The Tax Consequences of Estimating Assumed Obligations in a Purchase and Sale Agreement: The Daishowa-Marubeni Case

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On September 23, 2011, the Federal Court of Appeal (the "FCA") released the highly anticipated decision in *Daishowa-Marubeni International Ltd. v. The Queen* (2011 FCA 267). The decision of the FCA is of key importance in the mining, forestry, and oil and gas context, where the assumption of reforestation and reclamation liabilities is part and parcel of the sale of properties.

In this case, the corporate taxpayer ("Daishowa") sold two of its forestry divisions. As part of each of the divisions, Daishowa held timber rights, which gave rise to certain reforestation liabilities. The Purchase and Sale Agreement provided the following: a purchase price of $169,000,000 for the assets; the net working capital (as adjusted); and the assumption by the purchaser of $11,000,000 in reforestation obligations, plus or minus "any difference between a preliminary and a final estimate" of the reforestation obligations. The FCA noted that Daishowa admitted that the purchase price would have been greater if the purchaser had not assumed the reforestation liabilities.

The FCA held that the assumption of the reforestation obligations constituted additional proceeds of disposition of "timber resource property", which is treated as depreciable property for purposes of the *Income Tax Act* (Canada). Daishowa's argument that the $11,000,000 was simply an estimate and not an agreed upon value of the reforestation obligations was denied by the FCA.

Rather, the FCA held that, based on an interpretation of the contract, the parties had agreed that the value of the reforestation liability was $11,000,000 and therefore the entire $11,000,000 should be included in Daishowa's proceeds of disposition. According to the FCA, the issue in circumstances of this kind is whether the obligation assumed can be valued. As a result, if the parties do not assign a value to the reforestation or reclamation obligations, then presumably there is no amount to include in the vendor's proceeds of disposition.

This case has a broad impact with respect to any sale of a business where pension, severance and other obligations are assumed by the purchaser and a value is assigned to the assumption of those obligations. Taxpayers should consider this case and its implications when drafting purchase and sale agreements, as well as with respect to sale transactions that have already occurred. Further, this case may create additional complications for purchasers who assume certain obligations and an amount is assigned to such obligations as part of the transaction. Presumably, based on the FCA's decision, the assumption of such obligations may form additional cost of the properties acquired, although the timing of the addition to the cost of the properties is unclear. At this time, it is uncertain whether leave will be sought to appeal the decision of the FCA to the Supreme Court of Canada, or whether leave to appeal would be granted.

Please follow the link here for a more detailed analysis of this decision.