

Docket: 2005-528(IT)G

BETWEEN:

RENE NUYTEN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 26, 2007, at Vancouver, British Columbia.

Before: The Honourable Justice Pierre Archambault

Appearances:

Counsel for the Appellant: Douglas H. Mathew

Counsel for the Respondent: Michael Taylor

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2000 taxation year is dismissed, with costs, in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 16th day of July 2007.

“Pierre Archambault”

Archambault J.

Citation: 2007TCC321
Date: 20070716
Docket: 2005-528(IT)G

BETWEEN:

RENE NUYTEN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Archambault J.

[1] Mr. Rene Nuytten is appealing an income tax reassessment respecting the 2000 taxation year. In his reassessment, the Minister of National Revenue (**Minister**) disallowed a business expense of \$34,700 that had been claimed in the original tax return. He also disallowed an additional amount of \$218,042 claimed by Mr. Nuytten as research and development (**R&D**) expenses in a T1 adjustment request to amend his tax return. At the outset of the hearing, counsel for Mr. Nuytten indicated that he was not contesting the disallowance of the \$34,700. However, he argued that Mr. Nuytten was entitled to the deduction of \$218,042 on the basis that this amount constituted R&D expenses that were deductible pursuant to section 9 of the *Income Tax Act* (**Act**) in computing Mr. Nuytten's business income.

[2] When he issued his assessment, the Minister assumed as facts that Mr. Nuytten had carried on an R&D activity with respect to advanced deep-sea diving systems (**activity**) (subparagraph 12a) of the Reply to the Notice of Appeal), that Mr. Nuytten had begun this activity in 1996 (subparagraph 12b) of the Reply) and that in 2000 this activity constituted a business carried on by Mr. Nuytten (subparagraph 12c) of the Reply). However, before this Court, he advanced a different position and argued that the activity did not constitute a business or a source of income for the appellant in the 2000 taxation year (paragraph 13 of the Reply). Therefore, it is the Minister who bears the onus of

establishing that the activity did not constitute a business carried on by Mr. Nuytten.

[3] Both parties presented written submissions during oral argument. There is not much dispute as to the relevant facts. However, there are some slight differences in the parties' description of the facts. I shall first reproduce the statement of facts presented by counsel for Mr. Nuytten:

4. The Appellant, Mr. Nuytten is a world-class Canadian inventor who for almost 5 decades has been involved in advancing deep sea diving technologies and a variety of spin off technologies.
5. Mr. Nuytten's biography is impressive and worthy of careful review. Highlights include that he is a world leader in the diving community, has appeared on the cover of numerous magazines such as National Geographic and was the recipient of several Canadian government awards of excellence and awards from industry groups (both Canadian and foreign). He is a recipient of the Order of British Columbia, had an honorary doctorate conferred on him from Simon Fraser University and is regularly engaged by groups such as NASA and television and film producers because of his expertise. He is a true Canadian icon in his field.
6. After becoming interested in diving, he started his own dive shop while still in high school. After high school, Mr. Nuytten dedicated his working life to the technology of underwater diving and related activities beginning with a commercial diving company called Can-Dive Services Ltd. ("Can-Dive").
7. After the successful start up of Can-Dive, he joined two like-minded individuals in founding Oceaneering International. As part of founding Oceaneering International, Mr. Nuytten transferred Can-Dive to Oceaneering International.
8. At Oceaneering International, Mr. Nuytten was the Sr. Vice President of Technological Development and guided all research activities and personally performed field work and trials. Projects at Oceaneering International included an ROV (or, remote-operating vehicle) submarine, "bouns" diving bell systems and saturation diving systems. While Mr. Nuytten was at Oceaneering International, it prospered and gained an international reputation.
9. Mr. Nuytten left Oceaneering International in the mid-1980s to pursue his own projects. When he left, he repatriated Can-Dive from Oceaneering International.

10. Through the newly repatriated Can-Dive, Mr. Nuytten worked on developing what would become known as the “Newtsuit”, a revolutionary “one-atmosphere” diving suit designed to allow deep ocean dives to depths never before possible and surfacing without the need for time-consuming and hazardous decompression. The Newtsuit also allowed a measure of dexterity at deep levels that could be offered by no other product.
11. Can-Dive and the work on the Newtsuit were eventually transferred to a new enterprise, International Hardsuits. The transfer took place because development of the Newtsuit and his other projects required more financing than his personal resources allowed.
12. At International Hardsuits, Mr. Nuytten continued work on the Newtsuit to the point where he had a marketable product.
13. While at International Hardsuits, he also developed “Remora”, a new and unique submarine rescue system.
14. International Hardsuits obtained public financing and was listed on the Toronto and Vancouver stock exchanges. Through these public offerings, Mr. Nuytten’s interest in International Hardsuits was reduced from his original 100% shareholdings to below a controlling interest.
15. Both the Newtsuit and Remora drew interest from navies around the world. This attention brought with it the possibility of lucrative contracts for International Hardsuits.
16. An American corporation named American Oilfield Divers saw the potential in International Hardsuits and launched a hostile takeover.
17. Mr. Nuytten vigorously opposed the takeover but, because of his minority position, was not able to block it. In the result, Mr. Nuytten was ousted from International Hardsuits and the technology that he developed stayed with International Hardsuits.
18. In light of his unpleasant experience with the hostile takeover of International Hardsuits, the Appellant sought a method by which he could ensure that any new technologies would belong to him personally.
19. After being ousted from International Hardsuits, the Appellant created Nuytco Research Limited (“Nuytco”) in late 1996. He was, and remains, the sole shareholder of Nuytco.
20. The Appellant envisioned two main projects for Nuytco. First, a small deep-diving submersible now called a “Deep Worker”. His thought was that once the Deep Worker project had succeeded to the point that it was producing

revenue, he would move on to his second project, an improved version of the Newtsuit called the “Exosuit”.

21. The Appellant made the deliberate decision when he started Nuytco that he wanted to personally retain the technologies so that if Nuytco fell into unfriendly hands through hostile takeover, bankruptcy or any other reason, he would at least control the technology.
22. His concept was to divide the business between Nuytco and the Appellant in his personally *[sic]* capacity. He would develop the technology using his own funds thus ensuring that he owned the technology. This would give him the freedom to use the technology as he saw fit. This might include sales or licensing to third parties, or making the technology available to Nuytco.
23. In concept, the logistics were that amounts to be charged to Mr. Nuytten were paid by Nuytco because it had the relationship with the suppliers. These amounts were accumulated and charged against Mr. Nuytten’s shareholder loan account.
24. The evidence on the execution of this plan prior to 2000 is not entirely unclear. It is clear that expenses were charged to Mr. Nuytten at least in 2000 and that throughout the entire period, he viewed that technology as belonging to him.
25. The Minister assumed in assessing the Appellant that Mr. Nuytten had been doing the R&D Activity in his personal capacity since 1996 (Reply, paragraph 12(a)) and that Mr. Nuytten had reported losses from the R&D Activity each year up to and including 2000 (Reply, paragraph 12(q)). As a result, the billing and deductions of amounts in prior years were not put into dispute in this appeal. Had these prior years been put into dispute, a clearer evidentiary picture could have been made available to the Court.
26. The Expenses claimed in the 2000 taxation year involved seven projects. The costs for these projects were gathered in Nuytco but billed personally to the Appellant thus ensuring that it was clear that he personally funded the technology and was its owner.
27. The Expenses were claimed by the Appellant by filing a T1 ADJ¹ which included not only the claim for the Expenses, but also salary from Nuytco of \$499,309 which was the amount necessary for Nuytco to “bonus down” to the “business limit”.²

¹ Exhibit A-5.

² As defined in s. 125 of the Act.

28. Several of the projects to which the Expenses relate were accessories or sub-systems ancillary to the Deep Worker, which was the main revenue producer for Nuytco. Other projects involved the Exosuit and still others had multiple potential applications.
29. When the work at issue in this appeal was being performed, the four projects that make up the bulk of the Expenses were at various stages which can be summarized as follows:
 - a. The manipulator arm design project was intended to provide a revolutionary breakthrough which would allow for superior dexterity compared to conventional undersea remote arm systems. In the end, that breakthrough was not forthcoming, and the few “Newtarms” that were sold were replaced with conventional technology. Hindsight proves the technological uncertainty of that project because it failed.
 - b. The electronic research and development project covered several ideas. Mr. Nuytten explained the difficulty of developing electronics at a time when the world was rapidly switching from analogue to digital with the result that test results and product platforms quickly became obsolete. These projects were of benefit to the development of the Exosuit, the Deep Worker and a variety of other projects.
 - c. Newtsub development entailed classic trial and error testing to make product improvements and accessories to increase the functionality of the Newtsub. The very nature of this type of trial and error testing means that the technological issues had not been resolved.
 - d. Design Drawing was essentially support for other projects, and part of the development process.
30. Nothing in the seven projects in 2000 found their way into the patent for the submersible obtained by Mr. Nuytten in 2002 because it was an ornamental design patent.
31. The Appellant testified that he did not have much of a belief in the patent³ process and in his long career had patented only a few inventions. He made it clear that when he was performing the R&D Activities that are the subject of this appeal, he was not pursuing patents.
32. In 2000 year, the Appellant began to conclude that Nuytco was likely to be self-sustaining financially and could carry on without the need for outside financing. Thus, he found it no longer necessary to divide the business

³ Exhibit A-1.

between Nuytco and himself. Accordingly, Nuytco took over the R&D aspects of the business from the Appellant and the Appellant ceased personally funding the R&D.

33. However, he had a slight change of plan with respect to the Exosuit. On May 1, 2001, Mr. Nuytten and Nuytco entered into a Royalty Agreement concerning only the development of the Exosuit. Mr. Nuytten viewed the Royalty Agreement as a way to ensure he continued to own the Exosuit technology without having to personally fund the R&D. Under the Royalty Agreement, Mr. Nuytten would perform the work and own the intellectual property resulting from that work. In return, Nuytco would fund the R&D and would have the opportunity to exploit the intellectual property in exchange for a payment based on the greater of \$50,000 per year or 1½% royalty starting in 2003.
34. An evidentiary point is whether the Royalty Agreement covers Exosuit technology owned by Mr. Nuytten prior to May 1, 2001. The Royalty Agreement speaks for itself, and it is a matter of contract law if the prior technology was included. However, the evidence of Mr. Nuytten was clear that he viewed this as including his past technology.

[4] The most relevant part of the description of facts presented by counsel for the respondent is found in paragraphs 10 to 32 of his written submissions, which provide facts in addition to those set out by counsel for Mr. Nuytten:

Nuytco Research Ltd.

10. In late 1996, the Appellant commenced research and development through Nuytco Research Ltd. (“Nuytco”). The Appellant is the sole shareholder and director, and an employee, of Nuytco.
11. Nuytco’s primary business objectives were to develop and market a new submersible, which became the “Deep Worker”, and then an improved undersea suit, which became the “Exosuit”.
12. Nuytco began research and development operations in earnest in 1997. Until 1999, Nuytco financed its own research.
13. Nuytco sold its first Deep Worker submersible in 1998. In that same year, Nuytco secured a five-year contract with the National Geographic Society to charter submersibles for a project involving undersea mapping and filming of 13 United States Marine Sanctuaries. Nuytco also secured contracts with NASA, local utility companies, and other clients.

14. In 1999, the Appellant concluded that the Deep Worker submersible would be a successful product, and he became concerned about losing control of the intellectual property relating to the Deep Worker if for some reason he lost control of Nuytco.
15. On the advice of his accountant, the Appellant implemented a mechanism through which the costs of Nuytco's research from January 1 to April 30, 2000 were charged to him at Nuytco's year-end so that the Appellant would own the resulting intellectual property. Nuytco produced an invoice on August 30, 2000, charging the Appellant a total of \$218,042 for research costs from January to April 2000.
16. With a 5-year contract from the National Geographic Society in hand, the Appellant concluded that Nuytco would be financially successful and would not need outside investors to finance the Deep Worker. Therefore, after April 30, 2000, the Appellant ceased assuming the research costs personally.
17. The year 2000 was the only year that the Appellant assumed liability for Nuytco's research costs. Nuytco has paid all research costs since.
18. In its 1999, 2000 and 2001 taxation years, Nuytco reported the following gross sales and net income before tax:

<u>Taxation Year End</u>	<u>Gross Sales</u>	<u>Net Income Before Tax</u>
April 30, 1999	\$1,077,000	\$166,730
April 30, 2000	\$2,700,683	\$193,741 ⁴
April 30, 2001	\$1,728,811	\$155,111

The Appellant's Intentions for his Research in 2000

19. The Appellant personally funded the research in the [sic] 2000 in order to preserve personal ownership of any resulting intellectual property. The research related to the Deep Worker submersible concept that Nuytco had developed and was improving, as well as to other small products such as a manipulator arm, HMI lights, and an underwater telephone. Some of the research product would also be applicable to the upcoming Exosuit project.
20. The Appellant generally prefers not to patent his developments unless they are completely new because registering a patent announces the discovery to the outside world and invites competitors. The Appellant has registered only five patents: two for the Newtsuit, one for the Remora, one for the external design of the Deep Worker, and one for the "Morpheus" system. Ownership of the patents for the Newtsuit and Remora were lost when Hard-Suits was acquired by American Oilfield Divers.
21. Although the Appellant did not intend to create patents that he could license for royalties, he did intend to create valuable intellectual property assets such as know-how, processes, designs, drawings, prototypes, models, and so on.
22. The Appellant did not intend to exploit those assets himself by producing and marketing the submersible or other products outside of Nuytco. All of his research products were incorporated into Nuytco's business.
23. In 2000, the Appellant's research activity generated no revenue of any kind. Nor did he have any arrangements in place to receive royalties or other compensation from Nuytco for its use of those assets in the Deep Worker submersible.

Royalty Agreement and Patent

24. In 2000, the Appellant began work developing the Exosuit. He realized that the Exosuit would be a more expensive project than he originally expected, and he again became concerned about losing control of the Exosuit

⁴ Net income reported in the 1999 and 2000 taxation years included a reduction to expenses for research costs recovered from the Appellant.

technology if it became necessary to transfer the project into another company and to raise outside capital.

25. On May 1, 2001, the Appellant and Nuytco signed a Royalty Agreement under which Nuytco retained the Appellant to perform research and development relating to the Exosuit. The Agreement provided that all intellectual property developed by the Appellant would remain his property.
26. However, the Royalty Agreement gave Nuytco a “perpetual, worldwide right and license” to use any intellectual property developed by the Appellant, and required Nuytco to pay the Appellant the following royalties for that license:
 - a. From 2003 until 2010, the greater of 1.5% of Nuytco’s gross revenues from sales or licenses of products using his intellectual property or \$50,000 per year; and
 - b. After 2010, 1.5% of Nuytco’s gross revenues from sales or licenses of products made with his technology for as long as Nuytco made sales.
27. The Appellant explained that the 2001 Royalty Agreement guaranteed him an income stream from his research activity. If Nuytco was unable to pay the royalty, control of the intellectual assets would revert to him and he could do whatever he wished with them.
28. The Exosuit is not yet in production and it is not generating sales for Nuytco. Since 2004, the Appellant has received \$50,000 per year from Nuytco under the Royalty Agreement.
29. The Appellant obtained a patent in the United States for the exterior design of the Deep Worker submersible on August 13, 2002. The patent was assigned to Nuytco. The Deep Worker design patent was not contemplated by the Royalty Agreement. There is no evidence that the Deep Worker design patent has generated income to the Appellant.

The Appellant’s Income and Expenses in 2000

30. The Appellant’s 2000 tax return reported income from taxable dividends, interest and other investments, and taxable capital gains. The Appellant does not recall the dividends reported were from Nuytco.
31. The Appellant’s 2000 tax return also reported \$1 of gross business income and a net business loss of \$34,700. The \$34,700 reflects amounts that are no longer in issue in this appeal.

32. By a Request for Adjustment filed by the Appellant's accountant in December of 2001, the Appellant requested additional business expenses of \$218,042 resulting from the research costs charged to him by Nuytco.

[5] The appellant's position is outlined in paragraph 2 of his trial brief:

2. The Appellant's position is that these R&D Activities constituted a business of the Appellant and that the Expenses are deductible in computing income from that business in accordance with s. 9(1) of the *Income Tax Act* (the "Act"). Further, the deduction of the Expenses is not prohibited by s. 18(1)(b) as being on account of capital.

[6] Counsel for the respondent's position is outlined in his overview at page 1 of his written submissions:

OVERVIEW

The Appellant's research activity was not a business or other source of income for tax purposes in the 2000 taxation year. The evidence does not support the conclusion that the Appellant undertook the research in pursuit of personal profit. The predominant purpose for the Appellant funding the research personally was not to generate profit personally from operating a business separate from Nuytco's, but to maintain personal control of intellectual property assets intended to be used by Nuytco to produce its Deep Worker submersible. The Appellant has earned no income personally from the research done in the year 2000, either in 2000 or subsequently.

The evidence indicates that the research paid for by the Appellant in 2000 was effectively integrated with Nuytco's business. Everything that Nuytco produces is based on his research. In addition, Nuytco originally paid for that research from 1997 until 1999, and did so again from 2001 onward. Finally, when the Appellant was satisfied that Nuytco would be financially successful he discontinued the arrangement and Nuytco resumed paying for the research.

Even if the Appellant's research was a business in 2000, the expenditures were capital expenditures that may not be deducted in full. Their purpose was to create assets that would give enduring benefits to the Appellant by generating future income and by being used in future products. Since patents are "depreciable property" for purposes of the *Income Tax Act*, expenses that led to the US Design Patent for the Deep Worker assembly were the capital cost of a Class 44 asset. Expenses that did not result in the creation of any patent are, at most, eligible capital expenditures. However, deductions for eligible capital are available only for businesses, not taxpayers earning income from property.

The evidence discloses no patents or other depreciable properties held by the Appellant in the 2000 year. Therefore, he may not claim any capital cost allowance in that year, and the “leasing property” restrictions in the Regulations are not applicable.

[My emphasis.]

Analysis

[7] I would like to make some general comments on the more relevant facts and highlight some of the disturbing ones with regard to what took place during the relevant period in this appeal. I begin by observing that Mr. Nuytten was a fascinating witness to listen to. He appears to be a genius in coming up with designs for submersibles like the “DeepWorker” or atmospheric diving suits, such as the “Exosuit”. He also described a new submersible, which he called “Morpheus”, for exploring the tunnels used by large cities like New York to transport fresh water to their citizens. However, as far as the administration of his company’s business is concerned, he relies on hired professionals. Unfortunately, he was not in a position to describe accurately at the hearing what took place in relation to the R&D expenses. For instance, he could not state with enough precision when he himself started to incur expenses with respect to the development of the DeepWorker and the Exosuit. He said he relied on his accountant.

[8] However, when he testified, the accountant stated that the only year for which Mr. Nuytten was charged for R&D expenses by Nuytco was 2000, or, more accurately, he was charged for expenses incurred from January to April 2000.⁵ This statement by the accountant was quite a surprise for the Court and, I assume, for Mr. Nuytten’s counsel, given that the Minister had assumed that Mr. Nuytten had been carrying on the R&D activity himself from 1996 to at least 2000. But it was Mr. Nuytten’s own witness, namely, his personal accountant and Nuytco’s accountant, who contradicted these facts assumed by the Minister.

[9] In addition, when Mr. Nuytten filed his 2000 tax return on April 29, 2001, he did not claim any of the \$218,042 in R&D expenses; he only claimed a business loss of \$34,700, which resulted from the deduction of “management and

⁵ It should be noted that the statement of income and retained earnings of Nuytco for the fiscal year ending April 30, 2000 indicates that, for the fiscal year ending April 30, 1999, an amount of \$17,000 in expenses was recovered. However, the accountant did not testify concerning the nature of this adjustment. No extract from the ledger was filed either.

administration fees”.⁶ At subparagraph 12g) of the Reply, it is stated that the Minister assumed that these fees were paid to Mr. Nuytten’s spouse and daughter for their assistance with his research and development activities and in starting a historical diving society. Although he admitted this fact, Mr. Nuytten’s counsel informed the Court that he was no longer contesting the disallowance of these expenses. Therefore, it appears that the only expenses that had been claimed originally by Mr. Nuytten were not incurred for the purpose of earning income from a business.

[10] The R&D expenses of \$218,042 were only claimed subsequently by filing an adjustment request on December 18, 2001, approximately 8 months after having filed the original tax return. In the same adjustment request, Mr. Nuytten added \$499,309 of employment income allegedly paid as a bonus to him. Therefore, it is plausible that, on the basis of such business deductions as the \$34,700 claimed in the past by Mr. Nuytten, which amount Mr. Nuytten now acknowledges was not properly deductible, the Minister took for granted that Mr. Nuytten had been carrying on an R&D activity since 1996.

[11] Not only did the accountant confirm that the R&D expenses were only billed to Mr. Nuytten in 2000, but the billing took place after a year-end journal entry, the sort of entry that is generally made shortly after year-end (see Exhibits A-8 and A-9). The invoice itself is dated August 30, 2000, but refers to “bill[ed] as of April 30, 2000”. (Exhibit A-3) The tax return for Nuytco was filed on November 3, 2000, and it appears to have been filed late and to have been subject to a penalty (see Exhibit A-6).

[12] I do not doubt that Mr. Nuytten, as a result of his past experience in losing control of International Hardsuits after the hostile takeover by American Oilfield Divers, had serious concerns about keeping more effective control over his inventions. I do not doubt either that he meant to take steps to protect his position in case he allowed other investors to become shareholders in Nuytco. He testified that he consulted lawyers and accountants about ways to achieve these objectives. However, I cannot say that I am impressed by the steps that he took to achieve them. He did not get any formal opinion as to the proper thing to do. In addition, it appears that most of the expenses for the development of the DeepWorker and the Exosuit were incurred by Nuytco, not Mr. Nuytten, who failed, therefore, to

⁶ See the statement of business activities (Form T2124) (Exhibit A-4).

establish clearly that he owned the technology developed in the name of Nuytco.⁷ In addition, Mr. Nuytten acknowledged that the money that could be generated from the use of his technology would be earned through Nuytco, although he also stated that he could have disposed of his technology himself to another company.⁸

[13] Furthermore, it can be seen that Mr. Nuytten abandoned his 2000 strategy of incurring the R&D expenses himself and on May 1, 2001, entered into a Royalty Agreement with Nuytco whereby he would perform R&D activities for Nuytco as an independent contractor. It appears that the costs of carrying on the R&D activities were to be borne by Nuytco. For his services to Nuytco, Mr Nuytten is entitled to receive during the term of the agreement, which “shall commence on May 1, 2003 and shall terminate on April 30, 2010”, the greater of \$50,000 per annum and 1½% of all gross revenues derived from the sale or license of products developed by Nuytco using Mr. Nuytten’s work or intellectual property. After the expiration or termination of the agreement, Mr. Nuytten will be entitled to 1½% of all gross revenues derived from the sale or licence of these products for as long as Nuytco derives revenue from the sale or licence thereof.

[14] Given these facts, it is difficult to conclude that Mr. Nuytten was carrying on a business during 2000. First, there is no agreement in writing that provides for Nuytco to incur R&D expenses on behalf of Mr. Nuytten or for his benefit. The evidence produced at the hearing seems to indicate that the charging of the expenses to Mr. Nuytten was an afterthought that took place in the period during which the accountant was preparing the financial statements for the company. The invoice itself is dated August 30, 2000.

[15] Overall, the conduct of Mr. Nuytten appears to be an awkward attempt to retain control over his inventions in the eventuality of the acquisition of control of

⁷ The marketing material prepared by Nuytco states that “Nuytco designs, builds and operates atmospheric diving suits, submersibles, remotely operated vehicles, HMI lights and other specialty equipment for underwater applications.” Also, it adds that Nuytco “owns and operates a fleet of submersibles, ROV’s, sonar systems and specialized tools for commercial and scientific applications. We offer training on the ‘DeepWorker’ series, or can supply a full crew with pilot(s) and support, as the client requires.” (Exhibit A-13)

⁸ It should be recalled that the Minister took for granted that the disallowed expenses for 2000 (those still in issue) related to the development by Mr. Nuytten of intellectual property assets that he intended to be exploited for profit by other persons, such as Nuytco (subparagraph 12e) of the Reply), and that Mr. Nuytten did not intend to exploit any intellectual property assets for profit on his own account (subparagraph 12j) of the Reply). These facts assumed by the Minister have not been “demolished” by Mr. Nuytten.

Nuytco by another investor, and in the meantime Nuytco was intended to be the entity to make money from the exploitation of the technology developed by Mr. Nuytten and “his design team”.⁹ This conduct is not consistent with someone carrying on a business for profit. The business carried on for profit is that of Nuytco and therefore the expenses in question belong to Nuytco.¹⁰ In this particular case, it appears that Nuytco will not be prejudiced, since in forgoing the \$218,042 of R&D expenses billed to Mr. Nuytten, Nuytco paid Mr. Nuytten a large bonus of \$499,309 and used the deduction of that amount to reduce its income below the \$200,000 business limit for the purposes of section 125 of the Act.¹¹

[16] Given that the respondent has succeeded, in my view, in establishing that Mr. Nuytten did not carry on a business during the year 2000, the amount of \$218,042 billed to him by Nuytco cannot be deducted in computing his income for the 2000 taxation year. This is sufficient to justify the Minister’s assessment disallowing the deduction of the \$218,042.¹²

[17] For all these reasons, Mr. Nuytten’s appeal is dismissed with costs.

Signed at Ottawa, Canada, this 16th day of July 2007.

⁹ To use the words found in his biography (Exhibit A-2).

¹⁰ The conduct of Mr. Nuytten illustrates the difficulty that many taxpayers have in managing their business through a wholly owned corporation: they treat their corporation like their alter ego; they do not recognize the distinction between their own person and the legal personality of their corporation.

¹¹ I was surprised to hear that Nuytco does not deduct its R&D expenses pursuant to section 37 of the Act, since it does not file any prescribed form as required by that provision. If these expenses are of a capital nature in Nuytco’s hands and, accordingly, non-deductible pursuant to paragraph 18(1)(b) of the Act, it would appear that fulfilling the conditions of section 37 is necessary in order for Nuytco to deduct them.

¹² If I had concluded that Mr. Nuytten was carrying on a business, I would have held that these expenses were not fully deductible in computing his income pursuant to section 9 of the Act. In my view, they would be subject to the restriction of paragraph 18(1)(b) of the Act, because they constitute expenses of a capital nature. The fact that, for accounting purposes, the accountant, applying the generally accepted accounting principles, expensed those amounts is not conclusive for tax purposes. The principles governing the taxation of income, such as those found in paragraph 18(1)(b) of the Act, are not the same as those followed by accountants in producing their financial statements.

“Pierre Archambault”

Archambault J.

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APPEARANCES:

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