Federal Court of Appeal		Cour d'appel fédérale

Date: 20110923

Docket: A-287-10

Citation: 2011 FCA 267

CORAM: **NADON J.A.**
LAYDEN-STEVENSON J.A.
MAINVILLE J.A.

BETWEEN:

DAISHOWA-MARUBENI INTERNATIONAL LTD.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Vancouver, British Columbia, on May 3, 2011.

Judgment delivered at Ottawa, Ontario, on September 23, 2011.

REASONS FOR JUDGMENT BY: NADON J.A.

CONCURRED IN BY: LAYDEN-STEVENSON J.A.

DISSENTING REASONS BY: MAINVILLE J.A.

Federal Court of Appeal		Cour d'appel fédérale

Date: 20110923

Docket: A-287-10

Citation: 2011 FCA 267

CORAM: **NADON J.A.**
LAYDEN-STEVENSON J.A.
MAINVILLE J.A.

BETWEEN:

DAISHOWA-MARUBENI INTERNATIONAL LTD.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

REASONS FOR JUDGMENT

NADON J.A.

[1] Before us are an appeal and a cross-appeal from a Judgment dated June 11, 2010, 2010 TCC 317, 2010 DTC 1216, by Mr. Justice Campbell J. Miller (the Judge) of the Tax Court of Canada, wherein the Judge allowed in part the appellant's appeals from the Minister of Revenue's (the Minister) reassessments of its 1999 and 2000 taxation years.

[2] More particularly, the Judge concluded that the Minister was correct to include, in the calculation of the appellant's proceeds of disposition of two sawmill operations which included the transfer of forest tenures, the appellant's silviculture liabilities assumed by the purchasers as part of

the sales of the sawmill operations. However, the Judge concluded that the amounts of $11,000,000 and $2,996,380 included by the Minister constituted an error on his part.

[3] As a result, the Judge determined that the amounts that should have been included in the appellant's proceeds of disposition under subsection 13(21) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Suppl.) (the *Act*) were amounts which represented the current reforestation liability and the long-term reforestation liability discounted by 80%. The Judgment reads as follows:

> 1. On the sale to Tolko [the High Level Division], 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 [the Brewster Division], 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.

[4] Both the appellant and the respondent take issue with the Judge's decision. The appellant, on its appeal, takes the position that the Judge erred in including the assumption of silviculture (or reforestation) liabilities in the proceeds of disposition. In the alternative, the appellant says that it was entitled to an offsetting deduction equal to the amount included in the proceeds of disposition. On its cross-appeal, the respondent says that the Judge erred in ignoring the values attributed by the parties to the silviculture liabilities pursuant to their respective contracts, adding that it was not open to the Judge to arrive at values other than those agreed to by the parties.

The Facts

[5] During the 1990s, the appellant operated pulp mills in Peace River, Alberta and in Quesnel, British Columbia, from which it supplied pulp to its two shareholders, Daishowa Paper Manufacturing Co. Ltd. and Marubeni Corp.

[6] Two of the appellant's subsidiaries, namely High Level Forest Products Ltd., situated in High Level, Alberta and Brewster Construction Ltd., situated near Red Earth, Alberta, carried on the business of harvesting logs and manufacturing finished timber and other goods.

[7] On January 1, 1999, the appellant amalgamated with its subsidiaries, which became divisions thereof, namely the High Level Division (High Level) and the Brewster Lumber Division (Brewster). The Peace River pulp operation (Peace River) became the appellant's third division. With respect to High Level and Peace River, the appellant and the Province of Alberta entered into a Forest Management Agreement (FMA). With respect to Brewster, the appellant held a timber quota. Both the FMA and the timber quota (jointly, the timber rights) included a right or licence to cut or remove timber from a limit or area in Canada for the purposes of the definition of a "timber resource property" found in subsection 13(21) of the *Act*.

[8] Pursuant to the timber rights, the appellant was bound to provide reforestation plans to the Province of Alberta on an annual basis and to reforest all lands cut over by it (the silviculture liability or the reforestation obligations).

[9] At all times material to this appeal, Alberta law and the regulatory policies adopted pursuant thereto provided that a company's silviculture liability was not satisfied until a sufficient reforested tree crop passed a free-growing growth point. Generally, this took between eight to fourteen years from the date of cutting.

[10] By 1999, the appellant had decided to sell both High Level and Brewster. First, in 1999, it sold High Level to Tolko Industries Ltd. (Tolko). Pursuant to the sale, the appellant's FMA as well as various timber quotas, licence and permits were assigned to Tolko. Included in the sale was the disposition of a Timber Licence, a "timber resource property" for the purposes of subsection 13(21) of the *Act*.

[11] The sale of High Level was effected through a bid process with a submission date of September 23, 1999, resulting in the receipt of 5 separate bids for the purchase of High Level. After consideration of these bids, the appellant concluded that Tolko's bid 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 liability, was the most favourable. As of September 24, 1999, the appellant decided to negotiate the final terms of the sale as quickly as possible so as to minimize the possibility that Tolko might withdraw or reduce its bid.

[12] Although Tolko was prepared to accept the long-term reforestation obligation, it wanted the final adjusted silviculture liability to be audited and quantified and thus proposed a pricing formula

that set a gross price from which the amount that would be quantified for the long-term silviculture liability would be deducted.

[13] The appellant and Tolko signed their Agreement (Agreement or Contract) on October 6, 1999, with a closing date scheduled for November 1, 1999. As part of the Agreement, the appellant agreed to complete and produce a reforestation statement to confirm the quantification of the silviculture liability which Tolko would assume. In particular, the Agreement provided the following: (i) a purchase price of $169,000,000 for certain assets, plus (or minus); (ii) a net purchased working capital estimated at $16,628,400 plus (or minus) any difference between a preliminary and a final calculation; (iii) the assumption of $11,000,000 of estimated silviculture liability by Tolko, plus (or minus) any difference between a preliminary and a final estimate of assumed silviculture liability.

[14] On November 1, 1999, Tolko made a cash payment of $185,628,400 to the appellant.

[15] Pursuant to information provided by the appellant, the reforestation statement which it had agreed to produce was completed by PricewaterhouseCoopers LLP, Canada (the Accountants) on November 19, 1999. Based on this statement, the calculation of the silviculture liability was quantified at $296,225 more than the original estimate of $11,000,000. As a result, the appellant issued a bank draft in favour of Tolko in the amount of $296,225 plus interest.

[16] Consequently, as of October 31, 1999, the silviculture liability of $11,296,225 was classified by the appellant as a long-term liability of $9,238,727 – an amount that would not be expended within the 12 months following October 31, 1999 – and a current liability of $2,057,398 – an amount that would be expended within the 12 months following October 31, 1999. Of the $11,296,225 silviculture liability, a sum not exceeding $400,000 would have been spent during the appellant's 1999 tax year.

[17] Between the years 2000 and 2008, Tolko spent no less than $4,733,184.50 with respect to the silviculture liability it assumed when it purchased High Level.

[18] It is agreed by the parties that if Tolko had not assumed the appellant's silviculture liability, the amount of cash or other consideration that it would have paid to the appellant would have been greater.

[19] I now turn to the facts pertaining to the sale of Brewster. In the year 2000, the appellant sold Brewster to Seehta Forest Products (Seehta). The sale included the disposition of a Timber Licence, a "timber resource property" for the purposes of subsection 13(21) of the *Act*. The Agreement with Seehta was signed on August 11, 2000, with a closing date scheduled for November 24, 2000. Prior to the sale of Brewster, the appellant commissioned an independent valuation prepared by CIBC World Markets. The valuation was completed on June 30, 1999 and provided two valuations to the appellant. The first one provided for an amount "as low as $10,250,000" based on "limited

assumptions" by the purchaser. The second valuation, based on "unlimited assumptions" by the purchaser, was for a figure "as high as $35,406,000".

[20] The purchase price for Brewster was $6,100,000 cash for certain assets (plus or minus) any difference between a preliminary estimate of the net purchased working capital of $4,919,000 and a final estimate of the net purchased working capital (plus or minus). The terms of the sale of Brewster to Seehta also included the assumption of the silviculture liability. In that regard, the appellant's accounting estimate of its reforestation obligations, which appeared on its interim financial statements dated October 31, 2000, was $2,996,380. In its income tax return for the 2000 taxation year, the appellant indicated that its silviculture liability pertaining to Brewster was $2,996,380, which, as of December 31, 1999, the appellant classified as a long-term liability of $1,837,995 – an amount that would not be expended within the 12 months following December 31, 1999 – and a current liability of $558,615 – an amount that would be expended within the 12 months following December 31, 1999.

[21] Most of the silviculture liability assumed by Seehta as of November 24, 2000, i.e. the date of the Brewster disposition, was a long-term liability and not a current liability. Finally, of the portion of the silviculture liability that was current, only a small portion thereof could have been spent on silviculture during the appellant's 2000 taxation year.

[22] A few more facts to complete the picture will be helpful.

[23] The parties to the sales of both High Level and Brewster did not allocate any value to goodwill. Although the appellant could have sold both of its divisions without the Timber Licences, these licences were considered to be essential elements of the sales in the industry. Also of relevance is the fact that the Province of Alberta consented to the assignment of the Timber Licences to Tolko and Seehta. When giving its consent to the assignment of a Timber Licence, as in this case, the Province of Alberta took the position that, pursuant to the *Forests Act*, RSA 2000, c.-F-22, and the *Timber Management Regulations*, Alta. Reg. 60-1973, the assignee assumed the reforestation liability corresponding to the forest tenure and that, as a result, the assignor was no longer liable.

[24] In reporting its income for the 1999 and 2000 taxation years, the appellant did not include in its proceeds of disposition any amounts pertaining to the silviculture liabilities assumed by the purchasers.

[25] The Minister reassessed the appellant in respect of both sales by including, in the calculation of its proceed of disposition of "timber resource properties", the following amounts of estimated silviculture liability: $11,000,000 in respect of High Level and $2,966,301 in respect of Brewster.

The Tax Court Decision

[26] Other than brief remarks to the effect that the factual situation of the Brewster sale was indistinguishable from that of the High Level sale, the Judge's Reasons deal exclusively with the sale of High Level to Tolko.

[27] In allowing the appellant's appeal in part, the Judge found that Tolko's assumption of the appellant's reforestation obligations constituted consideration that could properly be included in the appellant's proceeds of disposition under subsection 13(21) of the *Act* (Judge's Reasons, paras. 24 to 27). In so concluding, the Judge noted that the appellant had admitted that it would have received additional consideration had Tolko not assumed its silviculture liability as part of the sale. He further noted that the applicable provincial legislation effectively forced all purchasers of forest tenures in Alberta to assume any corresponding reforestation liability.

[28] The Judge then analyzed the appellant's claim that the value of the purported benefit was so uncertain that it could not be included for tax purposes in its proceeds of disposition. More particularly, he found that although the deal was based on an audited estimate setting the value of the silviculture liability at $11,000,000, the parties did not actually agree that the appellant would receive additional consideration of $11,000,000 by reason of Tolko's assumption of the silviculture liability.

[29] Considering the realities of the timber industry, the Judge was satisfied that the reforestation liability arose as soon as a stand of trees was cut, but that the corresponding reforestation costs would not be known until the reforestation expenses were actually incurred. Although he did not accept that the authorities shielded the assumption of the appellant's silviculture liability from taxation, he found that only a portion of the estimated liability would be subject to tax. In so concluding, he noted that considerable uncertainty existed in estimating the value of the reforestation liability in that it was spread over many years, the appellant had little control over the

forces that would render the amount more certain, only when the amount became certain did it become deductible in that it was spent, and there was a significant tax impact of including the whole amount (Judge's Reasons, para. 39).

[30] It is clear that the Judge understood that Tolko had been successful in negotiating an $11,000,000 deduction in regard to the purchase price that it had originally offered, as a result of its assumption of the appellant's silviculture liability. However, in his view, the parties had not agreed that this amount constituted the actual value of the liability, the value of the benefit to the appellant by reason of the assumption of liability, or the value of the consideration that Tolko was actually offering. Rather, the Judge concluded that, in the circumstances, a proper disposition of the issue was to include in the appellant's proceeds of disposition an amount equalling the current reforestation liability of $2,057,498, and the long-term reforestation liability discounted by 80% so as to reflect six factors which he outlined at paragraph 40 of his Reasons.

[31] The Judge then dealt with the appellant's argument that, in the event he found that any amount fell into the proceeds of disposition, it was entitled to an offsetting deduction because of its payment to Tolko of assets (the forest tenure) to assume the reforestation liability. The Judge found this argument to be without merit because of his view that the transaction was one for the sale of capital assets and that the assumption of the reforestation liability was "simply part of that capital transaction" (Judge's Reasons, para. 44).

[32] The Judge further held that subsection 18(9) of the *Act* had no application to the transaction. At paragraph 49 of his Reasons, he dealt with that issue in the following terms:

> 49. The Respondent argues that this [subsection 18(9) of the *Act*] 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.

[33] Finally, the Judge, at paragraph 52 of his Reasons, indicated that he saw "no difference in the fact situation of the Seehta matter to reach any different conclusion". As a result, he rendered the Judgment which I have reproduced above at paragraph 3.

The Issues

[34] In order to dispose of the appeal and the cross-appeal, a number of issues must be addressed:

a. What is the applicable standard of review?

b. Did the Judge err in concluding that the silviculture liabilities assumed by the purchasers were to be included in the appellant's proceeds of disposition for the 1999 and 2000 taxation years? If the Judge made no error in so concluding, did the parties to the Agreements of sale of both High Level and Brewster agree to attribute a value to the reforestation liabilities assumed by the purchasers and, if so, what consequences flow from attributing values thereto?

c. Was the Trial Judge correct in concluding that only 20% of the long-term reforestation liability should be included in the appellant's income as proceeds of sale in the relevant tax years?

d. Was the appellant entitled to claim either a deduction from its income or include the capital expenditure amount paid for having the purchasers assume the reforestation liability in its adjusted cost base?

e. Did the judge err in allocating the $11,000,000 in respect of the silviculture liability to the timber resource property as opposed to goodwill?

f. Were the Judge's Reasons adequate?

g. Were the respondent's pleadings sufficient to ground the Judge's findings?

Relevant Legislative Provisions

[35] Before addressing the issues which arise in the appeal and the cross-appeal, it will be helpful to reproduce a number of provisions of the *Act* which are relevant to the determination of those issues.

13. (1) Where, at the end of a taxation year, the total of the amounts determined for E to J in the definition "undepreciated capital cost" in subsection 13(21) in respect of a taxpayer's depreciable property of a particular prescribed class exceeds the total of the amounts determined for A to D in that definition in respect thereof, the excess shall be included in computing the taxpayer's income for the year.	**13.** (1) Tout contribuable doit inclure, dans le calcul de son revenu pour une année d'imposition, l'excédent éventuel à la fin de l'année du total des sommes représentées par les éléments E à J de la formule figurant à la définition de «fraction non amortie du coût en capital» au paragraphe (21) sur le total des sommes représentées par les éléments A à D de cette formule, concernant ses biens amortissables d'une catégorie prescrite.

…

(21) In this section,

"proceeds of disposition" of property includes,
(a) the sale price of property that has been sold,

…

"timber resource property" of a taxpayer means
(a) a right or licence to cut or remove timber from a limit or area in Canada (in this definition referred to as an "original right") if
(i) that original right was acquired by the taxpayer (other than in the manner referred to in paragraph 13(21) "timber resource property" (b)) after May 6, 1974, and
(ii) at the time of the acquisition of the original right
(A) the taxpayer may reasonably be regarded as having acquired, directly or indirectly, the right to extend or renew that original right or to acquire another such right or licence in substitution therefor, or
(B) in the ordinary course of events, the taxpayer may reasonably expect to be able to extend or renew that original right or to acquire another such right or licence in substitution therefor, or
(b) any right or licence owned by the taxpayer to cut or remove timber from a limit or area in Canada if that right or licence may reasonably be regarded

…

(21) Les définitions qui suivent s'appliquent au présent article.

«produit de disposition » Le produit de disposition de biens comprend:
a) le prix de vente de biens qui ont été vendus;

[…]

«avoir forestier»
a) Droit ou permis de couper ou de retirer du bois sur une concession ou un territoire du Canada (appelé «droit initial» à la présente définition) si:
(i) d'une part, le contribuable a acquis ce droit initial (mais non de la manière visée à l'alinéa b)) après le 6 mai 1974,
(ii) d'autre part, au moment de l'acquisition du droit initial:
(A) soit il est raisonnable de considérer que le contribuable a acquis, directement ou indirectement, le droit à la prolongation ou au renouvellement de ce droit initial ou le droit d'acquérir un autre droit ou permis de ce genre pour le remplacer,
(B) soit dans le cours ordinaire des choses, le contribuable peut raisonnablement s'attendre de pouvoir obtenir la prolongation ou le renouvellement de ce droit initial ou de pouvoir acquérir un autre droit ou permis de ce genre pour le remplacer;

b) droit ou permis de couper ou de retirer du bois sur une concession ou un territoire du Canada dont le contribuable est propriétaire s'il est

(i) as an extension or renewal of or as one of a series of extensions or renewals of an original right of the taxpayer, or
(ii) as having been acquired in substitution for or as one of a series of substitutions for an original right of the taxpayer or any renewal or extension thereof;

raisonnable de considérer ce droit ou ce permis :
(i) soit comme une prolongation ou un renouvellement d'un droit initial ou comme l'une de plusieurs prolongations ou l'un de plusieurs renouvellements d'un tel droit du contribuable,
(ii) soit comme ayant été acquis en remplacement d'un droit initial du contribuable ou en remplacement d'un renouvellement ou d'une prolongation de celui-ci ou lors de l'un de plusieurs remplacements d'un tel droit, ou d'un renouvellement ou d'une prolongation d'un tel droit.

…

[…]

"undepreciated capital cost" to a taxpayer of depreciable property of a prescribed class as of any time means the amount determined by the formula
(A + B + C + D + D.1) - (E + E.1 + F + G + H + I + J + K)
where
A is the total of all amounts each of which is the capital cost to the taxpayer of a depreciable property of the class acquired before that time,

«fraction non amortie du coût en capital»
S'agissant de la fraction non amortie du coût en capital existant à un moment donné pour un contribuable, relativement à des biens amortissables d'une catégorie prescrite, le montant calculé selon la formule suivante:
(A + B + C + D + D.1) - (E + E.1 + F + G + H + I + J + K)
où:
A représente le total des sommes dont chacune est le coût en capital que le contribuable a supporté pour chaque bien amortissable de cette catégorie acquis avant ce moment;

…

[…]

G is the total of all amounts each of which is the proceeds of disposition before that time of a timber resource property of the taxpayer of the class

G le total des sommes dont chacune est, pour une disposition, avant ce moment, d'un avoir forestier de cette catégorie dont le contribuable est

minus any outlays and expenses to the extent that they were made or incurred by the taxpayer for the purpose of making the disposition,

propriétaire, le produit de disposition de cet avoir moins les dépenses engagées ou effectuées en vue de la disposition;

[…]

…

18. (1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of

18. (1) Dans le calcul du revenu du contribuable tiré d'une entreprise ou d'un bien, les éléments suivants ne sont pas déductibles :

…

[…]

(b) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part;

b) une dépense en capital, une perte en capital ou un remplacement de capital, un paiement à titre de capital ou une provision pour amortissement, désuétude ou épuisement, sauf ce qui est expressément permis par la présente partie;

…

[…]

(e) an amount as, or on account of, a reserve, a contingent liability or amount or a sinking fund except as expressly permitted by this Part;

e) un montant au titre d'une provision, d'une éventualité ou d'un fonds d'amortissement, sauf ce qui est expressément permis par la présente partie;

…

[…]

20. (1) Notwithstanding paragraphs 18(1)*(a)*, 18(1)*(b)* and 18(1)*(h)*, in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly

20. (1) Malgré les alinéas 18(1)*a)*, *b)* et *h)*, sont déductibles dans le calcul du revenu tiré par un contribuable d'une entreprise ou d'un bien pour une année d'imposition celles des sommes suivantes qui se rapportent entièrement à cette source de revenus ou la partie des sommes

applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto

(a) such part of the capital cost to the taxpayer of property, or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation;

…

39. (1) For the purposes of this Act,

(a) a taxpayer's capital gain for a taxation year from the disposition of any property is the taxpayer's gain for the year determined under this subdivision (to the extent of the amount thereof that would not, if section 3 were read without reference to the expression "other than a taxable capital gain from the disposition of a property" in paragraph 3(a) and without reference to paragraph 3(b), be included in computing the taxpayer's income for the year or any other taxation year) from the disposition of any property of the taxpayer other than

…

(iv) a timber resource property;

…

248. (1) In this Act,

…

suivantes qu'il est raisonnable de considérer comme s'y rapportant:

a) la partie du coût en capital des biens supporté par le contribuable ou le montant au titre de ce coût ainsi supporté que le règlement autorise;

[…]

39. (1) Pour l'application de la présente loi:

a) un gain en capital d'un contribuable, tiré, pour une année d'imposition, de la disposition d'un bien quelconque, est le gain, déterminé conformément à la présente sous-section (jusqu'à concurrence du montant de ce gain qui ne serait pas, compte non tenu du passage « autre qu'un gain en capital imposable résultant de la disposition d'un bien», à l'alinéa 3a), et de l'alinéa 3b), inclus dans le calcul de son revenu pour l'année ou pour toute autre année d'imposition), que ce contribuable a tiré, pour l'année, de la disposition d'un bien lui appartenant, à l'exception:

[…]

(iv) d'un avoir forestier;

[…]

248. (1) Les définitions qui suivent s'appliquent à la présente loi,

[…]

"amount" means money, rights or things expressed in terms of the amount of money or the value in terms of money of the right or thing…	«montant» Argent, droit ou chose exprimés sous forme d'un montant d'argent, ou valeur du droit ou de la chose exprimée en argent…

Analysis

1. *What is the Applicable Standard of Review?*

[36] As the issues before us arise from an appeal and a cross-appeal from a decision of the Tax Court, questions of law are reviewable on a standard of correctness and questions of fact and mixed fact and law are reviewable only if the Judge made a palpable and overriding error, unless the question of mixed fact and law contains an extricable question of law (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235), which then makes it reviewable on a standard of correctness.

[37] In my view, the principal issue before us is whether and how to value reforestation liabilities as "proceeds of sale" under subsection 13(21) of the *Act*. The resolution of this issue involves both statutory and contractual interpretations. Thus, it is a question of law which must be reviewed on the standard of correctness.

[38] The respondent argues that the standard of review with respect to the determination of whether the parties agreed on the value to be attributed to the silviculture liabilities is correctness. The appellant, on the other hand, takes the position that whether the parties agreed that the fair market value of the assumed obligations was equal to the accounting estimates, was a finding of fact entitled to deference. It then refers to the Judge's Reasons, including his determination found at paragraph 30 thereof, that "[t]here 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", and argues that this constitutes a factual finding on the part of the Judge deserving of deference.

[39] I cannot agree. In my view, there can be no doubt that the Judge, correctly in my view, considered this aspect of the case to be an issue of contractual interpretation. Such an issue is clearly one that is to be reviewed on a standard of correctness (see: *Canada v. Calgary (City)*, 2010 FCA 127, 2010 G.T.C. 1043, at para. 54; leave to appeal granted, 2010 SCCA 277; and *Canada v. General Motors of Canada*, 2008 FCA 142, 2008 D.T.C. 6381, at para. 31). In other words, the determination of what the parties agreed to on the plain language of their contracts is clearly a question reviewable on the basis of the correctness standard.

[40] The issue pertaining to the adequacy of the Judge's Reasons, being an issue of procedural fairness and natural justice, is also reviewable on the basis of the correctness standard. This Court will only intervene if the Judge's Reasons fail to disclose a logical connection between the evidence and the decision that permits meaningful appellate review (see: *R. v. R.E.M.*, 2008 SCC 51, [2008] 3 S.C.R. 3, at paras. 53 and 57) (*R.E.M.*). Although *R.E.M.* dealt with a criminal law matter, this Court has, on the basis of the principles enunciated in *R.E.M.*, found Reasons of the Tax Court to be inadequate (see: *Mahy v. Canada*, 2004 FCA 340, [2004] 327 N.R. 28, at paras. 13 to 16).

[41] The other issues before us pertain to the application of legal principles to the particular facts of the case and, thus, stand to be determined on the palpable and overriding error standard.

Consequently, determining whether consideration received in the form of an assumption of the appellant's silviculture liability was contingent or uncertain, whether it was received on income or capital account and whether it was properly allocated to goodwill, are all questions reviewable on the palpable and overriding error standard. Finally, because the function of pleadings is to "define the issues that have to be determined and to give each party notice of the case he or she has to meet" (*M.A.N. & W. Diesel v. Kingsway Transport Ltd.*, (1997) 33 O.R. (3d) 355, [1997] O.J. No. 1523 (CA) (Q.L.), at para. 10), the question of whether pleadings are sufficient to ground the Judge's findings is an issue of procedural fairness or natural justice reviewable on the basis of correctness (see: *The Queen v. Nunn*, 2006 FCA 403, 2007 D.T.C. 5111, at paras. 21 to 26).

2. Did the Judge err in concluding that the silviculture liabilities assumed by Tolko were to be included in the appellant's proceeds of disposition for the 1999 and 2000 taxation years?

[42] As I indicated earlier, the Judge's Reasons deal exclusively with the sale of High Level to Tolko. The following analysis will therefore deal with the Judge's findings in regard to that sale. As to the issues pertaining to the sale of Brewster, I will deal with them separately as they raise questions of a different nature.

[43] Before addressing the first question, a few preliminary remarks regarding the statutory context to which the proceeds of disposition of the sale of High Level and the transfer of the forest tenure are subject will be useful. Subsection 13(21) of the *Act* defines a "timber resource property" as "a right or licence to cut or remove timber from a limit or area in Canada…". The forest tenure

included in the sale of High Level therefore constitutes a timber resource property within the meaning of subsection 13(21), which property is depreciable capital property included in class 33 of Schedule II of the *Income Tax Regulations* (the *Regulations*).

[44] Ordinarily, the proceeds of disposition of a depreciable capital asset in excess of its capital cost constitute a capital gain (see IT 481 (Consolidated) – *Timber Resource Property and Timber Limit*). However, subparagraph 39(1)(*a)*(iv) of the *Act* excludes a timber resource property from capital gain treatment. Consequently, by reason of subsection 13(1) and the definition of "undepreciated capital cost" found at subsection 13(21) (variable G), the proceeds of disposition of a timber resource property in excess of the capital cost thereof are included in the vendor's income (see: *Kettle River Sawmill Ltd. v. The Queen* (1994), 1 C.T.C. 182, [1993] F.C.J. No. 1190 (Q.L.) (FCA), at para. 4).

[45] I now turn to the question of whether the Judge made any error in determining that Tolko's assumption of the appellant's silviculture liability constituted consideration and, thus, ought to have been included in the appellant's proceeds of disposition. There is no real debate between the parties that, as a matter of principle, the assumption of a liability by a purchaser may constitute a consideration which can be included in the proceeds of disposition. However, there is considerable debate as to the value, if any, of the liability assumed by Tolko.

[46] In my view, the Judge made no error in determining that the assumption of the appellant's silviculture liability by Tolko constituted consideration which ought to have been included in the

appellant's proceeds of disposition. The Judge dealt with this question at paragraphs 24 to 27 of his Reasons. He began by pointing to the fact that the appellant had admitted that "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" (see: Statement of Admitted Facts, para. 28, Appeal Book, Vol. 2, p. 168). This led the Judge to remark, at paragraph 24 of his Reasons:

> **[24]** ….. 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.

[47] The Judge, at paragraph 25, then referred to subsection 13(21) of the *Act*, which defines the "proceeds of disposition" as including the sale price of property sold. After stating that "[p]rice is commonly defined to include consideration" and after adopting one of the definitions of "consideration" proposed by the learned author of Fridman's *The Law of Contract in Canada*, 4th ed. (Toronto: Carswell, 2006) at p. 83, i.e. "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 definition was the one enunciated by the English High Court in *Currie v. Nisa*, (1875), L.R. 10 Ex. Ch. 153; affirmed 1 App. Cas. 554), the Judge held that an assumption of liability and a promise to indemnify clearly fell within the meaning of the word consideration. In that regard, the Judge had in mind article 3 of the Agreement of sale which provided, *inter alia*, that Tolko would be responsible for the reforestation liability and that it would hold the appellant harmless in respect of that liability.

[48] The Judge then made the following remarks at paragraphs 26 and 27 of his Reasons:

> **[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 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.

[49] I can find no error in the Judge's reasoning. As the Judge clearly explained, the sale price of a property is commonly defined to include any consideration received by a seller from a buyer, including cash, property and/or the assumption of liabilities: see: *Krauss v. Canada*, 2009 TCC 597, 2009 D.T.C. 1394, at para. 30; *Telus Communications (Edmonton) Inc. v. Canada*, 2009 FCA 49, (2009) 386 N.R. 354, at para. 28; *Loyens v. The Queen* 2003 TCC 214, (2003) D.T.C. 354, at paras. 31 and 33.

[50] I would add, as a matter of relevance, that the other bids made for High Level specifically included the assumption of reforestation liability as a separate portion of the consideration. The

appellant itself, when it purchased High Level in 1990, also included the assumption of reforestation liability as a separate portion of the consideration given (see: Appeal Book, Vol. 5, pp. 715-716, art. 8: "Assumption of Obligations and Liabilities" of the contract between Canadian Forest Products Ltd. and Daishowa Canada Ltd. of February 23, 1990). Further, as the Judge noted in his Reasons, it was admitted by the appellant that if Tolko had not agreed to assume its silviculture liability, the amount of cash or other consideration paid to the appellant would have been greater.

[51] Thus, I have no difficulty concluding that the Judge did not err in finding that the assumption of the appellant's silviculture liability by Tolko constituted consideration which had to be included in the appellant's proceeds of disposition. The more difficult question, however, is the one concerning the value of that consideration and that is the issue to which I now turn.

3. Did the appellant and Tolko agree to attribute a value to the reforestation liability assumed by Tolko and, if so, what consequences flow from that agreement?

[52] The Judge began his analysis by noting the appellant's argument that the value of the benefit conferred upon it by Tolko's assumption of its silviculture liability was "so uncertain as to be unascertainable" and that, as a result, its value was nil. He then reviewed the Contract between the parties and, in particular, focussed on article 3.2.1 thereof. In his view, that provision showed that Tolko's offer to purchase High Level was based on an estimate only of the reforestation liability. At paragraph 30 of his Reasons, the Judge stated that "[t]he reality is that the reforestation liability calculation was an estimate, an audited estimate, but an estimate nonetheless… ", adding that he could find nothing in the Contract to support the view that there was an agreement that the appellant

would receive consideration in the order of $11,000,000, by reason of Tolko's assumption of its silviculture liability. In his view, "…the $11,000,000 estimate was a factor in the determination of the cash price it [Tolko] was prepared to pay, but it was not an agreed upon value for purposes of determining its value as consideration".

[53] Having concluded that the parties had not agreed to attribute a value to the reforestation liability assumed by Tolko, the Judge then went on to find, at paragraph 40 of his Reasons, that "…[t]he 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".

[54] As a result, the Judge proceeded to attribute a value to Tolko's assumption of liability and, in performing that exercise, he considered a number of factors, including the estimate arrived at by the accountants, the uncertainty of the estimated liability and the fact that the estimated liability was used by the appellant to determine the cash price of the sale of the sawmill.

[55] This led the Judge, as I have already indicated, to discount by 80% the long-term liability assumed by Tolko.

[56] Because I conclude, on a proper interpretation of the Contract, that the parties did agree to attribute a value to Tolko's assumption of the appellant's silviculture liability, it was not open to the Judge to proceed as he did to discount the long-term liability assumed by Tolko.

[57] I now turn to the Contract and begin by reproducing the relevant provisions thereof.

ARTICLE 3

ASSUMPTION OF OBLIGATIONS AND LIABILITIES

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 actions, 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 of 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 Reforestation 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. DMI will cause two copies of the Reforestation Statement to be delivered to the Purchaser as soon as possible and in any event no later than 60 days after the Closing Date, accompanied by the written opinion of the Accountants in the form of the opinion attached as Schedule S. DMI will provide the Purchaser's representatives with such cooperation and supporting audit working papers as they may reasonably require to enable them to review the Reforestation Statement. Within 10 Business Days after delivery of the Reforestation Statement, the Purchaser will advise DMI in writing whether the amount of the current and long term reforestation liabilities is agreed to by the Purchaser and if not, specifying the matters not agreed to and, in such case, the matter will be referred to the Accountants and, if deemed appropriate by the Accountants, a recalculation of the current and long term reforestation liabilities will be performed. The costs associated with the audit by the Accountants shall be responsibility of DMI, and the costs associated with any recalculation by the Accountants will be allocated between DMI and the Purchaser based on the Accountants' assessment, in the Accountants' discretion, what is equitable having regard to the Accountants' recalculation based

> on the initial audited determination of the current and long term reforestation liabilities. If either of the parties refuses to accept the decisions of the Accountants, then either party may refer the matter directly to arbitration in accordance with Section 11.3(d).
>
> **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:
>
> i. DMI will pay 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
>
> ii. 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.
>
> **3.3 No Assumption by Purchaser.** Except as expressly provided for in Section 3.1 of this Agreement, the Purchaser will not assume or be responsible for any obligations or liabilities of DMI.

[58] In my view, the Judge erred in concluding that the $11,000,000 of the current and long-term reforestation liability was an estimate and not an agreed upon value. The essence of the Judge's reasoning on this point is found at paragraph 30 of his Reasons:

> [30] This [that part of clause 3.2.1 which provides that "... the Purchaser will advise DMI [Daishowa] in writing whether the amount of the current and long term reforestation liabilities is agreed to by the Purchaser… "] 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.

[59] I cannot agree with the Judge's reasoning.

[60] The critical provisions of the Contract between the appellant and Tolko are articles 3.2.1 and 3.2.2. Article 3.2.1 provides that the appellant has estimated in good faith the aggregate value of both the current and long-term reforestation liabilities to be $11,000,000. This figure is referred to in the provision as being the "Estimated Amount". The provision then goes on to say that following the closing of the Contract, the appellant will prepare a 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". The provision then goes on to provide that within 10 days of delivery to it of the Reforestation Statement, Tolko will advise the appellant in writing "… whether the amount of the current and long term Reforestation liabilities is agreed to by the Purchaser and if not, specifying the matters not agreed to and, in such case, the matter will be referred to the Accountants and, if deemed appropriate by the Accountants, a recalculation of the current and long term reforestation liabilities will be performed". Finally, article 3.2.1 provides that the matter may be referred to arbitration, in accordance with article 11.3*(d)* of the Contract, should one of the parties not be willing to abide by the Accountants' decision.

[61] As to article 3.2.2 of the Contract, it provides that following confirmation by Tolko to the appellant of its "approval of the Reforestation Statement, or final determination of the reforestation liabilities by the Accountants or arbitration… ", the appellant or Tolko will pay to the other 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… " or "is less than the Estimated Amount together with interest on the amount of such difference… ".

[62] In the present matter, as I have already indicated, the Accountants quantified the reforestation liabilities at $11,296,225, i.e. an amount exceeding the Estimated Amount by $296,225. Thus, the appellant paid to Tolko the sum of $296,225 plus interest of $4,297.32 in accordance with the agreed upon terms of the Contract.

[63] Although article 3.2.1 of the Contract does initially refer to the valuation as an "estimate", it is an estimate of the value of the reforestation liabilities. All subsequent references to the reforestation liabilities strongly suggest that the amounts are not merely estimates, but actual values. Indeed, the word "value" is specifically used in connection with the reforestation liabilities referred to in article 3.2.1. Thus, in my respectful opinion, there is nothing in the Contract itself which renders doubtful the fact that the parties attributed a specific and agreed to value with regard to the reforestation liability. The precise quantification by the Accountants lends strong support to the view that the reforestation liability was an intrinsic and valuable form of consideration. The payment of interest on the excess of $296,225 demonstrates that the adjustment payment was equally part of the Contract, even if made after the closing date.

[64] It seems to me that the true purpose of article 3.2.1 was to determine the "aggregate value of the current and long term reforestation liabilities" and to ensure that the cash portion of the consideration corresponded with the assumption of liabilities portion. The only reason why the $11,000,000 was initially an "estimated amount" was simply because the agreed upon value was to be refined and established based on the Reforestation Statement of the Accountants, which in turn affected the legal obligation for cash payment.

[65] With respect, the Judge appears to have elevated the significance of the words "estimated amount" found at article 3.2.1 to a level which led him to ignore the plain wording of article 3.2.1 in its totality.

[66] At subparagraph 40(IV) of his Reasons, the Judge indicated that "…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." I cannot agree with that proposition. The Judge appears to have made a distinction between agreeing on the true value of the assumption of liability and agreeing to accept an amount of consideration for that assumption. Indeed, the essence of his discussion concerning the six underlying contextual factors, which are set out at paragraph 40 of his Reasons, focuses on the determination of the fair value of the appellant's silviculture liabilities. For tax purposes, however, the question of concern is not the subjective value of property to the parties, or what returns or costs will ultimately flow from that property, but whether the parties agreed to accept a certain amount as consideration for that property.

[67] In *Teleglobe Inc. v. H.M.Q.*, 2002 FCA 408 (*Teleglobe*), the matter before this Court concerned the privatization of Teleglobe Canada by the Government of Canada. More particularly, privatization thereof was accomplished by selling Teleglobe Canada's assets to Teleglobe Canada Inc. in return for the assumption of certain liabilities, a promissory note and the issuance of common and special shares. The common voting shares were then sold by a bid process to Memotec Data Inc. for $488,300,000.

[68] The main issue before the Court was the determination of the true purchase price of Teleglobe Canada's assets. The appellant, Teleglobe Canada Inc., argued that its cost for all of the assets of Teleglobe Canada was $660,000,000, while the Minister argued that that price was approximately $530,000,000. The debate as to the purchase price arose by reason of the difference in the way the parties calculated the cost to the appellant of the shares issued in partial payment of Teleglobe Canada's assets. In making its determination, the Court had to consider an assumption of liability provision and a corresponding adjustment procedure similar to that before us in the present matter.

[69] In concluding that the price of $530,000,000 arrived at by the Minister was the correct one, Pelletier J.A., writing for the Court, indicated at paragraph 27:

> [27] In my view, it is evident from the agreement itself that the parties had agreed on a purchase price for the shares. The provisions of paragraph 3.02 of the Purchase Agreement provided a framework by which that price could be calculated. The two elements of the calculation are the assumed liabilities and the Excess of Assets over Assumed Monetary Liabilities. The amount which the parties contemplated as the Excess of Assets over the Assumed Monetary Liabilities is the amount which

> appears in Section 4.04 of the Agreement, the adjustment clause. It is there provided that if the calculation of the Excess Assets over Assumed Monetary Liabilities based on the Closing Date Financial Statements varies by more than 2% from $378,021,000, the purchase price of the shares will be adjusted. Since the Excess of Assets over Assumed Monetary Liabilities was to be made up of the promissory note, the Special Shares and the common shares, the value of the two classes of shares is the difference between $378,021,000 and the amount of the promissory note, or approximately $234,000,000.

[70] Following these remarks, Pelletier J.A. referred to the Supreme Court's decisions in *Shell Canada Ltd v.Canada*, [1999] 3 S.C.R. 622, *Singleton v. Canada*, [2001] 2 S.C.R. 1046, and *Ludco Enterprises Ltd. v. Canada*, [2001] 2 S.C.R. 1082, where the Supreme Court opined that absent factors which would make a transaction impeachable, such as a sham or legislative provisions to the contrary, the legal relationships established by taxpayers were to be respected (*Teleglobe*, paras. 28 to 31). Pelletier J.A. then went on to state that the parties, i.e. the Government of Canada and Memotec, had "…fixed the values in question. The fact that those values may have been responsive to considerations other than the market value of the assets simply means that market value was not the measure of the value of these assets to these parties." (*Teleglobe*, para. 30), adding that "[a]bsent factors which would make the transaction impeachable, the agreement of the parties determines the cost to the corporation of issuing shares in exchange for property." (*Teleglobe*, para. 31).

[71] Although the Court, in *Teleglobe*, did not have to determine the total proceeds of disposition, Pelletier J.A. nonetheless considered the assumption of liabilities and the formula for adjusting the final purchase price to be reflective of the parties' agreement as to consideration for purchasing the assets of Teleglobe Canada (*Teleglobe*, paras. 1, 9, 10 and 25).

[72] To sum up, the provisions of the Contract at issue are not ambiguous. The parties agreed to accept $11,000,000 as consideration for the assumption of the appellant's reforestation liability, subject to the specified adjustment procedure, as a term of the sale of High Level. In my view, this is analogous to the assumption of liabilities and corresponding adjustment procedure considered in *Teleglobe*.

[73] In the present matter, as part of the purchase of the appellant's timber rights, Tolko negotiated terms by which it would assume the appellant's silviculture liabilities. The Contract specified that the appellant had estimated in good faith the aggregate value of that liability at $11,000,000 and that the parties were agreed to pay to each other any difference between the preliminary value and the final amount determined by the Accountants, which difference would either be agreed to by the parties or be determined through arbitration. Hence, the Judge erred in interpreting the Contract as one not specifying the price agreed to by the parties for the assumption of the appellant's reforestation liability. The Judge's attempt to quantify the actual benefit to the appellant of Tolko's assumption of liability was the wrong approach. As a result, the Judge did not in fact determine whether the parties had agreed to a price for the assumption of the appellant's reforestation liability.

[74] In my opinion, the appellant and Tolko agreed to a price of $11,000,000 for the reforestation liability and they should be held to that price for income tax purposes.

[75] The appellant's arguments against this conclusion are unconvincing. It argues that the Minister erred because the accounting estimates of the reforestation liability are not present valued. The Judge accepted this idea and held that the estimate was not discounted to reflect present-day value (see: Judge's Reasons, para. 40).

[76] I cannot accept the appellant's argument. Because I conclude that the evidence supports the conclusion that the parties agreed to a specific value, the issue of present value disappears. The $11,000,000 amount agreed to was present valued, because it was precisely that value that was used to diminish the final amount Tolko had to pay to the appellant.

[77] The appellant also argues that the adjustment mechanism found in article 3.2.2 of the Contract was to allow for adjustment of the value between the initial estimate and the final estimate. In its view, the existence of such an adjustment mechanism, *per se*, does not render either the initial or final number a definite value as opposed to an uncertain estimate. Although this statement is correct, it does not undermine the fact the $11,000,000 figure is a value and not an estimate. The parties treated the $11,000,000 amount as if it were a present valued actual value when they used it to reduce the amount of consideration which Tolko had to give to the appellant. Even if I were to accept that the parties identified and thought of the amount as an estimate (which I do not), they still treated the $11,000,000 as if it were an actual value by adjusting the purchase price to take account of it. It would have been strange indeed if the parties had adjusted the final purchase price on account of an estimate to which they attached no value.

[78] As part of its argument that the $11,000,000 relating to the silviculture liability should not be included in the proceeds of distribution, the appellant argued that the liability was uncertain or contingent and, as a result, not subject to taxation. In view of my conclusion that Tolko and the appellant had agreed to a specific price for the assumption of the silviculture liability, this submission is without merit. However, the following remarks regarding that argument will, I hope, be helpful.

[79] Liabilities are absolute or contingent. The Supreme Court defined a contingent liability as "a liability which depends for its existence upon an event which may or not happen" (see: *Canada v. McLarty*, 2008 SCC 26, [2008] 2 S.C.R. 79, at para. 17). If a liability is not contingent, it is absolute. However, the jurisprudence interpreting subsection 13(21) of the *Act* does not ask whether the liability assumed by the purchaser is contingent or absolute; as a matter of fact, the nature of the liability assumed by a purchaser is irrelevant. Instead, the jurisprudence seems concerned only with the value attributed by the parties, if any, to the liability assumed by the purchaser. If the parties attribute no value to a future liability, then there is nothing to be added to the seller's proceeds of disposition for the purpose of taxation.

[80] For instance, in the Contracts for the sale of both High Level and Brewster, the purchasers assumed all future tort liability flowing from their running the appellant's timber mills. Obviously, if a worker had been injured through gross negligence at one of the two mills after the appellant had sold it, the purchasers would be liable for any tort damages that were awarded. Still, despite the existence of such future tort liability, the parties attributed no value to the assumption of this

liability by the purchasers. Because no value was attributed by the parties to the purchasers' assumption of tort liability, the Minister correctly did not add any income to the appellant's disposition of proceeds for the assumption of that liability. Conversely, if the parties to an agreement attribute a value to a future liability, then the Minister is entitled to add this amount to the vendor's proceeds of disposition – whether or not the liability assumed by the purchaser is contingent or absolute.

[81] In the present matter, while Tolko's future reforestation costs are likely uncertain or contingent, there is nothing uncertain or contingent about the consideration paid for the assumption of that liability. Indeed, there is a fundamental difference between allowing a taxpayer to deduct an expense yet to be incurred and excusing a taxpayer from reporting proceeds of capital disposition realized through the payment of a fixed amount for the permanent assumption of that taxpayer's liability.

[82] Thus, the focus of subsection 13(21) is on whether the seller received value, i.e. consideration, for the assumption of a liability. The nature of that liability, be it contingent or absolute, is irrelevant to this inquiry.

[83] This approach leads to minimal market distortion because value is attributed to future liability through the process of arm's length negotiation between a buyer and a seller and because in that negotiation, with respect to this issue, the parties' interests are divergent. A buyer wants to pay as little as possible for the purchase, and so will bargain to increase the amount attributed to future

liabilities as much as possible. A seller, on the other hand, wants to receive as much as possible and so will bargain to decrease the amount attributed to future liabilities as much as possible. Thus, in theory, the amount that the parties agree to should represent the fair market value of having the buyer assume the seller's future liability.

[84] I therefore conclude that the Judge erred in concluding that the appellant and Tolko did not agree to attribute a value to the silviculture liability assumed by Tolko. Consequently, for tax purposes, the parties must be held to the agreed upon price. Hence, the $11,000,000 was correctly added by the Minister to the appellant's income for the 1999 taxation year.

3. Was the Judge correct in concluding that only 20% of the long term reforestation liability should be included in the appellant's income as proceeds of sale in the relevant tax years?

[85] In view of my conclusion that the parties agreed to attribute a value to the reforestation liability assumed by Tolko, I need not discuss this question, other than to say that the judge erred in including only 20% of the long term reforestation liability in the appellant's income as proceeds of sale for its 1999 taxation year. In any event, the parties agreed that there was no evidentiary basis to support the Judge's finding.

4. Was the appellant entitled to claim either a deduction or include the capital expenditure amount paid for having Tolko assume the reforestation liability in its adjusted cost base?

[86] The appellant argues that if the reforestation obligation amounts are included in its proceeds of sale, it should be allowed to deduct an equal offsetting amount from its income because it essentially paid Tolko to assume its liability by accepting a lower sale price in return for the assumption of the liability (Appellant's Memorandum of Fact and Law on Appeal, para. 51). In my view, this argument cannot succeed.

[87] To repeat, the Judge decided against the appellant on this point because of his view that the transaction was one for the sale of capital assets and that the assumption of the reforestation liability was "simply part of that capital transaction" (Judge's Reasons, para. 44). I see no basis to disagree with the Judge's reasoning.

[88] Paragraph 18(1)(b) of the *Act* prohibits, in general, the deduction of capital expenditures from business income (see: Vern Krishna, *The Fundamentals of Canadian Income Tax*, 9th ed. (Toronto: Thomson Carswell, 2006) at pages 322-323). In *British Columbia Electric Company v. M.N.R.*, [1958] S.C.R. 133 at 138, the Supreme Court held that the test as to whether an expense is income or capital in nature is whether the expenditure was made "with a view of bringing into existence an advantage for the enduring benefit" of a taxpayer. In *Canadian Reynolds Metals Co. v. M.N.R.* (1996), 197 N.R. 272, our Court adopted that test. Writing for the Court, Décary J.A. made the following remarks at paragraph 3 of his Reasons:

> [3] With respect to the capitalization issue, we did not need to call upon counsel for Reynolds. There is little to add to the thorough reasons of Mr. Justice Joyal. The distinction between current expenses and capital expenditures arises from the importance of accurately matching income with expenditures over a given finite accounting period. Essentially, expenditures which are expected to confer a benefit of enduring nature to the enterprise are capital in nature. Without resorting to a

> survey of the ample jurisprudence on this issue, we will borrow from the following oft-cited passage from Viscount Cave L.C. in *British Insulated & Helsby Cables v. Atherton* [1926] A.C. 205 (H.L.) at 213-14:
>
> > ... when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.
> >
> > [Emphasis added]

[89] In the present matter, it is my view that it is an enduring benefit to the appellant to be relieved of a long term reforestation liability associated with the forest tenure it previously owned, as the Judge found (Judge's Reasons, para. 45). Further, the Alberta Department of Sustainable Resource Development has made it clear that by reason of section 163 of the *Timber Management Regulations, supra*, forest tenures cannot be assigned unless the assignee also assumes the reforestation liability associated thereto (Judge's Reasons, para. 3). The forest tenure, being a piece of land with a forest on it, has a capital nature. The reforestation liability, by law, passes with the ownership of the tenure itself. Hence, the reforestation liability also has a capital nature.

[90] Thus, the appellant's argument that it ought to have been given an income deduction for transferring the reforestation liability to Tolko cannot succeed since the reforestation liability expenditure has a capital nature and, as such, cannot be deducted from the appellant's income by reason of paragraph 11(1)*(b)* of the *Act*.

[91] As the respondent argues, "[t]he deduction of the assumed liability would also run afoul of s. 18(1)(a) of the Act, which requires that an expense be incurred for the purpose of gaining or producing income from a business or property" (Respondent's Memorandum of Fact and Law, para. 60). In effect, as the Judge correctly concluded, the expense could not have been incurred by the appellant following the sale to Tolko because the reforestation work is now Tolko's responsibility.

[92] To that, I would add that the Province of Alberta does not proceed against assignors of forest tenures for recovery of reforestation costs. Even if Alberta could, as the appellant suggests, Tolko has indemnified the appellant with regard to the reforestation liability which it has assumed pursuant to the Contract. Thus, the appellant has not incurred any expense in regard to the silviculture liability assumed by Tolko and never will.

[93] To conclude on this point, the appellant's approach results from a mischaracterization of the issue. No equivalent offsetting deduction of an expense arises from the inclusion of proceeds of a disposition of a capital asset. The appellant has conflated a gain from the disposition of a capital asset with the notion of deducting an expense from business income. Even though the gain from the disposition of the forest tenure falls into income, the sale of the sawmill operation with the forest tenure remains a disposition of a capital asset. I am unable to find any provision in the *Act* which would allow the appellant to deduct, from its income, expenses relating to the forest tenure. In other words, the sale of High Level was the sale of a capital asset and the appellant cannot parse out a specific component of its capital assets, i.e. the forest tenure, and re-characterize it as a current

expense. The Judge saw no merit in the appellant's argument and disposed of it at paragraph 45, as follows:

> [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 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.

[94] This is sufficient to dispose of this issue. However, the appellant makes a number of additional arguments, which I will address briefly.

[95] First, the appellant argues that the reforestation liability should be treated as income because if it had paid a sub-contractor to do the reforestation work, the expense would have been treated as an income deduction pursuant to this Court's reasoning in *Northwood Pulp & Timber Ltd. v. Canada*, [1999] 1 C.T.C. 53. In that case, this Court held that reforestation expenses could be deducted from income, but only in the year they were incurred. I therefore infer that the appellant's argument is that because reforestation expenses are deductible from income in other situations, they should be deductible from income here.

[96] I cannot agree. The tax treatment of a transaction in one situation does not necessarily mean that that transaction will be given the same tax treatment in another situation. Income and capital are

taxed according to the rules laid down in the *Act* and the treatment of a particular transaction may vary depending on the specific factual circumstances and how the *Act* is interpreted in relation to those circumstances. Taxpayers are taxed depending on what they did, not on what they might have done. Since the appellant did not pay a subcontractor to reforest the land it had cut, what the tax treatment would have been in such a situation is irrelevant to the determination of this appeal. Instead, the appellant essentially paid the purchaser to assume its reforestation liability, as required by Alberta legislation. As noted above, this expenditure, on the whole, has a capital nature.

[97] The appellant makes the further argument that in Alberta, unlike in British Columbia, forest tenure assignors are not legally relieved of their reforestation obligations, but it is simply Alberta's administrative practice to do so. Thus, it argues that there remains the possibility of Alberta attempting to enforce the reforestation liability against it. Here, I infer that the appellant is arguing that the possibility of future enforcement against it by Alberta means that paying Tolko to assume the reforestation liability is more like an income expense.

[98] Again, I cannot agree. As the respondent argues, the appellant was indemnified by Tolko with regard to the reforestation costs. Consequently, although the possibility that the appellant might be pursued by Alberta for the reforestation costs it assigned to Tolko exists, such an outcome is highly unlikely. Thus, I do not think that the Alberta legislation's failure to relieve the appellant of its reforestation liability transforms the nature of the appellant's expenditure from capital to income.

[99] The appellant also argues that it should not be taxed differently than if it had separately paid Tolko to relieve it of its reforestation liability. I cannot agree. As indicated above, the only issue before this Court is what the parties did, not what the parties might have done. In any case, such a transaction would also likely be treated as capital, since it would provide to the appellant the enduring benefit of no longer having the reforestation liability associated with its forest tenure. Further, such a transaction is purely hypothetical since Alberta legislation requires that the owner of the forest tenure and of the reforestation liability associated with that tenure be the same.

[100] I therefore see no basis to disagree with the Judge's conclusion that the assumption by Tolko of the appellant's reforestation liability should be treated as a capital expenditure and, thus, it cannot be deducted from the appellant's income.

5. Whether the Judge erred in allocating the $11,000,000 in respect of the silviculture liability to the timber resource property as opposed to goodwill?

[101] The appellant submits that if additional amounts must be included in its proceeds of disposition for the 1999 taxation year, these amounts should be allocated to goodwill rather than in respect of the timber resource property transferred to Tolko.

[102] The Judge allocated the entirety of the proceeds of disposition pertaining to the silviculture liability to the timber resource property. He did not make any allocation to "goodwill". In my view, the Judge's approach is perfectly understandable, considering that it was admitted by the parties that

neither the appellant nor Tolko had attributed any value to goodwill in the sale of High Level and the transfer of the forest tenure.

[103] The respondent argues that parties cannot reallocate consideration in a transaction "when it suits them for tax purposes" (para. 49 of Respondent's Memorandum of Fact and Law). I agree. Consideration in the form of the assumption of silviculture liability cannot be allocated to anything other than the forest tenure to which it is inextricably linked, given that the reforestation obligation is integral to the transfer of the forest tenure under the FMA (see: Appeal Book, Vol. IV, p. 460, paras. 23 to 27), it is clear that the FMA could not have been assigned without the accompanying silviculture liability (see Appeal Book, Vol. II, p. 197 and Supplementary Agreed Statement of Facts, paras. 3 and 4) and a forestry company cannot obtain a licence to cut timber without assuming a silviculture liability to reforest.

[104] In their Contract, the appellant and Tolko allocated only portions of the cash proceeds to the forest tenure and did not allocate the assumption of liability portion of the proceeds, as they did not want to identify it separately (see: Appeal Book, Vol. V, p. 734). While the appellant's Contract with Tolko allocated particular amounts to its timber rights, it did not allocate any amount to goodwill "because they did not think that they had to" (see: Appellant's Memorandum of Fact and Law, para. 64).

[105] I see no basis to allocate any of the proceeds of disposition to goodwill, unless the unreported component of the sale is properly classified as goodwill on its own. The appellant has

not satisfied me that the Judge's implicit finding that the unreported proceeds ought to be allocated to the timber rights, and not to goodwill, constitutes a palpable and overriding error. The Judge, at paragraph 45 of his Reasons, indicated that the reforestation liability was "part and parcel of the forest tenure" and that, consequently, no transfer of the timber rights was possible unless Tolko assumed the corresponding liability.

[106] Thus, I have no difficulty concluding that the assumption of liability by Tolko should be allocated to the timber rights as it constitutes an integral part of the transfer of the forest tenure.

6. Were the Judge's reasons adequate?

[107] The appellant submits that the Judge's reasons are inadequate. On the basis of the Supreme Court's decisions in *R. v. Sheppard*, [2002] 1 S.C.R. 869 and in *R. v. R.E.M.*, [2008] 3 S.C.R. 3, the appellant argues that the Judge's reasons are deficient in two respects. First, it says that the reasons are deficient with respect to the question of whether the future reforestation obligations were too uncertain to be included in its proceeds of disposition, adding that "he summarily dismissed these decisions [prior case law on the issue] as being too broad to have any application, with no reasons for having come to this conclusion". Second, the appellant says that the Judge's reasons are inadequate with respect to the question of the valuation of the reforestation obligations. In its view, although the Judge enumerated qualitative factors, "there is no logical connection between the enumerated qualitative factors and the quantitative valuation that he produced" (Appellant's Memorandum of Fact and Law on the appeal, para. 67), adding that the Judge's failure to explain

why, in the absence of any valuation evidence, he was entitled to value the obligations constitutes further proof of the inadequacy of his reasons.

[108] Although the respondent has not pursued the adequacy of the Judge's reasons as a separate ground in its cross-appeal, it does note that the Tax Court "appears to have simply applied its conclusion on the High Level sale, to the Brewster Division sale" (Respondent's Memorandum of Fact and Law, 99). The respondent also argues that the Judge's discount approach was arbitrary and unsupported by the evidence (Respondent's Memorandum of Fact and Law, para. 100).

[109] I have concluded that the parties to the Contract for the sale of High Level did agree to a value with respect to the reforestation liability. Although I have come to a conclusion different from that reached by the Judge, his reasons are, in my view, sufficient to allow us to perform our appellate role. I can find no basis on which we could conclude that the Judge's reasons are inadequate in regard to the issues which are determinative both of this appeal and the cross-appeal insofar as they pertain to the High Level sale. However, there is a need to consider the adequacy of the Judge's reasons with regard to the sale of Brewster to Seehta. I now turn to that issue.

[110] The Judge found that the sale of Brewster to Seehta should be treated the same way as the sale of High Level to Tolko (Judge's Reasons, para. 52). The Agreement reached between the appellant and Seehta is more precise than the Tolko Contract with regard to the treatment of the purchaser's reforestation liability. Article 3.1(b) thereof provides that "[a]s of the Effective Time, the Purchaser will assume and be responsible for all of the following obligations and liabilities of

DMI [the appellant]:… (b) notwithstanding that the Purchaser will not be given credit for reforestation liability in the determination of Net Purchase Working Capital, all reforestation liabilities [are assumed by the purchaser]".

[111] The respondent argues that the appellant's Comptroller, a chartered accountant, admitted in discovery that the value of the reforestation liability assumed by Seehta was $2,996,380 (Respondent's Memorandum, para. 93), adding that this admission was not withdrawn (Respondent's Memorandum, para. 94).

[112] The respondent further contends that the appellant's own internal memo described the purchase price as $7,000,000, being the $10,000,000 figure from the bank's evaluation of the assets less the short term and long term reforestation liability (Appeal Book, Vol. 5, p. 682). Further, the respondent argues that the appellant identified that amount as its reforestation liability associated with Brewster (Appeal Book, Vol. 2, p. 170). The respondent also says that on August 20, 1999, the CIBC – which valued the appellant's assets – informed a different bidder that the reforestation obligations were, as of that date, $2,900,000 (Appeal Book, Vol. 5, p. 683).

[113] In response, the appellant makes three arguments. First, it argues that the Seehta contract clearly states in article 3.1(b) that the purchaser was not being given credit for assuming the reforestation liability (Appellant's Memorandum on Cross-Appeal, para. 31). Second, the appellant argues that the $2,900,000 figure that the respondent attributed to the reforestation liability appears nowhere in the Seehta contract signed on August 11, 2000, or the financial statements attached

thereto (Appellant's Memorandum on Cross-Appeal, para. 32), adding that this figure came from the appellant's working paper for the period ending December 31, 2000. Thus, the appellant says that $2,900,000 could not possibly be a correct value because it was one that did not exist at the time the contract was signed. Third, the appellant argues that the admission by its Comptroller that the value of the reforestation liability was $2,900,000 was inadmissible opinion evidence (Appellant's Memorandum of Fact and Law on Cross-Appeal, para. 61).

[114] Unfortunately, we do not have the benefit of the Judge's Reasons. He made no factual findings on these points, but simply stated that he saw "no difference in the fact situation in the Seehta matter to reach any different conclusion" (Judge's Reasons, para. 52).

[115] While the extent of reasons required of a Judge obviously depends on the circumstances of each case, it is my view that the Judge's reasons herein are inadequate. In *Her Majesty the Queen v. Brokenhead First Nation*, 2011 FCA 148, I had occasion to discuss whether the reasons of the Federal Court were sufficient so as to permit meaningful appellate review. At paragraphs 31, 32, 33 and 50, I wrote the following:

> [31] In so concluding, I am mindful that "[s]erious remedies such as a new trial require serious justification": *R. v. Sheppard*, 2002 SCC 26, [2002] 1 S.C.R. 869 at paragraph 22 [*Sheppard*], and that the Judge's Reasons are 23 pages long. However, as this Court has held, "adequacy of reasons is not measured by the pound": *Ralph v. Canada (Attorney General)*, 2010 FCA 256, 410 N.R. 175, at paragraph 18.
>
> [32] Recently, in *R. v. R.E.M.*, 2008 SCC 51, [2008] 3 S.C.R. 3 [*R.E.M.*], the Supreme Court of Canada addressed the issue of adequacy of reasons when it said that reasons must be read in their whole context, which includes the evidentiary record and the submissions of counsel: at paragraph 55. The Supreme Court also said that reasons are especially crucial in circumstances – such as in the present

matter – where there are both difficult questions of law before the court and a confusing evidentiary record: ibid. Ultimately, reasons must be intelligible insofar as they establish a "logical connection between the evidence and the law on one hand, and the verdict on the other": at paragraphs 35, 41.

[33] The purpose for this minimal standard is to permit meaningful appellate review. At paragraph 11 in *R.E.M.*, the Chief Justice, writing for a unanimous Supreme Court, explained the need for adequate reasons so as to allow for effective appellate review:

> [11] …
>
> 3. … A clear articulation of the factual findings facilitates the correction of errors and enables appeal courts to discern the inferences drawn, while at the same time inhibiting appeal courts from making factual determinations "from the lifeless transcript of evidence, with the increased risk of factual error": M. Taggart, "Should Canadian judges be legally required to give reasoned decisions in civil cases?" (1983), 33 U.T.L.J. 1, at p. 7. Likewise, appellate review for an error of law will be greatly aided where the trial judge has articulated her understanding of the legal principles governing the outcome of the case. Moreover, parties and lawyers rely on reasons in order to decide whether an appeal is warranted and, if so, on what grounds.

…

[50] I therefore conclude that the Judge's reasons are inadequate. They do not grapple with and attempt to resolve the difficult legal issues and the confusing evidentiary record that were before him. At paragraph 55 of her Reasons in *R.E.M.*, the Chief Justice sets forth what, in her view, appellate courts should be looking for when attempting to determine whether a judge's reasons are adequate:

> [55]…..The appellate court, proceeding with deference, must ask itself whether the reasons, considered with the evidentiary record, the submissions of counsel and the live issues at the trial, reveals the basis for the verdict reached. It must look at the reasons in their entire context. It must ask itself whether, viewed thus, the trial judge appears to have

> seized the substance of the critical issues on the trial. If the evidence is contradictory or confusing, the appellate court should ask whether the trial judge appears to have recognized and dealt with the contradictions. If there is a difficult or novel question of law, it should ask itself if the trial judge has recognized and dealt with that issue.

[116] On the basis of these principles, I am satisfied that the Judge's reasons, as they pertain to the Brewster sale, are inadequate. The Judge failed to address the factual differences between the sale of High Level and that of Brewster and to make findings concerning whether the appellant and Seehta's Agreement was unambiguously expressed therein or what, if anything, can be inferred from the additional evidence put forth by the parties.

[117] Additionally, at least three of the six contextual factors set out by the Judge at paragraph 40 of his Reasons were closely related to the sale of High Level, but had little relevance to the sale of Brewster (Judge's Reasons, paras. 40(II) (the accounting estimates), 40(III) (the effect of the price adjustment formula), 40(IV) (the nature of the appellant's and Tolko's agreement on the estimated silviculture liability)). In my opinion, the Judge's failure to discuss or analyze the issues pertaining to the sale of Brewster renders his reasons inadequate to serve as a basis for meaningful appellate review.

[118] While it is always open to this Court to render the judgment that ought to have been rendered by the Judge, I do not believe that it would be appropriate in the circumstances, i.e. absent any relevant factual findings by the Judge or any substantive discussion on his part regarding the critical issues before him, for us to determine the relevant issues pertaining to the sale of Brewster.

As in *Brokenhead*, the only alternative open to us would be to embark upon a fact-finding mission and then to make determinations of law based on these findings; barring special circumstances, this is not our role. The Judge's reasons do not leave us in a position to conduct meaningful appellate review regarding the issues arising from the sale of Brewster to Seehta.

7. Were the Respondent's Pleadings Sufficient to Ground the Judge's Findings?

[119] The appellant argues that the respondent did not plead in its Reply to the Notice of Appeal that the parties to the Contract for the sale of High Level agreed that the accounting estimates of the silviculture liability constituted the value of that liability. Rather, according to the appellant, the respondent pleaded that "the Appellant and purchaser assumed the value of the silviculture obligation of the High Level Division to be $11,000,000" and the "value of the silviculture obligation of the Brewster Lumber Division to be $2,966,380" (Respondent's Reply to Tax Court Notice of Appeal, paras. 17(g), (j); Appellant's Memorandum of Fact and Law on Cross-Appeal, para. 16).

[120] Nevertheless, for the reasons that follow, I am satisfied that the pleadings before the Judge properly raised issues in respect of which the Judge could adjudicate the matter, despite the fact that the respondent did not explicitly plead an agreement as to the value of the silviculture liability.

[121] The appellant claims that, "[s]urely if the fundamental basis of the Crown's case is that the parties to a transaction agreed to something, the Crown is obligated to plead the existence of the agreement" (Appellant's Memorandum of Fact and Law on Cross-Appeal, para. 27). The

appellant's argument, in my view, ignores the fact that the fundamental basis of the respondent's case was that the amounts the parties assumed to be the value of the silviculture liability were properly included in the Minister's reassessments as unreported proceeds of disposition (Respondent's Tax Court Reply, para. 21). The respondent also took the position that the appellant's proceeds of disposition would include the fair market value of the assumed obligations (Respondent's Tax Court Reply, para. 20), although it did not directly quantify that fair market value. This is not inconsistent with the other submissions made by the respondent in its Tax Court Reply, namely: that the High Level sale Agreement included "a final estimate of the silviculture obligation for the purposes of the sale" (Respondent's Reply, para. 6), that consideration received for the High Level sale included "the assumption of $11,000,000 estimated silviculture obligations" (at para. 17(h)), and that the fair market value of the liability was part of the consideration for the sale (Respondent's Reply, para. 17(g)).

[122] More importantly, the appellant's Notice of Appeal to the Tax Court is proof positive that it understood the Minister's position to be that it "must include in [its] proceeds amounts equal to the accounting estimates of the silviculture obligations because [it] agreed with the purchasers on estimates of [its] silviculture obligations; *ergo* [it] received consideration equal to these estimates by having the obligations assumed by the purchasers" (Appellant's Tax Court Notice of Appeal, para. 20).

[123] These pleadings therefore put in issue the question of whether the parties agreed on the price of the silviculture liability, whether they agreed on estimated amounts for some other purposes,

whether those amounts reflected the fair market value of the liability, and more generally, whether the appellant improperly failed to report those amounts as proceeds of disposition. As a result, the Judge could properly consider these issues, and this Court may similarly render judgment in respect of these issues on appeal.

Disposition

[124] For these reasons, I would render the following judgment. With respect to the appellant's 1999 taxation year (the High Level disposition), I would dismiss the appeal, allow the cross-appeal and set aside the Judge's decision. Rendering the Judgment which ought to have been rendered, I would dismiss the appellant's appeal from the Minister's reassessment of its 1999 taxation year. With respect to the appellant's 2000 taxation year (the Brewster disposition), I would allow the appeal, dismiss the cross-appeal, set aside the Judge's decision and return the matter to him for reconsideration of the issues in the light of these reasons. Finally, because the respondent has been more successful, I would allow it 50% of its costs in this Court and in the Court below.

"M. Nadon"

J.A.

"I agree.
Carolyn Layden-Stevenson J.A."

Mainville J.A. (Dissenting)

[125] Forest tenures are a form of timber resource property and attract a hybrid treatment for tax purposes. A "timber resource property" under the meaning of subsection 13(21) of the *Income Tax Act*, R.S.C., 1985 c. I-13 (the "*Act*") is treated as capital property for the purposes of capital cost allowance but if it is sold, the entire proceeds are taxed as income. As noted by the Crown in its memorandum, forest tenures are, in this sense, anomalous. Sub-paragraph 39(1)(*a*)(iv) of the *Act* specifically excludes a timber resource property from capital gains treatment. As a result, by virtue of subsection 13(1) and the definition of "undepreciated capital cost" in subsection 13(21), the proceeds of disposition in excess of the capital cost of the timber resource property are included in the vendor's income.

[126] Under the regulatory framework governing forest tenures in Alberta, and in order to improve the sustainability of such tenures, silvicultural works must be carried out over time on the tenures until a sufficient reforestation crop passes a free-growing growth point. This may take a few years, but, as noted by my colleague Nadon J. A. at paragraph 9 of his reasons, generally eight to ten years are required. These silvicultural works are referred to by the Tax Court judge as "reforestation liabilities"; though this expression is deficient as it does not reflect the true nature of the silvicultural works at issue, I will nevertheless adopt it in these reasons for consistency purposes.

[127] This appeal requires this Court to interpret the meaning of the expression "proceeds of disposition" found in subsection 13(21) of the *Act* within the context of the transactions at issue in these proceedings. Specifically, we must decide whether the value of the reforestation liabilities in

the context of the sale of forest tenures is to be treated separately from the tenures themselves and thus included within the expression "proceeds of disposition", taking into account the entire scheme of the *Act* as it relates to forest harvesting operations, timber resource properties and forest harvesting businesses.

[128] In my view, the Tax Court judge erred in this case by assuming that the assumptions of the reforestation liabilities by the purchasers in the sales transactions at issue were a separate and distinct consideration for the sales of the tenures whose value necessarily had to be added to the proceeds of the disposition of the sales. I am rather of the view that the reforestation liabilities 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.

[129] The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis in order to find a meaning that is harmonious with the act as a whole: *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601 at para. 10. Where the provisions of the *Act* may be subject to varying interpretations, the meaning which is most harmonious with the scheme of the *Act* is to be preferred. The interpretation of the expression "proceeds of disposition" taken by the Tax Court judge and approved by my colleague Nadon J.A. leads to a "lack of symmetry in how the assumption of the reforestation liability is treated for tax purposes" as was aptly noted by the Tax Court judge in his reasons at paragraph 47. In the absence of a statutory constraint to the contrary, I prefer an interpretation which promotes symmetry and

fairness through a harmonious taxation scheme, to an interpretation which promotes neither of these values.

[130] 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. On this basis alone, I would allow the appeal and dismiss the cross-appeal.

[131] The background to these proceedings and the essential facts are extensively set out in the reasons of Nadon J.A. and need not be repeated. I need simply highlight some salient facts.

[132] In his reasons, the Tax Court judge found that the consent of the competent authorities of the province of Alberta is required for assigning forest tenures in that province. The Tax Court judge also found that this consent is not provided unless the assignee or purchaser assumes the reforestation liabilities associated with the tenures. Moreover, the Albertan authorities hold that, upon the transfer of the forest tenures, the assignor or vendor is no longer liable for the reforestation liabilities. Based on these findings, the Tax Court judge then identified in paragraph 22 of his reasons the fundamental question before him as whether the undertakings by the purchasers to incur expenditures in the future to meet the province of Alberta's reforestation requirements for the tenures was a "consideration" in their purchase of Daishowa's forest tenures, such that the value of

these undertakings became taxable in the hands of the vendor Daishowa. He answered that question as follows at paragraph 26 of his reasons:

> [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 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.

[133] As already noted, the Tax Court judge recognized that his approach resulted in a "lack of symmetry in how the assumption of the reforestation liability is treated for tax purposes" since "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": Tax Court reasons at para. 47. The Tax Court judge thus proposed a discount method to alleviate the objectionable tax consequences resulting from this asymmetry and thus applied an 80% discount on the long-term portion of the reforestation liabilities included in Daishowa's "proceeds of disposition" resulting from the sale.

[134] I agree with my colleague Nadon J.A. that the Tax Court judge could not propose a discount method to alleviate the perceived objectionable tax consequences of his findings, though this is not, in my view, the fundamental issue raised by these proceedings.

[135] However, respectfully disagreeing with my colleague Nadon J.A., I am also of the view that the Tax Court judge erred in answering the fundamental issue before him, and that on a proper construction of these sales transactions and of the reforestation liabilities at issue, no tax consequences befall on the vendor (Daishowa) from the compulsory assumption by the purchasers of the reforestation liabilities which form an integral part of the forest tenures which were sold.

[136] As found by the Tax Court judge, the vendor and the purchasers had no alternative but to transfer the reforestation liabilities related to the forest tenures upon the transfer or sale of the forest tenures. Indeed, since the Albertan authorities would not consent to the transfer of the tenures without the correlative transfer of the liabilities, Daishowa could not hold on to the liabilities, carry out the reforestation works in the manner it deemed appropriate and claim the resulting tax deductions. Rather, it was obliged to transfer the liabilities to the purchasers if it wished to complete the sale transactions. This was emphasized by the Tax Court judge at paragraph 45 of his reasons: "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." In my view, whether the reforestation liabilities pass automatically from the vendor to the purchasers of the forest tenures by operation of the legislation or as a result of the conditions attached to the required consent of the Albertan authorities is of no consequence; in either case the reforestation liabilities are inextricably linked to the forest tenures and form an integral part thereof.

[137] In this context, it is neither reasonable nor correct to conclude that the compulsory assumptions of the responsibilities for the future reforestation works by the purchasers were a "sale" or "disposition" of "liabilities" resulting in "proceeds of disposition" in the hands of Daishowa under the meaning of subsection 13(21) of the *Act*. Rather, the framework under which the reforestation liabilities are managed in Alberta is such that the liabilities run with the forest tenures; consequently whoever holds these tenures at any given time must assume the entire associated reforestation liabilities. The reforestation liabilities and the forest tenures are thus inextricably linked. Consequently, the reforestation liabilities depress the value of the underlying tenures in proportion to the estimated costs associated with the future reforestation works required for the tenures: see by analogy Ian Gamble, *Taxation of Canadian Mining*, Carswell at pp. 6-10 to 6-13 under "6.6 Assumption of future reclamation on sale".

[138] Though the reforestation liabilities are taken into account in determining the selling price of the tenures, since they form part of the tenures their "value" is not to be treated separately from the value of the tenures themselves. Consequently, this "value" does not form a distinct part of the "proceeds of disposition" resulting from the sales of the tenures. A simple example serves to illustrate the matter. All other economic factors being equal, if a forest tenure can generate $10 million over 10 years (on the basis of $1 million a year) and requires $2 million in reforestation works over this period (on the basis of $200,000 a year) under the applicable regulatory framework, the value of the tenure to its holder over 10 years is $8 million. Should the holder of the tenure not carry out reforestation works during the first year and extract $1 million worth of value out of the tenure, the value of the tenure would then be $7 million ($10 million, less $1 million extracted, less

$2 million in future reforestation work). On the other hand, should the holder of the tenure carry out $500,000 worth of reforestation work in that first year, the value of the tenure would increase to $7.5 million since the reforestation "liability" affecting the value would have decreased to $1.5 million.

[139] This example is far from perfect and fails to take into account timing and other considerations, but it nevertheless illustrates the market mechanisms at work. The important point is that the value of the forest tenures underlying the forest harvesting business fluctuates in accordance with both the extent of estimated required future reforestation works inextricably attached to the tenures and the extent of reforestation works actually carried out at the time of the sale.

[140] I use the analogy of the sale of a building which needs repairs and improvements to bring it up to building code standards, such as new public access facilities for persons with disabilities or new fire safety systems, and which must be installed or completed within a specific number of years under a compulsory regulatory framework. If the building is sold prior to the repairs and improvements being completed by the vendor, its value would be less than if these repairs and improvements had been previously completed by the vendor. Yet, the "liability" represented by the costs of these repairs and improvements which the purchaser assumes would be factored into the sale price, but would not be deemed proceeds of the sale for taxation purposes. In such a context, no "proceeds of disposition" under the meaning of subsection 13(21) of the *Income Tax Act* would be received by the vendor resulting from the assumption of the "liabilities" by the purchaser upon the

sale. I see no fundamental difference here in regard to future reforestation works associated with forest tenures.

[141] In my view, excessive weight has been placed in these proceedings on the issue of the value of the liabilities. The underlying assumption in the Crown's position and in the Tax Court judge's reasons is that since the parties agreed on the value of the assumed reforestation liabilities in order to calculate the final sale price, that value is a "consideration" which forms part of the "proceeds of disposition". The Crown however recognizes that had the value of the reforestation liabilities not been ascertained or ascertainable, it may not have been a consideration forming part of the "proceeds of disposition".

[142] Thus, following the Crown's approach, in circumstances where parties to a forest tenure sale transaction would not identify the value of the reforestation liabilities, those liabilities may well not be included in the proceeds of disposition and thus escape taxation in the hands of the vendor, while in circumstances where the parties are transparent in their transactions and clearly identify the value of the reforestation liabilities, these would be accordingly included in the vendors taxable proceeds resulting from the transaction. I have great difficulty with this approach.

[143] The reforestation liabilities either form an integral part of the forest tenures and depress their value and are thus not to be included as separate elements in the proceeds of disposition upon the sale of the tenures; or they are distinct from the tenures and their value is included in the proceeds of disposition upon their assumption by the purchaser. Whether the parties have agreed or not to the

value of the liabilities has little bearing on whether or not these liabilities form part of the "proceeds of disposition". I consequently respectfully disagree with my colleague Nadon J.A. that the sale of Brewster Division to Seehta Forest Products Ltd. could be treated differently from the sale of the High Level Division to Tolko Industries Ltd. since this implies that the different manners in which the values of the respective reforestation liabilities were treated in the sale agreements and related documentation could somehow impact on the "proceeds of disposition" for taxation purposes resulting from both transactions.

[144] I would consequently grant the appeal with costs, dismiss the cross-appeal with costs, and, rendering the judgment which ought to have been rendered, I would grant the appellant's appeal from the Minister's reassessment of the appellant's 1999 and 2000 taxation years and return the matter to the Minister for reconsideration and reassessment in accordance with these reasons.

"Robert M. Mainville"

J.A.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-287-10
STYLE OF CAUSE:	DAISHOWA-MARUBENI INTERNATIONAL LTD. v. H.M.Q.
PLACE OF HEARING:	Vancouver, B.C.
DATE OF HEARING:	May 3, 2011
REASONS FOR JUDGMENT BY:	NADON J.A.
CONCURRED IN BY:	LAYDEN-STEVENSON J.A.
DISSENTING REASONS BY:	MAINVILLE J.A.
DATED:	September 23, 2011

APPEARANCES:

John Saunders	FOR THE APPELLANT
David Jacyk Matthew Turnell	FOR THE RESPONDENT

SOLICITORS OF RECORD:

Wilson & Partners LLP Vancouver, B.C.	FOR THE APPELLANT
Myles J. Kirvan Deputy Attorney General of Canada	FOR THE RESPONDENT