Docket: 2003-2253(IT)G

BETWEEN:

MICHEL BROWN,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 21, 2005, at Montréal, Quebec.
Before: The Honourable Justice Pierre R. Dussault

Appearances:

Counsel for the Appellant: Agathe Cavanagh

Counsel for the Respondent: Johanne M. Boudreau

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* concerning the 1999 taxation year is dismissed, with costs awarded to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 9th day of September 2005.

"P. R. Dussault"

Dussault J.

Translation certified true
on this 9th day of January 2006.

Sharlene Cooper, Translator

Citation: 2005TCC563
Date: 20050909
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REASONS FOR JUDGMENT

Dussault J.

[1] On his income tax return for the 1999 taxation year, the Appellant indicated an allowable business investment loss of $112,194 resulting from a business investment loss ("BIL") of $149,592. The claimed deduction was disallowed in an initial assessment dated September 25, 2000. In addition, in a reassessment dated March 7, 2002, a capital loss of $178,412 was recognized. Reconciling the above amounts is not at issue. The only issue is to determine whether the Appellant sustained a BIL of $149,592 in 1999.

[2] In the years from 1996 to 1999, the Appellant advanced funds to Sapa International Inc. ("Sapa"); the advances totalled approximately $180,000. Sapa's fiscal year was from June 1 to May 31; it apparently ceased its operations on May 31, 1999. In addition, I would like to point out that paragraph 5 of the Notice of Appeal indicates that [TRANSLATION] "the Corporation ceased its operations in early 1999."

[3] According to the Respondent, the Appellant's debt for Sapa became uncollectible on May 31, 1999, and the Appellant could therefore avail himself of the provisions of subsection 50(1) of the *Income Tax Act* (the "*Act*") for 1999.

[4] To determine that the loss the Appellant sustained is a BIL, it is necessary to prove that the conditions set out in paragraph 39(1)(*c*) of the *Act* have been met and, more specifically, that Sapa can be deemed to have been a "small business corporation" according to the definition of this expression that is found in subsection 248(1) of the *Act*. The relevant portion of this definition reads as follows:

> "small business corporation", at any particular time, means, subject to subsection 110.6(15), a particular corporation that is a Canadian-controlled private corporation all or substantially all of the fair market value of the assets of which at that time is attributable to assets that are
>
> (*a*) used principally in an active business carried on primarily in Canada by the particular corporation or by a corporation related to it,
>
> (*b*) . . .
>
> (*c*) . . .
>
> including, for the purpose of paragraph 39(1)(*c*), a corporation that was at any time in the 12 months preceding that time a small business corporation, . . .

[5] The expression "active business" is also defined in subsection 248(1) of the *Act*, as follows:

> "active business", in relation to any business carried on by a taxpayer resident in Canada, means any business carried on by the taxpayer other than a specified investment business or a personal services business.

[6] In addition, the definition of the term "business", which is also found in subsection 248(1), reads as follows:

> "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatever and, except for the purposes of paragraph 18(2)(*c*), section 54.2, subsection 95(1) and paragraph 110.6(14)(*f*), an adventure or concern in the nature of trade but does not include an office or employment.

[7] Paragraph 11 of the Reply to the Notice of Appeal ("Reply") indicates that confirmation of the reassessment was based on the following assumptions of fact:

> [TRANSLATION]
>
> (a) On June 1, 1995, Sapa International Inc. (the "Corporation") was incorporated;
>
> (b) The Corporation's principal activity was to be the bottling of maple sap;
>
> (c) Between 1996 and 1999, the Appellant advanced $179,255 to the Corporation;
>
> (d) Most of the expenses were capitalized in the "start-up costs" item;
>
> (e) The Corporation had no assets or equipment for bottling production;
>
> (f) No water was bottled;
>
> (g) The Corporation never began operating any business; and
>
> (h) At all relevant times, the Corporation's assets were not used principally in an active business.

[8] At the hearing, Counsel for the Respondent adopted a more tentative position than the one expressed in the Reply, in that she recognized that Sapa had started operating a business. However, she argued that no objective evidence was adduced to prove that Sapa had carried on any business whatsoever subsequent to May 1997. In addition, she argued that one could not claim that Sapa's assets, mainly consisting of capitalized "start-up costs" could be deemed to be assets that were used principally in an active business.

Summary of the evidence

[9] The Appellant, as well as André Boudreau, an objections officer with the Canada Customs and Revenue Agency ("CCRA") testified.

[10] The Appellant is a dentist. During his testimony, he explained that because he had a weight problem, he was looking for a natural beverage that was healthy and low in fat. He noticed that the products on the market contained a lot of sugar, preservatives and chemicals and that it was during a discussion with a client that they came up with the idea to try bottling maple sap.

[11] This idea, to create and market a new beverage, led to Sapa's incorporation as a business in 1995.

[12] In his opinion, the idea of bottling maple sap, as such, was short-term. First, maple sap would not keep for more than 24 hours. After 48 hours, it became milky and started to ferment. Although the product's stability could be ensured using a special filtering process developed by an engineer the Appellant had met, problems associated with the supply and storage of this maple sap quickly led to a change in direction.

[13] Instead of using maple sap, they decided to use low-mineral spring water and grade AA maple syrup to sweeten the product. By adding citric acid, grape juice and fruit concentrates to this base, six different flavours of the beverage were created: grapefruit, strawberry, cherry, cranberry, raspberry and coffee-raspberry. Two sample batches were bottled first. Then Sapa bottled the product using subcontractors: 200 bottles (300 mL) for each flavour. The Appellant admitted that they were samples; however, he said that they could be marketed, because they met all of the standards. As we will see later, these activities took place in 1996. Although some of the bottles were given away, none of them were ever sold. The

bottles were stored in the basement of the Appellant's clinic and then eventually discarded.

[14] Although the new product was created through the collaboration of several stakeholders, particularly Cintech AA Inc. (Food Technology Innovation Centre), the Appellant also discussed the many steps that were taken to launch the Sapa business, to find suppliers and to market and distribute the product.

[15] Having no experience in the field, the Appellant claims he followed all of the steps in a business plan submitted by Division Externe Inc. (see Exhibit I-1, tab 8), in addition to taking other steps on his own. As such, the Appellant introduced Sapa's products at two international food shows held in Montréal. He also met with a potential distributor in Los Angeles. The latter was particularly interested in the coffee-raspberry-flavoured drink; however, the required financial terms were such that no agreement was made.

[16] Efforts were also made to obtain a supply of spring water from Aliments Lexus Foods, Inc. However, the Appellant explained that the wells to which this company had access presented a risk of contamination and the tests that were conducted showed that the water was of poor quality.

[17] The Appellant explained that he had found very high-quality spring water in the Les Cèdres area. The source belonged to an individual named Frank. A written agreement was drafted whereby the Appellant (or Sapa) would hold 25% of the land and Frank would receive a percentage of the product sales. In addition, the Appellant considered the possibility of bottling and marketing spring water. In the end, the agreement was never signed. According to the Appellant, Frank was required to register his source prior to the moratorium passed by the Government of Quebec,[1] which he failed to do, in spite of the pressure that was

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[1] This relates to *An Act to provide for the protection of groundwater*, S.Q. 1998, c. 25. Bill 405 was brought to the National Assembly on December 18, 1997, and the Act was given Royal Assent on June 17, 1998. The explanatory notes accompanying Bill 405 specify its scope of application. They read as follows:

EXPLANATORY NOTES

This bill provides that beginning on the date on which the bill is introduced in the National Assembly, no person will be authorized to establish facilities to extract groundwater all or part of which is to be marketed for human consumption in bottles or other containers, or to increase the rate of flow in

exerted on him. Thus, it was no longer possible to use the source as of December 18, 1997; it was therefore impossible to obtain water from this source before the moratorium ended. Although the Appellant claimed to have had plans to develop this source, such as building a bottling centre and a warehouse, these plans could not be undertaken due to the moratorium. According to the Appellant, the moratorium came about at a very bad time and, in some respects, it caused him to lose "momentum".

[18] The Appellant claimed that at the end of the moratorium he attempted to approach other companies to obtain water or to enter into an agreement for the manufacturing of the beverages. The first of these companies was located in the Eastern Townships and possessed very high-quality water that it already marketed in small quantities, was not interested in expanding and in making further investments.

[19] A second company, Bio-Pur, located on the South Shore of Montréal, required Sapa to become a half-owned subsidiary. In the case of a dispute, this company wanted to ensure that it had priority in decisions, which the Appellant was not willing to concede, due to the vulnerable position in which he would be placed.

[20] The Appellant also contacted a company in Ontario called Bessie. However, this company required that a minimum of 18,000 litres be bottled, which posed a major problem in terms of storage and preservation, given the sales, or rather the lack of sales, of the beverages that had already been manufactured. The Appellant claimed that he approached this company shortly before Sapa officially ceased its operations.

[21] The Appellant did not find a water supplier. In addition, although he claimed that he had made efforts to find market outlets and to "start over," these efforts did not produce any results. Realizing that the business required too much energy and

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facilities that extract groundwater, all or part of which is to be used for such purposes, above a certain rate of flow.

The bill also provides that such prohibition does not apply to projects to establish extraction facilities or to increase the rate of flow of existing facilities that were submitted to the Minister before the date of introduction of the bill and for which no authorization was issued up to that date.

Lastly, the bill provides that it is of temporary application; the provisions contained in the bill will cease to have effect on the date fixed by the Government or on 1 January 1999 at the latest.

involved too high a cost, the Appellant decided, after discussing the matter with his accountant, to end the business.

[22] In his testimony, the Appellant did not provide specific dates regarding the various steps taken to restart Sapa during and subsequent to the moratorium, claiming that he could not really remember the dates. He claimed that for some of the efforts that were made, particularly with the company located in the Eastern Townships, no invoices were submitted to Sapa for his travel expenses.

[23] Exhibit I-1, submitted on cross-examination of the Appellant, contains documents, invoices and statements of account from various firms and companies, relating to a number of the steps taken by Sapa, which the Appellant submitted in support of his claim. Thus, tab 5 of Exhibit I-1 includes an application for funding within the context of the Business Start-Up Investment Program (Paillé Plan). According to the Appellant, a $45,000 loan was obtained through this program. Tab 6 contains invoices from Analex Inc. According to the Appellant, these invoices are for the initial tests conducted on the maple sap. Tab 7 contains an invoice from the Copral company (professional food advisors); it relates to Canadian and American nutrition labels for two products. Tab 8 contains statements of account from Division Externe Inc.—communications relating to business start-up, principally for the preparation of a business plan, for surveys, for seeking strategic alliances and suppliers, and for the graphic design of the labels. Tab 9 contains a series of invoices from Cintech AA Inc. (Food Technology Innovation Centre) for analyses, professional and technical assistance, the use of a laboratory and a pilot plant to bottle 200 bottles of each of the above-mentioned flavours. Tab 10 contains an invoice from the IntelPro company, for research relating to the potential use of the trademarks "Cool Sap" and "Walk On Water." According to the Appellant, the name "Cool Sap" was already being used; however, Sapa registered the trademark "Walk On Water" in 1996, and then sold it in 1997 for a sum of $3,000. Tab 11 contains invoices from Aliments Lexus Foods Inc. relating to the purchase of bottles, caps and fruit concentrates used to manufacture and bottle beverages in the six fruit flavours mentioned previously. Tab 12 contains invoices from three law firms relating to the preparation of certain "corporate documents," the filing of the trademark "Walk On Water" in Canada and in the United States and the preparation of other agreements, including a confidentiality agreement.

[24] It is important to note that all of the documents, invoices and statements of account, without exception, that were adduced in evidence and included in tabs 5 to 12 of Exhibit I-1 and that were briefly described above and provided by the

Appellant, in support of his claimed BIL in 1999, are dated in 1995, 1996 or 1997. In 1997, no date is later than May 31.

[25] Tab 13 of Exhibit I-1, prepared by the Appellant's accountant, is a statement of all of Sapa's expenses as at May 31, 1996, described as "start-up costs." The total of $172,878 is for the fiscal year ending on May 31, 1996, and is capitalized and recorded on Sapa's balance sheet as "start-up costs" (Exhibit I-1, tab 1, financial statements, page 3). For the fiscal year ending on May 31, 1997, the financial statements indicate that these same costs increased to $185,508 (Exhibit I-1, tab 2, financial statements, page 3). For the fiscal year ending on May 31, 1998, these costs did not increase (Exhibit A-1, tab 5, financial statements as at May 31, 1998, page 3). Sapa did not file a tax return or financial statements for the fiscal year ending on May 31, 1999.

[26] The Appellant explained that Sapa never had any employees and had never sold the fruit beverages that it had manufactured. However, he never specified when the beverages for the 1,200 bottles (200 for each of the six flavours) had been manufactured and bottled. Based on the invoices for the purchase of the bottles, caps and fruit concentrates from Aliments Lexus Foods Inc. (Exhibit I-1, tab 11) and those from Cintech AA Inc. (Food Technology Innovation Centre), which bottled the beverages (Exhibit I-1, tab 9), it is reasonable to conclude that these operations occurred during the 1996 calendar year. According to the Appellant, some of the bottles were given out to spark peoples' interest and the remainder were stored in the basement of his dental clinic. They were discarded a year or two later.

[27] The financial statements for the fiscal year ending on May 31, 1996 indicate no income (Exhibit I-1, tab 1, financial statements, page 2). The financial statements for the fiscal year ending on May 31, 1997 indicate income of $3,000 (Exhibit I-1, tab 2, financial statements, page 2). According to the Appellant, Sapa needed money. Therefore, in exchange for $3,000, he decided to sell the trademark "Walk On Water," which Sapa had registered in 1996. The financial statements for the fiscal year ending on May 31, 1998 indicate no income (Exhibit A-1, tab 5, financial statements for the fiscal year ending on May 31, 1998, page 2).

[28] In its financial statements for the fiscal year ending on May 31, 1998, Sapa's latest products, assets on the balance sheet are described as follows:

[TRANSLATION]

ASSETS

CURRENT

Cash	$40
Accounts Receivable	3,418
Income tax	856
Amounts receivable	17,915
	22,229

OTHER

Incorporation expenses, amortized cost	1,269
Start-up costs	185,508
	186,777
	$209,006

The Appellant provided no explanation concerning the items included in Sapa's assets, aside from the "start-up costs." It is even more difficult to understand what these items represent, since it is known that Sapa never sold anything at all, except for its trademark "Walk On Water," which it sold for $3,000 in 1997, and it never reported any other income.

[29] André Boudreau is an objections officer with the CCRA. In his testimony concerning the BIL that the Appellant claimed, he first stated the position that was adopted at the audit stage and then he stated his own personal position that he adopted following the Appellant's objection. Tab 3 of Exhibit A-1 contains a report that he wrote outlining these positions. With regard to the position taken at the audit stage, the following appears on pages one and two:

> [TRANSLATION]
>
> According to the documents that the taxpayer provided, he proved that a business existed; however, he did not prove that it was an active business. Consequently, it does not fall within the definition of "small business corporation"(SBC) as defined in subsection 248(1). As a result, the loss does not qualify as a business investment loss. However, due to the fact that his debt was incurred for the purpose of earning income, the client can claim a capital loss in the year in which the debt became uncollectible.
>
> Throughout SAPA's entire period of activity, from June 1995 to May 1999, the Corporation only reported a gross income of $3,000, the source of which is unknown. All of the costs that SAPA incurred were recorded in the "start-up costs" account. There are no assets or equipment for bottling production. The business conducted market studies, research and laboratory tests to determine a

product to be sold on the market. Due to the fact that the product was not profitable on the market following these and other studies, the Corporation ceased its operations in May 1999. The taxpayer did not provide proof regarding purchases of the raw materials necessary to produce the products for the purpose of selling them. Analysis of the item "start-up costs" indicates that the invoices are primarily from:

- *Division Externe* for expenses totalling $92,779 between October 1, 1995 and May 30, 1996, relating to fees for the market surveys, business plan and other research;

- *Cintech AA* for expenses totalling $19,139 between October 1, 1995 and December 19, 1996, relating to the use of laboratories and the assistance of a technician to conduct product research and tests;

- *Legal fees* paid primarily to two firms. Fees were first paid for the preparation and filing of trademarks between February 26, 1996 and May 29, 1997 ($6,811). The second set of fees was for drafting the confidentiality contract and for the transfer of shares ($1,372);

- *Other expenses* relating to purchasing the sample products and laboratory analysis ($2,485), developing the nutritional text ($1,208) and purchasing bottles, caps and essence concentrate ($2,751).

None of these expenses have anything to do with the actual operation of a corporation. In addition, these expenses do not create assets regarding product production. According to the definition of SBC, 90% of the assets must be used principally in an active business. Based on the documents reviewed, the Corporation has no such assets. Consequently, the Corporation is not a SBC and the taxpayer's loss on the debt does not qualify as a business investment loss under paragraph 39(1)(*c*).

. . .

The position of the audit is that the Corporation did not begin operating an active business, or at least that it did not constitute a Corporation operating a small business, because all or substantially all of the fair market value of the assets were not attributable to assets used principally in an active business, as required by the definition of "small business corporation" in subsection 248(1), which reads as follows:

. . .

[30] With regard to his own opinion on the matter, Mr. Boudreau writes the following on pages three and four of his report:

> [TRANSLATION]
>
> In our opinion, all the steps taken, such as the surveys, business plan, market study and laboratory tests, were merely intended to bring together the basic elements of the structure of a new business, which was never actually put in place. The Corporation did not begin any activity giving rise to business income. The purpose of all its activities was to establish the structure of the business itself, which ultimately never saw the light of day. No water was bottled. The Corporation never developed a distribution network.
>
> . . .
>
> The Corporation's principal activities took place in 1996 and 1997. However, even at that time, no sufficient organizational structure was established to enable the Corporation to commence activities relating to the operation itself, such as looking for suppliers, developing markets and bottling the water. The Corporation never began to actively operate its business, which was to consist of the marketing of bottled maple sap water.

[31] According to Mr. Boudreau, his report was submitted to the Appellant's accountant, who was given the opportunity to make additional submissions. The accountant did not feel that it was appropriate to do so and asked Mr. Boudreau to close the file, preferring to appeal to the Court.

[32] In his testimony, Mr. Boudreau stated that, according to the invoices submitted by the Appellant, it was not apparent that a supplier had been sought. With regard to the invoices for the purchase of various concentrates, he claimed it was his understanding that it was a matter of trying "different varieties", "different flavours". With regard to bottling, Mr. Boudreau felt that it was a matter of minimum quantities.

[33] In light of the Appellant's testimony concerning the bottling of the six different flavours of beverages, Mr. Boudreau claimed that he still considered them to be samples and that, in reality, the invoices that had been submitted to him indicated that Sapa's operations had been carried out in 1995, in 1996 and in early 1997 and that the beverages were bottled in 1996. Mr. Boudreau stated that his report made no reference to the moratorium that the Appellant discussed in his testimony, because this issue had not been raised in the audit report or in the submissions.

[34] Mr. Boudreau also stated that he had reviewed Sapa's financial statements. For the fiscal year ending on May 31, 1996, expenses totalling $172,878 are recorded on the balance sheet as start-up costs (Exhibit I-1, tab 1, financial statements as at May 31, 1996, page 3). Upon reviewing the reconciliation sheet that the Appellant's accountant submitted entitled [TRANSLATION] "start-up costs," he was able to note that this represented all of the expenses for which invoices had been submitted (Exhibit I-1, tab 13). In the financial statements as at May 31, 1997, the balance sheet indicates that the start-up costs increased to $185,508 (Exhibit I-1, tab 2, financial statements as at May 31, 1997, page 3). Mr. Boudreau also noted that no income was reported in 1998 and that the start-up costs remained the same for the fiscal year ending on May 31, 1998 (Exhibit A-1, tab 5). With regard to 1999, he confirmed that no tax return had been filed.

[35] In short, Mr. Boudreau stated that the principal asset submitted in the financial statements was the start-up costs and that there was nothing to indicate that the business was active, as required by the *Act*.

Position of the Appellant

[36] Counsel for the Appellant maintains that Sapa actively carried on a business by seeking expertise, by having studies done, by seeking raw materials and by creating a product that was introduced at two food shows. Although the business began with maple sap, there was a subsequent change in order to make juice using spring water. However, according to Counsel, due to the moratorium imposed by the Government of Quebec from December 1997 to January 1999 on the marketing of spring water, Sapa's operations were interrupted, because the owner of the source that was to supply the water could henceforth no longer develop it. However, Counsel for the Appellant states that in spite of all of this, the Appellant continued to seek other water suppliers and even went to Los Angeles to meet with an individual who could have distributed his product.

[37] Counsel for the Appellant also emphasizes that the audit stage focused on the start of operations relating to the bottling of maple sap; however, she argues that the Appellant's testimony shows that after the studies were conducted, he decided to manufacture juice using spring water. In fact, 200 bottles were produced for each of the six different flavours, for a total of 1,200 bottles. Counsel emphasizes that although this quantity was not sufficient for commercial distribution, it was sufficient to introduce the product and to obtain orders. In addition, she notes the purchases made to produce the beverages, which were

bottled by subcontractors. In her opinion, this was a normal way in which to proceed and it was not necessary for Sapa to purchase its own plant to bottle its products.

[38] Counsel for the Appellant argues that the Appellant's efforts to find other water suppliers must be taken into consideration and that it cannot be said that the operations ceased on the date of the last invoice. She claims that the business did not necessarily cease operations because it had not paid for the studies that were conducted or for the professional services received.

[39] Counsel for the Appellant believes that Sapa was an active business within the definition of this expression in subsection 125(7) of the *Act*, in that it was definitely "an adventure or concern in the nature of trade", because the Appellant had invested and lost nearly $180,000 in the Corporation. As such, she argues that Sapa must be deemed to be a "small business corporation" according to the definition of this expression in subsection 248(1) of the *Act*.

[40] In support of her arguments, Counsel for the Appellant referred to the decisions rendered in *Boulanger v. Canada*, [2002] T.C.J. No. 344 (Q.L.), 2002 DTC 2016 (T.C.C.), *M.P. Drilling Ltd. v. Canada (M.N.R.)*, [1976] F.C.J. No. 12 (Q.L.), 76 DTC 6028 (F.C.A.), *Samson et Frères Ltée v. Canada*, [1995] T.C.J. No. 1385 (Q.L.), 96 DTC 1559 (T.C.C.), *Poulin v. Canada*, [1996] F.C.J. No. 960 (Q.L.), 96 DTC 6477 (F.C.A.), *Selig v. M.N.R.*, 55 DTC 46 (T.A.B.) and *Harquail v. Canada*, [2001] F.C.J. No. 1616 (Q.L.), 2001 FCA 320.

Position of the Respondent

[41] Counsel for the Respondent recognizes that a business was started, that the Appellant took steps and that some of Sapa's activities might have enabled the Corporation to qualify its business as an active business; however, she emphasizes that the issue in this case is essentially to determine whether Sapa operated a small business in the 12 months preceding May 31, 1999, the time at which the Appellant's debt became uncollectible.

[42] Counsel for the Respondent emphasizes that the documentary evidence consisting of the invoices submitted does not prove that Sapa carried on any kind of business whatsoever or took any steps subsequent to May 1997, in spite of the Appellant's testimony. Furthermore, in her opinion, this testimony was rather

vague regarding the true nature of the steps that were taken after the moratorium, in respect of which the Appellant was unable to provide specific dates.

[43] According to Counsel for the Respondent, a certain number of indications, including the fact that Sapa did not file a tax return for his 1999 year, confirm the absence of operations. In addition, in her opinion, the Corporation's assets as at May 31, 1998 were the same as they were on May 31, 1997. At this point, I must emphasize that in reality the total of the assets differs slightly from the previous year; however, the start-up costs are the same amount, that is, $185,508.

[44] With regard to these start-up costs, which constitute the principal asset if they are compared with the amounts, which she considers to be very minimal, recorded in the "cash," "incorporation expenses," "accounts receivable" and "amounts receivable" items, Counsel for the Respondent argues that it cannot logically be claimed that these assets are used principally in an active business, in such a way as to comply with the condition set out in the definition of the expression "small business corporation" in subsection 248(1) of the *Act*.

[45] Furthermore, with regard to these start-up costs, Counsel for the Respondent emphasizes that it can be noted in the reconciliation that the Corporation's accountant treated the costs of various steps and studies and of various business plans, as well as the purchase of bottles, caps and fruit essences as "start-up costs."

[46] Counsel for the Respondent calls into question the importance of the moratorium in terms of curbing Sapa's operations and emphasizes that this factor was never raised before, not even in the questionnaire that the accountant had to complete in support of the BIL (Exhibit I-1, tab 14). This document cites [TRANSLATION] "non-profitability" as the reason for which the Corporation ceased its operations. Counsel adds that she finds it somewhat difficult to understand how the Appellant could have attempted to establish a business by relying on a non-regulatory source to supply water.

[47] In addition, she notes that Sapa never had any employees and that the majority of the 1,200 bottles of beverages that were produced were stored in the basement of the Appellant's dental clinic and that they eventually had to be discarded.

[48] In conclusion, Counsel for the Respondent argued that the facts show that Sapa did not operate an active business in the 12 months preceding May 31, 1999.

Analysis

[49] In his testimony, the Appellant placed a great deal of emphasis on the commencement of the moratorium to explain Sapa's small amount of activity after 1997. Furthermore, in this respect, he raised the fact that he could not be supplied by the water source he had found and that seeking a water supplier became problematic. I find that this fact was raised for the first time at the hearing of this appeal and that [TRANSLATION] "non-profitability" was the only reason noted for ceasing operations in the questionnaire completed by the Appellant's and Corporation's accountant in support of the BIL (Exhibit I-1, tab 14). However, it is important to recognize that none of the beverages that were already bottled in 1996 were ever sold. Therefore, it is difficult to accept that the main problem the Appellant faced had to do with obtaining spring water of an acceptable quality. The Appellant referred to the meeting held with a potential distributor in Los Angeles, likely in 1996 or 1997, and to introducing the bottled beverages at two food shows in Montréal. I have no doubt that he took other steps relating to marketing. However, the total absence of any result observed in 1996 and 1997 probably contributed greatly to the subsequent cessation of any significant activity. In addition, the fact that Sapa sold its only trademark for its beverages, "Walk On Water," during the taxation year ending on May 31, 1997, is definitely a major indication of the cessation of any active operation of the business.

[50] The fact that there were no employees and the fact that no income was earned in spite of the Appellant's efforts are not in and of themselves indicative of a situation in which no active business was carried on (refer to *Harquail*, *supra*, at paragraphs 62 to 64). I am willing to acknowledge that the business plan, studies, laboratory tests and efforts made to obtain raw materials, as well as to market and distribute the bottled beverages, are activities that fall within the framework of an active business. The difficulty lies in determining when the business ceased to be active. As I indicated previously, paragraph 5 of the Notice of Appeal indicates that this occurred in early 1999. The questionnaire completed by the Appellant's accountant indicates May 31, 1999 (Exhibit I-1, tab 14). The Appellant testified that he had taken some steps after the moratorium; however, he was unable to specify the time frames. In addition, Sapa did not file a tax return or produce financial statements for the period from June 1, 1998 to May 31, 1999. Furthermore, the "start-up costs" remained the same for the fiscal year ending on May 31, 1998 and the one ending on May 31, 1997. In this context, it is difficult to conclude that Sapa continued to be an active business in 1998 or in 1999.

[51] In addition, Counsel for the Respondent argues that the condition relating to the market value of the assets used in an active business has not been met. I note that the definition of "small business corporation" in subsection 248(1) of the *Act* imposes the condition that "all or substantially all of the fair market value of the assets of which at that time is attributable to assets that are used principally in an active business carried on . . . by the particular corporation." The end of the definition specifies that for the purpose of paragraph 39(1)*(c*), a corporation shall be deemed to be a small business corporation if it was a small business corporation at any time in the 12 months preceding that time.

[52] In light of the evidence presented, I believe that there is insufficient evidence to determine that this condition has indeed been met. First, the asset composition is not known for the 12 months of Sapa's fiscal year, from June 1, 1998 to May 31, 1999. For the fiscal year of June 1, 1997 to May 31, 1998, it is known that the largest asset, as presented on the balance sheet, consists of capitalized start-up costs totalling $185,508, the same amount as for the previous year. Since these start-up costs were incurred during the 1996 and 1997 fiscal years, capitalized and placed on the asset side of the balance sheet by accounting policy, one can certainly question whether such an asset could continue to be deemed to have been "used" in an active business, even though there is no doubt that the costs so capitalized were capitalized for the benefit of the Corporation. Finally, as I pointed out previously, it is impossible to determine what the other assets represent, such as accounts receivable and amounts to be received, as the Corporation never sold anything except for its trademark "Walk On Water," which was sold for $3,000 in 1997.

[53] Counsel for the Appellant did not directly address the condition relating to the market value of the assets that must be used in the active business. This issue cannot simply be completely pushed aside or ignored without any attempt to prove that it has been met, because the evidence brought by the Respondent tends to demonstrate the contrary. However, even if one could consider that all of the fair market value of Sapa's assets was attributable to assets that are used principally in its business, it still would have been necessary to first establish that Sapa continued to be an active business at the relevant time, that is, on May 31, 1999, or at any time in the 12 months preceding this date, of which I am not satisfied.

[54] In conclusion, I believe that Sapa did not meet the requirements to be deemed a small business corporation for the purpose of applying paragraph 39(1)(*c*) of the *Act*. Therefore, the Appellant cannot claim a BIL for the 1999 taxation year.

[55] As a consequence of the foregoing, the appeal is dismissed, with costs awarded to the Respondent.

Signed at Ottawa, Canada, this 9th day of September 2005.

"P. R. Dussault"

Dussault J.

Translation certified true
on this 9th day of January 2006.

Sharlene Cooper, Translator