
The Qualities of a Judge

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INTRODUCTION

There are many qualities that a “good” judge should possess. Among these are intelligence, experience, an independent mind, clarity of thought, patience, knowledge of the law, skepticism, and humanity. Nevertheless, judges, being human, may lack one or more of these qualities, but they may still be able to carry out their duties effectively provided that they have a reasonable level of intelligence.

There can be little doubt, however, that the two most important qualities that a “good” judge must possess are good judgment and impartiality.

It is clear to anyone who has read and examined the judgments of former Chief Justice Bowman, or appeared before him, that he is scrupulously impartial and exhibits good judgment and common sense. Of course, “good judgment” and “common sense” may be qualities that in practice are often essentially synonymous.

It has been said that common sense is one of the most uncommon qualities to be found in humans, but in the case of Bowman J, it is patently clear that common sense is one of his great strengths. This conclusion can be drawn from dealing with

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him in or out of a court room, or by carefully reading his judgments as they relate to the many areas of law with which he has dealt.

I intend to review and compare two areas of the law where Bowman J's judgments have been important and reflect both his impartiality and good judgment. It should first be remembered, however, that Donald Bowman had the good fortune to have been able to spend a significant amount of time practising law on both sides of the tax fence. For the first 9 years of his professional career, he was a Department of Justice lawyer and argued many cases for the Crown. He then joined the highly regarded firm of Stikeman Elliott and was assigned the task of starting and developing the firm's office in Toronto. He spent the next 20 years building that office into one of Toronto's leading law offices. Clearly, he has spent a considerable amount of time on both sides of tax disputes and has a deep understanding of each side's objectives and difficulties.

As a Tax Court judge, Bowman J made an enormous contribution to Canadian tax jurisprudence in general. In at least two areas of Canadian tax law, however, his judgments were of particular importance because of their impact on many Canadian taxpayers and the tax administration. These two areas can generally be described as the reasonable expectation of profit (REOP) cases and the interest deductibility cases. As we shall see, in the REOP cases, it is clear that his decisions had a very significant impact on the Supreme Court of Canada and, ultimately, on the tax administration. In the interest deductibility cases, the Supreme Court of Canada did not adopt his approach, but his judgments in those cases are still of significant importance.

REOP CASES

Starting sometime in or about the early 1990s, the Canada Revenue Agency (CRA) started to wield an old weapon to prevent taxpayers from deducting losses that arose in a broad series of circumstances, ranging from legitimate business operations that had failed to aggressive tax-avoidance schemes that produced tax losses but had few, if any, real business objectives. That weapon was the reasonable-expectation-of-profit test, which previously had been used mainly to prevent would-be and sometimes real farmers from claiming deductions for expenses and losses to which the CRA believed they were not entitled.

The REOP test really came to light in *Moldowan v. The Queen*,¹ decided by the Supreme Court of Canada in 1977. It was not until the 1990s, however, that the CRA started to apply the REOP test to a wide variety of activities carried out by taxpayers. The common thread that ran through these cases was that the taxpayer engaged in an activity that resulted in a loss and took the position that the loss was incurred in the carrying on of a business and was, therefore, deductible in computing income from any source. The CRA always took the position that the activity was one that could not reasonably be expected to result in a profit and that, therefore, the taxpayer

1 77 DTC 5213 (SCC).

was not entitled to deduct the loss that resulted therefrom in computing income from other sources.

Bowman J decided more than 75 cases involving the application of the REOP test by the CRA. His pragmatic and commonsense approach to these cases is clearly evident in his judgments.

Allen

In *Allen et al. v. The Queen*,² the taxpayers invested in units of a limited partnership that carried on the business of renting apartments. The CRA, however, invoked the REOP test because the financing arrangements for the investment involved the payment of interest that exceeded the income from the limited partnership.

Bowman J had no difficulty in concluding that the taxpayers had a reasonable expectation of profit and distinguished their activities from those of taxpayers who simply carry on a hobby. His findings—clear, simple, and patently sensible—were as follows:

Whatever else may be said about 99% financing of an investment, it certainly cannot be said that its result is that the vehicle in which the taxpayer has invested did not carry on a business. *This is wrong as a matter of logic, law and common sense. . . .*

Where there is no personal element and a genuine business exists the NREOP doctrine has no application. . . .

To use it to restrict the deduction of interest that is specifically permitted by paragraph 20(1)(c) ignores not only the plain meaning of that paragraph, but the highest pronouncements as to the purpose of the interest deduction: *Tennant v. The Queen*, 96 DTC 6121 at 6125 (S.C.C.). *If the Government of Canada wishes to limit the extent to which business and investments may be financed with borrowed money, the NREOP principle is not the way to do it.*³

Nichol

In *Nichol v. The Queen*,⁴ the taxpayer was a successful business executive who operated a semi-professional baseball team at a loss. Bowman J found that the REOP doctrine was not applicable because

[t]he planning and projections of the London Royals had too many of the badges of trade and, if I may say so, the *indicia* of commerciality to be dismissed as a mere hobby or an idealistic labour of love. . . .

He [the taxpayer] made what might, in retrospect, be seen as an error in judgment but it was a matter of business judgment and it was not one so patently unreasonable as to entitle this Court or the Minister of National Revenue to substitute its or his judgment for it, or penalize him for having made a judgment call that, with the benefit

2 99 DTC 968 (TCC).

3 *Ibid.*, at paragraphs 22, 25, and 26 (emphasis added).

4 93 DTC 1216 (TCC).

of 20-20 hindsight, that Monday morning quarterbacks always have, I or the Minister of National Revenue might not make today. We were, after all, not there in 1986.⁵

Bélec

In *Bélec v. The Queen*,⁶ the appellant purchased a building, which he divided into three rental units. For the first two years of operation, the appellant realized losses and then, in the third year, he sold the building. The question was whether the appellant was entitled to deduct the losses. Bowman J said:

It is not up to the Minister (or this Court) to substitute his business acumen for that of the taxpayer, with the benefit of hindsight. The question to be asked is not, "Knowing what I know now, would I have embarked upon this enterprise?" The answer is no doubt "No," because the question only comes up when there are losses. The question should rather be: "In view of what the taxpayer knew or, as a reasonable man, ought to have known, was it reasonable for him to expect that he could make a profit, not necessarily at the beginning, but within a reasonable period of time?" . . .

It would be equally unacceptable to permit the Minister to disallow the deduction for losses at the beginning of a business's activities on the assumption that there was no reasonable expectation of profit, and then, after the business succeeded, to demand part of the profits as taxes by saying to the taxpayer "The fact that you lost money when you began the business proves that you did not have a reasonable expectation of profit, but as soon as you earn some money, it proves that you have now such an expectation."⁷

Influence on Decisions of the Supreme Court of Canada

Bowman J's comments in the *Allen, Nichol*, and *Bélec* cases typify his approach to the REOP issue and, in fact, typify his general approach to the resolution of disputes. His comments have a "plain meaning," can be easily understood, and reflect the exercise of good judgment and common sense. If the taxpayer's activities had an element of commerciality, Bowman J was clearly reluctant to recharacterize such activities as something other than the carrying on of a business.

All of this may seem obvious today, particularly in light of the fact that the Supreme Court of Canada ultimately adopted Bowman J's approach to the REOP cases in its judgments in *Brian J. Stewart v. The Queen*⁸ and *The Queen v. Walls et al.*⁹ In the reasons for judgment in the *Stewart* case, the Supreme Court relied heavily on Bowman J's reasoning in *Allen, Nichol*, and *Bélec*.

It is easy to forget, however, that before the Supreme Court of Canada ruled on the matter, some courts had strayed a long way from Bowman J's practical, common-sense approach.

5 Ibid., at 1218 and 1219.

6 95 DTC 121 (TCC).

7 Ibid., at 123.

8 2002 DTC 6969 (SCC).

9 2002 DTC 6960 (SCC).

For instance, in the case of *C. Landry v. Canada*,¹⁰ the taxpayer was a lawyer who returned to the practice of law in 1979 at the age of 71 years, after a 23-year absence. He carried on his practice without a budget, without keeping records of billings or books of account, without looking for clients, and sometimes not billing at all. In the decision of the Federal Court of Appeal, Décary J said (first quoting from the Supreme Court of Canada's decision in *Moldowan*):

I see no reason why the reasonable expectation of profit test should not apply to any profession, liberal or otherwise, any occupation or activity which purports to be in the course of carrying on a business. *As I see it, the reasonable expectation of a profit is a general rule applicable to any activity which may give rise to business income. . . .*

These comments and conclusions appear to me to be immune to any criticism and are not in any way open to judicial review. . . .

There comes a time in the life of any business operating at a deficit when the Minister must be able to determine objectively, after giving someone a head start for a number of years, as the case may be, that a reasonable expectation of profit has turned into an impossible dream.¹¹

One may hazard a guess that this kind of judicial pronouncement would not impress Bowman J, because it reflects a willingness on the part of the court to allow the minister to determine that a business that is losing money should be terminated when the minister determines that the business is not likely to make a profit.

In short, although the proper use of the REOP test has long been settled by the Supreme Court of Canada, Bowman J's role in helping the court to reach that conclusion cannot be overstated. His findings in the REOP cases reflected his good judgment and commonsense approach in resolving disputes, and that approach was ultimately adopted by the Supreme Court of Canada.

INTEREST DEDUCTIBILITY CASES

Whereas in the REOP cases, Bowman J, more often than not, found in favour of the taxpayer, the opposite is true in the interest deductibility cases. As in the case of REOP, interest deductibility is an issue that often comes before the courts, but, unlike REOP, it continues to be of great concern to taxpayers and in the last few years has received considerable judicial attention.

Although the Supreme Court of Canada appears to have followed Bowman J's lead in the REOP cases, it has clearly not done so in the interest deductibility cases. Instead, the Supreme Court has adopted a more taxpayer-friendly approach to the deductibility of interest than did Bowman J.

10 [1994] 1 CTC 2049 (TCC).

11 94 DTC 6624, at 6625 (FCA), quoting from *Moldowan*, supra note 1.

Mark Resources

In *Mark Resources Inc. v. The Queen*,¹² a Canadian company owned all of the shares of a US subsidiary that had losses. The Canadian company borrowed money from a Canadian bank and on the same day used the borrowed money to make a capital contribution to the US subsidiary. The US subsidiary invested the money in a term deposit and the subsidiary used its losses to offset the interest income earned by the subsidiary. Dividends were then paid by the US subsidiary to the Canadian parent out of the interest earned on the term deposit.

The effect of this series of transactions was that the US subsidiary was able to utilize its losses and avoid US income tax on the interest income, while the Canadian parent deducted the interest it paid to the Canadian bank in computing its income for Canadian tax purposes. The CRA, however, disallowed the deduction claimed by the Canadian company in respect of the interest paid to the Canadian bank. The Canadian company appealed to the Tax Court.

Bowman J dismissed the appeal on the basis that, on a careful examination of the series of transactions, it was clear that the overall purpose of the transactions was to enable the US subsidiary to utilize its losses.¹³ Bowman J appears to have rejected the arguments made on behalf of both the appellant and the respondent as to the purpose for which the borrowed money was used. He said:

I think they [the appellant's and the respondent's arguments] are both based on a logical fallacy and they attribute to one event in the series a purpose based upon the immediately subsequent event. The true purpose is a broader one that subsumes all of the subordinate and incidental links in the chain. *The overriding ultimate economic purpose for which the borrowed funds were used was to permit the U.S. losses of PDI to be, in effect, imported into Canada and deducted in computing PDL's income. . . .*

The direct and immediate use was the injection of capital into a subsidiary with the necessary and intended consequence that the subsidiary should earn interest income from term deposits from which it could pay dividends. The earning of dividend income cannot, however, in my opinion, be said to be the real purpose of the use of the borrowed funds.¹⁴

In finding against the taxpayer, Bowman J applied a commonsense approach and determined that the “real” purpose of the borrowing was not to pay dividends to the parent company, but rather to enable the US subsidiary to utilize its tax losses against income that, in the absence of the scheme, would have been subject to Canadian tax in the hands of the Canadian company.

12 93 DTC 1004 (TCC).

13 Bowman J had no difficulty in first concluding that the interest deduction claimed by the taxpayer was not prohibited by old subsection 245(1).

14 *Supra* note 12, at 1011 and 1012 (emphasis added).

Singleton

In *The Queen v. Singleton*,¹⁵ the taxpayer, a partner in a law firm, had a capital account of at least \$300,000 with the firm. This capital had been contributed out of the taxpayer's own resources and not from borrowed funds. Although there was some confusion as to the facts, it appears that the taxpayer withdrew the \$300,000 of equity in the law firm and used these funds for the purchase of a house. The taxpayer then borrowed \$300,000 from the bank and paid this amount back into his capital account at the law firm. He claimed a deduction for interest on the borrowed funds, but the CRA disallowed the deduction.

Bowman J dismissed the taxpayer's appeal to the Tax Court of Canada on the basis that the true economic purpose for which the borrowed money was used was to purchase a house and not to make a contribution of capital to the law firm. In coming to this conclusion, Bowman J said:

I am basing my decision on the fact that, even if one accepts the legal validity of the steps that were taken and also treats the obvious tax motivation as irrelevant, one is still left with the inescapable factual determination that the true economic purpose for which the borrowed money was used was the purchase of a house, not the enhancement of the firm's income earning potential by a contribution of capital.¹⁶

The taxpayer's appeal to the Federal Court of Appeal was allowed (Linden J dissenting),¹⁷ and the Crown's appeal from that judgment was dismissed by the Supreme Court of Canada.¹⁸ The Supreme Court held that the Tax Court judge applied the wrong legal test when he looked for the "true economic purpose." The court concluded that the transactions must be viewed independently rather than as parts of one transaction, and on this basis the taxpayer satisfied the test of deductibility set out in subparagraph 20(1)(c)(i) of the Income Tax Act.¹⁹ That is, the borrowed money was used for the purpose of earning income from a business.

In the court's decision, the majority stated:

In my respectful opinion, it is an error to treat this as one simultaneous transaction. In order to give effect to the legal relationships, the transactions must be viewed independently. When viewed that way . . . what the respondent did in this case was use the borrowed funds for the purpose of refinancing his partnership capital account with debt. This is the legal transaction to which the Court must give effect.²⁰

15 96 DTC 1850 (TCC).

16 *Ibid.*, at 1853.

17 99 DTC 5362 (FCA).

18 2001 DTC 5533 (SCC).

19 RSC 1985, c. 1 (5th Supp.), as amended.

20 *Supra* note 18, at paragraph 34.

In both *Mark Resources* and *Singleton*, Bowman J focused on the true business nature of the transaction in question. In *Mark Resources*, he refused to treat the transaction as simply the borrowing of funds to provide capital to a subsidiary company. Rather, he concluded that the true nature of the transaction was an attempt to use the losses of the US subsidiary to shelter income earned by the taxpayer in Canada. In *Singleton*, he concluded that the taxpayer simply needed funds to buy a house and devised a series of steps that permitted him to argue that the funds had been borrowed in order to make a contribution at his law firm.

The decision in *Mark Resources* was not appealed. In the appeal of *Singleton*, the Supreme Court ultimately rejected Bowman J's emphasis on examining and determining the true purpose of the transaction; rather, it found in favour of the taxpayer on the basis that the direct use of the money borrowed was to make a capital contribution to the law firm.

CONCLUSION

Whether one agrees or disagrees with Bowman J's decisions in the REOP and interest deductibility cases, there is little doubt that he was absolutely indifferent and impartial as to where his reasoning would lead him. The outcome—whether in favour of the taxpayer or the minister—had no influence on his reasoning, and that reasoning always reflected his clarity of thought, good judgment, and common sense, as well as his absolute impartiality.