



SUPREME COURT OF CANADA

CITATION: Daishowa-Marubeni International Ltd. v. Canada,
2013 SCC 29

DATE: 20130523
DOCKET: 34534

BETWEEN:

Daishowa-Marubeni International Ltd.

Appellant

and

Her Majesty The Queen

Respondent

- and -

**Her Majesty The Queen in Right of Alberta, Tolko Industries Ltd., International
Forest Products Ltd., West Fraser Timber Co. Ltd., Canfor Corporation and
Canadian Association of Petroleum Producers**

Interveners

CORAM: McLachlin C.J. and LeBel, Fish, Abella, Rothstein, Cromwell, Moldaver,
Karakatsanis and Wagner JJ.

REASONS FOR JUDGMENT:
(paras. 1 to 48)

Rothstein J. (McLachlin C.J. and LeBel, Fish, Abella,
Cromwell, Moldaver, Karakatsanis and Wagner JJ.
concurring)

NOTE: This document is subject to editorial revision before its reproduction in final
form in the *Canada Supreme Court Reports*.

DAISHOWA-MARUBENI INTERNATIONAL v. CANADA

Daishowa-Marubeni International Ltd.

Appellant

v.

Her Majesty The Queen

Respondent

and

**Her Majesty The Queen in Right of Alberta,
Tolko Industries Ltd., International Forest Products
Ltd., West Fraser Timber Co. Ltd., Canfor
Corporation and Canadian Association of Petroleum
Producers**

Interveners

Indexed as: Daishowa-Marubeni International Ltd. v. Canada

2013 SCC 29

File No.: 34534.

2013: February 20; 2013: May 23.

Present: McLachlin C.J. and LeBel, Fish, Abella, Rothstein, Cromwell, Moldaver,
Karakatsanis and Wagner JJ.

ON APPEAL FROM THE FEDERAL COURT OF APPEAL

Taxation — Income tax — Proceeds of disposition — Sale of forest tenures — Reforestation obligations imposed on forest tenures — Value of reforestation obligations not included in vendor's proceeds of disposition for tax purposes — Whether reforestation obligations should be included in vendor's proceeds of disposition for tax purposes — Whether reforestation obligations are distinct debts — Whether reforestation obligations are contingent liabilities — Whether contracting parties agreeing to specific value for future reforestation obligations relevant for tax purposes — Income Tax Act, R.S.C. 1985, c. I-13, s. 13(21).

In 1999 and 2000, DMI sold two forest tenures in Alberta. Alberta's regulatory regime imposed upon the licences an obligation to reforest the areas harvested, a process which generally takes eight to fourteen years. Both sale agreements provided that the purchasers assumed the obligation to reforest.

In the years in which DMI harvested timber in accordance with the forest tenures, it did not claim a tax deduction for the estimated future reforestation obligations that arose as a result of the harvesting. In the years in which the sales took place, DMI did not include in its income any amount to reflect the purchasers' assumption of the reforestation obligations.

The Minister of National Revenue reassessed DMI with respect to the 1999 and 2000 taxation years to include amounts equal to the estimated cost of the reforestation obligations in the "proceeds of disposition" under s. 13(21) of the

Income Tax Act. The Tax Court of Canada allowed DMI's appeal of the Minister's reassessment in part, holding that, upon sale of a forest tenure, the purchaser's assumption of reforestation obligations is properly included in the vendor's proceeds of disposition under s. 13(21), but that only a percentage of the estimated cost should have been included. A majority of the Court of Appeal held that DMI was required to include the entire estimated cost of the reforestation obligations associated with each tenure in its proceeds of disposition.

Held: The appeal should be allowed and the matter should be remitted to the Minister for reassessment.

DMI was not required to include the estimated cost of reforestation in its "proceeds of disposition" for income tax purposes. As a matter of principle, the assumption of a vendor's liability by a purchaser may constitute part of the sale price and therefore part of the proceeds of disposition. However, the reforestation obligation associated with a forest tenure is not a distinct existing liability that must be included in the proceeds disposition. The reforestation obligation is embedded in the forest tenure by virtue of Alberta's regulatory scheme, which prevents a vendor from selling forest tenures without also assigning the reforestation obligations. As such, they are simply a future cost tied to the tenure that depresses the value of the tenure. This is so irrespective of whether the contracting parties agreed to an estimated future cost for the reforestation or the vendor estimated the cost of future reforestation obligations to compute its income for accounting purposes.

DMI's argument that the reforestation obligations should not be included in its proceeds of disposition because they are a "contingent liability" is misplaced because it implicitly assumes that the reforestation obligations are a distinct existing liability of the vendor. As an embedded future cost, the reforestation obligations are properly excluded from proceeds of disposition regardless of whether they are contingent or absolute.

The conclusion that a purchaser's assumption of the reforestation obligations is not part of the proceeds of disposition avoids the asymmetry inherent in the Minister's approach, which would tax the vendor at the time of the sale as if the reforestation obligations assumed by the purchaser were part of the sale price, but tax the purchaser as if they were not.

Cases Cited

Referred to: *Telus Communications (Edmonton) Inc. v. Minister of National Revenue*, 2009 FCA 49, 386 N.R. 354; *Loyens v. The Queen*, 2003 TCC 214, 2003 D.T.C. 355; *Lord Elgin Hotel Ltd. v. Minister of National Revenue* (1964), 64 D.T.C. 637; *Canada v. McLarty*, 2008 SCC 26, [2008] 2 S.C.R. 79; *Winter v. Inland Revenue Commissioners*, [1963] A.C. 235; *Mandel v. The Queen*, [1980] 1 S.C.R. 318, aff'g [1979] 1 F.C. 560; *Canderel Ltd. v. Canada*, [1998] 1 S.C.R. 147.

Statutes and Regulations Cited

Forests Act, R.S.A. 1980, c. F-16, ss. 16, 17, 28(2).

Forests Act, R.S.A. 2000, c. F-22.

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 13(1), (21) “proceeds of disposition”, “timber resource property”, “undepreciated capital cost”, 39(1)(a)(iv).

Income Tax Regulations, C.R.C. 1978, c. 945, Sch. II, Class 33.

Timber Management Regulations, Alta. Reg. 60/73, s. 154.

Authors Cited

Canada. Canada Customs and Revenue Agency. Interpretation Bulletin IT-481 (Consolidated), “Timber Resource Property and Timber Limits”, January 13, 2004.

Colborne, Michael, and Steve Suarez. “Timber! Consequences of Assuming Reforestation Obligations” (2012), 60 *Can. Tax J.* 137.

Frankovic, Joseph. “Supreme Court to Hear *Daishowa* Appeal — Back to Basics on Basis and Proceeds” (July 12, 2012), CCH *Tax Topics Newsletter* No. 2105.

Gamble, Ian J. *Taxation of Canadian Mining*. Toronto: Carswell, 2004.

Hogg, Peter W., Joanne E. Magee and Jinyan Li. *Principles of Canadian Income Tax Law*, 7th ed. Scarborough, Ont.: Carswell, 2010.

Krishna, Vern. *The Fundamentals of Canadian Income Tax*, 9th ed. Toronto: Thomson/Carswell, 2006.

APPEAL from a judgment of the Federal Court of Appeal (Nadon, Layden-Stevenson and Mainville JJ.A.), 2011 FCA 267, 422 N.R. 108, 2011 D.T.C. 5157, [2012] 1 C.T.C. 116, [2011] F.C.J. No. 1351 (QL), 2011 CarswellNat 3770,

setting aside a decision of Miller J., 2010 TCC 317, 2010 D.T.C. 1216, [2010] 5 C.T.C. 2289, [2010] T.C.J. No. 228 (QL), 2010 CarswellNat 1649. Appeal allowed.

John H. Saunders, for the appellant.

David W. Jacyk and *Lisa M. Macdonell*, for the respondent.

Marta E. Burns, *Michael Sobkin*, *Jeffrey W. A. Moore* and *Monica Johnson*, for the intervener Her Majesty the Queen in Right of Alberta.

Warren J. A. Mitchell, Q.C., *Ian Gamble* and *Leah Plumridge*, for the interveners Tolko Industries Ltd., International Forest Products Ltd., West Fraser Timber Co. Ltd. and Canfor Corporation.

Al Meghji and *Monica Biringier*, for the intervener the Canadian Association of Petroleum Producers.

The judgment of the Court was delivered by

ROTHSTEIN J. —

I. Introduction

[1] In this appeal, the Court is called upon to answer the age-old question: **If a tree falls in the forest** and you are not around to replant it, how does it affect your taxes?

[2] Daishowa-Marubeni International Ltd. (“DMI”) was the owner of forest tenures in Alberta under which it was licensed to cut timber from designated provincial Crown land. In accordance with Alberta’s regulatory regime, DMI’s licence to cut timber was **subject to a corresponding obligation to reforest the areas** it harvested, in the manner specified by Alberta regulations. DMI sold two of its forest tenures and, under the terms of each sale agreement, the purchaser of each tenure assumed the obligation to reforest that arose from DMI’s past harvesting.

[3] **The issue** in this case is whether DMI was required to include in its “proceeds of disposition” for each sale an estimate of the cost of the reforestation obligations that the purchasers assumed. In my view, DMI was **not required to do so.** **The obligation to reforest** areas harvested in accordance with a forest tenure in Alberta is **a future expense that is embedded in the tenure.** As such, **the obligation serves to depress the value of the forest tenure.** It **is not a separate existing debt of the vendor that is assumed by the purchaser as part of the sale price of the forest tenure.**

II. Facts

[4] Prior to 1999, DMI operated two timber divisions that were referred to throughout these proceedings as the High Level Division and the Brewster Lumber

Division. Both divisions carried on the business of harvesting logs and manufacturing finished timber. To carry on that business, each division held a forest tenure that allowed it to cut and remove timber from an area of land owned by the province of Alberta. The High Level Division's forest tenure arose from a Forest Management Agreement that DMI signed with the province under s. 16 of the *Forests Act*, R.S.A. 1980, c. F-16, which, for the purposes of this case, is substantially similar to the *Forests Act*, R.S.A. 2000, c. F-22, which is currently in force. The Brewster Lumber Division's forest tenure arose from timber quotas issued by the province; see *Forests Act*, s. 17.

[5] In addition to permitting DMI's divisions to cut and remove timber, the Forest Management Agreement and timber quotas obliged each division to undertake certain reforestation or silviculture activities after it harvested the timber, in a manner specified by Alberta regulations. These reforestation obligations require a tenure holder, over time, to engage in activities that include brush disposal, scarification, mounding, planting, seeding, applying herbicides, brushweeding, and manual or chemical tending. The tenure holder is also required to complete and submit to the province multiple surveys to demonstrate its progress in reforesting. The tenure holder is relieved of its obligation to reforest when it satisfies the province that the reforested area has reached a threshold level of growth, referred to as "free-to-grow" status. This process generally takes eight to fourteen years. Alternatively, the province may relieve the holder of its obligation to reforest if natural processes, such as wildfire or flooding, make it impossible to achieve the regeneration standard.

[6] In 1999 and 2000, DMI sold its High Level and Brewster Lumber divisions, along with each division's forest tenure. With respect to the High Level Division, DMI entered into a sale agreement with Tolko Industries Ltd. on October 6, 1999. The agreement provided that Tolko would pay a purchase price of \$169 million for the division, plus an estimated value of the net purchased working capital. According to the agreement, \$20 million of the purchase price was allocated to the value of the High Level Division's forest tenure.

[7] The agreement to sell the High Level Division provided that Tolko would assume the reforestation obligations that had arisen as a result of DMI's past harvesting. The agreement stated that "DMI estimates in good faith that the aggregate value of the current and long term reforestation liabilities will be \$11 million". It required DMI to prepare a final estimate of the reforestation obligations after the closing date and provided for the purchase price to be adjusted in the event that the post-closing estimate of the reforestation obligations differed from DMI's original estimate. That is, if the post-closing estimate was greater than DMI's initial estimate of \$11 million, DMI was required to pay Tolko the difference. If the post-closing estimate was lower than DMI's initial estimate, Tolko was required to pay DMI the difference.

[8] On November 1, 1999, Tolko paid DMI \$169 million, plus an additional \$16.6 million for net purchased working capital. After the closing date, DMI

tendered a final estimate of the reforestation obligations that was \$296,225 greater than its initial \$11 million estimate. DMI accordingly returned \$296,225 to Tolko.

[9] DMI sold the Brewster Lumber Division, including its forest tenure, to Seehta Forest Products Ltd. on August 11, 2000. According to the sale agreement, the purchase price for the division was \$6.1 million, plus or minus any difference between the preliminary estimate of the net purchased working capital and a final estimate of the net purchased working capital. Similar to the High Level agreement, the agreement also provided that Seehta would assume all obligations to reforest land that was previously harvested pursuant to Brewster Lumber's forest tenure. The agreement did not, however, specify an estimated cost of performing the reforestation obligations.

[10] In accordance with ss. 16(3) and 28(2) of the *Forests Act* and *The Timber Management Regulations*, Alta. Reg. 60/73, s. 154, DMI sought the province of Alberta's consent to assign each of the forest tenures. The province consented to both assignments. The parties are in agreement that Alberta approves the assignment of a forest tenure only if the reforestation obligations that arose from the vendor's harvesting are undertaken by the purchaser of the tenure. Alberta, an intervener in these proceedings, takes the position that, upon assignment of a forest tenure, the vendor is relieved of any liability for completing the reforestation obligations. Upon assignment, the purchaser is solely responsible for carrying out the reforestation activities.

[11] In the years in which DMI harvested timber, for *accounting* purposes, it charged to earnings the estimated cost of future reforestation obligations in the year of the harvesting that gave rise to those obligations. However, each year, for *tax* purposes, DMI added back to its income the amounts it had charged to earnings for accounting purposes. Thus, DMI claimed no tax deduction for the estimated future reforestation obligations that arose as it harvested timber.

[12] In the years in which the sales took place, DMI increased its income for accounting purposes by including the amounts charged previously to earnings, to reflect the fact that it would no longer have to pay the future reforestation costs associated with the forest tenures it had sold. In filing its income tax return for those years, DMI did not include in its income any amount to reflect the purchasers' assumption of the reforestation obligations.

[13] The Minister of National Revenue reassessed DMI with respect to both the 1999 and 2000 taxation years. According to the Minister, DMI was required to include an amount equal to the estimated cost of the reforestation obligations assumed by Tolko and Seehta in its "proceeds of disposition" under s. 13(21) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.). The reassessment included in DMI's proceeds \$11 million for the sale to Tolko, based on the estimated cost of the reforestation obligations in the sale agreement, and \$2,996,380 for the sale to Seehta, based on the estimated cost in DMI's accounting records. DMI appealed that reassessment.

[14] The Minister's reassessment did not account for the \$296,225 that DMI returned to Tolko based on the final estimate of the future reforestation costs in reassessing DMI for the Tolko sale, but has since taken the position that that amount should have been included in the reassessment. Because the actual reassessment was based on the contracting parties' initial \$11 million estimate, the parties and the courts below have treated that as the amount in issue for the Tolko sale. I do the same in these reasons.

III. Procedural History

A. *Tax Court of Canada, 2010 TCC 317, 2010 D.T.C. 1216*

[15] Miller J. allowed DMI's appeal of the Minister's reassessment in part. He held that, upon sale of a forest tenure, the purchaser's assumption of reforestation obligations is properly included in the vendor's proceeds of disposition under s. 13(21) of the Act. He concluded that the assumption of the reforestation obligations was part of the consideration tendered for the forest tenure. Here, it was evident that the assumption of the reforestation obligations was part of the consideration received based on DMI's admission that "[i]f 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": A.R., at p. 286.

[16] According to Miller J., however, it was not appropriate to add the entire estimated cost of the reforestation obligations to DMI's proceeds of disposition.

After considering a number of factors, Miller J. concluded that DMI should have included in its proceeds of disposition the estimated cost of the reforestation activities that would take place within the 12 months following each sale, plus 20 percent of the estimated cost of the activities that would take place thereafter.

B. *Federal Court of Appeal, 2011 FCA 267, 422 N.R. 108*

[17] Writing for the majority, Nadon J.A. held that DMI was required to include in its proceeds of disposition the entire estimated cost of the reforestation obligations associated with each tenure.

[18] Nadon J.A. agreed with the Tax Court that a purchaser's assumption of reforestation obligations amounts to consideration received by the vendor. According to Nadon J.A., with respect to the sale of the High Level Division to Tolko, the Tax Court erred by treating the \$11 million cost of the reforestation obligations as an estimate that could be discounted for tax purposes. The relevant inquiry was the value attributed to the reforestation obligations by the contracting parties. Here, the sale agreement demonstrated that DMI and Tolko valued the reforestation obligations at \$11 million and thus that full amount should have been added to DMI's proceeds of disposition from the sale.

[19] Nadon J.A. found that the trial judge's reasons were inadequate with respect to the sale of the Brewster Lumber Division to Seehta because the trial judge did not address whether the evidence related to the transaction showed that DMI and

Seehta had agreed to a value for the reforestation obligations. The majority thus upheld the Minister's reassessment with respect to the sale of the High Level Division, but remitted the matter to the Tax Court for redetermination with respect to the sale of the Brewster Lumber Division.

[20] Mainville J.A. dissented. In his view, the reforestation obligations "form an integral part of the forest tenures, and, though they affect the value of the tenures, they are not a separate consideration of the sale transactions involving the tenures, and should thus not be added to the vendor's proceeds of disposition resulting from those sales": para. 128. For that reason, he concluded:

The proper approach in these proceedings is to recognize that the reforestation liabilities at issue depress the value of the timber resources properties to which they are inextricably linked, and that consequently the vendor in this case received a lower price on the sale of these properties than it might have otherwise received. [para. 130]

[21] On this basis, Mainville J.A. would have allowed DMI's appeal and dismissed the government's cross-appeal.

IV. Issues

[22] This Court granted leave on two issues:

1. Are the reforestation liabilities to be included in the proceeds of disposition because the vendor is relieved of a liability or are they integral to and run with the forest tenures?

2. Does it make any difference that the parties agreed to a specific amount of the future reforestation liability?

V. Analysis

A. *Whether the Reforestation Obligations Had To Be Included in DMI's Proceeds of Disposition*

(1) Whether Reforestation Obligations Are a Distinct Debt of DMI or Are Embedded in the Forest Tenure

[23] The parties agree that each of the forest tenures sold in this case is a “timber resource property” within the meaning of s. 13(21) of the *Income Tax Act* because each provides “a right or licence to cut or remove timber from a limit or area in Canada”.

[24] A timber resource property is treated as a hybrid for tax purposes. On the one hand, it is treated as a capital property for the purposes of capital cost allowance, such that the owner of a timber resource property may take an annual deduction on income equal to a percentage of the undepreciated capital cost; see *Income Tax Regulations*, C.R.C. 1978, c. 945, Sch. II, Class 33. On the other hand, a timber resource property is excluded from capital gains treatment: *Income Tax Act*, s. 39(1)(a)(iv). Therefore, upon sale of a timber resource property, any proceeds of disposition in excess of the property’s capital cost are treated as income; see *Income Tax Act*, s. 13(1) and (21) (variable G); Canada Customs and Revenue Agency,

Interpretation Bulletin IT-481 (Consolidated), “Timber Resource Property and Timber Limits” (Jan. 13, 2004), at para. 2.

[25] As set forth above, **the issue** in this appeal is whether the owner of a forest tenure who sells the tenure must include the estimated amount of future reforestation costs assumed by the purchaser in its proceeds of disposition. Section 13(21) of the *Income Tax Act* defines “proceeds of disposition” to include “the **sale price** of property that has been sold”. The focus of this case is thus on whether the purchasers’ assumption of the reforestation obligations arising from DMI’s previous harvesting is included in the sale price of the forest tenure.

[26] It is beyond dispute that, as a matter of principle, **the assumption of a vendor’s liability** by a purchaser may constitute part of the sale price and therefore part of the vendor’s proceeds of disposition; see, e.g., *Telus Communications (Edmonton) Inc. v. Minister of National Revenue*, 2009 FCA 49, 386 N.R. 354, at para. 28; *Loyens v. The Queen*, 2003 TCC 214, 2003 D.T.C. 355 (General Procedure), at paras. 31 and 33. A straightforward example of such a circumstance would be the purchase of a property that is encumbered by a mortgage. If, for instance, an individual purchases a building by paying some cash and also assumes the mortgage encumbering the property, the sale price of the property includes the amount of the cash received and the amount remaining on the mortgage assumed; see *Loyens*, at paras. 31 and 33. The vendor’s proceeds of disposition for tax purposes would thus

include both amounts; see *Lord Elgin Hotel Ltd. v. Minister of National Revenue* (1964), 64 D.T.C. 637 (Tax Appeal Board), at paras. 11-12.

[27] The Minister submits that a forest tenure with reforestation obligations that have arisen under Alberta law from past harvesting is analogous to property encumbered by a mortgage. According to the Minister, upon sale of the forest tenure, the purchaser's assumption of reforestation obligations, like the assumption of a mortgage, forms part of the sale price and must be included in the vendor's proceeds of disposition.

[28] DMI, supported by the industry interveners, submits that the analogy to a mortgage is misplaced. In their view, a forest tenure with reforestation obligations that have arisen from past harvesting is better analogized to property that is in need of repair. The need for repairs has the effect of depressing the property's value. If property in need of repair is sold, the purchaser's assumption of the cost of repairs does not form an additional part of the sale price of the property. And, as the Minister acknowledged at the oral hearing, the vendor would not be required to include in its proceeds of disposition an amount to reflect the estimated repair costs assumed by the purchaser. This would be true even if the parties attributed a value to the cost of those repairs in their contract and even if the repairs were required by law; see M. Colborne and S. Suarez, "Timber! Consequences of Assuming Reforestation Obligations" (2012), 60 *Can T.J.* 137, at p. 142.

[29] I agree with Mainville J.A., DMI and the industry interveners that the assumed reforestation obligations are not appropriately characterized as the assumption of an existing debt of the vendor that forms part of the sale price of the property. The obligations — much like needed repairs to property — are a future cost embedded in the forest tenure that serves to depress the tenure's value at the time of sale. This is different from a mortgage, which, as I explain below, does not affect the value of the property it encumbers.

[30] In this case, the reforestation obligations are embedded in the forest tenure by reason of the policy and practice of Alberta. As described above, Alberta law provides that a forest tenure may be transferred only with the consent of the appropriate provincial official; see the *Forests Act*, ss. 16(3) and 28(2), and *The Timber Management Regulations*, s. 154. As the trial judge found (para. 26) and Alberta has affirmed before this Court (factum, at paras. 24-26), “the Province of Alberta will not approve of a transfer of the forest tenures, unless a purchaser assumes the reforestation liability”. That is, “the situation in Alberta is that the Province effectively forces the purchaser to assume the reforestation liability: no assumption — no transfer of forest tenures”: para. 26. Further, Alberta takes the position that, after an assignment has been approved by the province, the vendor is absolved of all liability for the reforestation obligations.

[31] The effect of Alberta's scheme is to embed the reforestation obligations into the forest tenure, such that the obligations cannot be severed from the property

itself. As such, the reforestation obligations are simply a future cost tied to the tenure that depresses the value of the tenure. A prospective purchaser of the tenure would take into account the income-earning potential of the tenure as well as the expected future costs associated with ownership of the tenure. The existence of reforestation obligations, a future cost that cannot be severed from the tenure, would decrease the amount such a prospective purchaser would be willing to pay; see J. Frankovic, “Supreme Court to Hear *Daishowa* Appeal — Back to Basics on Basis and Proceeds”, (July 12, 2012), CCH *Tax Topics Newsletter* No. 1205, at pp. 2-3. Here, for instance, the record establishes that Tolko valued the High Level Division’s forest tenure at \$31 million less the \$11 million estimated cost of future reforestation obligations. The forest tenure thus had a value of \$20 million. To include the full \$31 million in DMI’s proceeds of disposition would disregard the fact that DMI did not have \$31 million of value to sell. Under no circumstances could DMI have received \$31 million for the forest tenure.

[32] This distinguishes the reforestation obligations tied to a forest tenure from a mortgage, which does not affect the value of the property it encumbers. For instance, a property worth \$31 million that is encumbered by a mortgage of \$11 million, despite the mortgage, still has a value of \$31 million. The vendor of such a property could obtain \$31 million for it and then pay off the mortgage. Alternatively, the vendor could obtain \$20 million and have the purchaser assume the mortgage. In either case, it makes sense for the vendor’s proceeds of disposition to equal the full \$31 million because that is the value of the asset being sold.

[33] Parenthetically, I note that it is true that in some circumstances, the *terms* of a mortgage might have an impact on the sale price of the property it encumbers. If, for instance, property is encumbered by a mortgage with a very favourable interest rate, it will be more attractive to purchasers who can assume such a mortgage and such purchasers will be prepared to pay more on that account. However, in such circumstances, the favourable interest rate has a separate value of its own to the purchaser who can assume the mortgage. The interest rate does not affect the value of the property. In any case, here, the Minister analogizes future reforestation costs to the vendor's *indebtedness* on a mortgage. As I have explained, the vendor's indebtedness does not affect the value of the property.

[34] At the oral hearing, the Minister's argument was that a forest tenure with reforestation obligations that have arisen from past harvesting differs from property that must be repaired because DMI's liability for the reforestation obligations had "crystallized" by the time of the sale. According to the Minister, the debt was "crystallized" because (1) at the time DMI sold the forest tenure, it had already incurred obligations to reforest land based on its past harvesting, and (2) it could not simply walk away from those obligations. The Minister submits that in these circumstances, DMI benefitted from the purchasers' assumption of the reforestation obligations by an amount equal to the estimated cost of the reforestation obligations.

[35] As Mr. Meghji, arguing for the Canadian Association of Petroleum Producers ("CAPP"), explained at the oral hearing, the problem with the Minister's

argument is that it presupposes that the reforestation obligations are a distinct existing liability. Implicit in the argument that DMI could not simply walk away from the reforestation obligations is the proposition that the obligations were an existing indebtedness of DMI. As I have explained above, the reforestation obligations were not a distinct existing debt, like a mortgage, but were embedded in the tenure so as to be a future cost associated with ownership of the tenure.

[36] I have concluded that Alberta's regulatory scheme, which prevents a vendor from selling a forest tenure without also assigning the reforestation obligations that have arisen from past harvesting, has the effect of embedding those reforestation obligations in the tenure itself. In this appeal, CAPP submits that future obligations may be embedded in a property right absent a legal requirement that precludes a vendor from selling the property right without assigning the obligations. CAPP submits, using the example of the mining of gas and oil, that statutory obligations to reclaim mined land may be so physically connected to the process of mining itself that the obligations cannot be separated from the property right. While I need not decide that question on the record before me, I would certainly not foreclose the possibility that obligations associated with a property right could be embedded in that property right without there being a statute, regulation or government policy that expressly restricts a vendor from selling the property right without assigning those obligations to the purchaser.

[37] In sum, the reforestation obligations imposed by Alberta law on DMI's forest tenures are embedded in those tenures and, as such, are future expenses tied to ownership of the property. They are not a liability that can be separated from the forest tenure, the assumption of which would form part of the sale price of the tenure. I would therefore reject the Minister's argument that the purchasers' assumption of the reforestation obligations had to be added to DMI's proceeds of disposition for income tax purposes.

(2) Contingent Liabilities

[38] DMI has also argued that it should not have been required to add the reforestation obligations to its proceeds of disposition because the obligations were a contingent liability.

[39] A contingent liability is "a liability which depends for its existence upon an event which may or may not happen": *Canada v. McLarty*, 2008 SCC 26, [2008] 2 S.C.R. 79, at para. 17, quoting *Winter v. Inland Revenue Commissioners*, [1963] A.C. 235 (H.L.), at p. 262. This Court has recognized that the contingent nature of a liability may have implications on the tax treatment of the liability. In *McLarty*, for instance, this Court recognized that, although a taxpayer generally incurs an expense when he has a legal obligation to pay a sum of money, no expense is incurred for tax purposes if the liability is contingent: paras. 14-16. In *Mandel v. The Queen*, [1980] 1 S.C.R. 318, aff'g [1979] 1 F.C. 560, this Court affirmed the Federal Court of

Appeal's determination that a taxpayer who purchases a capital asset may not include in his capital cost a liability to the vendor if the liability is contingent.

[40] However, DMI's argument that the reforestation obligations should not be included in its proceeds of disposition because they are a "contingent liability" is misplaced and appears to have caused some confusion in the courts below. The argument is problematic because, in focusing on whether the reforestation obligations are contingent or absolute, it implicitly accepts that the cost of reforestation is a liability of the vendor that is not embedded in the forest tenure and would constitute proceeds of disposition but for the contingent nature of the liability; see Frankovic, at p. 4. This implicit assumption is incorrect. As I have explained above, the cost of reforestation is not a distinct existing liability of the vendor. The assumption of the cost of reforestation would thus be excluded from proceeds of disposition independent of whether the cost is absolute or contingent. Using the example of the sale of a building in need of repair, the purchaser's assumption of the future cost of repairing the building is not part of the sale price of the building regardless of whether the purchaser is certain he will have to spend a specific amount on repairs in the future — such that the cost is absolute — or the requirement for repairs depends on some future event — such that the cost is contingent. The certainty or likelihood of the cost of repairs may, of course, affect the sale price by affecting the amount the purchaser is willing to pay for the building. It does not, however, affect whether the cost of repairs is part of the proceeds of disposition. The same is true of the reforestation obligations embedded in a forest tenure.

(3) Avoidance of Asymmetrical Tax Treatment

[41] The approach advanced by the Minister would lead to asymmetry between the vendor's proceeds of disposition and the purchaser's adjusted cost base at the time a forest tenure is acquired. The Minister's position is that the purchaser's adjusted cost base upon acquiring a forest tenure does not include the estimated reforestation obligations assumed. Notwithstanding that, the Minister would have the vendor's proceeds of disposition include the amount paid to the vendor plus an additional amount for the estimated future reforestation obligations assumed by the purchaser. The effect would be to tax the vendor as if the reforestation obligations assumed by the purchaser were part of the sale price, but to tax the purchaser as if the reforestation obligations it assumed were not part of the sale price; see P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (7th ed. 2010), at p. 322, which explains that a taxpayer's adjusted cost base generally includes the purchase price of the property, as well as any expenses or fees required to associated with the acquisition of the property.

[42] Counsel for the Minister acknowledged this asymmetry at the oral hearing. Under the Minister's approach, the sale of the High Level Division to Tolko would have resulted in taxable proceeds of \$31 million for DMI (\$20 million received plus \$11 million in assumed reforestation obligations). However, Tolko's adjusted cost base would be \$20 million (just the amount paid). The Minister's asymmetrical approach means that if Tolko sold the forest tenure to a new purchaser the very next

day, Tolko would be assessed taxable proceeds of \$31 million (the amount received plus the assumption of the future reforestation costs). That is, Tolko would be assessed \$11 million of taxable income, despite in no way receiving such additional income.

[43] The conclusion I have reached — that a purchaser's assumption of reforestation obligations does not form part of the vendor's proceeds of disposition — avoids this asymmetry. Although not dispositive, as Mainville J.A. recognized in his dissent, an interpretation of the Act that promotes symmetry and fairness through a harmonious taxation scheme is to be preferred over an interpretation which promotes neither value.

B. *Whether it Makes any Difference that the Contracting Parties Agreed to a Specific Amount of the Future Reforestation Obligations*

[44] The Minister reassessed DMI with respect to the Tolko sale using the \$11 million estimated cost of the reforestation obligations included in the sale agreement and reassessed DMI with respect to the Seehta sale using DMI's internal accounting estimates. The trial judge's determination of DMI's tax liability relied upon both of those estimates. According to the majority of the Court of Appeal, whether reforestation costs should be included in proceeds of disposition turns on whether the contracting parties agreed to an estimated future cost. It thus upheld the Minister's reassessment in the Tolko sale, but remitted the matter to the trial judge to determine whether there was an agreement as to the cost in the Seehta sale.

[45] In accordance with the analysis above, DMI's proceeds of disposition do not depend on whether the contracting parties agreed to a specific estimate of the cost of those obligations in their sale agreement. Any amount that the parties assigned to the reforestation obligations in the sale agreement was simply a factor in determining the fair market value of the forest tenures: I. J. Gamble, *Taxation of Canadian Mining* (2004), ch. 6.6.2, at pp. 6-14 to 6-15.

[46] It is also irrelevant that DMI estimated the cost of future reforestation to compute its income for accounting purposes. Although commercial and accounting principles allowed DMI to deduct reforestation obligations on a yearly basis and add back to income the deducted amounts at the time of the sale to provide a more accurate picture of its profit from year to year, as I have explained above, the *Income Tax Act* does not permit that approach; see V. Krishna, *The Fundamentals of Canadian Income Tax* (9th ed.), at pp. 171-72. This Court has recognized the distinct purposes of financial accounting and income tax calculation: *Canderel Ltd. v. Canada*, [1998] 1 S.C.R. 147, at para. 36. It would thus be an error to simply include DMI's accounting estimates in its proceeds of disposition.

VI. Conclusion

[47] DMI was not required to include in its taxable proceeds of disposition an amount reflecting the future reforestation costs assumed by Tolko and Seehta.

[48] The appeal is allowed with costs throughout to DMI and the matter is remitted to the Minister for reassessment in accordance with these reasons.

Appeal allowed with costs throughout.

Solicitors for the appellant: Wilson & Partners, Vancouver.

Solicitor for the respondent: Attorney General of Canada, Vancouver.

Solicitor for the intervener Her Majesty the Queen in Right of Alberta: Attorney General of Alberta, Edmonton.

Solicitors for the interveners Tolko Industries Ltd., International Forest Products Ltd., West Fraser Timber Co. Ltd. and Canfor Corporation: Thorsteinssons, Vancouver.

Solicitors for the intervener the Canadian Association of Petroleum Producers: Osler, Hoskin & Harcourt, Toronto.

