TAX INSURANCE

WHY WOULD TAX INSURANCE INTEREST US?

Tax and Tax Law in many jurisdictions is complex. Corporate entities and their advisers can spend enormous amounts of money obtaining tax advice, particularly during the due diligence processes involved in a transaction. Often, tax exposures arise following a transfer of shares or assets as a result of a corporate reorganisation, restructure, disposal or acquisition. However, due to the nature and breadth of the possible tax liabilities and governing laws, potential exposures can arise from other circumstances . What happens if, despite the best advice from qualified experts, the tax authorities challenge the planning? Such a challenge can be expensive and time consuming.

Tax Insurance has been developed in order to provide cover for the potential tax liability and the costs involved in the event it is necessary to defend a challenge by the tax authorities. In the context of a transaction, policies of this nature have unblocked deal deadlocks and enabled the successful completion, as illustrated in the case examples overleaf.

WHAT DOES IT OFFER PROTECTION AGAINST?

In most cases, the nature of the tax exposure has been identified by advisers either during their tax planning advice or in due diligence. Typically, the risk is contingent and based on the provisions of the prevailing tax law. Insurers are therefore able to offer an insurance policy to either the principal tax payer (typically a corporate entity or target), a seller by virtue of indemnities given under an acquisition agreement, or the buyer, where comfort from the seller is not available or any other party whom may have an insurable interest.

The key provisions of the policy contract indemnify the insured against:

- A claim for tax due from the relevant tax authority.
- Interest payments, fines and/or penalties.
- Costs and expenses incurred in defending such claims.

For cover to be offered insurers will need to reach an understanding of the tax structure to the extent that they fully believe it will be successful following a rigorous challenge. As a consequence, schemes or transactions that are solely based on the tax benefit and have no other commercial purpose are unlikely to be considered. The insurance market has grown in sophistication over the last five years and has therefore gained significant experience and appreciation of tax issues that arise. Based on the above principle they and are keen to consider these risks and adapt their capabilities to provide a solution.

WHEN SHOULD YOU INVOLVE WILLIS? HOW LONG DOES IT TAKE TO ARRANGE A POLICY?

When insurers first started to offer this type of insurance, they were cautious and required detailed and reasonably robust opinions from qualified tax advisers regarding the likelihood of the tax risk being challenged. As underwriters have gained experience and understanding of tax treatments this position has changed and insurers are sometimes able to get comfortable without such opinions. They will however require full access to information and guidance from the clients and their advisers on the underlying tax treatment and the potential contingency risk. This is vital and will heavily influence the timescales required for insurers to offer a policy. We would suggest the following steps in order to place a policy:

INITIAL CONSULTATION

The client will enter into discussions with Willis and explain the nature of the risk. Willis will then contact appropriate insurers whom have experience in underwriting tax risks. From these consultations, Willis will gauge the viability of insurers in offering insurance, subject to further details.

SUBMISSION AND INDICATION

If the initial consultations are positive, a submission to insurers will be required this includes:

- An overview of the tax issue and description of steps or transactions proposed.
- Copies of any advice (legal or accounting) provided by the clients' advisers regarding the exposure.
- Copies of any documentation which support the steps proposed / transaction e.g. minutes of meetings, sale or transfer agreements &/or any proposed indemnity to be given in relation to the tax liability.

Following a review of this information, it is typically helpful for insurers to have a conference call with the client and/or their advisers to answer any queries. Insurers will then offer an indication of terms including premium and any requests for further information. This indication will be subject to the insurers' own due diligence review.

INSURERS UNDERWRITING DILIGENCE

Insurers will appoint their own advisers to conduct an underwriting diligence review in order to assess the risk. If the tax exposure is simple and straightforward and they have experience of underwriting the risk before, this step may be limited. More complex transactions and exposures may need detailed underwriting diligence to enable the insurers to fully assess the risk. Following such due diligence, a bindable offer of insurance / quotation may be made along with a policy wording.

POLICY NEGOTIATION

As each tax risk is individual in nature, the policy wording for each project is specifically adapted, often resulting in some negotiation of its terms, in order to provide the required cover. This will also include a review of the representations the client will be required to give regarding information pertinent to the risk which needs to be provided to insurers, prior to binding cover. Willis' knowledge, expertise and experience in such negotiations is central during such discussion.

COMPLETION

Once the policy wording negotiations are settled, then the client can accept the offer from insurers. Cover will be incepted subject to insurers being in receipt of the premium.

HOW MUCH DOES IT COST?

It is extremely difficult to provide accurate guidance on premium levels without knowing the tax risk concerned. In our experience, if the risk is insurable the rate (which is applied to the aggregate policy limit) varies from a minimum of 1.5% upwards and is more typically between 3-7%. For a more accurate assessment of the current market position, please contact us.

CASE STUDIES

The benefits of tax insurance are more easily illustrated through case examples where such bespoke insurance has been critical to clients.

PROPERTY DEAL

A portfolio of commercial properties was being sold for £90 million. The properties had been owned through five 5 special purpose vehicles SPV's based in Guernsey for over four years. These SPV companies had purely owned the properties and had no employees and all management of the properties was conducted through a property management company. The properties were being sold through the sale and purchase of the shares in the SPV's. During due diligence the proposed buyer was advised of the contingent risk that the tax authorities may challenge the off-shore domicile of the SPV's resulting in exposure to corporation tax and capital gains arising if such a challenge was successful. The buyer was a large property trust fund and was unwilling to accept such exposure, although there was no evidence to suggest that the tax authorities could challenge the status of the SPV's. The ultimate sellers of the SPVs' were high net worth individuals and trust funds that would not provide an indemnity. Willis was engaged to advise and arrange tax contingent insurance for the risk on behalf of the buyer.

HIVE-OUT

A private equity firm appointed an adviser to consider the exit options in relation to its investee company. The findings suggested that better value could be obtained by splitting the company's operations in two and disposing of certain trademarks and separating business units from others. The operations of the business were re-organised with the result that the shareholders held shares in each of the two holding companies. It was identified that a potential exposure to capital gains for the value of the assets could arise if the necessary steps had not been followed and / or the tax authorities made a successful challenge to the provisions on which the steps to split the operations had taken place. The proposed buyer had appointed their own tax advisers to review the planning and recommended that the buyer seek an indemnity from the sellers for this issue. The private equity shareholders were unable to give an indemnity for the length of the required period. Tax Insurance was arranged for the benefit the targets from any challenge from the tax authorities regarding such steps, thus enabling the transaction to complete successfully and the private equity firm to realise its yield.