Are Assumed Reforestation / Rehabilitation Costs Part of the Price

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Daishowa-Marubeni International Ltd. v. The Queen

Price is important. What a purchaser pays can mean a lot. How much HST/GST/PST is payable? What is the land transfer tax? Has there been a gain/profit for income tax purposes? What is the value that gets "booked" by the purchaser? So how do you figure out the price when the buyer is required to take on some future expense as part of the deal to buy a forestry, mining or oil and gas asset?

The May, 23 2013 Supreme Court of Canada decision in *Daishowa-Marubeni International Ltd. v. The Queen (DMI)* dealt with whether reforestation obligations that were assumed by a purchaser needed to be included in reporting the purchase price received by DMI. In the words of Justice Rothstein (in a rare and better than average attempt at Supreme Court humour), "In this appeal, the Court is called upon to answer the age-old question: If a tree falls in the forest and you are not around to replant it, how does it affect your taxes?"

In 1999 and 2000 DMI sold two of its forestry divisions to two different purchasers. In each case part of the purchase price was allocated to the value of the forestry licences held by each division. The licences each carried outstanding reforestation obligations that were being assumed by the respective purchasers. The first agreement included an estimated value of current and long term reforestation obligations at $11 million. The second agreement did not include such an estimate.

DMI never deducted costs for future reforestation obligations as it reported its annual income for tax purposes while it operated the divisions. When DMI sold the divisions, it did not report any amount in respect of future reforestation costs assumed by the purchasers as part of the sale proceeds it received. The Minister of National Revenue (that other "MNR") reassessed DMI and tacked on about $14 million to the proceeds of disposition, representing the estimated reforestation obligations assumed by the two purchasers. DMI appealed.

The issue before the Court was, "… whether the purchasers' assumption of the reforestation obligations arising from DMI's previous harvesting is included in the sale price of the forest tenure."

MNR likened taking on the reforestation obligations to buying a property and assuming an existing mortgage; there is no question that the amount of an assumed mortgage forms part of the purchase price. DMI (backed by a cast of resource industry interveners) said that the obligations were costs that were imbedded in the licences - like the cost of needed repairs in the value of a house - that depress the value of the licences. In fact, in Alberta forest tenure is only transferrable with consent of the Province and consent depends on the purchaser agreeing to assume all reforestation obligations (at which time the seller is released of those obligations).

The Court agreed with DMI. A $1 million house with a $400 thousand mortgage could always be sold for $1 million because a purchaser does not need to assume the mortgage, but a $31 million forestry tenure with an $11 million reforestation obligation would never sell for more than $20 million because the obligation is always included in the package. As Justice Rothstein put it, “To include the full $31 million in DMI’s proceeds of disposition would disregard the fact that DMI did not have $31 million of value to sell. Under no circumstances could DMI have received $31 million for the forest tenure.”

The Court also commented on the lack of “symmetry” in the tax treatment of DMI and the purchaser. Notwithstanding that MNR wanted DMI to claim $31 million as the proceeds of disposition, it admitted that it was not going to allow the purchaser to include the $11 million in assumed reforestation costs as part of its adjusted cost base. As DMI pointed out, that would mean that the purchaser could sell the forestry tenure the next day at its market value of $20 million but it would get taxed on a sale price of $31 million (and only be able to claim a cost of $20 million). The Court stated that, where there are two different interpretations of a tax provision, the interpretation that is consistent with the principle of symmetry should be preferred.

Not in the forestry business? Well, think of rehabilitation obligations that come with mining and oil and gas developments. These obligations are typically assumed by the purchaser and often as a condition of any government approved transfer. Think of properties where the buyer assumes legal environmental cleanup liability. The DMI decision suggests that these costs, when assumed, are not part of the price. (Now remember, this is an article; get specific legal advice before you hang your hat on this.)

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