut to length or otherwise alter an item before it could be used on exempt machinery or equipment. He stated:

Generally, if the purchaser had to modify the item, then it was considered to be taxable as materials; if the item was ready to use when purchased, it was a part.

- [13] The Petitioner filed its Petition to the Court on August 21, 2012, appealing the decision of the Minister.
- [14] During the relevant period, WFM manufactured wood products, including lumber, plywood, medium density fibreboard, laminated veneer lumber, pulp, newsprint, and wood chips. WFM owned and operated a number of sawmills, plywood mills and pulp mills in British Columbia. During the relevant period, WFM had operations in at least eight locations in British Columbia, including a sawmill called 100 Mile House Lumber; a kraft or chemical pulp mill called Cariboo Pulp and Paper; a plywood mill called Quesnel Plywood; a mechanical pulp mill called Quesnel River Pulp; a lumber mill called North Star Lumber; a sawmill called Quesnel Sawmill that opened in January 2007; a plywood mill called Williams Lake Plywood; and a fibreboard plant called West Pine MDF. I shall refer to each of these operations as "a plant" and to one or more of the operations collectively as "plants".
- [15] Each of the plants contains many machines and pieces of equipment. Mr. Briggs testified, for example, that at a WFM sawmill there are debarkers, cut-off saws, canters, edgers, gang edgers, trimmers, sorters, dry kilns, planers, and "a whole host of optimization and scanning equipment". (Transcript, p.4, lines 30 to 39). Hydraulic hose and electrical cable is used at all of WFM's plants and production facilities. Mr. Briggs testified that every one of the machines used at a WFM sawmill has cable attached to it.
- [16] According to the paragraph 13 of the Petition Factual Basis, which Mr. Briggs affirmed to be true, WFM purchased electrical cable and "hydraulic hose" in "bulk lengths and sizes" during the relevant period.
- [17] The electrical cable consists of copper wire sheathed in either a rubber or a metal casing. The majority of cable - known as "teck cable" - has a steel armour casing. Different sizes of cable are purchased, including 18 gauge cable which is used in "low voltage control

equipment". As stated earlier in these Reasons, 12 and 14 gauge cable, used for lighting at various plants, is no longer in dispute. WFM has conceded that it is not eligible for exemption. Ten gauge and larger cable is used to connect the main power supply to "motor control centers" and to connect "motor control centers" to various machinery and equipment at the various plants.

[18] Mr. Briggs testified that a motor control center is:

" where we do the switching. Because most of the motors run on a higher voltage and our control is low voltage so a little voltage switch pulls in the breakers that puts the high voltage power. Switches it to the motor. (Transcript, p. 25, lines 24 to 29).

[19] All of the cable is purchased in bulk. At times, WFM purchased hundreds of metres of cable at a time. The cable arrives rolled or wrapped around a reel. Exhibit J to Mr. Briggs affidavit is a photograph of large reels (I would also call them spools) of bulk cable in different sizes. Other exhibits include photographs of cable in use in various locations in a WFM plant.

[20] The cable is used in a variety of ways in the plants, according to Mr. Briggs, including: new installations, modifications to existing machinery and equipment, maintenance, and emergency applications (paragraph 16 of Briggs affidavit #1.

[21] The particular application determines what type and length of cable will be used. Mr. Briggs testified that there are standard or common sizes of cable, depending on the motor in question. All 200 horsepower motors will require the same sized cable; all 300 horse power motors would require a different sized cable. WFM generally has more than one of each of these sizes of motors at each plant.

[22] Mr. Briggs has deposed that when cable is required for use in a plant, a WFM electrician takes cable from the reel or spool and cuts it to the length required for use. Sometimes the length of cable needed is known. At other times, cable is pulled off the reel or spool with "tuggers" or "winches" and pulled through a "cable tray" until there is a suitable length of cable to reach both ends of the intended route. The cable is then cut to length from the spool or reel.

[23] Mr. Briggs has deposed that the cable must be purchased in bulk, because purchasing it in pre-determined lengths for a specific use would be costly and involve too much lag time between order and delivery.

[24] Also included in photographs attached as exhibits to Mr. Briggs' affidavit are pictures of various "connectors" and "fittings" that must be attached to each length of cable in order to attach a piece or length of cable to a machine or to a piece of equipment. Mr. Briggs refers to "splicing" the measured cable length using a connector. The cable on the reel has nothing at either end - it is " just a straight cut of whatever the vendor cut it off of". (Transcript p. 27, lines.32 to 33). Generally, the vendor has cut it off a larger reel.

- [25] Generally, the cable has to be threaded through all the internal workings of a motor control centre before the connector or fitting can be attached to it, because the cable with connector or fitting already attached would be too large to fit. Certified electricians take the end of the cable that has been unrolled off the reel and pulled through the pathway into the machine. The electrician then must strip the outer layers off the end of the length of cable to expose the copper inside the cable; and then crimp or screw the fitting onto the exposed copper end of the cable. The fitting is then attached to a connector and the connector is attached to the motor control centre.
- [26] Mr. Briggs testified that the fittings and connectors can sometimes be removed from the cable, and "reused collectively or separately". A connector may be reused when a length of cable is replaced. Crimped connectors are not reused. Connectors that are screwed on can be reused.
- [27] Mr. Briggs also testified about hydraulic hose - the second of the disputed items on this appeal. Hydraulic hose is used at various WFM plants. In his affidavit, Mr. Briggs described it as "thick industrial hose that is used for hydraulic applications". (Paragraph 19 of Briggs Affidavit #1).
- [28] The hose is generally purchased in different sizes, by the meter, and comes wrapped or wound around a large reel or spool. The hose diameter ranges from one-quarter inch to two inches. The hose is used for a variety of applications - in general, applications that require a hydraulic cylinder, or motors that power equipment. Mr. Briggs testified that while hose may be used for air or water, usually the hose in a WFM plant carries an oil product. The fluid moves to create energy and power.
- [29] Like electrical cable, hose is used in new installations, modifications, maintenance applications and emergency applications. Installation of the hose involves pulling a measured amount of hose off the hose reel, cutting it, and affixing a screw style or crimped fitting connector to each end of the cut hose. The hose is then installed using the connectors. Sometimes an already installed hose will be cut and a connector attached to it so that "the new length of hose can be screwed on to the existing hose". (Paragraph 23 of Briggs Affidavit #1).
- [30] Occasionally, hose is purchased in a pre-determined length but this typically occurs only on a "capital project". Mr. Briggs deposed that it is impractical to purchase hose in pre-determined lengths because that would require measuring the length required for each potential application and that would be costly and involve too much lag time between order and delivery. Therefore, hose is generally purchased in bulk. Mr. Briggs agreed in cross-examination that during the relevant period, WFM purchased hose in lengths of 20 to 50 metres. Hose might be purchased to go immediately onto a specific machine, or it might go into inventory to await later use. Mr. Briggs testified that hose is something that wears out and requires regular replacement.

- [31] Attached to Mr. Briggs' affidavit are photographs of hose that has been attached to a "screw type connector" and hose that has been attached to a "crimp style connector". Mr. Briggs testified that there are "a whole host of different styles of fittings". (Transcript, p.50, lines. 10 to 11). The type of fitting required depends on the machine or machines to which the hose is to be attached. When required, the hose must be removed from the reel and cut to length and the correct fittings or connectors must be selected and attached to the hose ends. Some types of fittings require a rubber layer to be stripped off the hose before the fitting or connector can be attached.
- [32] While hose can be purchased with a connector attached, Mr. Briggs testified that it is "more than likely" that the hose in issue here was purchased without connectors or fittings attached.

THE LEGISLATIVE AND REGULATORY PROVISIONS

- [33] Section 5 of the Act imposes a tax on the purchaser of tangible personal property. The Act, and Regulations made pursuant to the Act provide that certain property is exempt from taxation. Section 76(1)(k) of the Act exempts:

- (k) prescribed machinery or equipment purchased or leased by a prescribed manufacturer or other prescribed person for a prescribed use.

- [34] Section 13.2(1) of the Regulations provides:

For the purposes of section 76(1)(k) of the Act and subject to subsections (2) and (4), the following are exempt from tax if purchased or leased by a manufacturer:

- (a) machinery or equipment for use primarily and directly in the manufacture of qualifying tangible personal property;

- [35] Section 79.1 of the Act provides:

An exemption provided under this Act for tangible personal property does not apply to tangible personal property used to make that property.

- [36] There is no dispute that WFM is a "prescribed manufacturer" and that in its plants it has machinery and equipment that fall within the definition of "prescribed machinery or equipment", being machinery or equipment for use primarily and directly in the manufacture of qualifying tangible personal property.

- [37] As stated earlier, the period during which the items in issue were purchased commenced January 31, 2005 and ended August 16, 2008. There was a change in the Regulations during that period.

- [38] During the period January 31, 2005 to February 22, 2006, the relevant Regulation - s. 13.10.2 - provided the following exemption for parts:

Parts purchased or leased for use on machinery or equipment that is exempt from tax under this Division are exempt from tax if purchased or leased by a person who is eligible to purchase or lease machinery or equipment exempt from tax under this Division.

[39] Effective February 22, 2006 and continuing to the end of the period in issue, the parts exemption was expanded to provide an exemption for:

Parts purchased or leased by a person to assemble machinery or equipment that would have been exempt from tax under this Division had it been purchased or leased by that person as machinery or equipment

Regulations, s. 13.10.2(2) as of February 22, 2006.

[40] After the end of the period at issue in this appeal, the Regulations were again amended, resulting in a further expansion of the exemption. After February 18, 2009, (after the relevant period covered by this appeal) the exemption applied to:

Materials purchased or leased to repair, maintain or modify machinery or equipment that is exempt from tax under this Division...

Regulations, s. 13.10.2(3), as of February 18, 2009.

[41] WFM submits that the electrical cable and hydraulic hose in dispute is "parts purchased for use on" exempt machinery or equipment" within the meaning of Regulation 13.10.2(2); and "parts purchased by a person to assemble" exempt machine or equipment, within the meaning of Regulation 13.10.2(3). WFM submits that other than cutting the item to the length required to fit the intended application, the installed cable or hose was identical to the cable or hose that was purchased. WFM concedes that the character of the items in dispute is to be determined at the time of purchase. WFM asserts that the cable and hose are "parts" when purchased.

[42] The Province submits that the electrical cable and hydraulic hose, at the time of purchase, are materials that are or may be used to make or manufacture parts of various kinds, but are not parts unless and until modified and installed and therefore, not exempt.

[43] In the Petitioner's Brief, counsel included an excerpt from a Consumer Taxation Branch Notice issued in February 2002 that reads:

Consumable and Materials to Make Parts

The exemption does not apply to consumable or to materials used to make parts. Materials used to make parts are tangible personal property that, at the time of purchase, must be modified before use as a part for machinery or equipment. This would include generic hoses that must be cut to length, conveyor belt material that requires fitting and processing, and sheet metal that may be of specialized density and strength but that must be cut, modified, or manufactured before use.

- [44] WFM submits that this Court is bound to follow the decision of this court in *Teck Cominco Metals Ltd. v. HMTQ*, 2008 BCSC 1131, and the Reasons given by Justice Frankel in denying leave to appeal, reported at 2009 BCCA 3.
- [45] In *Teck*, the item in dispute was a conveyor belt purchased to replace the conveyor belt in *Teck's* newly-acquired mine in Highland Valley. The conveyor belt was delivered in three pieces and the pieces had to be spliced together. The Crown denied *Teck's* application for an exemption and argued that conveyor belts were exempt parts only if the belt did not require any modification after purchase and did not have to be processed or fitted to secure it to the conveyor system.
- [46] Justice Satanove (as she then was) rejected the Crown's argument. At paras. 9 and 10 of her Reasons, Justice Satanove described the *Teck* conveyor belt that was in issue in that case:
9. The Petitioner concedes that the conveyor belt had to be cut into three segments and later spliced back together. The reason for this is that the belt was 9,268 feet long, 5 feet wide, weight 90,000 pounds, and was impossible to transport from the manufacturer to the mine site in one piece. In order to install the belt, the segments were laid out at the mine site next to the conveyor. To affix one segment to another, 10 feet of one layer of the two ply fabric of each segment was removed and the 2 remaining single ply areas were glued together with a sheet of untiered rubber between them. A vulcanizer using heat and air pressure sealed the pieces together so that the belt had the strength of a contiguous piece. The belt could not be ordered with mechanical fasteners, nor could a "saddle" be inserted using mechanical fasteners.
 10. The conveyor belt was manufactured to order based on specifications that required 3,268 feet of two layers of polyester nylon fabric weaved in between a one-half inch thick top cover and one-quarter inch thick bottom cover made of a special type of rubber especially designed to be cut and gouge resistant, and only used in heavy mine operations.
- [47] At paras. 25 to 28 of her Reasons, Justice Satanove dealt with the distinction between materials used to manufacture a part; and a part itself. At para. 26 she wrote:
26. I find on the evidence in the affidavits and cross examination transcripts before me that the conveyor belt was not used to make something else. It retained its form, qualities and properties as a conveyor belt. The only difference between the conveyor belt at the factory and the conveyor belt in the conveyor system was that the three pieces had been joined and installed so that the belt fulfilled its proper function in the system. The method of installation of the conveyor should be irrelevant; it is the use of it that defines its character as "a part" for social services tax purposes.
- [48] At para. 28, she wrote:

28. The conveyor belt as delivered from the factory was in as finished a state as it could be for transportation purposes. The materials used to manufacture it consisted of fibre, cable, polyester nylon weave and rubber compounds. The conveyor belt once so manufactured was complete and ready for installation. As previously stated, nothing in the installation process changed the properties of the conveyor belt.
- [49] The Crown sought leave to appeal Justice Satanove's decision. The application was heard by Justice Frankel, who denied leave. In the Reasons he gave for denying leave, he noted that the critical factor for his consideration was whether the proposed appeal raised "substantial questions to be argued" (at para. 20).
- [50] At para. 29, Justice Frankel stated his view that there was "no prospect" that a division of the Court of Appeal would disagree with Justice Satanove's findings of fact and her legal conclusion that "this particular replacement conveyor belt" was a "part" for the purpose of Regulation 13. 10.2(1).
- [51] In paras. 30 and 31 of his Reasons, Justice Frankel stated his view that Justice Satanove's decision was not authority for the proposition that "anything that goes into a tax-exempt piece of equipment or machinery will be considered a tax-exempt part". In his view, the decision was confined to its specific facts. He noted that the Crown's concern that the decision would greatly expand the scope of the "parts" exemption would have to be addressed in future cases "having regard to the particular facts on which an exemption claim is based".
- [52] I am of the view that the decision in Teck is distinguishable based on its facts. The hose and cable in issue on this appeal are of a quite different character than the unique piece of equipment at issue in Teck.
- [53] The cable and hose in question here are, in my view, not constituent "parts" of a machine at the time the hose and cable is purchased, but rather bulk materials capable of being manufactured into parts of various kinds that can be attached, once manufactured, to a variety of machinery or equipment. Unlike the conveyor belt in Teck, which was "manufactured to order based on specifications", the hose and cable here is generic in nature and largely interchangeable. The hose and cable was not manufactured to order based on WFM's specifications. It was not cut to pre-determined lengths for a pre-determined purpose or use. It could not be used as a part without adaptation, including cutting it to size and adding other items - fittings and connectors - which would allow it to be attached to a machine.
- [54] Although WFM has good reasons for its preference to buy cable and hose in bulk amounts on reels rather than pre-measured; it is not impossible for it to purchase pre-measured hose or cable in the sense that it was impossible for Teck to purchase a 90,000 pound conveyor belt in one, rather than three, sections.

- [55] So far as the evidence in this case indicates, the hose and cable was not purchased with a specific application in mind. WFM submits that because hose and cable are essential to the operation of the machines and equipment in the plants, hose and cable must be "parts". I do not agree. It is clear from the comments of Justice Frankel in *Teck* that not every item that goes into an exempt piece of machinery or equipment will be an exempt "part". Oil, grease or water could be said to be essential to the operation of machinery or equipment, but these could not be said to be "parts". Sheet metal could be cut and fitted to be attached to machines or equipment but in my view, bulk sheet metal does not meet the definition of "part" at the time it is purchased.
- [56] "Parts" is the plural of "part" or "a part". A reel of hose or cable is not, in my view, singular or "a part". A particular piece or section of hose or cable may become a "part" once cut, stripped, crimped or fitted and attached to a connector at one or both ends, but until those modifications and additions have been made, it is merely "material". In some instances, the hose or cable cannot even be cut to the correct length until threaded through guides or into equipment, after which it is stripped and added to a connector. I agree with the Province that the hose or cable may become a part, but if that occurs, it occurs after, and not at the time, the cable or hose is purchased. It is not a part at the time of purchase and that is the relevant time for determination of the exemption as both the taxpayer and the Province must be able to determine, at time of purchase, whether tax is payable.
- [57] For these Reasons, I am of the view that the appeal in relation to the Minister's rejection of the claimed refund for hose and cable must be dismissed, as well as the appeal in relation to the items for which no evidence was tendered. As stated earlier, the matter will be remitted to the Commissioner to reconsider the refund claim based on the concessions made by the parties at the hearing of this appeal; and my Reasons; and in order to determine if tax for which a refund may be due, was actually paid.

COSTS

- [58] Rule 14-1(9) provides that costs of a proceeding must be awarded to the successful party unless the court otherwise order. In my view, the Province has been the successful party on this appeal. The Province shall have its costs of the appeal, on scale B.

"W.G. Baker J."

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