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LCBO Mark-Up Challenged in Court

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In 2015, Toronto Distillery Co., a small craft distiller of spirits such as gin and whisky, launched a court challenge to Ontario's regulatory regime for on-site sales of spirits by producers.

Background

In Ontario the sale and distribution of alcoholic beverages – including spirits – is tightly regulated and controlled by the Government pursuant to the *Liquor Licence Act*, the *Liquor Control Act*, and the *Alcohol and Gaming Regulation and Public Protection Act, 1996*. In general, the sale of liquor is prohibited unless it is sold to the Liquor Control Board of Ontario ("LCBO") for resale in its various retail locations.

The Alcohol and Gaming Commission of Ontario ("AGCO") permits alcoholic beverage producers to apply for a Manufacturer's Retail Store Authorization, which allows the producer to sell its products on-site at the production facility. For producers of spirits, a condition of receiving authorization for a retail store is that the producer must enter into a contract with the LCBO that imposes certain requirements on the on-site sale process.

The contract requires that the manufacturer first "sell" its products to the LCBO, but retain the "sold" products on-premises for re-sale to the public, with the manufacturer acting as agent for the LCBO.

The effect of this arrangement is that the LCBO is able to ensure that the products sold on-premises by the manufacturer are subject to the same mark-up which the LCBO applies to products it sells in its own stores. The mark-up on each bottle is then remitted by the manufacturer to the LCBO.

The Challenge

Toronto Distillery Co. applied for and received a Manufacturer's Retail Store Authorization in 2013. As a condition of the authorization, Toronto Distillery Co. entered into a contract with the LCBO, which applied a 139.7% mark-up on products sold on-premises at the production facility. In the summer of 2015, Toronto Distillery Co. launched a court challenge to the constitutionality of the LCBO mark-up.

Toronto Distillery Co. took the position that the mark-up was in fact a tax applied by the government, a tax which violates sections 53 and 90 of the *Constitutional Act, 1867* because it was not authorized by Canada's parliament or Ontario's legislature.

The Supreme Court of Canada in *Lawson v Interior Tree Fruit and Vegetable Committee of Direction*, [1931] SCR 357, set out the test for determining whether a levy is a tax:

1. Is the levy enforceable by law?
2. Was the levy imposed under the authority of the legislature?
3. Was the charge levied by a public body?
4. Was the levy intended for a public purpose?

In *Toronto Distillery Company Ltd. v Ontario (Alcohol and Gaming Commission of Ontario)*, 2016 ONSC 2202, the Court held that "there is no doubt" that the LCBO mark-up fits within the *Lawson* test, and therefore may be a tax. However, if a levy is in pith and substance a regulatory or proprietary charge, it will not be classified as a tax.

The Respondents argued that the LCBO mark-up is a proprietary charge applied on products it owns in a commercial context. The products were sold to the LCBO under the terms of the contract, and were kept on-site to be sold by the manufacturer as agent for the LCBO. The mark-up, the Respondents argued, is thus a lawful charge applied to its own property.

The Court accepted this position and held that the LCBO mark-up is a proprietary charge, not a tax.

Change coming anyway?

In its February 2016 budget, the Government of Ontario announced that it would be reviewing the mark-up system for on-premises sale of spirits by manufacturers. The Government suggested that instead of the LCBO contract arrangement, it would introduce a traditional tax on the purchasers of spirits, bringing it in line with the beer and wine sectors.

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