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Thursday, February 25, 2010 - Issue 195

Bi-weekly issues are added on Thursdays.

**** HIGHLIGHTS ****

- * The Tax Court of Canada has allowed the appeal of a full-time Ottawa policeman who operated a farm, as well as three ancillary businesses from Revenue Canada's disallowance of business and farming expenses and farm losses. The Tax Court rejected the Minister's contention that the Tax Court had no jurisdiction to review the Minister's determination of whether a taxpayer's chief source of income was farming or a combination of farming and some other source of income under Section 31 of the Income Tax Act. The Tax Court also reviewed and applied the general principles of law which relate to this determination, and held that the policeman was entitled to deduct a farming loss of \$25,379.00 from his income. (Scharfe v. Canada, [CALN/2010-005](#), [\[2009\] T.C.J. No. 538](#), Tax Court of Canada)

**** NEW CASE LAW ****

Scharfe v. Canada; [CALN/2010-005](#), Full text: [\[2009\] T.C.J. No. 538](#); [2010 TCC 39](#), Tax Court of Canada, D'Arcy T.C.J., September 25, 2009.

Income Taxation -- Income Tax Act -- Farming Losses.

Income Taxation -- Right to Farming Losses.

Mark Scharfe ("Mr. Scharfe") appealed to the Tax Court of Canada from income tax assessments with respect to his 2002, 2003 and 2004 taxation years.

The issues before the Court were:

- Whether Mr. Scharfe was entitled to business expenses disallowed by the Minister of National Revenue (the "Minister") of \$35,856.00, \$17,519.00 and \$9,771.00 for each of the three taxation years;

- Whether Mr. Scharfe was entitled to farming expenses disallowed by the Minister of \$2,416.00, \$5,479.00 in the 2002 and 2003 taxation years; and
- Whether the Minister was correct in restricting Mr. Scharfe's farm losses in the 2004 taxation year.

Mr. Scharfe is a member of the Ottawa Police Force. He had been a member since 1981.

Mr. Scharfe was also involved in farming. He grew up on a farm. In 1985, he purchased cattle and farming equipment from his father and rented 49 acres of farm land from him. In 1998, he purchased his father's farm. He lived on one acre of the farm land. The remaining 48 acres were used as a farm. For the periods in question, he also rented an additional 100 acres of adjacent farm land.

During the period in question, he also operated three ancillary businesses on the farm land:

- A cold storage business;
- A business of selling police duty belt suspenders over the internet; and
- A home security business.

Mr. Scharfe's wife and his three children worked on the farm. He also put his sons to work in the business. His intention was to grow the farming business so that it could support his family after he retired from the police force.

Mr. Scharfe testified that he worked approximately 40 hours per week as a police officer and at least 40 hours per week on the farm.

The Minister disallowed business expenses for wages Mr. Scharfe paid to two of his three children, aged approximately 12 and 10 during the period in question. Wages paid to the eldest child were allowed, but not wages of \$10.00 per day paid to his two youngest sons because the Minister did not feel the amounts were reasonable in light of the age of the children [at para. 43].

Decision: D'Arcy, J. allowed Mr. Scharfe's deductions with respect to some business and farming expenses, but disallowed others, and concluded that Mr. Scharfe's source of income was either farming or a combination of farming and some other source of income and that his right to claim his farming losses was therefore not subject to the restrictions contained in Section 31 of the Income Tax Act [at para. 91].

D'Arcy, J. considered the following issues:

(a) Salaries Paid to the Children and Farming Expenses.

D'Arcy, J. held that salaries of \$10.00 per day paid to Mr. Scharfe's 10 and 12 year old sons for maintaining storage buildings, removing snow, cutting grass and cleaning

storage facilities was reasonable for the work they performed. A business deduction of \$7,300.00 for business expenses for the 2002 taxation year was allowed in this regard [at para. 40 to 46].

D'Arcy, J. also allowed a partial deduction with respect to Mr. Scharfe's insurance which included general liability insurance for the farm, cattle, tractors and vehicles, as well as the family home [at para. 77 and 78].

(b) Whether Mr. Scharfe's Chief Source of Income for the 2004 taxation year was Farming or a Combination of Farming and Some Other Source of Income.

The Minister argued that the Court did not have jurisdiction to review the Minister's determination under subsection 31(2) of the Income Tax Act -- with respect to Mr. Scharfe's source of income. D'Arcy, J. rejected this submission and held [at para. 82] that the Tax Court clearly has the exclusive jurisdiction to hear appeals from assessments under the Income Tax Act, including appeals in respect of Section 31.

D'Arcy, J. reviewed the principles to be applied in considering whether the taxpayer's chief source of income was either farming or a combination of farming and some other source of income [at para. 83 to 87]:

[83] The principles to be applied when considering whether a taxpayer's chief source of income was either farming or a combination of farming and some other source of income were established by the Supreme Court of Canada in its decision in *Moldowan v. Canada* [1978] 1 S.C.R. 480 and have been summarized by numerous decisions of the Federal Court of Appeal, including *Canada v. Donnelly*, [1998] 1 F.C. 513; *Taylor v. Canada*, [2002] FCA 425; and *Gunn v. The Queen*, 2006 FCCA 281.

[84] It is clear from these cases that the issue is one of fact and that each case is to be decided on its own facts. However, the Court of Appeal has summarized the factors that should be considered as follows: the capital committed to the farm; the time spent by the taxpayer working the farm; and the profitability of the farm.

[85] The Court of Appeal found in the *Taylor* case that "substantial" income from farming was not required to satisfy the chief source of income test. Further, the Court found that the taxpayer's farming operations were profitable when the operations generated profits before the deduction of CCA.

[86] The Court of Appeal in *Gunn* provided guidance with respect to the application of the factors when the taxpayer's chief source of income is a combination of farming and another source of income.

[87] In particular, the Court stated:

In my view, the combination question should be interpreted to require only an examination of the cumulative effect of the aggregate of the capital invested in farming and a second source of income, the aggregate of the income derived from farming and a second source of income, and the aggregate of the time spent on farming and on the second source of income, considered in the light of the taxpayer's ordinary mode of living, farming history, and future intentions and expectations.

D'Arcy, J. concluded that Mr. Scharfe was entitled to deduct his full farming loss of \$25,379.00 when calculating his income for the 2004 taxation year [at para. 90] for the following reasons [at para. 88]:

- The Appellant has lived and worked on the farm for most of his life.
- The Appellant intended agricultural college.
- The Appellant has made substantial investments in the farm. He purchased the 48 acres of farmland, the farm equipment and cattle from his father. He has continuously invested money to update and upgrade the farm equipment and also invested funds to build the new barn.
- He rented an additional 100 acres of adjacent land for this farming business.
- He divided his time between working as a police officer and operating the farm; working 40 hours a week as a police officer, and at least 40 hours per week operating the farm.
- His family assisted with the running of the farm.
- Documents filed by the Respondent (Exhibit R-1, pages 2 to 4) evidence that, before the deduction of CCA, the operation of the farm was profitable in 2003. It is important to note at the time this occurred the selling price of the main product of the farm, cattle, had collapsed as a result of the mad cow scare.
- Based upon pages 009 and 010 of R-1, it appears that the large loss suffered in 2004 was mainly as a result of the continuing low prices and a substantial claim for CCA.
- The Appellant intends to continue to grow the farming business.

**** CREDITS ****

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