Docket: 2005-2982(GST)G

BETWEEN:

SPORT COLLECTION PARIS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 28 and June 29, 2006, at Montréal, Quebec

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant:	Louis-Frédérick Côté and Josée Massicotte
Counsel for the Respondent:	Denis Émond

JUDGMENT

The appeal from the assessment made under Part IX of the *Excise Tax Act* ("ETA"), notice of which is dated December 23, 2004, and bears the number 0311010536, for the period from December 1, 2000, to November 30, 2003, is allowed, with costs, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is entitled to its $736,524.90 input tax credit claim in accordance with section 169 of the ETA. The penalty and interest are accordingly cancelled.

Signed at Ottawa, Canada, this 12th day of July 2006.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 29th day of January 2008.

François Brunet, Revisor

Citation: 2006TCC394
Date: 20060712
Docket: 2005-2982(GST)G

BETWEEN:

SPORT COLLECTION PARIS INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Lamarre J.

[1] In an assessment under Part IX of the *Excise Tax Act* ("ETA"), the Minister of National Revenue ("the Minister") disallowed input tax credits (ITCs) in the amount of $736,524.90 and imposed penalties and interest for the period from December 1, 2000, to November 30, 2003.

[2] The Minister disallowed the ITCs on the basis that the tax on which the Appellant had claimed the ITCs was paid to subcontractors which, in the Minister's determination, had issued invoices of convenience, either because they did not have the production capacity necessary to render the services requested, or because they were not acting as intermediaries (see subparagraph 24(d) of the Reply to the Notice of Appeal).

[3] The Appellant operates a business that designs and manufactures women's clothing. It purchases fabrics and subcontracts the garment-making. During the period in issue, the Appellant did business with 80 different subcontractors. The Minister is contesting the invoices of 26 of these 80 subcontractors.

[4] The Minister does acknowledge that the garments were made and that the subcontractors returned the merchandise to the Appellant in accordance with the Appellant's specifications. The Minister also acknowledges that the Appellant paid each contractor the tax on the agreed-upon cost for making the garments. In addition, the Minister acknowledges that the Appellant did not receive any rebate on the tax thereby paid.

[5] The Respondent submits that the Appellant is not entitled to its ITCs because the garment-making services were rendered by persons other than the subcontractors that issued the invoices. The evidence does suggest that most of the 26 subcontractors did not remit the tax that they collected to the government. In some cases, it would appear that the subcontractors contracted out to other subcontractors, which did not remit the tax to the government.

[6] While the Minister does not claim to have evidence that the Appellant colluded with the 26 subcontractors in question, he submits that the Appellant showed a type of wilful blindness by agreeing to subcontract with the subcontractors without really inquiring about whether they remitted the tax that they collected to the government. The Minister submits that the tax that these subcontractors collected from the Appellant was used in order to pay employees under the table, and that the Appellant is responsible for this because it did not show that these subcontractors actually rendered the invoiced services or acted as intermediaries for the purpose of collecting the Goods and Services Tax (GST). For these reasons, the Minister submits that the Appellant is not entitled to its ITCs. Counsel for the Respondent submits that since the Minister was not a party to the contract between the Appellant and the subcontractors, it is unable to establish that the Appellant was truly not privy to the subcontractors' scheme. He submits that the Appellant had an obligation to summon the subcontractors in question to testify in Court in order to prove that the Appellant was in perfectly good faith when it awarded them the garment-making contracts in question and paid them the tax. He submits that the Appellant has not proven that it knew each and every one of the subcontractors and that it actually entered into contracts with them. He submits that the Appellant must prove that the subcontractors were genuinely engaged in commercial activities.

[7] In my opinion, the Appellant has amply demonstrated that it contracted with the 80 subcontractors, including the 26 subcontractors in issue, proceeding in the same manner in each instance.

[8] I have heard the testimony of Phil Cohen, who controls the Appellant, and the testimony of production employees (who determined the pricing and chose the contractors), administrative employees, and employees who were responsible for controlling the quality of the garments during the period in question. All of these witnesses explained the Appellant's method for subcontracting garment-making. The Appellant, through its employees, demanded high-quality work from its subcontractors, and insisted that the work be done on time and at a reasonable price.

[9] The Appellant made sure that it obtained the corporate subcontractors' certificates of incorporation, as well as each subcontractor's declarations of registration. In addition, every month, it checked that each subcontractor had a GST and Quebec Sales Tax (QST) registration number. All of this was shown by supporting documents. In fact, Revenu Québec sent the Appellant letters confirming the validity of the subcontractors' GST and QST numbers. That is all the Appellant could do, because any information concerning a supplier's payment of taxes is confidential and cannot be disclosed to the Appellant. This is confirmed by the audit report tendered as Exhibit A-1, tab 4, page 6.

[10] Sometimes, when the Appellant got wind that not all tax remittances were being made, it even made cheques payable to the subcontractors and the Ministère du Revenu du Québec jointly. The person who controls the Appellant also confirmed that certain precautions were taken. For example, lists of subcontractors including their addresses and telephone numbers were drawn up and updated regularly (roughly once or twice a year). The old lists became obsolete when the new lists containing the changes were issued.

[11] The employees responsible for product quality control went to the subcontractors' places of business. They examined and approved the finishing work. It appears that the subcontractors contracted out the seaming, but the Appellant's employees were unable to verify this. The finished garments were delivered to the Appellant after its employees approved them.

[12] France Lamontagne, the Revenu Québec auditor, acknowledged that the Appellant's bookkeeping was proper and acceptable. She acknowledged that the Appellant received no rebates on the tax paid, and that she had no evidence on file that the Appellant was in bad faith or was aware that it was doing business with phoney businesses. Her audit report alludes to several other audit files of which she has no personal knowledge. No one else testified for the Respondent. Counsel for the Respondent did not impeach the credibility of any of the Appellant's witnesses

on cross-examination, and he asked them few or no questions. The auditor did not question the Appellant's employees during her audit.

[13] The facts of this case are similar to those in *Joseph Ribkoff Inc. v. R.*, [2003] G.S.T.C. 104 (T.C.C.) where Lamarre Proulx J. stated as follows, at paragraphs 100-101:

> 100 The appellant paid the tax on services to Her Majesty's agent. These were valid corporations. It was their conduct that was illegal. I am of the opinion that it is not up to the appellant to bear the economic burden of the deception organized by Her Majesty's agents on the basis of the decision of this court in *Manke* (*supra*) [[1998] T.C.J. No. 759 (T.C.C.), at paragraph 19], which refers to other decisions and to the decision I rendered in *Centre de la Cité Pointe Claire v. Her Majesty the Queen*, [2001] T.C.J. No. 674, [2001] G.S.T.C. 199 (Fr.), [2003] G.S.T.C. 76 (Eng.) (T.C.C. [Informal Procedure]), a decision to which counsel for the appellant referred me.
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> 101 If there had been knowledge, connivance or collusion on the part of the appellant, as the investigators had initially thought, the decision would be completely different. The agreement on the facts is clear: there is no evidence of knowledge, connivance or collusion between the appellant and these companies.

[14] In the editorial comment that follows this decision, David Sherman stated:

> In my view, this is the correct decision. If a supplier is GST-registered, provides real service and issues an invoice with a valid registration number, and the purchaser pays the GST, the purchaser should not have to worry about whether the supplier is remitting the GST. The entire GST system is invoice-driven, specifically so that purchasers need not worry about whether suppliers are filing and remitting their net tax. It would do violence to the GST system, and interfere with the orderly conduct of business, to require purchasers to investigate whether vendors are remitting GST, or whether vendors are subcontracting their work to others.

[15] In *Orly Automobiles Inc. v. Canada*, 2005 FCA 425, the Federal Court of Appeal stated as follows, at paragraph 26:

> [26] In addition, we agree with the A.C.J. that where the transaction upon which the claim for ITCs is asserted is a sham and the money purportedly paid as GST is never paid or is rerouted back to the claimant, that claimant cannot base a claim for ITCs on the fact that the tax has become payable. The A.C.J. found on the basis of the evidence that the appellant was involved in a sham of this kind. The Act and the Regulations were devised for *bona fide* transactions between *bona fide* businessmen. They were never intended to enable participants in a sham

> involving fictitious transactions to doubly benefit from it by successfully claiming input credits on a tax payable.

[16] The Federal Court of Appeal has impliedly acknowledged that, in the absence of evidence of connivance or collusion, or sham transactions in which the tax said to be payable is redirected to the claimant, the person who has paid the tax is entitled to the ITCs.

[17] In the instant case, the Appellant has shown that the subcontractors fulfilled the orders because the finished products were approved by and delivered to the Appellant. Employees of the Appellant went to the subcontractors' places of business to verify and control the finish of the products. The Respondent's cross-examination did not cast doubt on these facts. There is nothing to suggest that the Appellant demanded that subcontractors personally perform their work. An independent business would have every right to sub-subcontract, provided its contract with the Appellant did not prevent it from doing so. The Respondent did not contradict these points. The Minister's reasons for assessment allege no fraud or collusion. In fact, the auditor conceded that she was unable to obtain evidence in this regard. In my opinion, the Appellant has succeeded in showing, on a balance of probabilities (the requisite standard of proof in civil cases) that it paid the tax in good faith to the 26 subcontractors just as it did with all 80 subcontractors with which it did business, and that it is therefore entitled to the ITCs for this tax.

[18] The appeal is allowed, with costs, and the assessment is referred back to the Minister for reconsideration and reassessment on the basis that the Appellant is entitled to the ITCs claimed in the amount of $736,524.90, since it has complied with all the conditions set out in section 169 of the ETA. The penalty and interest imposed in the assessment under appeal are accordingly cancelled.

Signed at Ottawa, Canada, this 12th day of July 2006.

"Lucie Lamarre"

Lamarre J.

Translation certified true
on this 29th day of January 2008.

François Brunet, Revisor

CITATION:	2006TCC394
COURT FILE NO.:	2005-2982(GST)G
STYLE OF CAUSE:	SPORT COLLECTION PARIS INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	June 28 and 29, 2006
REASONS FOR JUDGMENT BY:	The Honourable Justice Lucie Lamarre
DATE OF JUDGMENT:	July 12, 2006

APPEARANCES:

Counsel for the Appellant:	Louis-Frédérick Côté and Josée Massicotte
Counsel for the Respondent:	Denis Émond

COUNSEL OF RECORD:

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