Docket: 2007-3534(IT)G

BETWEEN:

RAYMOND PAYETTE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on December 18, 2008, at Quebec, Quebec.

Before: The Honourable Gerald J. Rip, Chief Justice

Appearances:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Marie-Claude Landry

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the 2005 taxation year is dismissed, with costs if demanded by the respondent.

Signed at Ottawa, Canada, this 17th day of July 2009.

"Gerald J. Rip"

Rip C.J.

Citation: 2009 TCC 348
Date: 20090717
Docket: 2007-3534(IT)G

BETWEEN:

RAYMOND PAYETTE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Rip, C.J.

[1] Raymond Payette appeals from an income tax assessment for 2005 in which the Minister of National Revenue ("Minister") denied a business loss of $64,785 in accordance with paragraph 18(1)(*a*) of the *Income Tax Act* and a Scientific Research and Experimental Development ("SR&ED") tax credit of $13,757 pursuant to subparagraph 37(1)(*a*)(i) and subsection 127(9) of the *Act* claimed by him in filing his income tax return for 2005. The Minister's principal reason for denying the claims was his view that Mr. Payette was not carrying on a business in 2005[1].

[2] At the time of trial, Mr. Payette was retired from the Quebec Ministry of Finance where he worked for "30 odd years". He is a chartered accountant and also received a Master's Degree in Public Administration. He has no scientific background. Mr. Payette develops software programs which he intends to sell.

[3] The appellant says that he was carrying on a business during the year under appeal. His business was research and development. In 2003 he applied for a United

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[1] Mr. Payette testified in English and French and the other witnesses testified in French. The pleadings were in English and the documentation adduced in evidence was in both languages.

States and international patents for a propulsion system he developed to be used by spacecraft without having to interact with the environment. (The applications were included in the appellant's Book of documents, Exhibit A-1.) The propulsion mechanism was designed to thrust a space vehicle without using fuel; electrical energy would emanate from photoelectric cells. After three years of "trying and amending my application", the application was still refused. Mr. Payette testified that the application was refused by the U.S. Patent Office "because there was a moratorium on this kind of invention, which I was not aware of". Mr. Payette's goal was to earn money by selling or licensing the patent. He never intended to manufacture the device. Without the patent, he said, he had "nothing to sell".

[4] The following are the expenses Mr. Payette seeks to deduct and on which he is claiming a SR&ED tax credit and were incurred in 2003, 2004 and 2005, years during which the appellant says he was carrying on a business:

	2003	**2004**	**2005**	
Taxes	$ 110.00	$ 65.00	$ 85.00	$ 260.00
Intérêts	$ 423.36	$ 723.69	$ 2,122.53	$ 3,269.58
Frais de bureau	$ 734.07	$ 1,365.45	$ 2,375.86	$ 4,475.38
Fournitures	$ 1,129.23	$ 501.65	$ 1,267.38	$ 2,898.26
Frais juridiques	$ 4,011.37	$ 25,040.48	$ 15,927.71	$ 54,979.56
Frais de voyages	$	$	$ 876.36	$ 876.36
Ingénierie	$ 793.65		$ 1,232.22	$ 2,025.87
	$ 17,201.68	$ 27,696.27	$ 23,887.06	$ 68,785.01

[5] The legal expenses were laid out for the purpose of obtaining the patent.

[6] Mr. Payette did not deduct from his income any of the expenses he incurred in 2003 and 2004. If I understand his evidence, the appellant did not deduct the expenses incurred in the year they were incurred because he was carrying on a business and therefore accrued the expenses. Then, in 2005, he realized he could no longer carry on a business because he could not obtain a patent. He therefore capitalized the expenses from 2003 and 2004 and, together with the expenses incurred in 2005, he "wrote off" in 2005 the expenses for the three years. He deducted $68,785 in computing his income for 2005. Similarly, the appellant claimed the SR&ED tax credit for 2005 on expenses incurred in 2003, 2004 and 2005.

[7] In the years 2003, 2004 and 2005, Mr. Payette states he was carrying on a business. His notice of appeal declares that he commenced carrying on a business, insisting that his creation of a propulsion system device resulted from scientific work and experimental development. He claims he did "everything that could be expected" to obtain such a patent but failed to do so.

[8] His invention, Mr. Payette testified, was the answer to what the United States National Aeronautics and Space Administration ("NASA") required for human interstellar exploration. NASA had set goals necessary for interstellar exploration. These included propulsion methods that eliminate or radically reduce the need for propellant and new energy methods to power the propulsion devices.

[9] The evidence of Mr. Payette related to his efforts in obtaining a patent and securing financial assistance to fund his activities, all of which ended in failure. Other than his own testimony that the reason he did not obtain a U.S. patent was because the U.S. Patent Office took a moratorium on inventions similar to his, there was no evidence or suggestion corroborating his view.

[10] In March 2003, Mr. Payette incorporated Space Crab Corporation, the name of which was later changed to "Spacecraft Corporation". The company was inactive: no meeting of directors or shareholders was held, and except for corporate organization purposes, there was no resolution of directors or shareholders and no shares were issued. The company was authorized to open a bank account but did not. The evidence suggests – it is not clear and I do not make any finding – that Mr. Payette intended to transfer the right of ownership of the patent to Spacecraft.

[11] The evidence was not at all clear as to whether Mr. Payette or Space Crab was carrying on the purported business. In correspondence with the CRA, he advised that he paid all the expenses for the corporation. I assume these expenses are those in issue. As far as Mr. Payette carrying on a business as a sole proprietorship, he acknowledged, for example, that the business had no bank account. However, Mr. Payette filed his appeal on claiming that he carried on the business, not the corporation. The respondent led evidence to answer the basis of his claim, that is to prove that he did not carry on a business. In preparing these reasons I have considered whether or not a business was carried on, irrespective of whether it was carried on by Mr. Payette personally or by a corporation.

[12] Mr. Payette described his business as a "research business". He did not, nor did he intend to, manufacture any product. At time of trial, he had other patents that, he

said, were pending in other fields. He described himself as an "inventor" rather than an engineer.

[13] The only potential client in Canada that Mr. Payette identified was the Canada Space Agency ("CSA"). One of the reasons he renamed his company Spacecraft Corporation was that he thought that the CSA would give a corporate entity a contract or grant to prove his invention. He also sought financial aid from other government agencies and a private placement in Vancouver.

[14] Mr. Payette identified other countries active in launching satellites and space exploration as other potential clients. In his business plan he also referred to communication forums and spacecraft manufacturers. Mr. Payette wanted to prove his invention, "if I could prove to the patent office that it worked and from well known sources, then I would have had no problem patenting it and then I would have had no problem either licensing or selling it".

[15] Mr. Payette was able to prove the concept worked "to my satisfaction but not to anyone else's". He complained no engineer wanted to look at his concept because he did not make models, although he said he did make a hovercraft with radio control.

[16] Apparently, the CSA had a program to sponsor innovative technology and Mr. Payette made a request for a proposal with CSA's Space Technology Development Program – Innovative Technologies. The CSA did award contracts to ten successful builders under the Innovative Technologies Program, but not to Mr. Payette or Spacecraft. Indeed, Mr. Payette's application did not receive the minimum score requirement for technical criteria, management criteria and overall score in CSA's evaluation process.

[17] In its evaluation summary of Mr. Payette's application with respect to technical criteria, the CSA found, for example, that his engineering concepts and principles were incorrect in describing the proposed technology, that the proposal did not demonstrate an understanding of the technology or the skills needed to apply the basic engineering concepts and principles and that while the proposed methodology would likely resolve the challenges, the technology is fundamentally flawed and cannot be successfully developed. Building a hovercraft to prove the concept is not cost effective nor is it practical according to the CSA evaluation.

[18] A business plan was included in Spacecraft's original proposal to CSA in December 2003. The proposal proposed three methods of financing, one on a cost

reimbursement basis, one financed by private placements and one a partnership. Mr. Payette's preferred "evolution" was to obtain "quick backing from a government agency" and that is the reason he approached the CSA.

[19] Mr. Payette recognized that the technology involved high costs, high margins and low volume. The aimed business was to produce standardized spaceship drives for spacecrafts that can be produced in high quality at high margin. He also realized that "high level employees" were required. Mr. Payette saw himself as the Chief Executive Officer. There would also be a Chief Technology Executive, a Chief Financial Executive, a Chief Marketing Sales Executive and an Executive Vice-President. His business plan included a job description for each.

[20] As far as management criteria was concerned, the CSA was of the view that the proposed management personnel had no experience or track record of successfully completing projects of similar technology to that required for Mr. Payette's proposal; there was no one with experience to manage R&D projects. Also, according to the CSA, the technical team has no formal training in physics, despite Mr. Payette's three years of engineering education. There was no collaborator with experience in closely related technology or space related experience. The CSA also criticized the management plan of Mr. Payette. In the CSA's view, lack of experience with similar projects exposed the team to schedule risks where income and management estimates are made. There was also a lack of collaboration. Finally, the CSA's evaluation concluded that "the proposal indicates limited business opportunity and limited overall impact. The proposal is not likely to improve the company's overall space market scheme since all potential partners have either declined or not answered the company's request for partnership."

[21] No appeal from an assessment based on the Minister's view that no business pertaining to scientific research and experimental development was carried on should be dismissed solely because the taxpayer was overly optimistic as to a possible invention leading to a venture's success or that the venture was doomed to failure at inception. In enacting subsection 37(1) of the *Act*, Parliament wanted to encourage scientific discovery and invention through research and development and thus one ought not give a narrow interpretation to the expression "carried on business" or "carrying on business": Bowie J. in *Synchrosat Limited v. The Queen*[2]. The Federal Court of Appeal cautioned against being too quick to second guess the wisdom of a business judgment based on hindsight: *The Queen v. Tonn*[3].

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2 2000 DTC 2468, par. 24.

3 96 DTC 6001.

[22] The appellant's claim is that in the year in appeal he carried on a business and is thus entitled to deduct expenses and a SR&ED tax credit. I have no doubt he started work on his project in good faith and in the belief he could accomplish his goal. However, on the evidence before me, I cannot find that he carried on a business. His activity in 2005, as well as in 2003 and 2004, was essentially twofold, to obtain financing, primarily by government grant, and to obtain a patent. In and by themselves, these activities are not the carrying on of a business; they suggest preparation in anticipation of starting a business.

[23] Mr. Payette's activity did not have the ingredients of commerciality to make it a business. He had insufficient capital for a project of such dimensions, thus he had to secure financing. He did not have capital to construct a prototype or a model, for example. His business records, if any – I have to conclude - were not maintained in a businesslike manner[4]. No such records were produced. I have already commented on the problem of whether he or his corporation was seeking the patent and grants.

[24] In Mr. Payette's view all he required for success was a patent. He remains convinced that if he had been awarded a patent by the U.S. Patent Office, potential clients would flock to his door. He ignores the fact that no organization gave credence to his design; there is absolutely no evidence that his work was scientific research or experimental development. The CSA concluded that his proposal did "not demonstrate an understanding of the technology or the skills to apply the basic engineering concepts and principles … [T]he technology is fundamentally flawed …" These are views of third parties given before and during 2005, and are not based on hindsight. While Mr. Payette's work may have impressed Mr. Payette, it impressed no one else, he admitted.

[25] No business was carried on by Mr. Payette in 2005. He thought that obtaining a patent would solve his problems. According to the CSA the invention was flawed. But even if he had obtained a patent, there is absolutely no independent evidence that anyone would want to obtain a licence for the patent or purchase it from Mr. Payette. In seeking financing and a patent Mr. Payette was not carrying on a business but taking steps to start a business. In the year of appeal and earlier he did not have the necessary financing or assets to undertake a business he envisaged, a business in which research and experimental development would be costly, way beyond his means. Again, at best, he was preparing to start a business. None of the activities undertaken by Mr. Payette in 2005 or earlier was capable of generating income.

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4 *Martin v. R.*, [2003] 3 C.T.C. 2416.

[26] There are two other matters that were brought to my attention by Mr. Payette. The first is that if he had been carrying on a business, whether he would be permitted to deduct in computing income in 2005, current expenses he incurred in 2003 and 2004 but he did not deduct in computing income for those years, but capitalized. The answer to Mr. Payette's claim to deduct these capitalized expenses is found in paragraphs 18(1)(*a*) and (*b*) of the *Act*:

18(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of	**18(1)** Dans le calcul du revenu du contribuable tiré d'une entreprise ou d'un bien, les éléments suivants ne sont pas déductibles :
(*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;	*a*) les dépenses, sauf dans la mesure où elles ont été engagées ou effectuées par le contribuable en vue de tirer un revenu de l'entreprise ou du bien;
(*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part;	*b*) une dépense en capital, une perte en capital ou un remplacement de capital, un paiement à titre de capital ou une provision pour amortissement, désuétude ou épuisement, sauf ce qui est expressément permis par la présente partie;

[27] The second matter concerns Mr. Payette's claim for a SR&ED tax credit in 2005. Included among the expenses he claims for the credit are legal expenses and interest which, according to section 2902 of the *Income Tax Act Regulations*, are not included in the definition of "qualified expenditure" in subsection 127(9) of the *Act*. It is qualified expenditures that qualify for the SR&ED credit. Also, Mr. Payette's claim for a SR&ED tax credit may have been filed late.

[28] Since I have found Mr. Payette did not carry on a business in 2005, there is no need to consider these matters at this time.

[29] The appeal is dismissed with costs, if demanded by the respondent.
Signed at Ottawa, Canada, this 17th day of July 2009.

"Gerald J. Rip"

Rip C.J.

CITATION:	2009 TCC 348
COURT FILE NO.:	2007-3534(IT)G
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APPEARANCES:

For the Appellant:	The Appellant himself
Counsel for the Respondent:	Marie-Claude Landry

COUNSEL OF RECORD:

For the Appellant:

Name:	
Firm:	
For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa[ ], Canada