Docket: 2007-4121(IT)G

BETWEEN:

DAISHOWA-MARUBENI INTERNATIONAL LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on April 6 and 7, 2010, at Vancouver, British Columbia

Before: The Honourable Justice Campbell J. Miller

Appearances:

Counsel for the Appellant:	John H. Saunders
Counsel for the Respondent:	David Jacyk and John Gibb-Carsley

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JUDGMENT

The appeals for the 1999 and 2000 taxation years are allowed and referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that Daishowa received as proceeds of disposition:

1. On the sale to Tolko, an amount equal to the current silviculture liability of $2,057,498 plus 20% of the long-term silviculture liability of $9,238,727, for a total of $3,905,244; and

2. On the sale to Seehta, an amount equal to the current silviculture liability of $558,615 and 20% of the long-term silviculture liability of $2,407,693, for a total of $1,040,153.

Costs to the Appellant.

Signed at Ottawa, Canada, this 11th day of June, 2010.

"Campbell J. Miller"

C. Miller J.

Citation: 2010 TCC 317
Date: 20100611
Docket: 2007-4121(IT)G

BETWEEN:

DAISHOWA-MARUBENI INTERNATIONAL LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Miller J.

[1] In 1999 and 2000, respectively, Daishowa-Marubeni International Ltd. ("Daishowa") sold the assets of its two timber mill divisions, the one in High Level, Alberta ("High Level Division") to Tolko Industries ("Tolko") and the other near Red Earth, Alberta (the "Brewster Division") to Seehta Forest Products Ltd. ("Seehta"). Part of the agreement in both sales included a provision for the assumption by the purchasers of Daishowa's reforestation or silviculture liabilities. The Respondent assessed Daishowa by including in the calculation of its proceeds of disposition of timber resource properties, the amount of the estimated silviculture liability, being $11,000,000 in the Tolko deal and $2,996,380 in the Seehta deal. Daishowa argues no such amounts should be included in proceeds of disposition; and in the alternative, if any amount is to be so included, it is entitled to an offsetting deduction from income.

Facts

[2] In 1999, Daishowa operated the two timber divisions as well as operating the Peace River Pulp Division. It had a Forest Management Agreement for the High Level Division and held a timber quota for the Brewster Division: both included a right or licence to cut or remove timber (the "timber licence") for the

purposes of the definition of "timber resource property" in section 13(21) of the *Income Tax Act* (the "*Act*"). The Forest Management Agreement and quota also obliged the owner to submit reforestation plans and reforest all lands cut over by it (the silviculture or reforestation liability). A company is not relieved of this obligation to reforest until the cut block passes a free-to-grow survey, or if natural processes make achieving the regeneration standard impossible. The free-to-grow period was generally eight to 14 years after cutting.

[3] It was the position of the Alberta Department of Sustainable Resource Development that, based on section 163[1] of the *Timber Management Regulation*[2], a forest tenure cannot be assigned unless the assignee assumes the silviculture liability associated with the forest tenure. Further, it was the position of Alberta's Department of Sustainable Resource Development, based on its interpretation of the relevant statutory and regulatory provisions of the *Forests Act*[3] and *Timber Management Regulation*, that upon its consent to an assignment of a forest tenure, the assignee assumes the reforestation liability associated with the forest tenure, and that the assignor is no longer liable for the reforestation liability. On that basis, the Province of Alberta has not pursued assignors for recovery of the reforestation liability.

[4] By 1999, Daishowa decided to sell its timber divisions.

Sale of High Level Division

[5] Five bids were received by Daishowa for its High Level Division by September 23, 1999. The bid from Tolko was considered by far the most favourable. Tolko proposed "a purchase price of $180,000,000 plus an amount "equal to the estimated value of the net purchased working capital less the estimated amount of the long term reforestation liabilities of the division (the "Price"), subject to the following conditions":[4]

…

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1 Every assignment made shall be an unconditional assignment of the entire interest therein of the assignor, but the assignor may also be one of the assignees.

2 Alta. Reg. 60/1973.

3 R.S.A. 2000, c. F-22.

4 Joint Book of Documents, para. 25, letter from Tolko dated September 22, 1999.

1. Price Adjustments: as generally contemplated by DMI's draft *Asset Purchase Agreement*, the Price is subject to adjustment: (a) if the actual *Net Purchased Working Capital* is more or less than the estimated amount calculated by DMI prior to closing; and (b) for ordinary course adjustment items (ie. Property tax, other pre-payment items etc.). A further adjustment to the Price will be required if the final determination by the auditors of the long-term reforestation liability amount changes from the estimated amount calculated by DMI prior to Closing.

…

[6] Daishowa's professional advisors did not fully agree with the approach taken by Tolko, and in a memo from Davis & Co. to Daishowa's executive committee, Davis advised:

…

2. PriceWaterhouseCoopers ("PWC") advises that the pricing formula proposed by Tolko will have adverse tax consequences for DMI because it sets a gross price and then deducts from that price an amount that is allocated for long term reforestation liabilities (ie. $180 million, minus $10 million). In that situation, the amount allocated to long term reforestation liabilities will be included in DMI's income and subject to tax. However, if the purchase price is the "net amount" and DMI provides a representation and warranty that the long term reforestation liabilities will not exceed a certain specified amount (ie. $170 million, with an adjustment if the long term reforestation liabilities as of the Closing Date and determined in the Working Capital Statement are less than or greater than $10 million), then the amount that would be subject to tax under the existing provision would not be subject to tax. PWC advises that the same end result, without additional tax liability to DMI, can be achieved by simply restructuring the purchase price and adjustment provisions of the agreement. PWC believes that their proposed revisions will not have any adverse effect on Tolko's tax position. Tolko agreed that, as long as there is no material adverse tax consequence to them, they will accommodate DMI's reasonable requests.

…

[7] The final agreement between Daishowa and Tolko dated November 1, 1999, read in part as follows:

…

2.1 Purchase and Sale. DMI hereby agrees to sell, assign and transfer the Purchased Assets to the Purchaser free and clear of all Liens except

Permitted Encumbrances and Defects, and the Purchaser hereby agrees to purchase the Purchased Assets for the Purchase Price, upon and subject to the terms and conditions herein set forth.

2.2 Purchase Price. The Purchase Price for the Purchased Assets will be the aggregate of:

(a) $169 million; and

(b) Plus (or minus) the value of the Net Purchased Working Capital as of the Effective Time, determined in accordance with Section 2.4.

...

2.6 Allocation. The amount set forth in Section 2.2(a) will be allocated to the following asset classes:

Asset Class	Allocated Amount ($)
Land	1,000,000
Mill Buildings	18,000,000
Mill Machinery and Equipment	127,300,000
Logging Equipment, Roads and Bridges	199,000
Mobile Equipment	1,000,000
Lot Storage Area and Similar Surface Construction	1,500,000
Forest Tenures	20,000,000
Other Assets	1,000
Total	169,000,000

…

3.1 Assumed Obligations. As of the Effective Time, the Purchaser will assume and be responsible for the Assumed Obligations but specifically excluding the Excluded Liabilities. The Purchaser will indemnify and save DMI harmless from and against any claims, demands, actions, causes of action, loss, damage, cost or expense whatsoever, including legal fees, suffered or incurred by DMI by reason of the failure of the Purchaser to pay or discharge any of the Assumed Obligations from and after the Effective Time, and DMI will indemnify and save the Purchaser harmless from and against any claims, demands, actions, causes of action, loss, damage, cost or expense whatsoever, including legal fees, suffered or incurred by the Purchaser by reason of the failure of DMI to pay or discharge the Excluded Liabilities.

…

3.2.1 Preparation of Reforestation Statement. DMI estimates in good faith that the aggregate value of the current and long term reforestation liabilities will be $11 million as at the Effective Time ("Estimated Amount"). Forthwith after the Closing, DMI will prepare the Reforestation Statement setting out the current and long term reforestation liabilities associated with the Division as at the Effective Time and will cause the Reforestation Statement to be audited promptly by the Accountants. …

3.2.2 Reforestation Liabilities Adjustments. On the third Business Day following DMI's receipt of the Purchaser's notice of approval of the Reforestation Statement, or final determination of the reforestation liabilities by the Accountants or arbitration, as the case may be, pursuant to Section 3.2.1:

(a) DMI will pay to the Purchaser by bank draft the amount, if any, by which the final determination of the reforestation liabilities, exceeds the Estimated Amount together with interest on the amount of such excess calculated from the Closing Date to the date of payment at a rate equal to the Prime Rate; or

(b) the Purchaser will pay to DMI by bank draft the amount, if any, by which the final determination of the reforestation liabilities, is less than the Estimated Amount together with the interest on the amount of such difference calculated from the Closing Date to the date of payment at a rate equal to the Prime Rate.

…

The Parties also executed an Assignment Agreement dated November 1, 1999 which stipulated:

…

NOW THIS INDENTURE WINESSES that in consideration of the sum of ONE ($1.00) DOLLAR, and other good and valuable consideration, now paid by the Assignee to the Assignor, (the receipt whereof is hereby acknowledged by the Assignor) the Assignor hereby grants, assigns, transfers and sets over unto the Assignee, its heirs, executors, administrators and assigns forever, all and singular the Forest Management Agreement, the Coniferous Timber Quotas, the Coniferous Timber Licences and the Coniferous Timber Permit comprising the following lands, namely the lands described in the Forest Management Agreement, in the Coniferous Timber Quotas listed in Schedule "C", the Coniferous Timber Licences listed in Schedule "D", and in the Coniferous Timber Permit and all the right, title and interest therein and thereto of the Assignor subject to the payment by the Assignee of all the rents and other proper charges accruing due in respect to the Forest Management Agreement, Coniferous Timber Quotas, Coniferous Timber Licences

> and the Coniferous Timber Permit and the performance of all covenants and agreements contained in the Forest Management Agreement, Coniferous Timber Quotas, Coniferous Timber Licences and the Coniferous Timber Permit.
>
> …

[8] On November 1, 1999, Tolko gave Daishowa $185,628,000 cash being $169,000,000 allocated as set forth in section 2.6 of the agreement, and $16,628,400 for the net working capital.

[9] In accordance with section 3.2 of the agreement, on November 19, 1999 PriceWaterhouseCoopers Inc. provided a reforestation statement indicating:

> In our opinion, the statement presents fairly, in all material respects, the reforestation liabilities of the High Level Lumber Division as at the Effective Time in accordance with the definition of Reforestation Liabilities as set forth in the Purchase Agreement.
>
> | | |
> |---|---|
> | Current reforestation liability | 2,057,498 |
> | Long term reforestation liability | 9,238,727 |
> | Total | 11,296,225 |

Of the total amount, only approximately $400,000 could have been spent in 1999.

[10] On January 20, 2000 Tolko, in accordance with section 3.2 of the agreement, requested the additional $296,225. At the same time, there was an adjustment to the final net purchase working capital requiring Daishowa to pay back $2,174,039 to Tolko.

[11] According to Tolko, based on incomplete data, it spent no less than the following amounts with respect to the assumed silviculture liability:

2000	$1,374,824.43
2001	$246,004.39
2002	$1,404,221.74
2003	$107,616.91
2004	$108,570.82
2005	$385,355.46
2006	$280,405.11
2007	$610,840.65
2008	$215,344.99

Total	$4,733.184.50

Sale of Brewster Lumber Division

[12] In its 2000 taxation, Daishowa sold the Brewster Lumber Division including the forest tenures, a "timber resource property" for the purposes of section 13(21) of the *Act*, to Seehta. The agreement with Seehta was signed on August 11, 2000 with a closing date of November 24, 2000.

[13] The purchase price for the Brewster Lumber Division included a) $6,100,000 for certain assets, plus (or minus); and b) any difference between preliminary estimate of the net purchased working capital or $4,919,000, and a final estimate of net purchased working capital plus (or minus). The Parties allocated the purchase price as follows:

Asset Class	Allocated Amount
Improvements	$435,000,00
Equipment, furniture and fixtures	$5,315,000
Forest tenures	$350,000
Total	$6,100,000

[14] The net purchased working capital was ultimately determined to be $4,459,019 so Daishowa returned to Seehta the amount of $459,981 plus interest (the difference between the preliminary and a final estimate of net purchased working capital).

[15] The terms of the sale for the Brewster Lumber Division also included the assumption of the silviculture liability, found in article 3.1:

> 3.1 Assumed Obligations. As of the Effective Time the Purchaser will assume and be responsible for all of the following obligations and liabilities of DMI:
>
> (a) the payment and discharge as and when due of the liabilities of the Division shown on the Working Capital Statement;
>
> (b) notwithstanding that the Purchaser will not be given credit for reforestation liabilities in the determination of Net Purchased Working Capital, all reforestation liabilities of the Division of any nature both current and long term, whenever incurred;
>
> …

[16] Daishowa's accounting estimate of its reforestation obligations that appeared on its interim financial statements dated October 31, 2000 was $2,966,308, $558,615 of which was a current liability. Of the portion of the silviculture liability that was current, only a small portion could have been spent on silviculture during Daishowa's 2000 tax year, as the only activity that could have been performed during the period between November 21, 2000, the date of the sale and December 31, 2000, the end of the tax year, was scarification.

[17] With respect to both the sale of the High Level Division and Brewster Lumber Division, the Province of Alberta consented to the assignment of the forest tenures.

[18] In income tax returns for its 1999 and 2000 taxation years, Daishowa did not include in its proceeds of disposition any amounts in respect of the assumed silviculture liability. The Minister of National Revenue reassessed Daishowa in respect of both sales by including in the calculation of the Appellant's proceeds of disposition of timber resource properties, the amounts of estimated silviculture liability assumed by the purchasers.

Issues

[19] The issues in these appeals are:

a) whether in 1999 and 2000 taxation years, the Minister properly included in Daishowa's proceeds of disposition the amounts of silviculture obligations assumed by the purchasers.

b) whether these additional assessed proceeds of disposition were properly allocated to timber resource properties; and

c) whether the Appellant is entitled to any deductions in respect of the assumed silviculture obligations.

[20] Daishowa argues that, while there may be some benefit to Daishowa from Tolko's assumption of the reforestation liability, the fair market value of those liabilities was not determinable at the time of closing and therefore no amount in respect of the reforestation liabilities can be included in Daishowa's proceeds of disposition. Alternatively, Daishowa says that if the fair market value of the reforestation liabilities at the time of closing could be determined, that fair market value would inevitably be less than the accounting estimates of the liabilities (even if one assumed that the accounting estimates were correct), because the estimates reflected amounts which were estimated to be spent on reforestation over the next 14

years, and were not discounted to reflect this fact; neither were they discounted to reflect the fact that Daishowa remained secondarily liable to perform the reforestation if Tolko and/or Seehta failed to. In the alternative, Daishowa argues that if I find the parties did agree that the accounting estimates of the reforestation liabilities equalled the fair market value of those liabilities, or if the actual fair market value of the reforestation liabilities equalled the accounting estimates (or some lesser amount, provided I permit the Respondent to again reassess Daishowa for proceeds of a lesser amount), Daishowa is entitled to an equivalent deduction from income for having paid each of the purchasers with assets to assume Daishowa's liabilities, which liabilities were deductible when paid as they were on income account.

[21] The Respondent's argument is simply that the price in the two deals includes the consideration of the assumption of liabilities, being the relief of Daishowa from further obligation to the Province of Alberta in a quantifiable amount. According to the Respondent, it was clear from the outset, certainly with respect to the Tolko offer, that the purchase price started at $180,000,000 and was adjusted downwards to take into account the amount of the reforestation liability. The Respondent goes on to argue that no amount of that consideration should be deductible as it is part of a capital transaction which cannot be parsed into specific separate components of capital and income. Further, the Respondent suggests that if the Appellant is considered to have made any expenditure by foregoing consideration, the nature of that expenditure results in an enduring benefit and, as such, is a capital outlay that is not deductible from income.

Analysis

[22] I will reach a conclusion based on an analysis of the Tolko deal, and will then indicate if the Seehta deal differs significantly to lead to any different conclusion. As counsel for the Respondent emphasized, the interpretation of these agreements, specifically the determination of the role of the assumption of the reforestation liability, depends on how one reads the structure of the deal. Was this a purchase and sale between the two arms length parties of the forest tenures for $31,000,000 or for $20,000,000 or for something in between? The Respondent claims the purchase of the forest tenures was for $31,000,000 with the consideration of $20,000,000 cash and assumption of the reforestation liability valued at $11,000,000. Daishowa claims that it purchased the forest tenures for $20,000,000 cash, with the agreement providing that the Purchaser, Tolko, would pay, as required by Alberta policy, the reforestation liability attached to those forest tenures, estimated to be $11,000,000, such estimate not representing any agreed value of such consideration. Put another way, was Tolko's promise to incur expenditures in the future, estimated at

$11,000,000, to meet the Province of Alberta's reforestation requirements, consideration in its purchase of Daishowa's forest tenures?

[23] Both parties agree that Tolko did oblige itself, in the Purchase and Sale Agreement and Assignment Agreement, to pay the expenses of future reforestation, as required by the Province of Alberta. Was this consideration? If so, did the parties agree on the value of that assumption? If not, is the value so uncertain that it is improper to bring any amount into proceeds of disposition? If it is not so uncertain, how is the value of the benefit of the assumption to be determined?

[24] Dealing first with the issue of consideration, Daishowa has acknowledged that a benefit was received by it on the assumption by Tolko of the reforestation liability. Indeed there is an admitted fact: "If Tolko had not assumed the Appellant's silviculture liability, the amount of cash or other consideration it would have paid the Appellant would have increased". Given that acknowledgement and admission, it is difficult to find the assumption of liability is not part of the consideration in the deal notwithstanding Daishowa took great pains to have that element of the deal removed from the definition of purchase price in the final agreement.

[25] Subsection 13(21) of the *Act* defines proceeds of disposition to include the sale price of a property. Price is commonly defined to include consideration, which in turn is defined by Fridman in *The Law of Contract in Canada* (4th ed) as "some right, interest, profit, or benefit accruing to one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other". This certainly includes an assumption of a liability and a promise to indemnify (for an example see the case of *Loyens v. Queen*[5]).

[26] What is the nature of the liability, the relief of which leads to some benefit to Daishowa? It is not one that, as I initially thought, passes automatically with the forest tenures. From a careful review of the Alberta legislation and the Parties' agreed facts, it is clear that the Province of Alberta will not approve of a transfer of the forest tenures, unless a purchaser assumes the reforestation liability. This is quite different from any suggestion that the liability, simply by the operation of Alberta statutes, flows with the property; in other words, whoever owns the forest tenures is legally responsible for the reforestation obligation. No, the situation in Alberta is that the Province effectively forces the purchaser to assume the reforestation liability: no assumption – no transfer of forest tenures. Does the fact that a third party, the

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5 2003 TCC 214, paras 31 and 33.

Government of Alberta, forces an assumption of liability, make the assumption of that liability any less consideration? No, it does not affect the nature of the assumption of liability as consideration, though it may affect the value of that assumption.

[27] Does the fact that the final agreement between the Parties specifically excluded the assumption of liability from the purchase price have the legal effect of removing it from the consideration for the forest tenures and consequently from the proceeds of disposition? Further, does the fact that the Parties, in that agreement, only allocated the cash purchase price amongst the assets, likewise have the legal effect of removing the assumption of the liability as part of the consideration? I would answer no to both those questions. To answer positively would put form over substance in the interpretation of contracts which is not a supportable approach.

[28] Having concluded that the assumption of the reforestation liability does represent part of the consideration, I will now address the Appellant's position that the value of that purported benefit is so uncertain as to be unascertainable, and therefore I should conclude that the value is zero. The Respondent counters that the Parties got an estimate to the dollar of the reforestation liability, and that that amount reflects the value of the consideration that should fall into proceeds of disposition to be taxed. The Appellant's fall-back position is that the value of the assumption is considerably less than the face value of the $11,000,000.

[29] The first point to address is whether the Parties ever agreed that the $11,000,000 represented the value of the consideration. It was clear from the advice Daishowa received from its advisors that Daishowa should avoid assigning any value to the reforestation liability. The agreement itself refers to the $11,000,000 as an "estimated amount". Further, in section 3.2.1 of that final Agreement between Daishowa and Tolko it is stipulated:

> "The Purchaser will advise DMI in writing whether the amount of the current and long term reforestation liabilities is agreed to by the Purchaser." …

[30] This is important because it shows that Tolko based its offer on an estimate of the reforestation liability, and if the auditor's reforestation statement indicated something different then there would be a payment going one way or the other. This stipulation was not in the context of estimating the value of the assumption of liability for determining Daishowa's proceeds of disposition, but to get to an accurate cash purchase price. The reality is that the reforestation liability calculation was an estimate, an audited estimate, but an estimate nonetheless. There is nothing in the

Sale Agreement that constitutes an agreement between the Parties that Daishowa received additional consideration of $11,000,000 by Tolko's assumption of the reforestation liability. Where the Parties agreed to values, such as in the determination of the net purchase working capital, they specifically indicated such by referencing the term "value". Certainly, the $11,000,000 estimate was a factor in the determination of the cash price it was prepared to pay, but it was not an agreed upon value for purposes of determining its value as consideration.

[31] The Respondent's position was accurately summed up by Mr. Dan Carter of Canada Revenue Agency ("CRA") in his June 2, 2005 letter to the Appellant: "What we are saying is that Tolko reduced the cash consideration paid for the assets acquired as a result of the assumption of liability". Clearly, the Respondent's position is that the value is equal to the estimated amount. Mr. Carter also went on to quote a CRA technical interpretation which stated:

> "When a business is sold, and the purchaser assumes a contingent liability as part of the consideration for the business, it is our view that the Vendor's proceeds of disposition would include the Fair Market Value ("FMV") of the contingent liability assumed by the Purchaser."

[32] The Appellant's argument is that determining a value of the reforestation liability cannot be done with any degree of accuracy, and therefore no amount should be included in Daishowa's proceeds of disposition. In support of this proposition the Appellant relies on comments in the *Northland Pulp and Timber Ltd. v. Canada*[6] that the "Courts have consistently disqualified for tax purposes, in calculating taxable profits, amounts that are provisional estimates, are conditional, contingent or uncertain." There are two elements to this argument: the first, that the determination of an accurate Fair Market Value ("FMV") is not possible; and second, because of that, no amount shall be attributed to the FMV of such a liability.

[33] Dealing with the first arm of this argument, there is considerable uncertainty in estimating the value of an eight- to 14-year obligation to reforest that may be affected by a number of factors: weather, pests, flooding, fires, natural regeneration…. As stated in the auditor's Reforestation Statement:

> "The preparation of the Reforestation Statement in conformity with generally accepted accounting principles requires management to make significant estimates and assumptions that affect the reported amount of reforestation liabilities."

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6 [1999] 1 C.T.C. 53 (F.C.A.).

This recognizes that these amounts are just what they say they are – estimates. Indeed, the Appellant's High Level Lumber Division Reforestation Liability Summary contains guiding principles, one of which is that there should be a bi-annual review. This makes sense given the vagaries and uncertainties surrounding the need for reforestation. The industry can however point to past history, though the Appellant claims the past performance is not necessarily indicative of future results. Yet it is some guidance, and obviously what auditors, in creating reforestation liability statements, must rely upon.

[34] It is this uncertainty that underlies the decision in *Northwood* that, because actual reforestation expenses were not incurred until subsequent periods, they were not deductible until those subsequent periods. Or, as was put in the case of *R. v. Burnco Industries Ltd. et al*[7], "an obligation to do something which may in the future entail the necessity of paying money is not an expense". Implicit in these approaches is that you cannot deduct an amount when you are not sure what the amount is. The liability may exist today, as soon as you cut the trees, but the cost of reforesting that cut stand of trees will not be known until you actually incur the expense. Does it make sense then that to avoid having to tax an uncertain amount, the tax regime should only bring into the Vendor's income, as proceeds of disposition, such amounts when they are determinable, over the ensuing eight to 14 years, as only then do the Parties and the Government know with certainty the value of the benefit that Daishowa actually received? Neither party pursued this possible approach to the taxation of the assumption of the reforestation liability, so I will pursue it no further.

[35] Returning then to the Appellant's argument that the Government cannot include in income (or deduct from income – *Northwood*) uncertain amounts, the Appellant cites three authorities, in addition to its reliance on *Northwood* and *Burnco*. First, the case of *Harysh (Peter) v. Minister of National Revenue*[8] dealt with gift tax arising on the transfer of royalty payments to family members. There were no producing wells. The Minister valued the rights based on what the oil company paid to obtain the lease from the taxpayer. The Court held:

> …

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7 84 DTC 6348 (FCA).

8 52 DTC 122.

> It might well be that under different circumstances the method adopted here could be right, but I repeat that this case must be decided on the evidence of this case only. Acceptance of the respondent's argument would mean that because a certain amount is paid for the leasing of lands, there must be oil of an equal value under the said lands; why not more? why not less? why any at all? It is easy to see how one could be easily mislead if one let himself be guided by possibility and conjecture. I do not think that it is proper to delve into the realm of possibility and conjecture instead of adhering to known facts, especially when one is dealing with a taxing statute. On the whole, I am satisfied that the appellant has proven that the Minister was wrong when assessing him as he did.
>
> …

[36] Second, in the Federal Court of Appeal decision of *Peter Brown v. R.*[9], the Court ruled that the value of shares was not ascertainable for purposes of determining a taxpayer's at risk amount in accordance with subsection 96(2.2)(*b*) of the *Act*. The Court therefore attributed no value to the shares.

[37] Finally, in *J. Stuart Robertson v. R.*[10], the Federal Court of Appeal held an employee did not receive a taxable benefit at the time of receiving an option for shares in a company, not his employer, as no quantifiable benefit arises until the option is acted upon. As the Court stated:

> … The fact is however that while the second benefit can be measured by the discrepancy between the cost of exercising the option and the market value of the shares at the time of the acquisition, the first benefit, although a real one, eludes independent quantification. …

[38] I note that none of the above cases deal with proceeds of disposition arising from the assumption of a liability, whose quantum is uncertain. There is a common thread, however, that shows the tendency of the Courts to be reluctant to impose tax, regardless of the taxing regime, in situations where the amount to be taxed is uncertain or unascertainable. Certainly, the Federal Court of Appeal adopted this attitude in *Northwood*, albeit in the context of determining the deductibility of the reforestation liability, in citing the Tax Court of Canada's comment:

> …

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9 2003 DTC 5298.

10 90 DTC 6070.

> The thrust of the cases referred to by both counsel show that the Courts have consistently disqualified for income tax purposes, in calculating taxable profits, amounts that are provisional estimates, are conditional, contingent or uncertain. The estimates disallowed by the Minister here were certainly of that nature.
>
> …

[39] It would be overly broad to interpret these cases as supporting a general principle that if an amount is uncertain it is never to be subjected to the tax regime, as income, expense, proceeds, loss etc. A more apt approach is to consider the circumstances surrounding the uncertainty, the nature of the amount itself and the element of the tax regime to which it is to be subjected. In this case, I am influenced by the fact that the uncertainty is spread over many years, the Appellant has little control over factors that would render the amount more certain, the fact that only when the amount becomes certain (i.e. on incurring the expense) is the entity incurring the expense entitled to a deduction, and the significant tax impact of finding the uncertain amount is subject to the tax regime (in this case 100% of it would fall into income). In these circumstances, I am reluctant to find that the full amount of an estimate is properly captured by the provisions of the *Act*. But, at the same time, I am not prepared to rely on any general principle that uncertain amounts are simply left out of the tax regime. This leads to what I believe is the true issue to be determined in this case – what value is to be attributed to Tolko's assumption of the reforestation liability and indemnity as consideration in the purchase of Daishowa's forest tenures. I conclude that uncertainty is a factor to take into account.

[40] The Respondent's position on value is simple. Tolko reduced the cash consideration by $11,000,000, clearly indicating it valued the reforestation liability at its estimated face amount. My concern with that approach is that it is imparting to the Parties an intention that this determination, to get to the value of the High Level Division that Tolko was prepared to pay, is somehow an implicit understanding between the Parties that it thus represents the value of the consideration Tolko is offering. It is not the same. Tolko knows it has to assume the reforestation responsibility: the Province of Alberta demands it. Knowing that, it has to put a value on the business it is acquiring, and naturally wants to discount the value to take into account the liability. It successfully negotiates a dollar for dollar reduction in the value of the asset it intends to buy. That negotiation is in a different context than then valuing the assumption of liability as part of the consideration for the business. The reforestation expense Tolko will have to spend over the ensuing eight to 14 years will be whatever it will be (which turns out to be considerably less than the estimate). The fact Tolko has negotiated a reduction in the purchase price does not sway me that the benefit to Daishowa of Tolko's assumption of the liability must be the same amount.

I prefer looking at the value of the assumption of the liability and the indemnification in light of the following:

I. Tolko had to assume the liability. The Respondent argues that this should not matter. I believe it does matter. Both Daishowa and Tolko knew that, in Alberta, there could be no transfer of the Forest Management Agreement, the forest tenures, without the Purchaser taking over the reforestation responsibilities. Alberta insisted upon it. Daishowa could not sell the forest tenures without getting rid of the reforestation liability and by selling the forest tenures, because of Alberta's law and policy, it was no longer liable for those future expenses. The new owner was liable. An assumption of a liability in these circumstances does not equate to a negotiated arm's length determination of the value of the liability assumed. Expressed another way, if the assumor (Tolko) is obligated to assume the liability, not by Daishowa, but by the Province of Alberta, is Daishowa truly receiving a benefit equal to the face value of that liability? In effect, Daishowa knows that its liability, because of Alberta's approach, cannot and will not extend beyond its ownership of the forest tenures. How does one value a liability that effectively disappears on the transfer of the forest tenures and cannot extend beyond that? Daishowa is being relieved of the liability that it could not possibly hold after the transfer of the assets in any event. The $11,000,000 represents what Tolko will have to spend as the new owner. Does it truly reflect what Daishowa would have had to spend if it transferred the forest tenures without assigning the liability? No, because that scenario, under Alberta law and policy, was simply not possible. I believe the value of the liability should, accordingly, be discounted.

II. The liability was based on Deloitte's review of past history and speculation of future costs. It represented what Daishowa believed would have to be spent over the next several years. The estimate was not discounted to reflect any present day value.

III. The estimated reforestation liability was used by Daishowa and Tolko to ultimately determine the cash price for the mill. There are two ways of looking at this. One, the Respondent's view, is that the purchase price was always $180,000,000, paid for by $169,000,000 cash and an $11,000,000 assumption of liability. Two, the price

specifically excluded the $11,000,000 reforestation liability and was simply the cash price. Certainly, the $180,000,000 was the starting point for the deal, and yes, the advice Daishowa received was to rely on a net cash price to avoid the very issue now before me. The Respondent argues the consideration has simply been separated into two parts. But, to me, an analogy is that a reforestation liability is like a dent in a car: you determine the value of the car without the dent and then deduct an estimate of your repair cost to make a cash offer. Does it make a difference to the vendor of the car if the vendor of the car already obligated himself to make the repairs and the purchaser agrees to honour that obligation? Is the vendor receiving:

a) cash consideration for a dented car; or

b) greater consideration in the form of cash plus an assumption of the estimated cost of repairs?

The purchaser is still just getting and the vendor is still selling a dented car. The difference in the analogy is that with the car, the purchaser could demand that the vendor do the repairs first and then the purchaser will pay full price for an undented car. Here, it would not have been possible for Daishowa to incur all the reforestation expenses prior to handing the forest tenures to Tolko. The only such reforestation expenses that could have been done were the short term expenses.

IV. As I have already discussed at length, the estimated liability is uncertain. I have concluded Daishowa and Tolko agreed on the estimated amount for the purposes of determining the cash purchase price, but they did not agree on that amount as reflective of the value of the assumption of the liability as consideration.

V. The Appellant acknowledged the assumption was a benefit and has some value.

VI. Reforestation costs, according to *Northwood* are not deductible until paid.

[41] Factoring all these points together, I conclude that a fair approach is to include in proceeds of disposition an amount for the assumption of the reforestation liabilities as follows:

I. The current reforestation liability of $2,057,498;

II. a significantly discounted amount of the longer term reforestation liability due to the reasons I have discussed. I reduce the long-term liability by 80% being 80% of $9,238,727 or $7,390,981 leaving $1,847,746.

[42] The Appellant argues that I cannot do what I have just done: more accurately, the Appellant argues it is not open for the Minister, who assessed on the basis that the accounting estimate represented the value of the reforestation liabilities, to now argue that it can be valued at something less. I find no merit in this approach. The fact the Minister included the face value of the assumption of the liability in proceeds of disposition is the very issue in this appeal. I find it is open to me, based on the evidence I have heard, to conclude that the value should be something less, and therefore something less should be included in proceeds. I see no similarity with the case of *Sean Walsh and Brett Walsh v. R.*[11] referred to by Appellant's counsel.

[43] I turn now to the Appellant's contention that if I find any amount falls into proceeds of disposition, then the Appellant is entitled to an offsetting deduction because it incurred an expense on income account by paying Tolko with assets (the forest tenures) to assume the reforestation liability.

[44] The Appellant makes a somewhat circuitous argument that it was not only the vendor of assets and a recipient of consideration, but also a payer of consideration to have the reforestation liabilities assumed – what the Appellant calls a partial barter transaction. With respect, I do not see it. Daishowa did not pay Tolko separately to incur the reforestation expenditures. This deal was for the sale of capital assets: the assumption of the reforestation liability was simply part of that capital transaction.

[45] I do agree with the Appellant that payments do not have to be made in cash to be deductible. That is not the point. The nature of payment must be of an income or expense nature, rather than of a capital nature. Even looking on the transfer of the forest tenures by Daishowa as payment for Tolko to assume the future reforestation costs, the payment smacks more of an enduring benefit than current expense of the

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[11] 2008 DTC 3897.

actual reforestation. As has been made clear in Alberta, the forest tenures could not be transferred without the Purchaser assuming the reforestation liability. It is part and parcel of the forest tenures: you own the forest tenures and you are therefore responsible for the reforestation. It makes no commercial sense to me to view the transaction as payment of the reforestation costs by the transfer of the forest tenures. It is an Alice in Wonderful topsy turvy approach.

[46] The Appellant sought further support for the position that the transfer of the forest tenures to Tolko for Tolko's assumption of the reforestation liability was on income account in the case of *Basell Canada Inc. v. R.*[12] But the facts were significantly different. As Justice Lamarre made clear, the element carved out of the business deal in that case was already a separate stand-alone transaction, unlike here, where the forest tenures were an integral and essential part of the overall deal. There would be no sale of the business without the sale of the forest tenures and assumption of reforestation liability. In *Basell*, Justice Lamarre stated:

> …
>
> 32. In my view, an inference cannot be drawn from the documentation provided in evidence and from the testimony of Mr. Mineer that the intent was for the appellant to purchase as a complete package the entire polypropylene operation located in Sarnia. Although the appellant certainly enlarged its profit-making structure in acquiring Shell's business in Sarnia, I tend to agree with the appellant that the assignment of the Novacor Agreement was a subject matter that stood on its own in the negotiations with Shell. Shell was linked to that agreement and it was wholly in its interest to free itself from it by selling its business. The same cannot be said of the appellant. The appellant could very well have purchased Shell's business without accepting the assignment of the Novacor Agreement if the contract price of the propylene had not been advantageous to it at the time of the transaction.
>
> …

[47] I agree with the Appellant that there is a certain lack of symmetry in how the assumption of the reforestation liability is treated for tax purposes. No deduction is allowed until costs of reforestation are actually incurred, yet the value of the assumption of that very liability to incur those costs falls into income as proceeds in one fell swoop, with no recognition that the income recipient has no future opportunity to deduct such expenses. This logic leads somewhat full circle to justify

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[12] 2008 DTC 2108.

my view that the face amount of the assumption of the liability should be discounted to reflect this economic reality.

[48] Finally, the parties addressed the application of section 18(9) of the *Act* (which reads, in part):

> 18(9) Notwithstanding any other provision of this *Act*,
>
> (*a*) in computing a taxpayer's income for a taxation year from a business or property (other than income from a business computed in accordance with the method authorized by subsection 28(1)), no deduction shall be made in respect of an outlay or expense to the extent that it can reasonably be regarded as having been made or incurred
>
> (i) as consideration for services to be rendered after the end of the year,
>
> …

[49] The Respondent argues that this expressly precludes the deduction of any amount paid by Daishowa to Tolko as it was for services to be rendered after the end of the taxation year. The Appellant counters that this approach looks at what the payment was received by Tolko for, not, more accurately, according to the Appellant, what the payment was made by Daishowa for: the payment was made to Tolko to assume the liability to render services. This is a somewhat fine distinction, but what it does highlight for me is that this is simply not a prepaid expense situation. No payment was made by Daishowa for services to be rendered to Daishowa: that was not the nature of the payment, even if I were to consider the transfer of the forest tenures as payment. In brief, section 18(9) is a red herring.

[50] The Appellant has not convinced me that the transfer of forest tenures, being part of the sale of the mill generally, is anything other than a capital transaction for the sale of Daishowa's business. The Appellant has also not convinced me that even if I was to view the assumption of the reforestation liability as a separate transaction paid for by Daishowa passing consideration in the form of forest tenures, that this was on income or expense account. It was not.

[51] In conclusion, the deal for the sale of Daishowa's business to Tolko was a single transaction, and the assumption of the reforestation liabilities represented part of the consideration; however, the value of that consideration to Daishowa is less

than the face value of the estimated amount of those liabilities. Factors of uncertainty, lack of taxation symmetry, Alberta policy that Tolko had to assume the reforestation liabilities, lack of agreement on value and present-day valuing have led me to markedly discount the long term liability. I wish I could be more arithmetically accurate, but some of the principles on which I rely do not permit such accuracy. Even in taxation law, the law can sometimes be imprecise. Having concluded that neither the face value of the estimated reforestation liabilities, nor zero was the appropriate amount to represent proceeds of disposition to be taxed (either of which would have been an easier answer, but not to my mind an appropriate answer), then it inevitably left me with the dilemma of quantification.

[52] I see no difference in the fact situation of the Seehta matter to reach any different conclusion. The appeal is therefore allowed and referred back to the Minister for reconsideration and reassessment on the basis that Daishowa received as proceeds of disposition:

1. On the sale to Tolko, an amount equal to the current silviculture liability of $2,057,498 plus 20% of the long-term silviculture liability of $9,238,727, for a total of $3,905,244; and

2. On the sale to Seehta, an amount equal to the current silviculture liability of $558,615 and 20% of the long-term silviculture liability of $2,407,693, for a total of $1,040,153.

Costs to the Appellant.

Signed at Ottawa, Canada, this 11th day of June, 2010.

"Campbell J. Miller"

C. Miller J.

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