BETWEEN:

JAN V. WEINBERGER ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

1963
Jan. 22, 23
1964
Feb. 27

Revenue—Income tax—Income Tax Act R.S.C. 1952, c. 148, ss. 11(1)(a), 12(1)(b) and 144(1)—Income Tax Regulations, s. 1100(1)(c)—Value of uncorroborated evidence of appellant—Standard of proof—Capital cost of patent—Expense of turning patent to account not to be included in capital cost of patent.

This is an appeal from the disallowance by the respondent of a claim to a deduction equal to 1/17 of the amount calculated by the appellant to be the cost to him of proving an invention patented by him in 1946.

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He began to receive royalties from his patented invention in 1954 and it was in that year that he first claimed the deduction as a capital cost allowance.

It was found as a fact that the appellant did incur expenses of about $61,000 for production of cloth for use in testing his invention and in making the tests, and that 65% of this expense was incurred after the application for a patent had been made and that this portion of the expense had been incurred to make the invention commercially successful as well as, to some extent, for the purpose of satisfying the patent examiner that the invention had the utility to support a patent.

Held: That although the onus is on the appellant to establish the facts upon which his right to relief depends and his evidence when unsupported should be weighed with care, it must not be forgotten that there is no rule of law requiring corroboration of the testimony of an appellant and that the standard of proof required is that applicable in civil cases, that is to say, proof by a preponderance of evidence.

2. That the expenses incurred by the appellant in perfecting his invention are part of the "actual capital cost" of the patent be obtained therefor within the meaning of that expression in s. 144(1)(2) of the *Income Tax Act*.

3. That the cost of a patent to an inventor ordinarily includes not only what it has cost him to disclose his invention to the public in the prescribed manner and to satisfy the Commissioner of Patents that he is entitled to a patent therefor but also whatever other costs he has in fact incurred in producing the invention for which the patent is sought and in perfecting it to the point where its utility can be demonstrated and a patent can be obtained.

4. That expense incurred by an inventor for the purpose of turning the invention to account, as opposed to expense incurred to perfect the invention to the point where a patent can be obtained, cannot be regarded as part of the cost of the monopoly which the inventor is already in a position to obtain simply by disclosing his invention in the required manner.

APPEAL from a decision of the Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Thurlow at Ottawa.

L. M. Joyal for appellant.

G. W. Ainslie and *D. G. H. Bowman* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

THURLOW J. now (February 27, 1964) delivered the following judgment:

This is an appeal from a judgment of the Tax Appeal Board which allowed in part an appeal by the appellant against an assessment of income tax for the year 1954. The

matter in issue is the right of the appellant to a deduction, in computing his income for tax purposes, of capital cost allowance in respect of what he alleges to be the capital cost to him of a patent obtained by him in 1946 for an invention which he had devised some years earlier.

The appellant is an industrial consultant who emigrated from Czechoslovakia first to the United States and later to Canada in 1938. Some years before he left Czechoslovakia he had conceived an idea for weaving cloth in such a manner that the force of objects striking it would be distributed and dissipated over a considerable area bordering the point of impact, thus making the cloth resistent to penetration by bullets and other flying objects, and he had tried to put the idea into practice, using cotton as the material, but it did not work. After coming to Canada the appellant tried again using in various blends some further materials such as viscose, bermberg rayon and silk, and ultimately nylon. Supplies of nylon at that time were closely controlled for use in making parachutes but the appellant was able to acquire a small quantity of nylon filament and a larger quantity of nylon waste from which he had some 1,500 yards of cloth woven in the manner which he had contrived. To do this it was necessary to spin the material into threads of various gauges and then to weave the cloth from them but before the waste nylon could be spun it was necessary to have it cut in particular lengths and for this purpose the appellant devised a machine for which he later obtained a patent. This particular patent however proved valueless as a better machine was invented not long afterwards. All this was done at considerable out-of-pocket expense to the appellant but the 1,500 yards of cloth made of nylon enabled him to prove the soundness of his theory with respect to the manner of weaving which he had devised and to obtain a Canadian patent therefor. Whether he also obtained patents therefor in other countries does not appear.

The experiments in Canada for the purpose of testing his invention were carried out over the period from 1939 to 1946. In the meantime he had apparently satisfied himself of the soundness of his theory for he applied for a Canadian patent in October 1943, but he continued testing for some time thereafter in the hope of finding a practicable way of

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realizing its utility as well as, according to his evidence, for the purpose of satisfying the patent examiner that the invention had the utility necessary to support a patent. The patent was ultimately granted in 1946 but he derived no return from it until 1954 when according to his income tax return he received royalties amounting to $675. Up to that year he had never sought to deduct, in computing his income for tax purposes, any part of the expense which he had incurred in proving the invention but in his return for that year he deducted $3,588 representing 1/17 of an amount of $61,000 which he calculated to be the total amount of his expenses in connection therewith. The Minister having disallowed the whole of such claim, the appellant appealed to the Tax Appeal Board which held that a sum of $500 representing costs incidental to the application for the patent were costs in respect of which capital cost allowance might be claimed but that the appellant was not entitled to capital cost allowance in respect of the other sums allegedly expended in connection with the invention. The appellant thereupon appealed to this Court and the Minister cross-appealed but subsequently at the commencement of the trial abandoned the cross-appeal. In so doing counsel for the Minister stated his position as being that the actual capital cost to the appellant of obtaining the patent, within the meaning of s. 144 of the *Income Tax Act*, R.S.C. 1952, c. 148, was $500 and that he was prepared to admit that the capital cost as defined in that subsection, at the commencement of the 1949 taxation year, was $394.10.

Basically the Minister's case is that the appellant is not entitled to the capital cost allowance claimed because the patent cost the appellant nothing but the legal expenses of obtaining it and in support of this position he challenged the evidence that the expenses in question were incurred and submitted that even if they or some portion of them were incurred they did not constitute any part of the "cost" or the "capital cost" or the "actual capital cost" of the patent within the meaning of these expressions as used in the *Income Tax Act* and the Regulations made pursuant thereto.

At the trial of the appeal to this Court the appellant gave evidence of the facts which I have outlined and

answered in a forthright manner all the questions put to him respecting the alleged expenses and what they were for as well as to whom the amounts were paid. He explained his lack of records to support his statements by saying that security arrangements in effect at the time made it necessary for him to destroy documents which might disclose the source of his materials and that he had destroyed them. His evidence was not shaken by cross-examination. That considerable expense would be involved in proving the validity of his theory and the practical usefulness of it is I think apparent from the nature of the invention and in the course of the trial it was conceded that he had in fact conducted tests though nothing was admitted as to the number of tests conducted or their purpose or cost. On the other hand nothing was offered in the way of evidence to contradict the appellant.

While the onus is on the appellant in proceedings of this nature to establish the facts upon which his right to relief depends and the evidence of an appellant when unsupported is I think to be weighed with care, because of the temptation sometimes experienced by taxpayers to shape facts to suit their own purposes, it must not be forgotten that there is no rule of law requiring corroboration of the testimony of an appellant to support a finding and that the standard of proof required is that applicable in civil cases, that is to say, proof by a preponderance of evidence.

In the present case, the appellant impressed me as a reliable witness and bearing in mind the considerations which I have mentioned, as well as the fact that the situation is not one in which there was any statutory obligation on the appellant to keep records for tax purposes, I can see no valid reason for refusing to accept as credible his evidence that he incurred the expenses in question. I accordingly find that he did incur expenses to the extent of about $61,000 over a period of years, 98 per cent. of which occurred in the years 1939 to 1946, for the production of cloth for use in making tests of his invention and in making some 60 of such tests. I also find that 65 per cent. of this expense was incurred after the application for the patent was made and that this portion of the expense was incurred for the purpose of making the invention commercially successful as well as to some extent for the purpose of satisfy-

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ing the patent examiner that the invention had the utility to support a patent.

By s. 12(1)(*b*) of the *Income Tax Act* R.S.C. 1952, c. 148 it is provided that in computing income, no deduction shall be made in respect of 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 Part I of the Act but by s. 11(1)(*a*) it is also provided that:

> 11. (1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:
>
> (*a*) such part of the capital cost to the taxpayer of property, or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation;

Section 1100(1)(*c*) of the Income Tax Regulations as applicable to the year 1954 provided that:

> 1100. (1) Under paragraph (*a*) of subsection (1) of section 11 of the Act, there is hereby allowed to a taxpayer, in computing his income from a business or property, as the case may be, deductions for each taxation year equal to
>
> . . .
>
> (*c*) such amount as he may claim in respect of a property of class 14 in Schedule B not exceeding the lesser of
>
> (i) the amount for the year obtained by apportioning the capital cost to him of the property equally over the life of the property remaining at the time the cost was incurred, or
>
> (ii) the undepreciated capital cost to him as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class;

Schedule B, Class 14 reads in part as follows:

> Schedule B
> CLASS 14
>
> Property that is a patent, franchise, concession or license for a limited period in respect of property . . .

With respect to property owned by a taxpayer at the time of the coming into force of the 1948 *Income Tax Act*, s. 144 of the present Act provides as follows:

> 144. (1) Where a taxpayer has acquired depreciable property before the commencement of the 1949 taxation year, the following rules are applicable for the purpose of section 20 and regulations made under paragraph (*a*) of subsection (1) of section 11;

(*a*) except in a case to which paragraph (*b*) applies, all such property shall be deemed to have been acquired at the commencement of that year at a capital cost equal to

(i) the actual capital cost (or the capital cost as it is deemed to be by subsection (3) or (4)), of such of the said property as the taxpayer had at the commencement of that year,

minus the aggregate of

(ii) the total amount of depreciation for such of the said property as he had at the commencement of that year that, since the commencement of 1917, has been or should have been taken into account, in accordance with the practice of the Department of National Revenue, in ascertaining the taxpayer's income for the purpose of the *Income War Tax Act*, or in ascertaining his loss for a year for which there was no income under that Act, . . .

As paragraph (*b*) of subsection (1) and subsections (3) and (4) have no application in the present case, the effect of s. 144(1)(*a*) is that the appellant's patent is deemed to have been acquired at the commencement of 1949 at a capital cost equal to the "actual capital cost" of the property to him minus the amount referred to in paragraph (ii).

The first and the most substantial problem which arises on these provisions is whether the expenses incurred by the appellant in perfecting his invention are part of the "actual capital cost" of the patent which he obtained therefor within the meaning of that expression in s.144(1)(*a*). There appears to be no decided case offering any guidance on this question but, in my opinion, such expenses do form part of the actual capital cost of the patent. The significant property right in the case of a patent is the monopoly which it evidences and confers. That monopoly is an exclusive right granted for the term of 17 years to make, use, construct and vend to others to be used the invention in respect of which the patent has been granted and in the theory of the patent law that monopoly is granted in consideration of the disclosure of the invention to the public. A patent under the statute is thus obtainable by an inventor only when he has in fact invented something for which a patent may be obtained, that is to say, something which is new and useful in the sense of the patent law and when he has complied with the requirements of the law by disclosing the invention in the appropriate manner. It seems to me therefore to follow that the cost of a patent to an inventor would ordinarily include not only what it has cost him to disclose his invention to the public in the prescribed manner

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and to satisfy the Commissioner of Patents that he is entitled to a patent therefor but whatever other costs he has in fact incurred in producing the invention for which the patent is sought and in perfecting it to the point where its utility can be demonstrated and a patent can be obtained under the law relating thereto. Such expenses may be small in some cases and great in others but that feature in itself does not appear to me to bear on the question whether or not they are part of the cost of the patent to the inventor.

On the other hand once the invention has been perfected to the point where a patent can be obtained, an inventor may go on to incur further expense for the purpose of turning the invention to account and here I think it becomes necessary to distinguish between such expense and expense which has been incurred to perfect the invention, for whatever treatment of the former may be appropriate for accounting purposes, it does not seem to me that such expense can be regarded as part of the cost of the monopoly which the inventor is already in a position to obtain simply by disclosing his invention in the manner required by the patent law.

In the present case the evidence satisfies me that the expense incurred by the appellant prior to the time when he applied for the patent in question, that is to say, some 35 per cent of the total amount of $61,000 expended, was in fact incurred for the purpose of perfecting the invention and should accordingly be treated as part of the "actual capital cost" of the patent to him and I am also satisfied that some part of the remainder of the $61,000 expended is attributable to satisfying the patent examiner that the patent had the utility necessary to support a patent and that such part should also be regarded as part of the actual capital cost of the patent to him. But however the rest of the $61,000 may be classified the evidence leaves me unsatisfied that it was in fact part of the "actual capital cost" of the patent, or that it can be taken into account in compuing capital cost for the purposes of the statute. Viewing the matter at large, I think it is safe to assume that of the $61,000, an amount of $22,000 represents costs incurred by the appellant in making and proving his invention and obtaining the patent in question and I accordingly find that that amount was the actual capital cost of the patent to him.

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Two further points raised in the course of argument on behalf of the Minister should also be mentioned. Counsel pointed to the provision in Regulation 1100(1)(*c*)(i) for calculating capital cost allowance on the basis of "the life of the property remaining at the time the cost was incurred" and he submitted first that this showed that the expenses of perfecting an invention should not be considered to be part of the capital cost of a patent therefor since there would be no patent in existence at the time when the expense was incurred and, consequently, no part of such expense could be taken into account in calculating capital cost allowance in respect of a patent obtained after the commencement of the 1949 taxation year, and secondly that since the same regulation applies in respect of patents obtained both before and after that time, it would be illogical to treat such expenses as forming part of the capital cost of a patent acquired prior to that time when they could not be taken into account in computing capital cost allowance in respect of a patent obtained after that time. In the view I take of the matter it is not necessary to the determination of this case to express any opinion as to the effect of the words which I have quoted from Regulation 1100(1)(*c*)(i) with respect to a patent obtained after the beginning of 1949 but even assuming for the present purpose that the Minister's contention in that respect is correct, I do not think it can prevail in the case of a patent acquired before that time to which the provisions of s.144(1) apply. That subsection provides that in the case of property held at the commencement of the 1949 taxation year, for the purposes of regulations made under s. 11(1)(*a*) of the Act, the property (in this case the patent) "shall be deemed to have been acquired at the commencement of the year at a capital cost equal to the actual capital cost" less the amount therein mentioned. However limited the object which this provision may have been designed to serve it is an express enactment that for the purpose of the regulations a certain set of facts shall be deemed to have occurred and in the cases to which it applies it cannot be disregarded. Under this provision therefore property to which it applies is deemed to have been acquired on the date mentioned at the amount so prescribed and it appears to me to follow from this that the fictitious amount so prescribed as the capital cost of the property must be treated as having been incurred at the

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fictitious date of acquisition of the property and that expenditure which properly makes up part of the actual capital cost of such property to the owner must be taken into account in making the calculation prescribed by the subsection regardless of when such expenditure may have actually been incurred. When therefore one comes to apply the regulation in a case such as the present one no problem of the kind raised arises since the property is *ex hypothesi* in existence at the commencement of the 1949 taxation year and is deemed to have been acquired on that date at an amount which, because it is a fictitious amount can only be treated as having been incurred at that time. The point is accordingly, in my opinion, without substance.

The other point was that since no evidence was given of the practice of the Department of National Revenue in ascertaining (the appellant's) income for the purpose of the *Income War Tax Act* the total amount of depreciation in respect of the patent that "should have been taken into account in accordance with the practice of the Department" under that statute had not been established and that accordingly the appellant had not discharged the onus of proving the capital cost of the patent as defined by s. 144 (1)(*a*). It was not however suggested that the whole capital cost of a patent granted in 1946 would have been depreciable in that and the following two years under the practice followed by the department under the *Income War Tax Act* and on it being pointed out that the admission made at the commencement of the trial so indicated counsel retreated somewhat from the position that the appeal should be dismissed on that ground and submitted that in the event of a finding being made that the cost of the invention forms part of the actual capital cost of the patent the matter should be referred back to the Minister for the purpose of ascertaining the total amount of depreciation thereon which should have been taken into account under the earlier statute. This, I think, is the proper course under the circumstances.

The appeal will therefore be allowed and the assessment will be referred back to the Minister for reconsideration and re-assessment in accordance with these reasons. The appellant is entitled to the costs of the appeal.

Judgment accordingly.