

NO.: **IT-145R (Consolidated)**

DATE: See *Bulletin Revisions* section

SUBJECT: INCOME TAX ACT

Canadian Manufacturing and Processing Profits – Reduced Rate of Corporate Tax

REFERENCE: Section 125.1 of the *Income Tax Act* (the “Act”) (also Part LII of the *Income Tax Regulations* (the “Regulations”))

Latest Revisions – Contents, Summary and ¶s 2, 3, 5, 7, 8, 11 to 14, 21, 38, 39, 42 and 48

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Bulletin Revisions

Application

This bulletin is a consolidation of the following:

- IT-145R dated June 19, 1981, as revised by Special Release dated February 28, 1986; and
- subsequent amendments thereto.

For further particulars, see the “Bulletin Revisions” section near the end of this bulletin. Unless otherwise stated, all statutory references throughout the bulletin are to the Act.

Summary

Section 125.1 provides for the taxation of corporations at a reduced rate on their “Canadian manufacturing and processing profits”. This takes the form of a deduction from Part I tax otherwise payable and is an amount equal to a specified percentage of a corporation’s Canadian manufacturing and processing profits (subject to certain adjustments). This bulletin provides comments on various components of the calculation, activities that are not considered to be manufacturing or processing, and the point at which manufacturing or processing activities begin and end for certain industries.

Discussion and Interpretation

General

¶ 1. There are two methods for calculating a corporation’s Canadian manufacturing and processing profits. A simplified method is available to a small manufacturer provided that the corporation meets the qualifications in section 5201 of the Regulations (see ¶ 14). For other corporations, a basic labour and capital formula is used to determine their “Canadian manufacturing and processing profits” (see ¶ 15).

¶ 2. The reduced rate of corporate tax is applicable only to a corporation that carries on manufacturing or processing activities in Canada of goods for sale or lease. The manufacturer or processor of the goods need not necessarily be the vendor of the goods. However, the reduced rate is not applicable to income arising from service or repair activities carried out on goods that are not for sale or lease. Similarly, the reduced rate is not applicable to income arising from the supply of goods through contracts for work and material. A corporation that merely sells goods manufactured or processed by another party or supervises the manufacturing or processing of goods where the actual manufacturing or processing is carried on by another party will also not qualify

for the deduction. However, where the goods are being manufactured or processed by another party on behalf of the corporation and the corporation exercises extensive involvement and control over the content, design, and physical qualities of the goods from inception to completion, the corporation will qualify for the deduction.

Meaning of “Manufacturing or Processing”

¶ 3. The term “manufacturing or processing” is defined in subsection 125.1(3) as excluding farming, fishing, logging, construction, certain resource activities set out in paragraphs (d) to (k) of the definition, and activities where the 10 per cent *de minimis* rule set out in paragraph (l) of the definition is not met. As the definition does not specifically indicate activities that would be “manufacturing or processing”, the terms “manufacturing” and “processing” have their ordinary meaning. Unfortunately, those terms do not lend themselves to any simple, all-inclusive definition or explanation. It may be said, however, that the manufacture of goods normally involves the creation of something (e.g., making or assembling machines, clothing, soup) or the shaping, stamping or forming of an object out of something (e.g. making steel rails, wire nails, rubber balls, wood moulding). On the other hand, processing of goods usually refers to a technique of preparation, handling or other activity designed to effect a physical or chemical change in an article or substance, other than natural growth. Examples of such activities are galvanizing iron, creosoting fence posts, dyeing cloth, dehydrating foods and homogenizing and pasteurizing dairy products.

¶ 4. The activities of breaking bulk and repackaging for subsequent resale where there is a systematic procedure to make a product more marketable are generally considered to be processing. However, the filling of orders from bulk inventories is not viewed as processing where the activities involved are nothing more than counting or measuring and packaging.

Excluded Activities

¶ 5. The Canada Customs and Revenue Agency’s (CCRA) views on some of the activities specifically excluded from the definition of “manufacturing or processing” are as follows.

Construction

¶ 6. See the current version of IT-411 entitled “*Meaning of ‘Construction’*”.

Farming

¶ 7. The word “farming” is defined in subsection 248(1). It includes the various activities of a person who is engaged in the business of earning income from the tillage of soil, the raising or exhibiting of livestock, the maintenance of horses for racing, the raising of poultry, the keeping of bees, fur farming, dairy farming and fruit growing. Farming also

includes a mechanical hatching operation where eggs are acquired, hatched in incubators and the chicks sold within a few days of hatching. A farmer or a farming corporation may carry on certain activities that, if carried on by another person, would be considered to be the processing of farm products rather than farming. Some examples are: aging of cheese, plucking of chickens, cleaning, polishing and treating of beans, and cleaning, sorting, grading and spraying of eggs. Where a farmer or farming corporation separates the activities of farming and the processing of farm products, the CCRA will consider the processing activity to be a distinct business from that of farming provided that there is a clear delineation of the income from each business, and that the income from the processing business is properly calculated and is not eligible for any of the special sections in the Act dealing with income from a farming business, such as the cash method of computing income contained in section 28.

Fishing

¶ 8. The word “fishing” is defined in subsection 248(1). It includes fishing for or catching shellfish, crustaceans and marine animals and any incidental activities of a fisherman carried out on board the fishing vessel. Once the fish are caught and transported to a fish-processing plant or cannery, any activities carried out to prepare the fish for market, such as filleting, shelling, icing, canning, freezing, smoking, salting, cooking and pickling are considered to be processing activities. Generally, most of these processing activities will be carried out on shore and, therefore, a fisherman will not ordinarily be engaged in processing activities. However, where substantial processing activities are carried out on board a vessel, the CCRA will consider the processing activity to be a distinct business from that of fishing provided that there is a clear delineation of the income from each business and that the income from the processing business is properly calculated and is not eligible for any of the special sections in the Act dealing with income from a fishing business, such as the cash method of computing income contained in section 28.

Industrial Minerals

¶ 9. Producing industrial minerals is considered to include all activities connected with the mining, excavating and extracting the mineral material from the mine or pit area, including any primary crushing operation required to make it transportable from the mine or pit area as well as the transporting of the material from the mine or pit. Subsequent activities such as crushing, washing, screening and sorting of the mineral material in order to make the product of the mine or pit marketable are considered to be processing activities. The CCRA recognizes that in some cases some or all of these subsequent activities may be conducted within the confines of the mine or pit, in which case processing will commence after the delivery of the excavated pit run material to the first of these processing operations.

The CCRA considers an industrial mineral to include any mineral other than a mineral from a deposit that is a mineral resource as defined in subsection 248(1). Examples of industrial minerals (essentially non-metallic minerals) are:

Gravel	Limestone
Clay	Sand
Stone	Feldspar

Logging

¶ 10. The CCRA considers that logging does not include activities that take place after the delivery of the logs to a sawmill, pulp mill, plywood mill or other similar place for processing logs. Thus

- (a) the operation of a sawmill to saw logs into lumber,
- (b) the drying of lumber in kilns before shipment,
- (c) the operation of a planing mill to plane lumber,
- (d) the production of wood chips during the sawing process and the production of shavings during the planing process, and
- (e) any similar activities

are all activities that are considered to be manufacturing or processing. The operation of bulldozers and boom boats at the mill site are considered part of manufacturing activities.

Petroleum and Natural Gas Activities

¶ 11. Petroleum and natural gas activities that are **not** considered to be manufacturing or processing activities are as follows:

- operating an oil or gas well;
- extracting petroleum or natural gas from a natural accumulation of petroleum or natural gas;
- processing natural gas or oil as described in the definition of “Canadian field processing” in subsection 248(1);
- processing natural gas as part of the business of selling or distributing gas in the course of operating a public utility; and
- processing heavy crude oil recovered from a natural reservoir in Canada to a stage that is not beyond the crude oil stage or its equivalent.

Note: the processing of natural gas at

- a “straddle plant”, or
- a natural gas processing plant (or parts of such a plant) that is devoted primarily to the recovery of ethane

is a qualified processing activity.

Electrical Energy and Steam

¶ 12. The production or processing of electrical energy or steam used directly or indirectly by taxpayers in their own manufacturing or processing activities is generally considered to be a qualified activity. However, by virtue of paragraph (h) of the definition of “manufacturing or processing” in subsection 125.1(3), producing or processing electrical energy or steam, for sale, is specifically excluded

from being manufacturing or processing and those activities do not qualify for the manufacturing and processing profits deduction under subsection 125.1(1). Nevertheless, a corporation that generates electrical energy for sale or produces steam for sale (including for uses other than the generation of electricity) may qualify for a separate manufacturing and processing profits deduction under subsection 125.1(2) pursuant to a formula. Under subsection 125.1(5), for the purpose of certain parts of this formula, electrical energy and steam are deemed to be goods and the generation of electrical energy for sale and the production of steam for sale are deemed to be manufacturing or processing, subject to the 10% de minimis rule. However, the small manufacturers' rule (see ¶ 14) does not apply for the purpose of the calculation in subsection 125.1(2). Notwithstanding this separate deduction, equipment used in such activities does not qualify for inclusion in Class 43.

Adjusted Business Income

¶ 13. The term “adjusted business income”, as defined in section 5202 of the Regulations, is the excess of a corporation's income from active business carried on in Canada over its losses from similar businesses. The definition includes the corporation's share of active business income from a partnership but does not include income from an active business carried on outside Canada.

In addition, if a corporation has “resource activities” (as defined in subsection 5203(2) of the Regulations) for a taxation year, subsection 5203(1) of the Regulations provides that its adjusted business income be reduced by the amount, if any, of the total of:

- (a) the amount by which its “net resource income” (as defined in subsection 5203(3) of the Regulations) for the year exceeds its “net resource adjustment” (as defined in subsection 5203(3.1) of the Regulations) for the year;
- (b) the amount of “refund interest” (as defined in subsection 5203(4) of the Regulations) included in both its income and adjusted business income for the year; and
- (c) the amounts included in its income for the year for a prescribed resource loss under paragraph 12(1)(z.5).

Note: The Notice of Ways and Means Motion announced in Finance Canada's News Release 2003-030 dated June 6, 2003 proposes certain changes to the above calculation. If enacted as proposed, the definition of “adjusted business income” in subsection 5203(1) of the Regulations and “resource activities” in subsection 5203(2) of the Regulations will be amended consequential upon the repeal of paragraphs 12(1)(z.5) and 20(1)(v.1), respectively, for taxation years that begin after 2006. In addition, applicable to taxation years that begin after 2006 and consequential upon the repeal of paragraphs 12(1)(o) and 18(1)(m), the definition of “refund interest” will be amended as of that date.

Small Manufacturers

¶ 14. Section 5201 of the Regulations provides that a corporation will receive the reduced rate of tax on all of its adjusted business income if, in any particular taxation year, it meets all of the following tests:

- (a) Its activities are primarily manufacturing or processing in Canada of goods for sale or lease.
- (b) Its income and that of any associated corporations do not in the aggregate exceed \$200,000.
- (c) It is not engaged in any of the activities of farming, fishing, logging, construction or specified resource activities.
- (d) It is not engaged in a foreign active business.
- (e) It is not engaged in the processing of foreign tar sands and ore.

The CCRA's view is that the term “primarily” as used in paragraph 5201(a) of the Regulations means “principally” or “chiefly”. Since the activities of a corporation are generally carried on by its employees, the CCRA will look at their activities to determine whether they are principally or chiefly manufacturing or processing or something else. In some industries, the use of the company's assets in manufacturing or processing activities may also be considered where the use of labour does not accurately reflect the principal activities of the corporation.

Other Corporations

¶ 15. Where a corporation does not qualify under the small manufacturers' rule, it must look at the definitions contained in section 5202 of the Regulations and determine the amounts needed for the formula contained in section 5200 of the Regulations. This formula provides that the corporation's Canadian manufacturing and processing profits are equal to its adjusted business income (see ¶ 13) multiplied by a fraction equal to the sum of the corporation's labour and capital that is used in manufacturing or processing over the sum of the corporation's total labour and total capital. Many corporations may have difficulty in determining the amounts required under section 5202. Where a corporation can readily obtain information that is reasonably similar to that required in section 5202, it will be acceptable for purposes of the formula, provided, of course, that no significant distortion of the formula results.

Cost of Labour

Method of Determining Cost of Labour

¶ 16. Perhaps the most significant problem a corporation will face in calculating its Canadian manufacturing and processing profits is how to determine its “cost of labour” (as defined in section 5202 of the Regulations). The simplest method generally will be an analysis of the T-4 slips. This will be particularly suitable for a corporation with a taxation year ending on December 31, and will also be acceptable for many corporations whose taxation years do not end on December 31, provided that the total of wages and salaries as

shown by the T-4 slips approximates the total of wages and salaries for the fiscal year. For a corporation with a cost accounting system, an analysis of salaries and wages by cost centre may be more practical. It may happen that the figures most readily available for calculating cost of labour include certain amounts (such as fringe benefits) that do not form part of salaries and wages on a strict interpretation of the term. Where these amounts are insignificant in relation to the total salaries and wages of the corporation, the CCRA will not insist on their removal from the total. Where amounts are allowed as a deduction at year end as bonuses that are payable to specific employee, these amounts would form part of the “cost of labour”.

Interpretation of “Normally”

¶ 17. In addition to salaries and wages paid or payable to a corporation’s employees, amounts paid or payable to third parties for services that would normally be performed by the corporation’s own employees form part of the cost of labour. The term “normally” means “commonly”, “usually”, or “under normal or ordinary conditions”. It would apply in cases where a corporation usually performs certain services or functions itself but for some reason, such as lack of capacity, short-run economic conditions, labour problems, or machinery breakdowns, has sublet all or part of the work to third parties. It is the CCRA’s view that what is “normally ... performed” is determined in the context of a “service or function” of a particular corporation and not in context of the industry or a division of the corporation. Those corporations operating in more than one province will already have experience in calculating these amounts for purposes of allocating income to various provinces under subsection 402(7) of the Regulations.

Double Counting Problem

¶ 18. A problem will occur in a group of associated corporations where one corporation acts as a “paymaster” for the others. To mitigate the double counting effect that will occur when two associated corporations include the same wages in their cost of labour, the CCRA will allow the company paying the salaries and wages to treat these amounts as net of amounts received or receivable from associated corporations in respect of these expenses, provided that this is done for both qualified and non-qualified activities carried on by the employees.

Cost of Capital

Pre-1949 Assets

¶ 19. Subsection 144(1) of the pre-1972 Act deems the capital cost of assets acquired prior to the 1949 taxation year of a corporation to be, in most cases, the undepreciated capital cost of those assets at the beginning of that year. However, this section is only applicable for purposes of section 20 and regulations made under paragraph 11(1)(a) of the pre-1972 Act and thus does not apply to section 125.1 of the present Act. Since most corporations will have their 1949

deemed capital cost figures readily available, the CCRA will accept these figures as being the gross cost of such assets provided that these figures are used for all assets owned prior to 1949. A corporation may use the original cost of all such assets, if it wishes.

Assets Written Off

¶ 20. In many cases, the Act permits that assets may be written off to expense and thus no record may be available of those assets still on hand. The best example of this is class 12 assets that include, among other things, tools and small instruments costing less than \$200, dies and patterns. Where the value of these assets still in use is not significant in relation to other assets of the corporation, the CCRA will not require their inclusion in the cost of capital.

Rented Property

¶ 21. The amount to be included as the “rental cost” (as defined in section 5202 of the Regulations) of property is the amount required to be paid under the lease or rental agreement regardless of whether the agreement is on a “net” or “gross” basis. Where the property rented includes land and buildings, an allocation of the rental should be made based on a split between land and building on some reasonable basis, and only the portion of the rental applicable to the building should be included in the rental cost.

Royalty Payments

¶ 22. Royalty payments are considered to qualify as rental costs under “cost of capital” in paragraph (b) of the definition of that term in section 5202 of the Regulations provided they are payments made in respect of property that, if owned by the corporation at the end of a year, would have been included in paragraph (a) of the definition of “cost of capital” in section 5202 of the Regulations.

Telephone and Telegraph Rentals

¶ 23. Since an accurate allocation of rental charges for the use of telecommunication equipment is impossible, the CCRA will not require their inclusion in calculating cost of capital.

Double Counting Problem

¶ 24. A double counting problem occurs in a group of associated corporations where a charge is made by one corporation in the group to another corporation for the use of a building that it owns or rents. For example, if Corporation A pays \$100,000 rent for an office building and charges Corporation B (a related corporation) \$75,000 for the use of 3/4 of that building, the \$75,000 rental charge appears in the denominator of the fraction in the formula of both corporations and, in effect, is counted twice to the detriment of the group of corporations as a whole. To alleviate this inequity, the CCRA will allow rents paid for a property to be netted with rents received or receivable from related corporations for the use of that property. If the corporation

receiving such rents owns the building, it may exclude the portion of the capital cost of the building that related to the area rented to related corporations from its cost of capital calculation.

Qualified Activities

Definition

¶ 25. The definition of “qualified activities” in section 5202 of the Regulations is relevant for purposes of determining what amount of a corporation’s labour and capital is considered to be manufacturing and processing labour and capital. In addition to those activities that are manufacturing or processing within the ordinary meaning of the term, this section specifies several activities that are considered to be either qualified or nonqualified.

Receiving and Storing of Raw Materials

¶ 26. Receiving and storing of raw materials are qualified activities. While activities related to the receiving of raw materials away from a taxpayer’s plant or warehouse are considered to qualify, activities related to the transportation of the raw materials to the plant or warehouse are not considered to be “receiving or storing” notwithstanding that the transportation may be provided by the taxpayer’s own vehicle and it may not take place until after the time of actual receiving of the goods.

Line Supervision vs. Administration

¶ 27. The terms “line supervision” (a qualified activity) and “administration” (a nonqualified activity) may be confusing. The CCRA views “administration” as being the function of determining corporate policy and co-ordinating various activities (production, selling, etc.) of the corporation at the management level. “Line supervision”, on the other hand, refers to the line of authority for supervision of the manufacturing or processing activities of a corporation to the point where the activities of the supervisor can be said to be administrative. Since job titles and responsibilities vary considerably from industry to industry, identifying particular positions considered to be administrative is not possible. However, the persons who form part of the vertical line of supervision of the manufacturing or processing activities of a corporation, except those involved with the determination of corporate policy or the co-ordination of the production facilities, may be said to qualify. In most cases, the dividing line will occur, at, or somewhere near, the plant manager.

Data Processing

¶ 28. One of the nonqualified activities is data processing. This term is intended to exclude accounting activities that are merely ancillary to a manufacturing operation. However, where a computer is used as an integral part of a manufacturing process or other qualified activity, that portion of the cost of the computer that reflects the extent to which the computer is used directly in the qualified activity is included in the cost of manufacturing and processing capital.

Similarly, the portion of time the computer staff spends directly engaged in qualified activities is included in the cost of manufacturing and processing labour. An example of a direct application of a computer to a manufacturing operation is where the computer controls and directs the manufacturing and processing equipment. The compilation of cost records, payrolls, etc., by a computer is not considered to be a qualified activity.

Storing of Finished Goods

¶ 29. Storing, shipping, selling and leasing of finished goods are nonqualified activities. If a good can be sold in bulk, but is packaged for the convenience of making the sale or because the taxpayer can receive a higher price if the product is placed in packages, it will generally be considered to be a finished good before packaging takes place. However, a homogenous product that in the usual case must be broken from bulk and packaged before it is capable of sale is generally not considered to be a finished good until after the time it is packaged.

Cost of Manufacturing and Processing Labour and Capital

Time Spent in Qualified Activities

¶ 30. The “cost of manufacturing and processing labour” (as defined in section 5202 of the Regulations) includes salaries and wages paid to employees for the portion of their time that they were directly engaged in qualified manufacturing or processing activities and the portion of payments to third parties included in the cost of labour for services directly related to qualified activities.

¶ 31. Many employees may spend relatively minor amounts of their time in activities other than their primary activity. To alleviate the task of making numerous allocations and calculations in determining the cost of manufacturing and processing labour, the CCRA will accept the administrative practice of allocating all of an employee’s time to his primary activity where it is reasonable to assume that more than 75 per cent of that employee’s time is spent in his primary activity. Of course, where this practice is followed, it must be applied whether or not the primary activity is manufacturing or processing. A 50-50 split of an employee’s time is acceptable where it is reasonable to assume that between 50 and 75 per cent of his time is spent in his primary activity.

¶ 32. Most persons in a department or division who are carrying on a qualified activity (engineering design, quality control, etc.) are considered to be directly engaged in qualified activities. However, clerical and administrative staff within that department or division (such as stenographers, typists, secretaries and accounting personnel) are not considered to be directly engaged in qualified activities.

¶ 33. Where a bonus is payable to an employee who is directly engaged in manufacturing or processing activities and is also engaged in nonqualified activities such as administration, the portion of the bonus equal to the percentage of time that employee spent directly in qualified activities will be accepted by the CCRA as part of the cost of manufacturing and processing labour.

Meaning of “Used Directly”

¶ 34. The “cost of manufacturing and processing capital” (as defined in section 5202 of the Regulations) is that portion of the cost of capital that reflects the extent to which each asset is used directly in qualified activities. The term “used directly” refers to those assets that are an integral and essential part of the particular qualified activity being carried on. In all cases, the nature of the activity with which an asset is connected, and not the nature of the asset, should be examined to determine its use. In the case of a building which houses both plant equipment and administrative offices, an apportionment of cost is necessary. Generally, office furniture and equipment is not considered to be used directly in qualified activities unless the particular item of equipment is used solely by a person engaged in a qualified activity.

Warehousing Costs

¶ 35. A problem can arise in separating warehousing labour and capital costs that are qualified activities for the purpose of calculating manufacturing and processing labour and capital used in the formula in section 5200 of the Regulations (i.e. the storing of goods purchased for processing) from those that are not (i.e. storing of goods purchased only for resale). Generally the separation of these costs is difficult and arbitrary because in many instances no separate identification of these categories of goods is possible. It is considered that one method might be to analyse sales (by dollars or tons) of processed goods and non-processed goods. If the average time spent in storage by raw materials purchased for processing is greater or lesser than the average time spent in storage by materials purchased for resale, it may be necessary to weigh any calculations to produce a reasonable result. Since a 10 to 20% variance in the percentage of qualified warehousing labour and capital costs would not usually significantly effect the formula in section 5200 of the Regulations, it is not normally necessary that the taxpayer make elaborate calculations to separate these costs. However, any percentages used should be reasonable and have some logical basis.

Particular Industries

¶ 36. A few industries may have difficulty in determining the point at which manufacturing or processing begins and ends. The CCRA’s views concerning the delineation of qualified and nonqualified manufacturing or processing activities in some of these industries are as follows.

Cable Television

¶ 37. The capturing and delivering of air signals by a cable television company is not considered to be manufacturing or processing of goods.

Computer Services

¶ 38. There are perhaps four different types of business carried on in the computer service industry. These are:

- (a) computer consulting services;
- (b) computer graphic services;
- (c) computer networking services; and
- (d) software or programming services (the preparation of computer programs).

Computer consulting, graphic and networking firms are primarily rendering services to their customers rather than selling goods; consequently their activities do not qualify as manufacturing or processing goods for sale or lease. The sale or lease of computer software is considered to be the sale of information and, as a result, the costs of developing the software would not qualify as manufacturing or processing of goods. Where software is transmitted by way of tangible property, such as tapes, diskettes or compact discs, those activities that relate to the manufacture or process of this property, such as producing a clean compilation and testing the program, would be considered qualified activities.

Drugstores

¶ 39. The mixing of various liquids or compounds when preparing a drug prescription is considered to be processing. However, the filling of prescriptions by placing labels on products already in their own container or by the placing of pills, capsules or liquids purchased in bulk into small containers and labelling them is not considered to qualify as manufacturing or processing.

Films and Videotapes

¶ 40. Where a corporation is engaged in the production of motion picture films or programmes on videotape, the activities that would qualify as manufacturing or processing would include preparation and editing of the script, manufacture of screen sets and props, acting, directing, lighting, camera work (filming), adding sound and colour effects, cutting, splicing and editing the exposed film and reproducing copies from the master negative or videotape.

Photo Developers

¶ 41. The activities connected with the processing of film into prints and slides, negatives into prints and the enlarging of prints are considered to be qualified activities.

Printing and Publishing

¶ 42. The activities of a printing or publishing firm that qualify as manufacturing or processing include activities such as typesetting, printing, collating, folding and bundling.

Reporting of news, preparation of copy of advertisements, photographs and art work, and editing are also considered qualified activities provided that

- (a) the physical activities of manufacturing a newspaper, magazine or book are carried on by the taxpayer or
- (b) where such manufacturing activities are carried on by another party on the taxpayer's behalf, the taxpayer maintains extensive control over the content, design and physical qualities of the publication and sells the published product.

Some advertising activities may be qualified activities because these activities are connected with the manufacturing or processing of a newspaper, but the gross revenue from advertising is considered to be from a service and is not from the sale or lease of goods. Consequently, when determining whether a publisher of a newspaper meets the 10% *de minimis* rule in paragraph (l) of the definition of "manufacturing or processing" in subsection 125.1(3) gross revenue from sales of goods manufactured in Canada does not include advertising revenue.

Restaurants and "Take-Out Stores"

¶ 43. Generally, the primary activities of a restaurant are those of providing service to its patrons. Such services include the waiting upon tables, clearing, washing and drying of cutlery and dishes, cashier services and in some cases the provision of entertainment. However, the activities of preparing meals for consumption constitute processing and thus some part of a restaurant's income may be eligible for the reduced rate of corporate tax. The mixing of a number of ingredients of a drink is considered processing but the mere pouring of liquor or beer into a glass and the dispensing of draft beer are not considered processing.

In the case of "take-out" establishments, the primary activities may be the preparation of meals and thus all of the business income of the corporation may qualify for the reduced rate of tax under the small manufacturers' rule.

Scrap Metal Dealers

¶ 44. Activities carried on by a scrap metal dealer, such as sorting, removing contaminants, grading, cutting to size and baling, in order to make raw scrap saleable are considered qualified manufacturing or processing activities.

Shipbuilding and Similar Industries

¶ 45. In the case of shipbuilding, aircraft manufacturing and similar industries, it is the CCRA's view that movable objects, irrespective of size, are manufactured. Thus, the building of aircraft and ships is not regarded as construction.

Where a contract is entered into by a corporation to make repairs to a movable object, referred to above, activities connected with the repair work would normally be considered to be a service and not the manufacturing or processing of goods for sale or lease. On the other hand, if a corporation purchases a movable object with the intention of reselling it or leasing it, repair activities in preparing the object for sale would be considered manufacturing or processing activities. There may also be contracts that are primarily for the sale of goods to be installed in a ship, aircraft or similar movable object and these contracts may involve the manufacturing of goods for sale or lease notwithstanding that they also contain repair activity.

Tailors

¶ 46. The cutting and assembly of fabric into articles of clothing, including the production and custom-fitting of made-to-measure suits, would be a manufacturing activity by the maker of the clothing. However, the mere alteration of ready-made or custom-tailored clothing by a retail clothing establishment does not constitute a manufacturing or processing activity. Also, altering or repairing articles of clothing that are already owned by the customer does not qualify as manufacturing or processing goods for sale or lease.

Vehicle Repairs and Servicing

¶ 47. The activities of reconditioning used automobiles or trucks for resale, such as cleaning, painting, safety inspection, tune-ups, replacement of parts and repairing are considered qualified activities. However, repair activities, including body repairs and engine and transmission overhauls, relating to customer owned vehicles under warranty or otherwise would not qualify. Comments similar to the above would also apply to other machinery and equipment.

Processing Resource Minerals

¶ 48. Processing iron ore from a mineral resource located in Canada at any stage beyond the pellet stage or its equivalent, processing tar sands ore from a mineral resource located in Canada at any stage beyond the crude oil stage or its equivalent, and processing ore (other than iron ore or tar sands ore) from a mineral resource located in Canada at any stage beyond the prime metal stage or its equivalent are considered qualified manufacturing or processing activities.

Bulletin Revisions

¶ 1 of IT-145R dated June 19, 1981 is now the Summary of the consolidated bulletin. [June 23, 2000]

The Summary has been modified to eliminate outdated information concerning the accelerated capital cost allowance write-off of manufacturing machinery and equipment. As well, comments on other information provided in the bulletin were added. [January 6, 2004]

¶ 2 of IT-145R is now the Contents section at the beginning of the consolidated bulletin. [June 23, 2000]

The Contents section has been changed to reflect revised headings for ¶s 11 and 48, and the addition of new ¶ 12. [January 6, 2004]

¶s 3 to 49 of IT-145R have been renumbered as ¶s 1 to 47, respectively. Cross-referencing has been revised to reflect the above re-numbering. No other changes were made to those paragraphs of the bulletin except as noted below. [June 23, 2000]

¶ 2 (formerly ¶ 4), ¶ 7 (formerly ¶ 9), ¶ 11 (formerly ¶ 13), ¶ 14(b) (formerly ¶ 16(b)) and ¶ 42 (formerly ¶ 44) were revised by Special Release dated February 28, 1986.

¶ 2 has been further revised to add a sentence that reflects the impact of the Federal Court of Appeal's decision in the *Will-Kare Paving and Contracting Ltd. v. The Queen* case (2000 DTC 6467, [2000] 3 CTC 463). [January 6, 2004]

¶s 3 (formerly ¶ 5), ¶ 5 (formerly ¶ 7) and ¶ 42 (formerly ¶ 44) have been changed to reflect the restructuring of paragraphs within subsection 125.1(3). [January 6, 2004]

¶ 7 (formerly ¶ 9) has been amended to clarify that where a farmer or farming corporation separates the activities of farming and the processing of farm products, those activities will be considered separate businesses under certain circumstances. [January 6, 2004]

¶ 8 (formerly ¶ 10) has been modified to add certain comments included in ¶ 7 dealing with farming that are also applicable to fishing. [January 6, 2004]

¶ 11 (formerly ¶ 13) has been revised to reflect recent legislative amendments and to provide a more complete list of petroleum and natural gas activities that are not considered to be manufacturing or processing activities. The heading of the paragraph has been changed accordingly. [January 6, 2004]

New ¶ 12 has been added to describe a new manufacturing and processing profits deduction available to corporations that generate electrical energy or produce steam for sale. [January 6, 2004]

Former ¶ 13 (formerly ¶ 15) has been deleted because the comments it contained no longer reflect the legislation and are not applicable for purposes of assessments in respect of the manufacturing and processing profits deduction for 1985 and subsequent years. [January 6, 2004]

¶ 13 (formerly ¶ 14) has been modified to take into consideration recent legislative amendments to subsection 5203(1) of the Regulations, as well as to indicate proposed amendments to certain definitions. [January 6, 2004]

¶ 14 (formerly ¶ 16) has been revised to add point (e), further to the addition of paragraphs (c.1), (c.2) and (c.3) to section 5201 of the Regulations. [January 6, 2004]

¶ 21 (formerly ¶ 23) has been revised to delete outdated information that is no longer relevant. [January 6, 2004]

¶ 38 (formerly ¶ 40) has been changed to reflect the current types of computer services available. [January 6, 2004]

¶ 39 (formerly ¶ 41) has been modified to delete outdated information that is no longer relevant. [January 6, 2004]

¶ 46 (formerly ¶ 48) has been revised as a result of the position taken in the article entitled *Canadian Manufacturing and Processing Profits* contained in Issue No. 19 of the *Income Tax Technical News*, which was issued on June 16, 2000. [June 23, 2000]

¶ 47 (formerly ¶ 49) has been revised as a result of the position taken in the article entitled *Pre-delivery service of new vehicles – Interpretation Bulletin IT-145R* contained in Issue No. 8 of the *Income Tax Technical News*, which was issued on September 30, 1996. [June 23, 2000]

¶ 48 was added as ¶ 50 by Special Release dated February 28, 1986. ¶ 48 has been changed to reflect recent legislative amendments to paragraph (f) of the definition of “manufacturing or processing” in subsection 125.1(3). [January 6, 2004]

Throughout the bulletin we have replaced the reference to the former “Department” with the current name “Canada Customs and Revenue Agency” or “CCRA” and where appropriate, corrected the reference to “manufacturing and processing” to “manufacturing or processing” to better reflect the law. In addition, we have made minor changes for clarification and readability purposes, or to provide statutory references. [January 6, 2004]