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Current Cases

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SUPERIOR COURT OF JUSTICE—ONTARIO

TAX WARRANTY AND TAX INDEMNIFICATION CLAUSES APPLIED TO LOSS CARRYFORWARDS

Boliden Mineral AB v. FQM Kevitsa Sweden Holdings AB
2021 ONSC 6844 (Commercial List) (under appeal)

KEYWORDS: ACQUISITIONS ■ DISPUTES ■ LOSS CARRYOVER ■ TAX AUDITS

Introduction

Disputes over tax warranty and tax indemnification clauses in share purchase agreements have been generating more and more litigation in the civil courts,[105] including the recent decision of the Superior Court of Justice of Ontario (Commercial List) in

105 Other recent examples include *Jaeckel v. International Exhibition Services Inc.*, 2021 BCSC 1173 (considering whether a claim under a tax indemnification clause fell within the scope of an arbitration clause); *Brompton Corp. v. Tuckamore Holdings LP*, 2017 ONSC 775; aff'd 2017 ONCA 594 (considering claims for taxes assessed in post-closing periods resulting from denial of use of tax pools from pre-closing periods, and whether indemnity claims should be stayed pending resolution of tax issues); *CIT Financial Ltd. v. Canadian Imperial Bank of Commerce et al.*, 2017 ONSC 38 (considering whether the limitation period in respect of a tax indemnity provision ran while the underlying taxes remained in dispute, and the treatment of disputed taxes that are paid and later refunded); *Universal Currency Exchange Inc. c. Brull*, 2016 QCCQ 5553 (Small Claims) (considering whether the right to indemnity was forfeited by the failure to contest the tax assessment); and *Chemtrade West Limited v. MET Holdings Inc.*, 2013 ONSC 6093 (Commercial List) (considering whether the year of closing was covered by the applicable clause). For two non-Canadian examples, see *Mercury Systems v. Shareholder Representative Services*, 820 F 3d 46 (CA1 2016) (considering the effect of prepaid taxes on the scope of tax indemnification); and *Re Danka Business Systems v. Spratt*, [2012] EWHC 579 (Ch); aff'd [2013] EWCA Civ 92 (CA) (considering tax indemnifications in the liquidation context).

Boliden Mineral AB v. FQM Kevitsa Sweden Holdings AB.[106] *Boliden Mineral* offers a useful illustration of how standard tax warranty and indemnification clauses can fail to account for the complexities of tax administration and give rise to a host of difficult issues long after a transaction closes.

Boliden Mineral concerns a corporation's pre-closing tax losses that were disallowed as a result (allegedly) of a retrospective change in tax law following the closing. The disallowance of the pre-closing tax losses resulted in assessment of additional taxes in both pre-closing and post-closing tax periods. The purchaser sought indemnity from the seller for these additional taxes. The purchaser's claim raised a wide range of issues, including

- whether the additional taxes assessed for post-closing years were "with respect to" the pre-closing period,
- whether the additional taxes assessed for post-closing years constituted "indirect and consequential" losses,
- how to reconcile apparent divergences between the tax indemnification and tax warranty clauses,
- how indemnification obligations operate for taxes under dispute, and
- whether representations made to revenue officials are binding in related civil litigation.

The court ordered indemnification of all of the reassessed taxes at issue to the extent that they had already been paid, and issued declarations with respect to the remainder. As is often the case in decisions from the Commercial List, the decision is heavily grounded in common sense and in giving effect to "commercial reality." However, while the outcome may arguably be considered sensible, the court's reasoning raises a number of questions that the Ontario Court of Appeal will no doubt be called upon to address.

Background

Boliden Mineral concerned the Kevitsa mine in northern Finland, which commenced operations in 2012. The mine was owned by a Finnish corporation ("Kevitsa Mining").[107] The shares of Kevitsa Mining were originally owned by the Canadian public company First Quantum Minerals Limited ("FQM"). On June 1, 2016, FQM sold its shares in Kevitsa Mining to Boliden Mineral AB of Sweden ("Boliden") for US$712 million. The share purchase agreement ("the SPA") was governed by Ontario law and had a forum-selection clause conferring jurisdiction upon the courts of Ontario.

106 2021 ONSC 6844 (under appeal).

107 The name of Kevitsa Mining changed after the closing.

As of June 2016, Kevitsa Mining had accumulated tax losses of more than €81 million available for carryforward. As in Canada,[108] these losses were presumptively extinguished for Finnish tax purposes upon the change of control. Accordingly, Kevitsa Mining wrote off the entire value of the tax losses on its accounting statements immediately prior to closing. However, in Finland, a taxpayer can apply to the Finnish Tax Administration (FTA) for a permit to use tax losses accumulated prior to a change of control if, among other things, the taxpayer continues to operate the business that generated the losses.[109] Consequently, following the closing, Kevitsa Mining applied for and obtained the required permit from the FTA and re-recognized a deferred tax receivable on its financial statements.

Approximately 10 months following the closing, the FTA commenced an audit of Kevitsa Mining. The audit focused largely on a reorganization that had taken place seven years prior in 2010 (that is, two years before the mine started operating, and six years prior to the sale to Boliden). The FTA determined that the reorganization (which presumably involved some sort of financing structure) had been performed for tax-avoidance purposes and thus triggered Finnish anti-avoidance rules. Consequently, the FTA disallowed some €113 million of expenses (mostly interest and foreign exchange expenses) for the 2012-2016 taxation years.

The disallowance of the expenses wiped out all the pre-transaction losses available for carryforward and also resulted in assessments of taxes for 2015 (the year before the sale), 2016 (the year of the sale), and 2017 and 2018 (through the elimination of loss carryforwards). Significant amounts of interest and penalties were also assessed. All in all, Kevita Mining faced reassessments totalling more than €30 million.

FQM took carriage of disputing the reassessments on behalf of Kevitsa Mining, taking the position that "the grounds for that tax reassessment relied upon by the FTA consist of an improper and unlawful retrospective application of a material change in Finnish tax laws."[110] An appeal to the Finnish Tax Adjustment Board was rejected, and a further appeal is currently pending before the Northern Finnish Administrative Court. Yet a further appeal, with leave, is also possible to the Supreme Administrative Court of Finland.

Of the reassessed amounts, Kevita Mining has paid approximately €8.6 million to the FTA. Payment of the balance has been stayed pending the disposition of the dispute by the Finnish courts.

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108 Subsection 111(5) of the Income Tax Act, supra note 15.

109 Subsection 111(5) similarly allows the carryforward of pre-change-of-control losses if a taxpayer continues to operate the business that generated the losses with a reasonable expectation of profit. Unlike in Finland, the entitlement to carry forward such losses does not depend on prior approval by the minister.

110 This fact is taken from the Notice of Appeal, November 30, 2021 filed by FQM, at 6 (herein referred to as "the notice of appeal"). The Commercial List decision in *Boliden Mineral* does not discuss the merits of the FTA's position or the grounds for contestation.

Boliden and Kevitsa Mining claimed indemnity from FQM pursuant to the SPA under its tax indemnification clause (clause 8.2(c)(i)) and, alternatively, as damages resulting from a breach of a tax warranty (clause 3.1.22(d)). FQM resisted payment on various grounds, including the following:

- the reassessments were not final, given that they were still under dispute before the Finnish courts;
- FQM was not liable for any taxes reassessed in respect of post-closing periods that resulted from the disallowance of pre-closing losses; and
- the pre-closing writeoff of the pre-transaction losses established that they had no value.

Motion To Stay

At the outset of the proceedings, FQM sought to stay the claim pending the conclusion of the Finnish litigation against the reassessments. Koehnen J of the Commercial List rejected the motion for a stay, noting that,

> [t]he injustice here is substantial. Boliden has already paid €8.6 million to Finnish tax authorities as a result of the assessment. It says it is entitled to indemnity for that amount and wants that issue determined. FQM's only apparent answer is to wait three or four more years until Finnish tax appeals are exhausted at which point Boliden can lift the stay on the Ontario application, schedule a hearing and potentially wait for several more years until FQM exhausts all possible appeals in Ontario. The commercial idea behind an indemnity is based on a substantially more real-time approach than that.[111]

The "real-time approach" to resolving complex commercial disputes is one of the main features (and, indeed, attractions) of the Commercial List. However, given that tax dispute resolution tends to proceed at a much more measured pace, the court's decision not to stay the proceedings invariably meant that it would have to decide on FQM's liability for the additional taxes before their quantum (and even before their validity) would be definitively ascertained. How the court dealt with this procedural challenge is discussed further below.

The Tax Indemnification Clause

The relevant portions of the SPA's tax indemnification clause (clause 8.2(c)(i)) read as follows:

> (c) From and after the Closing Date, . . . the Seller . . . hereby agrees to . . . indemnify and hold harmless the Buyer Indemnitees from and against: (i) any Taxes required to

111 *Boliden Mineral*, supra note 106, at paragraph 32. The decision from Koehnen J is apparently unreported, but is reproduced in part in the *Boliden Mineral* decision, ibid.

> be paid or remitted by the Corporation or the Subsidiary *with respect to any Pre-Closing Tax Period* [that is, any period up to and including June 1, 2016].[112]

The term "Taxes" was defined as follows:

> [A]ll taxes, levies, duties, fees, premiums, assessments, reassessments and other charges of any nature whatsoever, whether direct or indirect, including without limitation, income tax, profits tax, gross receipts tax, corporation tax, mining tax, commodity tax, sales and use tax, wage tax, payroll tax, worker's compensation levy, employer health tax, capital tax, stamp duty, real and personal property tax, land transfer tax, customs or excise duty, excise tax, turnover or value added tax on goods sold or services rendered, withholding tax, pension plan, social security charges, unemployment insurance charges and retirement contributions, and any interest fines [sic], additions to tax and penalties thereon.[113]

FQM accepted that the tax indemnification clause covered taxes, interest, and penalties that Kevitsa Mining may eventually have to pay for periods up to and including the transaction (that is, 2015 and 2016). However, it argued that the clause did not extend to taxes assessed for 2017 or 2018 that resulted from the disallowance of losses carried forward from pre-closing periods. The debate before the court on this issue turned primarily on the phrase "with respect to." FQM's argument focused heavily on contrasting the phrase "with respect to" with the arguably broader "arising from, in connection with or related to" that was used elsewhere in the SPA.

FQM's position—namely, that taxes assessed for 2017 and 2018 were not "with respect to" 2012-2016—was arguably consistent with basic tax principles and the plain wording of the SPA. Income taxes are assessed on income. Consequently, if a given fiscal period shows a loss, there is no income and thus no tax to pay for that period. A loss is not a tax; rather, it is an excess of expenses over revenues in a given fiscal period. To "carry forward a loss" means to deduct expenses in a later fiscal period for the purpose of calculating income for *that* period.

In the case of Kevitsa Mining, the additional taxes that the FTA reassessed for the 2017 and 2018 periods were, unquestionably, taxes on income actually earned in 2017 and 2018. It seems counterintuitive to suggest that income tax paid on income earned in 2017 and 2018 was somehow "with respect to" 2012-2016.

The court, however, relying on "sound business principles and good commercial sense,"[114] rejected FQM's argument and found that taxes assessed for post-closing taxation years that resulted from the disallowance of pre-closing losses were, for the purposes of the SPA, "with respect to" the period of the losses:

112 Ibid., at paragraph 79 (emphasis added).

113 Ibid., at paragraph 40.

114 Ibid., at paragraph 93.

> FQM's interpretation assumes the pre- and post-closing tax periods are absolutely self-contained, impermeable silos. Yet, when it benefits FQM to take a different approach, it does so—in this case, by taking the benefit of what, on its basic argument, are out of period tax losses for which it had no responsibility whatsoever. FQM's interpretation is a highly technical one which takes no proper account of the economic and financial impact of the FTA's reassessment. It artificially restricts the scope of the Art. 8.2(c)(i) indemnity without accounting for the fact that *the taxes payable in 2017 and 2018 are merely a timing effect and, properly analyzed, reflect an increased tax cost imposed in respect of Pre-Closing Tax Periods*. FQM's approach is not consistent with the language of Art. 8.2(c)(i), read in the context of the SPA as a whole and the factual matrix reasonably known to the parties at the time of contracting. It produces a result which is not in accord with sound business principles and good commercial sense.[115]

In reaching this conclusion, however, the court remarked that

> [t]he tax losses carried forward by Kevitsa post-closing were not lost, eliminated, or rejected by the Finnish tax authorities. Rather, the FTA reassessed and recognized income in Pre-Closing Tax Periods which resulted in a cascading effect of substantially higher taxes payable by Kevitsa.[116]

In this statement, the court seems to suggest that it might have reached a different conclusion had the FTA simply refused (or revoked) the permit authorizing Kevitsa Mining to carry forward its pre-closing losses to post-closing periods. Whether that would have been possible under Finnish tax law is not discussed in the judgment. However, the court's reasoning invites reflection on whether FQM's indemnification obligations should depend on the particular procedure used by the FTA to disallow the loss carryforwards.

As discussed in the following section, the court found—separately—that FQM was also liable for the taxes reassessed for the 2017 and 2018 years as damages resulting from a breach of the SPA's tax warranty clause. The court rejected an argument from FQM that the tax indemnification clause restricted the scope of recovery that was possible for a breach of the tax warranty clause; rather, the court held that the tax warranty and tax indemnification clauses served different purposes and did not necessarily have to produce the same result.[117] Nevertheless, it is possible that the court stretched somewhat in its analysis of the tax indemnification clause to reach the same result under both provisions.

115 Ibid. (emphasis added).

116 Ibid., at paragraph 87.

117 Ibid., at paragraphs 54 to 55.

The Tax Warranty Clause

Scope of the Warranty

The SPA contained several tax warranty provisions, of which clause 3.1.22(d) formed the basis of Kevitsa Mining's claim against FQM. The salient portion of clause 3.1.22(d) read as follows:

> (d) There are no grounds for the reassessment of the Taxes of the Corporation.[118]

The SPA provided that this representation (like the other tax representations) would survive until six months following the expiration of the applicable reassessment periods for the tax periods concerned.

FQM argued that the phrase "grounds for the reassessment" was implicitly limited to grounds that were known or reasonably foreseeable to FQM at the time of closing and did not extend to grounds that came into existence subsequently (such as a "retrospective application of a material change in Finnish tax laws"). The court summarily rejected this argument, however, observing that

> FQM's representation and warranty that "[t]here are no grounds for the reassessment" is not knowledge-qualified. The SPA draws a clear distinction between representations and warranties that are knowledge-based and those that are not.[119]

Taken to its logical extreme, the court's reasoning suggests that even changes in statute law that are announced and enacted post-closing, and applied retroactively to pre-closing periods, could precipitate a breach of the tax warranty. Whether the court would consider that result to be consistent with "sound business principles and good commercial sense" remains an issue to be litigated another day.

Consequences of the Breach

FQM's breach of the tax warranty clause entitled Boliden to be compensated under the SPA's general indemnity provision (clause 8.2(a)(i)) for its "Losses" resulting from the breach, defined as

> any loss, Liability, demand, claim, cost, damage, award, suit, action, penalty, Tax, fine or expense (including interest, penalties and reasonable lawyers' fees and expenses) that are sustained, suffered or imposed, however, (i) a consequential or indirect loss shall only be considered a Loss to the extent it is a reasonably foreseeable consequence of the event or circumstance constituting the ground for the applicable indemnification obligation.[120]

118 Ibid., at paragraph 39.

119 Ibid., at paragraph 46.

120 Ibid., at paragraph 35.

FQM argued that it had no liability for the tax reassessments in 2017 and 2018 since they were (1) "consequential and indirect"[121] results of the breach of the tax warranty and (2) not reasonably foreseeable. The court agreed with FQM on the first prong of this argument, but not the second.

On the issue of whether the reassessments for 2017 and 2018 were "consequential and indirect" results of the breach of the tax warranty, the court held as follows:

> Here, the loss of the benefit of prior accumulated tax losses in 2017 and 2018 is an indirect consequence of the reassessment. The reassessment of 2012 had a domino effect on 2013, the reassessment of 2013 had a domino effect on 2014, and so on. This seems to me to show that the loss of the benefit of prior tax losses in 2017 and 2018 is an indirect consequence of the need to "use" those losses to reduce taxable income in prior years. Accordingly, I find that the first part of the proviso in the definition of "Losses" is engaged; the claimed loss is consequential or indirect.[122]

Given this finding, it was arguably fortuitous for Boliden that the definition of "loss" in the SPA—which was a definition of general application covering a wide range of potential breaches of contract—did not categorically exclude consequential and indirect losses, as similar definitions in share purchase agreements often do.

Moreover, there is arguably some dissonance between the court's conclusion that the taxes imposed for the 2017 and 2018 taxation years were, on the one hand, "with respect to" the pre-closing tax periods and, on the other hand, "consequential and indirect" relative to the reassessments issued for the pre-closing tax periods. While, strictly speaking, these two findings may not be mutually exclusive, they do not seem to sit together easily.

On the issue of foreseeability, FQM argued that because Kevitsa Mining's right to carry forward the pre-closing losses to 2017 and 2018 was subject to the permission of the FTA, it was not foreseeable that the disallowance of the losses in the pre-closing period would produce cascade effects in post-closing periods. The court rejected this reasoning, relying on expert evidence on Finnish tax law to find that the FTA was almost certain to issue the required permit and that this was known at all relevant times by FQM. The court therefore concluded that the 2017 and 2018 reassessments were reasonably foreseeable consequences of the reassessments of the pre-closing periods and, consequently, compensable "losses" attributable to the breach of the tax warranty.

The Accounting Writedown

FQM also argued that Kevitsa Mining's pre-closing writedown of its tax losses established that they had no value, and that any post-closing use made of them was entirely fortuitous. FQM also claimed that it was an "abuse of process" for Kevitsa Mining to

121 Ibid., at paragraph 59.

122 Ibid., at paragraph 61.

represent to the FTA that the losses had no value, but then to claim damages from FQM resulting from their disallowance. The court did not accept these arguments, finding as a fact that the writedown served to demonstrate to the FTA that the transaction was undertaken for bona fide business reasons and not as a tax-avoidance strategy.

Remedy

Having found FQM liable for the additional taxes reassessed by the FTA between 2015 and 2018, the court faced the question of what remedy to order, given that the taxes at issue were still under dispute before the Finnish courts and mostly unpaid.

Concerning the €8.6 million that Kevitsa Mining had already paid to the FTA, the court ordered FQM to reimburse this amount immediately, subject to an undertaking by Kevitsa Mining to hold the amount in trust pending the outcome of the proceedings before the Finnish courts. The judgment does not indicate whether Kevitsa Mining volunteered this undertaking (which, effectively, results in its having no use of the funds for potentially several years) or whether the court proposed it. One might contrast the outcome of this case with *Brompton*, where the Commercial List did not require such an undertaking when ordering the indemnification of taxes that remained under dispute.[123] However, the fact that Kevitsa Mining presumably has no assets in Canada (unlike the defendant in *Brompton*) arguably made the additional safeguard appropriate.

Concerning the more than €20 million of disputed taxes that had not yet been paid to the FTA, Kevitsa Mining asked the court either to order FQM to provide security or to order payment with suspended enforcement. The court declined to order either remedy, holding that

> (1) in the absence of a clause in the SPA requiring FQM to provide security, the Court could only order security under circumstances that would support the issuance of a *Mareva* injunction (which includes, among other things, a real risk that the party would seek to dissipate assets to avoid payment); and
>
> (2) an order with suspended enforcement would not be appropriate since the outcome of the proceedings before the Finnish courts was not necessarily "binary."[124]

Instead, the court issued various declarations with respect to FQM's breaches and yet-to-be-determined liabilities, and remained seized of the case pending the outcome of the Finnish proceedings.

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123 *Brompton*, supra note 105 (ONSC), at paragraph 48: "Further, to grant a stay would be unfair to Brompton which has to date paid $9.2 million to the CRA in respect of the assessment and has incurred all of the costs of appealing the assessment. Tuckamore is liable for 40.94% of these amounts and should be required to reimburse Brompton without further delay."

124 *Boliden Mineral*, supra note 106, at paragraph 113.

The Appeal

FQM has appealed the decision to the Ontario Court of Appeal. FQM's notice of appeal focuses almost exclusively on its obligation to indemnify taxes reassessed in 2017 and 2018 resulting from the disallowance of pre-closing losses. The notice of appeal emphasizes that the pre-closing losses were "forfeited" upon closing and that the SPA contained no express warranty with respect to their subsequent usability. FQM argues that the decision of the Commercial List has "subverted the allocation of risk and responsibility between these sophisticated parties in the SPA as that related to taxes and tax matters."[125]

Takeaways

Boliden Mineral provides an important reminder to parties seeking to acquire a company through a share purchase agreement that

- tax liabilities can lie hidden and dormant for many years;
- once raised, latent tax liabilities can take many years to resolve, during which time arrears interest—often at punitive rates and generally non-deductible—can accrue on disputed amounts; and
- tax adjustments in one year can produce cascade effects in other years potentially far removed from the year of the adjustment.

Consequently, parties negotiating tax warranty and tax indemnification clauses in share purchase agreements would do well to consider carefully, among other things,

- modalities for dealing with taxes under dispute, including potentially a requirement that the seller prepay or provide adequate security with respect to disputed amounts, and/or that the buyer hold in trust any amounts prepaid by the seller; and
- allocation of risk between buyer and seller with respect to cascade effects between pre-closing and post-closing fiscal periods (such as those resulting from the disallowance of losses or other expense pools, capital cost adjustments, and so forth).

In addition, if a share purchase agreement includes both tax warranty and tax indemnification provisions, it should expressly specify whether one limits the other or whether they operate independently. Indeed, parties would do well to consciously consider—with their tax counsel—whether circumstances exist that could potentially trigger one provision but not the other, and if so, whether the outcome would be consistent with "sound business principles and good commercial sense."

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125 The notice of appeal, supra note 110, at 2.