T-550-90

B E T W E E N:

WALTER KUHN

Plaintiff

- and -

HER MAJESTY THE QUEEN

Defendant

REASONS FOR ORDER

CAMPBELL J.

Let the attached transcript of my Reasons for Order delivered orally from the Bench in Edmonton, Alberta, the 4th day of June, 1997, now edited, be filed to comply with section 51 of the *Federal Court Act*.

Douglas R. Campbell
Judge

VANCOUVER
July 21, 1997

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B E T W E E N:

WALTER KUHN

Plaintiff

- and -

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REASONS FOR ORDER

CAMPBELL J.

During the 1970s and 1980s, Mr. Walter Kuhn owned and managed a business conglomerate composed of a heavy equipment business, a golf course, a modular home-building enterprise and a cattle-farming operation. These purely business concerns were held either by Mr. Kuhn's wholly owned corporation Northlands or in his own right.

The entire conglomerate was managed as a single entity for practical and tax purposes; that is, income and losses were distributed between the enterprises and between the legal owners throughout that period.

There is absolutely no concern on the evidence about the propriety of the financial management of the enterprises or the accounting related to them. There is also no concern on the evidence in this case about tax avoidance or tax evasion.

On the evidence I have heard, I find that Mr. Kuhn was a prudent, well-experienced and successful businessman. With the help of his son Dwight Kuhn,

who is a chartered accountant, the family carried on a well-financed, well-attended and skilfully managed business concern.

There is no suggestion that any aspect of the enterprises were for personal use. I find as a fact that all the enterprises were carried out by Mr. Kuhn or his corporation Northlands exclusively in the pursuit of profit through purely commercial activity.

The only question that arises within this context is the deductibility of interest paid on certain loans against the cattle-farming operation.

In 1979, Mr. Kuhn purchased what is known as the Neerlandia lands, and, on his evidence, because he felt, quote, "It was a good opportunity for a cattle operation," this subjective business intention was pursued with vigour.

Using equipment from the equipment enterprise, the land was partially cleared and drained and cattle were grazed on it. But this legitimate business pursuit together with the others in the conglomerate hit the wall in the 1981 economic downturn.

The downturn required Mr. Kuhn to sell off the assets of the machinery business, refinance outstanding loans by borrowing from legitimate creditors, including banks and personal friends, and focus energy into the most-lucrative aspects of the conglomerate, considering the market conditions at the time.

Thus, the golf course and the home-building enterprises were the focus of energy and activity, and the cattle-farming operation was effectively downgraded in priority.

In respect of the cattle-farming operation, however, Mr. Kuhn continued to hold out hope that, imminently, he could gain the full profit benefits for which the land was acquired, and, thus, he did not offer the land for lease on a long-term basis. I find that during the whole of the period that the land was held, that it was used in the course of a business.

It is important to note that all of the assets in the conglomerate were for sale, starting from the beginning of the downturn in 1981. The land eventually sold in 1989.

There is no suggestion on the evidence that there was any foot-dragging on Mr. Kuhn's part in disposing of the land. I find that Mr. Kuhn did all he could to reduce his liability and expenses and losses, respecting this and all others of the enterprises.

The deduction contested here is that of loan interest against Mr. Kuhn's personal income in years 1985 and 1986. The interest claimed is in relation to two separate personal loans from private individuals to Mr. Kuhn personally, both provided in 1982 in the sum of $100,000 and both initially at 20 percent per annum interest, which was not uncommon at that time.

No issue has been raised about the bona fide nature of these loans or the fact that interest was paid as agreed. Indeed, the loans were paid out in full with interest in 1989 upon sale of the golf course.

The only issue here is the ability of Mr. Kuhn to deduct the interest from his personal income in the tax years 1985 and 1986. There is no question that these were business loans. The money taken in by Mr. Kuhn went to support the enterprises he owned either personally or by Northlands.

According to the evidence of Mr. Dwight Kuhn, the interest deductions were taken by Northlands up to 1985, but for the years 1985 and 1986, the tax years in question, the deductions were taken by Mr. Kuhn personally as part of a planned approach to do so.

Mr. Dwight Kuhn, who is a chartered accountant, recommended this course of action, because in each year, Mr. Kuhn had sufficient income against which these interest deductions could be applied. I have no basis to find that there is anything irregular about the application so made. The interest was properly due and payable and was paid.

Therefore, I find the only issue is whether the law allows the deduction on the terms of the notification of confirmation by the Minister; that is, whether the deductions have been shown to have been made or incurred for the purpose of gaining or producing income from a business or property within the meaning of Section 18, 1(a) of the *Income Tax Act*.

The law is well-cited in the leading case of *Town* v. *The Queen* 96 DTC 6001 (F.C.A.), which is, I find, the leading and binding authority on this topic. The case describes that arising from the *Income Tax Act* and the common law, two tests must be met in a case such as this.

The following passage from Mr. Justice Linden's judgment at 6008 describes them in a capsulized way:

> "The *Moldowan* test is stricter than the business purpose tests set out in Subsection 9(i) and paragraph 18 1(a). As mentioned above, these tests stipulate that a taxpayer be subjectively motivated by profit when incurring an expenditure. The *Moldowan* test, however, also requires the presence of a profit motive, but, in addition, it must be objectively reasonable."

On the facts, I find that there is no question that Mr. Kuhn had a subjective motivation to acquire a profit when he purchased the land in question, and, thus, this subjective test is met.

Regarding the objective test, being that the motive must be objectively reasonable, there is no evidence to allow me to conclude otherwise.

Mr. Justice Linden stresses that in applying the objective test, all of the circumstances must be considered. In cases where this is being done, certain features trigger a concern, and they include cases where personal enjoyment is the dominant motivating force, cases where unrealistic intentions exist and cases where suspicious activities can be found. There is no evidence of any of these potential factors.

As Mr. Justice Linden sets out in *Town* at 6012:

> "The primary use of *Moldowan* as an *objective* test, therefore, is the prevention of inappropriate deductions in tax; it is not intended as a vehicle for the wholesale judicial second-guessing of business judgments.
>
> A note of caution must be sounded for instances where the test is applied to commercial operations. Errors in business judgment, unless the Act stipulates otherwise, do not prohibit one from claiming deductions for losses arising from those errors."

I have found and emphasize that Mr. Kuhn's activities were entirely commercial activities.

I find, therefore, that the interest deductions claimed are wholly, factually and legally appropriate, and, accordingly, I grant the appeal and vary the reassessments to reflect this finding.

I also order costs to Mr. Kuhn.

Douglas R. Campbell
Judge

VANCOUVER
July 21, 1997