



Taxing Matters

Navigating the complexities of the tax world

RPC

Season 4

Episode 4 – Unpacking the complexities of tax deed claims with Jivaan Bennett of Temple Tax Chambers

Alexis: Hello, and welcome to Taxing Matters, your one stop audio shop for all things tax brought to you by RPC. My name is Alexis Armitage and I'm a Senior Associate in RPC's Tax Disputes team. I will be your guide as we explore the sometimes hostile and ever-changing landscape that is the world of tax law and tax disputes. Taxing Matters brings you a roadmap to guide you and your business through this labyrinth. In case any of you miss any crucial information or just want some extra bedtime reading, there is a full transcript of this and indeed every episode of Taxing Matters on our website at www.rpclegal.com/taxingmatters.

I am delighted to be joined today by Barrister Jivaan Bennett from Temple Tax Chambers. Jivaan joined Temple Tax Chambers in September, bringing nearly 15 years of international experience in tax, commercial transactions and disputes gained across times spent at a big four accounting firm in the Caribbean, a band one rated tax disputes boutique, and most recently almost nine years in the London and New York teams at Linklaters.

Jivaan's expertise spans advising on complex contentious, commercial and corporate law issues, the tax aspects of high value cross border transactions and acting for the taxpayer on tax inquiries and litigation. Welcome, Jivaan and thank you so much for joining me today.

Jivaan: Thanks for having me on the podcast Alexis. I'm a listener of the podcast so it's a true privilege to be invited on to share my thoughts.

Alexis: Thank you so much. So everyone today, Jivaan and I are going to be discussing tax deed claims. So to kick things off then, what exactly is a tax deed in the context of corporate transactions, and how does it differ from a typical warranty or other forms of tax protection?

Jivaan: So let me break that down into two questions. Firstly, what is a tax deed in the context of corporate transactions? So to take a step back in the context of an acquisition by way of a share sale, the starting position commercially is that risk and reward of economic ownership of the business pass on an agreed date. That date being either the lockbox date or on completion.

Flowing from that is the linked principle that any liabilities that relate to the period of the seller's economic ownership, a period during which the seller enjoyed the benefit of any profits of the business, those liabilities should sit with the seller. Yet, in a share sale, a tax liability may materialise in a target company after the date of such economic ownership passing to the buyer by virtue of an assessment by the tax authority.

So where such liability has not been provided for in the target company's accounts and therefore has not been factored into the sale price, there is in effect a mismatch between what the buyer has paid for and what it has in fact acquired. So Alexis, for that reason, that parties would agree that if a tax liability arises in the target group in relation to a period during the seller's economic ownership of the business, the seller covenants to pay the buyer an amount equal to that liability. A tax deed in that context is the document, which is executed on completion, which includes these covenants to pay. In some cases, it may be a schedule to the SPA and may be referred to as the tax schedule.

One key point that makes a tax covenant claim attractive is that covenants to pay are recognised in English law as debt claims, meaning that there's no duty on the aggrieved party to mitigate its loss. So that's what a tax deed is.

Now, turning to the second part of the question on how it differs from tax warranties. This brings us back to contract 101, which for me, Alexis, I have to admit was quite some time ago. A warranty, as your listeners would know, is a statement of fact elevated to a term of the contract such that if the fact turns out to be false, there is potentially a breach of contract. In order for that breach to be actionable and to found the claim, one would recall that there must

be a proof of loss, a causal link between the loss and the breach, the aggrieved party is under positive obligation to mitigate its loss, and the loss must not be remote.

In a tax context, often a seller or in some cases the management sellers would give warranties about certain aspects of the state of the tax affairs of the target group. Should such sellers' tax warranties turn out to be false, there's potentially a breach of contract for which the buyer can successfully bring a claim, provided that it can overcome the various hurdles I mentioned, such as the proof of loss, mitigation etc. Now, there's one really important qualification for warranties that I need to mention. Unlike with tax covenants, warranties are qualified by disclosure. The standard wording in the tax warranty schedule in the SPA would read something like, 'save as disclosed, the seller warrants that the target has duly filed its tax returns in a timely manner for the last three years', for example. So as such, in practice, tax warranties are more often used to flush out disclosure, I would say. And here we're looking at the disclosure of the key tax risks to the buyer, as opposed to founding a claim. Now, that is not to say that there are not instances where the tax warranties can prove useful in bringing a claim. So to sum it all up, in most cases, but not all, a tax-deed claim may prove more attractive for a purchaser, while a tax warranty may be useful in helping to flush out disclosure.

Alexis: Brilliant, thank you, Jivaan. And so from your experience, what are some common issues or pitfalls that you see in the drafting of tax deeds? And are there any clauses that often lead to ambiguity or dispute in your view?

Jivaan: The one key issue to look out for may be the drafting of the key operative provisions as indemnities, as opposed to covenants to pay. The standard position long held is that an indemnity once triggered leads to a debt claim. Now, not all courts have agreed with this as categorically. There have been instances where courts have held that an indemnity based on the drafting in that particular contract could potentially lead to a claim for unliquidated damages. So the safer option, I would say, when acting for a purchaser is to ensure, one, that the operative provisions are drafted as covenants to pay, two, that all other terms point towards the purchaser having a debt claim as opposed to a claim for unliquidated damages.

Alexis: So when a party is considering making a claim under a tax deed, what are the key strategic or procedural considerations that they should keep in mind?

Jivaan: Well under procedural considerations, this is an area where we've had a flurry of judicial decisions over the last few years. We've seen the courts emphasise the importance of adherence to the agreed terms in the SPA relating to notice. One key point for purchasers to consider is whether any initial notice of the facts giving rise to a claim is a precondition to the bringing of the claim itself. This will depend on the drafting. The drafting may make it clear, or sometimes not so clear, that if notice of the facts giving rise to a claim are not shared with the seller within a specified time period, say 60 days, the purchaser is barred from bringing a claim. A more acceptable position, albeit a less seller-friendly one, is that if there is any increase in the losses suffered as a result of the purchaser not making that claim on time to the seller, the seller is not liable for such increase in losses suffered by the target and indirectly by the purchaser.

Alexis: And on the flip side then, if you're acting for a party receiving a tax deed claim, what are some of the common defences or limitations that can be raised?

Jivaan: So if I'm acting for the seller, there are various issues I'd want to consider. First, perhaps, would be whether the claim was duly brought. So for example, was the claim filed on time? Was it sent to the correct address? Where the parties have agreed expressly to a particular procedure in unambiguous terms, the courts have showed that they are unwilling to go against this. In such a case, where a claim is filed even a few minutes late, or not sent to the proper recipient, there may be a valid basis, even if perhaps not the most glamorous one on which to resist the claim. Now flowing from that, when acting for the sellers, one should begin here and by extension consider their correspondence with the other side going forward. There is a risk for the seller that its conduct could, to borrow the phrase used by the Supreme Court in *Tinkler*, cross the line, so as to suggest that it waives the breach by the purchaser in making the defective claim, and that there's a mutual understanding that the claim is valid. So if acting for the seller, that's one of the first things that I would want to consider.

Alexis: And so how do tax deed claims typically interact with ongoing tax authority inquiries or disputes? Does one usually follow the other or can they overlap?

Jivaan: Really good question. So where there is an ongoing tax authority inquiry or tax dispute as at the date of the transfer of economic ownership, we are in the realm of known risk. In the ideal world for the purchaser, the possible liability would be determined, a provision would be entered on the balance sheet of the target company, and consequently, the cost of the business would drop correspondingly.

As you could imagine, sellers would not be too keen on agreeing an actual irreversible price chip today for a risk that may never materialise. For example, the tax authority may not assess the target company for additional taxes, or the tax dispute may be decided in the target's favour. In such a scenario, the purchaser would in effect enjoy a windfall. So the parties may wish to deal with this in one of many ways.

One may consider that a fair middle ground would be to include a specific covenant to pay in the tax deed. So this covenant will reference the specific known risk and unlike the other more general covenants will usually be carved out of the financial caps that apply. A purchaser may wish to go beyond this and negotiate for a retention of consideration and that's effectively some portion of the consideration being held in escrow, and that gives added protection should that known tax risk materialise. On account of the liability not yet crystallizing, however, for example, an assessment not being made by the tax authority as at the date of the transfer of economic ownership, a claim under the tax deed cannot yet be made.

Alexis: So, are you seeing any trends or changes in how tax deeds are being drafted or litigated, especially in light of evolving tax law or economic conditions?

Jivaan: Yes, for starters, I would say volume. There are many more claims arising. The relative increase in the number of claims before the courts represent only a fraction of disputes, since many of them settle. Now, without any empirical data to support this, I would venture to say that the rise in tax deed claims is linked globally to an increase in tax authority audit activity. If we take a step back and think about it, many jurisdictions are still recovering from the effects of the pandemic. And when this is considered alongside the advent of AI, there are many tax authorities that not only have the need to increase their tax recovery, but the means to do so now. Inevitably, some of that increased audit activity will land at the doorstep of targets and will relate to pre-locked box date or pre-completion date periods. I'd say long gone are the days where the tax deed would be drafted, filed away, never to be seen again. For tax teams working on these documents, there's a premium to getting the drafting right. If I could mention one other trend very briefly. We're seeing an increase in the use of arbitration as a means of dispute resolution. During my final years as a solicitor, I drafted many more SPAs which would include this method of dispute resolution. In a tax deed context, there are many attractions to the use of arbitration with confidentiality being a main one, as well as an opportunity for the parties to select an arbitrator with specialist expertise.

Alexis: So with the rise of insurance products in the M&A market, what impact does this have on the way in which tax declaims are pursued?

Jivaan: I think these products are the future of the market, and not only in the M&A context. Once upon a time, the use of W&I insurance, or Reps and Warranties insurance for our American cousins, was something used predominantly by PE funds. We're seeing a growing use of W&I on deals even where there's not a PE seller. Equally, there has been a rise in the use of tax insurance to deal with specific known tax risk. For a purchaser who has the benefit of an insurance product, there's greater comfort that there's a party standing behind the tax deed. In terms of pursuing the claim, I suppose my one piece of advice to purchasers seeking to pursue a claim would be to review carefully the provisions of the insurance policy, to ensure that they comply with any requirements prior to bringing the claim.

Alexis: And so finally, for lawyers or advisors drafting these provisions or advising on claims, what would be your sort of top tips in terms of practical advice?

Jivaan: So Alexis, although your podcast talks about some of the exciting developments in tax law, your listeners may be disappointed to hear that my top tip is not tax law related. For those drafting tax deeds or reviewing the SPA more broadly to offer tax comments, my top tip, as pedestrian as it may seem, would be to keep in mind the principles of contractual interpretation. I've seen many instances where the tax specialist may have rightly identified a potential tax risk and has sought to provide for it in the documents. However, when doing so, the drafting is ambiguous and can open the door for a contested interpretation of what may have been the agreed position. The courts, as I've mentioned earlier, have demonstrated that especially where sophisticated parties have had the benefit of professional legal advice, they are less likely to stray from a natural meaning of the words used. To tax solicitors involved in the drafting, I would say reach out to your colleagues in dispute resolution who have not been involved in the drafting of the documents and ask for their thoughts on how a judge or arbitrator would interpret the provision.

Alexis: Some good advice there. Well, thank you. That's all we have time for today. Thank you so much again to Jivaan for joining me and to everyone for listening. Until next time.

Jivaan: Thanks for having me on, Alexis.

Alexis: Yes, it's been an absolute pleasure. Thank you, Jivaan.

As ever, a big thank you goes to RPC's in-house team for the production, music and sound editing of this episode. A full transcript of this episode together with our references can be found on our website at www.rpclegal.com/taxingmatters. And if you have any questions for me or any topics you'd us to cover in a future episode, please do email us on taxingmatters@rpclegal.com. I would love to hear from you. If you like Taxing Matters, why not try RPC's other podcast offerings, Insurance Covered, which looks at the inner workings of the insurance industry hosted by the brilliant Peter Mansfield and available on Apple podcasts, Spotify and our website. Or the Work Couch, the podcast series, which is where we explore how your business can navigate today's tricky people challenges and respond to key developments in the ever-evolving world of employment law. Hosted by the fantastic Ellie Gelder and also available on Apple podcasts, Spotify and our website rpclegal.com. If you like this episode, please take a moment to rate, review and subscribe and remember to tell a colleague about us. Thank you all for listening and talk to you again soon.



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