Docket: 2008-1848(IT)I

BETWEEN:

JOVAN SPASIC,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on February 26, 2009, at London, Ontario.

Before: The Honourable Justice Patrick Boyle

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Tanis Halpape

JUDGMENT

The appeal from the reassessments made under the *Income tax Act* for the 2003, 2004 and 2005 taxation years is dismissed without costs.

Signed at Ottawa, Canada, this 7th day of April 2009.

"Patrick Boyle"

Boyle J.

Citation: 2009 TCC 193
Date: 20090407
Docket: 2008-1848(IT)I

BETWEEN:

JOVAN SPASIC,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Boyle J.

[1] Mr. Spasic is employed full-time at Ford Motors as a millwright. While he gets 40 to 48 hours of work at Ford, he has concerns about Ford's future and thus for his future employment as well. Mr. Spasic has a passion for wanting to develop things that do not yet exist, and creating things you now cannot buy. His training is in electronics and he has a background as an electronics technician in technology-related engineering functions at major companies.

[2] Mr. Spasic hopes to be able to develop a transducer that is sensitive enough that it can form part of a sonic imaging device capable of producing three-dimensional images. Such a device once developed could be used in a number of different practical applications in diagnostic and working tools that he hopes to develop thereafter.

[3] In the years in question, 2003 through 2005, Mr. Spasic was in the early stages of pursuing his desire. In the years prior, in his basement workshop, he had limited success in electroplating 2.5 inch silicon wafers with copper. This was a necessary part of his planned transducer. By 2003 or 2004, he had stopped using his basement workshop. He began to substantially renovate an old barn on his farm property to convert part of it into a heated electronics workshop, part of it into a more traditional workshop, and the balance to be used for storage. He was also at the stage of

acquiring equipment and supplies in those years, both sophisticated electronic workstations and traditional heavy equipment, heavy and light tools that might be needed, etc. He also did some very limited work in these years on the transducer as well as the planned self-propelled riding lawnmower and the planned enhanced Pelletier junction heat pump, each of which would be applications of his planned transducer.

[4] Mr. Spasic has a limited amount of time and a limited amount of money that he is able to spend on his pursuits. He is very frugal with his expenses, acquiring things that may be needed or helpful second-hand or at auction. He is able to get good value in this way although it entails buying equipment and supplies knowing there is a risk that some of the purchases may never be needed or used. Accordingly, he has been careful to make sure he is only buying things that he could later resell if not needed for at least what he paid for them.

[5] He had begun his venture in 1999. In each of the years since then through 2007, Mr. Spasic claimed a business loss equal to the full amount of his expenses. In the three years in question, these were in the range of $20,000, $10,000 and $6,000 respectively. Mr. Spasic never received any revenues from his pursuits. For tax purposes, he deducted all of the amounts expended as scientific research and experimental development expenses in order to get an immediate deduction for his capital expenditures on equipment as well as on the barn renovations and the workshop construction within the barn.

[6] Unfortunately, his barn burned in mid-2008 shortly before the workshop areas were to be ready for use. Since the audit occurred in 2006, Mr. Spasic said his pursuits were focussed on the barn renovations and trying to understand the *Income Tax Act* (the "*ITA*"). He estimates he spent an average of 20 hours per week on the barn workshop renovations. It appears no effort was put into the transducer development or related research.

[7] The taxpayer’s pursuits were in the early stages. In his own words, he had performed research and development in his basement workshop and he was working towards a research and development business. At some stage he built a simple transducer but not one with the capabilities needed to pursue his projects. He does not keep track of nor record his experimental efforts or results. In this regard, Mr. Spasic’s activities certainly do not follow what is commonly referred to as the scientific method. Since he had not yet developed the capacity to develop or create the needed type of transducer, he was not yet at the prototype stage. He had not needed to prepare either a research plan or a business plan because he was a one-man

company and had a general direction in his head. That did not seem to include any timelines nor any forecasts. Being at the early stages of his pursuits, he did not feel he was at the stage of needing to conduct even preliminary market research.

I. Preliminary Issue

[8] It was Mr. Spasic's position that the 2003 and 2004 taxation years were statute-barred. It is clear that the assessments were all within the three-year statutory normal reassessment period. This preliminary issue appears to have arisen from some confusion on Mr. Spasic's part as to whether the period started when he filed his return or when the Minister initially assessed it, as well as whether any reassessment that may be needed as a result of the decision in these court proceedings also has to be within the three-year period. He further confused this somewhat with the Minister's obligations to proceed with due dispatch. Given the complexities of the *Income Tax Act*, it is certainly quite understandable that taxpayers like Mr. Spasic at times get confused on such procedural matters.

II. Principal Issue

[9] The primary and possibly determinative issue in this case is simply whether or not Mr. Spasic carried on a business in the years 2003 through 2005. In order to deduct business losses, it is obviously necessary that there first be a business carried on. This issue of whether or not a business was carried on may be determinative in this case because, unless there is a business, it is not necessary to determine (i) whether or not the expenses were qualifying research and development expenses related to that business or were ordinary business expenses to be tracked on capital and income account, (ii) whether all of the expenses claimed related to the business, nor (iii) whether the business carried on was itself the business of performing research and development.

[10] The Court's former Chief Justice Bowman in his 1998 decision in *Kaye v. The Queen*, 98 DTC 1659, described the test to be applied simply as "Is there or is there not truly a business?" Of this he went on to write:

> . . . 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 the 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, businesslike way and in the way that a business person would normally be expected to do.
>
> And:
>
> 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.

[11] The Supreme Court of Canada in *Stewart v. Canada*, 2002 SCC 46, 2002 DTC 6969, describes this as the need to look at the commerciality of the activity in question.

[12] Mr. Spasic's pursuits are focussed on trying to develop technological advances with a view to marketing them for profit whether by way of licence, manufacture or sale. The inherent need for creativity in his technological pursuits is quite analagous to those who wish to pursue a creative arts business. For this reason, creative science pursuits should be treated in those respects in a manner similar to creative arts pursuits. It has been recognized by this Court that, in the case of creative artists such as painters, authors, musicians and sculptors, a broader range of criteria and a broader contextual view reflective of the reality of the particular industry may be needed than might be in more traditional commercial pursuits when trying to establish whether a taxpayer has yet commenced to carry on his or her planned creative business. See, for example, *Harrison v. Canada*, 2007 TCC 19, 2007 DTC 377 (book publishing), *Malltezi v. Canada*, 2009 TCC 149, [2009] T.C.J. No. 104 (QL) (product development), *Li v. Canada*, 2008 TCC 175, 2008 DTC 3039 (product development), *Janitsch v. Canada*, 2004 TCC 378, [2004] G.S.T.C. 70 (artist), *Arsenault v. Canada*, 2006 TCC 42, 2008 DTC 2224 (film production), *Cossette v. Canada*, [2003] 1 C.T.C. 2359 (visual artist) and *Tramble v. Canada*, [2001] 4 C.T.C. 2160 (painter). This is also recognized by the Canada Revenue Agency ("CRA") in its Interpretation Bulletin IT-504 on "Visual Artists and Writers".

[13] Mr. Spasic gave his testimony in an honest and credible fashion and I do not doubt the truthfulness of his testimony. I believe Mr. Spasic claimed his tax deductions in good faith. However, I must apply the provisions of the *Act* as they have been written by Parliament and have been considered by the Courts. I am mindful that it is in the nature of technology research pursuits that they may

potentially remain in the start-up loss phase longer than other businesses after they are started. Based upon the totality of the evidence, I am simply unable to conclude that Mr. Spasic had started to carry on a business in any of the years in question. The underlying commerciality of an endeavour can often best be recognized by the organized or methodical approach with which the endeavour is pursued. I do not think a business person, a scientist or an engineer could describe Mr. Spasic's pursuits as business-like. There are clearly not sufficient indicia of commerciality to allow me to conclude that Mr. Spasic's efforts, expenditures and related pursuits in furtherance of his desired research and development business yet gave rise to a business in the year in question.

III. The Crown's Pleadings

[14] At the start of trial, Crown counsel suggested the Court should first decide whether or not Mr. Spasic carried on business and, if he was found to be in business, the Court could then deal with the issue of quantum of expenses incurred as well as an allocation of those expenses as between business and personal expenses. I advised Crown counsel that the reply, which had been drafted by a CRA "agent" not a lawyer with the Department of Justice, did not raise these last two issues so they were not properly before the Court. The pleadings govern notwithstanding that it may be clear from CRA's Audit and Appeal files that these were also in dispute. Taxpayers generally have the right to rely upon the issues as framed by the government in its reply as the case they must prepare to meet. While it is possible to amend the reply in appropriate circumstances, the general rule is there for the benefit of taxpayers to guide them in their preparation. It is also for the benefit of the proper and efficient administration of the Court. Had I found Mr. Spasic did carry on a business, the manner in which the reply was drafted by CRA's agent would have caused me to allow all of the expenses claimed subject only to those which should have been capitalized instead of expensed as that issue is the only expense-related issue set out in the reply. These comments are not intended in any way to reflect on the quality of Justice counsel's representation of the Crown's interests. They are to serve as a reminder to CRA that fine and capable auditors and appeals officers are not lawyers and that cost savings come at a cost.

[15] The taxpayer's appeal is dismissed without costs.

Signed at Ottawa, Canada, this 7th day of April 2009.

"Patrick Boyle"

Boyle J.

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APPEARANCES:

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