Federal Court of Appeal

Cour d'appel fédérale

Date: 20110121

Docket: A-20-10
A-19-10

Citation: 2011 FCA 22

CORAM: **EVANS J.A.**
DAWSON J.A.
STRATAS J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

JOHN H. CRAIG

Respondent

Heard at Toronto, Ontario, on October 14, 2010.

Judgment delivered at Ottawa, Ontario, on January 21, 2011.

REASONS FOR JUDGMENT BY: EVANS J.A.

CONCURRED IN BY: DAWSON J.A.
STRATAS J.A.

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REASONS FOR JUDGMENT

EVANS J.A.

Introduction

[1] The Minister of National Revenue (Minister) appeals from a decision of the Tax Court of Canada (2009 TCC 617), in which Justice Hershfield (Judge) allowed an appeal by John H. Craig against the Minister's reassessments of his income tax liability for the 2000 and 2001 taxation years. These reasons apply to the appeals in respect of both years, and a copy will be inserted in Court File No. A-19-10.

[2] While earning most of his income in the taxation years 2000 and 2001 as a partner of a Toronto law firm, Mr Craig also had employment and investment income. In addition, he conducted a business comprising the buying, selling, breeding, and racing of standardbred horses. The Minister disallowed the losses deducted by Mr Craig in those years in respect of the horse business.

[3] Relying on subsection 31(1) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.), the Minister restricted Mr Craig's allowable deductions from horse operation to $8,750 for each year. As relevant to this appeal, subsection 31(1) provides as follows:

31. (1) Where a taxpayer's chief source of income for a taxation year is neither farming nor a combination of farming and some other source of income, for the purposes of sections 3 and 111 the taxpayer's loss, if any, for the year from all farming businesses carried on by the taxpayer shall be deemed to be the total of	(1) Lorsque le revenu d'un contribuable, pour une année d'imposition, ne provient principalement ni de l'agriculture ni d'une combinaison de l'agriculture et de quelque autre source, pour l'application des articles 3 et 111, ses pertes pour l'année, provenant de toutes les entreprises agricoles exploitées par lui, sont réputées être le total des montants suivants :
…	[…]

[4] It is agreed that Mr Craig's horse activities constitute "farming" for the purpose of section 31, and are a business and a source of income for tax purposes as defined by *Stewart v. Canada*, 2002 SCC 46, [2002] 2 S.C.R. 645. It is equally evident that, considered in isolation, the horse business was not Mr Craig's "chief source of income" in the taxation years in question.

[5] The issue in dispute in this appeal is whether "a combination of farming and some other source of income" (in this case, Mr Craig's law practice) constituted his "chief source of income". If

they did, section 31 does not apply, and he is not subject to the restrictions imposed by section 31 on the losses that a taxpayer may deduct from farming.

[6] The Minister bases his appeal on two grounds: first, the Judge applied the wrong legal test to determining whether Mr Craig's farm income could be combined with his law practice income; second, if the Judge did not err in his formulation of the relevant legal test, he misapplied it to the facts. For the reasons that follow, the Judge in my view erred in neither respect. Accordingly, I would dismiss the appeal.

Issue 1: Is this Court bound by *Gunn*?

[7] Counsel for the Minister says that the Judge erred in law in relying on *Gunn v. Canada*, 2006 FCA 281, [2007] 3 F.C.R. 57 (*Gunn*), as the primary basis for his conclusion that Mr Craig's chief source of income was a combination of the income from his farm and his law practice, regardless of whether the income from his law practice was subordinate to that from his horse operation. Counsel argued that *Gunn* is inconsistent with the decision of the Supreme Court of Canada in *Moldowan v. Canada*, [1978] 1 S.C.R. 480 (*Moldowan*), where it was held that a taxpayer can only combine farming income and some other, *subordinate* source of income in order to escape from section 31.

[8] Counsel for the Minister submitted that, in permitting a taxpayer to avoid the effect of section 31 by combining farming and non-farming income, even when the farming income was subordinate to the other, the Court in *Gunn* failed to follow *Moldowan*. This, counsel said, breached

the principle of *stare decisis* that stipulates that an intermediate appellate court is bound by decisions of the Supreme Court of Canada. Accordingly, *Gunn* was wrongly decided, and should not be followed. I do not agree.

[9] First, the argument that we should not follow *Gunn* does not fall within any of the exceptions to the general principle formulated in *Miller v. Canada (Attorney General)*, 2002 FCA 370, 220 D.L.R. (4th) 149 (*Miller*), that, in the interests of jurisprudential stability and certainty in the law, a panel of this Court is normally bound by its previous decisions.

[10] The Court in *Miller* (at para. 10) stated that the general principle does not apply when a previous decision of the Court was made without regard to a decision that it ought to have followed. In my view, this exception refers to a *per incuriam* decision by the Court. This is not the case here.

[11] Writing for the Court in *Gunn*, Justice Sharlow considered *Moldowan* at length and largely adopted its analytical framework. However, she departed from the aspect of *Moldowan* in question here. She held that farming may be combined with some other source of income so as to constitute a taxpayer's chief source of income for the purpose of section 31, even though, as between the two, farming was the subordinate source of income.

[12] Justice Sharlow justified her decision in *Gunn* on the basis of her analysis of the shortcomings of *Moldowan*'s requirement that farming be the predominant source of income before it may be combined with another. She grounded her criticisms of this aspect of the decision in the

history and objectives of section 31, the difficulties of applying it, its tendency to produce arbitrary results, and critical commentary by judges and others.

[13] In addition, Justice Sharlow relied on post-*Moldowan* pronouncements by the Supreme Court of Canada on statutory interpretation, particularly warnings against reading words into a statutory text (in this case, the requirements that farming must be the "major preoccupation" of the taxpayer, and that the other income must be from a "subordinate" source), and failing to give the words of a taxation statute their straightforward meaning ("a combination of farming and some other source of income").

[14] *Gunn* was thus anything but a *per incuriam* decision: relevant precedents were not "overlooked". Similarly, the Court in *Miller* (at paras. 11- 17) rejected the argument that the decision of a previous panel of the Court was not binding because it had failed to take account of previous jurisprudence of the Supreme Court of Canada. This Court pointed out that the previous panel clearly had considered that jurisprudence; the appellant's essential complaint was about the way in which this Court had applied it.

[15] Second, counsel for the Minister relied on the statement by Lord Greene M.R. in *Young v. Bristol Aeroplane Co. Ltd*., [1944] K.B. 718 (Eng. C.A.) at 729, that the English Court of Appeal is not bound by a decision of its own that "cannot stand with a decision of the House of Lords". However, it is clear from a statement earlier in the judgment (at 725) that Lord Greene was referring to a decision of the House of Lords *subsequent* to the impugned decision of the Court of Appeal: see

also T. Prime and G. Scanlan, "*Stare Decisis* and the Court of Appeal: Judicial Confusion and Judicial Reform?" (2004), 23 *Civil Justice Quarterly* 212 at 213; and see Rupert Cross and J.W. Harris, *Precedent in English Law*, 4th edn. (Oxford: Clarendon Press, 1991) at 145-48, noting, however, that some judges have extended Lord Greene's exception to include inconsistency with prior decisions of the House of Lords.

[16] Since *Moldowan* was decided before *Gunn*, we are not at liberty to depart from *Gunn* on the ground that it has been overruled by the Supreme Court of Canada.

[17] Third, a decision by a panel of this Court on the precedential effect of a prior decision by the Supreme Court of Canada deserves as much respect from a subsequent panel of this Court as a decision by a previous panel on any other question of law. It was stated in *Miller* (at para. 22) that a previous decision by a panel of this Court on the interpretation of the *Canadian Charter of Rights and Freedoms* should be no more readily reversed than a decision concerning some other aspect of the law. I can think of no reason why *Gunn*, a decision of this Court dealing with a previous decision of the Supreme Court of Canada in a non-Charter case, should be treated as having less precedential effect than a case dealing with the Charter. The interests of certainty and stability in the law are equally applicable here.

[18] Fourth, on the assumption that this Court may depart from its previous decisions that it believes to be manifestly wrong in a sense not itemized in *Miller*, I am not persuaded for the reasons given by Justice Sharlow that *Gunn* is such a decision. Indeed, before us, counsel for the Minister

paid tribute to what she called the “brilliant analysis” of Justice Sharlow in *Gunn.* Counsel also conceded in her memorandum of fact and law (at para. 46) that, in view of subsequent decisions from the Supreme Court of Canada on the interpretation of taxation statutes, the aspect of *Moldowan* in question here might be decided differently today.

[19] Counsel’s principal complaint was that reassessing *Moldowan* was exclusively the responsibility of the Supreme Court of Canada. In effect, *Gunn* anticipated the reversal by the Supreme Court of Canada of one of its prior decisions, even though there may be little room, if any, for an intermediate appellate court to engage in anticipatory reversal of the court of last resort: see, for example, Debra Parkes, “Precedent Unbound? Contemporary Approaches to Precedent in Canada” (2007), 32 *Man. L.J.* 135 at 144-46; see, however, Bradley Scott Shannon, “Overruled by Implication” (2009), 33 *Seattle University L. Rev.* 151, doubting an appellate court’s duty to follow a Supreme Court decision which it concludes that the Supreme Court has impliedly overruled.

[20] Fifth, judge-made rules relating to precedent are not like other legal rules, in the sense that the Supreme Court of Canada does not reverse the decision of an intermediate appellate court on the ground that it failed to follow the principle of *stare decisis*. Rather, when the Supreme Court grants leave to appeal, the question before the Court will be whether the lower court’s decision is consistent with substantive law, including extant decisions of the Supreme Court, or whether the Supreme Court should modify its own jurisprudence on the point.

[21] In *Phoenix Bulk Carriers Ltd. v. Kremikovtzi Trade*, 2007 SCC 588, [2007] 1 S.C.R. 588, the Supreme Court chose to express no opinion on the merits of the practice whereby this Court normally regards itself bound by one of its prior decisions, even though it would have reached a different result. The Supreme Court allowed the appeal on the substantive ground that the earlier decision of this Court had been wrongly decided.

[22] To summarize, I am not persuaded that the Judge made any error of law in applying the somewhat more flexible and generous test in *Gunn* for determining the circumstances in which section 31 permits farming and non-farming income to be combined so that farming is a taxpayer's chief source of income.

[23] I would only add that, if it had been material to the decision, I doubt if I would have agreed with the Judge's conclusion that, even on the strict *Moldowan* test, Mr Craig's income from his horse business when combined with that from his law practice constituted his chief source of income in 2000 and 2001.

Issue 2: Did the Judge misapply *Gunn*?

[24] On the assumption that the Judge correctly identified *Gunn* as the legal test, the Minister argues that he erred in concluding that the facts of the present case satisfied it. I do not agree.

[25] In extensive reasons, the Judge carefully considered the facts of the present case (which are fully set out in his reasons for decision, are not in dispute, and need not be repeated here), and

compared them with those of other cases to which counsel directed him. He concluded on the basis of the factors and analytical framework set out in *Gunn* that farming constituted a significant part of Mr Craig's income in 2000 and 2001, and was more than a "sideline business". Hence, section 31 did not apply.

[26] The facts of this case may be fairly close to the line, and I might not have made the same decision as the Judge. However, I cannot say that his decision is based on a palpable and overriding error warranting the intervention of this Court.

[27] Counsel for the Minister essentially sought to reargue before us the case that she had lost at trial and to invite us to reweigh the factors considered by the Judge. However, the Supreme Court of Canada made clear in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 3 S.C.R. 235 at paras. 28-36, that it is not normally the function of an appellate court to second guess a trial judge's application of the law to the facts. Thus, in the absence of a palpable and overriding error in the application of the test, or of an error of law in formulating it, neither of which the Minister has demonstrated is present here, there is no basis for the Court to intervene.

Conclusion

[28] For these reasons, I would dismiss the appeal with costs.

"John M. Evans"

"I agree
Eleanor R. Dawson J.A."

"I agree
David Stratas J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-20-10 A-19-10

(APPEAL FROM A JUDGMENT OF THE HONOURABLE JUSTICE J.E. HERSHFIELD DATED DECEMBER 17, 2009, NOS. 2007-3040(IT)G, 2008-869(IT)G)

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DATED:	January 21, 2011

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