

Tax Court of Canada



Cour canadienne de l'impôt

[OFFICIAL ENGLISH TRANSLATION]

1999-4742(GST)I

BETWEEN:

YVES RAYMOND,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 14, 2000, at Montréal, Quebec, by

the Honourable Judge Louise Lamarre Proulx

Appearances

Counsel for the Appellant: Jacques Sylvestre, Jr.

Counsel for the Respondent: Benoit Denis

JUDGMENT

The appeal from the assessment made under Part IX of the *Excise Tax Act*, notice of which is dated August 30, 1999, and bears number PACT-1975Q, is allowed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 17th day of November 2000.

"Louise Lamarre Proulx"

J.T.C.C.

Tax Court of Canada



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Date: 20001117

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BETWEEN:

YVES RAYMOND,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Lamarre Proulx, J.T.C.C.

[1] This appeal under the informal procedure concerns the period from January 1, 1995, to December 31, 1998.

[2] The question at issue is whether the appellant, with respect to his farming activities, carried on a business with a reasonable expectation of profit. According to the appellant, the farming was a commercial activity within the meaning of subsection 123(1) of the *Excise Tax Act* (the "Act") and so would entitle him to an input tax credit under section 169 of the *Act*.

[3] The facts relied on by the Minister of National Revenue (the "Minister") in making his assessment are set out in paragraph 4 of the Amended Reply to the Notice of Appeal (the "Reply") as follows:

[TRANSLATION]

- (a) The appellant has operated a farm since 1988;
- (b) The appellant is a registrant for purposes of Part IX of the *Excise Tax Act*, R.S.C. 1985, c. E-15, hereinafter the "E.T.A.";
- (c) The appellant lives on the farm throughout the year;
- (d) The appellant's farming activities consist of growing corn and barley or corn and soybeans, depending on the year;
- (e) From 1988 to 1997, the appellant's farming activities resulted in the following losses:

YEAR	GROSS INCOME	EXPENSES	LOSSES
1988	\$4,630	\$5,606	\$976
1989	\$10,937	\$11,299	\$362
1990	\$10,868	\$13,398	\$2,530
1991	\$11,751	\$14,235	\$2,484
1992	\$10,875	\$12,822	\$1,947
1993	\$13,148	\$17,449	\$4,301
1994	\$16,555	\$24,809	\$8,254
1995	\$16,261	\$19,817	\$3,556
1996	\$20,019	\$28,475	\$8,456
1997	\$22,682	\$24,131	\$1,449

- (f) For 1998, the appellant's farming activities generated a profit of \$137, as shown hereunder:

<u>YEAR</u>	<u>GROSS INCOME</u>	<u>EXPENSES</u>	<u>PROFITS</u>
<u>1988</u>	<u>\$24,007</u>	<u>\$23,870</u>	<u>\$137</u>

however, in computing his income from farming, the appellant did not claim a deduction for capital cost allowance (deduction for depreciation), although he could have claimed such a deduction, and that would have changed the profit reported into a loss;

- (g) For 1995, in computing his income from farming, the appellant did not claim a deduction for capital cost allowance (deduction for depreciation).

although he could have claimed such a deduction, and that would have increased the reported loss;

- (h) For 1994 and 1997, in computing his income from farming, the appellant claimed only part of the amount of capital cost allowance (deduction for depreciation) to which he was entitled, although he could have claimed the full amount, and that would have increased the reported loss;
- (i) The appellant did not conduct a profitability study before starting up his business;
- (j) In view of the limited acreage of the land being farmed, it was difficult for the appellant to make his farm operation profitable;
- (k) During the years in question, the appellant had, at the very least, one other source of income, namely employment income, that was not connected with his farming activities;
- (l) The appellant devoted some 40 hours per week to his job or jobs during the years in question;
- (m) No reasonable expectation of profit can be demonstrated for future years;
- (n) In respect of his 1995 three-month reporting periods, the appellant, in computing his net tax for supplies purchased during those periods, claimed and obtained input tax credits totalling \$599;
- (o) In respect of his 1996 three-month reporting periods, the appellant, in computing his net tax for supplies purchased during those periods, claimed and obtained input tax credits totalling \$732.06;
- (p) In respect of his 1997 three-month reporting periods, the appellant, in computing his net tax for supplies purchased during those periods, claimed and obtained input tax credits totalling \$617.75;
- (q) In respect of his 1998 three-month reporting periods, the appellant, in computing his net tax for supplies purchased during those periods, claimed and obtained input tax credits totalling \$1,059;
- (r) Since there was no reasonable expectation of profit from them, the appellant's farming activities did not constitute a commercial activity in respect of which the appellant could claim the input tax credits referred to in subparagraphs (n), (o), (p) and (q).

[4] The grounds set out in the Notice of Appeal are the following:

[TRANSLATION]

The business is being operated with a reasonable expectation of profit in the long term.

In farming things are difficult when there is a high level of indebtedness.

In 1998, the taxpayer was able to purchase an additional 50 arpents of land to increase his productive capacity and thus reduce his fixed operating costs.

Figures for the 1998 financial year showed a small profit.

The results of the new acquisition are therefore positive and hold promise of operating profits in the short term.

[5] The witnesses for the appellant were Denis Charpentier, a chartered accountant, and the appellant himself. Louise Brisson, a tax law research officer, testified for the respondent.

[6] Mr. Charpentier is the appellant's accountant. He said that the appellant had consulted him when he purchased the land in 1988. The accountant belongs to a Montreal firm and has been, in particular, the accountant for the Union des producteurs agricoles and the Fédération des producteurs agricoles. He owns land in the appellant's area. In his opinion, the appellant's business is a commercial activity: the appellant was born on a farm; the land he purchased was a good size; moreover, he had the possibility of eventually acquiring the family's land. The appellant had to do major drainage work costing between \$25,000 and \$30,000 on the land he had purchased. That land is now much improved; it is well maintained and capable of yielding good harvests.

[7] The witness produced as Exhibit A-1 a table that he had prepared showing revenue and expenses for the appellant's farming activities for the years 1990 to 1999. The purpose of the table was to demonstrate that, if the appellant had not taken the depreciation to which he was entitled, the losses would have been almost minimal. On cross-examination, he acknowledged that the appellant had not taken the maximum capital cost allowance. There was no formal business plan either, but

there had been serious discussions concerning the possible return from the land. A positive return was possible, depending on the prices at which his crops could be sold.

[8] The appellant testified that he was born in 1956. He is married and has children aged 14, 12 and 6 years. He left school after Grade 10 to help his parents on the family dairy farm. His father died in 1978. The appellant continued to help his mother with farm chores. In 1984, his mother decided to sell the dairy cows because she did not want to make all the changes required by government authorities in order to bring the operation into compliance with the new standards. The family farm was thereafter used for large-scale production of corn, barley and soybeans.

[9] In 1988, the appellant purchased a 50-arpent property, next to his parents' land. According to the testimony at the hearing, an arpent is a unit of land area equivalent to 192 ft. by 192 ft. The appellant said he had greatly improved the land through irrigation work, the construction of buildings and the purchase of certain equipment. The crops raised were the same as those on his mother's land.

[10] Exhibit A-2 is a lease agreement, dated April 28, 2000, between the appellant and a farming business in the area for the years 2000 and 2001. The rent is \$150 per arpent. As the appellant has 95 arpents, the annual income is \$14,250. The agreement was entered in evidence to demonstrate that this land was considered by a farming business to be good land.

[11] In 1982, the appellant built his family residence. The evidence is not clear as to which land it was built on, but it must have been on the mother's land since, in 1982, the appellant had not yet purchased the land in question here. In 1998, he purchased his mother's land and she continued to live in the house.

[12] In 1994, the appellant began to work off the farm because his 50 arpents did not suffice to support his family. Before and after work and on weekends, he worked on the farm. The appellant explained that he had to augment his farm income with income from regular employment. He said that his fields were always well cultivated. He uses his own machinery for some of the work, but rents another farmer's services and machinery for the harvest.

[13] Every year, when he buys seed in May, in the summer and again in early autumn, he uses the consultation services offered by the businesses that sell agricultural products.

[14] Exhibits I-1 to I-5 are the appellant's statements of income and expenses for the years 1994 to 1998. Exhibit I-6 shows his income from the office of councillor that he held in the municipality of Saint-Simon, which was \$1,166.66 for 1994. Exhibits I-9, I-10 and I-13 are nearly identical statements for 1995, 1996 and 1997. Exhibit I-7 is the statement of the appellant's employment income for 1994 from the garage where he worked as a car washer. The amount of that income was \$24,868.73. Exhibits I-8, I-11 and I-12 are nearly identical statements for 1995, 1996 and 1997. Exhibits I-14, I-15 and I-16 are his employment records concerning his work as a farmer labourer for a farming operation in 1997 and 1998. In 1998, his total income from employment was \$25,440.

[15] A Revenu Québec questionnaire for farming operations showing constant losses was completed by the appellant in December 1997. It was produced in evidence as Exhibit I-17. The questions and answers for sections 2 and 4 are as follows:

[TRANSLATION]

SECTION 2

State the reasons for your continuous claims of losses.

The impossibility of making such a small operation profitable in current market conditions and given the direct costs.

...

SECTION 4

Since beginning your activities, what steps have you taken to develop your business and make it grow?

Everything has been done. The land has been carefully cultivated, drainage work has been carried out. But, once again, it is the size of the property.

...

What assets, property and immovables do you use in the course of your activities?

2 buildings used as sheds. 30' x 100' and 30' x 50'
2 grain silos
land, machinery

Please indicate the acquisition cost for these items and what percentage of your use of them is for:

- agricultural purposes 100% → \$60,000 land and building
in 1987
- employment purposes \$29,000 machinery
- personal purposes

If you own property and immovables, please indicate your sources of financing, the amounts of financing and the current outstanding balance.

Caisse Populaire St-Hugues: \$33,000 land
\$14,000 machinery

Indicate livestock inventory, if applicable.

None.

...

Did you conduct a profitability study before starting up your business?

[] Yes [✓] No

If yes, please provide supporting documents.

If no, indicate why you did not do so.

Initial purchase in 1987 with the objective of making further purchases within a reasonable time in order to build a profitable operation.

What changes or additions have you made to the farm since the commencement of your farming activities?

Primarily drainage.

Attach your balance sheet.

No balance sheet.

[16] In his Notice of Objection and in the questionnaire, the appellant indicated that the cause of his difficulties was the limited area of his land. Since 1998, when he purchased his mother's land, his farm income has been positive.

[17] Louise Brisson is a tax law research officer with the Quebec Department of Revenue. Her decision was based on the farm business's lack of profitability over the years and on the fact that the taxpayer had a 40-hour a week job and devoted only 20 hours a week to farming.

Argument

[18] Counsel for the appellant maintained that the appellant was not a gentleman farmer. The appellant has always been in farming, and farming is not a hobby for him. It is out of necessity that he has taken employment off the farm. While his losses are continuous, they are relatively small, especially if capital cost allowance is not taken into account. Taking capital cost allowance is a tax option allowed by the *Act* that should not be determinative of whether there is a reasonable expectation of profit. The appellant incurred expenses for drainage work which turned out to be very useful in improving the productivity of the land. There were no needless expenses. Counsel for the appellant referred to the decision of the Supreme Court of Canada in *Moldowan v. The Queen*, [1978] 1 S.C.R. 480, and to the decision of the Federal Court of Appeal in *The Queen v. Donnelly*, [1998] 1 F.C. 513. He referred to the following passage from page 486 of *Moldowan (supra)*:

Whether a source of income is a taxpayer's "chief source" of income is both a relative and objective test. It is decidedly not a pure quantum measurement. A man who has farmed all of his life does not cease to have his chief source of income from farming because he unexpectedly wins a lottery. The distinguishing features of "chief source" are the taxpayer's reasonable expectation of income from his various revenue sources and his ordinary mode and habit of work. These may be tested by considering, *inter alia* in relation to a source of income, the time spent, the capital

committed, the profitability both actual and potential. A change in the taxpayer's mode and habit of work or reasonable expectations may signify a change in the chief source, but that is a question of fact in the circumstances.

[19] Counsel for the respondent argued that the appellant did not spend all his time on farming. He devoted thereto only the time remaining after the 40 hours a week he put in on his off-farm job. He did not take the maximum capital cost allowance. Even though he took less than the maximum, his farming activities never showed a profit. This farming business had insufficient land. The taxpayer did not conduct preliminary profitability studies. There was an uninterrupted succession of business losses from 1988 to 1999. All these factors show that this is not a genuine farming business. Among the decisions referred to by counsel for the respondent were the same ones that had been cited by counsel for the appellant. From *Moldowan (supra)*, at pages 485 and 486, he quoted the following passages:

Although originally disputed, it is now accepted that in order to have a "source of income" the taxpayer must have a profit or a reasonable expectation of profit. Source of income, thus, is an equivalent term to business: *Dorfman v. M.N.R.*, [1972] C.T.C. 151. See also s. 139(1)(ae) of the *Income Tax Act* which includes as "personal and living expenses" and therefore not deductible for tax purposes, the expenses of properties maintained by the taxpayer for his own use and benefit, and not maintained in connection with a business carried on for profit or with a reasonable expectation of profit. If the taxpayer in operating his farm is merely indulging in a hobby, with no reasonable expectation of profit, he is disentitled to claim any deduction at all in respect of expenses incurred.

There is a vast case literature on what reasonable expectation of profit means and it is by no means entirely consistent. In my view, whether a taxpayer has a reasonable expectation of profit is an objective determination to be made from all of the facts. The following criteria should be considered: the profit and loss experience in past years, the taxpayer's training, the taxpayer's intended course of action, the capability of the venture as capitalized to show a profit after charging capital cost allowance. The list is not intended to be exhaustive. The factors will differ with the nature and extent of the undertaking: *The Queen v. Matthews* (1974), 74 D.T.C. 6193. One would not expect a farmer who purchased a productive going operation to suffer the same start-up losses as the man who begins a tree farm on raw land.

[20] Counsel for the respondent also referred to the decision of Judge Dussault of this Court in *Guimond c. La Reine*, [1999] T.C.J. No. 726, paragraph [11] (98-3854(IT)I, October 8, 1999):

Counsel for the respondent argued that not all of the expenses incurred in 1997 were claimed, so that the appellant showed an artificial profit. Thus, he said, the registration and gasoline expenses for two cars were about \$1,000 a year for the previous years, and they were in addition to the substantial maintenance and repair costs each year. He therefore questioned whether the total direct expenses related to the three cars was only \$1,144 for 1997. It should be noted that no wages were claimed as an expense during the years at issue. Nor did the appellant claim capital cost allowance or home office expenses.

[21] Counsel for the respondent submitted that the profit shown by the appellant for 1998—that referred to above in subparagraph 3(f) of the Reply—was similarly an artificial profit.

Conclusion

[22] The relevant portion of the definition of commercial activity in subsection 123(1) of the *Act* reads as follows:

. . . .

"commercial activity" of a person means
(a) a business carried on by the person (other than a business carried on without a reasonable expectation of profit by an individual

[23] Subsection 169(1) of the *Act* describes the method of calculating the input tax credit and the conditions applicable to that calculation. The goods or the service for which the input tax credit is claimed must have been used in the course of commercial activities, which is why it is important for an individual to operate a business that has a reasonable expectation of profit.

[24] In addition to the passage from *Moldowan (supra)* cited by counsel for the appellant, I refer to the following at pages 487 and 488:

In my opinion, the *Income Tax Act* as a whole envisages three classes of farmers:

(1) a taxpayer, for whom farming may reasonably be expected to provide the bulk of income or the centre of work routine. Such a taxpayer, who looks to farming for his livelihood, is free of the limitation of s. 13(1) in those years in which he sustains a farming loss.

(2) the taxpayer who does not look to farming, or to farming and some subordinate source of income, for his livelihood but carries on farming as a sideline business. Such a taxpayer is entitled to the deductions spelled out in s. 13(1) in respect of farming losses.

(3) the taxpayer who does not look to farming, or to farming and some subordinate source of income, for his livelihood and who carries on some farming activities as a hobby. The losses sustained by such a taxpayer on his non-business farming are not deductible in any amount.

[25] That decision and recent decisions relating to farming activities led me, in *Les Entreprises L. Clancy Inc. v. Canada*, [1998] T.C.J. No. 513, paragraphs [23], [24] and [25], to make the following analysis of the different classes of farmers:

A person who carries on mainly a farming business is someone whose major concern is farming, for whom farming constitutes his way of life. In actual fact, we are dealing in such a case with a genuine farmer or farming business. A genuine farming business, like a genuine farmer, is concerned with being profitable. A farming business may not be profitable some years or over a number of years. For those years, a genuine farming business is entitled to deduct all its losses. A genuine farmer can be identified by the fact that he will generally have been raised on a farm and/or will have taken courses directly related to farming and that he devotes himself entirely to farming in the hope of earning his living therefrom. Should his activity not be sufficiently profitable, he may augment his farming income through other economic activities.

Sometimes, people whose major occupational concern is not farming will be nevertheless be sufficiently interested in farming and invest enough effort and financial resources for their farming business to be considered a business for restricted farm loss purposes. I say may be considered a business for restricted farm

loss purposes because such an operation will only rarely be classified as a business for the purposes of sections 3 and 9 and paragraph 18(1)(a) of the Act. Since it is not the chief work activity, such business's profitability is not the primary objective and losses are usually substantial.

The last category consists of farming businesses that are carried on without regard to standard agricultural practice, without the knowledge required to carry on farming or without hiring people qualified in that particular field.

[26] To show that one must be cautious in assessing the profitability of a farming business in the case of a person who has always been in farming and is a genuine farmer, I refer now to the following comments by Robertson J.A. in paragraphs [19] and [20] of *Donnelly (supra)*, at pages 526 and 527:

In the end, *Graham* stands or falls on its unique facts. But there is at least one lesson that can be derived from the case. It seems to me that *Graham* comes closer to a case in which an otherwise full-time farmer is forced to seek additional income in the city to offset losses incurred in the country. The second generation farmer who is unable to adequately support a family may well turn to other employment to offset persistent annual losses. These are the types of cases which never make it to the courts. Presumably, the Minister of National Revenue has made a policy decision to concede the reasonable expectation of profit requirement in situations where a taxpayer's family has always looked to farming as a means of providing for their livelihood, albeit with limited financial success. The same policy considerations allow for greater weight to be placed on the capital and time factors under section 31 of the Act, while less weight is given to profitability. I have yet to see a case where the Minister denies such a taxpayer the right to deduct full farming losses because of a competing income source. Perhaps this is because it is unlikely a hog farmer such as Mr. Graham would pursue the activity as a hobby.

As is well known, section 31 of the Act is aimed at preventing "gentlemen" farmers who enjoy substantial income from claiming full farming losses: see *Morrissey v. Canada, supra*, at pages 420-423. More often than not it is invoked in circumstances where farmers are prepared to carry on with a blatant indifference toward the losses being incurred. The practical and legal reality is that these farmers are hobby farmers but the Minister allows them the

limited deduction under section 31 of the Act. Such cases almost always involve horse farmers who are engaged in purchasing or breeding horses for racing. In truth, there is rarely even a reasonable expectation of profit in such endeavours much less the makings of a chief source of income.

[27] It would appear, then, that, in the area of farm economics, profitability criteria are not in every respect the same as they are for other commercial undertakings. In a similar vein, I would like to refer to the analysis of Judge Beaubier of this Court in his decision in *Finch v. The Queen*, 2000 DTC 2382, allowing an appeal by a taxpayer farmer from western Canada. That taxpayer had also accumulated business losses over the years and he too had had to seek extra income off the farm. Judge Beaubier expressed surprise that the policy described by Robertson J.A. in *Donnelly (supra)* (cited in the preceding paragraph of these Reasons) as being that followed by the Minister was not adhered to in the *Finch* case. Judge Beaubier found that that case involved a genuine farmer who had had to take action in response to adverse economic conditions for farming and that there was no reason not to consider the farming activities as a business within the meaning of sections 3 and 9 of the *Income Tax Act*.

[28] In the case at bar, the appellant is also a genuine farmer. He was born on a farm and has always worked on farms. Since the income from his farming activities was inadequate to support his family, the appellant judged that it was necessary to augment his income with income from employment. It would be hard to fault him for doing so. Having said that, the income from the sale of the appellant's crops still seems reasonable in relation to expenses. It must therefore be considered that the business was managed in a reasonable manner. Capital cost allowance is a factor to be taken into account according to *Moldowan (supra)*, but, as counsel for the appellant indicated, taking capital cost allowance remains a tax choice that is permitted by the *Income Tax Act*. Another factor to consider according to *Moldowan (supra)* is the taxpayer's training and his intended course of action. The appellant is a farmer and it seems to me that the evidence has shown that the business was operated according to the standards usually applied to farming. There was no evidence to the contrary.

[29] I therefore find that the appellant's farming business was operated by him with a reasonable expectation of profit. Furthermore, it seems to me that, in the context of a farming business that is being managed normally, it would be unreasonable to disallow the input tax credits. In my opinion, one should be

cautious in assessing the commercial nature of an individual's business for the purposes of the *Act*. In my view, such an assessment should initially be conducted in terms of the *Income Tax Act*.

[30] The appeal is allowed, with costs.

Signed at Ottawa, Canada, this 17th day of November 2000.

"Louise Lamarre Proulx"

J.T.C.C.