

Date: 20001213  
Docket: 1999-3997(IT)I  
1999-4004(IT)I

BETWEEN:

JENNY XU and  
GEORGE Q.W. YE

Appellants

and

HER MAJESTY THE QUEEN,

Respondent.

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Counsel for the Appellants: Stephen Du and Howard Markowitz  
Counsel for the Respondent: Jocelyn Espejo-Clarke

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### **REASONS FOR JUDGMENT**

**(Delivered orally from the Bench at  
Toronto, Ontario, on October 6, 2000)**

#### **McArthur J.**

[1] These appeals are from assessments of tax for the 1994, 1995 and 1996 taxation years. The issue in each year is whether the Appellants were carrying on a business under the registered partnership name "Yes International" and whether the losses from that business are deductible from their taxable incomes. The losses arise primarily from travel expenses. The primary position of the Minister of National Revenue is that the Appellants had no reasonable expectation of profit. The Appellants are husband and wife, and their appeals were heard together on common evidence. Although Jenny Xu did not appear at the hearing, she was represented by counsel, and George Ye gave evidence on behalf of both Appellants. Deborah Chapman, a Revenue Canada field officer, testified on behalf of the Respondent.

[2] Dr. Ye obtained a PhD in microbiology from the University of Illinois in 1984. After working in New York City, he moved to Toronto in 1989, where he founded "Yes Biotech Laboratories Ltd." (the "Company"). The Company manufactured antibodies and Dr. Ye headed the research department and had from five to 15 employees, dependent on the year. Up to 1996, the decision-maker and substantial shareholder was Mr. Wu who was also the major financial contributor. Dr. Ye had a serious falling out with Mr. Wu primarily because of his refusal to fund Dr. Ye's business trips, particularly to China. As a result, Ye and his wife Jenny Xu, registered the partnership "Yes International" in March 1993. Jenny Xu is a skilled technician who worked in a third-party laboratory prior to being employed by the Company.

[3] During the three relevant years, the Appellants travelled several times annually to China. Precisely what the purpose of these trips was is not entirely clear. Dr. Ye stated that he thought China would be a big market, presumably for Biotech's antibodies. He was somewhat obsessed with obtaining business in China but found it very difficult. In 1994, 1995 and 1996, little became of his efforts. Some success came, not for Yes International, but for Biotech when it obtained funding of \$300,000 per year from a Chinese source in 1998 and in subsequent years. In late 1996, after an out-of-court settlement, Mr. Wu was no longer a part of Biotech and Dr. Ye took control. He no longer needed Yes International, and it appears it ceased carrying on business after 1996.

[4] Dr. Ye sought to deduct losses from Yes International in 1994, 1995 and 1996 of \$7,787, \$6,876 and \$5,203, respectively. Ms. Xu claimed losses of \$2,000, \$2,292 and \$1,387 in 1994, 1995 and 1996, respectively. The income and expenses for Yes International were as follows: in 1994, income of \$3,070 and expenses of \$11,077; in 1995, income of \$4,010 and expenses of \$10,383; and in 1996, income of \$5,700 and expenses of \$10,650. The travel expenses alone averaged about \$8,000 in each year and it is primarily the travel expenses to China, with which these appeals are concerned.

[5] The Appellants established that they personally expended the amount claimed for travel and that their travelling was for business purposes and not personal. They had a four-year old son in Toronto in 1994, whom they left with Dr. Ye's mother when they travelled. Often Dr. Ye travelled to China alone. I accept his evidence that while in China, he sold his knowledge and expertise together with selling pharmaceutical products produced by third parties for which he received a commission. He established that he communicated with his Chinese contacts through exchange of over 50 faxes. He admitted that there was some overlap and mingling of

efforts between Biotech and Yes International while travelling, both in the USA and in China. There was apparently no allocation made to reflect work done for Biotech while travelling for Yes International. I have no doubt that he was carrying on a business. While it ultimately benefited Biotech, Dr. Ye and Ms. Xu took the personal risk and expended their own funds to promote the objects of Yes International. Had Dr. Ye not won the Biotech internal conflict, he was poised to continue his technological efforts under the name of "Yes International."

[6] I cannot accept that travelling to China several times a year, while his child and most often, his wife stayed in Toronto was anything but for the purpose of earning income from Yes International and secondarily, from Biotech. Dr. Ye and Ms. Xu's activity falls within the definition of "business" in section 248 as an undertaking of any kind. The following quotation from Bowman J. in *Keery v. The Queen*<sup>1</sup> applies to the present case. At pages 4 and 5, Judge Bowman stated:

... The respondent, however, says that despite its commercial animus, he had no reasonable expectation of profit. It is more accurate to say that he had no profit, and therefore the respondent concludes that he had no reasonable expectation of it. The two are not the same. In *Kaye v. R.* [1998] 3 C.T.C. 2248, in commenting on the NREOP principle I said:

...

One cannot view the reasonableness of the expectation of profit in isolation. One must ask, "Would a reasonable person, looking at a particular activity and applying ordinary standards of commercial common sense say, 'yes, this is a business?'" In answering this question, a hypothetical, reasonable person would look at such things as capitalization, knowledge of the participant, and time spent. He or she would also consider whether the person claiming to be in business has gone about it in an orderly business-like way and in the way that a business person would be normally be expected to do.

This leads to a further consideration - that of reasonableness. The reasonableness of expenditures is dealt with specifically in section 67 of the *Income Tax Act*, but it does not exist in a watertight compartment. Section 67 operates within the context of a business and assumes the existence of a business. It is also a component in the question whether a particular activity is a business. For example, it cannot be said in the absence of compelling reasons that a person would spend a million dollars if all that could reasonably be expected to be earned is \$1,000.00.

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<sup>1</sup> Decision dated September 22, 1999 – Court file no. 98-1271(IT)I.

Ultimately, it boils down to a common-sense appreciation of all of the factors in which each is assigned its appropriate weight in the overall context. One must of course not discount entrepreneurial vision and imagination, but they are hard to evaluate at the outset. Simply put, if you want to be treated as carrying on a business, you should act like a businessman.

Here we have all of the business elements of a business, commercial animus, a pure profit motive, a type of business that is carried on by many people in that area, and a significant commitment of capital and time to the enterprise.

It cannot be said that his expectation of profit was unreasonable in the sense that it was "irrational, absurd, and ridiculous", the words used by the Federal Court of Appeal in *Kuhlmann et al v. The Queen*, 98 DTC 6653 to define 'unreasonable' in the context of NREOP.

The problem is that Mr. Keery had no profits ...

[9] The Appellants' accounting records were lacking, and I am left to extract some meaningful expenditures. There were two problems: (a) the overlapping of Biotech's work without any evidence that the Appellants received expense payments from Biotech; and (b) the Appellants claimed some expenditures that appeared more personal than for business or appear to be capital in nature. For instance, expenditures include The Disney Store, Harvey's and Burger King restaurants, a coffee table, end tables and chairs. My deductions of expenses are somewhat rough and ready. In each year, the expenses of Dr. Ye are reduced by \$1,200, to reflect \$1,000 for Biotech's portion of the expenses while travelling and \$200 annually to reflect personal and capital expenditures.

[10] With respect to Ms. Xu, she was not present to support her appeals and expenditures. I am left with the evidence of Dr. Ye. While satisfied that she was required to attend on some of the trips, I am not prepared to guess at her personal expenditures included in her claim for losses and the appeals for Jenny Xu are dismissed.

[11] The appeals of Dr. Ye are allowed and referred back to the Minister of National Revenue for reconsideration and reassessment to allow losses in 1994 of \$6,587, in 1995 of \$5,676 and in 1996 of \$3,005. I have deducted from Dr. Ye's losses claimed \$1,200 in each of the three years. Costs, if any, are awarded to Dr. Ye, his having been substantially successful.

Signed at Ottawa, Canada, this 13th day of December, 2000.

"C.H. McArthur"

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J.T.C.C.

COURT FILE NOS.: 1999-3997(IT)I and 1999-4004(IT)I

STYLE OF CAUSE: Jenny Xu & George Q.W. Ye and  
Her Majesty the Queen

PLACE OF HEARING: Toronto, Ontario

DATE OF HEARING: October 5, 2000

REASONS FOR JUDGMENT BY: The Honourable Judge C.H. McArthur

DATE OF JUDGMENT: October 11, 2000

APPEARANCES:

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