Mergers and Acquisitions

Tax Liability Insurance

A taxpayer may have to proceed with a transaction or investment where there is uncertainty in the application of tax laws or inadequate time to obtain an advance tax ruling. The risk for the taxpayer is that their tax treatment of the transaction will be challenged by the tax authorities, potentially leading to substantial costs and liabilities. AIG's Tax Liability Insurance can mitigate that risk.

Cover

Tax Liability Insurance from AIG can reduce or eliminate a loss arising from the successful challenge by the tax authorities of a taxpayer's tax treatment of a transaction or investment.

Highly customised coverage can address:

- Expenses that might be incurred by the insured in engaging outside legal advisers and/or accountants in order to resolve the dispute with a relevant tax authority;
- Interest and insurable fines or penalties as well as additional tax payable if the dispute is lost; and
- Gross-up of taxes payable (ie if the taxpayer is found to have an additional tax liability, the insurance proceeds may be deemed taxable: the policy will cover any tax incurred on receiving the proceeds).

Policy Form

Our tax policies are tailor-made, in conjunction with our clients, to cover their specific tax exposures.

- Policy Period - The policy period is generally aligned with the applicable limitation period.
- Retention - The insurer and insured will agree on the "retention" or excess, which is the uninsured amount of the loss to be borne by the insured. The higher the retention, the lower the insurance premium will be. In some cases the retention will correspond to the amount of cover available to the insured under an existing insurance policy from another insurer, in other cases the retention will be borne by the insured directly.
- Exclusions - As cover is tailor-made for each situation, cover will vary from policy to policy but will generally exclude losses resulting from inaccurate facts or omission of material information given by the insured; criminal or fraudulent acts or intentional violations of law; and changes in legislation after the inception date of the policy.

Underwriting Considerations

AIG will consider offering insurance in respect of a very wide variety of tax risks provided the underwriter is able to review detailed advice from the insured's financial advisers or its lawyers setting out the background, the potential tax liability and a legal analysis of the likelihood of the liability arising. Tax Liability Insurance is suitable for risks turning on questions of law rather than fact and is unlikely to be available for promoter-driven, repetitive or purely tax motivated transactions or those cases already subject to audit, litigation or on appeal from a tax authority.

Limit

£2m to £15m aggregate limit of liability with larger limits available on a case-by-case basis.

Strategic Benefits

- Transfers an uncertain liability from the insured to the insurer. Reduces the insured's concerns about the potential for an adverse tax challenge
- Transforms contingent claims into a quantified insurance cost allowing them to be accounted for precisely
- Used pre or post M&A transactions / investments / intra-group restructuring
- Can facilitate a sale or acquisition by providing certainty and managing negative financial impact
- Can preserve or enhance the value of a business or an asset
- Can be used where parties do not want or do not have time to obtain prior clearance from tax authorities

In the event of a claim, the AIG companies have an in-house team of claims professionals dedicated to these products. These seasoned experts specialise in disputes surrounding complex issues and in processing claims both professionally and expediently

Premium

Given the bespoke nature of the product the policy premium will vary widely from case to case. Premiums for policies have, in the past, been as low as 3% of the limit of liability purchased. At the other end of the scale, where an adverse outcome was more likely, the premiums have been as high as 12% of the policy limit.

Case Studies

- PAYE and NIC Liability - Prior to the disposal of a company by a number of individuals, it was identified that a tax liability under the old conditional share regime would have been triggered under ITEPA 2003, s 427 (as originally enacted) on the disposal. The sellers and the buyer took advice and the sellers undertook a pre-sale reorganisation in order to seek to avoid such a charge arising. The parties were advised that, as a result of the reorganisation, there was a risk that a number of other provisions in ITEPA 2003, Part 7 (employment-related securities) could apply, giving rise to a potential PAYE and NIC liability for the target company. The buyer insisted on the sellers giving a specific indemnity in respect of such liabilities and the sellers sought insurance against having to pay out under that specific indemnity.

- Discounted Loan Notes **-** As part of an agreement for the sale of a company, the buyer also agreed to purchase loan notes issued by the target company to the seller. The loan notes were acquired at a discount and it was considered that there might be a tax charge as a result of an actual or deemed release once the buyer and target became connected. The buyer identified that there was a risk of a tax charge arising:
  - under the deemed release provisions in FA 1996, Sch 9, para 4A; and/or
  - on the actual release of the debt, despite the fact that the parties were connected for the purposes of the loan relationship rules.

- Tax liability insurance was obtained by the buyer of the discounted loan notes, insuring it against each of these specific risks.

- VAT Risk - An insurance solution was sought for a scheme involving a land development incorporating the construction of a number of holiday homes. Under the scheme, the land owner and building developer (which were connected parties) entered into separate but inter-conditional contracts with the purchaser of the land - for the freehold sale of the land and the subsequent design and build services respectively (rather than a single sale of land containing completed holiday homes). Insurance was offered against the risk of a successful challenge from HMRC that the sale of the land would be standard rated as opposed to exempt.

- Substantial Shareholder Exemption - Insurance was arranged to cover a challenge by HMRC as to the availability of the substantial shareholder exemption in relation to a disposal of shares.

These scenarios show the potential applications and possible scope of Tax Liability Insurance. Note that they are illustrative only and not to be relied on to justify coverage in any particular situation.

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