Mergers and Acquisitions

Specific Tax Risk Policy

A Specific Tax Risk Policy is a bespoke insurance solution designed to transfer an identified tax risk to the insurance market. Whether held by a buyer or a seller, the product provides financial cover to the insured in the event of an identified tax risk crystallising into an actual liability.

The product can be a valuable tool during mergers and acquisitions when the parties have identified a tax risk but neither the seller nor the buyer is willing or able to retain the risk. A Specific Tax Risk Policy is often used to replace the need for a seller to place funds in escrow for a number of years in the event that the identified tax risk crystallises.

Our dedicated Mergers and Acquisitions team offers a specialist service to structure, market and negotiate Specific Tax Risk policies on behalf of our clients. Our experienced team, which includes a senior tax specialist, is able to fully understand the issue in question and negotiate a bespoke policy that best covers the client’s needs.

The Cover

Each policy is negotiated on a case-by-case basis and is developed by assessing the facts associated with the identified tax risk.

Broadly, a Specific Tax Risk Policy can provide cover for:

- Protection from a successful tax assessment from a tax authority in respect of an identified tax risk; and
- The costs, including legal costs, interest and penalties, associated with the tax assessment.

Successfully placed policies have, in the past, included cover in respect of corporation tax, income tax, capital gains tax, stamp duty land tax and VAT.
The Parameters

A Specific Tax Risk Policy is tailored to each risk and, as such, there is no rigid structure.

**Policy period** – in the UK, HMRC, broadly, has the ability to look back six accounting periods when assessing a company’s tax. The policy in respect of UK tax would therefore be for up to seven years to cover the full look back period. A Specific Tax Risk Policy will be designed to cover the applicable statute of limitations in the jurisdiction of the insured.

**Policy limit** - this will aim to match the estimated value of the identified tax risk including any interest and penalties that could be levied by a tax authority and reasonably incurred defence costs.

**Deductible** - the insurer might require an element of the loss to be borne by the insured. This is usually where there is a higher risk of detection; in these circumstances, the deductible amount usually only relates to defence costs. Whether a deductible is required will be determined on a case-by-case basis.

**Legal fees** - before an insurer begins fully underwriting the risk, the client must enter into an expense agreement to cover the underwriter’s legal costs. The overall cost depends on the value, complexity and jurisdiction of the identified tax risk. Depending on the insurer, this might be payable in addition to the premium or, in certain instances, waived upon the policy binding.

**Premium** - this is calculated as a percentage of the policy limit and will depend on a variety of factors including the strength of the analysis and legal opinion in respect of the identified risk, the quality of the analysis of the identified risk, the technical defence available to the insured if an assessment was raised in respect of the risk and the perceived likelihood of such an assessment arising. The premium rate applied is typically 3-8% of the policy limit depending on the risk.

The Process

The whole process as set out below generally takes between 2-3 weeks.

Information required for the initial consultation:

1. The facts which give rise to the identified risk; and
2. A tax analysis and legal opinion (if available).

**Step 1**
Initial consultation with Howden’s tax specialist to discuss the transaction and review the initial information in respect of the tax risk. Further information may be requested at this time.

**Step 2**
Once all information has been collated, Howden prepares the submission and approaches the insurance market.

**Step 3**
Howden markets the deal to potential insurers.

**Step 4**
Howden receives non-binding indications from the insurers and prepares a report which provides the client with a comparative study of the cover and pricing. Our report also includes our recommendation of the insurer with which to proceed.

**Step 5**
The client selects an insurer and executes the expense agreement.

**Step 6**
The insurer reviews all the information made available to it as part of the underwriting process.

**Step 7**
Howden hosts an underwriting call that gives the insurer the opportunity to ask direct questions of the client.

**Step 8**
Howden and the insurer negotiate the policy wording and coverage position.

**Step 9**
The final policy is issued and the cover from the insurer begins.

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