

Dai-showa-me-the-money: The Supreme Court of Canada decision in *Daishowa-Marubeni v. R.*

Moody's
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Yesterday, the Supreme Court of Canada released the eagerly-anticipated decision in [*Daishowa-Marubeni v. R.*](#) The question before the Court was whether a reforestation obligation attached to a timber resource property should form part of the vendor's proceeds of disposition when the property is sold.

This decision is very significant in Canada since land rehabilitation costs are common to all extraction related industries, including oil & gas and mining. It is clear from the Court's decision that future expenses that may be obligated by statute, regulation or government policy should not form part of proceeds of disposition. However, it is important to note that the Court did not restrict their finding to the fact that a reduction in the purchase price had to be derived from statute, regulation or government policy. The real question is whether certain land rehabilitation obligations may be inextricably tied to a given property.

Writing on behalf of the Court, Justice Rothstein begins his well-reasoned analysis by asking the tongue-in-cheek question, *"If a tree falls in the forest and you are not around to replant it, how does it affect your taxes?"*

In a nutshell, Daishowa-Marubeni International Ltd. ("Daishowa") assigned forest tenures located in Alberta which included a license to cut timber from certain provincial Crown lands as well as reforestation and silviculture obligations with respect to these lands pursuant to forest management agreements signed with the Alberta government. While the parties agreed on a price of \$180 million for the forest tenure assignment, the sale price used in the agreement was discounted to \$169 million to reflect the cost of anticipated reforestation obligations estimated at \$11 million. Daishowa reported proceeds of disposition for tax purposes of \$169 million.

The Minister of National Revenue (the "Minister") reassessed Daishowa asserting that proceeds of disposition for tax purposes should actually be \$180 million as it cannot include a discount for a future obligation. The Minister argued that the reforestation obligation was akin to a mortgage on a house: if you sell your house and the purchaser pays you cash and assumes your mortgage, the appropriate proceeds of disposition includes the amount of cash you received plus the amount remaining on the mortgage the purchaser assumed on your behalf.

The Court rejected the Minister's reasoning finding that the sale of the forest tenures was more akin to selling a house in need of repairs: if you sell a house in need of desperate repair the purchaser will pay you only for the current market value of the house. The appropriate proceeds of disposition is simply the amount paid by the purchaser, and not an amount that includes both the amount the purchaser actually paid and an estimated amount for the much needed repairs. In other words, the repair obligations are simply taken into account by the parties when they agree on the market value of the property, and thus the agreed upon amount forms the proceeds of disposition for tax purposes.

The Court's conclusion is quite sensible: if an obligation cannot be severed from a piece of property, the

obligation should not form part of the proceeds of disposition as it is really just representative of a future expense.

However, the more interesting question is whether obligations associated with a property could be embedded in the property without there being a statute, regulation or government policy that expressly restricts a vendor from selling the property without assigning these obligations to the purchaser. Consider whether contractual obligations related to future rehabilitation of farm land that was used in oil extraction may be so physically connected to the process of extracting oil that such obligations cannot be separated from the property itself?

When reviewing a purchase and sale agreement it will be important to be aware of what obligations are being assumed by the purchaser in connection with extraction properties and decide whether such obligations are tied to the property itself. If it can reasonably be concluded that the obligations are expressly tied to the property itself then it will become important to ensure that the purchase and sale agreement reflects a single price for the transaction, which includes the both the right to the property and the assumption of the related obligations.

We applaud the Court for its well-reasoned decision and note it was refreshing to see the Court inject a bit of humour into the decision since we all know that tax practitioners are very funny!