Judicial Confessions or How I Learned to Love the *Income Tax Act*

by

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[Speaking notes for an address to the annual meeting of the Ontario Bar Association, Tax Law Section, in Toronto on June 10, 2011]

I am not sure who was more surprised that I was invited to speak to this prestigious gathering of many of the country's leading tax lawyers: me or my colleagues, Justices Noël and Sharlow, our two tax gurus. Needless to say, as good colleagues will, they urged me to come, saying that I had written some interesting tax decisions. Now, I know enough to understand that "interesting" may not be exactly the highest praise for a judge in this area of the law, where certainty and predictability represent the gold standard.

Most important, though, I want to thank the organizers of today's program for their kind invitation and for permitting me to introduce myself to an audience who, if they know me at all, might know me only as a name on judgments of the Federal Court of Appeal.

Let me start in confessional mode. Few judges of our Court can have come to the Bench with thinner credentials than mine for pronouncing on the most challenging tax law issues to be litigated in Canada. As a law student in Oxford in the 1960s I took no course in taxation law, for the very good reason that none was offered. English legal

education at that time, particularly at Oxford and Cambridge which saw themselves as educating future leaders of Bar and Bench, virtually ignored areas of the law dominated by statute. Company law was not offered at Oxford either. They were not "subjects" based on organizing principles elaborated case-by-case by judges in prose more literary than that found in the statute book, and therefore suitable for study by tender minds.

Nor did my experience as a Canadian taxpayer do much to enlighten me about tax. My personal finances were sufficiently simple that the only help I needed come tax time was Revenue Canada's instructions on completing the form. At Osgoode, my office for many years was next door to Neil Brooks's, but I never felt tax vibes reaching me through the wall. In fact, I can confess right now that, before being given responsibility for adjudicating tax disputes, I thought GAAP was where my children bought clothes and I had never as much as opened the *Income Tax Act*!

Not surprisingly, then, my first judicial venture into the mysteries of tax law as a Judge of the Federal Court-Trial Division (as the Federal Court then was) was not auspicious. The case concerned a Mr Markevich[1], who owed about three quarters of a million dollars in tax, but argued that he did not have to pay it because Revenue Canada had delayed in taking collection measures and was caught by the limitation period in the *Crown Liability and Proceedings Act.* I took the view that the *Income Tax Act* was, in this respect, a complete code and that Mr Markevich had to be a *mensch* and pay his taxes.

When Justice Rothstein, then of the Federal Court of Appeal, called me, with his usual kindness, to say that the Federal Court of Appeal had taken a different view of the matter (such a diplomatic way of saying you're wrong!), he added that the case had turned on a dime. However, when the Supreme Court upheld the unanimous FCA 9-0, I realized this "turn on a dime" phrase was just another of Marshall's ways of letting colleagues down gently after demonstrating the errors of their ways!

After being reversed in *Markevich* by a grand total of 12-0, I felt that my judicial career in tax could only be upwards. Indeed, I can say with some pride that I have not been reversed in a tax case since, in large part, no doubt, because, as a judge of the Federal Court of Appeal, there are fewer opportunities for being reversed. Indeed, a case that I dispatched orally from the Bench in four short paragraphs (*Canada v. Canada Trustco Mortgage Co.)*[2] was actually upheld by the Supreme Court, but not from the Bench, nor in four pithy paragraphs either, I may add.

Three tax cases that I have been associated with recently have received or are about to receive the attention of the Supreme Court: *Copthorne*, *Zen,* and *Craig*.

Copthorne Holdings Ltd. v. Canada[3] is a GAAR case. The reasons were written by our much admired former colleague, Michael Ryer, who is very learned in the law of taxation and was very generous in taking time to answer questions from less learned colleagues like me. *Copthorne* was argued in the Supreme Court on January 21, 2011, and we are awaiting the decision.

In *Zen v. Canada*[4] we held that the section of the ITA providing that interest accruing on an assessed tax debt may be collected without a further notice of assessment can also be applied to interest accruing on the assessed joint and several vicarious liability of a director for the corporation's tax debt, including interest that accrued after the assessment.

We were able to reach this sensible result thanks to the phrase in the relevant statutory provision "with any modifications that circumstances require". In January, the Supreme Court denied leave to appeal. This isn't exactly like being upheld, of course, but I think I shall enter it in my win column any way!

Canada v. *Craig*[5], concerned subsection 31(1) of the ITA which limits the losses deductible from a part-time farm business. Mr Craig, a Toronto lawyer in his day job, also had a horse breeding, training and racing business which was not the predominant source of his income in the years in question. We were asked by the Crown not to follow the earlier decision of our Court in *Gunn*, where, we were in effect told by counsel for the Crown, Justice Sharlow had "gone rogue" and refused to follow the Supreme Court's decision in *Moldowan v. the Queen*[6].

As many of you will recall, *Moldowan* deals with the reach of ITA, subsection 31(1), which artificially limits the amount of losses that can be deducted from a farming business, when farming, either alone or combined with another source of income, is not the taxpayer's chief source of income. In

particular, *Moldowan* held that, for the purpose of determining whether farming is a taxpayer's chief source of income so as to enable the taxpayer to claim full losses from the farming business, farming income can only be combined with another source when that other source iss subordinate to the farming income.

In *Gunn*, Justice Sharlow had held that farming and non-farming incomes could be combined under subsection 31(1), even though farming was not the taxpayer's "major occupation" and the other income source was not subordinate to farming. She reached this result on the basis of critical commentary on this aspect of Justice Dickson's judgment in *Moldowan*, her own analysis of the shortcomings of *Moldowan* in light of the legislative history and the statutory text, and subsequent admonitions from the Supreme Court against reading words into the ITA: section 31 simply does not say that sources of income can be combined only when farming is the predominant source.

Not surprisingly, *Gunn* has caused problems for the Tax Court; some Judges have felt bound to follow it, while others have followed *Moldowan.* In *Craig,* we characterized what Justice Sharlow did in *Gunn* as an anticipatory overruling of a 30-year old decision in the light of contrary subsequent Supreme Court jurisprudence. It is, of course, difficult to reconcile the practice of anticipatory overruling of the Supreme Court by an intermediate appellate court with a strict application of the doctrine of *stare decisis*.

Nonetheless, in *Craig* we followed *Gunn*, fundamentally because we were not persuaded that, *Moldowan* apart, there was anything wrong with Justice Sharlow's

analysis. After all, the Supreme Court does not decide cases on the basis that the lower court misapplied *stare decisis*. There was thus no basis for departing from the general principle established in *Miller*,[7] that this Court normally follows its own previous decisions.

The Crown has applied for leave to appeal, which I expect to be granted: the Supreme Court is the proper forum for settling the issue and for bringing stability to the law. Incidentally, unlike in *Gunn*,we did ***not*** say in *Craig* that the result would have been the same if the strict *Moldowan* test had been applied. While predicting Supreme Court decisions is as hazardous as predicting new appointees to the Court, I expect the Court to decide the *Moldowan v. Gunn* dispute in favour of *Gunn*, and to dismiss the Crown's appeal from our decision in *Craig*.

So, how did a judge of the Federal Court of Appeal progress from a tax law ignoramus to at least a passable tax law faker? Answer: with a lot of help. I have already indicated that members of our Court generously share their expertise with less knowledgeable colleagues. I want to say something about three other important sources of support for judges, like me, coming new to the complexities of taxation law: the Tax Court, the Bar and general legal experience.

Tax Court of Canada

It is an open secret among judges that trial courts do the bulk of the heavy judicial lifting in any system for the administration of justice. They sift through the evidence to

make the findings of fact (often the hardest part of judging), do the initial legal analysis necessary to identify the applicable law, and then apply that law to the facts. *Housen v. Nikolaisen*[8] properly instructs appellate courts that they may normally only interfere with a judge's findings of fact, and the application of the law to those facts, if the judge made a palpable and overriding error. Hence, it is difficult for an appellant to persuade us that we should interfere with the Tax Court's finding of fact or its application of the law to the facts found.

Only on questions of law do appellate courts review to see if the trial court judge got it right. Thus, correctness is the standard of review applied by our Court to the Tax Court Judge's interpretation of the relevant statutory provision, and any more general question of law that can be readily extricated from its application to the facts.

I am very well aware of the challenges facing judges of the Tax Court as finders of fact, whether it is in dealing with the shoe boxes of receipts sometimes handed up by the self-represented, or in describing the complex commercial and corporate transactions in a tax-driven scheme. And although we review *de novo* Tax Court judges' interpretation of the statutory provisions relevant to the case, we are always assisted by the fact that someone else has had the first crack at the analysis.

In my experience, the work of the Tax Court is of a generally high quality. Their reasons are typically succinct, carefully thought out, and well crafted. They tell the losing

party in language that they will understand why they lost, and enable our Court to perform its appellate role.

The statistics are revealing. In the years 2005-2010, on average only 1.5% of all the decisions rendered by the Tax Court were appealed to our Court (**Table 1**). This figure is somewhat misleading, however, because "decisions" of the Tax Court include interlocutory orders, directions, and judgments entered without a contested hearing. I am told that only 10% to 15% of those "decisions" are final judgments rendered after a contested hearing. Of these, the percentage appealed tends to be no more than 10-12%. On the other hand, in this same period appeals from the Tax Court represented almost 30% of our total case load (**Table 2**). In the years 2005 to 2010, we gave final judgment in an average of 100 appeals a year from the Tax Court, with some indication that the trend may be upwards (**Table 3**). These figures come from the Courts Administration Service and may be found in Tables in an Appendix to this paper.

I have less complete data on the percentage of appeals from the Tax Court that are allowed by the Federal Court of Appeal. Suffice it to say that of the appeals from the Tax Court decided by our Court in the calendar years 2007-2009, the Court granted on average 25% of the appeals, which seems to me to be relatively low.

Here are three lessons from these statistics. First, the vast majority of those who lose their appeal in the Tax Court are sufficiently accepting of the decision that they do not appeal further. Second, when appellants do appeal, they have no more than a 1 in 4

chance of succeeding, which again suggests that the Tax Court is doing a good job. Third, the Federal Court of Appeal is peripheral to the overall work of the Tax Court, but the Tax Court is an important source of our case load.

The program organizers suggested two issues concerning the Tax Court that I might address. First, do we need an intermediate appellate court between the Tax Court and the Federal Court of Appeal? Speaking entirely for myself, I see no reason to create another layer of appeal, with its inevitable expense and delays in the resolution of disputes, except, of course, to provide more work for lawyers. One appeal as of right is the norm in our judicial system.

The Federal Court of Appeal has no difficulty handling the present volume of appeals from the Tax Court, and there are minimal delays in scheduling hearings. The only scheduling complaint we hear most often from lawyers is that their case is coming on too quickly after the appeal is perfected!

Second, should the jurisdiction of the Tax Court be expanded to include decisions that can currently only be challenged in the Federal Court on an application for judicial review, or in the Federal Court of Appeal? Examples include the exercise of Ministerial discretion in granting relief from interest and penalties, and the revocation of charitable registration.

In my view, there is a lot to be said for putting into one court all proceedings connected with the administration of federal taxation. This would make things easier for litigants, who would not have to consider which court has jurisdiction over their particular matter. “One stop shopping” is nearly always more efficient.

However, the more controversial question is in what court should consolidation take place. Some say that the Tax Court should be given plenary and exclusive jurisdiction over all tax disputes. Others argue, however, that the Tax Court should be folded into a single federal trial court, which already exercises a broad judicial review jurisdiction. I will only say that my instinct for self-preservation saves me from wading further into this particular minefield!

The Bar

Lawyers underestimate how much judges rely on them for their understanding of the facts of a case and the applicable law. In my experience, it is comparatively rare that judges come up with a way of looking at a case that counsel have not already put before us. Judges who are not already steeped in the mysteries of tax law particularly need the assistance of counsel: to clearly identify the issues to be decided; to take the court step by step through the transactions underlying the assessment; and to give the legal context of the dispute.

Counsel on both sides typically do a very good job: some are absolutely outstanding. My impression is that, increasingly, counsel who appear in our Court are specialist tax litigators, who do not have to rely on a “note passer” to help them to answer

questions from the Bench. Lawyers who combine the skills of the advocate with a deep substantive knowledge of tax law are, quite rightly, very highly prized.

If I were to offer advice to young counsel, I would emphasize two points. First, even at an appellate level, the facts of a case are pivotal. Once we have sorted out the real story, the application of the law is in most cases relatively straightforward. Make sure, in both your written and oral submissions, that the Court has a complete and clear picture of the facts, particularly, of course, those that favour your client, but without giving them too much spin.

Second, appellate judges have to read a lot of material in preparing for a week of hearings. In a week in Toronto, for example, we may hear five or six cases, of which yours is only one. Do not add unnecessarily to our reading burden. Focus your arguments on your strongest points; if you can't win on these, you aren't going to win on the others! 30 pages for a memorandum of fact and law are a maximum, not a mandatory minimum. Do not play tricks with the page limit; we always notice and are irritated, This is not the frame of mind you want to foster in the judge who is trying to come to grips with your case. No matter how elegant a memorandum may be, I can tell you that judges will not finish reading it wishing there was more!

Tax law is not a silo

On their appointment, all judges have to come to grips with areas of the law about which they know nothing. All legal specialties have their own knowledge base, and none

more so than tax. But they are also part of the wider universe of law, and solving tax law problems calls upon skills that all judges have developed over their years of practice or, in my case, as a law professor, regardless of their practice area.

One of the pleasant surprises for new judges is that, even in middle age, they can learn about a totally new area of the law, and to derive a lot satisfaction from doing so. This is because much of what you have learned from working in one area of the law is transferable to others: the methodology of legal analysis and, in tax law, statutory interpretation. Tax law is also parasitic, in the sense that it must be applied to relationships and transactions governed by other bodies of law: contract, property, and corporate law, for example.

One of the most important changes in the law over the last 30 years has been in the courts' approach to the interpretation of statutes. What the statute says is the beginning, not the end, of the search for what it means: statutory context and legislative objectives provide indispensable clues to the meaning of the text. Nowadays, the old maxims or presumptions of statutory construction (replete with Latin tags!) are rarely treated as dispositive of a question of statutory interpretation.

This revolution has been enormously important in tax law. As you know, the Supreme Court has told us that, for the most part, tax statutes are to be interpreted in the same way as other statutes: by reference to text, context and purpose, but with more

weight being given to text, especially when detailed and precise, because of the reliance placed upon it by taxpayers when arranging their affairs.

Conclusions

So, there you have it. It remains only to repeat my sincere thanks to the organizing committee for inviting me to speak, and to you for being such a patient audience.

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[1] *Markevich v. Canada* [1999] 3 F.C. 28; 172 D.L.R. (4th) 164; 53 D.T.C. 5136.

[2] 2004 FCA 67; 58 D.T.C. 6119; [2004] 2 C.T.C. 276.

[3] 2009 FCA 163; [2009] 5 C.T.C. 1.

[4] 2010 FCA 180.

[5] 2011 FCA 22.

[6] [1978] 1 S.C.R. 480.

[7] *Miller v. Canada (Attorney General)*, 2002 FCA 370, 220 D.L.R. (4th) 149.

[8] 2002 SCC 33, [2002] 2 S.C.R. 235.

APPENDIX

Table 1: Percentage of TCC decisions appealed to FCA

Fiscal Year	2009-2010	2008-2009	2007-2008	2006-2007	2005-2006
Appeals from TCC decisions filed in FCA	123	229	142	187	150
TCC decisions	10,333	8,719	12,709	9,999	8,118
Percentage of TCC decisions appealed to FCA	1.2%	2.6%	1.1%	1.9%	1.8%

- "Decisions" of the TCC are the Judgments, Orders and Directions of the Court processed by the Registry during the fiscal year.

Table 2: Appeals from TCC as percentage of FCA's active files

Fiscal Year FCA Active Files	2009-2010	2008-2009	2007-2008	2006-2007	2005-2006
Appeals from TCC	118	192	151	171	157
All other active files (non-TCC)	329	358	378	421	371
Percentage of FCA active files consisting of TCC appeals	26.4	34.9	28.5	28.9	29.7

Table 3: **Disposed appeals from TCC to the FCA**

Fiscal Year	2009-2010	2008-2009	2007-2008	2006-2007	2005-2006
Final judgment rendered	117	102	83	101	86
Sudden disposition by the Court	53	32	56	43	25
Sudden disposition by the Party	29	51	26	26	31
Total	**199**	**185**	**165**	**170**	**142**

- *"Final judgment rendered"* means instances where the Court gives its judgment after hearing the merits of the appeal.
- *"Sudden disposition by the Court"* means instances where the Court renders consent judgment, strikes out the proceeding, etc.
- *"Sudden disposition by the Party"* means instances where a party discontinues the proceeding.