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Taxation Decisions and Legislative and Administrative Developments

The Valuation Law Review is a joint publication of The Canadian Institute of Chartered Business Valuators and Stikeman Elliott. This issue summarizes taxation law decisions of interest to business valuators. The Valuation Law Review is not intended to provide legal advice and readers should not act on information in the publication without seeking particular advice on matters that are of concern to them. Readers are cautioned against relying upon the decision abstracts contained herein, which are edited and in outline form only, and are directed to the full report of the reasons of the Court.

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Nanji, I. et al. v. The Queen
2002 CarswellNat 583
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Less weight may be given to a valuation provided by a valuator who has never been active in the relevant market. A court should not be bedazzled by the mystique and jargon of real estate appraisals where the results, based on assumptions that are either not articulated or not substantiated, run counter to ordinary commercial common sense.

The sole issue in this case was the fair market value of a parcel of land on a particular date in 1994. The land was a commercial lot upon which a garage was situated. Three taxpayers held and used the land together with a fourth person in carrying on a business. In order to preserve a capital gains exemption that was about to be lost in respect of an accrued gain on the land, the taxpayers filed an election in 1994. The election required the taxpayers to designate an amount at which the property would be deemed to be disposed of and reacquired for the purpose of triggering the gain. Any excess of the elected amount over 110% of the fair market value of the property would reduce the new adjusted cost base by the amount of the excess, and where there was such an excess, the election could not be amended or revoked.

The taxpayers designated $500,000 as the elected amount. Subsequently, in 1999, the taxpayers sold the property for $350,000. In their 1999 returns, they calculated the adjusted cost base of the property on the assumption that $350,000 was the fair market value of the property in 1994. Taking into account the resulting reduction in the cost base, due to the excess election, the result was a taxable capital gain. The taxpayers deducted this gain from income as though the exemption still applied. The deduction was disallowed and the remaining issue was whether $350,000 was the correct fair market value for the land in 1994.

The Minister's expert valuator testified that the fair market value of the property in 1994 was $275,000. The self-represented taxpayers did not call an expert witness. Despite having only the Minister's expert report before it, the Court held that it was not bound by that report. Although the Court acknowledged that it must rely solely on the comparables chosen by the Minister's expert, the Court was critical of the expert's lack of real estate experience. The valuator chosen by the Minister had apparently never been active in the real estate market as a broker or dealer in the relevant location. While this did not exclude his evidence, it did reduce its weight, the Court held. Valuation, the Court observed, is "an art that requires molding and tempering in the marketplace".

The Court also questioned other aspects of the expert's report. The valuation was based on values determined using a cost approach and a direct comparison approach. With respect to the cost approach, after noting that the choice of a 60% depreciation factor was "admittedly highly subjective", the Court questioned the expert's conclusion that the presence of the garage added nothing to the value of the subject property. It was not "realistic", according to the Court, to value the

property as though it were vacant but then to use comparables with similar buildings.

The Court then reviewed the comparables. Cumulatively, their average fair market value was significantly higher than the figure arrived at by the expert. Although one could not simply take the average of the comparables and thereby arrive at fair market value, the Court reasoned, the discrepancy was enough to raise "serious doubts" about the expert's valuation. "Judges should not let themselves be overly bedazzled by the mystique and jargon of real estate appraisals", the Court observed, where "the results based on assumptions that are either not articulated or not substantiated, yield valuations that run counter to ordinary commercial common sense". The Court focussed on one comparable in particular, a property that sold only three weeks before the valuation date. The Court adopted the value per square foot from that property for the subject property. "Where a property is as comparable to the subject as this one, and a sale takes place at about the relevant date," the Court concluded, "I can see no reason for making adjustments or calculations of averages". On this basis, the Court assigned a fair market value for the property in 1994 of $421,950 and referred the assessments back to the Minister for reconsideration.

Miller, R. et al. v. The Queen
[2002] 2 C.T.C. 120
Federal Court of Appeal
March 1, 2002

In 1989, Mr. Miller and Mr. Webber developed software intended to be used in law office management. By 1992, the software was used only in the law practice of Mr. Miller's wife and was subject to some technical problems. In December of 1992, Mr. Miller transferred his 50% interest in the software to J. Miller & Associates (the "Corporation") of which he was the sole shareholder and director, for an agreed purchase price of $100,000. The Corporation then claimed capital cost allowance on the software as Class 12 property, acquired at a cost of $100,000. After 1994, it claimed an undepreciated capital cost of $100 for the software. In February 1994, the Corporation and Mr. Webber transferred their interests in the software to Simplexity Software Solutions Inc., for payments consisting of $100,000 to Mr. Webber, and $100 to the Corporation.

Once it is established that an auditor's reassessment of an asset is not unreasonable, the onus shifts to the taxpayer to establish on a balance of probabilities that the asset had a different value.

This case is an appeal of the decision of the Tax Court where the Tax Court judge confirmed Revenue Canada's reassessment that, for purposes of capital cost allowance, the Corporation's cost of the software acquired in 1992 was $100, rather than $100,000.

The appellants (Mr. Miller and the Corporation) claimed that, in making his assessment, the auditor had acted unreasonably and in an arbitrary manner. The auditor had initially intended to obtain the advice of a Revenue Canada software expert. However, the expert valuation never materialized.

The Federal Court of Appeal found that, even without the expert valuation, it was not unreasonable for the auditor to reassess the 50% interest in the software as $100 for 1992. Furthermore, since it was not unreasonable for the auditor to reassess the Corporation in that way, the onus shifted to the appellants to establish on a balance of probabilities that the software had a higher value.

The Court noted that, despite the fact that both Mr. Miller's wife and Mr. Webber could have testified as to the value of the software, the only evidence adduced was the testimony of Mr. Miller himself, which was supported by documents that he had prepared. The Court of Appeal thus agreed with the Tax Court judge that the appellants had not adduced enough evidence to rebut the Crown's assumption that the 1992 value of the 50% interest in the software was $100.

The appeal was dismissed with costs.

Brown v. R.
[2001] 1 C.T.C. 2451
Tax Court of Canada
November 15, 2001
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Brown, P.M. v. The Queen
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February 21, 2002

In using the discounted cash flow method to value a pool of assets based on sales projections, the value should reflect the limited sales history of the seller by excluding "outlyers" and possible "hits" that skew the average upwards. For valuation purposes, quality refers not only to technical quality but also to commercial viability. The tax results of a transaction to a particular taxpayer should not influence the value of the assets purchased.

The Brown case required the Court to assess the fair market value of certain software assets or "engines" purchased by a partnership from a software publisher. The partnership purported to acquire an interest in those assets at a certain price and then to carry on the business of selling computer games based on those assets in a joint venture with the publisher. The partnership added the aggregate cost of the assets to the capital cost of its Class 12 assets for tax purposes and deducted capital cost allowance in computing its income.

The appellant taxpayer had acquired units in the partnership. The Minister denied the deduction of the taxpayer's share of the partnership's business losses and his interest expenses claimed in respect of acquiring the units, and deleted income reported from the partnership in subsequent years. As part of the reassessment, the Minister assigned the software assets a lower fair market value than that claimed by the partnership. One of the issues in the case was whether the partnership and the publisher were dealing at arm's length and, if not, what was the fair market value of the assets.

The Court considered both the original valuation report used in the transaction (even though the valuator had no professional qualifications), and the valuation produced by the CCRA for the purposes of reassessment. In addition, each side produced an additional valuation report for trial. The Court found problems with each report. The original valuation report was based on a review of many assets that were different from those ultimately acquired. Also, it assumed that the publisher had a licence that it did not have at the time of the report. The initial CCRA valuation misstated the state of the market and did not examine the qualifications of the authors of various publications it relied on. In addition, the valuator had not retained notes of conversations and meetings held in the course of preparing the report.

As for the trial reports, the Court accepted the use of the discounted cash flow method. However, the Court noted that the taxpayer's report did not accurately reflect the publisher's track record, as it assumed that the publisher had successfully published game units in the past. In addition, the valuators did not examine the existing units and had assigned the underlying assets a residual value beyond the projected sales period. The CCRA report only dealt with two of the eleven assets, as the valuator had no objective evidence that the other assets existed. The Court, however, found that eleven assets had been purchased. In addition, the second CCRA report was based on a technical report that misstated the programming language used for the assets, the effect of which was to lower the development costs. The Court held that this misstatement severely affected the import of the report.

In considering how a proper valuation should proceed, the Court held that when using the discounted cash flow method to value a pool of software assets based on sales projections for game units developed from each asset, the value should reflect the limited sales history of the seller. Accordingly, the Court excluded "outlyers" and possible "hits" that skewed the average value upwards. The Court also held that ability of the seller to cross-promote titles in its marketing added little to no value as it was not reflected in a past history of sales. Unit quality for valuation purposes referred not only to technical quality but also to commercial viability. The quality of the game units produced from each asset was not the sole basis of valuation, but only one factor that modified the pooling approach. An anticipated decline in the market for the game units and projected market oversaturation led the Court to adjust projected sales downwards. However, to account for investor expectations that performance might improve, the Court adjusted projected sales upwards. Where projections were adjusted upwards, the Court noted, the discount factor should also rise accordingly to reflect the

increased risk of obtaining the projected sales. The Court also noted that the calculations should find after tax values and that the assets should not be assigned a residual value.

The use of the pooling method was a "commercial reality" in determining how much a purchaser would pay for a group of assets. However, it was not a barrier to claiming capital cost allowance on the assets, even though it posed a "conceptual problem". The Court observed that to qualify as a depreciable asset under Class 12, each computer software asset had to be added separately to the class. However, although the purchaser may purchase a group of assets, a price is still paid for each specific asset which may be added to the class as such. If one asset has a greater value, an adjustment to the allocation of the purchase price can be made. Otherwise, assuming all assets are equal, once the value of the pool of assets is identified, the actual price paid can be divided by the number of assets to find the amount the purchaser was willing to pay for each asset.

In this case, the Court concluded that the partnership and the publisher did not deal at arm's length and the price the partnership purported to pay for the software assets was greater than fair market value. However, the Court declined to fix a value for the assets, in light of its subsequent findings that the partnership was deemed to be a limited partnership and that the taxpayer's "at risk" amount was nil. If, however, a valuation was necessary, the Court's reasons were to serve as the basis for the valuation.

As it turned out, a new valuation was necessary for the purposes of reassessment. The parties were unable to agree, however, about how to account for the tax benefit associated with the "tax shield" provided by the taxpayer's investment in the partnership as a tax shelter. The parties returned to Court, seeking directions on this and certain other points.

The taxpayer argued that the tax benefit to the purchaser of the partnership units should be reflected in the fair market value of the assets purchased. The Court rejected this argument and held that the tax aspects of a transaction to any individual taxpayer should not influence the value of the assets purchased. The Court also clarified that where it was unclear whether a dollar amount provided at trial was expressed in Canadian or United States currency and it was not possible to discover which currency was used, the Court would infer that the currency stated at trial was Canadian currency.

Savage et al. v. R.
2001 CarswellNat 2500
Tax Court of Canada
August 30, 2001

The taxpayers in this case were a father and son carrying on business as farmers. They purchased combines and a tractor for a combination of cash and trade-ins of similar equipment. The value of the equipment traded-in was negotiated with the vendor. The taxpayers treated the trade-in value as part of the contract price, which they then used for the purpose of calculating capital cost allowance and input tax credits. The Minister reassessed and took the position that the fair market value of the equipment traded-in was less than that negotiated by the parties. The Court was thus asked to determine the capital cost of the new equipment, which required a determination of the fair market value of the equipment traded-in.

Negotiated prices between cagey and hard-nosed parties are preferable to guidelines provided in a guide where the publishers have little experience with the property at issue. Also, the washout price for trade-in equipment is subject to too many variables to be a satisfactory method of determining value.

For valuation purposes, the CCRA relied solely on figures presented in the Western Canada Trade Guide, which contained guidelines for the valuation of used farm equipment. The taxpayers relied on the testimony of the vendor, who described the negotiations as tough and arm's length. The vendor testified that the prices in the Guide were unreliable because the publishers had little experience with the particular equipment at issue in the case. The vendor explained that the negotiated prices were based on prices he thought he could obtain on a resale of the equipment.

The Court accepted the vendor's testimony and noted that the characteristics of a hypothetical informed vendor and purchaser were present in this case. The parties were "honest, but cagey" and "smart and hard-nosed". "I never thought I would meet such people, but I was wrong," explained the judge. "These two tough old birds are the archetypes of a knowledgeable vendor and purchaser, and I mean that in a complimentary sense". The negotiated figures thus came as close as is possible to the price that two knowledgeable persons would negotiate.

The Court also observed that there was no suggestion that the negotiated values were inflated or manipulated. In addition, the Court held that the "washout price" (the aggregate of cash components in all subsequent transactions related to the transaction until nothing but cash remains) was subject to too many variables to be a satisfactory method of determining value. It would take years for the series of trades to be completed before the figures could be ascertained, and the

determination of fair market value at a point in time was made dependent on events and economic conditions that may not occur until years later. Accordingly, the Court allowed the appeals and referred the matter back for reassessment.

Canada (Deputy Minister of National Revenue - M.N.R.) v. Mattel Canada Inc.
[2001] 2 S.C.R. 100
June 7, 2001

Value must be attributed to goods imported to Canada in order to determine duty. In this case, the Supreme Court of Canada clarified the meaning of the terms "export" and "condition of sale" for the purposes of such valuation and determined that the periodic payments obligated to be made by the final purchaser were not included in the price "paid or payable" for the products at issue.

Mattel Canada ordered goods manufactured in Hong Kong. Title passed through a series of intermediate purchasers at progressively higher prices. Mattel Canada was the third and final purchaser. The Customs Act requires that value be attributed to goods imported to Canada to determine duty, and prescribes methods to determine the value for duty. In this case, the Supreme Court of Canada clarified some of the possible valuation methods.

The Customs Act provides that value for duty may be determined as "the price paid or payable … when the goods are sold for export to Canada" (subsection 48(4)). Also, the Customs Act requires that the price paid or payable be adjusted by adding royalties and licence fees that the purchaser must pay as a condition of the sale of the goods for export to Canada (subparagraph 48(5)(a)(iv)).

The first issue was when the goods were "sold for export to Canada". Mattel Canada argued that duty should be calculated based on the price paid or payable on the sale of goods by the manufacturers to the first intermediary. The Court disagreed. Justice Major, writing for the Court, considered the ordinary meaning of "export", in s. 48(4), and concluded that the relevant sale for export is the sale by which title to the goods passes to the importer. The importer is the party who has title to the goods at the time when the goods are transported into Canada. The importer's residency is not material, and the importer can be an intermediary or the ultimate purchaser. In the present case, Mattel Canada had title prior to transport into Canada, so the sale to Mattel Canada was the appropriate sale for the determination of the price of goods. The Court rejected Mattel Canada's argument that selling goods with the intent that they eventually be exported is sufficient to meet the requirement of subsection 48(4). Instead, as noted above, the Court held that the genesis of an "export" occurs at the point when goods are actually transported into Canada.

The second issue addressed by the Court was the appropriate adjustments to price. Mattel Canada paid royalties to a third party trademark licensor of the imported goods. Furthermore, Mattel U.S., the parent company of which Mattel Canada is a wholly owned sub-subsidiary, had entered into agreements with various third party licensors. Mattel Canada made periodic payments to Mattel U.S. which were passed through Mattel U.S. to these licensors.

The Federal Court of Appeal determined that the periodic payments should be included in the value for duty of the imported products, but that the royalties should not. The Supreme Court of Canada noted that subparagraph 48(5)(a)(iv) requires that royalties and license fees must be paid by the purchaser as a condition of the sale of the goods for export to Canada, in order for the payments to be added to the "price paid or payable." The Court expressly rejected the Canadian International Trade Tribunal's earlier analysis of this case, in which it suggested that there must be a "sufficient nexus" between the payments and the sales for export. The Court also expressly rejected the Federal Court of Appeal's control test, pursuant to which royalties would be paid as a condition of the sale of goods for export not only where the sale of goods was made contingent on the royalties being paid but also where the licensor owned or controlled the vendor or where the vendor held the trademark or copyright, such that the importer's failure to pay royalties could prevent or seriously compromise its ability to import products. The Court emphasized that the Federal Court of Appeal erred in holding that the term "condition" was not used as a term of art in subparagraph 48(5)(a)(iv). Rather, the term incorporates concepts from the common law of contracts and from sale of goods legislation, and has a settled legal meaning. The payment of the royalties and license fees is a condition of the sale of the goods for export to Canada if the vendor is entitled to refuse to sell the licensed goods or to repudiate the contract for non-payment of those royalties and license fees.

In the present case, neither the royalty payments nor the periodic payments were made a condition of sale. The royalties contract and sales contract were two separate agreements involving different parties. Similarly, the periodic payments involved Mattel Canada's obligation to pay licence fees to the licensors, and this obligation was distinct from its obligation to purchase goods from Mattel U.S.

Mattel Canada's appeal was allowed in part, as the periodic payments were not included in the "price paid or payable," but the Court agreed with the Federal Court of Appeal and the Canadian International Trade Tribunal that the relevant

sale transaction for determining the "price paid or payable" was the third and final sale, which occurred at the highest price. The Deputy Minister's cross-appeal was dismissed: the royalties were not included in the "price paid or payable".

Double Diamond Ranch Ltd. v. Saskatchewan Assessment Management Agency
(2001) S.K.Q.B. 46
(Saskatchewan Court of Queen's Bench)
January 26, 2001

In some valuation cases, a government agency may be required to prepare assessment manuals for the valuation of property. Where land is assessed based on such a manual, the owner of the assessed land may be successful in applying for judicial review of the assessment manual itself.

This case dealt with the valuation of pasture lands. The Saskatchewan Assessment Management Agency ("SAMA") is responsible for valuing property in Saskatchewan for assessment purposes. Its governing legislation, The Assessment Management Agency Act, requires that it prepare any assessment manuals required for the valuation of property that are required by a Municipal Act. The applicants, in their personal capacities and as representatives for the owners of pasture land in Saskatchewan, applied for judicial review of the assessment manual established by the respondent SAMA.

The applicants' complaint, in this case, was that the respondent had assessed their land as though it were owned in fee simple, when in fact it was leased from the Province of Saskatchewan, and was therefore subject to certain conditions and restrictions that reduced its value. The basis for their application for judicial review was that various features of SAMA's assessment manual were inconsistent with The Rural Municipality Act (the "Act").

The first issue raised by the appellants was whether the assessment was inconsistent with subsection 284(6) of the Act because its formulas contained no variable permitting the assessor to consider any effect on the assessment resulting from the land being held by way of a beneficial interest in a Crown lease.

Section 284(6) of the Act provides that where:

> the holder of land under a grazing or hay lease, licence or permit … is assessed with respect to his or her occupancy or to his or her beneficial or equitable interest in the land, the value of the occupancy or interest for the purpose of assessment shall be the fair value having regard to the use to which the land is put.

In the present case, the Court appears to have interpreted this provision to mean that the use to which lands are put is the only basis for valuing the land in the

context of subsection 284(6), so that the type of ownership interest held in the land is irrelevant to the valuation. Therefore, the Court rejected the suggestion that the assessment manual was inconsistent with this subsection of the Act.

The Court next considered provisions of the assessment manual dealing with land sales. Unlike subsection 284(6) of the Act, the sections of the Act that address land sales were not restricted to pasture lands. The assessment manual required assessment on the basis of productivity and sales comparisons of single, fee simple sales. Also, the assessment manual did not allow for the use of Crown pasture sales in its calculation of its local market index and provincial market index.

The Court recognized that numerous factors reduce the value of Crown lease land compared to the value of fee simple land. Subsection 284(1) of the Act requires that land be assessed at its fair value. Subsection 284(4) of the Act requires that, in determining the fair value of land, the assessor must take into consideration the present use of the land and any other condition or circumstance affecting its value. Because the manual did not take into account evidence that the value of Crown lease land is less than fee simple land, the manual ignored conditions or circumstances affecting the land value, and assessments did not reflect the fair value of the Crown lease lands. In this regard, the assessment manual offended the provisions of section 284 of the Act.

The Court also considered the applicants' argument that the assessment manual did not account for zoning restrictions and restrictions on clearing wildlife habitat, imposed by The Wildlife Habitat Protection Act and The Wildlife Habitat Lands Disposition and Alteration Regulations. However, the Court accepted the respondent's argument that the pasture portion of the assessment manual was concerned with present use, and that the above restrictions did not affect the value of land, with respect to the present use of pasture land.

The applicants were successful in part. The assessment manual's failure to take into account the effect of the form of ownership upon land value was inconsistent with those provisions of the Act dealing with land generally. But the provisions of the assessment manual dealing specifically with pasture land did not offend subsection 284(6) of the Act - the provision dealing specifically with pasture land - as the latter restricted the valuation to a consideration of use.

Erdmann v. R.
[2001] G.S.T.C. 28
(Tax Court of Canada)
January 19, 2001

Under the GST transfer-of-property rule, a payment deposited in a joint bank account of the transferor and transferee and subsequently used to buy real property registered solely in the transferee's name will not reduce the transferee's liability.

This case deals with the GST transfer-of-property rule outlined in section 160 of the Income Tax Act and section 325 of the Excise Tax Act. Pursuant to these rules, where a person with a tax liability transfers property to a related person, the CCRA can assess the transferee. Under the rule, the transferee's liability cannot be more than the amount by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property.

At issue in this case was the valuation of the property transferred. John Swift had transferred a townhouse to his then spouse, the appellant, who was subsequently assessed for Swift's tax debts. Both the appellant and the respondent had expert appraisers testify. Both appraisers used two identical properties to value the townhouse on a fair market value basis. The appellant's appraiser valued the townhouse at $90,000, while the respondent's appraiser valued the townhouse at $114,000. On the facts, the Court found that the respondent's valuation was more accurate. As the value of the property transferred exceeded the amount assessed against the appellant, the appeal was dismissed. The Court also noted that even the appellant's own appraiser valued the townhouse at an amount exceeding the amount of the assessment.

An interesting element of this decision is the Court's treatment of payments made by the appellant to Swift as consideration for the townhouse. In the present case, a payment of $20,542.78 was deposited in a joint bank account, and subsequently used to buy real property, registered solely in the appellant's name. The Court therefore held that the appellant never lost the benefit of this money. The payment did not reduce the transferee's liability.

Hallatt v. R.
[2001] 1 C.T.C. 2626
(Tax Court of Canada)
December 28, 2000

Where experts' valuations of a nursing home presented the polarized extreme ends of value, the Court focused on the reasoning underlying each expert's conclusion and ultimately relied on "common sense and commercial reality" in approving a valuation much closer to one end of the spectrum than the other.

At issue in this case was the valuation of shares in a nursing home. Each of the appellants, Mr. and Mrs. Hallatt, was a 50% owner of shares in Brantwood Manor Nursing Homes Limited ("Brantwood"). The appellants sold their shares for $2.4 million in December 1988, and each reported an adjusted cost base of $1.25 million. The Minister of National Revenue (the "Minister") assessed the capital gain on the basis that the adjusted cost base was $250,000 for each appellant. The valuation date for purposes of calculating the adjusted cost base was December 31, 1971.

The appellants and respondent both called expert appraisers. The expert for the appellants used the discretionary cash flow capitalization method to value the shares at $1.76 million. The expert for the respondents reached a figure of $503,000, using the capitalized earnings approach.

The approach of the appellant's appraiser involved two straightforward steps. First, he calculated the after-tax cost of the debt component of the weighted average cost of capital. Second, he determined the cost of equity, dividing the maintainable discretionary cash flow by the capitalization rate. Following certain adjustments, these calculations resulted in the above-noted figure of $1.76 million as the fair market value for the shares of Brantwood.

The report of the respondent's appraiser listed the valuation results of three different methodologies: the comparative market approach, the capitalized earnings approach, and the value indicated by "Rule of Thumb." Judge Bowman rejected the first and third approaches because the comparisons made under the first approach were not sufficiently comparable and the figures relied on for the third approach were of insufficient accuracy. As discussed below, Judge Bowman found the second approach, pursuant to which the respondent's appraiser capitalized the estimated maintainable earnings at 11%, somewhat more persuasive. Judge Bowman emphasized that he found it difficult to accept either appraisal in its entirety. In this case, inflation was treated differently by each appraiser. Judge Bowman noted that the treatment of inflation for purposes of valuation of a business is complex, and an appraiser must therefore provide a detailed and comprehensive explanation of his or her treatment of inflation. In the present case, this explanation was not provided.

More generally, Judge Bowman noted that "the court is not bound to accept any expert opinion. Indeed, since the function of the expert is to assist the court in arriving at its own conclusion, the expert's conclusion is frequently of less importance than the reasoning that lies behind the conclusion." In concluding that he would accept the respondent's calculations of annual revenues, subject to a reduction in the estimated vacancy rate, Judge Bowman observed that the $1.7 million figure suggested by the appellant was simply unrealistic, given that the real property owned by Brantwood was worth about $600,000 on December 31, 1971. Judge Bowman, in choosing between the two sets of calculations, observed that both had used accepted methods of valuing a privately owned business. He noted that "what the court has to do in a valuation case of this type is to attempt to arrive at the price upon which willing and knowledgeable vendors and purchasers would settle." Judge Bowman suggested that the final figure presented by the respondent was more consistent with his "common sense and idea of reality", and held that the appropriate value of the shares of each appellant was $325,000.

Earlier in his reasons, Judge Bowman cited his comments in Western Securities Limited v. The Queen, 97 D.T.C. 977 (T.C.C.) at 979, where he noted that judges frequently determine a value between the experts' opposing positions, "because of a recognition that the positions adopted by the experts represent the polarized extreme ends of value." In the present case, Judge Bowman approved a valuation much closer to one end of the spectrum than the other. In reaching this result, Judge Bowman made certain noteworthy observations: although a purchaser might well consider the profit and loss statement for the year ended December 31, 1971 to be of little significance, given that part of the nursing home was still in construction, "it would be surprising if a prospective purchaser were to be totally oblivious to the financial results in the year of acquisition." Also, although the comparative market approach was rejected as being unreliable in the present case because of a lack of sufficiently comparable sales of nursing homes, Judge Bowman nonetheless suggested that the "$1.7 million figure is very much out of line when one considers that a 51 bed home ... sold in 1974 for $386,000." In the present case, Brantwood had the capacity to operate 140 beds, and was legally in a position to operate 129 on December 31, 1971.

The non-technical approach to valuation in this case is not surprising, given Judge Bowman's own emphasis on the fact that "common sense and commercial reality necessarily play a large part" in determining the price upon which willing and knowledgeable vendors and purchasers would settle.

Sira Enterprises Ltd. v. R.
[2000] G.S.T.C. 102
(Tax Court of Canada)
November 22, 2000

In this case the Court had to determine the appropriate method for the valuation of newly built residential apartment complexes for the purposes of the self-supply rule in subsection 191(3) of the Excise Tax Act (the "ETA"). The appellant had valued the complexes using the cost approach while Revenue Canada valued the complexes using the income approach and the direct-comparison approach to arrive at a higher value. The Court found that, in the appellant's circumstances, the cost approach was more suited to the calculation of the fair market value for the complexes.

In determining the fair market value of a newly built apartment complex for GST purposes, the use of the cost approach is appropriate, absent special circumstances. The fair market value of the complex for GST purposes is not necessarily equal to the fair market value of the complex for the purpose of sale.

In 1995, the appellant corporation built a number of residential apartment complexes and reported their self-supply pursuant to subsection 191(3) of the ETA. The appellant valued the complexes at $36,757 per unit, based on the costs incurred for the construction of the complexes. After meeting with a Revenue Canada auditor and real estate appraiser, the appellant was (re)assessed at $42,000 per unit. This resulted in an outstanding GST amount of $49,913.36. The appellant filed a notice of objection which was disallowed by the Appeals Division of Revenue Canada in August 1998. The appellant thus brought this appeal to the Tax Court.

The Minister argued that subsection 191(3) of the ETA takes into account market value and not the cost of building the complex. He further argued that anyone buying the buildings would consider the rental income from the units and that this would be relevant to a valuation of the units. Hence, the Minister considered that the direct-comparison approach and the income based approach provided a good estimate of the fair market value of the units for purposes of subsection 191(3) of the ETA.

The appellant argued that, since the complexes were new, the cost approach was the correct valuation method. It claimed that the Minister's valuations were flawed because the GST would have been included in the value of the buildings used as comparables and the Minister’s valuator had not backed them out. Moreover, the amounts used and arrived at by the Minister were mere estimates, while the values arrived at by the cost approach were the real values for the cost of the buildings.

In his decision, Judge Margeson distinguished between determining the fair market value of an asset for the purposes of sale and its fair market value for GST purposes:

> The GST provisions in essence require the payment of a tax on goods and services supplied or rendered. The goods and services supplied or rendered in the case at bar are those goods and services rendered in the course of the construction of the properties in question. The Court's duty is to determine the fair market value of the properties for the purpose of the GST. The Court is not interested in the fair market value of these properties for the purpose of sale.

His Honour recognized that there are three accepted methods of determining fair market value: 1) the cost approach, 2) the income approach, and 3) the market approach or direct comparison approach and found that the appraiser for the Minister had no explanation for excluding the cost approach. Moreover, although the appraiser had claimed that the comparable buildings truly were comparable, there was evidence that there were some differences between the properties compared, and the comparables that were ultimately used. Finally, in all the comparables, the vacancy and rental rates used were estimates, and GST amounts may have been improperly included.

Reliance was placed by the Court on two cases, Charleswood Legion Non-Profit Housing Inc. v. R., [1998] G.S.T.C. 65 (T.C.C.), and Timber Lodge Ltd. v. Canada, [1994] G.S.T. C. 73 (T.C.C.), where the cost approach was used because the buildings were new on the relevant valuation date. However, Judge Margeson also recognized that in some circumstances the cost of a new building may be different than its fair market value, including situations with cost overruns during construction, or circumstances where the parties hired in the course of construction were not at arm's length.

Ultimately, Judge Margeson found that the cost approach was the most appropriate method. However, His Honour found that in the construction of the complexes, there would have been $65,236 of additional costs if the appellant had been dealing with the corporation that constructed the units at arm’s length. This amount, the Court found, should be added for the purposes of the valuation, resulting in a fair market value of $37,005 per unit.

The appeal was allowed and the matter was referred back to the Minister of National Revenue for reassessment.

Teleglobe Canada Inc. v. Canada
[2000] 4 CTC 2448
(Tax Court of Canada)
September 14, 2000

This was an appeal by Teleglobe (the "appellant") from an income tax assessment, whereby the Minister disallowed a deduction for goodwill under paragraph 20(1)(b) of the Income Tax Act (the "Act").

Where a corporation issues shares for property, the value of the property acquired is not necessarily reflected in the value of the shares issued. Rather, the stated capital of those shares is the value placed by the corporation on that class of shares when issued, notwithstanding that the fair market value of the property acquired at the time may have been different.

The facts are straightforward. The Government decided it was going to dispose of its interest in several Crown corporations, one of which was Teleglobe. To privatize Teleglobe, the Government transferred the business of Teleglobe (old Teleglobe), as a going concern to the appellant (new Teleglobe). As consideration for the transfer of the business, the appellant issued common and special shares, a promissory note and assumed liabilities. To complete the privatization, the Government sold the common shares and the promissory note in a bidding process.

The Government had retained consultants to determine the value of old Teleglobe's assets and liabilities. The Government believed the valuation report could be useful to the purchaser of the assets, as it would help set a reasonable rate base. It was thought that potential bidders could also use the valuation in preparing their bids to purchase the common shares and the promissory note. Since the consultant was using a rate base valuation (for regulatory purposes) for the assets and liabilities, there was no attempt to determine the fair market value of old Teleglobe's assets and liabilities. Generally, the fair market value is in excess of the rate base. In preparing the valuation report, the consultant testified that he did not take goodwill into account at all. As a result, there was no specific number attributed to goodwill in the valuation report.

The appellant claimed that the value of the goodwill was to be determined by reference to the price paid for the shares sold by the Government. Those shares sold for $130,000,000 more than the stated capital, which the appellant argued was the amount of value attributable to the goodwill it was entitled to deduct. The Minister argued that $530,547,000 was the value of the consideration paid by the appellant when it purchased the business from old Teleglobe, and since no goodwill had been factored into those figures, no amount could be allocated to it. The Court determined that old Teleglobe's business had an element of goodwill and this goodwill became an asset to the appellant on the transfer of the

business. The Court did not accept the appellant's argument that the value of the asset acquired is reflected in the value of the shares issued. Rather, the Court found that the stated capital of the shares issued for the property was the value placed by the corporation on that class of shares when issued, notwithstanding the fair market value of the property acquired at the time may have been different. The Court also noted that the amount determined as the stated capital for the issued shares was not affected by the fair market value when those shares were sold. When the business was sold the value of the appellant's shares was based on the valuation report, which did not take goodwill into account. The Court concluded that the appellant did not make or incur an outlay or expense to acquire the goodwill when it issued the shares and therefore could not deduct an amount for goodwill as an eligible capital expenditure.

Estevan Coal Corp. v. Estevan (Rural Municipality No. 5)
2000 SKCA 82
(Saskatchewan Court of Appeal)
June 29, 2000

In determining a market adjustment factor for non-special purpose buildings, an assessor is bound to conduct all assessments uniformly, following the formulas set out in the assessment manual in order to achieve the concept of equity as required by the statute in issue.

This appeal concerns the assessment of the fair value of certain buildings for municipal tax purposes. At issue was the determination of the market adjustment factor. The Court considered the issue of whether the Assessment Appeals Committee (the "Assessment Committee") made an error in law in failing to take into consideration and be guided by any applicable formula, rule or principle as set out in the Saskatchewan Assessment Manual (the "assessment manual") as required by subsection 285(6) of the Rural Municipal Act (the "Act").

The appellant operated a coal mine in the Rural Municipality of Estevan. The appellant owned buildings adjacent to the mine. The buildings contained offices for administration, parts warehouses, and storage areas. The assessor classified the building as a special purpose building, which is defined as a heavily integrated building with machinery and equipment used in mining and not readily adaptable to an alternate use. The assessment manual provides that no market adjustment factor should be used in the calculation of the assessed value of a special purpose building. For all non-special purpose buildings, the assessment manual provides that a market adjustment factor should be used. The market adjustment factor is calculated based on sales of similar improved properties in the same or similar neighbourhoods. Since the building was assessed as a special purpose building, no market adjustment factor was calculated or used in the 1997 assessment.

The appellant appealed the assessment on the basis that the building was not a special purpose building and therefore a market adjustment factor should have been calculated and used in the assessment. The Board of Revision denied the appeal, and the appellant took its appeal to the Assessment Committee. The Assessment Committee found that the buildings did not fit the definition of special purpose building, and fixed the market adjustment factor at 1.0. The use of a market adjustment factor of 1.0 results in the same value as the application of no market adjustment factor at all. The Assessment Committee made its determination based on evidence that the only comparable buildings in the area were special purpose buildings, to which no market adjustment factor applied. The appellant appealed to the Court on the basis that the Assessment Committee erred in law by not assessing a market adjustment factor according to the rules and guidelines in the assessment manual.

The Court considered how a proper market adjustment factor should be determined. The assessment manual provides that "improvements are to be assessed at their fair value as of the applicable base date." The Court reviewed the concept of "fair value" as discussed in Regina (City) v. Laing Property Corp., [1995], 3 W.W.R. 551 ("Laing"). In Laing, the Saskatchewan Court of Appeal stated that the fairness of value is what is equitable, and equity in "fair value" is derived through the process of "applying the directed method of assessment uniformly and fairly throughout the assessment roll." Therefore, to achieve the concept of equity as required by the statute, the Court concluded that the assessor was bound by the Act to conduct all assessments uniformly and on redetermination the formulas set out in the assessment manual must be followed.

The assessment manual set out in detail a calculation procedure for determining the market adjustment factor for commercial buildings. To determine the market adjustment factor of the appellant's buildings, the Assessment Committee used a comparison of the assessed value of special purpose buildings, a method not permitted by the manual. The Court held that the Assessment Committee erred in law because it did not use any of the methods set out in the assessment manual to calculate the market adjustment factor, as required pursuant to subsection 285(6) of the Act.

The Court was also asked to consider whether the appellant was not only required to provide evidence of the correct assessment, but also to prove that the assessment was unfair or inequitable. The Court stated that where the assessor follows the assessment manual, the burden of proving inequity usually falls on the taxpayer. However, where the assessor had not followed the assessment manual,

the burden of proving equity usually would fall on the assessor. The Court concluded there was nothing in the relevant legislation or the case law that required a taxpayer to establish exactly what a correct assessment should have been to succeed on appeal. It also noted that neither the taxpayer nor the appeal bodies had the necessary evidence available to them to calculate a market adjustment factor because the assessor, and the Assessment Committee, failed in their obligation to collect the relevant data necessary to calculate and apply a market adjustment factor.

The entire assessment was set aside because the Court held that an assessment for the 1997 taxation year had to be undertaken *ab initio*. The matter was therefore remitted to the assessor for the purpose of lawfully assessing the fair value of the buildings and correctly determining the assessed value.