

O'CONNORS

Tax Liability Insurance for Tax Professionals

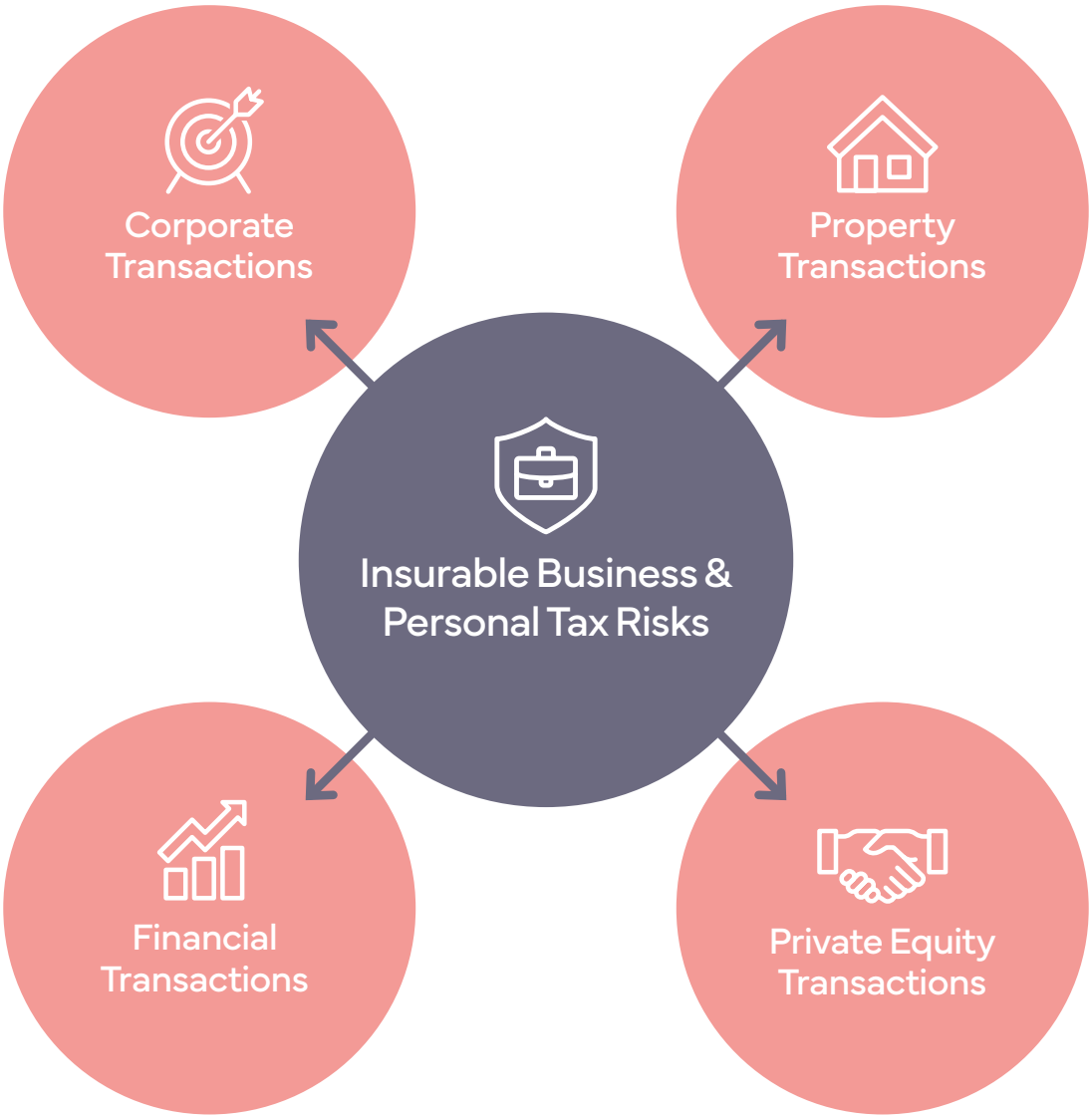
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Tax liability insurance for tax professionals

Tax is an increasingly hostile environment, for both individuals and businesses. Enquiry activity and enforcement continue to rise, and advisers are asked with growing frequency what can be done about a material tax position that is technically defensible but not free from doubt. Insurance is now a realistic answer to that question, and it is available in far more situations than most advisers assume.

Specialist commercial insurance law firm, O'Connors, working alongside their London market connections, can assist tax professionals in better understanding how to secure insurance protection for their clients. This protects against the risk of a challenge from the tax authorities and, if successful, the consequential tax liability, interest, penalties (depending on jurisdiction and terms), and the defence costs that may follow. This protection covers a wide range of transactions as shown below.

Tax insurance is no longer confined to transactions. Cover is now regularly placed on restructurings, operational tax positions, distributions, provision releases, fund wind-ups, and private client matters where there is no transaction in contemplation at all.





Benefits to tax professionals and their clients

Direct access by O'Connors to the specialist transactional risk brokers at no cost to the tax professional or their client to:

- ✔ secure an early indication of the availability of cover, likely level of excess, and premium cost;
- ✔ identify key policy conditions, terms, and exclusions which the insurer is likely to require;
- ✔ deliver this initial response to the tax adviser and their client within 48 hours of receiving enquiry.

Policy issued by an insurer with:

- ✔ specialist tax liability underwriting experience;
- ✔ a credit rating of not less than A;
- ✔ a willingness to engage in a direct dialogue with O'Connors and the tax professional and their client in order to properly understand all aspects of the risk;
- ✔ a genuine appetite to underwrite good quality, well thought through tax structures.

Independent review by O'Connors of the draft policy wording to ensure that it:

- ✔ covers the proposed tax arrangement and the risk of a challenge to any aspect of it;
- ✔ does not contain any unreasonable terms, conditions, or exclusions;
- ✔ has an adequate limit of indemnity;
- ✔ has clear and unambiguous language which the insured party can understand.

As a guide to cost, premiums for straightforward risks are typically in the region of 1% of the insured limit, with minimum premiums from approximately £40,000. Most advisers assume the product is considerably more expensive than it is.



What makes a tax risk insurable?

Insurers look for four key factors. When all are present, the risk will usually attract terms; if any is missing, it rarely will. The factors are:

- ✔ a specifically identified risk, rather than a general concern;
- ✔ a low probability of successful challenge, with a quantifiable exposure;
- ✔ written technical analysis from a credible adviser supporting the position taken;
- ✔ no live claim and no notified dispute.

In practice, the adviser's own analysis is the underwriting submission. Advisers who understand that send better enquiries and, in our experience, secure better terms.

What has changed?

Two shifts in the market are worth drawing out, because they are the points a tax specialist is most likely to find genuinely new:

- ✔ An existing HMRC enquiry used to end the conversation, however, this is no longer the case. Insurers will at least consider risks a tax authority is already reviewing, depending on the stage of the enquiry, the correspondence to date, and the strength of the technical case.
- ✔ Appetite has broadened into anti-avoidance territory that was previously a flat decline, including s.75A SDLT, transactions in land and securities. These remain highly fact-specific and still require strong technical analysis, but "anti-avoidance, therefore uninsurable" is no longer correct.

Case Studies

UK tax residence

The Buyer was concerned that the Target would be deemed to be tax resident in the UK as well as in Germany where it was incorporated. The Buyer had instructed accountants to undertake due diligence on the issue, and they had concluded that there was a low risk of the target being deemed to be UK tax resident.

The Buyer decided nonetheless to secure the protection of insurance against any acts of the seller that might create a UK tax liability as it could not be certain of all the Target's historic acts, even with thorough due diligence.

Board minutes were analysed as part of the underwriting due diligence process and insurers issued a policy to cover the jurisdiction risk and the transaction was able to proceed.

The Buyer also took comfort that the policy would still pay for losses if the Target had been dishonest or fraudulent.

Retrospective withdrawal of tax exemption

The vendor shareholders of a European manufacturing business took out a W&I policy when they sold their business for £150 million to a large trade buyer. The buyer made various claims against the vendor shareholders relating to the way in which costs had been accounted for historically, including French corporate taxes of approximately €300,000.

The W&I policy included cover for tax liabilities and had a policy period of six years post completion of the sale. The French tax authorities refused the vendor the benefit of an exemption it had claimed in the year before the sale, leading to the assessment of €300,000.

The vendor shareholders are defending all of the claims brought by the buyer and have comfort in knowing that the policy covers any liabilities which are ultimately payable by them, including the tax liability and all defence costs.

VAT on a business sale

A family sold a business for £1.75 million. HMRC subsequently demanded output VAT of £200,000. Under the terms of the insurance policy, the Insurer had the right to be involved in the conduct of claims. The Insurer agreed to the appointment of the seller's advisers to deal with the claim as they had historic knowledge of the company's tax affairs.

The Insurer paid £200,000 upfront, within a few days of the claim being notified, to enable HMRC's demand to be challenged. HMRC subsequently offered a settlement figure of £100,000. At the point of receiving this offer, the accounting and legal costs were £90,000.

Despite the seller's advisers' view that HMRC was incorrect in its analysis, the Insurer accepted the HMRC settlement offer of £100,000 and also paid the £90,000 in legal and accounting costs, less the policy excess of £25,000.

Case Studies

Specific tax indemnities in a mergers and acquisitions deal

The seller of a €200 million European property was an investment fund intending to liquidate its assets. The buyer's accountants due diligence work identified tax warranties and (eight) specific tax indemnities relating to historic tax risks, with a potential exposure of €10 million.

Given the seller's intention to liquidate all its assets, the buyer made the purchase of the property conditional on there being an insurance policy in place from the date of the sale agreement and where the buyer was the insured and the premium was paid by the seller.

Thin capitalisation risk

A private equity house selling one of its investee companies required cover for tax risks arising in connection with a historic loan structure under which the Target obtained debt funding from various sources, including its private equity shareholder. The risk was that HMRC would consider the target to be thinly capitalised with the tax risk consequent upon this.

The buyer required an indemnity for the tax risk for a seven-year period. In order to be able to distribute the sale proceeds, a seven-year policy with an indemnity limit of £600,000 was secured by the private equity house to cover the risk of a possible HMRC challenge.

Benefit in kind liabilities

A private equity buyer paid approximately £100 million for the entire share capital of an established UK manufacturer (the 'Target'). Several months later, the Target received a demand for £500,000 (plus interest and penalties) from HMRC. This liability was in connection with benefits given to directors.

The Target's employment contracts provided for it to meet the PAYE and NICs obligations on these benefits. These obligations had not been disclosed to the private equity buyer, but the buyer did have the benefit of the protection afforded under the tax covenant in the deal, which the buyer had chosen to insure and which the policy paid out.

Debt for equity swap

The buyer of a UK target company faced the risk of a tax liability of £1.7 million arising on a historic debt for equity swap. This was because there was doubt over HMRC's view on the meaning of 'ordinary share capital'. Neither party was prepared to assume this tax risk.

The seller agreed to pay the premium for the policy (in circumstances where the buyer was the insured under the policy) because the seller wished to distribute funds to investors and did not wish to retain the £1.7 million in escrow or give an indemnity with a seven-year term.



The O'Connors Delivery Team



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Paul is one of the leading commercial insurance lawyers in the UK. He specialises in advising businesses on how best to use insurance to generate value and mitigate risk. His expertise includes Captives, Protected Cell Companies and other alternative risk transfer facilities.



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David is a highly experienced corporate lawyer with a strong track record of leading corporate and commercial projects and transactions. He has significant experience of working with legal and financial services businesses as well as structuring and establishing private equity funds.



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Mollie advises on a wide range of matters, including mergers and acquisitions, corporate restructuring, business disposals, and commercial agreements. Her M&A experience has included transactions involving specific tax indemnities, where bespoke insurance policies have been obtained to cover these risks.



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Luke is a trainee solicitor who supports our whole team with a particular focus on insurance and financial services regulatory work. He has experience of working on matters advising insurers and insurance intermediaries on FCA regulation both onshore and offshore.



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