USING INSURANCE TO REMOVE POTENTIAL TAX EXPOSURES

The management of tax liabilities is a contentious issue for those involved in M&A deals or restructurings and affects those overseeing the day-to-day tax management of companies

HWF are able to structure insurance backed solutions to ring-fence potential tax issues providing certainty if that issue crystallises.

What is insurable?

A Tax Liability insurance policy will cover an identified tax risk and remove the financial uncertainty of an adverse determination. For a risk to be insurable the following criteria are necessary:

- Advice from a credible tax advisor. This can be in the form of a due diligence report, structure paper or legal opinion
- The risk must be quantifiable
- The probability of loss must be relatively low and supported by the advice
- The risk must not be part of a tax avoidance scheme

There are a number of situations where tax insurance is used to protect against potential tax exposures.

M&A Processes

Quantification and likelihood of crystalisation of a potential tax risk identified in a M&A transaction regularly causes friction between the buyer and seller. Such risks can be dealt with by way of indemnity or escrow with a negative impact on the seller's exit. Matters with a significant perceived quantum can stall or prohibit a transaction from progressing further.

Insurance can be a cost effective way of dealing with the difficulties noted above. It can either back up an indemnity or directly insure the identified tax exposure for the entity that may suffer the loss.

Often in sale processes sellers provide a 'stapled' insurance solution where there is a significant potential exposure they are aware of (from their VDD or otherwise) and expect the bidders to be unwilling to accept on their or the target's balance sheet.

Synthetic Tax Deeds

A recent development has been the placing of insurance policies in lieu of the traditional tax deed/covenant.

This is a very attractive solution for sellers to gain a clean exit from a transaction, removing the long tail of a tax liability.

HWF works with insurers to structure a solution that provides cover for exposures that would ordinarily covered by a tax deed.

Key Points:

- A thorough buyers diligence exercise is required
- Matters that have a significant quantum or that are relatively likely to crystallise are likely to be excluded from cover

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Restructurings or Re-organisations

In the current economic climate restructurings and re-organisations are a common solution for corporates seeking to maintain their financial strength and fiscal advantage. While potential tax implications are always a key consideration of any restructuring or re-organisation, often certainty cannot be gained on tax matters without seeking clearance from a tax authority.

Where clearance is not commercially practical or where time is of the essence insurance can be used as an alternative to provide protection against subsequent challenges of the tax risks resulting from the restructuring or re-organisation.

Trading

With tax authorities taking a more robust approach to corporate tax structures businesses need to maintain a cautious approach to their tax affairs. Where a business has concerns over its current or historic tax treatment it can look to offset this risk against insurance.

Alternatively, it may be the case that a business has a balance sheet provision for a particular tax issue and insurance can also be used to give certainty allowing the release of capital.

Key Policy Points

- Policy can directly insure an issue or sit behind a contractual indemnity.
- The costs associated with defending any tax challenge are often covered.
- Policy term typically matches the statute of limitations in the relevant jurisdiction up to a maximum of 10 years.
- Policy will either insure the whole liability or provide cover in excess of the probable outcome.
- Where full cover is provided there may be a small excess on the policy that relates to defence costs.
- Premiums typically range from 2-8% of the limit to be insured depending on the perceived risk of the issue

Excluded items

- Fraud of the insured party including wilful concealment of key information from insurers.
- Incorrect implementation of tax advice/steps or structures
- Aggressive tax structures for individuals' personal gain

About us

HWF is a Specialist Independent M&A insurance broker and advisor led by senior professionals with extensive experience in M&A transactions.

The team has worked with many leading legal and financial advisors in providing services to private equity houses, management teams, real estate firms, banks and corporates.

The team has a combined 30 years of experience in our market and has advised on over 900 transactions, with values ranging from £5m - £5bn and structured over 500 policies.

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