

SALE AGREEMENT AND WARRANTY THAT TAX AFFAIRS ARE IN ORDER: IS A SARS ASSESSMENT FINAL PROOF OF THE DEBT DUE?

EBS International (Pty) Ltd and Another v Wright (19128 / 2020) [2022] ZAWCHC 69 (9 May 2022)

Sale agreements for property or shares in an entity often provide for a guarantee that the seller's or entity's tax affairs are in order. To add teeth to the warranty, a clause is included indemnifying the purchaser should the warranty turn out to be flawed. Should the purchaser then apply to SARS for relief under the latter's tax relief programme, would SARS' assessment constitute final proof of liability and can the seller be held liable to perform under the warranty? Yes, the court said in this judgment, and the summary explains why.

The Judgment can be viewed [here](#).

FACTS

EBS International (Pty) Ltd ('EBS') purchased the shares and loan accounts in Megatech Systems (Pty) Ltd ('Megatech') from the latter's sole director and shareholder, one Wright.

In the parties' written agreement, Wright represented that Megatech's tax affairs were in order and provided certain warranties to this effect, namely: (a) that Megatech's tax affairs were in order and that it had no outstanding tax liabilities; and (b) that Megatech's financial records comprehensively reflected a true and fair view of its financial position at the time. Flowing from this, the agreement provided that Wright indemnified EBS against any liability (inclusive of any costs, expenses, or damages) incurred if any of these warranties turned out to be incorrect or untrue.

Some years after the sale, the tax authorities ('SARS') assessed Megatech's affairs and ruled that (in the time that it was under the sole directorship of Wright), Megatech had significantly understated its tax liabilities. This substantially reduced Megatech's capital value.

EBS instituted arbitration proceedings to recover the reduction in Megatech's capital value from Wright. An independent tax consultant was appointed in the process and acting upon the consultant's advice, Megatech commenced steps to regularize its tax affairs and filed for tax relief. The tax relief, if granted, allows for certain exemptions from penalties that would ordinarily otherwise have been payable by Megatech.

The arbitrator found, amongst other things, that the incorrect treatment of Megatech's expenditure had given rise to a contractual breach of the warranties in the sale agreement. The arbitrator directed that Wright's liability under the indemnity would be activated once a tax liability had been assessed to the detriment of Megatech.

Megatech engaged with the tax authorities in the spirit of complete disclosure and transparency. It became apparent that comprehensive records were never disclosed to EBS. These additional accounting records were sufficient to finally satisfy Megatech that its relief application to SARS was comprehensive and complete.

As a direct result of the final agreed tax relief application (having been signed by both Megatech and SARS), the tax authorities assessed Megatech to pay further taxes for some R6,2 million, which Megatech paid.

EBS then issued summons against Wright, arguing that the tax irregularities constituted a breach of the contractual warranties, which in turn triggered their right to rely on the indemnity provided in the written sale agreement.

Wright denied liability and argued that the tax assessments were not *conclusive evidence* of liability and hence deprived him of his basic right to a fair hearing before adverse findings are rendered to his financial detriment; and that the process was not proper under the voluntary disclosure programme because it was initiated in bad faith on the side of EBS.

EBS and Megatech, on the contrary, averred that Wright's arguments constituted no defence, especially because Wright was afforded at least two opportunities to make extensive submissions to SARS in connection with the subsequent new tax assessments; made such submissions on at least two occasions; and, as a matter of law, once a tax assessment is rendered it is deemed to be conclusive evidence that the particulars in the assessment are correct. They accordingly elected to claim specific performance against Wright and sought payment of the sum of R6,2 million.

HELD

- As a general proposition, a company is legally obliged to register as a taxpayer and pay income tax on its taxable income once it meets the relevant and appropriate registration requirements. In addition, it will be so required to submit a return indicating a tax loss sustained or a profit earned, if it has met the registration criteria. Whether or not a company is liable for tax is simply a question of the application of the relevant legislative taxing provisions to the facts.
- Compliance with tax laws is a non-negotiable imperative for any business and Wright was fully aware hereof. This is precisely why the warranties and indemnities were negotiated into the sale agreement. It is against this factual canvass that Wright chartered the position that EBS and Megatech 'concocted' the tax relief program liability out of malice and spite against him.

Arguments in short

- EBS and Megatech however showed that Wright misrepresented the nature and the extent of Megatech's tax liability and of his involvement and participation in the tax relief program. In any event, Wright was possessed of every reasonable opportunity to ensure that Megatech's tax affairs were in order before the conclusion of the sale agreement, as sole director and shareholder. Moreover, Wright was invited to engage with and participate in the tax relief process initiated by EBS and Megatech made on his behalf and in which, amongst other things, a specific entitlement to certain tax deductions were claimed at the instance of Megatech.
- EBS and Megatech also sought refuge in the relevant tax legislation, which contained a deeming provision that the particulars in assessments by the tax authorities are deemed to be correct. In terms of the sale agreement, Wright warranted that Megatech was fully tax compliant and had accurately accounted for and paid all its tax liabilities. On this basis, the particulars of the tax relief assessments established that Wright had breached his warranties in the sale agreement and that EBS was entitled to the relief now sought in terms of the indemnities.

Was the assessment final proof?

- By the provisions of the appropriate tax legislation, the particulars of an assessment raised by the tax authorities (for obvious reasons) are deemed to be correct. The relevant provisions indicate as follows: "The production of a document issued by SARS purporting to be a copy of or an extract from an assessment is conclusive evidence – .. of the making of the assessment; and ... except in the case of proceedings on appeal ... against the assessment, that all the particulars of the assessment are correct ...".

- Accordingly, it must be so that once an assessment is raised by the tax authorities, the particulars of the assessment are deemed to be conclusive against the person so assessed, subject to the proviso set out therein.

Specific performance under the indemnity

- It is common cause that the warranty was breached and that the indemnities that were tendered, triggered. The question now arises whether the claim by EBS, as a direct result of the breach of the warranties, was one of a claim for specific performance in these circumstances (as opposed to a claim for damages). The argument by EBS on this score is that the tax authorities considered the input and representations from Wright and this notwithstanding, were independently satisfied that Megatech was compelled to apply for the appropriate tax relief given the genuine understatement of its tax liabilities. By contrast, Wright took the position that the disclosures on the part of Megatech were engineered by EBS and were not voluntary. Put in another way, Wright's case was that EBS in some manner coerced and influenced Megatech to apply for the tax relief. This, out of spite and malice towards him.
- Wright's argument was incorrect. The tax authorities independently verified that the subsequent tax disclosures made by Megatech were, as a matter of fact, voluntary disclosures. By way of elaboration on this score, EBS made the point that Wright did not 'offer up' to the tax authorities any relevant substantiating documentation in support of the opinions that were expressed by his attorneys and his tax advisors in his opposition to the tax relief application by Megatech.
- The particulars of the tax assessments in connection with the indemnity claim indeed amounted to conclusive evidence that Wright breached his contractual warranties and this, in turn, triggered his obligation to make good on his indemnity. EBS had met the requirements for a claim of specific performance given the contractual obligations in the written sale agreement with Wright.
- Legally this is so because: (a) the terms of the agreement were not in dispute; (b) EBS had demonstrated compliance with its reciprocal obligations in terms of the agreement of sale; (c) EBS had demonstrated non-performance by Wright; and, (d) EBS had accordingly elected to claim (as it is entitled to do) specific performance.
- Judicial discretion exists in an appropriate case to refuse specific performance and to leave it to someone in the position of EBS to claim damages. Every exercise of such discretion is case-specific. Most importantly this discretion must be exercised concerning the facts as they existed when the performance is claimed and not as they were when the contract was concluded. The factual matrix, in this case, demonstrates, in the main, that EBS and Megatech were obliged to seek the necessary and appropriate tax relief because Wright understated Megatech's tax liabilities.

CONCLUSION

The outstanding tax has been paid and Wright is obliged to make good on his indemnity.