

TAX  
CORPORATE AND M&A

# Buyer Beware – Sellers’ challenge to validity of claim notice successful despite knowledge of ongoing tax investigation

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## INTRODUCTION

The High Court of England and Wales recently held that a claim under a tax covenant in a sale and purchase agreement was unenforceable because the claim notice did not contain sufficient detail of the matter which gave rise to the claim.

## FACTS

The case of *Dodika Limited v United Luck Group Holdings Ltd [2020] EWHC 2101 (Comm)*, concerned a claim notice issued pursuant to a sale and purchase agreement entered into in December 2016 in relation to the purchase of a target group (the “SPA”). The SPA contained a tax covenant which provided that the sellers would reimburse the buyer in respect of tax liabilities arising from certain pre-sale events (the “Tax Covenant”). The SPA provided that in order for the buyer to make a claim under the Tax Covenant the buyer was required to give written notice “stating in reasonable detail the matter which gives rise to such Claim ...”.

In June 2019, the buyer sent a letter to the sellers, which purported to be written notice of a claim for breach of the Tax Covenant. The notice identified and provided a chronology of an on-going investigation which was commenced in 2018 by the Slovenian tax authority into certain transfer pricing practices of the

target group. The sellers’ representatives were aware of this investigation, had access to relevant documents, attended meetings and were involved in strategy discussions in relation to the investigation. Nonetheless, the sellers issued legal proceedings seeking declarations that the June 2019 notice from the buyer did not comply with the notice provisions of the SPA, and that therefore the claim was not enforceable. Although it was uncontested that the buyer’s notice gave reasonable detail of the nature of the claim, the sellers submitted that the notice failed to provide the reasonable detail required of the matter which constituted the factual basis of the claim.

## COURT’S VIEW

The Court concluded that the notice from the buyer was not a valid claim notice under the SPA as it did not provide reasonable detail of the matter which gave rise to the claim, being the facts, events and circumstances that were the subject of the investigation by the Slovenian tax authority, rather than the mere existence of the investigation. The claim would not be based on the existence of a tax investigation, but on the factual reasons why a tax liability had or might accrue, such as particular features of transfer pricing practices or specific transactions. While the Court noted that the sellers’ representatives may have been aware of the tax investigation, this

did not detract from the obligation to comply with the notification requirement in the SPA. Ultimately, the Court found that:

- i. the purpose of the claim notice is to inform the receiving party of what facts unearthed during a tax investigation are relied on by the notifying party in support of a claim for breach of the Tax Covenant and to enable the receiving party to deal with the claim (such as carrying out further investigations obtaining legal or tax advice and participating in any ongoing investigation);
- ii. the information in the notice must also allow the receiving party to determine, with the benefit of legal or tax advice, at least in general terms whether the facts as alleged give rise to or might give rise to liability for breach of the Tax Covenant; and
- iii. a reasonable person reading the letter would be uncertain if asked the basis of the general facts under which the claim was being made.

## IMPACT

Expert legal advice in relation to drafting is not limited to executing the transaction, but is equally important when it comes to reviewing limitation provisions and drafting and/or reviewing claim notices which are made after the transaction has closed.

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Despite the Court reaching what could be perceived as an unfair result, due to the perceived knowledge of the sellers’ representative of the investigation, its progress and the facts involved, the Court has found strongly in favour of upholding the objective standard required in contractual interpretation. The notification clause in this case had to be interpreted in line with the specific wording of the SPA. As a result, an essential part of making a claim under an SPA or a standalone tax deed must be to review the terms of the document under which a claim is to be made to

ensure that any claim notice is compliant with the specific limitation period and / or separate notice provisions agreed. It can be tempting to assume that notice provisions are somewhat standard form, but this case makes it clear that care must be taken when preparing and delivering a claim notice to ensure that it complies with the language set out in the agreement and not what a party might think the agreement says.

The Court’s finding here means that a party making a claim should not rely on the counterparty’s knowledge and instead needs to ensure that the claim notice

provides the relevant background of the facts, events and circumstances that are the subject of the claim, not just the facts which brought the claim to light (e.g. a tax authority query or investigation). Taking legal advice and spending the required time on ensuring that any inter-parties correspondence or notices are correctly drafted is an important element in claims for breaches of warranties, indemnities or tax covenants under an SPA or tax deed.

*If you would like to discuss this case or the matters it raises in more detail, please contact a member of our Tax (see details below) or Corporate and M&A teams.*

### KEY CONTACTS

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