Docket: 1999-664(IT)I

BETWEEN:

JOHN FOSTER,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Douglas Atherton (1999-758(IT)I)
on January 17, 18, 19 and 20, 2006, May 8, 9, 10, 11 and 12, 2006,
October 16, 17 and 18, 2006 and April 25, 2007, at Montréal, Quebec

Before: The Honourable Justice François Angers

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Dany Leduc and Marie-Andrée Legault

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JUDGMENT

The appeal from the assessment made under the *Income Tax Act* in respect of the 1988 taxation year is dismissed in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 5th day of December 2007.

"François Angers"

Angers J.

Docket: 1999-758(IT)I

BETWEEN:

DOUGLAS ATHERTON,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
John Foster (1999-664(IT)I)
on January 17, 18, 19 and 20, 2006, May 8, 9, 10, 11 and 12, 2006,
October 16, 17 and 18, 2006, and April 25, 2007, at Montréal, Quebec

Before: The Honourable Justice François Angers

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Dany Leduc and Marie-Andrée Legault

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JUDGMENT

The appeal from the assessment made under the *Income Tax Act* in respect of the 1988 taxation year is dismissed, and the Appellant Atherton is ordered to pay costs in the amount of $3,000 to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 5th day of December 2007.

"François Angers"

Angers J.

Citation: 2007TCC659
Date: 20071205
Dockets: 1999-664(IT)I
1999-758(IT)I

BETWEEN:

JOHN FOSTER,
DOUGLAS ATHERTON,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Angers J.

[1] These appeals were heard on common evidence. The Appellants are appealing from their respective assessments, which were made by the Minister of National Revenue ("the Minister") for the 1988 taxation year. The Appellant Foster's assessment is dated April 29, 1992, and the Appellant Atherton's assessment is dated May 19, 1992. Both Appellants were denied an investment tax credit that they had claimed; the Appellant Foster had claimed $2,000 credit for a $9,993 investment, and the Appellant Atherton had claimed $4,000 for a $19,997 investment. In both cases, the funds were invested in Système ALH Enr. (hereinafter "ALH"), a partnership that did scientific research and experimental development work (hereinafter "SRED") that the Minister does not recognize. I should emphasize that the Appellant Foster appeared only at the beginning and end of the hearing, entrusting the carriage of the matter to the Appellant Atherton.

[2] It should also be noted that the Appellants each reported the complete amount of their investments as a business loss for the same taxation year. These losses were not disallowed by the Minister at the time of the audit, so the only point in issue in the instant cases is whether the Appellants are entitled to their investment tax credits.

[3] Even though the Minister permitted the Appellants to deduct their business losses, counsel for the Respondent submit that the Appellants were not members of a partnership and that ALH did not carry on business. In the alternative, the Respondent submits that the Appellants were either "specified members" and "limited partners" within the meaning of subsection 96(2.4) of the *Income Tax Act* ("the Act") and the definition of "specified member" set out in subsection 248(1), or passive "specified members" within the definition of "specified member" set out in subsection 248(1). The Respondent is not seeking to increase the two assessments in issue, but is raising these new arguments in support of her assessments. This approach was accepted by the Federal Court of Appeal in *Canada v. Loewen*, 2004 FCA 146, and is based on subsection 152(9) of the Act.

[4] The new arguments in question were raised in the Reply to the Notice of Appeal dated March 23, 1999, and have been made in several matters that have come before this Court, so the factual allegations involved are not novel to this Court. Moreover, the Respondent is justified in making these new arguments, because the Court is not bound by a factual admission that is not supported by the evidence.

[5] The Appellant Foster invested in SRED projects in 1988 and 1989 through his broker. In his testimony, he admitted that he never attended any ALH partnership meeting and that he was never engaged in any research project of the partnership. His only involvement was his initial investment, which I will round off to $10,000. His offer of participation in the ALH partnership was signed in Montréal at his broker's office. However, the offer of participation states that the partnership in question was registered under the laws of Ontario and that the offer was signed in Ottawa, Ontario, on October 13, 1988, despite the fact that the Appellant Foster did not go to Ottawa to sign the document. The Appellant Foster did business through his broker, who looked after his income tax returns. He claims that he does not know the other partners of ALH and that there were roughly a hundred of them. He was unable to recognize the documentation attached to his 1988 income tax return. Actually, he invested in ALH in 1988, but the financial statements attached to his income tax return are the statements of another partnership called Société d'informatique A.H.D. Enr.

[6] The Appellant Foster thought that he still held an interest in ALH when he testified, but the documentation adduced in evidence shows that, in the months following the purchase, he sold his interest for half the price that he had paid for it. Since the Appellant Foster reported an investment loss in his 1988 taxation year, he received the investment tax credits (ITCs) and recovered half the value of his

interest when he sold it in the subsequent year; thus, Foster obtained a return of roughly 20% on his initial investment. ALH had invested in SRED, but Foster does not know how much time this research was supposed to last, and, in fact, he never received any information concerning the SRED from the time that he made his investment to the date of the hearing.

[7] The Appellant Atherton made the same type of investment. He learned about the SRED, about ALH's project, which he found interesting and useful to his employer at the time, and about the tax benefit that he could derive from such an investment. In fact, he continued to make the same type of investments until 1992, when he received a notice of assessment from Revenue Canada disallowing his ITCs. On October 1, 1988, he had signed an offer of participation which stated that he was purchasing 20,000 units in the ALH partnership for $1.00 each. The document states that it was signed in Ottawa, but the Appellant did not go there to sign it. By resolution of the ALH partnership bearing the same date, ALH entrusts Nguyen T. Dzung, as manager, with the responsibility for carrying out its research project, which pertains to a prototype computer-assisted training system for learning interpersonal communication. The Appellant Atherton had no input with respect to this decision, and is the only one who signed the resolution.

[8] The ALH partnership contract tendered in evidence (Exhibit A-25, tab 6) is unsigned. The two partners identified in the contract are Nguyen T. Dzung and Susan Hann, both of whom are from Calgary, Alberta. The Appellant Atherton signed the appendix, which states the amount of his equity as at December 30, 1988. There are no other signatures. The Appellant Atherton said that he did not know the two individuals at the time.

[9] ALH's financial statements for the period ended December 31, 1988, state that ALH is a partnership formed on October 28, 1988, but, this time, under the laws of Alberta. The total amount invested by the partners is $3,171,000. The partnership paid in SRED costs an amount equal to the reported loss.

[10] As with all the other projects in which he invested, the Appellant Atherton sold his entire interest the following year for half the price that he had paid. The Appellant Atherton received research documents explaining the nature of the research, and, over the years, personally took part in the research on a few occasions by filling out a questionnaire or doing some work on the computer. However, he was unable to find any document concerning his contributions. When questioned about what the ALH partnership did in 1988, the Appellant Atherton answered that this should be explained by a

Zuniq Corporation representative, and that Dr. Vohuang, its president, was the only one who could really have provided answers. Zuniq Corporation is the company to which ALH entrusted its research project. Dr. Vohuang was its president until his death in 1993.

[11] The Appellant Atherton testified that he was made aware that since he was a partner, he was liable for the partnership's debts. However, he acknowledges that he did not verify the financial condition of the partnership. He invested because he thought the ALH project would interest his employer and because of the favourable return on his investments. However, he was not acting on any instructions from his employer in this regard. He acknowledges that he did not know how many partners ALH had at the time, other than the six or seven who worked for the same employer as he did. Today, he sees that there were more than 200 partners. He also acknowledges that ALH had no business plan, that the partnership relied on Mr. Dzung and Ms. Hann, and that ALH's activities were limited to the granting of a contract to Zuniq Corporation before he even purchased his interest. The amount of capital raised to carry out the project was decided upon in advance by Dr. Vohuang, and the Appellant Atherton did not know the total value of the contract; he did not know whether ALH had a bank account, who signed the cheques, or even whether ALH's funds were managed properly. No meetings were ever held with the partners.

[12] When cross-examined about who ALH was, the Appellant Atherton suggested that Mr. Dzung and Dr. Vohuang be asked this question. He admits that he reported a business loss, not because he was aware of ALH's activities, but because someone told him that the expenses, including the research contract entrusted to Zuniq Corporation, had to be claimed during the year in order for him to be entitled to the expenses, even if ALH had earned no income in 1988.

[13] ALH's financial statements for the year ended December 31, 1988 report income in the amount of $18,000, but the Appellant Atherton does not know where this income came from. In fact, he never got a copy of these financial statements while he was a partner. He acknowledges that he never exercised any decision-making power with regard to the management of ALH, and, lastly, he states that he was never "in business" with the other 223 partners. In his view, he was merely an investor. He got very good returns on the dispositions of his interest in ALH and other partnerships in subsequent years. He admits that in 1990-91, he realized none of this made much sense. However, he testified that he had a personal interest in some of these projects. He says that he participated to some

degree in these projects, but cannot explain why he always sold all his interest in the partnerships.

Zuniq Corporation and Dr. Vohuang

[14] The Dr. Vohuang to whom we have been referring is a scientist who had research projects that needed financing. Unable to finance his research through bank loans, he decided to finance it through private investors. He wanted to keep the intellectual property rights for his work, so he was advised to use partnerships. Partnership structures had proved to be useful as a means of avoiding having passive investors, provided the partners did not come within the definition of "specified member" introduced in December 1987; and this appears to explain certain activities intended for the partners.

[15] Dr. Vohuang managed Zuniq Corporation, the company to which the various partnerships — ALH and roughly 11 others — granted the SRED contracts. Each of the partnerships would raise funds and grant the research contract to Zuniq Corporation for the same amount, and Zuniq Corporation would bill the partnerships accordingly. All of this was done in the short period of time between the creation of the partnership and the payment for the research contract; thus, within a few months, the partnership spent all the money that it had raised. Zuniq Corporation prepared various information concerning the research project and sent it to the partners, but the partnership itself no longer did anything.

[16] Potential investors were solicited by means of presentations, and, based on the evidence heard, it is clear that the emphasis was primarily on the tax benefits that would be derived from such an investment. For example, the documentation tendered in evidence includes a table submitted to the investors, which explains the potential return on a $10,000 investment. It indicates a potential return of $6,819 once the business losses are reported, the ITCs are claimed and the partner's share is sold for half the price paid for it. Thus, in such a scenario, the return on the initial $10,000 would be $1,819. The purchaser of the shares was Zuniq Corporation or one of its related companies, all of which were controlled by Dr. Vohuang. The buyback was done in order to enable to purchaser to keep the intellectual property rights to the research and development activity. The end result was that all participants benefitted. Zuniq Corporation benefitted because the taxpayers' investments allowed it to finance its research, and the investors benefitted by getting a good return on their investments.

[17] Obviously, in order for this scenario to be attractive to investors, Zuniq Corporation or its related companies had to buy back their shares. While there was no written guarantee that this would occur, this was clearly touted at the presentations as one of the incentives to invest, and almost all the shares were, in fact, bought back by Zuniq Corporation or its subsidiaries.

[18] Potential investors were also given a summary of the research project, the names of the key scientific staff that would be working on it, the names of those who would be directing and carrying out the various stages of the project, and other articles regarding the research entrusted to Zuniq Corporation.

The audit

[19] Richard Bernier is a project manager with the Canada Revenue Agency. He was directed to verify the validity of the SRED done by ALH and Zuniq Corporation, and to ensure that the amounts that were invested were actually subscribed. In other words, he was assigned a financial audit. He compiled a list of the partnerships created from 1986 through 1988, and it was found that 12 partnerships had presented SRED projects that were subcontracted to Zuniq or related corporations. Mr. Bernier also prepared a table showing how their operations tied in to Zuniq Corporation, and identifying the main players. Given the number of partnerships that were created during this period and were claiming ITCs, Revenue Canada decided to pursue a more thorough investigation, especially with respect to the validity of the SRED projects.

[20] Claude Papion testified as computer expert. He was retained by Revenue Canada starting in June 1987 as an external scientific advisor for the purpose of assessing eligibility for the tax credit in respect of SRED activities reported by private businesses. On March 15, 1991, he was retained to assess claims concerning ALH's research activities and its work in 1988, having regard to the criteria set out in section 2900 of the Income Tax Regulations ("the Regulations"). Revenue Canada identified three essential criteria in Information Circular 86-4RZ: the advancement of science or technology criterion; the scientific or technological uncertainty criterion; and the scientific or technical content criterion.

[21] Consequently, at Revenue Canada's express request, Zuniq Corporation gave Mr. Papion all the available documentation. Mr. Papion's first observation upon examining Form T661, which is used for claiming an SRED expense deduction, was that the period in issue was from October 28 to December 31, 1988, and that

the expense was $3.1 million, an amount he testified would pay the annual salaries of 60 scientific advisors.

[22] ALH's project is called INCOM, and the first documents that Mr. Papion reviewed did not provide him with enough of the five basic criteria necessary for his analysis. Therefore, Mr. Papion requested and received additional documents. Based on these new documents, he determined that, as of February 12, 1990, no research pertaining to ALH's project had commenced, and thus, that nothing had been done in 1988. He determined that the project underwent a reorientation, but not in any way that was in keeping with the basic criteria.

[23] Consequently, Mr. Papion requested more documents and met with the representatives of Zuniq Corporation, including Dr. Vohuang, in September 1990. He was given more documents at that time, and was told that the work had begun in May 1990. Nevertheless, Mr. Papion concluded that the only documents concerning ALH were about what it wanted to do, not what it had done. He saw no genuine technological uncertainty to be resolved, and no work undertaken for the advancement of science. There was no information indicating who had done what, nothing about the personnel involved in the project, and nothing pertaining to the technological content criterion, even though an accurate description of the technological progress made was required. He was given additional information, but his initial conclusion remained unchanged: the ALH INCOM project was not eligible. Surprisingly, while assessing the other partnerships' different research projects, he found the same documents that had been submitted for the ALH project.

[24] When questioned about the fact that certain investors were given questionnaires, diskettes and other documents, Mr. Papion replied that these were basic documents of the type used in junior colleges at the time. He saw no evidence other than very rudimentary things, and nothing about the nature of the investments.

[25] All in all, Mr. Papion provided very clear and precise explanations. He saw nothing in ALH's INCOM project that met the eligibility criteria for a research and development project that would qualify for an investment tax credit under the legislation.

[26] Following the issuance of the reassessments, the members of nine of the partnerships filed objections. The objections were handled by Sonia Borin, who was an objection officer at the time. Naturally, the reason for the objection was the

disallowance of the ITC claims. Given the nature of the research and the number of partnerships involved, she asked for an expert opinion from a consultant named George White. In fact, Mr. White's opinions and findings were tendered in evidence by the Appellant. Mr. White's finding regarding the projects associated with ALH and six other partnerships was that they did not come within the Regulations' definition of scientific research and experimental development.

[27] The first thing that Ms. Borin noticed while studying the files was the degree of similarity between the partnerships in question. Here is what she said about this subject (see the transcript, at page 10):

> [TRANSLATION]
>
> A. There were several similarities among all the partnerships — the nine partnerships about which I received notices of objection. First of all, the partners became members of the partnership shortly before its one and only financial year. Then, shortly after that, anywhere from a few days before the end of the fiscal year to a few weeks, or perhaps a month or two at most, generally, all the partners ... I mean, all the partnerships, in the days or few weeks following the creation of the partnership, granted research contracts to Zuniq Corp., or, in the case of Partnership No. 9, S.E.D., to Gestion DAC, a company that was related to Zuniq in that its shareholder, Mr. Vohuang, was the same. The amount paid for the research contract was equal or just about equal to the total funding that the partnership had received from the investors. All the amounts spent by the corporation were characterized as research and development expenses. The partnership's loss was equal, or just about equal, to the funding received from the investors, and the partnerships were given investment tax credits.
>
> Then, in the days or weeks following the end of the partnership's one and only fiscal year, a company, like a corporation related to Zuniq, bought back the partners' shares for an amount ranging from 50 to 60 percent of the investors' initial investment, depending on the partnership.
>
> Then, as I said, the partnership produced a single financial statement for the year of the investment, and there was no subsequent activity in the partnership or any of the partnerships. Lastly, the addresses of the partnerships were all located in roughly the same place. There were a few different addresses, but the partnerships were generally located where Zuniq was located.
>
> And finally, I found that the actors involved, the actors who gravitated around the partnerships, were always the same. And they were related to Zuniq; there was Zuniq Corp, Mr. Vohuang, Mrs. Vohuang, Data Age, Dalat Investment, Système Inar, it was always — and I'm skipping over a few of them — it was always the same actors who gravitated around.

[28] Ms. Borin also analysed all the documentation adduced in evidence that was in the audit file for each of the partnerships. The scenario for each of the partnerships is the same. With respect to the buyback of the shares of each ALH partner, the year of the buyback, namely 1989, was pre-printed on the assignment forms. Ms. Borin also found a document referring to the buybacks of the ALH partners' shares in 1989 and containing both Appellants' names. Each Appellant sold his entire interest for half the price that he had paid.

[29] Ms. Borin also testified about the financial statements of the nine partnerships that she examined. The shortest of the nine partnerships' fiscal years was 52 days, and the longest was 11 months. ALH's financial statement reports a $3.1 million loss at December 31, 1988 — a loss attributable to scientific research expenses incurred after two months of operation. The partners' equity was $3.1 million, but the financial statements refer to $2.4 million in subscriptions payable, even though the subscription documents state that the shares, or at least the second half of the investments, were to be paid for by December 15, 1988. The financial statement reports no assets or liabilities other than those related to research. The last comment is about the fact that the financial statements refer to a partnership created on October 28, 1988 under the laws of Alberta, whereas the contract of partnership refers to a partnership created under the laws of Ontario.

[30] Ms. Borin's determination is set out in her Report on Objection (Exhibit R-2, tab 2). However, she summarized all of it in her testimony. The explanations constitute the basis of the assessments concerning the Appellants, the ALH partners, and the members of the other partnerships. I shall reproduce a part of her testimony concerning these issues below:

> [TRANSLATION]
>
> A. So here are the findings, in a different order from the one in the report. First of all ... well, the first finding ... is that no investment tax credit is permitted. With respect to that finding, I refer you to Finding D, at page 10. So no investment tax credit is permitted, because the activities that were carried out do not qualify under Regulation 2900 based on the finding of Mr. Papion, and, at ... And this was confirmed by Mr. White, the second scientist.
>
> I made other, alternative findings after examining all those nine partnerships. I found that even if the research were eligible under Regulation 2900, the partnership and its investors would not be entitled to the investment tax credit and the research and development expense because there was no partnership, there was no legally existing partnership, and the purported partnership did not carry on business.

These two findings are set out in Finding A, at page 9, and Finding B, at pages 9 and 10.

. . .

Q. What were the clues that enabled you to make your determination that there was no existing partnership and that the partnership was not carrying on a business?

A. After looking at all those documents, and for the following reasons, I determined that the members of the partnership had no intention of working in common with a view to operating a business and producing a profit or causing a profit to be produced: the partners were from different trades and occupations and did not know each other; the partnership had a single fiscal year which lasted two months and in which the investors' only activity was to invest money. Moreover, in the partnerships that I looked at, including ALH, there was no income in the partnership, or, if there was income, it was consulting fees from a related partnership or corporation ... that is often what it was, if I was able to trace it. That the only expenses incurred were related to research and development, or purported research; that these expenses were equal to the investments, that these partnerships had no other assets or liabilities. And the investors' shares were bought back in the weeks or days following the end of the one and only fiscal year, and, in those partnerships, they were bought back for 50 to 60 percent of the value of their initial investment, and it was 50 percent in the case of ALH, apart from certain exceptions where the buyback was for 55 percent.

Based on this, I concluded that the partners' only role was to invest. And in order for an expense to be deductible under section 37 as a research and development expense, and then qualify for the investment tax credit, the expense must be incurred by a taxpayer who carries on a business. Since the partnership has no legal existence and does not carry on a business, the expense is not eligible under section 37. Consequently, it does not entitle the taxpayer to the investment tax credit, and should not entitle the taxpayer to the business loss either.

Moreover, I found that if it were decided that the partnership existed and carried on a business, the partners would still not be entitled to the investment tax credit, because the partners would be considered passive specified members of the partnership. I address this in the second part of Finding B. And the reason I say this is that they were not engaged in the activities of the business on a regular, continuous and substantial basis.

Why do I say this? Because there was a short holding period, and the investors' only involvement was to invest. There was no other proof of involvement. However, if they were passive partners, they might be entitled to the loss, which was, in fact, already granted. Thus, they would not be entitled to the investment tax credit in any event.

> And in addition to being passive, it was my opinion that they were limited partners. That was my Finding E, which can be found at paragraphs ... sorry, pages 10 and 11, because they were entitled to receive an amount that limited their risk. That amount was the proceeds of disposition following the buyback of their shares. And I saw the assignment forms which have a year pre-printed on it, and this led me to believe that, at the time of the purchase, the assignment was slated for '89; that the buybacks were for 50 to 60 percent of the initial investment regardless of the fair market value of the shares on that date. And the fair market value of the shares at that date, if one takes the investors' shares minus the partnership's loss in Year 1, the result is zero. And in addition, the purchase and buyback dates were very close to each other. Thus, my conclusion about this, is that they would not be allowed the investment tax credit and would not be allowed the loss.
>
> Q. However, my understanding of your testimony is that your level allowed the loss, but ... in fact it was at the audit level, but did not change at your level, it was allowed as an "other" business loss?
>
> A. Exactly.
>
> Q. In your case, why did you not alter that finding if, in your opinion, there was no partnership and no business?
>
> A. Because, at that time, those years were otherwise time-barred, so we don't do adjustments for years that are otherwise time-barred. So, in conclusion, all the information that I saw led me to believe that those partnerships were shams. That's what I say in Finding C, at page 10, because the partnerships, including ALH, had no *raison d'être* except as a tool to generate tax benefits and as a financing tool for Zuniq's activities.
>
> . . .

[31] The Appellant Atherton called several witnesses. The participation and interest of a few of these witnesses in the ALH or other partnerships' research projects in no way tip the scales in favour of the Appellants. In fact, some of the witnesses who were called to the stand provided evidence that weighs heavily in favour of the Minister's position.

[32] The questions raised and answered by Ms. Borin in her findings aptly summarize the issues in the case at bar. Was there truly a partnership, and, if so, was it carrying on a business? If the Appellants were partners, were they specified members of the partnership and limited partners within the meaning of subsection 96(2.4) of the Act at a time of the year that is relevant to the appeals?

If that question need be answered, were they partners who were not, on a regular, continuous and substantial basis throughout the year in issue when the alleged partnership claims to have ordinarily carried on business, actively engaged in the activities of the alleged partnership business, and did not carry on a business similar to that carried on by the partnership in the relevant taxation year, within the meaning of the definition of "specified member" set out in subsection 248(1) of the Act? Lastly, did the work submitted by ALH constitute scientific research and experimental development under section 37 of the Act and subsection 2900(1) of the Regulations?

Analysis

[33] In both the civil law and the common law, the criteria for determining the creation of a partnership pertain to intention of each partner to pursue a profit, in common, using the partnership's assets (see *Backman v. Canada*, [2001] 1 S.C.R. 367 and *Bourboin c. Savard*, [1926] 40 B.R. 68. The current law governing this question was clarified by Lamarre J. of this Court in the following excerpts from *Carpentier v. The Queen*, 2005 TCC 666, at paragraphs 40, 41 and 42.

> [40] In *Backman v. Canada*, [2001] 1 S.C.R. 367, the Supreme Court of Canada wrote that "[...] to ascertain the existence of a partnership the courts must inquire into whether the objective, documentary evidence and the surrounding facts, including what the parties actually did, are consistent with a subjective intention to carry on business in common with a view to profit" (page 382, paragraph 25).
>
> [41] Documentary evidence is not the only criterion for determining the existence of a partnership. It must be determined whether the tangible actions of the parties are compatible with such subjective intent to carry on business in common with a view to profit (see *Witkin v. Canada*, [2002] F.C.J. No. 703 (Q.L.), paragraph 12, which reiterates *Backman*, *supra*).
>
> [42] Further, where it is established that the sole reason for the creation of a partnership was to give a partner the benefit of a tax loss, when there was no contemplation in the parties' minds that a profit would be derived from carrying on the relevant business, the partnership could not in any real sense be said to have been formed "with a view of profit"(see *Continental Bank*, *supra*, paragraph 43).

[34] I have examined all the documentation tendered in evidence with respect to the creation of ALH and the other partnerships, and my conclusion is the same as Ms. Borin's: There was no partnership, and no business was being operated by the purported ALH partnership. The partners never worked in common with a view to

a profit. They never met, and they did not know each other. The purported ALH partnership lasted only a few months, and the only activity was the investment of money by the partners. There was very little if any income, and the income source is unknown. The only expenses were research and development expenses. All the partners' shares were bought back, for 50% of the value of the initial investment, in the days following the only fiscal year of the purported ALH partnership. There is no way to consider the investment in issue to have been made with the intent to carry on a business.

[35] In addition to the documentary evidence, I cannot disregard the assertions made by the Appellants Atherton and Foster with respect to their role and involvement in the purported ALH partnership. The Appellant Foster essentially knew nothing about his interest in ALH. He did everything through a broker, he did not know whether his interest had been bought back or not, he was unsure of the amount initially invested, he did not know the other partners, he did not know how many of them there were, he never attended an ALH meeting, he knew nothing about ALH's research project, the progress on that project, or its results, he did not know anyone involved in the research or anyone to whom the research project had been entrusted, and I could go on.

[36] For his part, the Appellant Atherton flatly stated that he did not think that he was in business with the other ALH partners, or that he was carrying on a business. Actually, he considered himself an investor. It is therefore impossible to find that the Appellant Atherton had the intent to form a partnership or operate a business. He did not know Susan Hann and Dzung Nguyen, the founding members of the purported ALH partnership, at the relevant time. He had no input with respect to the choice of Dzung Nguyen as manager, saw no market study concerning ALH, and did not know whether ALH had debts, a bank account, etc. When asked what the ALH project was, he answered that Mr. Nguyen should have been asked that question. He was unable to provide any explanations regarding the contents of ALH's financial statements. Ultimately, the evidence as a whole clearly showed that the Appellant Atherton's sole objective was to benefit from the attractive return on this type of investment, not to be a member of a partnership. According to his tax returns, he repeated this exercise in subsequent years. The tax deductions were the sole objective of the Appellant Atherton, even though he might have participated slightly in the research by answering questionnaires and going to the premises of Zuniq Corporation. In my opinion, these exercises were for the benefit of Zuniq Corporation, and were engaged in on a volunteer basis. According to Claude Papion, the computer expert, these exercises did nothing for the research project. Another thing that I cannot overlook is Ms. Borin's testimony

concerning the similarities between ALH and the nine other purported partnerships that entrusted a research contract to Zuniq Corporation. I refer to paragraph 27 of these reasons in that regard.

[37] Given these circumstances, I must conclude that, in the case at bar, the ALH partnership does not meet the criteria, under the Act, that would enable me to find that the Appellants Foster and Atherton were members of a partnership that carried on a business. Thus, on a balance of probabilities, the Respondent has met her burden of proof. Since the Appellants were not members of a genuine partnership that carried on a business, they are not entitled to the ITCs under subsection 127(8) and section 37 of the Act.

[38] In my opinion, this is sufficient to dispose of the two appeals in the case at bar. However, I consider it important to add that even if I had come to a different conclusion — that is to say, that there was a partnership carrying on business — I would have found that the two Appellants were limited partners within the meaning of paragraph (a) of the definition of "specified member" in subsection 248(1) of the Act, and, more specifically, within the meaning assigned by paragraphs 96(2.4)(*b*) and 96.(2.2)(*d*) of the Act, and that, consequently, the Minister properly disallowed the ITCs associated with their investment. Without going over the entirety of the evidence, it is clear that the Appellants were informed of the mechanism for buying back their interest, and that it was all part of the benefit that was to be derived from the investment regardless of the fair market value of their interest at the time of the buyback. The evidence as a whole permits me to conclude that the Appellants knew that their interest would be bought back; otherwise, how could they have been persuaded to invest?

[39] If I had found that there was a partnership carrying on a business, I would also have concluded that, on a balance of probabilities, both appellants were passive specified members of the partnership within the meaning of paragraph 248(1)(*b*). In order to be entitled to ITCs in respect of eligible SRED expenses, a partner must either be actively engaged in those activities of the partnership business that are other than the financing of the partnership business, on a regular, continuous and substantial basis throughout the part of the period or year during which those activities are carried on; or be carrying on a business, similar to that carried on by the partnership in its taxation year, on a regular, continuous and substantial basis during the period or year in which the business of the partnership is ordinarily carried on.

[40] This concept of specified (passive) member has been examined in several decisions of this Court, including *McKeown v. Canada*, [2001] T.C.J. No. 236, *Bastien v. Canada*, [2003] T.C.J. No. 771 and *Maslanka v. The Queen*, [2004] T.C.J. No. 311. Once again, I will not go over all the evidence, but, on the whole, it supports the finding that neither of the Appellants was actively engaged in ALH's activities on a regular, continuous and substantial basis throughout the year in which the business of the partnership was ordinarily carried on. Foster's engagement was nil, and Atherton's engagement was limited to answering a few questionnaires and visiting the partnership's premises a few times. He was unable to specify the scope of this work or even to describe ALH's project. In my opinion they come within the definition of a specified (passive) member and are therefore not entitled to the ITCs.

[41] In addition, although it is not necessary, I wish to make certain findings regarding the research project's ineligibility under section 37 of the Act and section 2900 of the Regulations; this was the ground raised by the Minister, and it is the very heart of the assessment. The Appellants have not satisfied me that the Minister erred in determining that ALH's research project was ineligible. The work done by computer expert Claude Papion was in keeping with the criteria for determining whether a scientific research project is eligible. The decision of the Federal Court of Appeal in *C.W. Agencies Inc. v. Canada*, [2001] F.C.A. No. 1886, and Information Circular 86-4R3, summarize the criteria as follows:

1. Was there a technological risk or uncertainty which could not be removed by routine engineering or standard procedures?

2. Did the person claiming to be doing SRED formulate hypotheses specifically aimed at reducing or eliminating that technological uncertainty?

3. Did the procedure adopted accord with the total discipline of the scientific method including the formulation, testing and modification of hypotheses?

4. Did the process result in a technological advancement?

5. Was a detailed record of the hypotheses tested and results kept as the work progressed?

[42] Naturally, these five criteria stem from the definition of "scientific research and experimental development" in subsection 2900(1) of the Rules:

> 2900. For the purposes of this Part and paragraphs 37(7)(*b*) and 37.1(5)(*e*) of the Act, "scientific research and experimental development" means systematic investigation or search carried out in a field of science or technology by means of experiment or analysis, that is to say
>
> (*a*) basic research, namely, work undertaken for the advancement of scientific knowledge without a specific practical application in view,
>
> (*b*) applied research, namely, work undertaken for the advancement of scientific knowledge with a specific practical application in view, or
>
> (*c*) development, namely, use of the results of basic or applied research for the purpose of creating new, or improving existing, materials, devices, products or processes,
>
> and, where such activities are undertaken directly in support of activities described in paragraph (a), (b) or (c), includes activities with respect to engineering or design, operations research, mathematical analysis or computer programming and psychological research, but does not include activities with respect to
>
> (*d*) market research or sales promotion;
>
> (*e*) quality control or routine testing of materials, devices or products;
>
> (*f*) research in the social sciences or humanities;
>
> (*g*) prospecting, exploring or drilling for or producing minerals, petroleum or natural gas;
>
> (*h*) the commercial production of a new or improved material, device or product or the commercial use of a new or improved process;
>
> (*i*) style changes; or
>
> (*j*) routine data collection.

[43] I have summarized Mr. Papion's testimony elsewhere in my reasons and do not want to repeat that summary, but suffice it to say that although Mr. Papion said that the assessment of the ALH project was a difficult one for him, he acted

objectively at all times. Upon evaluating the Appellant Atherton's contribution to the research involving ALH, Mr. Papion said that what Mr. Atherton did does not meet the requirements that must be met in order for an activity to be eligible for scientific research and experimental development, and that the ALH project as a whole does not meet those requirements either. I agree with Mr. Papion's findings.

[44] Consequently, the appeals are dismissed.

[45] However, the Respondent is asking this Court to order the Appellant Atherton to pay costs by reason of his vexatious conduct at the trial and because he pursued his appeal even though it disclosed no reasonable cause of action. The Respondent also asks the Court to order the Appellant Atherton to pay 10% of all amounts in issue, in accordance with section 179.1 of the Act.

[46] In support of their submissions, counsel for the Respondent submit that the length of the trial, which was initially expected to be four days, but took 13, was more than sufficient to enable the Appellants to present their evidence and arguments adequately. They submit that the Appellant Atherton called 22 witnesses, most of whom offered testimony that was unhelpful, irrelevant or even unfavourable to his cause, thereby prolonging the hearing by almost two additional weeks. In their presentation, counsel for the Respondent went over the testimony that was unfavourable or not relevant to the Appellant Atherton's cause with respect to the points in issue, for 22 of the 24 witnesses that he called. They also referred to several decisions, all of which were rendered by this Court, and which concern the same questions of law, involve the SRED partnerships related to Zuniq Corp. and Dr. Vohuang, and are unfavourable to the Appellant Atherton.

[47] For his part, the Appellant Atherton submits that the proceedings lasted as long as they did because the Respondent raised additional arguments in support of her assessments, thereby requiring him to call additional witnesses in order to demolish those new arguments. He says that the unexpected death of Dr. Vohuang also forced him to call other witnesses in order to show the Court the scope of the research projects that he initiated and the eligibility of those projects for the ITCs. He also submits that the Respondent is solely responsible for the length of this hearing because of the time that the Respondent took to make reassessments and confirm them after receiving the notices of objection. With all the time that elapsed, several items of evidence dissipated, making it more difficult, in the Appellant Atherton's submission, to adduce valid evidence, and thereby undermining his chances of making full answer and defence.

[48] I acknowledge from the outset that several years elapsed between the assessment (1992) and the date that the hearing began (May 2006). But given that Dr. Vohuang died in 1993, the Appellant cannot claim that this event took him by surprise. Prior to his death, Dr. Vohuang met with the Respondent's auditors and expert, and had the opportunity to provide them with all the information in his possession regarding his research work. The testimony heard at the hearing described how this man was the only one who knew the scope of all his projects, which were characterized as a "one-man show". But the fact remains that the computer expert's work was finished before Dr. Vohuang died, leading me to conclude that the documentation that he gave the tax authorities and the meetings that he had with the expert did not alter the expert's finding that there was no SRED in relation to the ALH project during the year in issue. The Appellant Atherton himself tendered the report of a second expert, George White, whose finding was the same. This evidence was available starting in 1992. The involvement of the Appellant and a few other alleged partners was characterized by the expert witness as less than minimal and unrelated to ALH's project. The evidence clearly shows that neither the Appellant Atherton nor the Appellant Foster participated in the decisions leading to the granting of these contracts, or in any other decision pertaining to the existence and management of ALH, and thus, one can conclude that they were not actively engaged in the activities of the business of the purported partnership. The quick selloff of their interests in the early months of 1989, in what was obviously a buyback planned in advance by the promoters, and the fact that they were never concerned about negotiating the price of that buyback, are clear indications that these partnerships, including ALH, had no rationale apart from serving as tax shelters and financing the projects of Zuniq Corporation. None of this evidence dissipated with the passage of time.

[49] I must acknowledge that, in presenting his evidence, the Appellant Atherton called witnesses who were unfavourable to his case or whose testimony was irrelevant. However, he also called witnesses who would normally be called by the Respondent to support the factual assumptions on which the assessment is based, or to meet her burden of proof with respect to the new arguments. The Appellant Atherton called 23 witnesses, apart from his own testimony and that of the Appellant Foster. In short, the witness Ganesan Ramini tells us nothing about the investments made by the Appellants in ALH. The witness Michel Mendes invested in a partnership called AHD in 1988. He says that he met Yves Renaud, who told him about the tax credit. He cannot say whether there is a partnership or whether he is a partner. He was only interested in the investment, and would not have

agreed to invest if even a penny of his had been at risk. He said that he did some typing with respect to the process, but nothing more.

[50] The witness Carl Delongchamps was the Revenue Canada auditor. He explained the process by which Dr. Vohuang created the partnerships with a view to financing his research projects, and the progress of the Appellants' and the other investors' files during and after the audit. Despite the fact that the Appellants and the other investors were not entitled to deduct their loss, Revenue Canada granted the ALH members a business loss equal to the amount of their investments. Thus, the auditor's findings support the position that Revenue Canada adopted in processing the assessments of the Appellants and the other investors. The Appellant Atherton chose to add this testimony to his evidence.

[51] The witness Christian Lavoie invested in ALH in 1988 and in four other projects in subsequent years. He knew that he would receive a return of roughly 20 to 30% on his initial investment because he was told so. He knew that his partnership interest would be bought back for half the price that he paid, because this aspect had been discussed in advance and it is what, in fact, transpired. He says that he did some work, but he does not recall what he did.

[52] Marjorie Lauger also testified about the structure that was established, and about the financial package set up by Dr. Vohuang to finance his activities. Each partnership was created for a research project, and each had a short lifespan so that the investors could derive significant tax benefits. Once again, this testimony was of little help to the Appellant. The same can be said about the witness Serge Le Guerrier. Not only did he not participate in ALH, his testimony regarding his involvement in another partnership describes the same scenario regarding the anticipated return on their investments and the existence of the same mechanism for buying back the partnership equity. Mr. Le Guerrier also testified that he did not know what role Zuniq Corporation played in all this, or what progress was being made on the research. He said that he never tried to sell his interest to others, or to find out how the price of his interest was set. However, he knew that he would make a profit. This testimony was also not very favourable to the Appellant.

[53] The witness Pierre Black was not involved in the ALH project. However, his testimony once again helped explain the equity buyback mechanism. The witness Benoit Amar invested in the AHD partnership in 1988. The scenario was the same as it was for ALH. His equity was bought back. He found the ability to resell his interest attractive, and adds that the investors were encouraged to sell their interest,

which he did, in order to realize a gain right away. This testimony was far from being favourable to the Appellant.

[54] The witness Yves Renaud spent all his time on the witness stand explaining the process set up to encourage people to invest. He said that even though the buyback of the equity was not guaranteed, it was stated that such a buyback made this type of investment very attractive. The witness Denis McNamara invested in ALH. He testified that losing money was not an option for him. His broker told him that his interest would definitely be bought back. He did not know the other members of ALH, and his involvement in ALH's activities was limited to a visit of the premises of Zuniq Corporation and a few jobs done at his school. These two testimonies were not favourable to the Appellant.

[55] The witness Pierre Paul Lafond invested in purported partnerships similar to ALH, partnerships that entered into subcontracts with Zuniq Corporation, in 1987 and 1988. Zuniq demanded that the partnerships prepare financial statements. Mr. Lafond did not know anything about the project or how much progress had been made on it. He never saw his partnership contract, not to mention many other things. This was unfavourable testimony that showed how little interest this equityholder had in the research project and the partnership.

[56] The witness Nicola Ivanov is a science manager at the Canada Revenue Agency. Her only role in this entire matter was to send a letter to Dr. Vohuang asking him to provide documents, which Dr. Vohuang subsequently submitted to Bernard Descamps. This testimony was completely irrelevant, as was that of Réjean Dutil, except perhaps when the Court noticed how astonished Mr. Dutil was at the $3.1 million research cost having regard to the documentation that he had examined in connection with the project. Réjean Dutil is a computer science consultant at the Université de Montréal, and a representative of Zuniq Corporation asked him his opinion on the ALH project. He did not testify as an expert at the hearing, because no notice of intent to present an expert witness was served on the opposing party. Moreover, he could not provide an opinion as to whether or not the research was done well, because he himself acknowledged that he was not an expert concerning the eligibility criteria for research projects. His assessment was limited to an evaluation of the project on paper. And as we have seen, Claude Papion testified that what Zuniq Corporation said on paper about what it wanted to do was different from what it actually did.

[57] The witness Miguel Morin is a retired engineer. He did not invest in ALH. He provided consulting services to Revenue Canada and evaluated projects similar

to ALH's. He also worked for Zuniq Corporation. With respect to Dr. Vohuang's projects, he added that it is one thing to say what one will do, and another thing to actually carry it out. The projects looked nice on paper. The witness Richard Bernier gave testimony that was very unfavourable to the Appellant Atherton. He explained how the funds invested in partnerships similar to ALH worked their way through the process, and how half of the funds went back to the investors. The witness Dzung Nguyen, who is Dr. Vohuang's brother-in-law and a researcher, was the person who tried to take over from Dr. Vohuang after his death. His testimony did not address ALH's project.

[58] The witness Alessandro Malutta worked for Zuniq Corporation, solely as a programmer, for more than three years, from 1988 to 1991. He was shown documents that he did not recognize, and other documents which, at Dr. Vohuang's request, he had signed without reading. The witness Bernard Descamps is a manager at the Canada Revenue Agency and was a scientific advisor for Revenue Canada during the relevant period. He met with Dr. Vohuang on the occasions that he visited Zuniq Corporation. He testified that Dr. Vohuang had nothing to show him. Mr. Descamps stated that the thing that he found frustrating was that he did not know what Dr. Vohuang was actually doing when he was speaking about his research projects. Thus, it was impossible to evaluate the research activities. The documents were confusing, and nothing was very clear. The Appellant Atherton even dared to ask Mr. Descamps whether Claude Papion had the skills necessary to evaluate the projects. He answered yes, and added that he was extremely satisfied with Mr. Papion. The witness Jean-Marc Boucher provided no relevant testimony.

[59] The witness Normand Lassonde had nothing to do with the ALH file at any time. He explained what scientific research was, but did not elaborate on the ALH project or on the question whether the partners of ALH made any contribution to its project. The witness Sylvain Castonguay made representations on behalf of Dr. Vohuang, and the investors, to Revenue Canada. The Appellant Atherton never mandated him to act on his behalf in relation to Revenue Canada. He looked after notices of objection in 1992 and never informed the investors of their right to lodge an appeal within 90 days of the filing of the notices of objection. He never informed the investors that he was lodging appeals in their name. Nothing in his testimony was relevant to the resolution of this dispute.

[60] The testimony elicited by the two Appellants, which I have just summarized, supports the factual assumptions on which the assessment is based, as well as the new arguments raised by the Respondent. There have been decisions of the

Tax Court of Canada in this whole affair, in cases quite similar to the Appellant Atherton's. He knew of these cases, and he knew that they were not favourable to him. Based on an affidavit tendered in evidence, the Appellant knew, by 1995, that it had become impossible for him to adequately discharge his burden of proof. He blamed the Revenue Canada representatives for processing their objections slowly (see affidavit constituting Exhibit R-47, tab 17.)

[61] The Appellant Atherton is entitled to bring matters before the courts. He has the right to appeal from an assessment made by the Minister. He decides what evidence to adduce. I also acknowledge from the outset that he did not study law and that he might not be familiar with the rules of procedure or have experience in advocacy. I realize that this appeal is under the informal procedure and that the Rules of this Court do not provide for the award of costs in favour of the Crown.

[62] However, the fact is that he was unsuccessful in the outcome, and in such a situation, the opposing party is normally entitled to its costs. The hearing of this matter lasted 13 days — three times longer than was necessary to address all aspects of the issue. The vast majority of the witnesses gave testimony that was irrelevant or unfavourable to the Appellant Atherton. Mr. Atherton's plan was to put lawmakers, the tax authorities, the Finance and Economic Affairs Committee and the project proponents on trial, bring everything to light and launch a fishing expedition, with very little concern for how relevant the questions and answers were to the resolution of the litigation, or for the harm that the questioning could do to his own case. He was quite unconcerned about the time that he caused the Court and the opposing party to waste, or the expenses that the opposing party had to incur in order to satisfy his curiosity and give free reign to his zealous pursuit of all those whom he deems responsible for what happened to him.

[63] In my opinion, this additional time taken to make his case constitutes an abuse of process. By his unacceptable and reprehensible conduct, the Appellant showed indifference, not only to the Court, with respect to the amount of time that it had to devote to this matter, but also to the opposing party, who had to incur additional expenses to assert her rights.

[64] In *Sherman v. Minister of National Revenue*, 2003 FCA 202, the Federal Court of Appeal wrote the following passage about the award of costs:

> 46. It is now generally accepted that an award of costs may perform more than one function. Costs under modern rules may serve to regulate, indemnify and deter. They regulate by promoting early settlements and restraint. . . .

> They seek to compensate, at least in part, the successful party who has incurred, sometimes, large expenses to vindicate its rights.

[65] This passage was adopted in *Fournier v. The Queen*, 2005 FCA 131. The Federal Court of Appeal has said that this Court has the inherent power to prevent and control abuses of process by awarding costs.

[66] I am satisfied that the circumstances of the instant case justify the exercise of the discretion conferred upon me, and I order the Appellant Atherton to pay costs to the Respondent in the lump sum of $3,000.

[67] However, I am not satisfied that the main purpose for which the Appellant Atherton instituted an appeal was to defer the payment of an amount payable. Consequently, the application under section 179.1 of the Act is dismissed.

Signed at Ottawa, Canada, this 5th day of December 2007.

"François Angers"

Angers J.

CITATION:	2007TCC659
COURT FILE NOS.:	1999-664(IT)I and 1999-758(IT)I
STYLES OF CAUSE:	John Foster and Her Majesty the Queen Douglas Atherton and Her Majesty the Queen
PLACE OF HEARING:	Montréal, Quebec
DATES OF HEARING:	January 17, 18, 19 and 20, 2006, May 8, 9, 10, 11 and 12, 2006, October 16, 17 and 18, 2006 and April 25, 2007
REASONS FOR JUDGMENT BY:	The Honourable Justice François Angers
DATE OF JUDGMENTS:	December 5, 2007

APPEARANCES:

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