Obligation of a contracting party to act against its own interests?

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The general principle of good faith does not establish an ancillary obligation requiring the seller in a real estate transaction to act against his or her own interests or prevent the buyer from needing to pay tax on the sale.

Judgment of the Federal Supreme Court of 3 September 2020
Case Reference : 4A_45/2020

Facts

The dispute arose in respect to the tax consequences resulting from a real estate sale. On December 16, 2008, the seller sold the buyer two apartments located in the canton of Valais, Switzerland, for the price of CHF 1,300,000 by public deed. According to Clause 6 of the sale agreement, all costs relating to the sale were to be borne by the buyer and any taxes on real estate capital gains would be paid by the buyer, in full discharge of the seller.

In order to settle tax matters related to the acquisition of the apartments, in particular real estate capital gains taxes, the buyer initially appointed the trustee X SA, a subsidiary of the international group ABC. The buyer was a member of the management team of the group ABC. The cantonal tax office in Valais notified the seller of a tax decision fixing the amount of tax related to the real estate capital gains at CHF 111,590.40, against which the seller filed a complaint. The cantonal tax office reversed the decision and agreed to tax the real estate capital gains resulting from the sale of the real estate as ordinary income tax.

The trustee X SA terminated its contractual relationship with the seller on the grounds that it has not been able to obtain the necessary information to process the tax return. As a result, the seller hired a second trustee, which asked the cantonal tax office to reconsider its decision and to qualify the capital gain as private assets, subject to real estate capital gains taxes. As a result, a new tax decision was issued fixing the amount of tax relating to the real estate capital gains at CHF 141,273.90. Pursuant to the sale agreement, the seller sent the invoice to the buyer, who refused to pay it.

On September 19, 2019, the seller filed a claim against the buyer for the payment of the full amount of the tax (CHF 141,273.90) with interest. The court of first instance ruled in favor of the seller and the buyer's appeal was rejected by the court of appeal.

The buyer's main argument was that he had only accepted the terms stated in Clause 6 of the sale agreement because he had a good faith expectation that the seller would use the trustee X SA, which was a subsidiary of the international group ABC of which the buyer was a member of the management team, to administer taxes related to the sale of the apartments. The buyer considered that the seller had a duty to collaborate with his trustee and a duty to take all necessary actions to reduce the tax burden. The buyer considered that the seller failed to fulfil its obligations, resulting in the tax authorities levying a capital gains tax on the property that was higher than the amount that they had initially taxed the buyer.

Issue

The Federal Supreme Court was required to determine whether the principle of good faith gave rise to an ancillary obligation requiring the seller to act against his own interests by entrusting the administration of his tax interests to the trustee X SA, which was a subsidiary of the international group ABC of which the buyer was a member of the management team, and to take all necessary actions to reduce or discharge the capital gains tax on the property (borne by the buyer), in favor of an income tax (borne by the seller).

Decision

An ancillary obligation is generally defined as an obligation arising from the contractual relationship of trust between

contracting parties. Pursuant to the general principle of good faith under Swiss law (art. 2 para. 1 of the Swiss Civil Code [SCC]), the debtor must do all that is necessary for the proper performance of its principal contractual obligation. Ancillary obligations can be obligations to monitor or protect. For instance, when the performance of a contract creates a dangerous situation, the principal obligation of the contracting party creating the dangerous situation can be coupled with an ancillary obligation to ensure the safety of the contracting party. A principal contractual obligation can also be complemented by an obligation to supply or disclose information. For example, if one party produces an ambiguous legal situation, that party should draw the attention of its contractual partner to this issue.

In this case, the issue was whether the seller had an ancillary obligation to prevent the buyer from needing to pay tax on the sale of the real estate. The buyer challenged the tax strategy of the seller and the trustee Z SA. The buyer was in fact expecting the tax authorities to subject the capital gain from the sale to ordinary income tax (borne by the seller), which would discharge the real estate capital gains tax (borne by the buyer). The buyer assumed that the seller had the obligation to comply with this strategy.

However, the seller could only implement this strategy if the sale of the apartments were allocated to the business assets of the seller. According to tax law rules in the canton of Valais, in order to tax real estate as business assets, it is necessary to carry out a self-employed activity. The existence of such activity is determined on the basis of various indications, which are lacking in this case. According to the trustee Z SA, the seller had never been active in the real estate business and the real estate owned by the seller had always been classified as private assets for tax purposes. In addition, the Federal Supreme Court stated that, given that the seller had not been automatically taxed, he collaborated and provided the tax authorities with the necessary elements to determine the taxable real estate capital gains.

On this basis, the Federal Supreme Court held that the seller did not have an ancillary obligation arising from the principle of good faith to give a partial representation of the facts to the cantonal tax office with the sole aim of preventing the buyer from needing to pay tax on the sale of the real estate. In addition, if the buyer's tax strategy had been successful, this could have had the consequence of discharging the real estate capital gains tax, but could have resulted in the tax authorities levying an income tax, payable by the seller.

The Federal Supreme Court concluded that there was no ancillary obligation for the seller to entrust the administration of his taxes to the trustee X SA (as desired by the buyer) and that it was unconscionable for the principle of good faith to impose an ancillary obligation on the seller to act against his or her own interests.

Key takeaway

A contracting party cannot have an ancillary obligation based on the principle of good faith to act in its disadvantage and even to submit false or incomplete information to the tax authorities, even if this could have improved the other party's financial position (in this case the avoidance of taxes). The duty to act in good faith cannot lead one party to act against its own interests.

Parties are advised to specify clearly in the agreement the terms related to any potential ancillary obligation.

Comments

This decision confirms previous decisions of the Federal Supreme Court where the existence of an ancillary obligation arising from the principle of good faith was denied. In particular, the Federal Supreme Court held there was no ancillary obligation for a credit card organization to report all card losses to the affiliated company, even if the losses could cause damage to the merchant (ATF 113 II 174, c. 1b). In another decision, the Federal Supreme Court held that a telecommunications service provider did not have a duty to warn – based on the principle of good faith – when the fees for a given connection exceeded a certain amount during the current month (ATF 129 III 604, c. 4.2.2).

On the other hand, the Federal Supreme Court held that there was a duty to protect, not only when the life or health of the contractual partner may be jeopardized, but also when financial interests were at stake. In particular, the Court held that a doctor has a contractual duty to provide information to the patient when a treatment, an intervention or his fees might not be covered by health insurances (ATF 119 II 456, c. 2). Contrary to the above-mentioned decisions, where the existence of an ancillary obligation arising from the principle of good faith was denied, the parties entered into a mandate agreement (art. 394 ss of the Swiss Code of Obligations [SCO]) for which the parties rely on a relationship of trust for the execution of the agreement. Such relationship of trust does not arise from the real estate sale agreement itself.

The existence of an ancillary obligation arising from the principle of good faith might therefore depend on the qualification

of the contract, in particular the existence of a relationship of trust between the parties.

Other source presenting the case

Leandro Schafer/Dario Galli/Markus Vischer, Nebenpflichten aus Treu und Glauben bei Drittansprüchen, *in*: dRSK, published on December 8, 2020

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